SUSTAINABLE HOUSING FINANCE: PRIVATE SECTOR PERSPECTIVES ON HOUSING FINANCE REFORM, PART IV

HEARING

BEFORE THE

SUBCOMMITTEE ON HOUSING AND INSURANCE

OF THE

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WEDNESDAY, DECEMBER 6, 2017

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

SUSTAINABLE HOUSING FINANCE: PRIVATE SECTOR PERSPECTIVES ON HOUSING FINANCE REFORM, PART IV

Wednesday, December 6, 2017

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND INSURANCE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:08 a.m., in room 2128, Rayburn House Office Building, Hon. Sean P. Duffy [Chairman of the subcommittee] presiding.

Present: Representatives Duffy, Ross, Royce, Posey, Luetkemeyer, Stivers, Hultgren, Rothfus, Zeldin, Trott, MacArthur, Cleaver, Valazquez, Kildee, Delaney, and Gonzalez.

Chairman DUFFY. The Subcommittee on Housing and Insurance will come to order.

Today's hearing is entitled Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform, Part IV.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Without objection, all members will have 5 legislative days within which to submit extraneous materials to the Chair for inclusion in the record. Without objection, members of the full committee who are not members of this subcommittee may participate in today's hearing for the purposes of making an opening statement and questioning our great panel of witnesses.

The Chair now recognizes himself for 3 minutes for an opening statement.

I first want to welcome our panel and thank them for participating in today's hearing on housing finance reform. We have had many. I don't know if you followed all of them, but this is a particular interest to us today on this topic.

We have witnesses that offer credit enhancement products and participate in credit risk transfers. As we look to reform the housing finance system, I hope to explore whether they can play a larger role in this space as we move forward.

Expansion of private sector capital into the housing finance system should be a key goal of any restructuring of our housing finance. We have seen how successful these products have been in offloading risk in recent years. And the Federal Government has engaged in these products and programs to some extent.

Now, Fannie, Freddie, and Ginnie themselves use forms of credit risk enhancements in the present day to offload their risk to the private sector. And I look forward to hearing from our witnesses about how the various programs work to help relieve the burden of our taxpayers should we see another malfunction in our housing finance market.

These programs and products include mortgage insurance and credit risk transfer (CRT) programs such as Structured Agency Credit Risk, or STACR, and Credit Insurance Risk Transfers, or CIRT. I think it is important to note that just yesterday FEMA (Federal Emergency Management Agency) announced that, in the NFIP (National Flood Insurance Program) program, they will recover over $1 billion in reinsurance coverage under their 2017 reinsurance program. It seems like the program actually worked. Wow. Maybe we can learn lessons from what FEMA did and apply this in the housing finance space. And it could bode well not just for homeowners, for the private sector, but, man, would it be cool if it worked well for the taxpayer too. Everyone could be a winner.

Seen as the first reinsurance purchase by the Federal Government was—has borne fruit in terms of a successful transfer of risk, I am interested in hearing how reinsurance already plays and can play an increased role as we look at offloading risk in the housing finance space.

As any private sector capital product, we must look at the availability of coverage or capacity and the impact of cycles on these products. While I believe these products will ultimately help bring in capital to the housing finance system, we must make sure taxpayers are protected and not left holding the bag in economic downturns.

And so I want to re-emphasize that we must look at ways to make sure that the housing finance system relies primarily on private capital and utilizes the tools and products that are available. Development in this space is an example of how the private sector will react in developing a free market and fill the void the Government I don't believe can fill.

With that, my time just now expired, so I recognize the Ranking Member, the gentleman from Missouri, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman, and thank you to the panelists for being here in your wide array of stakeholders and individuals who can perhaps help us as we deal with this issue, because one of the things that is troublesome to me is that we are seemingly just holding on in keeping Fannie and Freddie in conservatorship, and I don't think that to do so is sustainable. I don't think that it is prudent. And as one who was here when this was done, I can tell you I don't think there was anybody on this committee who believed that that was a permanent arrangement, but it is moving along as if it is.

And so today our hearing is going to focus on private capital credit risk and credit enhancement as well as the steps that the FHFA (Federal Housing Finance Agency) has undertaken in the past few years to transfer the risk and assets and new ways to do so as we move toward the end of one year and into a new year.

Right now, according to the most recent progress report from FHFA, since 2013, the enterprise transferred a portion of the risk on 1.8 trillion of unpaid principal balance with a combined risk in force of about 60.6 billion, or 3.3 percent of UPB. And so I want to discuss with those of you who have been kind enough to come, find out whether or not you believe that these steps have and will have a positive impact on the overall housing finance system.

And it would be helpful, at least to me, to hear how different kinds of risk transfers, such as the front-end credit risk transfers, would affect the housing system.

Last week we held a hearing. The acting president of Ginnie Mae provided testimony. And he proposed a housing finance reform plan that would rely on Ginnie Mae as the centerpiece of the housing finance system. And this proposal would also introduce private credit enhancers to compete with the Federal agencies in taking on some of the credit risk.

And so I am hopeful that you will be willing to share your views on the proposal as well as discuss the impact that such a proposal would have on small lenders and the issue that I am extremely concerned about, affordability.

The path to housing finance reform may not be easy—well, it is not going to be easy. But I am encouraged, and I say this interplays, because I think we are having a robust bipartisan dialog, and I feel very good about it.

So thank you for being here today. We look forward to you solving most of the problems that we have before us.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the Vice Chair of the committee, the gentleman from Florida, Mr. Ross, for 2 minutes.

Mr. ROSS. Thank you, Chairman, and thank you again for holding another hearing on this important issue. And also thank you to our great panel, the witnesses, for sharing your insights with us this morning.

We want all homeownership to be more affordable, but affordability isn't just for home buyers eager to own a part of the American Dream. If the Government is involved, we need to make it affordable for taxpayers too.

Today we will examine the financial tools that allow Fannie and Freddie to take such a balanced approach. It wasn't long ago that Fannie and Freddie took major risks in the housing market. Reasonable minds may disagree about the impetus for that risk, whether it was overzealous profit seeking or, as I believe, misguided Government policy. Regardless, one thing is clear, the result was a systemic calamity that reverberated throughout the world economy.

Those homeowners we were trying to help were ultimately hurt. Many couldn't afford to stay in their homes, and taxpayers could barely afford to bail out Fannie and Freddie. Fortunately, there is a smarter way. You see, many Americans think of risk as a feeling or a worry, but it is not. It is a way of looking at an investment that ensures we consider the context of that investment.

What is the likelihood something will fail? High? Low? If we are guessing, we are losing. Thankfully we have inherited an intellectual tradition that allows us to calculate our likelihood of success and transform the threat of failure into a commodity. I bring this up because I think there is something to be applauded in the new approach as Fannie and Freddie have taken into managing risk.

During the financial crisis, most lawmakers were taken by surprise because they were completely unaware of the risk our GSEs (government-sponsored enterprises) took on. They were also surprised because there didn't seem to be a way of effectively mitigating that risk as it stood. One might even say that the risk management strategy was, quote, "If something goes wrong, the taxpayers will pony up," unquote.

This implicit taxpayer insurance was opaque. It was a moral hazard, and we are done with it. We are developing new and better approaches that take into account the realties we face today and pave the way for a better tomorrow. The credit risk transfer programs we will discuss in this hearing are a remarkable demonstration of how markets and human entrepreneurship can solve many of the problems created or made worse by the Government.

I am excited that today we will talk about how your organizations participate in that conversation and make it so that our housing market continues to thrive and our taxpayers aren't on the hook.

I yield back.

Chairman DUFFY. The gentleman yields back.

We now welcome our witnesses here today.

And by way of introduction, our first witness is Mr. Michael Canter, Director of U.S. Multi-Sector and Securitized Assets at Alliance Bernstein. Welcome.

Our next witness is Dr. Susan Wachter, Professor of Real Estate and Finance at the Wharton School at the University of Pennsylvania.

Next we have Mr. Jeffrey Krohn, Managing Director at Guy Carpenter and Company. Welcome.

Our fourth witness is Mr. Andrew Rippert, CEO of Global Mortgage Group at Arch Capital Group. Welcome.

And finally, last but not least, our fifth witness is Mr. Patrick Sinks, the CEO of Mortgage Guaranty Insurance Corporation, or MGIC, headquartered in the greatest State in the Nation, Wisconsin. Welcome all of you.

In a moment the witnesses will be recognized for 5 minutes to give an oral presentation of their testimony. Without objection, the witnesses' written statements will be made part of the record following your oral remarks. Once the witnesses have finished presenting their testimony, each member of the subcommittee will have 5 minutes within which to ask all of you questions.

You will note on your table you have three lights. Green means go, yellow means you have 1 minute left, and red means your time is up. We will try to be cognizant on our end of the time. But please, on your end too, try to be aware of those times and lights. Your microphones are sensitive, so please make sure you are speaking directly into them.

And so with that, Mr. Canter, you are recognized for 5 minutes.

STATEMENT OF MICHAEL S. CANTER

Mr. CANTER. Good morning, Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee. Thank you for the opportunity to testify before you today. My name is Michael Canter, and I am the head of Securitized Assets at Alliance Bernstein, also known as AB.

At AB we manage over $500 billion of assets on behalf of many different types of investors ranging from individuals and retail mutual funds to pension funds, insurers, and global corporations. I am appearing here today on behalf of AB and not any specific trade group, though we are members of SIFMA and the Association of Mortgage Investors. AB is one of the largest investors in the credit risk transfer market, and I hope that our experience will be helpful to the subcommittee in the important work that it is doing.

Today the CRT market has $40 billion of securities outstanding, referencing over 1.3 trillion of mortgages. That is 32 percent of the GSE's overall mortgage exposure. In fact, 50 percent of all GSE mortgages created today go into CRT's transactions. So without a doubt, the CRT bond market is crucial to how mortgages get financed in the country.

CRTs also play a prominent role in many GSE reform proposals. The fact that the GSEs have multiple ways to hedge their risk is important, and all of them have value, but we see the fixed income market solution as the cornerstone to any system going forward. I will highlight a few reasons why.

First, a CRT bond is fully funded at issuance, so the GSEs do not have any counterparty risk. There is no risk of nonpayment. In contrast, there are some proposals that urge greater use of mortgage insurance, sometimes called deep MI. It is important to remember that the ability and willingness of MI companies to pay claims becomes highly questionable in times of stress. It certainly did during the crisis.

The GSEs already have $200 billion of counterparty exposure to the MIs. A deep MI would only increase that. Also, once risk is in bond form, it can be distributed across a wide swath of investors and included in diversified portfolios across the globe. This is not the case for mortgage insurers, of which there are eight, whose entire levered capital base of 12.5 billion is exposed to mortgage losses.

Last, CRT bonds pay claims immediately whereas recouping MI payments can be a long, drawn-out process involving negotiation and sometimes litigation.

So what are the key attributes needed to perpetuate the success of the CRT market in a new housing finance system? The first I will mention is the ability of the GSEs to take risk alongside of investors. This alignment of interest has been crucial to investors' comfort in buying CRT securities and is a must-have in any new system. This is especially true when transferring first-loss risk. There is an abundance of capital willing to take this first-loss risk with the right structure and risk sharing by the GSEs.

Second, the GSEs are trusted by investors for the power they have in not only setting underwriting and servicing standards but ensuring that they are enforced. Confidence in any guarantor's ability to do this is essential. Such confidence, however, may be difficult for new guarantors to replicate.

Third, there has been a healthy competition between the GSEs to attract investor dollars. This dynamic allowed for innovation and kept the GSEs open-minded to investors' needs. In my view, there is no magic number of guarantors for a new system, but I think it is probably safe to say that it is greater than two.

Last, I would state that the FHFA has been very effective at encouraging risk transfer to protect the U.S. taxpayer. We think the lesson learned here is that it may be best for policymakers and regulators to avoid being overly prescriptive. Instead, a thoughtful capital framework needs to be put in place that puts a high value on risk transfer.

All this being said, I would like to mention two ways the CRT market could be improved. First, the broker-dealer capital charge for holding and trading these securities is unnecessarily onerous at 100 percent or greater. This is detached from the risk in these bonds and does nothing to help support the housing market.

Second, the GSEs need to more rigorously evaluate and perhaps separate out the natural catastrophe risk that is embedded in CRTs. If homeowners default on their mortgages because of a flood, hurricane, or earthquake, any resulting loss flows through to the CRT structure. This may be good for the taxpayer in the short-term, but I would venture to say that these risks had been woefully undermodeled and underconsidered by the GSEs and the rating agencies.

In conclusion, I want to thank you all for proceeding with this critically important reform effort. And we at Alliance Bernstein stand ready to assist the subcommittee in any way we can. And I look forward to answering your questions.

[The prepared statement of Mr. Canter can be found on page 24 of the Appendix]

Chairman DUFFY. Thank you, Mr. Canter.

Ms. Wachter, you are now recognized for 5 minutes.

STATEMENT OF DR. SUSAN M. WACHTER

Dr. WACHTER. Good morning, Chairman Duffy, Ranking Member Cleaver, and other distinguished members of the subcommittee. Thank you for the invitation to testify at today's hearing. I am the Sussman Professor of Real Estate and Professor of Finance at the Wharton School of the University of Pennsylvania. It is an honor to be here today to discuss the future of the housing finance system and the role of credit risk transfers in helping to assure a stable and sustainable housing finance system going forward.

In the past crisis, the housing finance system failed borrowers and taxpayers, and it is important to understand why. We now know but did not know the shift toward unsound lending as it happened. The bubble in housing prices at the expansion of unsound credit enabled masked the increasing credit risk. The failure to identify credit and systemic risk must be corrected going forward. Credit risk transfer programs, if properly structured, can help. Securities trading can discourage excessive borrowing if credit risk is priced accurately and in this way counter housing bubbles. Securitization markets, including the overcounter market for residential mortgage-backed securities failed in this, in the run-up to the crisis.

Beginning in 2013, under the direction of FHFA, the GSEs have developed credit risk transfers to share and trade credit risk. How

CRTs are structured matters greatly to their potential role in reducing systemic risk. In addition, the eventual reform of the housing finance system will influence how well the CRT markets work or even whether the market can work at all.

What is necessary for the structuring of credit risk transfers and, more generally, for the reform of the GSEs to enable the CRT market to inform on credit risk going forward.

First is the direct linkage of CRTs' performance of the risk of default of the underlying mortgages. This is in place. In addition, the use of a reference pool allows the so-called TBA market to trade inefficiently priced interest rate risk, which is important separately from the pricing of credit risk.

A second requirement to afford the pitfalls of the past mispricing credit risk is transparency and standardization to allow the identification of aggregate credit risk. The full provision of information on mortgages in the GSE portfolios referenced by CRTs does this as well.

Third, to avoid counterparty risk, credit risk transfers must be structured so that, in the event of losses, funds are transferred and available to be transferred automatically. This is achieved now also in the so-called back-end credit transfers by writing down the outstanding principal balance of the CRT securities thereby reducing the amount the GSEs are obligated to repay to holders of CRT securities.

Fourth, there needs to be trading of the credit risk instruments with open pricing and liquid markets unlike in the crisis where credit risk instruments traded over-the-counter and infrequently. This too is in place. Currently CRTs provide information on how markets price credit risk without mandatory linking of GIFIs to credit risk trading pricing and without mandating the level of use of CRTs by the GSEs. Both are important to market stability.

While the performance of CRTs should be linked to the underlying performance of mortgages in the reference pool as it currently is, in back-end credit transfers, the pricing of CRTs should not determine GIFIs or mortgage interest rates. In a period of market stress, investors and CRTs are likely to pull back. If so, interest mortgage rates, if automatically linked, would have to rise. And this would cause a decline in housing prices. And that would, in turn, cause a pullback in credit and a follow-on decline in housing prices and a reinforcing cycling as we saw in the crisis.

The discretionary setting of GIFIs over the cycle is necessary to avoid reintroducing market instability. For the same reason, the use of CRTs should not be mandatory; that is, their use should be discretionary. Mandatory risk sharing is an inefficient policy, and it encourages transactions where the cost of the risk transfer is greater than the cost of the GSEs retaining the risk thus potentially raising the cost of mortgage lending.

Currently, the trading of CRTs provide information about what private market capital markets would trade for the credit risk generated by the credit guarantee business of the GSEs, but it is not automatically linked to GIFIs. GIFI is set administratively with significant guidance from the FHA (Federal Housing Administration). This should not change. The structure of the housing finance system itself is important to the functioning of CRTs. If there are many guarantors each with its own CRT market, such markets would not be liquid. Moreover, with many entities each setting its own standards and its own GIFIs, even with the guidance of FHA, there would be a tendency to compete over the standards and undermine them overtime.

The pricing of the housing finance should be set over the cycle, and standards should be maintained over the cycle as well to limit risk and to provide sustainable housing finance for the long-term.

I thank you for the opportunity to testify today, and I welcome your questions.

[The prepared statement of Dr. Wachter can be found on page 66 of the Appendix]

Chairman DUFFY. Thank you.

Mr. Krohn, you are now recognized for 5 minutes.

STATEMENT OF JEFFREY N. KROHN

Mr. KROHN. Chairman Duffy, Ranking Member Cleaver, distinguished members of the committee, it is an honor to have the opportunity to provide this testimony regarding the sustainability of housing finance.

My name is Jeff Krohn. I lead the global mortgage credit practice at Guy Carpenter. Our company is part of the Marsh and McLennan Companies and occupies a unique position within the mortgage credit reinsurance market.

In my role, I oversee all client relationships with our GSE clients, Fannie Mae and Freddie Mac, and our global mortgage insurance clients. Separately, our organization is the broker for FEMA's National Flood Insurance Program. This program was put into place last year and proved to be a success by responding to Hurricane Harvey and reduce the burden to the taxpayer by over a billion dollars.

Today, the U.S. economy enjoys a very strong housing market. However, the last financial crisis revealed the GSEs and private mortgage insurers carried all the weight of the losses caused by borrowers that could not make their mortgage payments. As a result of the crisis, material reform has taken place. The most notable change occurred in 2013 when the FHFA mandated Fannie Mae and Freddie Mac to initiate a credit risk transfer program that derisked their portfolios and protected the U.S. taxpayer by introducing private bond investors and multiline global reinsurers into the system.

Today, reinsurers, bond investors, and private mortgage insurers provide the GSEs with a countercyclical force that sustains the housing market during uncertain times.

The reinsurance market represents a significant and attractive source of private capital for the GSEs, because the industry bears a small amount of U.S. residential mortgage risk. And its other forms of risk are not correlated to mortgage credit risk to any meaningful degree. A.M. Best's top 50 reinsurers have $727 billion of capital, and the stability of the reinsurance market has stood the test of time. Before, during, and after the crisis, the composite ratings of core reinsurers writing mortgage credit have remained strong and within a very narrow band of S&P ratings between A and A plus.

The recent $73 billion in industry losses from this year's hurricanes, wildfires, and earthquakes have not impacted pricing or available capacity for the various GSE and mortgage reinsurance placements. The reinsurance market will continue to be an attractive and significant source of private capital for years to come.

The Federal Housing Administration's mission is vitally important to first-time home buyers, low income borrowers, and consumers with limited credit history. But it is not a mission without risk for the U.S. taxpayer. The FHA's mission leads it to provide broader coverage on a pool of loans that is riskier than those of the GSEs. And the FHA lacks a credit risk transfer mechanism.

The FHA capital requirements to support portfolio risk remain low. The latest actuarial report estimates the mutual mortgage insurance fund to be at 2.09 percent, just above the minimum 2 percent threshold.

