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Thank you for inviting me here today. This is my first public speech since my return to life as a private citizen and I can't think of a better audience for it.

I want to talk today about a framework for housing finance reform. Before I do, I thought I'd sketch out briefly where we've been.

Two years ago, our housing markets and financial system were on the verge of collapse.

In the decade leading up to the financial crisis, there was a global boom in asset prices, particularly in housing. Loose monetary policy played a role in the boom, and the flow of global capital from nations building foreign currency reserves undoubtedly helped to set the stage. But the financial crisis was not a perfect storm, a tidal wave, or an Act of God. The financial crisis stemmed from basic failings in our domestic and the global system of financial regulation, and the way firms globally exploited those failings.

Our financial system had inadequate capital, inadequate transparency, too many conflicts of interest, and not enough risk management. The shadow banking system grew up outside the system of bank regulation even though shadow banking is, simply, banking. Highly levered institutions engaged in significant maturity transformation without adequate transparency, capital,

regulation and oversight. The risk in funding markets through overnight repo were poorly understood and the basic infrastructure in our payments, clearance and settlement systems were more fragile than participants knew. Derivatives were traded in the dark, backed by insufficient capital and no one to police the markets for abuse. Major financial institutions could not be wound down without either taxpayer bailouts or risks to our whole economy. And consumer protection was sorely lacking, with divided responsibilities at the federal level and no real supervision of large swaths of the nonbank participants in the mortgage markets, among other problems.

In that regard, the events that led the last Administration to need to put the GSEs into conservatorship was symptomatic of a range of regulatory, management, and oversight failures throughout our financial system. As the private, unregulated mortgage market grew, and market players began to loosen credit standards to pursue ever-riskier business in a booming market, the GSEs, which initially stuck to their core business of guaranteeing well-underwritten loans, saw their market shares fall precipitously. Driven by management's desires to regain market share, the GSEs sought, and were permitted, to guarantee and to purchase riskier mortgages without holding adequate capital or employing appropriate risk management techniques. These moves left Fannie Mae and Freddie Mac dangerously exposed when the housing bubble began to burst.

The GSEs were allowed to operate under an unacceptable "heads I win, tails you lose" system. They enjoyed the benefits of the perception of government support. They had inadequate oversight and inadequate capital, and the market did not instill appropriate discipline because the market assumed that they had a government backstop.

As a result of the substantial deterioration in the housing market and Fannie Mae and Freddie Mac's growing inability to raise new capital, FHFA placed the GSEs into conservatorship on September 6, 2008 under the authority granted to them by Congress under the bi-partisan Housing Economic Recovery Act of 2008 (HERA). Under HERA authority, Treasury agreed to provide financial support to the GSEs through the establishment of Preferred Stock Purchase Agreements (PSPAs). The goal of the PSPAs and subsequent amendments was to preserve overall stability in financial markets and to allow the GSEs to continue to provide liquidity in the secondary market. The PSPAs ensured that the GSEs would be able to meet their obligations and continue to support the housing finance system, which was then on the verge of collapse.

Since September 2008, FHFA, in its role as conservator, has acted carefully to help ensure that Fannie Mae and Freddie Mac's assets are conserved while continuing to play a critical role in making mortgage credit available. By facilitating the flow of credit for responsibly underwritten mortgages, the GSEs have served as a source of stability for the housing market and enabled millions of Americans to continue to have the ability to take out a new mortgage or refinance.

Important progress has been made towards stabilizing the housing market but it remains fragile. Private capital has not yet returned to the market, and the GSEs and Ginnie Mae continue to play an outsized role in ensuring the availability of mortgage credit. Roughly 95% of the mortgages originated in this country are currently financed through either the GSEs or Ginnie Mae. Put simply, without the GSEs and Ginne Mae, there would be no functioning mortgage market today.

