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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

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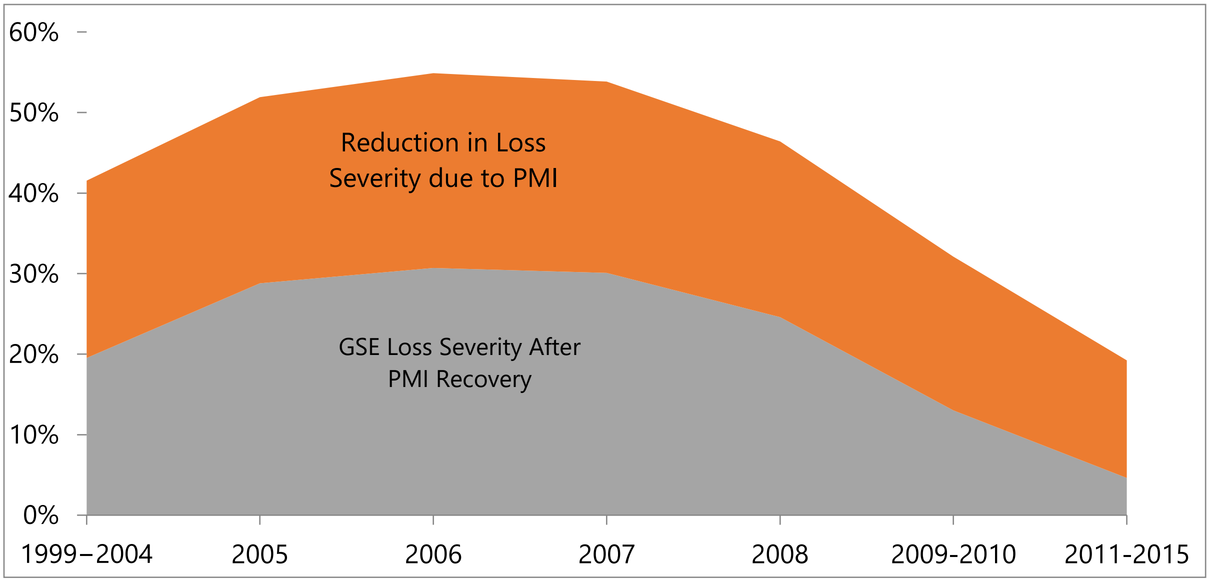
[11] Mortgage insurance reduces the regulatory capital required for depository financial institution from 8% to 4% for conforming and jumbo mortgage loans at or above 90 LTV.

[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]

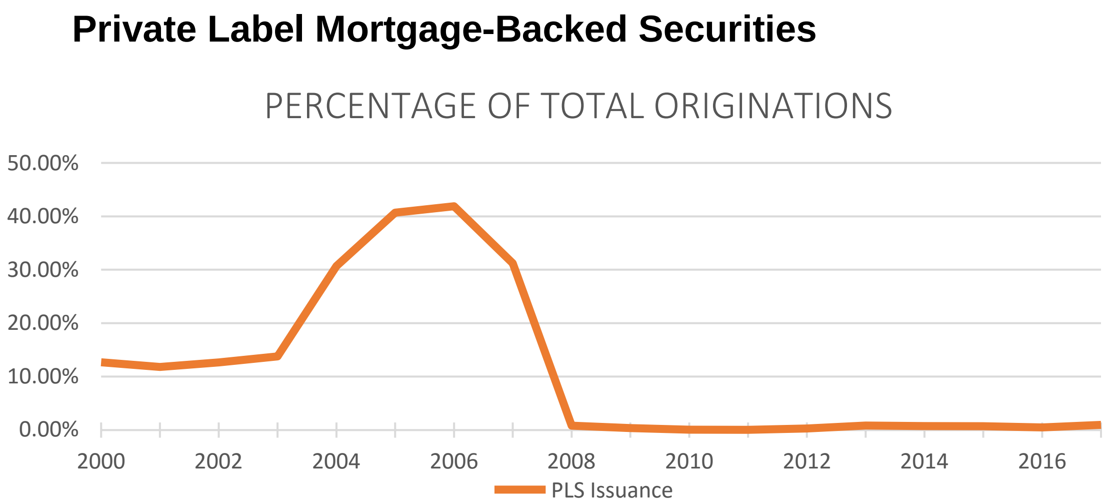
GSE Repurchases	FHA	PLS Suits	Fees & Damages	Ongoing Legal Damages
Since 2009, GSE repurchases accounted for nearly $78 billion. According to some reports, 4,200 sellers and originators were subject to repurchase demands over time.[14]	Under the False Claims Act, the Department of Justice recovered more 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 <u>permanent</u> 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.*** <u>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.</u> 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] 1 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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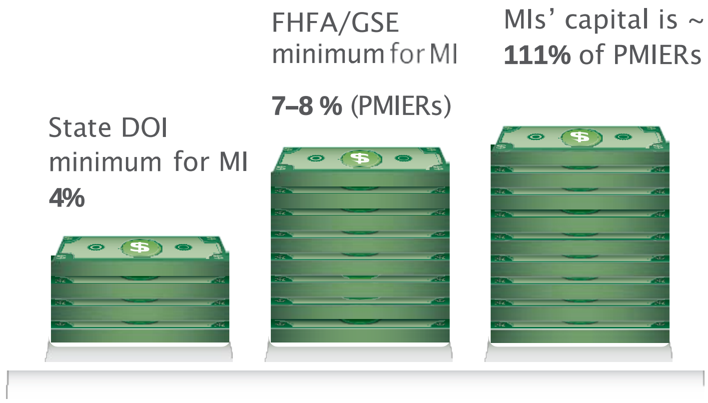
Key Improvements to the Industry to Make It More Resilient Going Forward

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.

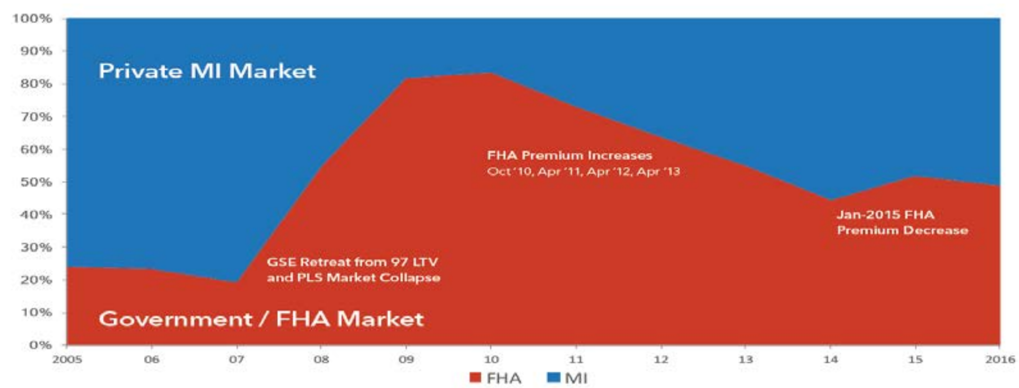
Risk Transfer Type	Stability: Is the form of CRT available at stable pricing through all economic cycles?	Timing: Is credit risk absorbed as part of the form of CRT before loans are purchased by the Enterprise?	Access: Do large and small lenders have systems, processes, and resources to use the form 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.