STATEMENT OF TERESA BRYCE BEFORE THE SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPPORTUNITY OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES ON BEHALF OF THE MORTGAGE INSURANCE COMPANIES OF AMERICA
October 8, 2009

I am Teresa Bryce, president of Radian Guaranty Inc. I am here today on behalf of the Mortgage Insurance Companies of America (MICA), the trade association representing the entire private mortgage insurance industry.[1] The Subcommittee today is discussing the critical issues of the financial health of the Federal Housing Administration (FHA). Both FHA and private mortgage insurers play an important part in making homeownership affordable and possible for millions of Americans. While we cannot comment on the actuarial study since it has not been made public, we hope that by explaining the private mortgage insurance (MI) industry's regulatory structure and business model – with its rigorous reserve requirements and its natural alignment with the borrower's interests -- we can help the subcommittee determine the best way to both support and promote a vibrant and sustainable housing market.

The Role of Private Mortgage Insurance

The MI industry was founded in 1957 and since then has helped over 25 million low and moderate income people become homeowners by enabling them to buy affordable homes with small down payments. Lenders require MI on low-down payment loans because experience and research show that a borrower with less than 20% invested in a home is more likely to default on a mortgage. Today, the MI industry's capital stands behind approximately $900 billion of mortgage loans. That is approximately 9% of outstanding home mortgages held by financial institutions.

Mortgage insurers insure mortgages in all 50 states. No one market needs MI more than another because all markets have first-time home buyers struggling to achieve the dream of homeownership and enabling first-time homebuyers to purchase homes is essential to revitalizing the market. As first-time homebuyers purchase homes, existing homebuyers can trade-up to larger ones, thus ensuring a vibrant housing market.

We serve the mortgage market by providing credit enhancement – that is credit-risk mitigation – to ensure that lenders and investors such as the government sponsored enterprises (GSEs) are protected in the event of borrower default. This means that private mortgage insurers stand first in line to pay a loss if borrowers default. MI generally covers costs associated with defaulted loans (interest charges, legal fees, home maintenance and repair costs, real estate broker fees and closing costs) and any loss resulting from selling the property for less than its original sales price. In 2007 and 2008, mortgage insurers paid $15 billion in claims and continue to pay billions of dollars more in claims in 2009. Mortgage insurers are providing this protection while continuing to write new business that enables borrowers to purchase homes with small down payments and loans that are affordable for the life of the loan.

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[1] The members of MICA are as follows: Genworth Mortgage Insurance Corporation; Mortgage Guaranty Insurance Corporation; PMI Mortgage Insurance Co.; Radian Guaranty Inc.; Republic Mortgage Insurance Company; and United Guaranty Corporation.

Rigorous reserve and regulatory structure - The backbone of the industry's financial strength is its state-imposed reserve, capital and regulatory requirements. It is because of this structure that mortgage insurers continue to pay their claims as they come due and write new business in these very stressful economic times. Our structure mirrors some of the key recommendations made by the heads of state at the recent G-20 summit to reform the mortgage securitization market. The key elements of the industry's regulatory structure are discussed below.

Capital at risk – While rejecting a simple risk-retention requirement because it could adversely affect credit availability, the G-20 has demanded that private capital be at risk to ensure that securitizations are based on incentives aligned with those of borrowers and investors. As noted above, mortgage insurers take the first dollar of loss if the borrower defaults, which aligns our interests with those of the borrower. Mortgage insurers' interests are also aligned with the investor who generally will take a loss if a borrower defaults. Private mortgage insurance is private sector capital at risk.

Proven ability to absorb risk (contingency reserve) – The G-20 is determined to ensure that credit default swaps (CDS) and other forms of credit enhancement have a proven ability to absorb risk. The state requirements for MI are specifically structured to address the long-term nature of the capital at risk for a mortgage insurer. They enable the mortgage insurer to withstand a sustained period of heavy defaults arising from serious regional or national economic downturns, as well as routine defaults and claims that occur throughout the normal course of business.

