THE FUTURE OF HOUSING FINANCE: THE ROLE OF PRIVATE MORTGAGE INSURANCE

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

JULY 29, 2010

Printed for the use of the Committee on Financial Services

Serial No. 111–149

U.S. GOVERNMENT PRINTING OFFICE

61–853 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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THE FUTURE OF HOUSING FINANCE: THE ROLE OF PRIVATE MORTGAGE INSURANCE

Thursday, July 29, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Members present: Representatives Kanjorski, Sherman, Hinojosa, McCarthy of New York, Baca, Miller of North Carolina, Scott, Perlmutter, Donnelly, Adler; Garrett, Manzullo, Biggert, Capito, Hensarling, Neugebauer, Posey, and Jenkins.

Chairman KANJORSKI. This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will come to order. Without objection, all members' opening statements will be made a part of the record.

We meet today to continue our hearings about the future of housing finance. As we work to reform this complex system, we must learn more about private mortgage insurance and determine whether to make changes related to this product. We will therefore examine the structure, regulation, obligations, and performance of mortgage insurers.

Since its creation more than a century ago, private mortgage insurance has, without question, allowed countless families to achieve the American dream of homeownership. It has also worked to safeguard taxpayers by providing a first layer of protection against foreclosure losses for lenders and for mortgages securitized by Fannie Mae and Freddie Mac.

Over the years, the industry has had to respond to significant economic changes. During the Great Depression, inadequate capital reserves and an inordinate amount of mortgage defaults drove every mortgage insurer into bankruptcy. As a result, the private mortgage insurance industry disappeared for more than 2 decades.

Many, including me, feared the recent collapse of the housing bubble could produce a similar result. For a while, the industry teetered on the brink of extinction. Some mortgage insurers also sought, but never received, direct TARP assistance.

We had good reason to worry. Historically, about 4 percent of mortgages guaranteed by mortgage insurers go into default in an average year. During this crisis however, approximately one in three mortgages made in 2006 and 2007 and insured by mortgage insurers are expected to go into foreclosure over the life of the loan. As a result, some estimate the industry will lose between $35 billion and $50 billion when all is said and done.

Nevertheless, it appears the industry will survive because of some economic luck, many regulatory waivers, and its distinctive capital structure. In particular, mortgage insurers maintain contingency reserves of 50 cents on every premium dollar earned for 10 years. Thus, they build up capital in good times in order to pay out claims in rocky financial periods.

While these countercyclical reserves are unique to the mortgage insurance industry, they provide an important model for Congress to consider in reforming the structure of the housing finance system. If Fannie Mae and Freddie Mac had held similar reserves, both Enterprises may have weathered the recent financial hurricane much better.

Still, the industry's performance has been far from perfect during this crisis. Some have questioned whether mortgage insurers held enough capital. Because they had to seek regulatory forbearance and curtail underwriting, this reduction in new business has probably slowed the recovery of our housing markets.

Others have raised concerns about whether mortgage insurers have increased the government's cost related to the conservatorship of the Enterprises. Specifically, mortgage insurers only pay claims on foreclosed homes. They have no affirmative obligation to prevent foreclosures. As a result, Fannie Mae and Freddie Mac, rather than mortgage insurers, have often had to bear the financial losses related to loan modifications. Mortgage insurers exist to provide the first level of protection against losses and should not evade their responsibilities by contractual technicalities. We must review this arrangement.

We also need to explore the present credit enhancement requirements under the charters of Fannie Mae and Freddie Mac. While the standard U.S. mortgage insurance policy indemnifies against losses created by a default in an amount equal to the first 20 to 30 percent of the lost loan principal, an Australian policy covers 100 percent of the home loan amount.

Additionally, we should examine the consumer protection issues, the State regulation of the industry, and its indirect Federal regulation. The problems of Fannie Mae and Freddie Mac resulted, in part, from the competing mandates of two regulators. As we reform our housing finance system, we may therefore want to streamline the oversight of mortgage insurers.

In sum, all options for reforming our housing finance system are on the table, including those related to private mortgage insurance. I anticipate a fruitful and productive discussion around these and other issues today.

I now recognize the gentleman from New Jersey for 4 minutes.