The new loans being guaranteed by the GSEs are not contributing in any material way to the losses the GSEs face. It is the GSEs' old

book of loans, those acquired before conservatorship, which are the overwhelming source of losses. Under the conservatorship, the credit quality and risk profile of the post-conservatorship book of business has dramatically improved compared to pre-conservatorship. While it is still early to make definitive judgments, to date, less than 1% of losses have come from loans originated in 2009 and 2010. In that regard, the process of reform has already begun, in that the conservatorship is working in keeping GSE activities within prudent bounds.

Guarantee fees have been increased and the GSEs have adjusted their pricing to account more accurately for the risks that they face. Alt-A loans now account for 0% of the new book of business since conservatorship; this compares to 22% for Fannie Mae in 2006 and 18% for Freddie Mac in 2006. Low credit (<620 FICO scores) purchases are now only 1% as compared to 5% for both Fannie Mae and Freddie Mac from 2001-2008. Average FICO scores of new business improved from roughly 715 in 2006 to 750 or more for both Fannie Mae and Freddie Mac in 2010. While new mortgages with loan-to-value ratios greater than 90% are slightly up in 2010 from 2009, much of this is related to the Home Affordability Refinance Program (HARP), which is a refinance loss mitigation mechanism for loans already guaranteed by the GSEs, and which reduces the risk of default and any potential losses at the GSEs.

The new, higher credit quality book of business from 2009 has seen dramatically lower cumulative default rates when adjusted for loan age: For example, 2009 cumulative defaults for Freddie Mac and Fannie Mae were 1.1% and 1.2%, respectively, in the loans' first 18 months, as compared to cumulative default rates for the first 18 months for loans originated in 2007, which were 22.3% and 28.7% for Freddie Mac and Fannie Mae, respectively.

The country is unfortunately stuck with the consequences of the poor credit choices the GSEs made prior to conservatorship. No one can undo those decisions. Some suggest that taking time to get reform right will expose taxpayers to even greater losses at Fannie Mae and Freddie Mac. That is simply not true. The losses that Fannie Mae and Freddie Mac face are the result of mistakes made in the years leading up to the crisis, not the consequences of actions by the GSEs since 2008. There is nothing the government can do to decrease the obligations Fannie Mae and Freddie Mac incurred ahead of this crisis. Given this unfortunate truth, the most responsible course is to minimize the risk that those losses get worse.

Now, while the country is appropriately focused on stability in the mortgage market, we also need to stay focused on the hard work of reform.

Congress began the process of reform with the passage of HERA in 2008.

The prior Administration continued the path of reform when it placed Fannie Mae and Freddie Mac into conservatorship in September 2008. That action arrested the sharp deterioration of market confidence in these two institutions that was intensifying the broader financial crisis. And it finally put an end to the harmful practices that had contributed to the firms' failures.

The next phase of reform came with the passage of the Dodd-Frank Act, which improves the regulation of lending standards so that the mistakes of the past are not repeated in the housing market in the future. The Dodd-Frank Act includes fundamental reform of mortgage market rules, including ability-to-pay requirements and risk retention standards for mortgages. This new Act will help to ensure that homeowners are not sold products that they cannot afford. It ensures that originators retain skin in the game

when they originate risky mortgages. Capital rules are being reformed so that the shadow banking system cannot arbitrage banking capital, and that capital levels throughout the system are higher. Transparency will now be required deep into securitization structures. And regulators have the powers to establish national servicing standards so that borrowers can work out problems with their loans rather than go through costly foreclosures. These necessary reforms are critical steps. Regulators will take the next steps with issuance of regulations for "qualified residential mortgages" soon. And there will soon be a Consumer Financial Protection Bureau with market-wide coverage.

As we consider the next phase of reform, we should keep in mind a set of objectives for a well-functioning, stable housing finance system. As I've said while serving in government, and echoing what Secretary Geithner has said as well, these include:

(1) Widely available mortgage credit. Mortgage credit should be available and distributed on an efficient basis to a wide range of borrowers, including those with low and moderate incomes, to support the purchase of homes they can afford. Given the centrality of housing to households, we need to ensure that housing finance is available even when markets may be under severe stress, and at rates that are not excessively volatile.