Mortgage insurers are required to keep three types of reserves, the most important of which is the contingency reserve. Half of each premium dollar earned goes into the contingency reserve and generally cannot be touched by the mortgage insurer for a 10-year period. It ensures that significant reserves are accumulated during good times not only to handle claims under stress, but also to avoid boom-bust cycles. Therefore, unlike other financial institutions that may pay high dividends during profitable periods, MI companies build their contingency reserves during these periods in order to have the capital ready to pay the higher claims that inevitably occur during periods of market corrections such as the one the U.S. is now experiencing.

Unlike CDS or other forms of credit enhancement, MI has already demonstrated its ability to absorb risk. The history of the MI industry proves that they have paid their claims through good and bad economic cycles. For example, in the early 1980s, the mortgage market had to cope with double-digit interest rates and inflation in a period of severe recession and, therefore, introduced many experimental adjustable-rate mortgages. As economic conditions deteriorated — particularly in energy-oriented regions of the country — defaults began to rise, resulting in numerous foreclosures. The MI industry paid more than $6 billion in claims to its policyholders during the 1980s. In the early 1990s, the MI industry paid more than $8 billion in claims, primarily in California and the Northeast. Policyholders included the GSEs, commercial banks, savings institutions,

institutional mortgage investors, mortgage bankers, the Federal Deposit Insurance Corporation, and the Federal Savings and Loan Insurance Corporation.

The attached appendix is composed of three charts that provide the most recent available data. They show how the MI industry's statutory structure and resulting capital build-up allowed the industry to handle these various regional recessions described above. Mortgage insurers built capital after the oil patch recession and then were able to pay claims during the recessions in California and the Northeast. Once again the industry built capital so mortgage insurers are able to meet their claims obligations today.

Counter-cyclical capital - One reason the mortgage boom was so pronounced is that bank regulatory capital requirements permitted speculative growth and then sharply curtailed the ability of lenders to support market recovery. MI, on the other hand, is supported by a unique form of counter-cyclical capital which permits mortgage insurers – unlike every other provider of mortgage credit risk mitigation – to meet claims and handle new business even under unprecedented stress. Mortgage insurers' contingency reserves are directly comparable to the "dynamic provisioning" bank regulators now know they need. Bank regulators are only now working to construct a similar system for banks in the U.S. and around the world, with Federal Reserve Chairman Ben Bernanke highlighting this as a critical initiative.

Conservative Capital Requirements – Mortgage insurers operate within a conservative risk-to-capital ratio, with capital guidelines established by state insurance departments. MICA's member companies reported total capital of $11.98 billion against $227.7 billion of net risk-in-force as of the end of 2008, giving them a combined risk-to-capital ratio of 19 to 1. Indeed, the existing state regulatory structure has served the MI industry well during the current economic downturn.

Other regulatory features of MI - The two reserves other than the contingency reserve discussed above that mortgage insurers must maintain are case-basis loss reserves and unearned premium reserves. Case-basis loss reserves are established for estimated losses on individual policies when the insurer is notified of defaults and when foreclosures occur. Premiums received for the term of a policy are placed in unearned premium reserves and are earned over time in accordance with state regulation. As defaults have increased, the amount of capital put into these reserves has increased in order to ensure that the money is available to pay claims.

Beyond the reserves requirements, state regulators have detailed and comprehensive regulations designed to protect policyholders. State insurance regulation addresses among other issues, the licensing of companies to transact business, policy forms, claims handling, financial statements, periodic reporting, permissible investments, adherence to financial standards, and premium rates. The premium rates and policy forms are generally subject to regulation in every state and are intended to protect policyholders against the effects of excessive, inadequate or unfairly discriminatory rates and to encourage competition.

Finally, state regulations provide for a structure that allows mortgage insurers to continue to pay their claims even if they no longer write new business. One company announced last year that it would go into what is known in the industry as "run-off." That is, it collects its premiums on existing policies and pays its claims as they come due. Interestingly, a new company has announced its intention to enter the business and is raising capital and complying with the rigorous state regulations required of a new entrant.