Mr. GARRETT. I thank the Chair and I thank the witnesses. And I thank the Chair for holding this important hearing on the PMI, or the private mortgage insurance industry. Now, unfortunately, because of the current Federal Government policies, their role right now is very limited, almost nonexistent.

If I could direct your attention, following yesterday's chart, to the chart over here, this chart illustrates the percentage amount of new high loan to value, or LTV, loans that PMI writes and the percentage that the government backs. Currently, the Federal Government, as you see in the chart there, which you can say is the taxpayer, is underwriting 99 percent of every high LTV mortgage through FHA and GSEs. And so, this level of taxpayer support for the mortgage market, you must admit, is completely unsustainable and also unwise.

We constantly hear that the government has to play this large role because the private sector is unable or maybe unwilling to reenter the market and provide the needed capital. But if you look at the details, you will see that is false. Over the last 2 years, private mortgage insurance companies have raised roughly $7.5 billion in new capital that could support $260 billion in new high LTV loans. However, the current marketplace only allows the PMI industry to support between maybe $40 billion or $50 billion of such loans.

So what are some of the specific factors preventing more private capital from returning to the mortgage market through the private insurance? First are the changes in the loan limits for FHA that were made during the financial crisis.

So if I could now direct your attention to my second chart, you will see that, before the crisis, the GSE loan limits were $417,000 and the FHA loan limits varied from 48 percent to 87 percent of the GSE limits based on the area median price. Now, after the changes, the FHA loan limits vary from 65 to 175 percent of that $417,000 house price number. So most of the attention in the debate over loan limits centers on the top-line limit in the high-cost areas, as you see on the chart there.

Now, while that is important, it is not the only area where the private market is being basically squeezed out. And as you can see on the chart, down there at the bottom, the changes that were made essentially increase the loan limits for the FHA in the lower-cost areas, as well. What does this mean? This means that in areas where housing is less expensive, say in Nebraska, where the average median home price is $150,000, the FHA can insure loans up to $271,000. And that is almost 100 percent more than the average price in that low-cost area.

So you have to ask yourself, why should the taxpayer be insuring mortgages that are almost double the average median home price in those lower-cost areas? And this is after mortgage prices have, I would just note, declined by 30 percent over the last 3 years. This area is prime territory for PMI to become more active while we roll back the taxpayers' support and liability.

Another way that the government is prohibiting the return of private capital to our mortgage market is a rule instituted by the Federal Housing Finance Agency, and that is the loan level price adjustment. You see, when these fees were implemented, it was a turbulent time in the economy when housing prices were declining, particularly in distressed areas. However, it is 2 years later now, and we are seeing some encouraging signs that house prices are stabilizing, in addition to the fact that loans are being originated today at full documentation, amortized, and being prudentially underwritten.

What I have been told is that Fannie and Freddie are not reserving these fees, so they are not providing any additional stabilizing effect. And I think these fees need to be given more attention, and Congress should more closely examine how these fees are pushing more people to FHA loans and away from conventional mortgages.

Finally, just 2 months ago, Treasury Secretary Geithner told Congress, "The government's role in the housing finance system and level of direct involvement would change," and that, "The Administration is committed to encouraging private capital to return to the housing market." However, as you can see from my first chart, if he and President Obama are serious about restoring the housing market and relieving the taxpayer of the risk—and that is a pretty big risk, all the blue area—they must return to traditional and more responsible methods of financing.

The current loan limits, coupled with new and arbitrary fees by the GSEs make it impossible for the private capital to compete in the market. And this is exactly the opposite of what we want. The government has created a perverse incentive to provide private capital from being used in this market and relieve some of the burdens.

So, Mr. Chairman, if we don't make changes, the FHA and GSEs will continuing to service a radically disproportionate share of the market, and they will collapse under their own weight, and we will face another taxpayer bailout from the GSEs and FHA. We need to shift the burden of mortgage finance off the backs of the American taxpayer and back onto the private investor.

With that, I thank you, Mr. Chairman.

Chairman KANJORSKI. The gentleman's time has expired.

We now recognize the gentleman from California, Mr. Sherman, for 3 minutes.

Mr. SHERMAN. Thank you, Mr. Chairman.

First, I should congratulate the survivors. To think that you could be in the business of insuring real estate loans in America at this time and still be here shows, as I think the chairman pointed out, perhaps some luck, but it also shows that both the regulators of the industry and the participants in it were prepared for the thousand-year flood. Very few other entities in our country are prepared for the thousand-year flood or even the hundred-year flood.

