U.S. DEPARTMENT OF THE TREASURY

Press Center

Treasury Assistant Secretary David Nason Remarks before the Women in Housing and Finance

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Washington- Thank you for inviting me to join you today at this luncheon. I am honored to have the opportunity to speak to this distinguished group of financial services industry professionals and policy leaders. It is great to see so many familiar faces here. Women in Housing and Finance is a significant contributor to the success of many women in the financial services arena, particularly here in our Nation's capital.

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It has been an especially busy time at the Treasury Department so there are plenty of issues that are ripe for our discussion today. I would like to begin my remarks with a brief economic update after which I will cover two issues that are currently front and center at the Treasury Department, particularly for Domestic Finance: housing policy issues and capital markets competitiveness.

General Economic and Market Conditions

As you know, there have been adjustments taking place in the credit and mortgage markets. Largely because of lax underwriting, the mortgage market, especially the subprime market, has been experiencing a high number of delinquencies and defaults. As a result, subprime mortgage-backed securities have performed poorly. This has led investors to reassess the risk and as a corollary reassess the pricing of these securities.

At the Treasury Department, we have been engaged actively in this developing situation. Secretary Paulson has been working with financial regulators and market participants. At a time like this when markets are reappraising risk and imposing market discipline, confidence is key. Our country and the Treasury Department are fortunate to have a Treasury Secretary who has spent his life in the financial markets, through good times and bad times.

Fortunately, this market stress is occurring against the backdrop of a strong global economy. However, as Secretary Paulson noted recently, the ongoing housing correction, rooted in an eight year period of exceptional housing price appreciation, will continue to impact the economy adversely. We continually analyze this situation, knowing that it will take time to work itself out. In our view, the underlying strength of the economy should enable further continued growth. However, despite these strong fundamentals it is the Treasury Department's view that the housing decline is the most significant current risk to our economy.

Housing Policy Issues

The Administration's Response

The Administration recognizes the importance of housing to our economy and the fact that a significant number of homeowners will experience strain due to resetting mortgage rates and housing pricing pressures. In August, President Bush laid out an aggressive plan to stem the rising tide of foreclosures. His plan is motivated by the realization that many distressed homeowners can avoid foreclosure with additional flexibility.

The Administration's foreclosure avoidance plan has three main parts. First, the Administration renewed its call on Congress to modernize the Federal Housing Administration (FHA). This FHA modernization proposal would lower down payment requirements, allow FHA to insure bigger loans, and give FHA more pricing flexibility. Second, we called on Congress to change the Federal Tax Code temporarily so it does not punish homeowners who have mortgage debt cancelled. Third, we announced a foreclosure avoidance initiative, which sought the assistance and expertise of housing counselors and coordinated the response efforts of mortgage industry market participants in a way that is flexible and adaptive to the subprime mortgage market challenges.

I would like to discuss the foreclosure initiative in greater detail, but first it is important to make two general observations about the Administration's plan. The components of the plan enjoy wide bipartisan support on Capitol Hill. FHA modernization language has passed the House twice. In the Senate, FHA modernization legislation passed the Senate Banking Committee and has wide bipartisan support. The Administration's tax code proposal is also bipartisan, with Republican and Democratic support in each chamber.

The second general point I would like to make is that time is of the essence. Adjustable rate mortgage resets will occur in the coming months regardless of Congressional action. It is important to act quickly. Homeowners not reached before their resets occur are at a much higher risk of defaulting. Our plan supports an increased role for housing counselors, but their efforts will be less meaningful if the appropriate tools are not available.

The Joint Economic Committee, under the leadership of Chairman Charles Schumer and Vice Chair Carolyn Maloney, issued several reports on the current housing market. Their reports repeatedly recognize the appropriateness of the ideas in the Administration's plan to minimize foreclosures. The Committee's policy recommendations include passing FHA modernization legislation, changing the Federal Tax Code so cancelled mortgage debt is not treated as income, and acknowledging the importance of housing counselors to the loan modification process. Just last week, the Joint Economic Committee, in another published report, repeated its call for these issues (and others) to be addressed. Congress should send legislation to the President on these bipartisan efforts as soon as possible.

HOPE NOW Alliance

On October 10, consistent with President Bush's call for action, Secretary Paulson and Department of Housing and Urban Development Secretary Jackson joined a group of mortgage servicers, counselors and investors as they launched an effort, called the HOPE NOW Alliance, to coordinate efforts to reach more homeowners and find long-term solutions. I would like to discuss with you the issues that the Alliance has identified and its strategy for success.

First, as I already stated, but it is worth restating, the earlier we identify struggling borrowers, the more likely they will be able to modify their mortgage or refinance into a sustainable mortgage. If we wait until borrowers default, their credit will be damaged and they will have far fewer options.