Alignment with the borrower – Mortgage insurers and homebuyers share a common interest in the mortgage transaction because they each have the greatest risk of loss in the event of default. Upon default, the borrower will lose his or her home and the equity invested in it, and the mortgage insurer will incur a loss by paying a claim. Thus, the insurer and the borrower are both concerned that the home is affordable not only at the time of purchase, but throughout the years of homeownership. Therefore, while mortgage insurers do not interact directly with borrowers, they act as review underwriters for the credit and collateral risks related to individual loans. Mortgage insurers established independent underwriting guidelines with respect to the borrower's financial capabilities and the property value, to ensure that the borrower can afford the home.

Having its own capital at risk also means that mortgage insurers have very clear incentives to mitigate their losses if loans are in default. Mortgage insurers have a history of partnering with lenders, investors and community groups to work with borrowers in default. In today's devastating mortgage market, mortgage insurers continue to play a leadership role in working with all parties, including with the Obama Administration's HARP and HAMP programs as well as other foreclosure relief programs. In 2008 mortgage insurers were able to save almost 100,000 people from losing their homes and in the first half of this year the industry has worked to enable an additional 100,000 people to remain in their homes.

Comparison of Private MI to FHA

FHA and MI are similar in that they enable borrowers to buy homes with less than a 20% down payment by paying claims if the loan goes to foreclosure. However, there are some significant differences in the way the two models are structured. These key differences may well have come about because FHA is a government program and not a private insurance firm. However, as Congress considers ways to improve FHA's financial health it should consider attributes of the private sector that are a proven formula for success. These key differences are discussed below.

Coinsurance feature – An essential feature of private mortgage insurance is the concept of coinsurance on the part of all parties to the transaction. MI generally covers 20% to 25% of the loan amount. However, that percentage generally does not cover all of the losses that the parties to the mortgage transaction experience. FHA, on the other hand, insures 100% of the loan amount if the loan goes to foreclosure so that the loan originator lacks any meaningful risk of loss. The private MI model ensures that there is private sector capital at risk to act as a bellwether for the risk to the borrower.

Respond to market conditions – FHA has a "one size fits all" type of underwriting system which does not allow FHA to respond to the build–up or deflation of mortgage market bubbles. Mortgage insurers, on the other hand, have heavily invested in analytical and automated underwriting tools so that we can make sure the loans we insure meet our independent underwriting. Mortgage insurers are constantly monitoring the regional mortgage markets and altering their underwriting to ensure that the home is both affordable for the borrower at closing and sustainable over the life of the mortgage. If there is one thing the mortgage market has learned in recent years it is that sustainability is as important as affordability.

The members of MICA do not discuss underwriting or premium changes with each other. Therefore, I cannot speak specifically on that issue for MICA. However, I can say as president of Radian that we have adjusted our underwriting guidelines to reflect the realities of today's mortgage market. For example, as house values continue to decline around the country it only makes sense that we require that borrowers have some initial equity in their property. Therefore, in today's market we generally require a 5% down payment as we believe do most other mortgage insurers. Regarding premiums Radian's premiums are filed with and approved by state regulators to ensure that the insurer is adequately capitalized. To meet the challenges in today's market, state regulators have approved increases to Radian's premiums as they have for other mortgage insurers.

Consistent with the realities of the market place today, during the past 18 months mortgage insurers insured $242.5 billion of mortgages which represented 9.8% of total mortgage originations during this period. However, the percentage of MI originations has declined from 14.7% in the first quarter of 2008 to 4.3% during the second quarter of 2009. This has primarily been due to the mortgage insurers changing credit guidelines and adjusting pricing to properly address the current market risks.

Appropriate Systems in Place – Over the last several years the HUD Inspector General and the General Accountability Office have enumerated various problems with FHA's automated underwriting systems and other operating systems. Because private capital is at risk, private mortgage insurers have the most current technology and can receive up-to-date information on their portfolios. This enables them to better understand trends in the market and set better criteria.

Difference in borrower profiles - The only data available to compare the typical FHA borrower to the typical borrower using MI is the Home Mortgage Disclosure Act (HMDA) data which was just made available last week for 2008. That data shows that the typical MI borrower is likely to have a slightly higher income than the typical FHA borrower because the average FHA-insured purchase loan was $171,462 while the average privately insured purchase loan amount was $201,539. This is also reflected in HMDA data showing that 58% of MI purchase borrowers had incomes above 100% of their metropolitan statistical area (MSA) median income whereas 45% of FHA purchase borrowers had incomes above 100% of the MSA median income.