Right now, the taxpayers are involved in the real estate market to a greater degree than in the past. Taxpayers are, therefore, taking an extraordinary percentage of the risk. I look forward to returning to a more traditional level of taxpayer involvement.

And while I don't think that we can return to 2007, in terms of who can get some sort of mortgage, we don't want to return to 1920 either. And so, as the taxpayers play less of a role in absorbing the risk, we don't want to say, as in some European countries, "Wait till you have a 40 percent downpayment, and then you can buy a home." Therefore, there is a need for a robust private mortgage insurance industry.

One way to make sure that it is robust is to turn to the financial regulatory reform bill, where we require that the securitizer retain, I believe it is 5 percent, of the risk in that pool, unless the pool consists of plain vanilla, safe, not-risky, not-possibly-risky mortgages.

Regulations have to be written that define what is "plain vanilla." I suggest that plain vanilla includes both American vanilla and French vanilla—that is to say, that it includes not only mortgages which by themselves meet the criteria, but mortgages that meet the criteria of low risk to the investors when one factors in the fact that private mortgage insurance applies to some or all of the loans in that pool.

To do otherwise would be to ignore economic reality, but, worse than that, it would be to deny a route to homeownership that does not put the taxpayer at risk. And certainly, we want the lowest possible taxpayer risk with the best possible opportunities for people to acquire a home.

I yield back.

Chairman KANJORSKI. The gentleman's time has expired.

We will now hear from the gentlelady from West Virginia, Ms. Capito, for 2 minutes.

Mrs. CAPITO. Thank you.

I would like to thank Chairman Kanjorski and Ranking Member Garrett for holding this hearing today. I look forward to hearing from our witnesses on the current status of private mortgage insurance and how we can work together to get a more vibrant private mortgage market, or to restore one, in any event.

As my colleagues know, over the last few years, the Federal Housing Administration has dominated the residential mortgage market, providing federally backed mortgage insurance to borrowers. While FHA does have a role to play in the market, I am very concerned—we have had hearings, and I have made numerous statements about my concern over this recent expansion in market share, especially when the FHA is struggling financially. In order to have a healthy residential mortgage market, we must reduce FHA's market share and restore the private market.

Earlier this year, the House passed much-needed FHA reform legislation that I believe will make significant improvements to the FHA program. While more reform may be needed, the legislation that we authored will give the FHA the ability to charge higher premiums. And this is important not only for the health of the FHA capital reserve fund, but it could also have the effect of leveling the playing field between FHA and the private mortgage insurance industry.

I also have concerns with sections of the recently adopted Dodd-Frank financial reform bill and the effect it will have on the return of the private mortgage market. Included in this large package is a section requiring risk retention for mortgages but an exemption from this requirement for FHA mortgages. I was able to insert an amendment that will study the effect of this dichotomy and what effect it would have on the private mortgage market. I look forward to seeing these results to see if there is an unfair advantage for FHA and to level that playing field.

Again, thank you, Mr. Chairman, for the hearing, and I look forward to the witnesses' testimony.

Chairman KANJORSKI. I thank the gentlelady from West Virginia.

And now, we will hear from the gentleman from Georgia for 2 minutes, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

It is difficult to deny that the American dream remains today to own a home. That is the American dream. However, once that goal is achieved, it has become increasingly harder for some Americans to hold on to their homes and avoid foreclosure. Indeed, right now, as we speak, the foreclosure pipeline is full and getting overflowing.

More access to mortgages, and thus homeownership, often coming to fruition due to use of private mortgage insurance is, ideally, a positive aspect of the current system. However, with job instability and unemployment rates reaching over 10 percent in much of the country, many Americans are finding it difficult to hold on to their homes despite their initial success.

And when a homebuyer has less than 20 percent as a downpayment for their home, they are required to purchase a PMI policy, private mortgage insurance. This permits an individual the ability to afford a home who otherwise could not purchase a home. However, the use of subprime mortgages and jumbo loans contains obvious risk, namely traditionally higher default rates. And about a third of the mortgages made in 2006–2007 and insured by PMI's providers are expected to go into foreclosure during the life of the loan.