(2) Housing affordability. A well-functioning housing market should provide affordable housing options, both ownership and rental, for low- and moderate-income households. The government has a role in promoting the development and occupancy of affordable single and multifamily residences for these families. We need to be sure that the future housing finance system does not relegate minority home buyers to a separate market. Both affirmative obligation (duty to serve), and negative prohibition (anti-discrimination) measures are warranted and the new system might appropriately be taxed to support affordable

housing initiatives. At the same time, there is little rationale for generalized, untargeted support for subsidies to housing and guarantee fees should not be subsidized.

(3) Consumer protection market-wide. Consumers should have access to mortgage products that are easily understood, such as the 30-year fixed rate mortgage and conventional variable rate mortgages with straightforward terms and pricing. Effective consumer financial protection should keep unfair, abusive or deceptive practices out of the marketplace and help to ensure that consumers have the information they need about the costs, terms, and conditions of their mortgages. We cannot allow a bifurcated market to redevelop, in which some market participants are only subject to weak supervision or enforcement. Market-wide regulation should (i) ensure capital adequacy, (ii) enforce strict underwriting standards and (iii) protect borrowers from unfair, abusive or deceptive practices. Regulators should have the ability and incentive to identify and respond to problems that may develop in the mortgage finance system. We cannot afford a housing finance system that permits regulatory arbitrage.

(4) Financial stability. The housing finance system should distribute the credit and interest rate risk that results from mortgage lending in an efficient and transparent manner that minimizes risk to the broader financial and economic system and does not generate excess volatility. The mortgage finance system should not contribute to systemic risk or overly increase interconnectedness from the failure of any one institution. At the same time, history suggests that the government will intervene in the event of a crisis in the housing market of sufficient magnitude. That is because real estate markets are prone to booms and busts; housing is a very large component of the financial sector; and housing assets are a large component of assets held by households. Any housing finance system must acknowledge that fact, and

provide a realistic mechanism for responding, while protecting taxpayers.

(5) Alignment of incentives. A well functioning mortgage finance system should better align incentives for all actors – issuers, originators, brokers, ratings agencies, insurers, borrowers – so that mortgages are originated and held or securitized with the goal of long-term viability rather than short term gains. That means avoidance of privatized gains funded by public losses.

If there is a government guarantee provided, it should earn an appropriate return for taxpayers and ensure that private sector gains do not come at the expense of public losses. Moreover, if government support is provided, the role and risks assumed must be clear and transparent to all market participants and the American people. If government guarantees are provided, they should be priced accurately and transparently.

Private sector, share-holder owned entities should not issue government guarantees because the inherent conflict between shareholder interests and the public interest is too strong.

(6) Standardization. Standardization of mortgage products improves transparency and efficiency and should provide a sound basis in a reformed system that increases liquidity, helps to keep rates competitive, and promotes financial stability. The market should also have ample room for innovation to develop new products which can bring benefits for both lenders and borrowers.

(7) Diversified sources of funding and reduced concentration. Through securitization and other forms of intermediation, a well functioning mortgage finance system should be able to draw efficiently upon a wide variety of sources of capital and investment both to lower costs and to diversify risk. Concentration in mortgage origination and servicing should be reduced, both to

enhance price competition and to reduce concentration of risk. A bank-focused housing system does not necessarily meaningfully reduce government exposure as compared to a government-guaranteed securitization system.

(8) Secondary market liquidity. Today, the U.S. housing finance market is one of the most liquid markets in the world, and benefits from certain innovations like the "to be announced" (or TBA) market. This liquidity has provided benefits to both borrowers and lenders, including lower borrowing costs, the ability to "lock in" a mortgage rate prior to completing the purchase of a home, flexibility in refinancing, the ability to pre-pay a mortgage at the borrowers' discretion, and diversified sources of mortgage funding.