The other characteristic that likely is different in today's market is the amount of a down payment that an FHA borrower must make as opposed to the down payment required by a mortgage insurer. FHA's minimum down payment requirement is set in law and is 3.5%. As discussed above, MICA's members make separate decisions on their down payment requirements and have the flexibility FHA does not have to make adjustments to reflect economic conditions.

Conclusion

Until the actuarial report on FHA is released, it is difficult to know exactly what changes need to be made in order to ensure that FHA continues to meet the needs of people buying homes with low down payments. The Administration has taken some good initial steps towards this goal, but it is likely more is needed. However, there is no one single change that will solve FHA's financial problems. As MICA's statement outlines, the private mortgage insurance industry, because of its stringent regulatory and reserve structure, is still paying claims and writing new business on low-down payments loans. Also, as MICA's statement discusses, many of the key factors that enable the industry to do so in this economic environment are not present in the FHA model. However, the MI industry is willing to bring its expertise to FHA and to Congress so that we can work together on a solution to ensure the existence of a robust mortgage market.

Appendix

Chart A

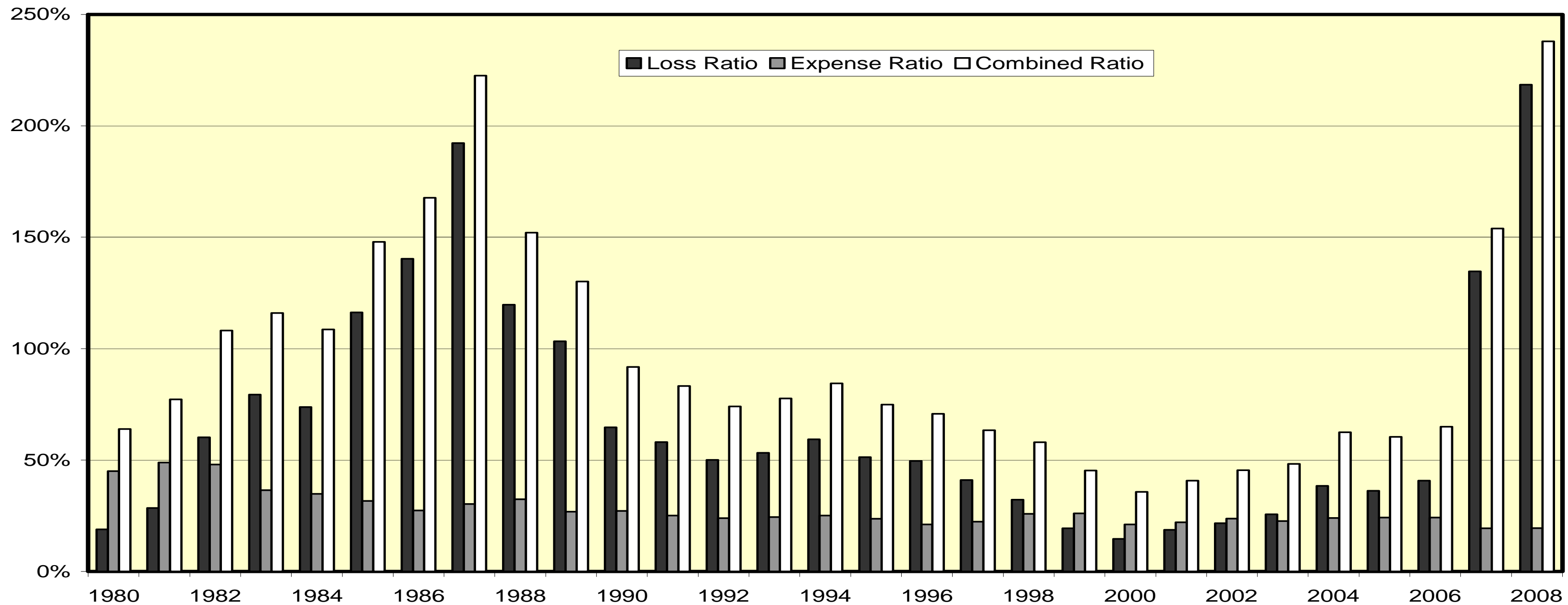

Chart A above shows the critical ratios for the MI industry from 1980 through 2008. The current stress in the housing market matches that experienced by the MI industry during the oil patch decline of the mid-1980s. However, note that the annual combined ratios exceeded 100% or more for eight straight years beginning in 1982 and the industry paid all claims and grew during that period. The reason for the continued strong claims paying ability of the MI industry is tied to its state capital and reserve requirements.