Guy Carpenter believes the FHA should fully explore ways to introduce private capital to effectively manage its credit risk and fulfill its mission. Private capital will introduce a market-like view of FHA's portfolio and provide valuable insights. Real-time pricing discovery and feedback could be incorporated into the FHA's insurance premium rates, underwriting, and loan programs. The results of which would make a more stable and predictable mutual mortgage insurance fund.

Guy Carpenter's mission remains to develop broad and diversified reinsurance markets that reduce taxpayer risk, maintain liquidity, and help to build a strong housing finance system. Credit risk transfer has the interest of the American people at heart and will ensure continued access to affordable credit to underserved borrowers and act as a countercyclical force that sustains the housing market in uncertain times.

Thank you again for the opportunity to provide this testimony.

[The prepared statement of Mr. Krohn can be found on page 35 of the Appendix]

Chairman DUFFY. Thank you.

Mr. Rippert, you are recognized for 5 minutes.

STATEMENT OF ANDREW RIPPERT

Mr. RIPPERT. Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee, thank you for the opportunity to testify. My name is Andrew Rippert, and I am the CEO of Arch Capital Group's mortgage operations. In this role, I am responsible for the global mortgage guarantee and credit risk transfer business of Arch with an emphasis on the U.S. housing market. This includes Arch MI, the largest private mortgage insurer in the country. More importantly, Arch Capital Group is committed to expanding sustainable home ownership and affordable lending.

Housing finance reform legislation has the potential to increase private investment, economic growth, and the availability of mortgages for creditworthy borrowers. The continued conservatorship of the GSEs increases systemic risk and policy uncertainty. These issues are keeping private capital on the sidelines and have contributed to a more anemic housing recovery and lower home ownership levels than we might have otherwise experienced.

Legislative reform will help ensure that the system is prepared to handle an eventual and an inevitable market downturn. The work done to diversify risk through the CRT programs developed by the enterprises with the support of the FHFA has been significant in bringing private capital to the market. In fact, Arch has been a major supporter of and participant in CRT through our reinsurance operations.

Arch recommends that the GSEs continue to innovate and expand on the available risk transfer structures. Additionally, legislation is needed to codify these policies and ensure that programmatic CRT is a permanent feature of the housing finance system. It is critical to lock in the advances made over the past 5 years to avoid the possibility of reverting to previous counterproductive norms and ensure the permanency and consistency of these programs.

Existing CRT programs have reduced taxpayer exposure and provided important diversification of private capital sources. But the GSEs still hold significant first loss exposure concentrated on two highly leveraged balance sheets with an implicit taxpayer backstop. This structure needs to change to institute an explicit government guarantee at the security level, expand to include multiple guarantors, and ensure that private capital is positioned ahead of taxpayers in a meaningful way.

Until structural changes are made to the guarantor model, the GSEs should continue to expand their use of back-end and front-end CRT transactions with reinsurers, mortgage insurers, and capital debt markets. There are a variety of CRT options available to the enterprises that offer practical and cost-efficient ways to transfer risk that have yet to be implemented.

Reinsurers, in particular, offer a highly rated pool of capital that is dedicated to housing finance reform on a long-term strategic basis. They broaden the base of available capital and provide greater taxpayer protections.

The most important thing that Congress can do from Arch's perspective to encourage the return of private capital is to make programmatic CRT a permanent feature of the housing finance system through legislation.

With CRT assured as a permanent feature, private capital will make the necessary investments to underwrite mortgage credit risk across all market conditions. This will also provide regulators and policymakers with tremendously valuable, well-informed, and timely feedback on both the level of risk in the market and the economic cost associated with that risk.

Reforming the U.S. housing finance system calls for a significant volume of private capital. Arch believes that if Congress were to enact legislation passed on the following key factors, additional private capital will be drawn into the system and promote a greater level of market certainty and sustainability.

First, we need to position private capital ahead of taxpayers in a meaningful way.

Second, we need to establish a regulatory framework that requires mortgage guarantors to follow a countercyclical capital model that is responsive to the dynamic nature of housing market risk.

Third, require mortgage guarantors to follow and accumulate to distribute model that programmatically moves risk to diverse pools of private capital.

Fourth, require additional transparency into the cost of credit risk as identified through CRT and its relationship to guarantee fees. And finally, reform the FHA to eliminate negative competition between the enterprises and the FHA programs.

Thank you for the opportunity to testify. Arch is committed to working with this committee. I look forward to answering your questions.

[The prepared statement of Mr. Rippert can be found on page 42 of the Appendix]

Chairman DUFFY. Thank you.

Mr. Sinks, you are recognized for 5 minutes.

STATEMENT OF PATRICK SINKS

Mr. SINKS. Chairman Duffy, Ranking Member Cleaver, and the members of the subcommittee, thank you for this opportunity to come before you to discuss the housing finance system and opportunities for reform.

This here marks the 60th anniversary of the modern-day private MI industry when my company, MGIC, was founded by Max Karl as a private sector alternative for borrowers and lenders to the government-backed and mortgage insurance provided by the FHA.

We also appreciate the opportunity provide you with our experience of being providers of first loss credit risk transfer and recommendations for encouraging use of a loan-level credit enhancement like MI in the mortgage finance system.

While I will focus merely exclusively on the value and role of MI in my testimony, I will note that we believe in a future system of housing finance where there will be enough credit risk transfer that there will be a need for a variety of types of private capital, each playing a unique role.

Private mortgage insurance's unique loan-level approach shields taxpayers from mortgage-related credit risks while ensuring creditworthy borrowers have consistent access to mortgage financing.

Over the last 60 years, MI has helped more than 25 million families attain home ownership in a prudent and affordable manner, the majority of whom were first-time home buyers and more than 40 percent of incomes below $75,000.

In my written testimony, I have covered a number of issues related to the MI industry, but here I will focus on three important attributes of MI that are critical to any housing finance system: Flexibility, stability, and reliability.

First flexibility. Private mortgage insurance is typically provided at the individual loan level at the same time as a loan is originated. The mortgage insurance protection travels with the loan wherever it goes, whether or not that is onto a lender's balance sheet, sold to an investor, or placed into a securitization pool. As a result, private MI is fully compatible with the broadly shared goal of a housing finance system with multiple funding sources, a feature that distinguishes MI from other forms of credit risk transfer.

It also means that MI is accessible to lenders across the country, from the biggest money center banks and nonbanks to small community banks, credit unions, and independent mortgage bankers. And because government insurance program like FHA are loan level as well, borrowers can easily compare mortgage offerings available to them.

Over our history, we have readily adapted as the mortgage finance system has evolved from savings and loans to the GSEs and independent mortgage bankers. We are confident of our ability to continue to evolve and serve any new system that is created with virtually no disruption to the origination and servicing of mortgage loans.

The ability of MI companies to scale up to cover a broader segment of the market is primarily controlled by the amount of capital they hold. That said, MI companies are no strangers to expanding or shrinking their capital to meet the need for their product in adapting to housing market trends.

Since 2007, MI companies have collectively raised more than $14 billion to meet capacity, support new business, and pay claims. And we have seen three new companies enter the market since the crisis. In addition, we have used the same resources as the GSEs, reinsurance and capital markets transactions, to supplement our equity capital.

We are confident in our ability to grow our capital, all of which will stand in front of the taxpayers to support an expanded role in the housing finance system.

Next stability. Housing and mortgage markets are, by their nature, cyclical and can produce extraordinary catastrophic losses both at the national and individual levels. In this type of environment, there are sound reasons for creating monoline entities to provide coverage against that risk. The monoline regulatory regime for MI is intended to ensure the industry does not create systemic risk even during the worst downturn.

It is not because regulators and MIs do not understand the value of diversification, which is evident in our investment portfolios and our insurance in force over time, and across geographies.

Additionally, because MI's regulatory regime was designed with cyclical mortgage markets in mind, the MI industry has a commercial interest in remaining in markets being prepared for downturns. Indeed, this regulatory regime ensured that the MI industry continued to ensure new loans and pay claims. We are not too big to fail. We provide predictability and stability to the housing finance system.

And finally reliability. Since the onset of the financial crisis, private MI companies have paid over $50 billion in claims, almost all of which directly reduce the amount required to rescue the GSEs. And during that time, MI has continuously been available at a reasonable cost in all markets across the U.S.

Increased capital and operational standards in the PMI eligibility requirements, along with revised master policy terms developed with the GSEs, ensure that the private MI industry will be able to cover an even greater amount of mortgage risk in the next crisis.

The private MI model has worked for 60 years. Each market cycle brings new lessons and adaptations. But the fundamental approach has been tested multiple times and still works. No other form of credit enhancement has a similar record of performance or resilience. Any policymaker looking at what works now for inclusion in a reform system would add MI to the list.

With that said, I thank you again for the opportunity to testify and to answer your questions.

[The prepared statement of Mr. Sinks can be found on page 49 of the Appendix]

Chairman DUFFY. Thank you, Mr. Sinks.

The Chair now recognizes himself for 5 minutes to ask questions of the panel.

Mr. Canter, I don't know if you just heard Mr. Sinks' testimony, but if I read your testimony correctly, I think you said downturns, MI doesn't pay; is that correct? Is that a correct characterization of your—I kept you two separated, either side of the table.

Mr. CANTER. Yes. Certainly when there are large amounts of mortgage losses, the MI companies are going to come under stress. So that is—I think that is just a fact. If you buy hurricane insurance from an insurance company that just insures hurricanes, do you really want to keep buying hurricane insurance from them when there is a hurricane approaching? That is the issue. And that is all they do.

That has a lot of value. I don't want to say that it doesn't. It has a lot of value. It is just that, when we talk about increasing how much exposure Fannie and Freddie are going to have and what the best way for them to hedge their risk, the fixed income markets provide a way for them to do that without taking that counterparty risk. And that is really the key.

It is not that deep MI doesn't have any value. It does. And it should be pursued. It is really a matter of, when we are talking about what the cornerstone of the system is going to be, we think it should be the capital markets.

Chairman DUFFY. Mr. Sinks, what is your pushback?

Mr. SINKS. As I said in my testimony, we paid $50 billion in claims. That would have increased that GSE number of 189 billion by net 50.

In addition to that, the MI's have paid 97 percent of the eligible claims coming out of the Great Recession, and the remaining 3 percent will be paid over time. So while there was stress and companies were impacted, at the end of the day, the claims were paid.

Chairman DUFFY. OK. That wasn't my main question, but I thought it was unique. You guys had different positions here, so I thought I would bring it up to start with.

But the panel's view on the availability of private capital to assume first loss mortgage credit risk, there has been some debate on that topic. Any thoughts, Mr. Canter?

Mr. CANTER. So at the beginning of 2016, the GSE started to hedge their first-loss risk. And what I mean by "first loss," it is important to understand, is that they hedge what we would call the bottom tranche of risk, meaning they start to—they pay for insurance or a bond issuance. That covers them from losses starting at 0 and going up to, say, 1 percent or up to 4 percent.

In the beginning of 2017, they changed that. And now they are retaining the bottom .5 percent of risk. So they are no longer hedging their first-loss risk from where we sit. We think, if the goal is for them to hedge as much risk away from the taxpayer as possible, they're not doing that. They are operating as if they are a finance company or a bank looking to achieve a certain return on what they think their capital is.

Chairman DUFFY. Anybody else? Thoughts, Mr. Rippert?

Mr. RIPPERT. Private capital is, today, assuming first-loss risk. Mortgage insurers assume a meaningful amount of first-loss risk. They are the biggest single counterparty to the GSEs, $200 to $250 billion of limited exposure. And reinsurers, frankly, are taking a first-loss risk as well through quota share reinsurance programs. And, frankly, they are positioned to take more first-loss risk.

And I think an important distinction between mortgage insurers, reinsurers, and capital market's participants is mortgage insurers and reinsurers are set up to take first-loss risk on a front-end basis, to take the risk away from the GSEs before they even own the mortgage loan or at the time they purchase the mortgage loan. That is something that mortgage insurers and reinsurers can do much more effectively, frankly, than the capital markets can today.

Chairman DUFFY. I only have a minute left.

We hear a lot of debate about, so when times are great, private capital is going to flow in, it is going to be wonderful. But when the cycle turns against us, everyone runs for the hills. Thoughts on that point? Any pushback on that point, Mr. Rippert?

Mr. RIPPERT. I think—yes. I think that one of the biggest things, keeping private capital on the sidelines, is this uncertainty about—is the credit risk transfer programs of the GSEs here to stay, or is it, frankly, a science experiment? And if it is here to stay, private capital will make meaningful deeper investments to understand mortgage credit risk at a more fundamental level and be there over the long-term.

Chairman DUFFY. Even in a downturn. Even in an 2008-esque cycle?

Mr. RIPPERT. I would give the example of reinsurance markets and, frankly, mortgage insurers as well. If you look at reinsurers as one example, they make an investment in a line of business to understand that risk and underwrite it, and they stay in it through the ups and downs. They moderate their exposure. They change their pricing. But they stay in the businesses through the cycle.

The same is true of the mortgage insurers. They stay in the business through the cycle. So, yes, I do completely believe private capital can do that.

Chairman DUFFY. My time is up. And I want to be respectful of all the other members. I wanted to actually get to Mrs. Wachter's point on tying CRT pricing to GIFIs. I thought that was an interesting point that you made, and also the natural disaster risk separated from credit risk, which Mr. Canter brought up in his testimony, I don't have time for that, but I look forward working with all of you as we are trying to do a bipartisan product here on the committee.

So I thank you.

My time has expired.

I now recognize the gentleman from Missouri, Mr. Cleaver, 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. I am struggling a little bit.

A few weeks ago, I had the opportunity to meet—spend some time with Edward DeMarco, and we—he talked about this, what I thought was an interesting proposal that would use Ginnie Mae as the centerpiece for the housing finance system and then create a new kind of credit enhancer to transfer risk.

Dr. Wachter, Mr. Canter, I am interested in your response to—are you familiar at all with—all right. Would you just let me allow you—what your response is to his proposal?

Dr. WACHTER. Today's hearing is on credit risk transfer, and so I would like to respond to your question in the light of credit risk transfer efficacy. And it seems to me that, while competition, of course, is important in many regards, competition over standards is not helpful. So to the extent that we have many guarantors or many credit enhancers, each with its own standards, each with its own premiums, this, in fact, can be destabilizing.

So particularly, the purpose of CRTs, from my perspective, is to complete the market, inform the market, bring information to the market. And CRTs that are tied to individual guarantor portfolios, which is my understanding of how that proposal would work, would not be very liquid, and they would not be referencing the risk of the market as a whole, nor would they actually be referencing the risk only of the particular guarantors, because the risk that is created by one guarantor affects the entire market.

So that is exactly what we want to avoid. We want to have the risk transfer—risk transfer programs pricing the overall market risk.

So one thing you could do is require all of the guarantors, all of the credit enhancers to participate in one single credit risk transfer program and to have one single set of standards and one single set of rates. That would be very much like FHA and Ginnie Mae works now. And that would work.

Mr. CLEAVER. Before I hear from Dr. Canter, what is your opinion over collaterization as that one new standard?

Mr. CANTER. So we are very supportive of the Bright-DeMarco plan. We agree that there needs to be a balance between competition and underwriting guidelines. And that is really important, because if we have—if we had just one entity like some of the plans out there had envisioned, we don't think there would be enough incentive to respond to what investors need, and that could be long-term detrimental.

On the other hand, if we have too many guarantors, the sizes of the deals get very small, and the capital markets find it difficult to participate, the liquidity of the bonds that we buy would suffer. And so there is this balance. And that is why I say there needs to be more than two guarantors in any new system, whether it is five or eight. It is probably less than 10 is the way we would think about it. And the bond solution being fully collateralized is why we think it is such a key component.

Mr. CLEAVER. So do we have too much concentrated risk? Did that play a role, do you think, in the housing crisis? Dr. Wachter.

Dr. WACHTER. It wasn't concentrated risk. It was correlated risk. It was risk created by sectors that were underwriting unsoundly which then pervaded the entire market.

So I don't think the problem was a problem of one set of standards. It was a race to the bottom, it was a race of declining standards, and a race where credit was not accurately priced, it was underpriced.

So, no, absolutely not. That wasn't the problem. I am not saying that we can't have that problem, but that wasn't what caused the crisis.

Mr. CLEAVER. The last question. I am concerned about any kind of transfer. Is that going to be a very long process? Anybody. If we are going to transfer risk, we can't vote on it today and have that settled tomorrow.

My time is up. I would like to talk to you about it at a later time.

Thank you.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the Chair of the Subcommittee on Financial Institutions, Mr. Luetkemeyer, the gentleman from Missouri, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman, and thank the panel this morning.

I want to follow up. Mr. Chairman made a good comment here which was something I was concerned about as well. Mr. Canter made—I believe it was—made the comment with regards to the GSEs' new takeout of the natural catastrophe loss risk and separate that from the credit risk. Can you explain that a little bit and what your thought process would be on that, sir?

Mr. CANTER. Sure.

So right now, the way CRTs are constructed, if there are natural catastrophes like Harvey, Irma, and Maria, and there are resulting losses, that loss flows through to the CRT investor. If that loss happens through an MI policy, the MIs don't pay that claim if that house is uninhabitable. So from a CRT investor perspective, we are experts in valuing mortgage credit risk.

Mr. LUETKEMEYER. Who pays the loss, then, on the mortgage insurance?

Mr. CANTER. Fannie and Freddie. And eventually the CRT losses, if it is—

Mr. LUETKEMEYER. No other outside insurance, like homeowners insurance or the flood insurance, or whatever the takeover?

Mr. CANTER. Right. Obviously, if there is homeowner insurance, great. But a lot of hurricanes are not covered by a standard policy. Earthquakes are not required to be covered by Fannie and Freddie for California. So these are risks that my insurance colleagues, I think, have spent a lot of time on. I don't think that the GSEs and the rating agencies spend enough time on.

And so from my perspective, the reason why this is important is because the capital markets are investing in this because they think they are there taking mortgage credit risk. We know we are also taking some natural catastrophe risk. But if losses were to happen, it could jeopardize the whole CRT market.

And to me it is much more important that the CRT market is here to absorb financial condition losses and economic losses, because there are plenty of insurance companies throughout the world that can take natural catastrophe risk. And so that is what I am interested in is the long-term viability of the CRT market.

And I just think that this natural catastrophe risk is misplaced in CRTs. But most importantly, the GSEs need to provide us the data and analysis to really be able to evaluate it, and they haven't really done so yet.

Mr. LUETKEMEYER. Mr. Krohn, in your testimony, maybe I misunderstood you, but you said something like FHA lacks the ability to lay off—work with CRTs to lay off some of the risk; is that correct?

Mr. KROHN. That is correct.

Mr. LUETKEMEYER. Can you expand on that a little bit?

Mr. KROHN. The risk remains within the FHA. There is no mechanism to transfer out of the system to bond investors, to reinsurers. That is the way it exists today.

Mr. LUETKEMEYER. OK. What are your suggestions on that?

Mr. KROHN. I'm sorry?

Mr. LUETKEMEYER. What are your suggestions on how to solve that problem?

Mr. KROHN. Well, we think the FHA should explore credit risk transfer. There are a number of things that we think might come out of that. It should increase the availability of coverage for the FHA if it can go through the cycles. They should get real-time pricing feedback, pricing discovery is part of the CRT process, and feedback around underwriting and the loan products offered by investors, by the reinsurance market.