We need to ensure that risky mortgages that are unsafe to potential lenders are avoided. The American dream of owning a home is something that I hope most Americans will certainly someday see fulfilled, but without the excessive risk that come with the use of certain PMIs. I hope to learn more about what PMIs are doing to reduce mortgage defaults and to protect potential homeowners.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much.

We will now hear from the gentleman from Texas, Mr. Hensarling, for 3 minutes.

Mr. HENSARLING. I thank you, Mr. Chairman.

Private mortgage insurance is clearly a rarity in our mortgage market: a private-sector solution for a private-sector challenge that, number one, actually worked, seemingly free of Federal handouts, bailouts, and also an industry that survived this market turmoil in relatively good shape, and also—I don't know how—it managed to survive competition with the GSE oligopoly.

It seems like ancient history now, but there was a time, very recently in America's history, where one could actually get a mortgage on a home without having to go through their Federal Government. But now we know that Fannie and Freddie, which were left untouched, if nothing else, affirmed in the recent Dodd-Frank financial regulatory bill, now control roughly three-quarters of the new loan originations. FHA, whose own capital reserve losses are currently 75 percent below its statutory minimum, has roughly 20 percent of the market. We don't need to have a Ph.D. in economics to know that this is neither healthy nor sustainable.

Again, private mortgage insurance has been an exception to the rule. It has been a very valuable, consumer-friendly, private-capital-backed tool, sold in a competitive market, that allows Americans to buy a home, and keep a home, without exposing taxpayers to risk. And this is a market, I think, that we would want to see flourish.

Again, it appears, relatively speaking, to have weathered the recent economic crisis well. And, as I said earlier, these companies did not succumb to the temptation to take TARP money, bailout money from the Federal Government. And, in fact, we see that this is an industry that is back to raising capital in the private market, showing again that private-sector competition can work if we allow it to work.

But, clearly, the private mortgage insurance market faces challenges. They were articulated very well by our ranking member from New Jersey. And so I continue to lament and decry the fact that this committee has yet to take up any type of reform of Fannie and Freddie, notwithstanding the fact that we have $150 billion of taxpayer-spent money, trillions of dollars of exposure. They continued to flourish, and yet we need this market to flourish.

There is an old saying, "If it ain't broke, don't fix it." Please don't bail it out; just let freedom work and allow this market to flourish.

I yield back.

Chairman KANJORSKI. Thank you very much.

We will now go to our panel.

Thank you very much for being present today. And, without objection, your written statements will be made a part of the record. You will each be recognized for a 5-minute summary of your testimony.

Our first witness will be Mr. Patrick Sinks, president and chief operating officer of the Mortgage Guaranty Insurance Corporation, testifying on behalf of the Mortgage Insurance Companies of America.

And I would like every panelist to respond to Mr. Hensarling's opening remarks. Is there no further need for a secondary market? Shall we just allow the existence of financing of mortgages to be made in the tradition prior to the 1929 crash? If you could give that answer, it would be very helpful, because we are certainly thinking about that.

So, Mr. Sinks, start off, if you will.

And I would like to hear this panel say that the government should get out of supporting the secondary market and probably do away with any involvement in the mortgage market other than you folks doing it all in the private sector. That would be a welcome relief for me, because I anticipate it would probably save me the next 2 years of my life.

STATEMENT OF PATRICK SINKS, PRESIDENT AND CHIEF OPERATING OFFICER, MORTGAGE GUARANTY INSURANCE CORPORATION, ON BEHALF OF THE MORTGAGE INSURANCE COMPANIES OF AMERICA

Mr. SINKS. Let me go with my prepared remarks, and I will get to answering your question.

First, thank you, Mr. Chairman, and Ranking Member Garrett. I appreciate the opportunity to testify on behalf of the Mortgage Insurance Companies of America, the trade association representing the private mortgage insurance industry.

Mortgage insurance enables borrowers to responsibly buy homes with less than a 20 percent downpayment. Many of these borrowers are first-time or lower-income homebuyers. Since 1957, private mortgage insurance has helped 25 million families buy homes. Today, about 9 percent of all outstanding mortgages have private mortgage insurance.

This afternoon, I would like to make four important points.

First, mortgage insurance is essential to ensuring mortgages are both affordable and sustainable. These goals are not mutually exclusive, and such loans are vital to the housing recovery.