Chart B

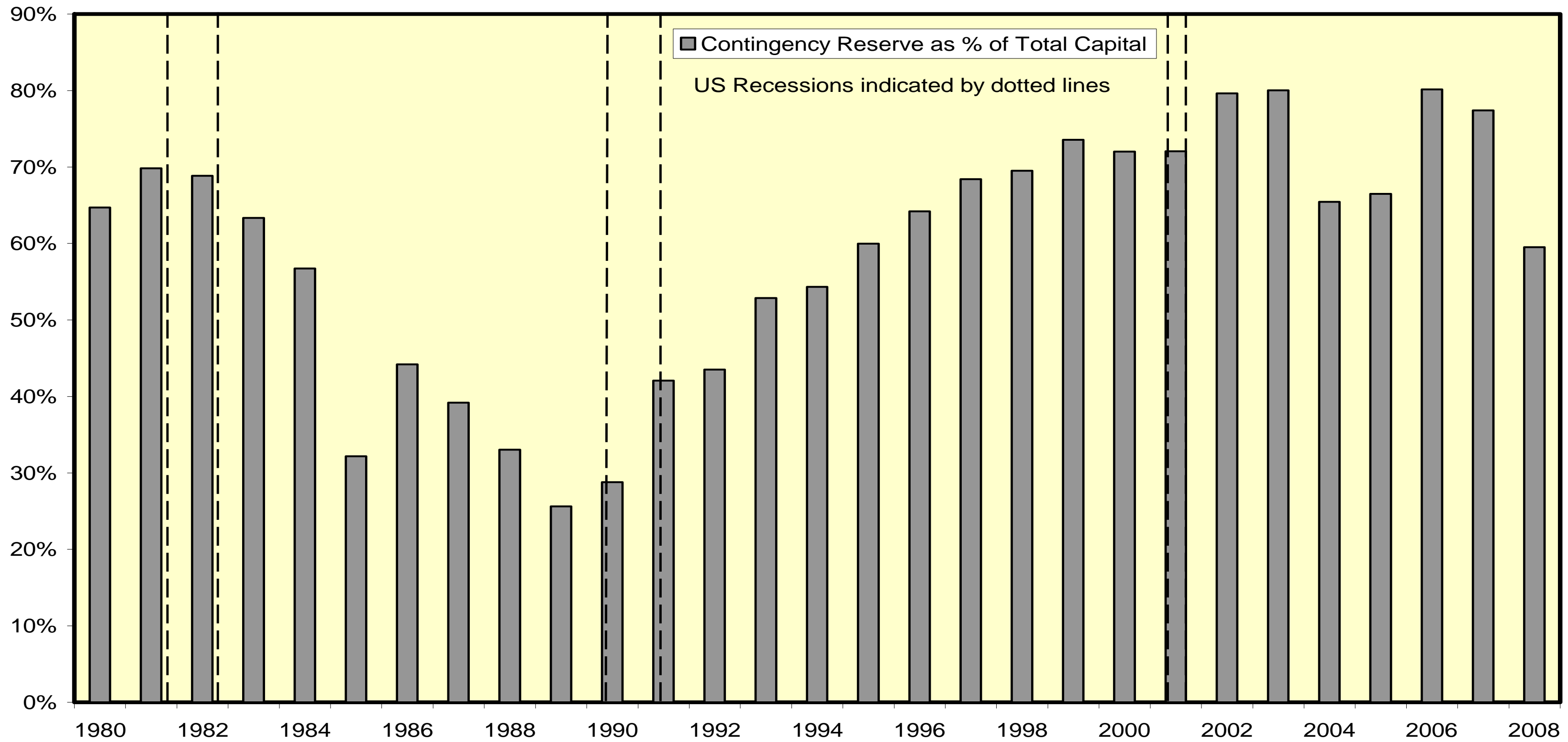

Chart B above shows how contingency reserves are built up during periods of low claims and economic prosperity to be used during periods of economic stress as we are currently experiencing.