Mr. LUETKEMEYER. OK. During the discussion here, it seems as though we—the word hasn't been used with regards to the different tools with the CRTs. But there seems to be, in my mind, a diversification that is necessary. But it wasn't, so there was no concentration within one particular area, whether it is reinsurance or whether it is the bond market or whether it is mortgage insurance. Would that be the assumption that—or would that be something—would you agree with that statement?

There needs to be some diversification of each one of these different types of credit risk transfers would be necessary, or do you think one entity can handle all the risk?

Mr. SINKS. If I may, I will take a shot at that.

Our view is that you need to have multiple sources, which is inherent in your question. The smart people think that they are in a mature market. Private capital needs to put up about $200 to $250 billion of capital to support a multi-trillion dollar market. I don't think there is any one execution that can consistently deliver that through all markets, good times and bad times.

And thus they need to try multiple executions, whether it is reinsurance, mortgage insurance, capital markets transactions. It is all of the above. It will take a commitment from everybody to meet the market needs.

Mr. LUETKEMEYER. Do the other guys agree with that?

Dr. WACHTER. No.

Mr. KROHN. I agree with that statement.

Mr. RIPPERT. I agree with that statement. And I think that the most popular—or the most effective source of capital, rather, at this point in time will change with conditions in the market.

Mr. LUETKEMEYER. Diversification is always the way you want to spread your investments.

With that, Mr. Chairman, I yield back.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the very gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Rippert, I believe that a strong and well-functioning secondary market should encourage lending to all income levels and communities.

So my question to you is: What is the best thing we can do to ensure that private investors continue to invest in the secondary market? And what type of front-end or back-end credit risk transfer should we be looking at? And will that help first-time buyers or lower income borrowers?

Mr. RIPPERT. I believe that the best way to address affordable lending standards, low income borrowers, is with a responsible lending platform that has three basic components. That is one of financial literacy and education to help inform borrowers that the responsibility they are taking on before they get into a mortgage product. I think that product guidelines need to be set forth that put guardrails on the system, that we are not offering mortgage products to borrowers that have this concept of a teaser rate initially and then escalated costs after a period of time. These are some of the sorts of products that cause problems in the market.

And I think a third element is we really need to think carefully about making mortgage loans to borrowers, especially low income borrowers, when housing markets are overheated, housing prices are overinflated. In that scenario, based on the credit risk analytic work that we do, when borrowers get into a property that is significantly overvalued, their propensity to default, to reach financial stress, to not be able to make their mortgage payments, increases dramatically, anywhere from five to tenfold.

And so we need to think carefully about extending mortgage credit to a borrower when prices are overheated, because this has a significant disproportionate impact, especially on low income borrowers. I think if we have a framework like that, then private capital will show up and support that.

Ms. VELAZQUEZ. Dr. Wachter, will you please respond?

Dr. WACHTER. I think that the potential for front-end discount to be procyclical is great. That, therefore, in good times, the front end would be their pricing, in good times. And bad times it withdraws. And in the good times it has the potential for effectively raising prices and creating a bubble if it goes too far.

That destabilizes the market raising risk overall, and that higher risk overall will be eventually priced in and will cause less affordability. What we need is a stable system which will, then, be less risky so that the market pricing of that less risk makes housing more affordable. This goes in the other direction.

Ms. VELAZQUEZ. Thank you.

Mr. Canter, in addition to exploring various types of front-end and back-end credit risk transfers, the GSEs have also explored expanding their investor profiles in the CRTs, including rates.

What advantages do you believe expanding the investor profiles in CRTs will have? And do you believe that expanding the CRTs could disrupt the TBA market?

Mr. CANTER. So, no, I think the CRT market today is functioning very well, and the TBA market is functioning very well. So as the system stands today, there are no issues with TBA or the CRT market.

As one of the members mentioned earlier, the transition to a new system is extremely important, probably just as important as the system that is actually decided upon. But in terms of the REITs (real estate investment trusts), the GSEs have been innovative. They have come out with a new structure that will make the CRTs more REIT friendly.

So here we are talking about mortgage REITs. So that is a dedicated pool of capital that invests in mortgage products. And so we are going to see that as positive, because it brings down the cost of credit risk transfer the more investors that there are. It brings down the cost to Fannie and Freddie. And when that cost comes down, it means that potentially it has an effect on the GIFI, which can affect the borrower. Or even if it doesn't do that, it means that the U.S. taxpayer is paying less for the insurance, which ultimately is good for the taxpayer.

Ms. VELAZQUEZ. Thank you. And I guess I will yield back.

Chairman DUFFY. The gentlelady yields back.

The Chair now recognizes the gentleman from California, Mr. Royce, for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman.

In Mr. Rippert's testimony, you wrote: "One of the biggest regulatory risks we see is the potential for the progress made over the past 5 years to be abandoned, in the absence of statutory changes."

So this is a concern I have as well. I think we have to lock in successes and build on those successes. And so, as some of you know, Representative Gwen Moore and I have introduced legislation requiring the GSEs to maintain the credit risk transfer market while increasing the amount and types of CRT transactions.

To date, I suspect everyone on the panel would agree that Fannie and Freddie's CRT initiatives have been a success, in the sense that they are decreasing the exposure to unexpected loss and, in turn, decreasing risks to the taxpayers.

We have heard more today on ensuring that CRT works as a stable source of capital through the economic cycle, even in a downturn. We need to get more institution-based capital involved. We have kicked that around. We need more players. We need mortgage insurers in this deeper. We need REITs and reinsurers, and we need to bring transparency and competition to front-end deals.

So I would just ask the entire panel here, is this a laudable goal and how do we get there? I would just like to hear from you.

Mr. RIPPERT. I think it is a very worthy goal. It aligns well with how we at Arch Capital Group think about the market and creating a more sustainable market that facilitates affordable lending to creditworthy borrowers. So we think that diversity of capital is critical, not just because at various times some capital will work more efficiently than others—and by more efficient, lower cost to borrowers—but you need it because of the amount of risk that needs to be transferred, this is approximately $250 billion of risk to be transferred to private capital.

I think the functioning of capital across a cycle will be very effective as well in giving feedback. This concept of price discovery that gives an indication of the level of risk in the market will be a very important feedback mechanism from all these various sources of capital as well.

Mr. SINKS. If I may, I would add I concur it is a laudable goal. I think it is necessary to have not only the variety of capital alternatives, but also the permanence of the capital. We need to know, in creating a housing policy system, that capital is going to be there in all markets. And so we need to clarify rules, develop capital requirements, and make sure that people can participate in all markets.

Mr. ROYCE. So I think that experience shows that risk transfer worked and is working now at Fannie and Freddie. And we have also seen private reinsurers add about a billion dollars to the National Flood Insurance Program during the storm season, and there is even more capacity in the private market for increased risk transfer. Aon Benfield puts the reinsurance capital and derisking capacity at about 600 billion worldwide.

So why not look elsewhere in the Federal Government? Why not—on the housing front, why not replicate risk transfer at FHA and Ginnie Mae, and why not encourage derisking for all Federal credit guarantee and insurance programs? That was the question I just wanted to ask in general of the panel. I don't know, Mr. Krohn, if you would care to comment.

Mr. KROHN. Yes. I believe you need to look at these alternative sources of capital. The reinsurance industry, you mentioned the NFIP was incepted last year on January 1. In its first year, the program returned the entire limit to the Federal Government. This year, as it is being renewed, reinsurers have not fled for the hills. They are back, and they are having discussions with the NFIP and pricing that now, going forward.

Mr. ROYCE. Yes. Well, with that in mind, I plan to introduce legislation to direct the Office of Management and Budget to identify other areas in the Federal balance sheet where derisking could be used to protect taxpayers. I think it is a strategy that would accrue to the benefit of stability all the way around, and in terms of proper pricing of risk and offsetting moral hazard in the system.

But thank you very much.

And, Chairman, thank you for the hearing.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the Vice Ranking Member of the full committee, the gentleman from Michigan, Mr. Kildee, for 5 minutes.

Mr. KILDEE. Thank you, Mr. Chairman.

Chairman DUFFY. It rolls off the tongue, doesn't it?

Mr. KILDEE. You got it right. You can just say assistant to the regional manager, that is fine.

Before I turn to the panel, I do want to commend the Ranking Member and the Chairman for this series of hearings and reiterate what I think has been discussed previously, and that is this is an area of policy where I think the divisions that often manifest on this committee might be able to be overcome. And so I want to encourage the leadership of the subcommittee to continue on that path.

Very often, I think we imply ideological differences where technical solutions are really at the core of the issue. And as long as we know what direction we are going, I do think there is enough common ground for us to try to knit together some policy that we could all work together on, not 100 percent, but perhaps at least something that we could present to the full Congress in a bipartisan fashion. So I want to encourage that.

It is also very good to see Professor Wachter. We worked together in my—well, when I was in real life before I came to Congress. And so it is good to see you and to have you here.

I want to follow up a bit on the line of questioning that Representative Velazquez initiated. Not so much dealing with the secondary market or the structure on that end, but actually thinking about how the structure of the market and the way we manage risk could have an impact on certain cohorts of the housing market.

And I am particularly concerned about the impact in weak markets and low-value markets, where we are already seeing real difficulty in getting mortgage financing. It is a pretty simple problem we face. And for those who don't know, I come from Michigan, from a string of older industrial cities that includes my hometown of Flint.

And I recall having conversations in this committee about small mortgages. And I do remember—I don't want to throw any member under the bus, but I was crowing about the need for small mortgages and somebody said, oh, you can get a small mortgage. You can get a $150,000, $200,000 mortgage, no problem. In my hometown of Flint, we are looking for ways to finance home mortgages $25,000 and $30,000. And we just cannot get financing, because the risk associated with that mortgage versus the value of that mortgage on a balance sheet makes it really impossible for a lot of lenders to justify engaging.

So I guess a couple of questions. What impact—well, I guess I will turn it around the other way. What suggestions can any of you offer that allow us to balance this question of the institutional risk in the marketplace and the need to make sure that we are penetrating with mortgage products into these really weak markets?

So that it is not just a question of creditworthiness, which is another part of the question I want to get to, but the market in which a person lives with great credit, very often they are locked out of the housing market because they can't get a small mortgage in the size that I am talking about.

Perhaps starting with Dr. Wachter, but I want to go to Mr. Rippert on a couple of other questions as well. Could you comment on that particular issue?

Dr. WACHTER. Yes. It is a very difficult problem. And it goes to the question of the lack of supply of mortgages affects the prices.

So the very fact that mortgages are not there means that the properties are valued less. That is a reinforcing cycle.

And that was the point of the CRA, Community Reinvestment Act, because the thought is that there are good risks out there, but they are being avoided. There is good lending, creditworthy lending that is being avoided just because of the perceived risk; and that other entities will not come into the market, so that is artificially limiting the pricing of that market. That is a real problem.

My concern is that it is a natural outcome of cycles that pricing of capital does change over the cycle and it does change over place. So if we allow each place to have its own credit risk and that changes over the cycle, we will basically undo a national credit market, a national insurance market for default risk.

That national insurance market for default risk has been very liquid and has efficiently priced interest rate risk, allowing for a 30-year fixed rate mortgage, and has allowed for credit risk to be priced relatively reasonably. But if we had every size of property, every geography having its own price, that would be very volatile over the cycle. So the problems you describe, which are very real, would become far worse.

The way to directly take on your problem is to go back to the concepts behind the CRA and think of revitalizing communities with pools of capital. And that we need to return to, but it is probably a subject of another discussion.

Mr. KILDEE. Thank you. I appreciate it. I know the Chairman is a pretty good timekeeper. I think I have gone over a little bit. I appreciate the indulgence.

Chairman DUFFY. The regional manager yields back. Thank you for that.

Listen. It looks like we have had a lot of members come in, but I think they have been pulled away so we don't have any other members to ask questions.

But I want to thank the panel for their time—I know you are all very busy people—for sharing your expertise with us. This is an important space that we want to make sure we get right, and I can guarantee you that we will all be having additional conversations with you, if you don't mind, continuing to consult with the subcommittee and the committee as a whole. So we again thank you for your participation today.

Without objection, all members will have 5 legislative days within which to submit additional written questions to the Chair, which will be forwarded to the witnesses. I would ask the witnesses to please respond in as prompt a timeframe as you can.

Without objection, this hearing is now adjourned.

[Whereupon, at 11:20 a.m., the subcommittee was adjourned.]

A P P E N D I X

December 6, 2017

Written Statement of Michael Canter, Ph.D.

Senior Vice President and Head of Securitized Assets, AllianceBernstein

On behalf of AllianceBernstein

Before the Subcommittee on Housing and Insurance

December 6, 2017

Chairman Duffy, Ranking Member Cleaver, and members of the Subcommittee, thank you for the opportunity to testify today. My name is Michael Canter and I am Senior Vice President and Head of Securitized Assets at AllianceBernstein (AB). AB is an asset management firm with $500 billion of assets under management – that we manage on behalf of pension funds, retail mutual funds, insurers, charities, individuals, and global investors. I am appearing here today on behalf of AB – one of the largest investors in the CRT market.[1] AB is a member of SIFMA (the Securities Industry and Financial Markets Association) and I am also on the board of the Association of Mortgage Investors.

Housing Finance Reforms – A CRT Investor's Perspective

The debate around Housing Reform has been heating up recently with numerous proposals being put forward by various interested stakeholders. I agree for the need to further housing finance reform viewing the status quo as untenable longer term. However, I view the process of Housing Finance reform as a continuum, noting that the Government Sponsored Enterprises (GSEs) that are at the center of the housing finance system and their regulator the Federal Housing Finance Agency (FHFA) have already made some progress in reforms post-crisis most notably through the introduction of the Credit Risk Transfer (CRT) market. CRTs are debt issuances with payments linked to the credit performance of an underlying pool of loans, and they provide a layer of private capital as well as a source of market pricing of risk that the GSEs had lacked pre-crisis. As we move forward with reforms, I think it's important to build on these early successes especially since it's clear that we need to promote even greater involvement of private capital in housing finance, making future tax payer risk even more remote.

In this testimony, I lay out what I believe have been the drivers of the CRT market's success. Preserving and enhancing these drivers will be most likely to help the success of housing finance reforms in the years ahead, and to help prevent a repeat of the housing crisis of 2008.

But before I delve into my views on the future, a quick recap of where we stand and how we got here.

[1] This testimony is based on a paper co-authored with Janaki Rao of AB, "Housing Finance Reforms – A CRT Investor's Perspective."

The Past

Prior to the crisis the GSEs existed as private entities with public charters and implicit government backing. As private entities, the GSEs looked to maximize equity returns, which led them to invest in mortgages in whole loan and securitized form in a levered manner in addition to their core business of guaranteeing MBS. However, as the subsequent bail-out of the GSEs by the Government in 2008 showed, this model was unsustainable because it promoted risk taking which benefited private investors in ways that were not necessarily consistent with their public mission, with the implicit understanding that the tax-payers would bail-out the GSEs that were deemed "too-big-to-fail."

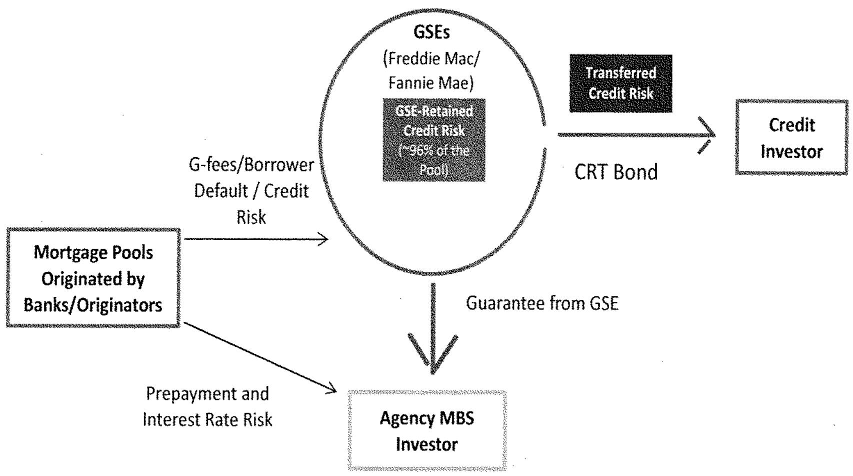
The Present

In 2008, the GSEs received a sizable equity inflow from the Treasury and today continue to have an agreement with the Treasury to inject further capital as required. This capital backstop is sizable but limited. In return, the GSEs are required to sweep all earnings to the Treasury over a minimal, declining capital buffer. In addition, the GSEs were placed in conservatorship under their revamped regulator, the FHFA. Under the terms of the conservatorship, the FHFA has a significant say in the running of the two GSEs including in product development that has limited their risk-taking ability. Furthermore, the terms of the Treasury agreement with the GSEs includes reducing the GSEs sizable retained portfolios. The regulatory environment also tightened as Congress and the Administration moved to avoid a repeat of that housing crisis. A combination of tighter regulation and lowered risk appetite means that the GSE guarantee books present a far more favorable credit profile at present.

Meanwhile, the GSEs as required by their regulator have started reducing their credit exposure further through various structures including the Credit Risk Transfer (CRT) securities. From a GSE and taxpayer perspective, the creation of the CRT market introduces a layer of private capital cushion that didn't exist before. The CRT issuances also provide a market-based source of price validation. For instance, CRT spreads reflect private investors view of the credit risk and can thus be compared to the Guarantee fee charged by the GSEs. For mortgage credit investors, the CRTs represent an investment opportunity that is especially valuable since the non-agency RMBS market is in decline with limited issuance post-crisis.

A graphical description of the current situation is depicted below.

Display 1



The status quo, however, is unlikely to be long lasting. The status of the GSEs is dependent on their Treasury equity back stop, which is limited. This limited support was by design to prevent the status quo from becoming permanent. While there remains significant runway before the Treasury's backing disappears, the discussion around the future state of the GSEs is gathering momentum. There is also recognition that housing finance reforms may unlock potential growth if it increases credit availability.

In the following section, I highlight factors that I believe led to the success of the CRT program. It is these successes on which future reform efforts should build.

What Made the CRT Succeed?

1. **Role of the FHFA:** The development of the CRT market was innovated by the GSEs, but highly encouraged by the FHFA as they mandated risk reduction at the GSEs while in conservatorship. Pre-crisis, however, the ability of the regulator to influence the GSEs was very limited. That changed in 2008, during the crisis, as the Government stepped in to bail-out the two GSEs. That year Congress passed the Housing and Economic Recovery Act (HERA) that established the FHFA as the GSEs regulator. The FHFA replaced the Office of Federal Housing Enterprise Oversight (OFHEO) and the Federal Housing Finance Board (FHFB) – the erstwhile regulators of the GSEs

and the FHLBs respectively. HERA also transferred mission supervision of the GSEs from the HUD. Importantly, the Act provided the FHFA supervisory authority on par with other federal safety and soundness supervisors. These changes allowed the FHFA to relentlessly focus on getting the GSEs to reduce their risk by involving private capital.

Looking to the future, a healthy housing finance market requires an appropriate regulatory and capital regime that emphasizes continuing risk transfer to private capital. Having a regulator that can continue to push the GSEs or their successors to continue down that path is therefore important in our view. The best way to formalize this credit risk transfer is through the capital plan that the regulator will need to craft going forward. The capital structure that the GSEs operated under pre-crisis was designed to maximize earnings by keeping the capital cushion thin thereby increasing the risk for tax-payers. The GSEs under the current conservatorship regime are not allowed to build any capital with all earnings swept to the Treasury. However, in a post-conservatorship world the regulator need not be overly prescriptive in a new housing finance system, but must create a well thought out capital framework that puts a high value on risk transfer and appropriately discourages risk taking above and beyond the risk retention needed for CRT issuance. The regulator must also be cognizant that GSEs/ guarantors can become focused on short term results and thus, a regulator should give attention to ensuring that the CRT structures are well conceived and durable so that they can support US housing for decades to come.