Mortgage insurance is in the first-loss position on individual high-ratio loans, and, as a result, private-sector capital is at risk. If a borrower defaults and that default results in a claim, mortgage insurers will typically pay the investor 20 to 25 percent of the loan amount.

Because we are in the first-loss position, mortgage insurers' incentives are aligned with both the borrowers and the investors. As a result, mortgage insurers work to ensure that the home is affordable both at the time of purchase and throughout the years of homeownership.

My second point: The mortgage insurance regulatory model works. The mortgage insurance regulatory model has been in place for over 50 years. This model has enabled the industry to write both new business and meet its claim obligations through many different economic environments, including some severe housing downturns such as we are currently experiencing.

The most important element of the model is that it requires capital to be maintained through one of three reserves, known as the contingency reserve. Private MIs are required to put 50 percent of every premium dollar into a contingency reserve for 10 years so adequate resources are there to pay claims. This, in effect, causes capital to be set aside during good times such that it is available in bad times. It serves to provide capital in a countercyclical manner.

Since 2007, the private mortgage insurance industry has paid over $20 billion in claims. In fact, mortgage insurers have paid $14.5 billion in claims and receivables to the GSEs, which is equivalent to 10 percent of the amount taxpayers have paid to the GSEs to date.

My third point: The private mortgage insurers are well-capitalized and can help with the housing recovery. Not only does the MI industry have ample regulatory capital, but it has attracted capital, even during these difficult times. We have raised $7.4 billion in capital through new capital raises and asset sales, and a new entrant has raised a further $600 million since the mortgage crisis began.

In fact, based on industry estimates, the MI industry has sufficient capital to increase our total insurance exposure by $261 billion a year for the next 3 calendar years. If this additional volume would be realized, it would mean that approximately 1.3 million additional mortgages would be insured in each of those years. Many of these new, prudently underwritten insured mortgages would go to low- and moderate-income and first-time homebuyers.

My final point: Mortgage insurers are committed to helping borrowers stay in their homes. Because mortgage insurance companies have their own capital at risk in a first-loss position, we have very clear incentives to mitigate our losses by taking action to avoid foreclosures. We have a long history of working with servicers and community groups to help keep borrowers in their homes.

Mortgage insurers have fully participated in the Administration's loss-mitigation programs and other programs. These combined efforts have resulted in over 374,000 completed workouts from 2008 through the first quarter of 2010 by the MI industry, covering $73.8 billion in mortgage loans.

In summary, the private mortgage insurance model has worked over many years. We have capital sufficient to meet the needs of the market, and we plan to continue to play a crucial role in the future of housing finance.

Thank you for this opportunity to testify, and I will be happen to answer any questions.

[The prepared statement of Mr. Sinks can be found on page 89 of the appendix.]

Chairman KANJORSKI. Thank you.

We will now have our next witness, Ms. Marti Rodamaker, president of the First Citizens National Bank of Iowa, testifying on behalf of the Independent Community Bankers of America.

Ms. Rodamaker?

STATEMENT OF MARTI TOMSON RODAMAKER, PRESIDENT, FIRST CITIZENS NATIONAL BANK, MASON CITY, IOWA, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Ms. RODAMAKER. Thank you very much, Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee.

First Citizens National Bank in Mason City, Iowa, is a nationally chartered community bank with $925 million in assets. I am pleased to represent the community bankers and ICBA's nearly 5,000 members at this important hearing on "The Future of Housing Finance: The Role of Private Mortgage Insurance."

Residential mortgage lending, supported by conservative underwriting, is a staple of community banking, and mortgage insurance is an indispensable risk-management tool. The MI business model has been tested by the housing crisis, with repercussions for all participants in the lending process. I expect that it will emerge from the crisis looking significantly different than it has in the past, as a result of business imperatives but also as a result of policy decisions made by Congress.

Any reform of MI must be made in coordination with the reform of other elements of housing finance, notably the GSEs. ICBA hopes to participate in all aspects of housing finance reform. Our members and their customers have a great deal at stake in the outcome.