Chart C

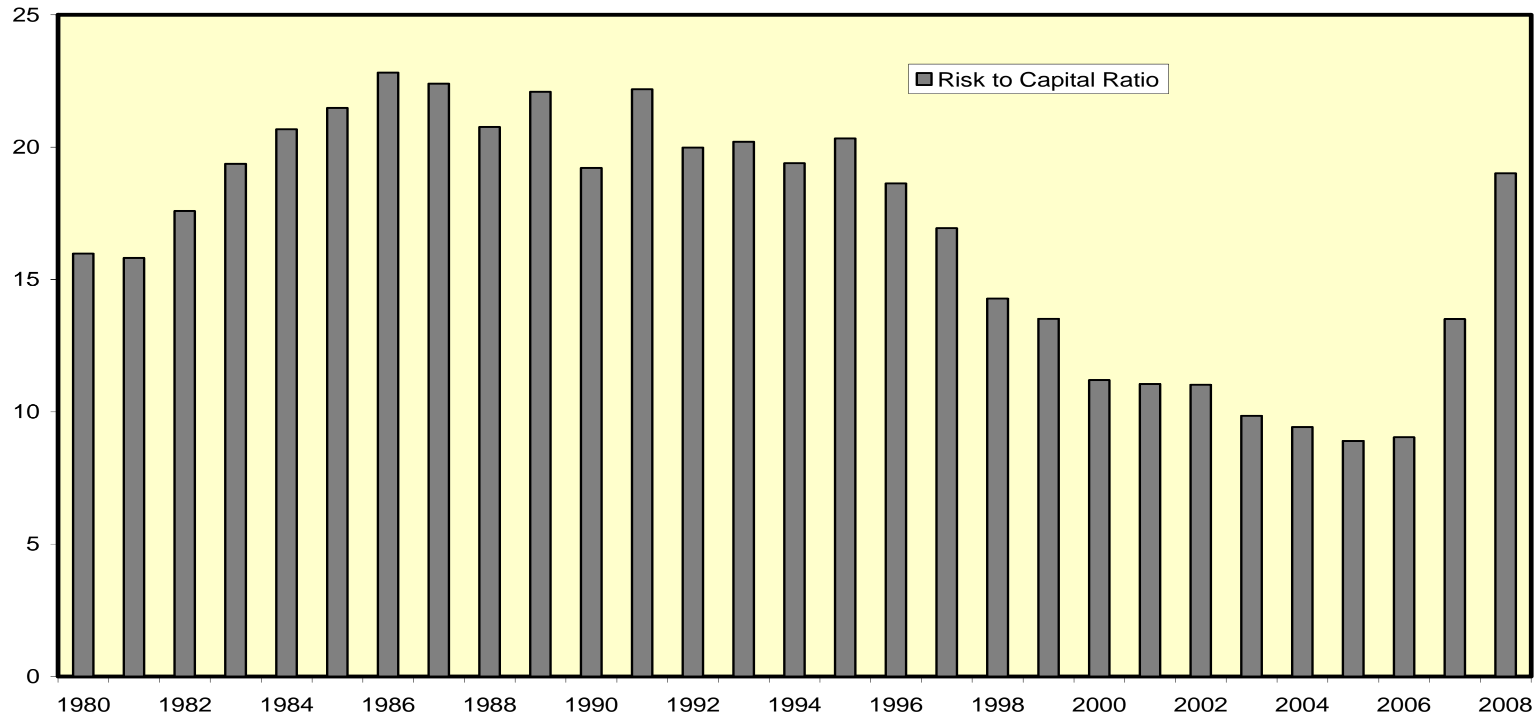

Chart C above shows the industry risk to capital ratio which now stands at 19 to 1, but still below levels seen in the mid-1990s and well below the levels reached during the mind-1980s house price declines.