2. **Skin in the Game:** An alignment of interests re-assures investors beyond any risk metric alone. As structured today the GSEs only partly transfer their credit exposure – they retain first loss risk along with 5% of other tranches of the CRT structure, while retaining the most risk remote tranche (typically the most senior 96% of the structure). Therefore, the GSEs are sharing the same risk as the CRT investors. This stands in contrast to the "Originate-to-Distribute" model that existed in pre-crisis nonagency bonds whereby loans were securitized and sold to investors with originators not retaining any risk -- a significant contributing factor in the housing crisis. Therefore, the alignment of risk interests is an important factor in the success of the CRT program and should be retained in future iterations of Housing finance. There is an abundance of capital willing to take more first loss risk and more senior risk- should legislators, regulators, or the GSEs/Guarantors want to transfer it, but risk retention is essential.
3. **GSEs' Market Power:** The success of the CRT program had a lot to do with the ability of the GSEs to drive the changes needed to make it successful. This ability to enforce change has a lot to do with the dominant market power that they display. Their market power has conferred several benefits to the market:
    a. The GSEs' roles as deal agents, in a manner of speaking, where they orchestrate the whole process of securitization from origination onwards. In this role, the GSEs set origination, underwriting and servicing guidelines and importantly enforce the guidelines. For originators and servicers, the GSE securitization route represent a lucrative business opportunity, but in turn they must play by the rules that the GSEs lay

out. Clearly, the size of the GSEs is an important reason for their ability to be a successful deal agent;

b. The institutional knowledge and skills that the GSEs have accumulated over the decades that they have been in business of guaranteeing mortgage credit risk is a considerable competitive advantage. The experience of the recent housing crash has added to the depth and richness of the GSE knowledge in a way that would have been impossible to do so without;
c. The infrastructure the GSEs have built over the years to make the MBS securitization business successful is critical to their market acceptance and a model for the rest of the market (e.g., loan documentation, etc.).

4. **More than 1 GSE:** Having more than 1 issuer of CRT has been beneficial. Fannie and Freddie have competed amongst themselves to offer their investors products that best meet their expectations. In the process the GSEs have experimented and have benefited from having a competitor's product act as a "control product" thus helping isolate what works and what doesn't. In addition, the GSEs have also divided the task of designing a better product between themselves and thus achieving greater efficiencies along the way.
5. **Liquidity/Transparency:** The CRT market's development has also been aided by the enhanced liquidity and transparency in the CRT market relative to private label RMBS. This is a combination of various factors, as I describe below:
   a. **Historical data and experience:** A critical piece of the CRT market's success in our view is the availability of twenty years of loan level performance data; including the crisis, which defines the worst-case scenario for a mortgage credit investor. Some of the experiences through the crisis, for instance extended resolution timelines for defaulted mortgages, would have been impossible to predict pre-crisis. In addition, there is the knowledge gained of what works and what doesn't, meaning that there is clarity around the integrity of processes going forward leading to more reasonable expectations built into scenarios. But, to be fair, the data has been significantly influenced by government intervention at all levels, including the mandated modification programs that were implemented. Should another crisis occur and different policies be in effect, the historical data may not prove as effective a guide as previously thought.
   b. **TRACE:** FINRA's TRACE dissemination of trade prices for CRT transactions has led to more efficient price discovery as trade prices are disseminated widely and on time. This is an important development that removes a significant flaw of the previous non-agency market where price discovery was cloudy at best.
   c. **Dealer involvement:** Dealers have been competing to provide liquidity in the CRT market. The banking fees from the primary issuance of the CRT securities are attractive and make the Dealers willing to participate in the secondary market despite the onerous capital charges that holding CRTs involve. Dealer interest in making markets in CRT is a recognition that the CRT market is here to stay and is growing – and could be much improved were capital requirements rationalized.
   d. **Issuance calendar:** Having a frequent schedule of issuance has helped maintain liquidity in the market. The GSEs have borrowed heavily from their experience in the Agency

Debt market in have a well-defined issuance calendar but also been helped along by the FHFA setting targets on their issuance. Frequent issuance also allowed the GSEs to experiment with various innovations that they could then compare against nearby issuance to see what works and what doesn't as they had reasonable data points to compare with.

e. **Large deals:** CRT deal issuance size have been large, and that has contributed to their liquidity. Some part of the large issuance size was due to the design of the program, where the GSEs have warehoused loans and issued CRTs over a schedule that allows for large issuance size. However, some of the larger issuance has also been due to the high origination volumes over the past few years that the CRT program has been in place. This however is not completely in the control of the GSEs and origination volumes have declined from their peaks and may remain depressed unless mortgage rates move lower. Nonetheless, the large deal size and frequent issuance mean that large investors have participated in the program as they could scale up their investments.

6. **Market Conditions:** Finally, I acknowledge the positive impact that market conditions have had on CRT's success.
    a. **Tighter Underwriting:** The pendulum of credit underwriting has swung towards greater conservatism in response to the housing crisis. This has kept credit performance high even relative to the pre-crisis period. Investors have benefitted from the positive performance, which was critical for the budding CRT market to establish itself.
    b. **Failure of Non-Agency MBS to Launch:** The non-agency RMBS market has not returned in any appreciable size post-crisis. In addition, with the legacy non-agency RMBS market declining as loans pay off, investors looking for housing credit exposure have little to no options outside of the CRT market. Indeed, there was a tremendous buildup of intellectual and technological capital in mortgage credit in the years following the distress in the mortgage market. As volatility subsided, this capital was primed to focus on a new mortgage product. This provided momentum in the initial phase of the CRT market without which it could easily have withered.
    c. **Risk-on:** The risk-on environment has also expanded investor appetite, which has been fortuitous for a new product like CRT to establish itself as part of the menu that investors look at.
    d. **Strong Economic Environment:** The strong economic environment since the launch of the CRT market has also been a positive influence. Modest but positive economic growth, strong home price appreciation, and low unemployment have contributed to positive performance besides the tighter underwriting I mentioned earlier.

Without taking anything away from the product design and the inherent qualities and appeal of the CRT product, there is no doubt that the product was fortuitous in its launch timing as well.

The Appeal of Back End CRT

In reviewing the many different GSE reform proposals being evaluated by Congress, it is clear that risk transfer plays a prominent role in almost all of them. The fact that the GSEs have multiple avenues to hedge their risk is important, and all have value, but I see the fixed income / bond market solution as the cornerstone to any system going forward, for a number or reasons:

1. All CRT bond issuances are fully funded - the GSEs do not have counterparty risk, and don't have to worry about risk unexpectedly coming back on to their balance sheet. There are some proposals that highlight the potential of greater use of mortgage insurance (sometimes called deep MI). It is important to consider that the ability and willingness of MI companies to pay claims becomes highly questionable in times of stress; it certainly did during the crisis. The GSEs already have $200bln of counterparty exposure to the MIs, and deep MI would only increase that.

2. CRT bonds can be distributed across a wide swath of investors and included in diversified portfolios all over the globe. So, should we enter a high default environment, the risk of loss would have a diminished impact because these portfolios only have a small portion of their portfolios/capital invested in these securities. In contrast, mortgage insurers' entire levered capital base of $12.5bln is exposed to mortgage losses. Following an adverse economic environment, the trillions of dollars that exist in the global fixed income markets are the deepest source of capital that can price and take risk.

3. The capital markets provides cash to the GSEs at the time the risk is sold, and writedowns are immediate, whereas recouping MI payments can be a long drawn out process involving negotiation and sometimes litigation.

Envisioning the Future

I have examined various proposals on the future of housing finance, which range from recapitalizing the GSEs and returning them to their pre-crisis state, a complete privatization of the GSEs with no Government linkages to an explicitly guaranteed GSE issued MBS. I find the idea of an explicitly guaranteed GSE issued MBS to be the most appealing for the reasons explained below:

1. **Maintain the TBA market.** In general, our approach has been to preserve elements of the system that work, and the To-Be-Announced or TBA market is a successful, critical part of the current housing finance system. The TBA market is a source of over $5 trillion in financing for the housing market from rate investors that is unlikely to be replicated using credit investors alone. The TBA market is also the source of pricing in the primary market and helps borrowers to "lock-in" rates during the home purchase/refinance process and lenders to hedge their pipeline.

2. **The 30-year Fixed Rate Product.** Without a Government guarantee, the fixed rate 30-year mortgage may no longer be available as credit investors will not be willing to shoulder the entire duration risk of a non-guaranteed 30-year, fixed rate mortgage product. The absence of the 30-year mortgage would be hugely disruptive to the housing market as it is the preferred choice of financing for home buyers, and its withdrawal would impact not just home transactions going forward but also home prices.

Maintaining the TBA market and the 30y fixed rate product will require Government support. I believe that support should be in the form of an explicit guarantee on the MBS issued by the GSEs or their successors. I understand the concerns of those who argue against having taxpayers on the hook for any future losses. However, I would counter that it is unlikely that any government, now or in the future, would do nothing if a housing crisis of the magnitude that hit in 2008 were to hit the US again. Thus, it is better to explicitly recognize reality and get paid a fair fee for the guarantee provided. In addition, I believe that the taxpayers should be protected by:

1. Requiring significant private capital before the Government's guarantee;
2. Charging an actuarially-based premium for issuing the guarantee;
3. Providing for robust regulatory oversight over the guarantors of the guaranteed MBS.

The Government should establish a separate mortgage insurance fund, like the FHA's Mutual Mortgage Insurance Fund. This would allow the Government to ensure that they are getting a fair price on their guarantee and be transparent.

In addition, I advocate for retaining the GSEs either under the existing charters or as re-chartered entities as guarantors under the reformed system. In addition, the FHFA (or successor regulator) should be granted authority to charter other guarantors if they feel that is necessary, although I think the bar to add more guarantors should be high. The newly chartered guarantors should continue with parts of their current role including operating a cash window execution to help smaller originators with managing their origination pipeline. In addition, the move towards a single security as well as the development of the common securitization platform should proceed and form a part of the reformed system.

Having laid out our vision of the future, I want to spend some time explaining why I think the structure laid out builds on the success of the current reform efforts that have led to the CRT.

Our View on Policy Choices Facing Legislators

As stated at the beginning, I believe that housing finance reform should build on the successes of the previous efforts at reform that have led to the CRT market. I present the following views as a CRT investor. This is an important perspective as private capital is expected to provide a capital cushion before the tax-payers. CRT investors are a part of the private capital cushion, and a critical one at that, as they are the only ones that are external to the origination process, i.e. outside of the borrower's equity and the Guarantors and can thus provide a market based pricing check. Based on the factors that

I described earlier as being instrumental in CRT's success, here are our views on some of the important elements of housing finance that are currently being debated.

1. **Common Securitization Platform:** The common securitization platform or CSP helps retain several elements of the above-mentioned factors. For instance, the CSP leverages off the institutional knowledge and skills built by the GSEs over the past few decades. In addition, the CSP takes over the role of the GSEs as the "deal agent". The CSP will act as a utility providing the infrastructure that will be used for future securitizations. I anticipate that the CSP will verify and validate the origination and securitization process and thus act as a deal agent on behalf of the Investor. This addresses concerns that investors had with the pre-crisis securitization model. Note that the CSP can accommodate both guaranteed and non-guaranteed mortgage issuance.

2. **Guarantors:** Again, I would encourage the utilization of the bits of the current system that have worked. The GSEs have a long experience with guaranteeing mortgage securities and that expertise should be saved. Whether the GSEs are kept in their current corporate shape or reincarnated as new entities – preserving the current expertise is important. Why this matters to us is that this expertise provides a level of comfort as the GSEs and CRT investors have aligned interests and the GSEs control the credit underwriting dials. There are additional questions that arise when I think about the guarantors as I discuss ahead.

    a. **Light Touch Private Entity or Highly Regulated Utility:** This addresses the question of how to balance innovation and stability. Lightly regulated private for-profit entities are well designed to innovate as they seek to maximize their earnings. These innovations could be both on the origination side of the business as well on their issuance side; for instance, as credit investors we are interested in the different structures that could be used to lay off risk. However, I also recognize that innovation potentially leads to greater instability, which in turn increases the risk of equity cushions being reduced. Note that this issue is also related to the following one that looks at the type of investors. In our view, the desire for stability and avoidance of future government interventions would lead to a more regulated utility model with a guaranteed rate of return. This would reduce the incentive to innovate but lead to a more stable outcome, thus placating concerns on the side of those who would prefer that tax payers have no exposure to future housing market losses.

    b. **Outside Investors or Mutual:** Another issue to be addressed is whether the guarantors are capitalized using outside investors or through a mutual structure whereby they are capitalized by the originators that utilize their guarantee. I believe that a mutual structure is better suited to the mortgage guarantee business as it allows for a dedicated investor base that will likely to recapitalize faster in the event of a crisis unlike outside investors that may hesitate to do so. I also believe that the mutual structure creates a better alignment of interest between the originators and the guarantor. This alignment should create better outcomes both at the front and back end – meaning that originators are better incentivized to adhere to underwriting standards set by the guarantor as well as making put back decisions less contentious. This structure could prove beneficial to borrowers and the housing market if the lowered risk of contentious put backs causes originators to shrink the credit overlays.

c. **National vs Regional Guarantors:** Should guarantors be national or regional in scope? Regional guarantors can build their policies to better reflect their regional housing markets. However, regional guarantors would lack diversity in their credit portfolios and thus exposed to a regional housing downturn, which have tended to be more common than national housing downturns. A regional guarantor would also have low competitive pressures unlike a national market as it's inconceivable that there could be more than 1 guarantor in most regions. As CRT investors, we prefer a product that is scalable and thus a national guarantor model would be our preferred choice. A nationwide market would thus be able to create a more liquid product with a regular issuance calendar.

3. **Easing Regulatory Burdens:** It has been suggested that origination volumes could be higher with a few regulatory tweaks. Mortgage originators, bank originators in particular, have been vocal about the impact that various regulatory burdens are placing on their ability and/or willingness to originate loans. The GSEs have made some changes to their origination process to make the representation and warranty risk less onerous and more upfront to prevent large scale put back risks later in the cycle. This has helped ease the credit box to some extent and further easing of regulatory pressure could build on that. I welcome tweaking of the regulatory environment to the extent that it allows for an easing of burdens on the originators and expands the origination universe. An expanded origination universe is a positive from the broader perspective of economic growth but also specifically it helps maintain the liquidity and scalability of the CRT product. However, while I am against any wholesale easing of credit standards, I feel moderate changes will be a positive provided our other suggestions are accepted, meaning that the CSP acts as a "deal agent" and the GSEs continue to have "skin in the game" through warehousing and risk sharing.

Improvements That Can Be Made Today

While I have many subtle structural suggestions, the two bigger picture issues that I would like to bring to your attention are:

- The Broker/Dealer Capital charge for holding/trading these securities is unnecessarily onerous at 100% or greater. This is detached from the reality of the risk in these bonds and does nothing to help support the housing market.
- The GSEs should give serious consideration to separating out the natural catastrophe risk embedded in CRTs.

  If homeowners default on their mortgage because of a flood, hurricane, or earthquake any resulting loss flows through to the CRT structure as currently constructed. This may be good for the taxpayer in the short term, but not the longer term. I believe these risks have been woefully under-modeled and under-considered by the GSEs, rating agencies, and most investors. Simply put, CRT investors are experts in evaluating mortgage credit risk, not natural catastrophe risk. I am concerned that should there be disasters that affect the value of investors' CRT holdings it could have a permanent damaging effect on the market. If the goal is to create a market that is durable for decades to come, the GSEs need to hire firms with expertise in natural catastrophe modeling to better understand the risks. If this analysis is then shared with the market, it can more fully understand and price the risks being transferred. At that point the GSEs can evaluate keeping the CRT structure as is or separating it from natural catastrophe risk. They could achieve this by buying separate natural catastrophe protection in the reinsurance market where that pricing expertise lies. As we have seen in the private label nonagency market, once a market has structural flaws, and losses result, it is often too late to create a better structure. We await analysis from the GSEs in this regard, but without that information I would support the separation of true mortgage credit risk from natural catastrophe risk, as I think this would best serve the longevity of this extremely important source of risk capital for the U.S. housing market.

In conclusion, I want to thank you all for proceeding with this critically important reform effort. We at AllianceBernstein and the investor community stand ready to assist you and your colleagues as you help develop a more sustainable housing finance system

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Sustainable Housing Finance:

Private Sector Perspectives on Housing Finance Reform – Part IV

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Subcommittee on Housing and Insurance

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MARSH & McLENNAN COMPANIES

Introduction

Chairman Hensarling, Ranking Member Waters, distinguished members of the Committee, it is an honor to have the opportunity to provide this testimony regarding the sustainability of housing finance.

My name is Jeff Krohn. I am a Managing Director at Guy Carpenter and have over 25 years of management consulting, financial advisory and (re)insurance experience. I have been at Guy Carpenter for 15 years, where I currently lead our Global Mortgage Credit Practice. While Guy Carpenter is not an insurer, the company occupies a unique position within the mortgage credit reinsurance market. In my role, I oversee all client relationships with our government-sponsored enterprise (GSE) clients: Fannie Mae and Freddie Mac and our private mortgage insurance clients in the United States, Australia, Europe and Canada. I am supported by a large diverse team of colleagues who bring analytical, contract, capital market and financial engineering expertise. Since the global financial crisis, Guy Carpenter has been active in providing syndicated reinsurance protection for many clients.

Guy Carpenter is a business unit of Marsh & McLennan Companies (MMC). MMC operates through four market-leading brands — Guy Carpenter, Oliver Wyman, Marsh and Mercer. MMC is a global network of more than 60,000 experts who provide advice and solutions to clients across an array of industries in the areas of risk, strategy and human capital. In particular, Guy Carpenter assist companies in identifying and mitigating key risks to their business — including risk of mortgage credit default — the risk that consumers are unable to pay their mortgages and default on their homes. MMC is the only major intermediary that is domiciled in the United States and we are proud of that.

Before sharing thoughts on the housing market, I wanted to make you aware that Guy Carpenter is very familiar with syndicating extreme tail risk and helping to reduce risk to U.S. taxpayers. We are the broker for FEMA's National Flood Insurance Program (NFIP) reinsurance program. This program was put into place at January 1, 2017 and proved a success by reducing the burden to Treasury by over USD 1 billion this past year. This placement constituted the first reinsurance program ever placed by a Federal Agency. Guy Carpenter knows how to work with the Federal Government and the global reinsurance market to structure effective risk mitigation strategies.

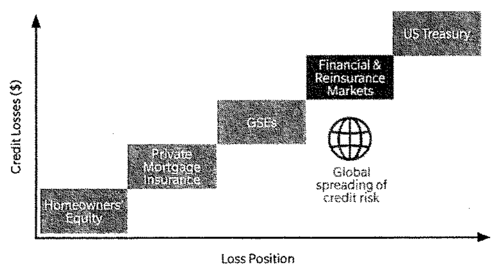
Credit Risk Transfer Background

I would like to offer a few general thoughts and then provide specific commentary on how credit risk transfer is proving to be an effective tool to reduce taxpayer exposure to credit default risk. The U.S. economy enjoys a very strong housing market. Our strong and diverse economy mitigates against any one market segment creating a major disruption in consumers' timely loan payments. However, the global financial crisis revealed a weakness in our system. We found that there was too high a concentration of risk in a few market participants. The GSEs and private mortgage insurance companies carried all the weight of a major credit default. Several private mortgage insurers went bankrupt and the U.S. government needed to step in to help the GSEs.