Second, borrowers are fearful of foreclosure and not aware that their lenders may be able to work out a solution. Many borrowers mistakenly believe that lenders want to repossess their homes through foreclosure. Foreclosure is very costly for lenders too. According to most of the servicers and counselors with whom we have spoken, 50 percent of those who lose their homes to foreclosure never contacted their mortgage servicers or mortgage counselors. We must work around the unfortunate stigma that many homeowners mistakenly associate with asking for mortgage help.

Third, while bringing benefits to our economy and homeowners, innovation in the mortgage sector has also introduced some challenges. Today, the mortgage process is disaggregated. A mortgage loan is likely to be originated, serviced, and owned by three different entities. In today's system, a homeowner having trouble making payments often does not know where to turn for assistance.

The Alliance members believe they can keep more Americans in their homes by joining together to address the problems in the subprime mortgage market. They have identified a set of specific actions to pursue:

- *Counseling* – Local housing counselors are already in place and have the required expertise. The Alliance is working with counseling organizations such as NeighborWorks to establish a simple, clear, and uniform message for homeowners that they counsel.
- *Communication* – Servicers indicated that they have poor success rates when they reach out to homeowners directly, sometimes as low as 3 to 5 percent. Homeowners are far more responsive to independent counselors, so the Alliance will develop in the near future a direct mail campaign directing distressed homeowners to counselors.
- *Process* – Servicers and counselors lack established protocols and standards for working together. Members of the Alliance have agreed to adopt standard practices to increase process efficiency.
- *Investors* – In the past housing counselors were funded by federal, state and local governments, but the investor community has now recognized that counselors play an important role in foreclosure avoidance. The American Securitization Forum has joined the Alliance and announced that counseling fees can be reimbursed from securitization transactions in appropriate circumstances.
- *Performance Measurements* – Today the industry does not have a thorough, standardized set of metrics with which to evaluate servicers' loss-mitigation performance or to evaluate counselors' effectiveness. The Alliance is developing these standard metrics which policymakers, homeowners, and investors need in order to monitor performance and develop loss mitigation strategies.
- *Technology* – The servicers have agreed to work toward cross-industry web-enabled technology solutions to connect servicers and counselors more effectively in order to better serve the homeowner. This should increase the speed of the loan modification process.

Recently, there has been a great deal of discussion about voluntary modifications. Preventing foreclosures is in investors' and homeowners' interests. Investors must take an active role in demanding that all mortgage servicers, large or small, are pursuing all available loss-mitigation strategies. We have an immediate need to see more loan modifications and refinancing and other flexibility. But, genuine voluntary actions are best taken under informed circumstances. The HOPE NOW Alliance is well suited to help homeowners and investors understand the value of their impaired assets by developing reliable housing data and encouraging the creation of industry guidance to increase effectiveness and standardize loss mitigation efforts.

There are many dedicated people working very hard on this initiative and their efforts should be appreciated. This is a very complex set of problems without an easy solution. I encourage you and your members to think creatively on these issues and communicate your ideas to us and Congress.

Capital Markets Competitiveness

When Secretary Paulson arrived at the Treasury Department, he immediately and appropriately focused his attention on financial preparedness and the competitiveness of our capital markets. Capital markets are the lifeblood of the United States economy. They enable capital investments to seed new companies, leading to job creation and economic prosperity. American consumers and investors benefit from a vibrant and healthy financial services sector that provides opportunities to access credit, save and invest for the future, and insure against risks. It is important, therefore, that our capital markets remain the best in the world. Accordingly, I would like to discuss three competitiveness-related initiatives that are underway at the Treasury Department.

Auditing Profession

In an address last November, Secretary Paulson specifically pointed out a strong and viable auditing profession as a crucial component of capital markets competitiveness. For nearly 75 years, the auditing profession has been charged with certifying public company financial statements. The fulfillment of this charge is critical to investor confidence in financial reporting, critical to the flow of capital, and thus critical to capital markets competitiveness.

Recognizing the challenges facing the auditing profession, Secretary Paulson announced last May the creation of a federal advisory committee to examine and develop recommendations relating to the sustainability of the auditing profession. Co-Chaired by former Securities and Exchange Commission (SEC) Chairman Arthur Levitt, Jr. and former SEC Chief Accountant Donald T. Nicolaisen and made up of a diverse group of impressive members representing investors, auditors, large and small public companies, insurance companies, lawyers and regulators, the Advisory Committee on the Auditing Profession convened its first meeting two weeks ago. By all accounts, the meeting was a success and we are thankful that this extraordinary group has agreed to take on these challenging issues.