(9) Private capital. Our housing finance system, like our financial system generally, was woefully undercapitalized. Any new housing finance system must draw in private capital, and credit insurers or other system participants must be clearly regulated.

(10) Stable mortgage products for households. Coming out of the Great Depression, our nation saw the strong need to provide a housing finance mechanism with greater stability than existed in the 1920s—the 5 year balloon payment mortgage created enormous hardship and contributed mightily to massive foreclosures in the 1930s. The creation of the 30 year fixed-rate, prepayable, self-amortizing mortgage was a singular achievement. While many borrowers appropriately can and should use standard adjustable rate mortgages with straightforward terms, households and the market are benefited by the existence of the 30-year fixed rate mortgage. A fixed rate mortgage does not require households to self-insure against interest rate risk, or against the risk of a change in their financial circumstances that would prevent refinancing. A housing finance system without such a product would be a radical departure from our current system.

These objectives suggest that there is a fundamental choice that the Congress and the Administration will need to confront. A central question is whether, beyond FHA-insured mortgages, there will be a role for a government guarantee.

Those who are opposed to such a guarantee focus on moral hazard, on the risk of government mis-pricing the guarantee and putting taxpayers at risk, on the dangers of over-subsidization of housing, and on the political economy of loan limits and the GSE credit box which may increase over time.

Those who favor a role for a government guarantee in the future suggest that the major problem in the past was with the inherent conflict between an implicit guarantee and shareholder ownership, and argue that a government guarantee is required to maintain the availability of the 30 year fixed rate mortgage for most homeowners. Moreover, in the event of a housing crisis, the presence of paid-for guarantees permits the government to be in place as a lender of last resort and to insure against catastrophic loss. Without a government guarantee, the housing finance system will also tend to be concentrated in the banking sector, and given economies of scale, in the top handful of financial institutions.

Regardless of the shape of the housing finance system in the future, we will need an orderly transition while Congress debates reform.

The GSEs and the government are currently playing an outsized role in the housing finance market. This situation is neither sustainable nor desirable, but if the GSEs were suddenly to exit the market the stability of the housing market would be undermined. Mortgage rates would skyrocket and most homeowners would be unable to obtain mortgage credit. The transition to a new system must occur in an orderly fashion that is minimally disruptive to the market. Enabling households to maintain access to credit at

reasonable rates throughout the transition is essential to our housing and broader economic recovery.

Financial markets and the public depend on the ability of the GSEs to perform on their obligations. That is why the government has made clear that it is committed to ensuring that the GSEs have sufficient capital to perform under any guarantees issued now or in the future and the ability to meet any debt obligations.

I think that we can agree on some clear steps that should occur regardless of the outcome of the reform debate:

- loan limits should be allowed gradually to come down.
- guarantee fees should be priced to cover risk.
- Treasury should make clear that the GSEs will not emerge from conservatorship as shareholder-owned entities.
- FHFA should require the GSEs to reduce their retained portfolios gradually.
- FHFA should ensure high capital standards
- Regulators should put in place QRM rules that make clear that risk retention will be the norm but provide for a wide latitude in types of risk retention so that we can bring a diversity of capital sources into the housing finance system.
- FHFA should set a credit box for the GSEs that would be sustainable going forward.
- FHFA and Treasury should plan to wind down the GSEs gradually while retaining human capital and infrastructure that are necessary in the future.
- CFPB should put in place strong consumer protection rules market wide.

Conclusion

Fixing our nation's housing finance system is critically important to our economy and to our country's future. The housing market supports millions of jobs for Americans in construction,

manufacturing, real estate, finance, and other industries. Moreover, for the majority of Americans homeowners, their house is their largest financial asset and the single largest purchase that they will make in their lifetimes. Housing is equally important to the tens of millions of families who choose to rent; their quality of life is directly affected by access to affordable, quality rental housing in good neighborhoods.

A new system must be designed to ensure that our housing finance system is more stable, consumers are protected, and sustainable credit is widely accessible.

Thank you.