In the last five years the GSEs have undergone major reform. Both Fannie Mae and Freddie Mac developed highly automated systems to verify credit scores, employment, consumer financial resources and home valuations. Because of GSE validation of loan information, originators will be able to reduce repurchase of loans that fall outside of guidelines. The massive mortgage data sets of the GSEs, once viewed as proprietary, are now publicly available, allowing investors and reinsurers to perform sophisticated analytics to better evaluate and price credit default risk. These reforms, together with increased transparency, have been vital to improving the loan manufacturing process and making credit risk transfer possible.

In 2013, the Federal Housing Finance Agency (FHFA) mandated Fannie Mae and Freddie Mac to initiate a credit risk transfer program that de-risked the GSEs and protected the U.S. taxpayer by introducing global private capital into the system.

CRT Introduced Global Private Capital into the System

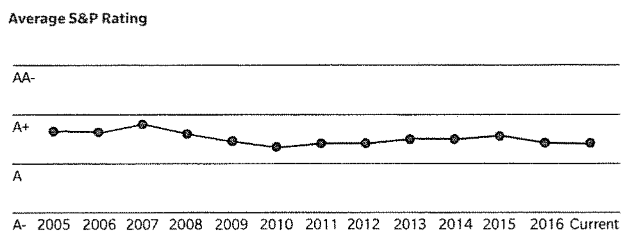


Today, the GSEs transfer a substantial amount of the credit risk of new acquisitions in targeted loan categories to private investors and reinsurers. The programs include credit risk transfers via debt issuances, insurance and reinsurance transactions, senior subordinate securitizations and a variety of lender collateralized recourse transactions. Guy Carpenter has worked first hand with the GSEs on their (re)insurance credit risk transfer programs. We have been a part of the structural innovation and the efforts to reduce credit risk where it has been economically sensible. From the beginning of the credit risk transfer program in 2013, the GSEs have transferred a portion of the credit risk on USD 1.8 trillion of unpaid principal balance to 230 investors and (re)insurers[1]. The combined risk in force transferred on these portfolios is in excess of USD 65 billion[2]. Total limit ceded to the reinsurance market to date is USD 14 billion and approximately one quarter of the risk today is transferred programmatically to global reinsurers.

[1] Guy Carpenter, Freddie Mac and Fannie Mae for STACR, ACIS, CAS and CIRT
[2] AIR, RMS, KCC, CoreLogic, PCS and Guy Carpenter

Global Reinsurance Market

The reinsurance market represents a significant and attractive source of private capital for the GSEs because it bears a small amount of U.S. residential mortgage risk and its other forms of risk are not correlated to mortgage credit risk to any meaningful degree. In aggregate, the natural catastrophe events of 2017, including Hurricanes Harvey, Irma, Maria, multiple earthquakes in Mexico and California wildfires, were the worst in terms of losses in 12 years and have not impaired any reinsurer. Despite handing reinsurers an approximate USD 73 billion industry loss[3], these events have not impacted the pricing or available capacity for the various GSE and mortgage insurance reinsurance placements that have transacted since. The stability of the reinsurance market has stood the test of time. The average rating of reinsurers in the Guy Carpenter Mortgage Reinsurer Composite has consistently been in the 'A' range, before, during and after the global financial crisis.



Source: Guy Carpenter and S&P

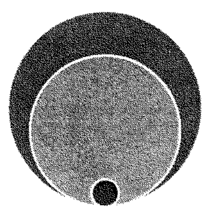
Diversification plays a key factor in the stability of capacity and pricing of the reinsurance market. Like mutual funds that invest in a diversified basket of stocks, reinsurers invest and offer protection across many classes of business and territories, many of which are completely uncorrelated. Typical classes of business written by reinsurers include homeowners, auto, casualty, marine, aviation and professional liability insurance. Reinsurers gain further diversification by writing across multiple territories. Homeowners insurance losses in the United States are generally uncorrelated with homeowners losses in Europe and less so with professional liability in Italy, for instance. Sometimes, reinsurers have aggregations of losses across lines of business in the same event and the recent flooding from Hurricane Irma caused losses across homeowners, auto and flood insurance. Reinsurers recognize these accumulations and have developed sophisticated approaches to manage the downside risk of their portfolio.

[3] Guy Carpenter

Hurricane Irma highlighted one of the reasons mortgage credit risk offers an attractive opportunity to reinsurers. It simply does not have any meaningful correlation to most of the other lines of business reinsurers write. Reinsurers can also diversify within the mortgage segment – they can choose to write across the suite of credit risk transfer products including low loan to value (LTV) loans, high LTV loans, 30 year or 15 year loans. Credit risk transfer also offers reinsurers temporal diversity and the ability to assume credit risk over time. Temporal diversity is extremely valuable to reinsurers because loss propensity reduces as pools season under normal circumstances. Additionally, reinsurers appreciate the quality and richness of mortgage data because it allows them to better underwrite and manage their inforce portfolios.

More reinsurers are participating in the credit risk transfer program, reflecting strong and growing interest. Today, almost 35 global reinsurers participate in GSE credit risk transfer programs. The GSEs find these multi-line counterparties attractive because they are geographically diversified, highly-rated, offer consistent capacity, competitive pricing and coverage options not found in other markets.

When losses occur, reinsurers are required to pay claims in less than 30 days. Reinsurers also provide GSEs a valuable feedback mechanism and enforce risk disciplines when pricing and evaluating mortgage pools. The full potential of the reinsurance market has not yet been fully realized. The chart below illustrates the total insurance / reinsurance industry capital and dedicated reinsurance capital relative to the credit risk transfer reinsurance limits placed.



- Top 50 Reinsurer Capital $727 Billion
- Dedicated Reinsurance Sector Capital $436 Billion
- GSE CRT Reinsurance Limits $14 Billion

Source: Guy Carpenter, AM Best, Fannie Mae and Freddie Mac

The reinsurance market will continue to be a significant and attractive source of private capital for years to come.

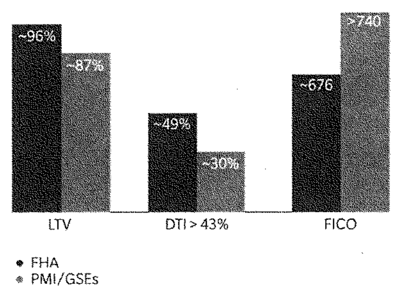
Guy Carpenter's mandate remains to develop broad and diversified reinsurance markets that reduce taxpayer risk, maintain liquidity and help to build a strong housing finance system, while providing transparency and a reasonable return for reinsurers in exchange for the transfer of credit risk.

The Federal Housing Administration and Credit Risk Transfer

The Federal Housing Administration's mission is vitally important for first-time homebuyers, low-income borrowers, and consumers with limited credit history. But, it is not a mission without risk for the U.S. taxpayer. The FHA's focus on these communities leads to an insured portfolio of loans with a credit default risk that, on average, is higher than Fannie Mae, Freddie Mac or private mortgage insurers.

Three factors account for the FHA portfolio's risk profile: higher loan-to-value LTV ratios, greater borrower debt-to-income ratios (DTIs), and lower FICO credit scores. Loans with a higher LTV have less equity to cushion a default. Loans with a greater DTI rely on a greater percentage of an individual's income to service the debt, thus job loss or illness could lead to default. Similarly, loans based on a lower FICO credit score have a higher default rate. Naturally, there are many specific instances that run counter to the broad generalization, but loans with these characteristics are proven to have a higher propensity for default risk. The chart below illustrates how the FHA's mortgage portfolio compares to portfolios for PMIs and GSEs.

FHA has higher LTVs, higher DTIs and lower FICO credit scores



Sources: Cited reports by HFPC, AEI, and HUD

In addition to these risk factors, the FHA offers deeper coverage than the PMIs, which increases its exposure to default risk. The mortgage insurance coverage provided by the FHA transfers the risk of the entire loan balance to the FHA. Whereas, private mortgage insurance, on average, covers the first 25 percent of risk and Fannie Mae and Freddie Mac retain the remainder.

As part of the recent reforms, the GSEs now require PMIs to hold almost twice the amount of capital per dollar of risk than they did before the crisis. The FHA's capital requirements to support its portfolio risk remain low. The latest actuarial report estimates the Mutual Mortgage Insurance Fund to be at 2.09 percent — barely above the 2 percent minimum threshold. This capital calculation includes future annual premium that has not yet been received.

In short, the FHA's mission leads it to provide broader coverage on a pool of loans that is riskier than those held by the PMIs and GSEs. Furthermore, the FHA lacks a risk transfer mechanism similar to the one developed by the PMIs and GSEs to help manage default risk. The question policymakers frequently grapple with is how to manage the tension between the FHA's mission and the need to protect taxpayers against FHA's potential losses.

Guy Carpenter believes the FHA should explore ways to introduce private capital to effectively manage its credit risk. Ultimately, the FHA might develop a credit risk transfer mechanism similar to the approach successfully used by the GSEs. Such a program would reduce risks to the U.S. taxpayer and enable the FHA to fulfill its mission.

Beyond using diverse sources of private capital to reduce FHA risk and losses, a credit risk transfer program would transform the FHA's understanding of its mortgage portfolio. A market-like view of risk would provide valuable feedback and insights to FHA's management and policymakers. Real time information could be incorporated into the FHA's insurance premium rates, underwriting guidelines, and loan programs.

Congress and the Administration are currently considering a number of policy options to help mitigate the loss potential to the FHA. Guy Carpenter recommends that policymakers evaluate whether a credit risk transfer program could strengthen the FHA to the benefit of homebuyers and taxpayers alike. Our experience designing similar programs for the GSEs and private mortgage insurers lead us to believe that private capital and reinsurance credit risk transfer could support the FHA, promote a more sustainable housing finance system, and insulate the program against losses, especially during macro-economic disruptions.

Thank you again for the opportunity to provide this testimony. I welcome the opportunity to answer any questions you may have.

Arch | MI

Statement of Andrew Rippert

Chief Executive Officer

Global Mortgage Group

Arch Capital Group Ltd.

Before the

Subcommittee on Housing and Insurance

United States House of Representatives

Hearing on

Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform – Part IV

December 6, 2017

Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee, thank you for the opportunity to testify on behalf of Arch Capital Group Ltd. (Arch). My name is Andrew Rippert, and I am the Chief Executive Officer of Arch's Global Mortgage Group. In this role, I am responsible for our mortgage guaranty and credit risk transfer operations around the world with an emphasis on the US housing market, and it is in this capacity that I offer my testimony today. I also have over 25 years of experience in real estate finance, and currently serve on the Board of Directors of the Mortgage Bankers Association (MBA), as a voting member of the MBA's Residential Board of Governors and as a member of the Executive Committee of the Housing Policy Council.

Arch's Global Mortgage Group provides mortgage insurance and reinsurance on a worldwide basis, and we are committed to making substantial, long-term equity investments in support of the US housing market. Since entering the US mortgage insurance market in 2010, Arch has recognized that we cannot determine how the housing finance system of the future would operate – that is the job of Congress – but has also known that whatever the structure of the future system, the US mortgage market would need substantial private capital to de-risk taxpayers and help homeowners, and the housing market, recover and thrive in the future. To that end, we sought to build our company on a solid base of equity capital and with an orientation to bearing mortgage credit risk in whatever form it might come, be it traditional private mortgage insurance, or alternative models of credit risk transfer on the front or back-end, in ways that can expand sustainable homeownership.

We operate Arch MI, the largest private mortgage insurance company in the country. At the end of the third quarter, we had over $250 billion of insurance in force (IIF) ($64 billion of risk in force – excluding our CRT transactions) – $54 billion more IIF than the next largest private mortgage insurer.

In addition to our primary mortgage insurance operations, we have led the development of reinsurance executions for Government-Sponsored Enterprise (GSE) credit risk transfer (CRT) transactions under Freddie Mac's Agency Credit Insurance Structure (ACIS). We continue to be a leading participant and innovator in the growing CRT market and engage regularly with regulators, the GSEs, and other market participants on how we can help them accomplish their credit-risk sharing and management objectives.

We believe Arch's mortgage guaranty practice is consistent with the important public policy goal of responsible transfer of risk from taxpayers to the private sector. Our operating model is unique in that it utilizes diverse channels for acquiring risk (including both the private mortgage insurance and CRT models), performs comprehensive assessment of the risk acquired, and then syndicates a portion of that risk on a programmatic basis to achieve price discovery and market validation of our own risk assessments, and to ensure our capacity to support the housing market through a downturn in the housing cycle. This model, which we call "buy-manage-syndicate," is similar to that which the GSEs have evolved under the guidance of the Federal Housing Finance Agency (FHFA) as conservator. We see this evolution, from essentially a model of "accumulate and hold" to a model of "accumulate to distribute," as a critically important advance to put the US housing market on a more sustainable path for the future.

The Committee has requested views and perspectives on three topics: (1) the need to enact comprehensive housing finance reform; (2) the legal, statutory or regulatory impediments to the return of private capital to the housing finance system; and (3) what factors and metrics Congress should consider to reform the housing finance system.

Before addressing the specific topics, I want to take the opportunity to commend the meaningful and significant administrative reforms that FHFA has put in place since 2012. Under both Acting Director DeMarco and Director Watt, FHFA has progressed from a model in which risk was overly concentrated in a limited number of entities to one that – through CRT – has transferred risk to hundreds or perhaps thousands of investors across the reinsurance and capital debt markets. Additionally, through the introduction of the Private Mortgage Insurer Eligibility Requirements (PMIERs), the private mortgage insurers – currently the largest counterparties to the GSEs – have greatly improved their risk and capital frameworks. Finally, important progress has been made in the development of a common securitization platform (CSP) is critical to addressing systemic risk in which the failure of a guarantor could threaten to take down the nation's critical securitization infrastructure.

These actions represent meaningful evolutionary reforms that have reduced taxpayer exposure to mortgage risk, and provided important diversification of private capital sources for the GSEs. But reform remains incomplete, and absent legislative action, we share the concerns of many market participants and other housing stakeholders, that homeowners, taxpayers and the economy remain greatly at risk. We hope that conversations about continued housing finance reform build upon and solidify these advances.

Need to Enact Comprehensive Housing Finance Reform

The status quo in the US housing finance system, as has been widely observed by analysts and policymakers from across the ideological spectrum, is unsustainable and Arch supports comprehensive, housing finance reform legislation as soon as possible. The lack of comprehensive housing finance reform in the aftermath of the financial crisis adversely impacts private investment, economic growth, and the availability of mortgages for creditworthy borrowers. While mortgage credit markets have been healthy in recent years as markets have been recovering from a historic trough, making reform a priority now can help ensure that the system is well prepared to handle an eventual and inevitable market downturn.

The continued conservatorship of the GSEs creates systemic risk and policy uncertainty that is keeping private capital on the sidelines. This has contributed to a more anemic housing recovery and homeownership levels than we might have otherwise experienced. The reality is that even with the risk syndication initiatives of the GSEs, there exists a duopoly in which two companies control the entire secondary market infrastructure for the conforming market. They remain prime examples of "too big to fail."

Several models have been proposed to reform the current structure of the GSEs. We believe that a multiple guarantor model would best diversify risk and permit greater competition on operations, system development, customer service, production and pricing. Additionally, a multiple guarantor model that includes private sector guarantors, coupled with programmatic syndication of risk to third parties, would continue the precedent established through CRT of shifting first loss risk away from government exposure.

The work done to transfer risk through the CRT programs developed by the Enterprises with the support of FHFA has been significant in bringing private capital to bear in the market and the GSEs should continue to expand to new innovative structures and ideas. However, it should be noted that these programs are not statutory in nature. Therefore, one of the biggest regulatory risks we see is the potential for the progress made over the past five years to be abandoned in the absence of a statutory change. Arch recognizes that the FHFA Director is invested with an enormous amount of power over what is arguably the second largest financial market in the world, and pending regime change at the Agency has the potential to contribute to additional market uncertainty.

Legislation is the only way to ensure that these policies have permanence and consistency. All participants in housing finance reform should support ways to "lock in" the advances of the past five years to avoid the possibility of reverting to previous counterproductive practices.

Finally, comprehensive housing finance reform is necessary to structurally shift more first loss risk from the government. For all of the merits of the current CRT programs, the GSEs still hold significant first loss exposure concentrated on two highly leveraged balance sheets with explicit taxpayer backstops. By fundamentally changing the structure to include multiple guarantors, or instituting a government guarantee similar to that provided by Ginnie Mae, the current proposals structurally shift first loss exposure to private market participants.

Until such structural changes are made, the GSEs should continue to engage and expand their utilization of back-end transactions, including CRT and reinsurance transactions, such as Fannie Mae's Credit Insurance Risk Transfer (CIRT) and Freddie Mac's ACIS. Reinsurers offer a highly rated, well-capitalized and more diverse private capital option – therefore broadening the base of available global capital and providing greater taxpayer protections. Reinsurance is a long-standing means for various industries to transfer both catastrophic and non-catastrophic risk. In addition to reducing risk exposure, another benefit of risk syndication is the price discovery that it provides. By receiving real-time price discovery, the syndicator of risk can assess whether it is adequately underwriting and pricing its risk. This type of feedback can help inform policymakers, consumers and other key stakeholders to determine if the market may be getting overheated. Additionally, if used appropriately, this information can inform consumers, investors and policymakers of developing bubbles, and ultimately help temper some of the historical boom and bust cycles that have had a negative effect on homeownership rates, wealth accumulation and wealth inequality.

In parallel, the GSEs should expand their utilization of front-end transactions including the use of mortgage insurance with greater coverage percentages than currently required by the Enterprises on loans with loan-to-value (LTV) ratios greater than 80%, as well as on loans with below 80% LTV ratios (Deep Cover MI). For example, the GSEs could engage in CRT transactions using a combination of Deep Cover MI and reinsurance options offered through well-capitalized global reinsurers. Each option has significant merit, and a combination of them will better serve the interests of taxpayers, consumers, and economic growth broadly.

Legal, Statutory or Regulatory Impediments to the Return of Private Capital to the Housing Finance System

Arch believes that the most important thing Congress – and only Congress – can do to address the legal, statutory or regulatory impediments to the return of private capital to the housing finance system is pass comprehensive housing finance reform legislation attending to the uncertainty of the unsustainable conservatorships. Our recommendation is, through legislation, to affirm that programmatic CRT will be a permanent feature of the housing finance system of the future. It takes a substantial commitment of both human and financial capital to participate in these markets, and while the CRT market is flourishing, we believe more participants will emerge once it is clear that these successful pilot programs are a permanent feature of the housing finance system.

As previously noted, with CRT as a permanent feature, private capital will make the levels of investment necessary to prudently and proactively underwrite mortgage credit risk across all market conditions, thereby providing well-informed, timely and valuable feedback on the level of risk in the market. We believe such feedback will provide tremendous value to policymakers, market participants and consumers alike.

