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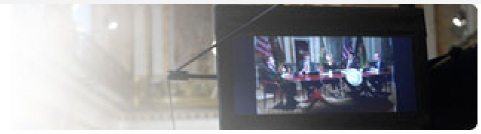

Secretary of Treasury Tim Geithner Opening Remarks at the Conference on the Future of Housing Finance - As Prepared for Delivery

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Good morning.

Let me start with some acknowledgments.

My thanks and compliments to Shaun Donovan and his team at the Department of Housing and Urban Development, to Diana Farrell at the White House, and to my colleagues at the Treasury, led by Jeffrey Goldstein, for pulling together this impressive conference.

Thanks as well to those of you who agreed to participate in the panels and to join us in the subsequent discussions. You represent a very wide range of perspectives and interests. You bring substantial expertise. And we appreciate the fact that you were willing to come and provide your informed opinions on this important topic.

Today we consider the challenge of how to build a more stable housing finance system.

Fixing this system is one of the most consequential and complicated economic policy problems we face as a country. And I think it's worth stepping back and asking the basic questions: What went wrong over the past few years? And what are the most important flaws in the system that we have to fix?

Alongside the broader failures that contributed to this financial crisis, there are several that directly involved the government sponsored entities, Fannie Mae and Freddie Mac.

Amid the general race to the bottom in standards across the private sector, Fannie and Freddie lowered their underwriting standards, providing guarantees for increasingly risky types of mortgages without charging nearly enough to cover the risk.
And Fannie and Freddie were allowed to build up substantial portfolios of mortgage-backed securities, which rose to a level of more than $1.6 trillion dollars at their peak, without the financial resources to cover potential losses.

These two strategies were pursued to maximize short-term returns to shareholders and senior management. They were possible only because of the toxic combination of a perceived guarantee by the government and an absence of effective oversight. They were not the sole causes of the crisis, but they made the financial crisis worse. And they resulted in huge losses for the taxpayer.

Now, these failures in our housing finance system were avoidable. And it is our responsibility to make sure that we create a system that is not vulnerable to these same failures happening again.

Toward that end, earlier this year, we posed a set of key policy questions for public comment and we've received more than 300 responses covering a full range of opinion.

Some propose getting the government completely out of the business of supporting housing finance, while others propose reforms that would leave the current system largely in place.

Some suggest that, as a government, we have provided too much support for housing, while others suggest we provided too little support to promote affordability for lower income Americans.

It's safe to say there's no clear consensus yet on how best to design a new system.
But this Administration will side with those who want fundamental change.
It is not tenable to leave in place the system we have today.

We will not support returning Fannie and Freddie to the role they played before conservatorship, where they fought to take market share from private competitors while enjoying the privilege of government support.

We will not support a return to the system where private gains are subsidized by taxpayer losses.

We need to delineate more clearly the public policy goals of how best to promote reasonably priced and stable mortgage costs for most Americans from how best to provide access to affordable housing for lower income Americans.

The challenge of reform has many different dimensions.

And I want to start the conference today by presenting what I think are the four key questions underlying reform and outline some of the key policy choices we face in answering them.

The first is the most fundamental.

What role should the government play to provide stability to the housing finance system, both in times of prosperity and during downturns?

This question is really about whether the government – in order to make sure that Americans can borrow at reasonable interest rates to buy a house even in a downturn – has to provide a form of guarantee or insurance against losses.
Many countries do this, but they do it in very different ways.

Some do it through the banking system, with the array of instruments used to protect banks.

Some do it with specialized mortgage finance companies, with backing from the government.

Some do it with covered bonds, which are bonds issued by banks but backed by individual mortgage loans.

Some make the insurance or guarantees explicit. Many leave them implicit or hidden.
Without such support, the risk is that future recessions could be more severe because the financial system would not have the capital to support mortgage lending on an adequate scale. House price declines could be more acute, with even greater damage to financial wealth and economic security.

The policy question is to what extent the private market can provide that form of insurance or guarantee on its own, or whether this is fundamentally a role for government.

This crisis – where we saw a full retreat by private financial institutions from many forms of mortgage and consumer lending – provides a compelling illustration of why private markets, left to their own devices, find it hard to resolve financial crises.

As I have said in the past, I believe there is a strong case to be made for a carefully designed guarantee in a reformed system, with the objective of providing a measure of stability in access to mortgages, even in future economic downturns.

The challenge is to make sure that any government guarantee is priced to cover the risk of losses, and structured to minimize taxpayer exposure.

The second question is what role should the government play in providing financial support to improve access to affordable housing?

This is a question Shaun Donovan will touch upon in his remarks and discuss more fully in our second panel. The choices here range from whether we should provide more support or less; whether we should realign our incentives for owning or renting a house; and how we delineate our support for affordable housing from the mechanisms we use for general housing finance.

The third question is what should we do about the securitization market more generally?

In the lead-up to this crisis, we saw a fundamental breakdown in incentives around underwriting.

Risk migrated away from banks to non-banks that were not subject to supervision.
Many firms in the mortgage business were not required to hold capital against the risks they took.

Credit ratings agencies did not adequately capture the risks of a significant fall in housing prices.

The Dodd-Frank reforms require very substantial changes to the securitization markets – markets that are so important to how we finance housing in America.

Among other things, these reforms require a level playing field in terms of constraints on risk taking across financial firms – whether banks or non-banks – operating in the housing finance market, stronger consumer protections, new disclosure requirements, reforms of the credit rating agencies, and risk retention thresholds for specified mortgage products.

We hope the discussions today will help us shape the rules required to implement these reforms.

The fourth – and final – question is how do we best manage the transition to a new housing finance system?

Here we face several different imperatives.

We need to begin the process of weaning the markets away from government programs and make room for the private sector to get back into the business of providing mortgages.

We need to continue working to keep overall mortgage rates low.

As we go through this transition, it is important that consumers maintain access to credit at attractive rates.

The planned wind down of the GSEs' portfolios should be done in a careful way.
And we need to make it absolutely clear that we will make sure the GSEs have the resources to meet their financial commitments.

Now, in order to better inform our discussion today, I want to take just a few minutes to address some persistent misconceptions about Fannie and Freddie.
First, the process of housing reform is not just beginning today.

It began in the fall of 2008.

The first step in reform was the action taken to place Fannie and Freddie into conservatorship.

That step, taken by a Republican President, with authority from the Congress, was essential to break the model that helped produce the crisis. And without that action, home prices would have fallen even further and the recession would have been dramatically worse.

Another myth is that by taking the time to get reform right, taxpayers are being exposed to even greater losses in Fannie and Freddie.

This is not true.

The losses that Fannie and Freddie face right now are the result of mistakes made in the years leading up to this crisis. They are the result of loans purchased and guaranteed in the years before the crisis, not the consequence of the actions by the GSEs since 2008.

There is nothing we can do to decrease the significant loses Fannie and Freddie incurred ahead of this crisis. All we can do is to minimize the risk that they get worse. And the FHFA and the boards of those two entities have acted to raise underwriting standards so that new loans guaranteed since the end of 2008 have lower risk and higher credit quality and that the fees charged for the guarantees provide adequate income to cover future losses.

And, finally, it is important to note that reform, as Barney Frank has said, is about more than designing an elegant funeral for Fannie and Freddie. It requires a broader reassessment of how much support the government should provide for housing finance.

The failures that produced the system we have today were bi-partisan. The solution must be as well. This is a test for Washington. The stakes are high. For many Americans, their home is their largest financial asset and the housing industry supports millions of jobs.

We must take this opportunity to build a more stable housing finance system that that better protects American taxpayers.