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**St. Louis Fed President Bullard: Opening Remarks
“Past, Present and Future of Government-Sponsored Enterprises” Conference
St. Louis, Mo. | Nov. 17, 2010**

It is my pleasure to welcome you to the Federal Reserve Bank of St. Louis’ research conference on the “Past, Present, and Future of the Government-Sponsored Enterprises.”

The role of the housing market has been central in the recent financial crisis. Mortgage financing, in particular, turned out to be an exceptionally weak link as the crisis unfolded.

The U.S. government has often modified the structure of housing finance after a crisis. For example, before the Great Depression, a large fraction of mortgages was relatively short term (five-to-seven years). These loans were mostly non-amortizing balloon mortgages, with low loan-to-value ratios of 50-60 percent.

The intervention of the government changed those terms in favor of fixed-rate mortgages with longer maturities (20-30 years) and higher loan-to-value ratios (80 percent and above). In 1938, Fannie Mae was established to create a secondary market to provide liquidity by buying primarily FHA-insured loans. In 1968, Fannie Mae split into a private corporation (Fannie Mae) and a publicly-financed institution (Ginnie Mae). To provide competition for the newly private Fannie Mae, Congress established Freddie Mac in 1970.

The extent of Congressional meddling in this market has been astonishing to the point where one can barely identify what the private sector outcomes would be in the absence of intervention.

To the extent possible, we need to let the private sector provide the bulk of U.S. housing finance going forward, without the incentive-distorting set of government programs and taxpayer guarantees that caused our current system to collapse. Those programs meant well, but ended up costing everyone dearly.

It makes little sense to try to design programs that subsidize everyone. If everyone is subsidized, then no one is subsidized.

We should perceive the current situation as an opportunity to reform housing finance according to best principles and sound lending practices. The future of Fannie Mae and Freddie Mac will depend on the nature and structure of the new mortgage finance system.

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Here are a few principles that may be used to guide the reform process, and which may be discussed during the conference today:

- **Housing affordability:** To the extent possible, government subsidies to lower-income and first-time buyers should be disentangled from housing finance more broadly defined. Subsidies should be regularly reviewed and subject to Congressional approval and appropriation of funds. These functions could be merged into the structure of the Department of Housing and Urban Development along with the government mortgage programs of the FHA and Ginnie Mae.
- **Mortgage loan origination:** One of the rationales for the GSEs is to enhance the flow of credit to specific sectors of the economy. A key question we need to ask is whether the private market will allocate credit more efficiently. In most developed countries, mortgage finance is provided by the private sector. Ideally, in a well-functioning private system, taxpayers can be sheltered so they are not exposed to insolvency risk.
- **Leverage:** Home equity is the best insurance against default. Loan-to-value ratios of 80 percent or below should be adequate to insure against most house price movements. Homeowners who choose higher loan-to-value ratios could be required to purchase default insurance or to increase the amortization component of their mortgage payments.
- **Recourse:** Many European countries had housing booms and busts of a similar magnitude to the one in the U.S., but they experienced a different pattern of default rates. For example, in Spain mortgage debt cannot be discharged in the event of default, and as a result, the default rate is much lower than in the United States. A possible reform of recourse regulation along European lines may improve the pattern of default in the U.S., which is currently regulated at the state level.
- **Transparency, risk, and insurance:** The pooling of mortgages into mortgage-backed securities could be constrained to pool loans with similar characteristics (i.e., \$150,000 to \$200,000 with a loan-to-value ratio of 80 percent). In order to avoid one-sided bets, financial intermediaries could be required to purchase insurance or otherwise appropriately hedge their MBS portfolios.

The research presented at this Conference addresses these important issues and is thus particularly timely. The range of issues we will study today ranges from the evaluation of the role of the GSEs in the expansion of the home ownership rate to their role in the purchase of subprime agency debt, as well as several proposals to reform their structure and regulation. The Federal Reserve Bank of St. Louis has long supported fundamental research in economic policy. Our goal has long been to provide perspectives on whether the policies adopted in the past still serve us well today, and on how recent developments at the frontier of research can be applied to improve policy. That is what the St. Louis Fed has aimed to do for the past four decades.

With that in mind, I welcome the speakers who have agreed to share their insights with us today. I trust that we will all learn quite a lot. Thank you for being here, and have a great conference.

James Bullard, President and CEO
Federal Reserve Bank of St. Louis