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Written Testimony by

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Chairman Bachus, Ranking Member Frank, and members of the committee, thank you for the opportunity to testify this morning.

Two weeks ago, we released a report outlining our vision of the next steps for reforming the housing finance market. My testimony today summarizes the content of that report.

There is little dispute that the financial crisis was partly the result of fundamental flaws in the housing finance market. The consequences of those flaws, and the losses Fannie Mae and Freddie Mac have inflicted on taxpayers, make clear that we must build a healthier, more stable market that will work better for American families and our nation's economy.

For decades, the government supported incentives for housing that distorted the market, created significant moral hazard, and ultimately left taxpayers responsible for much of the risk incurred by a poorly supervised housing finance market. In more recent years, we allowed an enormous amount of the mortgage market to shift to where there was little regulation and oversight. We allowed underwriting standards to erode and left consumers vulnerable to predatory practices. We allowed the market to increasingly rely on a securitization chain that lacked transparency and accountability. And we allowed the financial system as a whole to take on too much risk and leverage.

These were avoidable mistakes. Their convergence, as we all know, resulted in a financial system vulnerable to bubbles, panic, and failure. Reforming our country's housing finance market is an essential part of our broader efforts to help ensure Americans will never again suffer the consequences of a preventable economic crisis.

Our proposal for reform breaks sharply from the past to fundamentally transform the role of government in the housing market.

We believe the government's primary role should be limited to several key responsibilities: consumer protection and robust oversight; targeted assistance for low- and moderate-income homeowners and renters; and a targeted capacity to support market stability and crisis response.

The Administration is committed to a system in which the private market – subject to strong oversight and strong consumer and investor protections – is the primary source of mortgage credit.

We are committed to a system in which the private market – not American taxpayers – bears the burden for losses.

And while we believe that all Americans should have access to affordable, quality housing, our goal is not for every American to become a homeowner. We should provide targeted and effective support to families who have the financial capacity to own a home but are underserved by the private market, as well as a range of options for Americans who rent.

As the housing market recovers and the economy heals, the Administration and Congress have a responsibility to look forward, reconsider the role government has played in the past, and work together to build a stronger and more balanced system of housing finance.

Reducing the Government's Role in the Mortgage Market

In the wake of the financial crisis, private capital has not sufficiently returned to the mortgage market, leaving Fannie Mae, Freddie Mac, FHA, and Ginnie Mae to insure or guarantee more than nine out of every ten new mortgages. Under normal market conditions, the essential components of housing finance – buying houses, lending money, determining how best to invest capital, and bearing credit risk – should be private sector activities.

We will work closely with the Federal Housing Finance Agency to determine the best way to responsibly reduce Fannie Mae and Freddie Mac's role in the market and ultimately wind down both institutions. This objective can be accomplished by gradually increasing guarantee pricing at Fannie Mae and Freddie Mac, as if they were held to the same capital standards as private institutions; reducing conforming loan limits by allowing the temporary increases enacted in 2008 to expire as scheduled on October 1, 2011; and gradually increasing the amount of private capital that risks loss ahead of taxpayers through credit loss protections from private entities and gradually increased down payment requirements. We also support the continued wind down of Fannie Mae and Freddie Mac's investment portfolios at a rate of no less than ten percent annually.

I want to emphasize that it is very important that we wind down Fannie Mae and Freddie Mac at a careful and deliberate pace. Closing the doors at Fannie Mae and Freddie Mac without consideration for the pace of economic recovery could shock an already-fragile housing market, severely constrain mortgage credit for American families, and expose taxpayers to unnecessary losses on loans the institutions already guarantee. It is ultimately in the best interest of the economy and the country to wind down Fannie Mae and Freddie Mac in a responsible and prudent manner.

The Administration is fully committed to ensuring Fannie Mae and Freddie Mac have sufficient capital to perform under any guarantees issued now or in the future, as well as the ability to meet any of their debt obligations. Ensuring these institutions have the financial capacity to meet their obligations is essential to maintaining stability in the housing finance market and the broader economy. During the transition, it is also important that the operations of Fannie Mae and Freddie Mac continue to serve the market and the American people, including retaining the human capital necessary to effectively run both institutions.

