Remarks by
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Let me start with a show of hands on a couple of things. How many of you are still buying mortgage-backed securities? Any subprime securities? Who's long the market? And who's short?

Without a doubt, Wall Street's luster as the world's premier capital market has been tarnished. Will the securitization market come back? Will we recapture our reputation for being the most liquid, open, and innovative capital market in the world?

We've had five tough months of reassessing risk and re-pricing securities in the wake of the housing slump and tight credit. The market has punished the lending practices that got us into trouble. We need that market discipline. It was sorely lacking during the housing boom

We're trying to get back to economic fundamentals. People are starting to ask tougher questions before investing. Financial institutions are raising capital to offset losses. And for the long term, a key lesson is being relearned: the critical role of strong underwriting, and transparency for healthy credit markets.

All this is painful but necessary. But it will help ensure our markets remain strong and resilient.

But we're not out of the woods yet. More adjustment is needed, and it's going to take more time before it's over.

Economy slowing

We now have a slowing economy largely because of the housing downturn. The question now is how long the credit market turmoil will last and how much of a toll it will inflict on economic activity. We've already seen a sharp slowing in fourth quarter economic activity. Job growth and manufacturing are down, retail sales are flat, housing starts are sinking, and the unemployment rate is going up. The risk of recession is clearly rising.

Both the Federal Reserve and the Bush Administration are addressing these issues. The Fed is using a variety of monetary tools to inject liquidity into the markets to offset a

sluggish economy. The Treasury Department, housing-related agencies, industry, and the FDIC have been working on market-based ways to refinance and restructure subprime mortgages.

The subprime mortgage turmoil is a major cause of the current problems. Over the next two years through the end of 2009 nearly 2 million subprime borrowers are facing resets to much higher rates. And several hundred thousand have already reset.

Since these loans were underwritten at their initial rate, and not the reset rates, many borrowers cannot afford the reset. These are enormous numbers. They're unprecedented. And they demand immediate solutions.

Curbing foreclosures

Many homeowners are at risk of default and foreclosure. Refinance is not an option for many. Falling home prices are sharply reducing their equity. Foreclosures are on the rise in communities across the nation. And without swift and decisive action, I fear they will continue to rise. The number of resets is simply way too big for the industry to handle one-by-one.

So a government- and industry-wide effort worked out voluntary measures. The goals were to keep people in their homes, to reduce industry losses, and to use market-based principles. There are many parts to the effort, all of which are helpful.

A key element deals with the pressing need of 2 million subprime borrowers facing resets. These are hybrid adjustable rate mortgages --the so-called 2/28s and 3/27s.

Renegotiating all these loans, homeowner-by-homeowner, is too costly, and too time-consuming. So we're calling on mortgage servicers to take a fast-track, standardized approach for owner-occupied homes for borrowers who are making timely payments but can't afford the reset and can't refinance. Convert these adjustable loans at the starter rate for a long-term, sustainable period of at least five years

This is no sweet-heart-deal for borrowers. They would still have to make monthly payments. And they're already paying premium rates. The starter rates on these loans were often higher than the rates on subprime fixed rate loans. This would avoid unnecessary foreclosures. And it would honor the loan servicer's legal obligation to follow loss mitigation strategies that are in the best interests of investors.

Billions would be saved by avoiding the enormous costs of foreclosure. Most importantly, this will free up time and resources for lenders and services to deal with more deeply troubled loans, such as delinquent loans, Alt-A loans, or when borrowers can't make the starter rate.

Obviously, there will be situations where losing a home is the only option. There is no question that some borrowers simply can't afford their homes. Others speculated on

home prices or were involved in fraud. In these cases, loss of the home may be the only option.

However, foreclosure is a nasty business. It should be avoided whenever possible. Foreclosures drive down the values of surrounding homes. They hurt other homeowners and communities.

In most cases, avoiding foreclosure protects investors who get more value from a restructured loan than they do from a foreclosure. I doubt there's a single investor here today who wants to own a foreclosed property.

The bottom line: business as usual is not an option. A more systematic approach to troubled mortgages avoids unnecessary foreclosures. And that's good for borrowers, investors and the markets.

This is not a bailout. Bailouts erode market discipline, and they raise the likelihood of repeat bailouts. Borrowers would still have to make monthly payments at premium rates that are often 8 percent or higher.

And investors will have to take losses. But these will be less than those generated by massive foreclosures. And no taxpayer money has been committed.

Major newspapers endorsed the fast track concept last fall, from the Wall Street Journal to the New York Times. California Governor Schwarzenegger and major servicers agreed to apply it in November.