The Advisory Committee will be considering several issues confronting the auditing profession. These issues include: the auditing profession's ability to attract and retain the human capital necessary to meet developments in the business and financial reporting environment, audit market competition and concentration, and the financial resources of the auditing profession. By early Summer 2008, the Advisory Committee expects to deliver recommendations to the Treasury Department.

Restatement Study

The second capital markets competitiveness initiative I would like to discuss is the Treasury Department's public company financial restatement study. Numerous studies have pointed to a significant increase in the number of financial restatements over the past decade.

On the one hand, many reports attribute the growing number of restatements to increased management and auditor focus on accurate financial reporting due to the mandates in the Sarbanes-Oxley Act of 2002 and greater financial reporting review by the SEC and the Public Company Accounting Oversight Board.

However some studies suggest that while some financial restatements are clearly material, immaterial financial restatements might pose significant and unwarranted challenges to the capital markets. Immaterial restatements might unnecessarily harm investor confidence by calling into question the credibility of company management, auditors, and the financial reporting system as a whole.

Earlier this month, the Treasury Department announced the selection of University of Kansas Professor Susan Scholz to conduct its examination of the impact of and the reasons behind public company financial restatements. Professor Scholz will describe these restatements, examine the factors triggering these restatements, and analyze their significance on investors and the capital markets.

The study will analyze restatement data from 1997 to 2006 in order to perform a thorough assessment of several recent changes in the financial reporting system, including the impact of the Sarbanes-Oxley internal control requirements and SEC Staff Accounting Bulletin No. 99--Materiality. Through this process, our goal is to understand the significance of restatements upon investors and capital markets. The Treasury Department intends to make the study's results public by early 2008.

Regulatory Blueprint

Finally, I would like to discuss regulatory structure issues associated with the U.S. financial services industry. The regulatory policies in place for financial institutions must effectively protect consumers and investors, while at the same time promote entrepreneurialism and capitalism that is the foundation of our national economic success. These qualities are not at all mutually exclusive. Our regulatory system has adapted to the changing market by expanding, but perhaps not always by focusing on the broader objective of regulatory effectiveness and protecting consumers and investors. We should analyze and understand the rationale or justification for our current regulatory structure as well as the inefficiencies it can breed along with the benefit and burden of our regulations.

Therefore, under Secretary Paulson's leadership, the Treasury Department is engaged in a comprehensive review of our regulatory structure to evaluate these issues and propose solutions that achieve the right balance. Over the next several months, we will produce a regulatory reform blueprint that will outline recommendations on how to modernize our regulatory regime.

While this project was contemplated well before we entered this period of mortgage market stress, the complexity of the mortgage market regulatory structure provides an interesting backdrop. More people are now willing to consider and discuss regulatory structure and these issues associated with the current situation in the mortgage market are directly related to some of the specific questions posed in the Treasury Department's recent Federal Register notice seeking comments on our comprehensive review of regulatory structure.

In particular, the notice asked about what role states should have in the regulation of financial institutions. This issue has been debated for a long time, but is taking even greater prominence with the consideration of current proposals related to mortgage originators and long-term structural issues.

Much like evaluating federal versus state issues in other areas of regulation, in financial services, consideration of what areas are appropriate for federal standards, and if so, what role should the states have in setting or enforcing those standards is the appropriate approach. The notice also specifically asks if the current regulatory structure adequately addresses consumer or investor protection issues. Much of the current debate on issues related to mortgage origination focuses on enhancing consumer protection in the mortgage origination process, with current proposals focusing on tightening current standards or providing new regulatory authority to a number of agencies. Again, as the Treasury Department looks to the future in this report, one aspect that the Department will focus on is what regulatory structure is the most effective from a consumer protection perspective, and what type of regulatory structure is necessary to perform that function effectively.

These are significant issues that many policymakers have considered over the years. Success of this initiative will not and should not be tied to short-term accomplishments. We will recommend specific changes to our financial services industry regulatory structure. Some of the recommendations will be immediately relevant to legislative and regulatory policy issues. On these matters, our hope is that the Treasury Department's report will spur near-term tangible results. Implementation of other, longer-term recommendations will be subject to outside factors, but will be ready should support for these reforms develop. Finally, our hope is that some of the recommendations will shape debates in the future when regulatory structure issues are considered.

The Treasury Department is pursuing each of these three initiatives as part of the Secretary's broader competitiveness agenda, which seeks to ensure that U.S. capital markets remain efficient, innovative, and continue to drive capital to its most productive uses. Our markets must retain the integrity and efficiency that has contributed greatly to prosperity in America and around the world. Thank you for listening. I would be happy to take a few questions.