As we decrease Fannie Mae and Freddie Mac's presence in the market, we will also scale back FHA to its more traditionally targeted role. We support decreasing the maximum loan size that qualifies for FHA insurance – first by allowing the present increase in those limits to expire as scheduled on October 1, 2011, and then by reviewing whether those limits should be further decreased going forward.

We will also increase the pricing of FHA mortgage insurance. FHA has already raised premiums twice since the beginning of this Administration, and an additional 25 basis point increase in the annual mortgage insurance premium is included in the President's 2012 Budget and will be levied on all new loans insured by FHA as of mid-April 2011. This will continue ongoing efforts to strengthen the capital reserve account of FHA and align its pricing structure in a more appropriate relationship with the private sector, putting the program in a better position to gradually return to its traditional and more targeted role in the market.

The Administration also supports reforms at the Federal Home Loan Banks (FHLBs) to strengthen the FHLB system, which provides an important source of liquidity for small- and medium-sized financial institutions. These reforms include instituting single district membership, capping the level of advances for any institution, and reducing the FHLBs' investment portfolios.

We also believe it is appropriate to consider additional means of advance funding for mortgage credit as a part of the broader reform process, including potentially developing a legislative framework for a covered bond market. We will work with Congress to explore opportunities in this area.

Addressing Fundamental Flaws in the Mortgage Market

Winding down Fannie Mae and Freddie Mac and implementing reforms at FHA and the FHLBs, however, is only one side of the coin. These steps alone will not give rise to a housing finance market that meets the needs of families and communities, nor will it guarantee that private markets can effectively play a predominant role. We must also pursue reforms that restore confidence in the mortgage market among borrowers, lenders, and investors.

The Administration supports the strong implementation of reforms to help address pre-crisis flaws and rebuild trust and integrity in the mortgage market. Taken together, these reforms will improve consumer protection, support the creation of safe, high-quality mortgage products with strong underwriting standards, restore the integrity of the securitization market, restructure the servicing industry, and establish clear and consolidated regulatory oversight. The Dodd-Frank Act laid the groundwork for many of these reforms. We will implement its provisions in a thoughtful manner to protect borrowers and promote stability across the housing finance markets.

Treasury is currently coordinating critical reforms to the securitization market that will require originators and securitizers to retain risk, including coordinating an interagency process to determine the parameters for Qualified Residential Mortgages (QRM) under the Dodd-Frank Act. This summer, the Consumer Financial Protection Bureau will assume authority to set new rules to curb abusive practices, promote choice and clarity for consumers, and set stronger underwriting standards. Federal regulators will require banks to increase capital standards, including maintaining larger capital buffers against higher-risk mortgages that have a greater risk of default.

Treasury is also actively participating in interagency efforts to design and implement near-term reforms that will help correct chronic problems in the servicing industry, which has proven especially ill-equipped to deal fairly and efficiently with the sharp increase in the number of families facing foreclosure. Right now, we are working together to design national servicing standards that better align incentives and provide clarity and consistency to borrowers and investors regarding their treatment by servicers, especially in the event of delinquency. Our work includes identifying ways to reduce conflicts of interest between holders of first and second mortgages and improving incentives for servicers to work with troubled borrowers to avoid foreclosure.

Alongside these efforts, Treasury, the Department of Housing and Urban Development, and the Department of Justice are coordinating the Administration's interagency foreclosure task force, which is comprised of eleven federal agencies and also works closely with the state Attorneys General. In light of reports of misconduct in the servicing industry, the task force is currently reviewing foreclosure processing, loss mitigation, and disclosure requirements at the country's largest mortgage servicers. Those that have acted improperly will be held accountable.

Providing Targeted and Transparent Support for Access and Affordability

Low-and moderate-income families and communities account for a large proportion of all home purchase mortgages, and 100 million Americans are renters. The Administration stands strongly behind our obligation to support an adequate range of affordable housing options and access to fairly priced, sustainable mortgage credit for all communities and families – including those in rural and economically-distressed areas, and those with low- or moderate-incomes.

Although homeownership is not the best option for everyone, affordable opportunities should be available to Americans with the financial capacity to own a home. Part of our efforts to reform the housing finance system will focus on helping ensure FHA is a sustainable, efficient resource for creditworthy first-time homebuyers and families of modest incomes. We are working expeditiously with the FHA to plan and carry out reforms so its programs are more efficient and responsive to changing market conditions. To improve and streamline other government initiatives, the Departments of Housing and Urban Development, Agriculture, and Veterans Affairs – which all operate targeted housing finance programs – will establish a task force to explore ways to better coordinate or consolidate their efforts.