MI is used by lenders to insure mortgages of greater than 80 percent loan to value. It enables lenders to reach those borrowers who cannot make a 20 percent downpayment, which is a sizable portion of today's market. These borrowers include the younger, first-time homebuyers who have traditionally used MI, as well as current homeowners who don't have enough home equity to sell and make a 20 percent downpayment on their next home.

Most Americans have also experienced a drain in their savings accounts, depleting yet another source of downpayments. MI will be used to serve a broader segment of homebuyers than ever before. Without MI, the housing recovery will take longer. With MI, the recovery can be managed prudently.

From the lenders' perspective, perhaps the most significant function of MI is to allow for the sale of high loan-to-value loans to Fannie or Freddie, who require insurance for such loans. Fannie and Freddie provide secondary market access and critical funding to community bank mortgage lending. Lenders who hold high LTV loans in portfolio also require mortgage insurance because our regulators apply a higher capital charge to uninsured high LTV loans.

In sum, the only practical means of making high loan-to-value loans, whether they are sold or held in portfolio, is with the credit enhancement provided by MI. If prudently underwritten, high loan-to-value loans can't be made, the market will take longer to recover, consumer options will be more limited, and banks will have fewer lending opportunities.

Unfortunately for all parties, the MI market was severely disrupted during the housing crisis, and the MI companies have tightened their underwriting requirements in response to the market conditions. As a consequence, MI underwriting has fallen out of lockstep with GSE underwriting.

Before the crisis, approval by Fannie or Freddie implied approval by the insurer—a linkage that greatly facilitated the loan processing. The breakdown of this linkage has impeded the recovery. We need to achieve a new consensus in which lenders, mortgage insurers, and Fannie and Freddie are all using the same underwriting and appraisals standards. This new consensus may not be achievable until the housing market stabilizes.

In addition to tightening the underwriting of new loans, the MI companies are also disputing some claims. Denied MI claims on defaulted loans sold to GSE have become increasingly common and generally result in a buy-back request from Fannie or Freddie to the original lender.

While some of these claim denials are supportable, many are based on questionable challenges to the original underwriting or appraisal. As a banker, I understand the reality of higher defaults and losses during difficult economic times. It is part of the price of doing business. However, high levels of denied claims and GSE buy-back requests have put an additional strain on all market participants, including community banks.

In closing, ICBA appreciates the opportunity to participate in this subcommittee's review of MI. The recent dislocation in the MI industry has only underscored the critical role that it plays in housing finance. Restoration of a strong and competitive MI industry will be a critical part of the housing recovery.

We would be pleased to comment on any proposals to reform MI that emerge from this subcommittee, and we hope to have the opportunity to share our views on other aspects of housing finance reform, as well.

Thank you.

[The prepared statement of Ms. Rodamaker can be found on page 68 of the appendix.]

Chairman KANJORSKI. Thank you very much, Ms. Rodamaker.

Next, we will hear from Ms. Janneke Ratcliffe, associate director of the University of North Carolina Center for Community Capital, and senior fellow at the Center for American Progress Action Fund.

Ms. Ratcliffe?

STATEMENT OF JANNEKE RATCLIFFE, ASSOCIATE DIRECTOR, UNIVERSITY OF NORTH CAROLINA CENTER FOR COMMUNITY CAPITAL, AND SENIOR FELLOW, CENTER FOR AMERICAN PROGRESS ACTION FUND

Ms. RATCLIFFE. Good afternoon, Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee. I am Janneke Ratcliffe, associate director at the UNC Center for Community Capital and a senior research fellow at the Center for American Progress Action Fund. I am honored to have the opportunity to share my thoughts about the role of private mortgage insurance, an industry that plays a key part in facilitating homeownership.

Indeed, a discussion on the role of private MI must begin by stressing the importance of giving families the opportunity to buy homes when they have not yet accumulated enough wealth to make a big downpayment, which is what private mortgage insurance exists to do.

To put that in context, to make a 20 percent downpayment on the median home sold in the United States in 2009 required $34,000, which is more than the annual earnings of 35 percent of U.S. households. When done right, high loan-to-value mortgages are essential for the U.S. housing system to offer opportunities and a pathway to the middle class. And the best way to put this opportunity within reach for more first-time and minority and low-income households is to reduce the downpayment barrier.