In December, Secretary Paulson announced that the American Securitization Forum (ASF) -- a major player in the process -- had developed a new set of protocols to fast-track loans into extensions at the starter rate for five years or longer. He urged the industry to apply those protocols to speed up the pace of loan modifications.

Just last week, the SEC ruled that the ASF fast-track protocols met the accounting requirements for securitizations. And many loan servicers have, or are in the process of applying this process.

Reset process slow

So, how's it going? Not as well as it should be.

Moody's, the rating agency, says that at the end of September, just 3.5 percent of loans that reset in 2007 had been modified. That puts us way behind the curve going into the New Year. We have some 2 million loans to adjust, the bulk of them in 2008. Time is of the essence.

We must see a pickup in the pace, and the sooner the better. It's like having your football team in the Super Bowl win the coin toss, but fumbling the ball on the kickoff and giving up a touchdown.

You're behind at the get-go.

To be sure, the loan modification program is no cure-all. It's part of a broader effort. But the true test of success will be whether industry can show progress in avoiding foreclosures. We'll be closely watching for progress.

It is essential that industry reports, such as those being prepared for the states and Hope Now, show true progress. While no one likes reporting, given the current situation it's critical that industry show effective action to avoid unnecessary foreclosures.

I urge servicers to cooperate in making these reports. It's in your best interest to do so. Working with Treasury and government regulators, the industry has tools to address this on its own. And the key is to quickly get borrowers who can afford their homes, into long-term loans they can afford to pay.

Risks of failure

What if foreclosures fail to abate?

First, there are economic consequences. It doesn't take a crystal ball to predict that more foreclosures will put additional downward pressure on home prices. This would be an even bigger drag on economic growth.

Another outcome is the potential for greater governmental involvement in the market, and in contractual relationships.

Foreclosure rates may be a kind of barometer for what's ahead. Lawmakers at all levels of government -- local, state, and national -- will look to take additional action if foreclosures keep rising, and the economic fallout continues. This is the simple reality. Congress is already considering a number of proposals.

I very much believe in the market. But if market solutions fail to solve the problem, government will step in.

SIVs, risk exposure and transparency

Let me make a final comment about another major issue: structured-credit products.

This market has taken a beating, to say the least. Losses are already in the billions, and more write-downs are expected. Reputations have been tarnished. And new issues nearly halted.

The root of the problem: a lack of transparency. There was a general lack of reliable information to adequately assess the risks of the underlying assets for these securities. Many often failed to ask the most basic questions: What precisely are the risks? What kinds of underlying credits are these? What are the terms and conditions? What is the repayment capacity of the borrowers?

This is the 21st century. We're living the Information Age. We need more data, and we need to ask more questions.

External ratings are no substitute for performing rigorous due diligence. Take for example double digit downgrades on collateralized debt obligations (CDOs). Downgrades that are based on the riskier tranches in a subprime securitization are clearly a yellow warning light about the ratings process.

While there are legitimate criticisms of the models used by the rating agencies, ratings were never designed to take the place of investor due diligence. Investors must do their homework for efficient markets to exist. Ratings must not be a proxy. At the same time, more transparency surrounding the information behind the rating would enhance the ability of investors to conduct their own due diligence.

Another difficulty is the complexity of the structures themselves. In many ways the very financial engineering that helped create a once vibrant mortgage market, greatly complicated the true understanding of risk. Making more information available to investors will force the market to do a better job of assessing risk to compete more effectively.

To be sure, ratings agencies such as Moody's have been taking positive steps to enhance transparency. And I think it essential that all market participants fully understand the ratings process. This includes the high-tech models used by the ratings agencies in assigning ratings.

Regulatory measures may also be required to encourage greater transparency. Regulators may want to further review capital requirements that are based on external ratings for structured financings.

Beefing up disclosure requirements may be another necessary measure. It's a real challenge for regulators to set capital requirements without understanding the risks of underlying assets.

More discussion is needed. And you can expect it in the coming weeks and months. As Supreme Court Justice Louis D. Brandeis once said: "Sunshine is the best disinfectant." And that's more true than ever in today's credit markets.

Conclusion

Let me end by strongly encouraging all of you to embrace the fast-track plan for modifying subprime mortgages. Learn how the ASF fast-track protocols work, and what they mean for your clients and other investors. I urge you to support this and other ways to stream-line loan modifications. Now is the time to show real results.

And keep in mind that Wall Street's problem has moved to Main Street. Working together we can restore confidence in our credit markets, in our economy, and in our communities across the nation. The resiliency and strength of our financial system gives me confidence that it will navigate these difficult times, emerging in a stronger, healthier position. Thank you very much.

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