We will also consider measures to help ensure secondary market participants – securitizers and mortgage guarantors – provide capital to all communities in ways that reflect activity in the primary market consistent with safety and soundness. In addition, we will focus on making sure all mortgage market participants comply with antidiscrimination laws, and work with Congress to require greater transparency for data that tracks where and to whom mortgage credit is flowing.

Our approach should also encourage greater balance between homeownership and rental opportunities. That means improving support to the one-third of Americans who rent their homes, and especially to low- and moderate-income families. In the near term, the Administration will begin work to strengthen and expand FHA's capacity to support both lending to the multifamily market and adequate financing for affordable properties that private credit markets generally underserve. As part of our efforts, we will explore innovative ways to finance smaller multifamily properties, which contain a third of all multifamily rental units but the housing finance system has not adequately served.

Addressing long-standing problems in housing finance, like rental supply shortages for the lowest income families, will require a dedicated commitment, but it is one that can be made in a budget neutral way. We look forward to working with Congress and other stakeholders to discuss this and other avenues for improving access and affordability in a targeted, transparent way.

Options for the Long-Term Structure of Housing Finance

In the paper the Administration released last month, we laid out three potential ways to structure government support in a housing finance market where the private sector is the predominant provider of mortgage credit.

In each option, government support would be transparent, explicit, and limited. Each would make private markets the primary source of mortgage credit and the primary bearer of mortgage losses. Each would preserve FHA assistance and similar government initiatives that assist targeted groups, such as low- and moderate-income families, farmers, and veterans.

The first option would limit the government's role almost exclusively to these targeted assistance initiatives. The overwhelming majority of mortgages would be financed by lenders and investors and would not benefit from a government guarantee.

In the second option, targeted assistance through FHA and other initiatives would be complemented by a government backstop designed only to promote stability and access to mortgage credit in times of market stress. The government backstop would have a minimal presence in the market under normal economic conditions, but would scale up to help fund mortgages if private capital became unavailable in times of crisis.

The third option broadens access for creditworthy Americans and helps ensure stability in times of market stress. Alongside the FHA and targeted assistance initiatives, the government would provide reinsurance for certain securities that would be backed by high-quality mortgages. These securities would be guaranteed by closely regulated private companies under stringent capital standards and strict oversight, and reinsured by the government. The government would charge a premium to cover future claims and would not pay claims until private guarantors are wiped out.

The report we released last month discusses the advantages and disadvantages of each approach in additional detail, and also encourages Congress and the public to evaluate each option in light of four common criteria: access to mortgage credit, including the future role of the 30-year fixed-rate mortgage; incentives for private investment in the housing sector; taxpayer protection; and financial and economic stability.

Part of our intention in providing this narrow set of options and key criteria by which they should be judged is to encourage an honest conversation about the merits and drawbacks of each approach among the Administration, Congress, and stakeholders. We are faced with difficult choices that will involve real trade-offs. The challenge before us is to strike the right balance between providing access to mortgages for American families and communities, managing the risk to taxpayers, and maintaining a stable and healthy mortgage market.

In choosing among these options, care must be given to designing a system that maximizes the benefits we are seeking from government involvement in the mortgage market, while minimizing the costs. We should also be sure to consider how to utilize the existing systems and assets in our housing finance system, including those at Fannie Mae and Freddie Mac, as best as possible for the benefit of the taxpayer and the American people.

Each of the longer-term reform options we have outlined will require legislation from Congress, and we hope to work together with you and your colleagues to pass comprehensive legislation within the next two years. Failing to act would exacerbate market uncertainty and risk leaving many of the flaws in the market that brought us to this point in the first place unaddressed. We look forward to continuing the dialogue with consumer and community organizations, market participants, and academic experts as we work together to build a housing finance market that is stronger and more stable than it was in the past.

I want to conclude with one important point. Housing is a critical part of our economy and we will proceed with our plan for reform with great care. Our objective, after all, is a healthier, more stable housing finance system. While we are confident that the steps we have laid out follow the right path, haste would be counterproductive – possibly destabilizing the housing finance market or even disrupting the broader recovery.

I'd be happy to take your questions now and, again, thank you for the opportunity to be here today.