Factors and Metrics Congress Should Consider to Reform the Housing Finance System

Arch recommends that Congress consider the following key factors as it seeks reforms to bring certainty and stability to the housing finance system:

1. Private capital should be positioned ahead of taxpayers in a meaningful way.
2. The regulatory framework for any future system should require mortgage guarantors to follow a countercyclical capital model that is responsive to the dynamic nature of housing market risk. Participants should be required to hold capital in proportion to that risk in order to keep the government and taxpayers in a risk-remote position.
3. The regulatory framework for any future system should require mortgage guarantors to follow an "accumulate to distribute" model to ensure a diverse pool of private capital – including equity capital, debt off the balance sheet, and true credit risk transfer through the capital and reinsurance markets. This "accumulate to distribute" model will ensure ongoing price discovery, important risk and capital management information and that the most efficient form of private capital is regularly made available to the US housing finance system.
4. Reform should encourage additional transparency into the cost of credit and collateral risk associated with CRT.
5. FHA reform to eliminate negative competition.

We provide additional detail on each of these factors below.

1. Since the GSEs entered conservatorship, and with bipartisan support from Congress and successive Presidential administrations, the GSEs' strategic model has evolved from "buy and hold" risk to "accumulate to distribute" risk across multiple balance sheets in the reinsurance and capital markets – primarily through CRT programs. This emphasis on additional private capital is positive for the industry in that it has reduced the GSEs' overall risk exposure, and by extension, lessened the risks to taxpayers, homeowners and the economy as a whole.

   Additional work should be done to better protect the US taxpayer vis a vis housing risk on LTV ratios below 80% where the GSEs continue to hold a significant amount of first loss risk. Private capital continues to look for opportunities to take some of this risk from the taxpayer.

2. Critical to the long-term success of any housing reform is the development and implementation of a clear, transparent, risk-based countercyclical capital model. A countercyclical framework is sustainable through economic cycles to support a strong guarantor and will help ensure effective risk management by market participants.

   Current capital models such as the PMIERs are not countercyclical as they do not encourage counterparties to either raise capital or reduce the amount risk they are aggregating when market fundamentals indicate a riskier market with the potential for more severe losses. Several proposed capital models, including that of the National Association of Insurance Commissioners, include elements that increase capital requirements for mortgage credit risk when properties become over-valued. In a countercyclical capital model, mortgage insurers would be incentivized to minimize exposure to riskier loans because capital requirements for those mortgages would be higher.

   Pursuing a clear, transparent set of countercyclical capital requirements on mortgage risk counterparties could help dampen market bubbles and reduce the risk of dramatic downturns in the housing cycle with the attendant negative consequences for households and the economy as a whole.

3. Diversified sources of capital and options for placing risk are critical to housing reform. While Congress debates statutory reform, the GSEs and FHFA should continue engaging in back-end CRT transactions while expanding their focus to front-end transactions. Accessing a broad set of private capital sources, including private mortgage insurance, reinsurance and the capital markets is a proven and effective way to reduce concentration risk and lessen taxpayer exposure to the housing market.

4. We believe that the GSEs need to continuously evaluate and price the risk of loss to ensure that loans do not present an unacceptable risk to families and taxpayers. In addition, the GSEs should report on the cost of the credit and collateral risk associated with their lending programs, as well as any subsidization necessary to maintain affordability. This added transparency will enable the FHFA to confirm that the GSEs are serving their intended purpose without imposing excessive risks on borrowers, taxpayers or the economy as a whole. It will also ensure that the GSEs are better

prepared to weather all economic cycles. Additionally, added transparency is essential to permit private market participants to effectively price mortgage credit risk, and to arm Congress and policymakers with the information they need make effective decisions on affordable housing subsidization.

5. Finally, as part of any potential housing finance reform we believe it is imperative for FHFA to consider the strategic initiatives and loan programs offered by the FHA, which help ensure broader access for qualified borrowers. Coordination is necessary to eliminate any negative competition or unnecessary overlap between the government programs, which could lead to the accumulation of excess risk for consumers and taxpayers in the housing finance system. Controlling these excessive risks is critical to protecting individual borrowers, helping keep credit affordable for aspiring homeowners and ensuring stability through credit cycles across the broader market.

Conclusion

The evolution of the US housing finance market calls for a significant increase in the volume of private capital as well as access to additional diverse sources of capital that provide first loss coverage on mortgage credit risk. Equally as necessary, the solution should reduce taxpayer risk, lower cost to all borrowers and reduce operational costs for lenders, large and small alike. At a minimum, Congress should pass legislation to secure the positive gains made in the area of CRT by the FHFA and the Enterprises over the past five years by requiring greater levels of both back-end and front-end risk transfer with mortgage insurers, reinsurers and the capital debt markets in a variety of forms.

Ideally, more comprehensive legislation will be achieved that addresses the additional issues of "too big to fail," completing the work on the CSP and a Single Security, and ultimately separating the critical secondary market infrastructure from the risk-taking guarantor function, requiring a prudential capital framework for mortgage guarantors based on a countercyclical capital model, implementing reporting requirements to ensure transparency of costs related to CRT versus front-end guaranty fees, and addressing FHA reform to eliminate negative competition.

Making homeownership possible for 60 years

USMI

U.S. Mortgage Insurers

Statement of Patrick Sinks

President and CEO of Mortgage Guaranty Insurance Corporation (MGIC) &

Chairman of U.S. Mortgage Insurers (USMI)

Before

The United States House Committee on Financial Services

December 6, 2017

Sustainable Housing Finance:
Private Sector Perspectives on Housing Finance Reform – Part IV

Chairman Duffy, Ranking Member Cleaver and the members of the Subcommittee, thank you for this opportunity to come before you to discuss the housing finance system and opportunities for reform. We also appreciate the opportunity to share with you our unique experience of being providers of first-loss credit protection, the lessons learned that should be applied to all forms of credit enhancement, and recommendations for increasing and enhancing permanent private capital in the mortgage finance system. Mortgage insurance (MI) is a means to better shield taxpayers from mortgage related credit risks while ensuring creditworthy borrowers have sustainable access to prudent and affordable mortgage finance credit.

This year marks the 60th Anniversary of the modern-day private mortgage insurance industry—when my company, MGIC was founded by Max Karl as an alternative for borrowers and lenders to the Federal Housing Administration (FHA). Over the last 60 years, private MI has helped more than 25 million families attain homeownership in a prudent and affordable manner.

MI reduces taxpayer risk exposure by transferring to private capital participants a substantial portion of mortgage credit risk to companies backed by private capital. Mortgage insurers covered more than $50 billion in claims since Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs), entered conservatorship resulting in substantial savings to taxpayers. Private MI is required to be a monoline form of insurance because, unlike other forms of capital markets executions and reinsurance, policymakers intended to ensure that there is a dedicated form of credit enhancement that will not exit mortgage markets for other forms of risk during times of market stress. Because of this, MI is one of the only forms of *permanent* private capital—capital provided through various market cycles – other than the GSEs. Through our 60-year history, including throughout the Great Recession, the MI industry *never* stopped paying claims, and *never* stopped writing new insurance. Because the industry was not considered too-big-to-fail, MIs did not receive any bailout money from the Federal government during the financial crisis.

Borrowers with lower down payments present a greater risk of default and a significantly increased risk of loss to a lender than those with a significant down payment. The private MI industry is designed to protect lenders and investors from this risk, while ensuring low down payment borrowers have access to safe, reliable and prudently underwritten mortgage credit. In this testimony, I will cover the following topics:

- The Need for MI and Who Private MI Serves;
- Private MI's Performance Through the Great Recession;
- Key Improvements to the Industry that Make It More Resilient Going Forward;
- Principles for Housing Finance Reform and Lessons that Should be Applied to All Market Participants;
- How MI is Different from Other Sources of Credit Enhancement and Why Those Differences Matter; and
- Recommendations to Increase and Enhance *Permanent* Private Capital to Stand in Front of an Explicit Government Guaranty.

The Need for MI and Who Private MI Serves

The Need for MI: First, it is important to understand *why* there is a need for private MI. Borrowers who make larger down payments are less likely to default on their mortgages than lower down payment borrowers.[1] Congress understood the additional risk posed by those with lower down payments and the need to mitigate that risk. But Congress also understood the importance of ensuring that there are prudent and affordable low down payment options available to homebuyers. In 1970, Congress included in the GSEs' legislative charters, the requirement to obtain credit enhancement on loans with down payments less than 20 percent.[2] This credit enhancement can be achieved in several ways—lender recourse, participation or private mortgage insurance.[3]

While private MI is not the only credit enhancement available under the GSEs' charters, there are several reasons why private MI has been the most widely used in the high loan-to-value (LTV) space, including the benefits to borrowers and lenders.

Who Private MI Serves: MI makes homeownership possible for creditworthy homebuyers who do not have the resources for a large down payment. MI has helped millions of Americans become homeowners sooner in both a prudent and affordable way by reducing the risk on their loans. Research from both the Urban Institute and from USMI suggests that it could take approximately 20 years for the average firefighter or schoolteacher to save for a typical 20

[1] Urban Institute, *Mortgage Insurance Data at a* Glance (August 22, 2017).
[2] Federal National Mortgage Association Charter Act, 12 U.S.C. 1717(b)(2) and Federal Home Loan Mortgage Corporation Act, 12 U.S.C. 1454(a)(2).
[3] Federal National Mortgage Association Charter Act, 12 U.S.C. 1717(b)(2) and Federal Home Loan Mortgage Corporation Act, 12 U.S.C. 1454(a)(2).

percent down payment[4] and research by the National Association of REALTORS and others suggest that Americans continuously cite saving for a down payment as one of the biggest hurdles for attaining homeownership. Furthermore, the demographic landscape of U.S. homeownership is forecasted to look significantly different than in decades past, with the share of minority households projected to increase from 30 percent in 2010 to 38 percent by 2030[5] and account for approximately 80 percent of household formation for 2015-2035.[6] Due to limited assets and savings for a large down payment[7], minority families tend to overwhelmingly rely on low down payment mortgage options to secure mortgage financing.

In the past year alone, our industry has helped more than 1 million families purchase or refinance their mortgage with less than a 20 percent down payment. More than 50 percent of all borrowers who have private MI were first-time homebuyers. MI is focused on low- to moderate-income borrowers—with more than 40 percent of borrowers with MI having incomes below $75,000 per year.[8] Private MI draws on decades of experience to balance the need for cross-subsidization and risk-sensitive pricing to provide competitive pricing through a greater variety of premium plans that include advantageous characteristics such as cancellation when the mortgage insurance is no longer necessary[9]. A further consumer benefit associated with private MI as a form of credit enhancement, it that MIs have a strong incentive to help borrowers to achieve a workout to stay in their home rather than default. To be sure, private MI plays a very important role in the housing finance system, allowing many creditworthy borrowers to access affordable mortgage finance credit through the conventional market. In a recent report released by Urban Institute, Urban notes that, "within the conventional space, GSE borrowers with PMI tend to have higher [loan-to-value] ratios, lower credit scores and higher DTI ratios than GSE borrowers without PMI. These findings suggest that the presence of PMI makes it easier for creditworthy borrowers to access conventional credit."[10]

MI also serves lenders—of all sizes and types. As you have heard in a previous hearing focused on smaller financial institutions, it is imperative that smaller lenders have access to the secondary market on an equitable basis to ensure accessible financial services across the country and to level the playing field for smaller institutions. One reason that MI has worked so well and played such a significant role is the ability to be used with *any* approved lender doing business with the GSEs—private MI is simple and transparent. MI has the distinct advantage of being inclusive and scalable for originators of all types and sizes, including for example, community banks, credit unions and other small originators, using processes and techniques already in place and familiar to those stakeholders. Further, every financial institution that can originate and sell loans to the GSEs can do business with private mortgage insurers and has the freedom to select their MI provider(s) rather than being mandated to use a specific provider. MIs have relationships with several thousand financial institutions and compete on services provided to these institutions such as education, technology and efficiency. MI serves lenders by enabling

[4] Urban Institute, *Sixty Years of Private Mortgage Insurance in the United States* (August 22, 2017); U.S. Mortgage Insurers based on data from U.S. Census Bureau, U.S. Department of Labor, Federal Reserve, and National Association of REALTORS.
[5] Urban Institute, "Can the mortgage market handle the surge in minority homeownership?" (July 1, 2015).
[6] Harvard Joint Center for Housing Studies, *Updated Household Projections, 2015-2035: Methodology and Results* (December 12, 2016).
[7] Urban Institute, "Nine Charts about Wealth Inequality in America" (July 16, 2017).
[8] U.S. Mortgage Insurers member data.
[9] For borrower paid private MI, insurance is cancelled when the borrower reaches 78% of the value of the loan according to HOEPA (1998)
[10] Urban Institute, *Sixty Years of Private Mortgage Insurance in the United States* (August 22, 2017).

them to originate high LTV loans on a capital efficient basis—as federal regulators recognize this credit enhancement and reduction in loss severity associated with mortgage insurance, and provide capital relief to financial institutions with its use.[11]

Finally, MI serves the GSEs and ultimately protects taxpayers. As mentioned above, MIs have paid more than $50 billion in claims since the onset of the financial crisis—a direct benefit to taxpayers.

Private MI's Performance Through the Great Recession

Housing finance is cyclical and there have been a number of mortgage market downturns over the 60 years that private MI has been in business—mostly regional downturns such as in the West South Central "Oil Patch" bust in the 1980s. While MI has paid billions in claims through these regional downturns, it was the recent financial crisis where the MI industry—like all financial services industries—was tested like never before. It is important to note that, similar to other financial companies in the mortgage finance system—including individual banks and community banks, credit unions and other independent financial companies-there were individual MI companies that did not withstand the severe downturn. Three MI companies exited the business. However, the companies that exited the business did so in an orderly manner and continued to pay claims, and three new MIs came into the marketplace, demonstrating that MIs are *not* too-big-to-fail. Overall, the industry not only survived the Great Recession but served its purpose and absorbed significant losses ahead of taxpayers.

Private MI covers between 6 and 35 percent of the value of a loan depending on the size of the down payment, covering on average 25 percent of the value of a loan. At the time that the GSEs entered into conservatorship, they guaranteed 44 percent of the mortgage market[12] and ultimately received a taxpayer bailout of $187 billion. Since the GSEs entered into conservatorship, private MIs have paid more than $50 billion in claims—which represents 100 percent of valid claims from the financial crisis—with more than 97 percent paid in cash and the remainder scheduled to be paid over time.

According to the recent independent analysis by Urban Institute, the GSEs' overall risk exposure on "30-year fixed rate, fully documentation, fully amortizing mortgages, the loss severity of loans with PMI is 40% lower than that without, despite the higher LTV of mortgages with PMI."[13]

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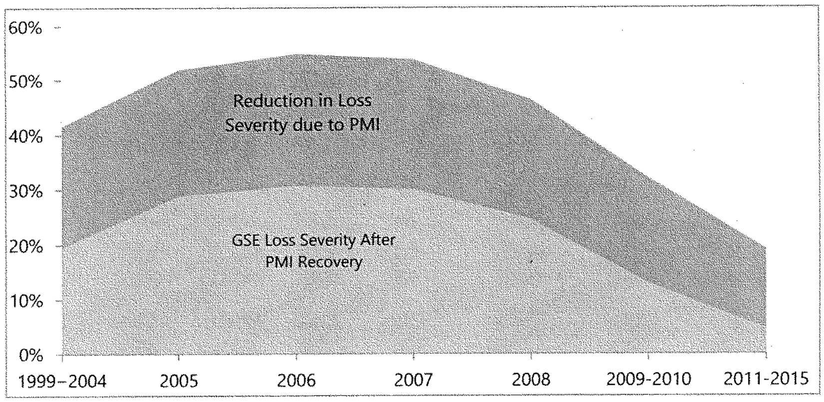
[11] Mortgage insurance reduces the regulatory capital required for depository financial institution from 8% to 4% for conforming and jumbo mortgage loans at or above 90 LTV.

[12] Federal Housing Finance Agency, Residential Mortgage Debt Outstanding – Enterprise Share, 1990-2010. The datasets reflect the total mortgages held or securitized by Fannie Mae and Freddie as a percentage of residential mortgage debt outstanding.

[13] Urban Institute, *Sixty Years of Private Mortgage Insurance in the United States* (August 22, 2017).

GSE Loans with PMI: Reduction in Loss Severity Because of PMI, by Origination Year Groupings



Sources: Fannie Mae, Freddie Mac, and the Urban Institute.
Note: GSE = government-sponsored enterprise; PMI = private mortgage insurance. The GSE credit data are limited to 30-year fixed-rate, full documentation, fully amortizing mortgage loans. Adjustable-rate mortgages and Relief Refinance Mortgages are not included. Fannie Mae data include loans originated from the first quarter of 1999 (Q1 1999) to Q4 2015, with performance information on these loans through Q3 2016. Freddie Mac data include loans originated from Q1 1999 to Q3 2015, with performance information on these loans through Q1 2016.

Occasionally, our industry will hear claims that the MIs did not pay our claims. This statement is simply not accurate, and it misses the mark in two important ways. First is the misperception that MIs did not have sufficient resources to pay claims due to the financial stress of the Great Recession and its effect on the MI industry. The fact is that, even with the three companies who were placed into runoff, MIs paid 100 percent of valid claims—with more than 97 percent of claims being paid in cash and the remainder being paid over time by the companies that went into runoff. This can be verified by looking at the official statutory filings of MI companies.

It is important to understand when and how MIs rescind coverage and denied claims on loans that went to foreclosure. Private mortgage insurance does not pay in the event there was originator fraud or misrepresentation. This is analogous to a homeowner's insurance policy not paying when the homeowner is found guilty of arson. The vast majority of claims during the recent downturn were covered under contract and paid. The primary reasons behind rescissions during the recent financial crisis were fraud/misrepresentation in origination. In other words, this was not an improvised, arbitrary response by the industry to the Great Recession. Bond investors (including the Federal Housing Finance Agency (FHFA) on behalf of the GSEs) had (and are still having) similar disputes regarding loans originated in the run-up to the Great Recession. Downturns generate disputes, but our industry has revised our policies and practices to reflect lessons learned to further clarify our coverage obligations and processes.

Problems in Mortgage Lending Impacted All Areas of Housing Finance
3

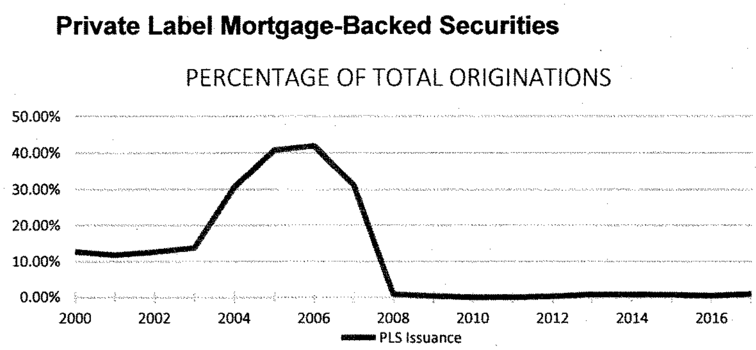
GSE Repurchases	FHA	PLS Suits	Fees & Damages	Ongoing Legal Damages
Since 2009, GSE repurchases accounted for nearly $78 billion. According to some reports, 4,200 sellers and originators were subject to repurchase demands over time.[14]	Under the False Claims Act, the Department of Justice recovered more than $7 billion related to housing and financial fraud in FY 2009-2018 for FHA-insured mortgages.[15]	FHFA initiated litigation against nearly 20 financial institutions in 2011, involving allegations of securities law violations; in some instances, fraud in the sale of PLS to the GSEs. Settlements reached in 2013 through July 2017 totaled nearly $23.7 billion.[16]	In the eight years after the financial crisis, banks and other financial institutions paid roughly $160 billion in fees since 2010.[17]	In 2017 the top banks estimated that damages related to approximately $37.5 billion in securities are at stake and remain outstanding from pending suits from the financial crisis – cases brought by FDIC, FHFA, and NCUA.

Further, it is very important to note that, MI has been ***a significant source of permanent private capital available in all market cycles.*** We have heard some argue that the "monoline" industry model is a reason not to do additional risk transfer with MI. However, the comprehensive state insurance regulatory framework and Congressional action in establishing a GSE loan-level credit enhancement requirement (and related federal banking provisions) required and valued MIs as monoline businesses. While mortgage insurers are in the same residential mortgage business as the Enterprises, mortgage insurers have a unique countercyclical capital model and other prudential restrictions that substantially lowers the risk of failure in a housing market downturn. For example, state mortgage insurance laws require mortgage insurers to reserve 50 percent of premiums for a period of 10 years, to be used to pay claims during periods of stress. In addition, MIs are not allowed to invest in mortgages and there are provisions to prevent becoming overly concentrated in certain geographic areas.

Further, MIs have a direct interest in being available to take mortgage credit and absorb mortgage losses through *all* credit cycles—something that is different than other forms of credit enhancement being explored today. Unlike most other forms of mortgage credit risk transfer, MI companies are 100 percent dedicated to the housing economy, as evidenced by their monoline operations, steady market presence across cycles, and work with investors and servicers to provide solutions for borrowers facing foreclosure. Nearly all other forms of private capital taking mortgage credit risk prior to the financial crisis ceased to exist during the financial crisis. However, during its 60-year history, including the most recent financial crisis, the private MI industry has ***never stopped writing new business and never stopped paying claims.*** Private MI is one of the ***only*** time-tested ***permanent*** source of private capital that serves to protect lenders, the GSEs and taxpayers against first-loss credit risk. The mortgage insurance industry, through its

[14] Cliff Rossi, Presentation at Mortgage Risk Summit (June 1, 2017).
[15] https://www.justice.gov/opa/press-release/file/918366/download
[16] https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFAs-Update-on-Private-Label-Securities-Actions-71217.aspx
[17] http://www.ibtimes.com/political-capital/how-much-did-banks-pay-2008-financial-crisis-fines-settlements-over-160-billion

performance through the unprecedented downturn of the recent housing crisis, has demonstrated both its utility and resiliency.



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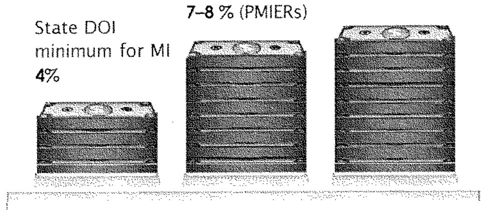
Key Improvements to the Industry to Make It More Resilient Going Forward

Enhanced and Increased Capital Standards: PMIERs. In addition to an ongoing effort to update the state insurance regulatory framework for MI[19], MIs have new capital and operational standards under the Private Mortgage Insurer Eligibility Requirements (PMIERs) issued by the GSEs in conjunction with FHFA.[20] These higher capital requirements are more risk sensitive based on FICO, LTV and MI product type and the GSEs conduct regular monitoring of capital and operational compliance. MIs' minimum surplus and reserve requirements cause MIs to retain premiums earned during periods of economic expansion in order to be able to cover losses during downturns. Under the new risk sensitive requirements, most MIs have current asset requirement over 7 percent with a minimum 5.6 percent risk-in-force.

[18] *Inside Mortgage Finance*, Mortgage Origination Indicators (as of September 30, 2017).
[19] The National Association of Insurance Commissioners (NAIC) is currently in the process of modifying its *Mortgage Guaranty Insurers Model Act* to revise areas of solvency regulation for mortgage insurers, particularly minimum capital and surplus requirements.
[20] See Fannie Mae, Private Mortgage Insurer Eligibility Requirements (Dec. 21, 2015), available at https://www.fanniemae.com/content/eligibility_information/private-mortgage-insurer-eligibility-requirements.pdf, Freddie Mac, Private Mortgage Insurer Eligibility Requirements (Dec. 21, 2015), available at http://www.freddiemac.com/singlefamily/pdf/PMIERs.pdf. The PMIERs are complemented by the updated MI Master Policy developed in conjunction with FHFA and Enterprises, which was revised to improve clarity regarding policy disputes that sometimes led to coverage rescissions under the prior version.



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The MIs build capital through retained earnings and external investments. This has resulted in over $14B in new capital since 2008.

The recently implemented PMIERs are expressly designed to measure, monitor, and control mortgage insurer counterparty risk by establishing robust standards for the companies' capital levels, business activities, risk management, underwriting practices, quality control, and lender approval and monitoring activities. PMIERs are also updated on a regular basis to address any new concerns that arise in the markets. **The combination of PMIERs and state regulation results in a level of oversight that is unprecedented compared to other GSE counterparties.**

MIs provide both loan level and pool insurance, and both forms of coverage face the same balancing act between achieving sufficient risk sensitivity to make coverage and pricing fair and achieving affordability for the largest possible number of consumers. There is no advantage to pool insurance over loan-level in this regard.

A fundamental rule of risk pooling is that pools should consist of consumers that are similar in risk in order to make the pricing fair and to avoid adverse selection. In addition, the price must be sufficient to provide a return on capital that ensures the coverage will be available from a reasonable number of competitive providers. Greater risk sensitivity in MI capital requirements, particularly in the recently adopted PMIERs capital standards, elicits a response from MI companies to align their pricing with the risk factors that drive the capital requirements. These considerations apply regardless of whether the insurance is being provided on loan-level or a pool-basis, as all U.S. private MI companies have large, well-diversified portfolios of insured loans. This is also not unique to mortgage insurance, but is true of other credit enhancement providers who might provide risk protection at the loan or pool level. Indeed, the current credit risk transfer transactions currently being done on the back-end of the transaction at the GSEs using pooled insurance also price based on risk. And risk-based

[21] U.S. Mortgage Insurers member companies' 2016 annual reports.

pricing is used by nearly every capital markets transaction and private-sector participant, whether it is reinsurance, lender or other credit enhancement providers. USMI member companies do not have a fixed notion of where the balance lies between risk sensitivity and affordability, but we are unique in that we have decades of experience with the problem and solutions. We encourage policymakers to engage with our industry in a conversation about how best to find that balance and implement it in a reformed housing finance system.

Updated Master Polices for MIs

In October 2014, new MI Master Policies went into effect – following substantial input from FHFA – that increase clarity of terms and streamline the payment of claims to ensure that, in the event of borrower defaults, the MI results in reliable and predictable payments. These new policies articulate in much greater detail the conditions, in some cases tied to quantitative thresholds, that must be met before coverage on an insured loan may be rescinded. The new Master Policies ensure timely, consistent and accurate policy and claim administration, creating high visibility and responsiveness for performing loss mitigation (workouts for borrowers who become late on their payments). MIs work with investors and servicers to help homeowners facing foreclosure. The industry's business model aligns with borrowers, investors and servicers to not only help put borrowers into homes, but to keep them there.[22]

The new Master Policies ensure timely, consistent and accurate policy and claim administration, creating high visibility and responsiveness for performing loss mitigation. MIs have the ability to work with distressed borrowers in real time and the industry's business model is built around serving lenders and their customers – incentive alignment to put borrowers in sustainable financial situations.

While MIs have made significant improvements to ensure resiliency going forward, as importantly significant are improvements in origination quality and in lender representations and warranties.

Market/Regulatory Enhancements Post-Crisis		
Qualified Mortgage (QM)	**Representations & Warranties Framework**	**MI Underwriting**
Loan quality has vastly improved, with delinquencies and defects only being 1.01% for Fannie Mae and 0.86% for Freddie Mac[23], representing the overall conventional market. Much of this is the result of enhanced lending standards stemming from the implementation of QM.	FHFA and the GSEs have engaged in a multi-year effort since 2012 to improve the Framework. Prior to this effort, the GSEs had significant discretion to determine whether or not a loan had underwriting defects and what constituted an appropriate remedy for a defective loan.	In addition to higher capital and operational standards through PMIERs and updated Master Policies, MIs have increased their reviews of both their own and delegated underwriting.

[22] Cliff Rossi, Presentation at Mortgage Risk Summit (June 1, 2017).
[23] Fannie Mae Monthly Summary (October 2017) and Freddie Mac Monthly Volume Summary (October 2017).

Principles for Housing Finance Reform—Lessons that Should be Applied to All Market Participants.

The private MI industry does not originate mortgages, set lending standards or establish GSE acceptance criteria for the mortgage market—the MI industry insures high LTV qualifying loans. The government continues to back approximately 75 percent of new mortgages[24], therefore, like other mortgage market players, MIs' primary business (as MIs currently do not do business with FHA or other government agencies) is concentrated within the GSE market and therefore tied to where federal policy and markets dictate lending standards within the conventional market. Leading up to the financial crisis, there was a significant weakening of lending and underwriting standards—first within the private-label securities (PLS) markets and then followed by reduced standards at the GSEs. Through the early-mid 2000s, lax underwriting, imprudent risk taking on the part of borrowers, lenders and investors, and fraud and misrepresentation were rampant. The net result of this was the unprecedented housing collapse that roiled economies across the globe. In the aftermath of the financial crisis, there was as significant of tightening of mortgage credit.

As the country continues to recover from the financial crisis and policymakers look to reform the U.S. housing finance system, it is critical to balance access to affordable mortgage credit with prudent safeguards to ensure that taxpayers are better shielded from housing related credit risks. Comprehensive reform should be consistent with the following principles:

- **Protect Taxpayers:** ***Private capital should absorb all losses in front of any government guaranty – which should be remote and drawn on only in catastrophic scenarios.***
    - Private capital should be the preferred method to minimize taxpayer risk, with an emphasis on the use of loan-level credit enhancement that is well capitalized and available throughout all housing market cycles. It is critical to have sources of private capital committed to the housing finance system that participate in both good and bad times and offers lenders flexibility regarding how they operate their businesses.
    - There should be comparable standards for all forms of credit enhancement, including oversight, regulatory capital, reserves, and leverage and liquidity requirements. This will ensure robust risk management practices and internal controls to support minimizing taxpayers' exposure to mortgage credit risk and will provide a level playing field that does not favor one class of credit enhancers over another.
- **Promote Stability:** ***A goal of the reformed system should be to promote stability.***
    - To foster a stable secondary market across housing market cycles, the federal government should provide an explicit guaranty on qualifying mortgage-backed securities (MBS) but not on the financial institutions issuing or guarantying such MBS. This will protect the integrity of the housing finance system by guaranteeing MBS backed by prudently underwritten mortgages and prevent a return to Too-Big-To-Fail financial institutions.
    - Uniform guardrails across all mortgage lending and insuring channels will promote strong underwriting practices and ensure that taxpayers, borrowers and lenders are

[24] *Inside Mortgage Finance*, Mortgage Origination Indicators (as of September 30, 2017).

appropriately protected from the consequences of mortgage default. The federal government has an important role in formulating mortgage lending and servicing standards across the conventional and government markets to promote stability and responsible behavior by all housing finance system stakeholders.

- **Ensure Accessibility:** ***A reformed system should ensure broad access to mortgage finance for creditworthy borrowers and participation by lenders of all sizes and types.***
    - To ensure that mortgage lenders of all sizes and types in all parts of the country have access to the secondary market, no lender should receive discounts on fees based on volume or market share.
    - The use of loan-level credit enhancement can facilitate access to low down payment lending to creditworthy borrowers, especially when placed on mortgages before they are guaranteed by the federal government. Importantly, loan-level credit enhancement with MI uniquely reduces credit risk without directing mortgage originators to fund their loans in a particular way – whether by deposits, mortgage bonds, private securitization or GSE-guaranteed mortgage-backed securities.
- **Foster Transparency:** ***There should be a consistent, transparent and coordinated approach to the federal government's housing policy.***
    - The government's guaranty on qualifying MBS should be priced in a transparent manner to reflect losses and to fully take into account all of the risk-reducing benefits of MI and other forms of credit enhancement. This includes reforming loan-level price adjustments (LLPAs) – crisis era fees levied by the GSEs based largely on credit score and size of down payment – that are driving up the cost of homeownership. These fees disproportionately harm first-time homebuyers and those without the means for large down payments.
    - Transparency is also essential for the GSEs' (or what replaces their role in a future system) capital framework. Not only will this ensure there is greater visibility and accountability about the mortgage credit risk in the conventional market, but it will also provide insight into the level of capital standing behind that risk. Transparency in this area is essential for informing housing finance reform discussions—including how much private capital should stand in front of the guaranty. Finally, there should be much greater transparency, especially for those taking first loss credit risk positions, in the automatic underwriting systems (AUS) used by the GSEs. This will ensure there is a second pair of eyes in the underwriting process and will serve as a validation for credit risk being assumed and priced.
    - Federal policy should clarify which borrowers should be served by the conventional market and which are better served by government insurance programs. A coordinated policy could address existing regulatory redundancies and significant overlaps in additional to informing how best to facilitate low down payment lending. For example, the use of limits on loan size and/or borrower incomes are effective tools to more clearly define the conventional and government markets and ensure that government insurance programs do not extend beyond their mission borrowers.

How MI is Different from Other Sources of Credit Enhancement—and *Why* Those Differences Matter

While there are several types of credit enhancement, there are important distinctions between private MI and other forms of credit enhancement.

Private MI is time-tested, reliable, ***permanent*** *private capital*

As monoline insurers, MIs are singularly focused on and have deep experience managing mortgage credit risk with the underwriting expertise and operational capabilities to achieve diversification across vintages, geographies, and product types. Unlike other sources of private capital, MIs operate through the economic cycle and exclusively commit their capital to housing finance. While no form of credit enhancement is immune to cyclical pressures, the MI industry has demonstrated its ability, through housing and broader economic cycles, to remain a steady source of credit enhancement for loans acquired and guaranteed by the GSEs. At no point during the industry's 60-year history has the industry ceased writing new business, insuring new mortgages, or paying claims in the event of borrowers defaulting. The industry had three new market entrants during the most recent financial crisis, demonstrating the demand for this form of private capital. In fact, MIs have proven their resiliency during times of economic stress by raising additional capital through the equity, debt, and reinsurance markets—something unique to entity-based credit enhancement that would not be possible for most other forms of credit enhancement structures.

While USMI supports the exploration of additional forms of private capital, including through the use of different credit risk transfer structures, USMI broadly believes that loan-level entity-based credit enhancers such as MI have several advantages for sustaining access to credit and credit protection during all cycles that should be noted. The MI industry is a time-tested reliable GSE counterparty that has weathered several periods of economic stress while still protecting taxpayers and enabling borrowers to access low down payment mortgage credit. New, complex structure-based CRT, however, does not have the track record of MI and other forms of entity-based CRT, and have not been tested during a housing downturn. While these transactions are attractive under current market and housing conditions, they could easily leave the market during times of stress, to the detriment of mortgage credit availability and affordability. MI, unlike CRT structures that do not have operating entities standing behind them, is carried out by monoline insurers that have as their sole business and purpose the assumption of mortgage default risk in *all* market conditions.

Private MI is one of the only forms of CRT that has a business model that makes prudent affordable mortgages accessible

One of the distinguishing features of the MI industry and its products is the simultaneous business of protecting taxpayers *and* helping borrowers access affordable low- down payment mortgage products. The down payment is routinely identified by consumers as the biggest impediment to buying a home and could take a typical family approximately 23 years to save for a 20 percent down payment.[25] Conventional loans with private MI, however, allow borrowers to prudently get into homes with down payments as low as 3 percent and the MI industry has helped more than 25 million families nationally become homeowners over the past 60 years.

MI is a "retail distribution" form of credit enhancement—accessible for borrowers across the country due to the industry's relationships with several thousand originators of all sizes and types, from the biggest money center banks and non-banks to the small community banks, credit unions, and independent mortgage bankers. In addition, MIs' portfolios of products provide for flexible payment options, enabling borrowers to work with their lender to select the most appropriate form of private MI based on their specific needs and financial profiles. The vast majority of policies are borrower-paid mortgage insurance that is temporary, lasting between five and seven years, due to the fact that it generally can be canceled once the borrower has established 20 percent equity in the property or when the principal balance of the mortgage is scheduled to reach 78 percent of the of the property's original value.

Private MI is also unique in its direct interest in ensuring that borrowers have access to workouts, loan modifications, and other remedies should they experience trouble paying their monthly mortgage payment. The business model of private MI works to ensure that Americans have access to both prudent, safe and affordable low-down payment mortgages while offering taxpayer protection in the event that there are borrower defaults.

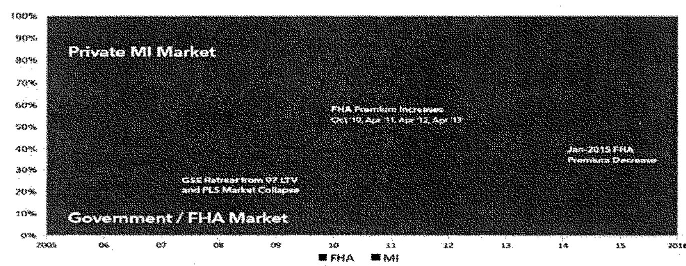
Risk Transfer Type	Stability: Is the form of CRT available at stable pricing through all economic cycles?	Timing: Is credit risk absorbed as part of the form of CRT before loans are purchased by the Enterprise?	Access: Do large and small lenders have systems, processes, and resources to use the form of CRT?	Transparency: Is the cost of the form of CRT published, and is there a direct link to the borrower cost?
STACR / CAS Credit Linked Notes Senior-Sub (Back-End CRT)	-	-	-	-
CIRT / ACIS (Back-End CRT)	-	-	-	-
Collateralized Recourse (Front-End CRT)	-	+	-	-
Deeper MI (Front-End CRT)	+	+	+	+

[25] Based on analysis by U.S. Mortgage Insurers (USMI) using the following data points: median household income (U.S. Census Bureau); median sales price for single-family home (National Association of REALTORS); median of estimated closing costs (Zillow) and average savings rate and ratio dedicated towards mortgage (Federal Reserve).

Recommendations to Increase and Enhance P*ermanent* Private Capital to Stand in Front of an Explicit Government Guaranty

Mortgage markets are cyclical and, while significant improvements have been made to bolster the economy from a future significant housing bubble and bust, it cannot and should not be overlooked that in the future, there will be another downturn.

One of the most important things that federal regulators can do to increase private capital is to establish and implement a coordinated and consistent housing policy. USMI has argued that major housing policy in our nation has been reactive, which has led to inconsistencies and overlaps within the various government agencies that support housing finance in America. USMI continues to call for a coordinated and consistent policy, specifically as it relates to how low-down payment lending is carried out in the United States. Today, instead of having a clear and consistent policy, preferences for low down payment lending are created indirectly through premium rate setting and competition, which results in an unstable policy environment. The resulting outcome is dramatic fluctuations between these mortgage finance markets, which at times is most evident between the private mortgage insurance market and the 100% government-backed mortgage insurance market at FHA, which is held to a much lower financial and operational standard and therefore competes on a completely unlevel playing field. The fluctuations this creates are not the result of FHA serving in a countercyclical role, but the result of undesirable competition between the markets. These fluctuations are not conducive for the most efficient and effective mortgage finance market nor do they ensure that borrowers are being best served. Applying a consistent policy requires two things: 1) a long-term perspective and position on mortgage finance policy that acknowledges the cyclical nature of mortgage credit; and 2) the application of consistent principles across government insurance programs and government instrumentalities in the housing finance system.



Year	2005	06	07	08	09	10	11	12	13	14	15	2016
MI ($B)	184	174	286	190	77	56	70	131	175	169	216	268
FHA ($B)	58	53	68	231	344	282	190	232	212	135	234	256

The Federal Housing Administration (FHA) market share is still above historical levels. This means a larger amount of government and taxpayer funds are backing the mortgage market. As illustrated above, FHA market share is highly sensitive to changes in premiums it charges.

Therefore, one of the most effective means for reducing taxpayer exposure and increasing private capital is to establish a housing policy that promotes private capital ahead of taxpayer risk exposure—including by striking the right balance for taxpayers in establishing complementary roles for FHA and MI.

Federal regulators—not quasi-government agencies or GSEs—should set the comparable standards for participation of all private credit enhancement in the market place. The current structure (including prior to conservatorship) of the GSEs is a system that promotes private sector gains and taxpayer risk exposure and losses. The structure is also flawed in that it establishes a system where two duopolistic government-sponsored enterprises at times compete with the private sector, have increasingly assumed primary market roles and functions, can pick winners and losers within the industry based on differing standards, and also serve as de-facto regulators, often by establishing inconsistent rules and requirements for themselves and for different companies with whom they do business. To prevent these flaws and inconsistencies within the structure going forward, USMI recommends that any guarantor or utility (i.e. whatever replaces the GSEs) should be: 1) highly regulated; 2) unable to set regulations for industry competitors/counterparts; and 3) limited to secondary market functions so as to maintain and strengthen the "bright line" between the primary and secondary mortgage markets. The federal regulator with oversight of the GSEs, or their successor entities, should establish comparable, rules and requirements for different market participants who take the same credit risk, that are evenly applied to prevent market arbitrage and to ensure a level playing field. Finally, the GSEs, or their successor entities, should be subject to the same rules and requirements, if not higher, than other counterparties.

The level of permanent private capital should be explicit in statute. As previously stated, while reforms in the mortgage finance system should make future downturns in housing less severe and the system generally more resilient, there *will* be another downturn. Therefore, it is essential that Congress require that there be an explicit amount of permanent private capital available to stand in front of any government catastrophic guaranty. In 1970, Congress required the GSEs obtain credit enhancement on low down payment mortgages (those with LTVs > 80 percent) to protect the government sponsored entities from the risks posed in the high LTV space. While this has proven to be essential protection, it is critical that, with the stated bipartisan desire to have more private capital in a first loss position, that protection also be required. It should also be *permanent* capital—capital that is available to cover losses even during the most stressed economic environments and that will also be available to provide additional protection (such as when MIs write new insurance) during all economic cycles. During the recent financial crisis, private MI was one of the only sources of available capital in the market that was able to not only pay claims, but also to write new insurance to ensure individuals were able to get mortgage finance, even at the height of the crisis.

USMI has continually suggested that there is an important role for the new credit risk transfer partners and transaction types that the GSEs have experimented with over the last several years. However, it is important to note for any credit enhancement or CRT to have real value, it must be a ***reliable*** source of loss absorption when needed, ahead of the Enterprises and taxpayers, and it must be consistently ***available*** as a form of risk transfer, including during volatile mortgage credit markets. The reliability of a form of CRT in providing loss absorption can be enhanced through structural mechanisms such as collateral, segregated accounts, asset requirements, and counterparty financial and operational reviews. The availability, on the other hand, is not as readily enhanced, especially where the CRT is provided in the form of structured transactions that depend on market receptivity at particular points in time.

In contrast, CRT is likely to be more consistently available when provided by entities that are focused on mortgage finance, have a long-term interest in CRT and depend on their reputation as reliable counterparties in the housing industry. Mortgage insurers have such a long-term, reputational interest. They are dedicated exclusively to providing credit loss protection on residential mortgages, most commonly on a loan-level basis upon origination, and they specialize in residential mortgage credit risk. Expanding the proportional use of MI-based CRT will enhance the overall availability of CRT to the Enterprises and therefore contribute significantly to market stability.

Gains that have been made in protecting consumers and the markets, should not be lost. In response to the Great Recession, Congress and the industry made a number of improvements to prevent consumers from being over exposed to mortgage credit and also to reduce mortgage fraud, misrepresentation and abuse. Some of this was accomplished through reforms such as the qualified mortgage (QM) rule. Mortgages with any government backstop should have clear standards – set by a federal regulator and applicable across entities and government agencies—to ensure consumer safety and to safeguard the financial system. The safeguards that came into the marketplace for borrowers, lenders, investors, and ultimately taxpayers with the implementation of the QM standard have been helpful in improving the credit quality of the housing market in the United States. Safe and prudent lending standards must remain in intact throughout the system to avoid another housing crisis, though we must also ensure affordable mortgages don't become out of reach for creditworthy borrowers. This balance is achievable and must be struck.

Looking Ahead: Making a Stronger Tomorrow for Housing

To summarize, as Congress debates the many complex issues around the different important elements of housing finance, we are encouraged that there continues to be strong bipartisan support in the House and Senate for increasing private capital ahead of government and taxpayer risk exposure.

I am very proud to represent an industry that for the last 60 years has provided substantial private capital in front of a government guaranty, has never left the market place, and has helped millions of people to become homeowners. USMI strongly believes that the reform efforts this committee is undertaking are critical and we believe much more can be done to reduce the risk to the federal government and make taxpayer risk exposure even more remote including:

- Increasing *permanent* private capital ahead of government and taxpayer risk exposure and;
- Encouraging a coordinated and consistent housing policy that prefers private capital ahead of government exposure, including reducing the FHA's footprint so

that it can more effectively focus on the borrowers that need the government's support the most.

We appreciate the opportunity to bring our experience and recommendations for putting the country's housing finance system on more stable footing. I look forward to answering your questions.

"CREDIT RISK TRANSFER AND THE SUSTAINABILITY OF HOUSING FINANCE"

Testimony prepared for

"SUSTAINABLE HOUSING FINANCE: PRIVATE SECTOR PERSPECTIVES ON HOUSING FINANCE REFORM – PART IV"

ON

DECEMBER 6, 2017

BEFORE THE

SUBCOMMITTEE ON HOUSING AND INSURANCE

U.S. HOUSE OF REPRESENTATIVES

WRITTEN TESTIMONY

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Chairman Duffy, Ranking Member Cleaver, and other distinguished members of the Subcommittee:

Thank you for the invitation to testify at today's hearing on "sustainable housing finance: private sector perspectives on housing finance reform." I am the Sussman Professor of Real Estate and Professor of Finance at The Wharton School of the University of Pennsylvania. Together with co-authors, I have researched and written scholarly papers on the stability of the housing finance system. Recent papers, from which this testimony is drawn, are listed at the end of this statement. It is an honor to be here today to discuss the future of the housing finance system and the role of credit risk transfers in helping to assure a stable and sustainable housing finance system going forward.

The housing finance system failed borrowers and taxpayers and it is important to understand why. We know now but did not know in real time the shift toward unsound lending. The bubble in housing prices that the expansion of unsound credit enabled masked the increase in credit risk. The failure to identify credit and systemic risk must be corrected going forward. Credit risk transfer programs, if properly structured, can help.

The global financial crisis began a decade ago with the Panic of 2007. Prior to this, credit markets' pricing gave no indication of increased risk. Rising house prices censored the underlying credit risk. Housing markets are prone to bubbles. Optimistic buyers, subject to "bubble thinking," determine real estate prices, even if prices exceed fundamental values, as long as they can access credit. Unlike in other asset markets, in housing markets, short-sellers cannot counter optimist buyers. In this way housing markets are incomplete.

Securities trading, however, can discourage excessive borrowing if credit risk is priced accurately and in this way counter housing bubbles. Securitization markets, including the over the counter market for residential mortgage backed securities, however, failed at this in the run-up to the crisis. Mortgage backed securities traded infrequently and a lack of information on credit conditions misinformed markets.

Beginning in 2013, under the direction of FHFA, the GSEs have developed Credit Risk Transfers (CRTs) to share and trade credit risk. How these CRTs are structured matters greatly to their potential role in reducing endogenous systemic risk. In addition, the eventual reform of the housing finance system will influence how well the CRT markets work or even whether the market can work at all.

What is necessary for the structuring of Credit Risk Transfers, and, more generally, for the restructuring of the GSEs to enable the CRT market to inform on credit risk going forward?

A first requirement is the direct linkage of CRTs' performance to the risk of the default of the underlying mortgages, with credit losses born by CRTs, tied to specific portfolios of GSE loans whose characteristics are known, tracked and available to investors—an important contrast from the earlier MBS. This is in place. In addition, the use of a reference pool, allows the so-called TBA market to trade and price efficiently interest rate risk.

A second requirement, to avoid the pitfalls of the past mispricing of credit risk, is standardization to allow the identification of aggregate credit risk. The full provision of information on the mortgages in the GSE portfolios referenced by CRTs does this as well (along with information on portfolio lending and other sources of mortgage finance).

Third, to avoid counterparty risk, credit risk transfers must be structured so that the in the event of losses, funds are transferred automatically. This is achieved, in so-called back end credit risk transfers, by writing down the outstanding principal balance of the CRT securities, thereby reducing the amount that the GSEs are obligated to repay to holders of CRT securities, offsetting credit losses on the related loans. The GSEs reduce the amount they pay on the CRT securities by the amount of losses on the loans so there is no counterparty risk for the credit risk transfer, as there would be in an insurance or reinsurance transaction for a third party. Counterparty risk is eliminated in the structuring of the so-called back-end credit risk transfer program.

Fourth, there needs to be trading of the credit risk instruments with open pricing in liquid markets, unlike in the crisis, where credit risk instruments traded over the counter. This too is in place.

Currently CRTs provide information on how markets price credit risk without mandatory linking of guarantee fees (g fees) to CRT pricing and without mandating the level of use of CRTs by the GSEs. Both are important to market stability.

While the performance of CRTs should be linked the underlying performance of mortgages in the reference pool, as it currently is in back-end credit risk transfers, the pricing of CRTs should not determine g fees or mortgage interest rates.

While it is important to take into account market information in a build up to a crisis, , in a period of market stress, investors in CRTs are likely to pull back; if so, nothing would prevent the collapse of housing credit and the follow-on implosion of housing prices. The discretionary setting of G fees over the cycle is necessary to limit pro-cyclicality and avoid reintroducing market instability. (G fee, or guarantee fee, is the fee retained by the GSEs from the payments received on mortgages as compensation for guaranteeing the timely payment of principle and interest on the MBS that Fannie and Freddie issue). For the same reason, the use of CRT should not be mandated—that is, it should be discretionary. Mandatory risk sharing is an inefficient policy as it encourages transactions where the cost of the risk transfer is greater than the cost of the GSE retaining the risk and thus raises the cost of mortgage lending.

Currently the trading of CRTs provides information about what private capital markets would charge for the credit risk generated by the credit guarantee business of the GSEs (as well as sharing that risk) but is not automatically linked to G fees. The G fee is set administratively, with significant guidance from the FHFA and CRT does not directly impact the setting of g fees or mortgage rates. This should not change.

The structure of the housing finance system itself is important to the functioning of credit risk transfer markets. If there are many guarantors or credit enhancers, each with its own CRT market, such markets will not be liquid. Moreover, with many entities each setting its own standards and its own pricing or g fees, even with the guidance of FHFA; there would be a tendency to compete over these standards and undermine them over time. Nor would the pricing and the risk this entails be fully reflected in the pricing of that firms' CRTs as this would raise prices throughout the market, and impact market risk accordingly. Similarly, CRTs are not a substitute for equity capital, that is, internal capital that the regulator can require for the long run.

The pricing of housing finance should be set over the cycle and standards should be maintained over the cycle as well to limit risk and to provide sustainable housing finance for the long term.

I thank you for the opportunity to testify today and I welcome your questions.

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Questions for the Record
Congresswoman Joyce Beatty (OH-03)
Financial Services Committee Hearing, Housing and Insurance Subcommittee, December 6, 2017
"Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform – Part IV"

Question #1

This question is for Ms. Wachter.

In your testimony you state that mandatory risk sharing is an inefficient policy as it encourages transactions where the cost of the risk transfer is greater than the cost of the GSE retaining the risk and thereby raising the cost of mortgage lending.

Ideally, we want to encourage our future housing finance system and GSEs to shed risk when possible.

If there were proposals to mandate risk sharing, would you suggest that we at least add language to mandate risk sharing to the extent it is cost effective? YES I WOULD SUGGEST THAT IN THIS CASE LANGUAGE BE ADDED THAT THE MANDATE WAS TO THE EXTENT THIS IS COST EFFECTIVE. THANK YOU.

To: Andrew Rippert, Chief Executive Officer, Global Mortgage Group, Arch Capital Group, Ltd.

From: Representative Nydia Velazquez (NY-7)

Hearing Date: Wednesday, December 6, 2017

Hearing Title: Housing and Insurance Subcommittee Hearing entitled: "Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform, Part IV"

Mr. Rippert, a strong and well-functioning secondary market should encourage lending to all income levels and communities. What can we do to ensure that private investors continue to invest in the secondary market? Will credit risk transfer help first time or lower income borrowers?

I believe that the best way to ensure access to affordable, responsible lending for first-time and lower income borrowers is a system that has three basic components.

The first component is encouraging financial literacy and education to help inform and prepare borrowers for the responsibilities of homeownership before they enter in to a mortgage loan. For instance, Arch MI administers a program – Roadmap to Homeownership – that provides current and prospective borrowers with a toolkit explaining the process, benefits, and financial implications of homeownership, as well as a set of mortgage insurance solutions to help borrowers qualify, and other additional resources.

Second, I believe that reasonable product guidelines should be put in place to ensure responsible lending and avoid the predatory products, such as teaser rate loans, that contributed to the financial crisis and led to devastating consequences for borrowers and families.

Finally, I believe the mortgage industry needs to carefully analyze not only borrower characteristics, but also market characteristics. Arch's analysis demonstrates that extending mortgage credit to borrowers in markets where housing prices are over-inflated relative to the economic fundamentals of the region can dramatically increase borrowers' propensity to experience financial stress, which can lead them to default on their mortgage payments when the market corrects. It's intuitive that when mortgage pricing fails to take account of overheated markets, borrowers wind up overpaying for their homes. Often, this phenomenon disproportionately impacts lower-income and lower-wealth borrowers who, under loose credit conditions, are only extended affordable credit when the market is at or near its peak. This can (and did) result in lower-income borrowers paying too much for their homes, only to be turned out of them and have their wealth destroyed during the downturn. This has devastating effects even across generations.

Arch itself uses credit risk transfer (CRT) to inform our assessment of market risk, believing that risk syndication and price discovery are fundamental risk management tools necessary to weather the market's cyclical nature.

It is in Arch's interest – and that of most others in the homeownership business we believe – to maximize the number of Americans who can achieve sustainable homeownership through all market cycles. To achieve this, market participants need to spend more time analyzing market risk characteristics to ensure we aren't setting borrowers up for failure by encouraging hard-working people to take on excessive risks. Requiring regular, programmatic CRT is critical to supplying policymakers, market participants, and, most importantly, consumers, with the information necessary to make fully-informed decisions and ultimately increase the number of lower-income, creditworthy borrowers who can sustain homeownership over the long-run through multiple credit cycles.

<u>Congresswoman Joyce Beatty's Question to Patrick Sinks, CEO of MGIC</u>

<u>Question #2:</u>

This question is for Mr. Sinks.

Your organization, the U.S. Mortgage Insurers, released a study in October 2015, conducted by Milliman, Inc, entitled "Analysis of Deep Coverage Mortgage Insurance," which found that covering additional mortgage credit risk with mortgage insurance "reduces borrower costs by an average of $8 per month or approximately $2,300 over the average life of the loan."

While I can appreciate lower prices for consumers, one of the frequent criticisms of Deep Coverage Mortgage Insurance is that it will lead to reduced access to credit, specifically for lower income and lower credit score borrowers.

How would you respond to that criticism?

<u>PATRICK SINKS RESPONSE TO CONGRESSWOMAN JOYCE BEATTY:</u>

Congresswoman Beatty, thank you for this question. Private mortgage insurance (MI) has existed for 60 years with a singular focus—enabling individuals who are unable to make a down payment of 20 percent (and thus viewed as higher risk borrowers by lenders) prudently qualify for a conventional loan sooner than they otherwise may be able to by reducing the risk of their loans. In 2017 alone, private mortgage insurance helped approximately one million people purchase or refinance their mortgage. Over half of these borrowers were first time homebuyers and more than 40 percent of these borrowers had incomes of $75,000 or less.

As Congress and the Administration consider ways to prevent another taxpayer bailout of the GSEs as was done in 2008, there has been broad bipartisan support for increasing private capital ahead of taxpayer mortgage credit risk exposure. In 2015 USMI commissioned Milliman, Inc., an independent consulting and actuarial firm, to conduct a third-party study of a proposal to deepen private MI to 50% of the value of the loan. Among the key findings of the "Analysis of Deep Coverage Mortgage Insurance," prepared by Milliman, Inc., covering additional mortgage credit risk with MI:

1. Almost doubles the amount of loss protection afforded to the GSEs;
2. Would allow the GSEs to reduce their committed capital for this risk by approximately 75 percent, resulting in lower GSE guarantee fees (G-Fees); and
3. Reduces borrower costs by an average of $8 per month or approximately $2,300 over the average life of the loan.

One of the distinguishing features of the MI industry and its products is the simultaneous business of protecting taxpayers *and* helping borrowers access affordable low- down payment mortgage products. Private MI is the only time-tested form of CRT specifically focused on borrowers who have limited means for a down payment. As stated in my testimony, the down payment is routinely identified by consumers as the biggest impediment to buying a home and could take a typical family approximately 23 years to save for a 20 percent down payment.[1] Conventional loans with private MI, however, allow borrowers to prudently get into homes with down payments as low as 3 percent and the MI industry has helped more than 25 million families nationally become homeowners over the past 60 years. In addition, MIs' portfolios of products provide for flexible payment options, enabling borrowers to work with their lender to select the most appropriate form of private MI based on their specific needs and financial profiles. Private MI draws on decades of experience to balance the need for cross- subsidization and risk-sensitive pricing to provide competitive pricing through a greater variety of premium plans that include advantageous characteristics such as cancellation when the mortgage insurance is no longer necessary[2].

To be sure, private MI plays a very important role in the housing finance system, allowing many creditworthy borrowers to access affordable mortgage finance credit through the conventional market. In a recent report released by Urban Institute, Urban notes that, "within the conventional space, GSE borrowers with PMI tend to have higher [loan-to-value] ratios, lower credit scores and higher DTI ratios than GSE borrowers without PMI. These findings suggest that the presence of PMI makes it easier for creditworthy borrowers to access conventional credit."[3]

Private MI is one of the only forms of CRT that has a business model that makes prudent ***affordable*** *mortgages accessible.* I very much appreciate the opportunity to respond to this question and would be happy to provide any further information to you and your office if helpful.

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[1] Based on analysis by U.S. Mortgage Insurers (USMI) using the following data points: median household income (U.S. Census Bureau); median sales price for single-family home (National Association of REALTORS); median of estimated closing costs (Zillow) and average savings rate and ratio dedicated towards mortgage (Federal Reserve).

[2] For borrower paid private MI, insurance is cancelled when the borrower reaches 78% of the value of the loan according to HOEPA (1998)

[3] Urban Institute, *Sixty Years of Private Mortgage Insurance in the United States* (August 22, 2017).