Many of us started up the homeownership ladder with a modest downpayment and a loan made possible because of some form of mortgage insurance, be it private or a Federal Housing Administration or Veterans Administration program. In an average year, in fact, between a quarter and a third of all the mortgages made are to families with less than 20 percent equity. And among these are the families who will later buy another house, perhaps yours or mine.

We have ample evidence that the risks associated with high LTV lending can be managed. One example is the Community Advantage Program that has funded affordable mortgages to 50,000 lower-income, low-downpayment borrowers nationwide. The results: Defaults are low, and the median borrower accumulated $20,000 in equity through the end of 2009.

This is just one example of how high LTV lending makes sense for lenders and for households when done right, in this case through fixed-rate, 30-year amortizing mortgages underwritten for ability to repay.

The private mortgage insurance industry provides on a larger scale another answer to the right way to support high loan-to-value lending. An industry built on insuring mortgages with low downpayments has weathered the mortgage crisis, paid substantial claims without Federal support, and even managed to attract new capital.

Three principles contribute to this outcome. First, as we have heard, are the countercyclical reserving requirements imposed by State insurance regulators. These days, we hear a lot about regulatory failures, but here is one story of regulatory success. The system of State regulation, combined with Federal oversight, played a critical role in maintaining systemic stability, and its principal elements should be preserved.

Second are the standards set by mortgage insurers themselves, because their interests are aligned with keeping the borrower in the home. From underwriting through foreclosure prevention, they live or die by whether they get this right.

And a third virtue of the mortgage insurance industry lies in its role as a pooler of risk. Mortgage insurance companies smooth risk out more efficiently, across multiple lenders, across securities, regions, and by reserving across time periods. In this way, they bring efficiency and stability to the entire system.

But mortgage insurance only covers a portion of the high loan-to-value loan market. During the bubble, less regulated alternatives became increasingly cheap relative to the institutional monoline sources, both primary mortgage insurance and FHA. Lack of consistent oversight enabled risk to be laid off where no or low capital requirements existed.

At the time, this looked like innovation, but in hindsight it was recklessness. The lesson learned is that an effective mortgage finance system must consider total system capital at risk on each loan, inhibit capital arbitrage, and prevent a race to the bottom.

Justifiably, private mortgage insurance has special consideration in the GSE charter and is a qualified residential mortgage factor to offset risk-retention requirements. But this implies that this industry will play a critical role in determining who gets access to homeownership. This is no small concern because today, barriers are actually growing, particularly for those households and communities hit by the full cycle: first, by lack of access to capital; then, by subprime lending; then, by foreclosures; and now, by income losses and tight credit. Rebuilding will require the affirmative involvement of all market participants.

Going forward, PMI insurance should have an important role in the market, but let me suggest three provisos. First, policymakers should maintain a level regulatory playing field, one that considers long-term, systemwide risk-taking capacity. Second, mortgage insurers must be held accountable to public policy goals of enabling access to safe mortgage products under affordable and transparent terms that do not unfairly handicap some market segments. Finally, recognizing that some markets may still go underserved, it is important to ensure alternative channels exist for innovation and expanding constructive credit to those markets.

Thank you for the opportunity to testify, and I look forward to your questions.

[The prepared statement of Ms. Ratcliffe can be found on page 60 of the appendix.]

Chairman KANJORSKI. Thank you, Ms. Ratcliffe.

Next, we will hear from Mr. Anthony B. Sanders, distinguished professor of finance at George Mason University, and senior scholar at The Mercatus Center at George Mason University.

Mr. Sanders?

STATEMENT OF ANTHONY B. SANDERS, DISTINGUISHED PROFESSOR OF FINANCE, GEORGE MASON UNIVERSITY, AND SENIOR SCHOLAR, THE MERCATUS CENTER

Mr. SANDERS. Mr. Chairman and distinguished members of the subcommittee, my name is Anthony B. Sanders, and I am a distinguished professor of finance at George Mason University and a senior scholar at The Mercatus Center. It is an honor to testify before you today.

The Federal Government purchases or insures over 90 percent of the residential mortgages originated in the United States. The proliferation of government programs for homeownership purchase and insurance of low-downpayment loans by the GSEs and tax incentives for homeownership were largely responsible for the housing bubble that occurred in the 2001 to 2006 period.

The problem is that public policy and risk management are intertwined, resulting in bubbles and devastating bursts. And the most vulnerable households are the ones who are most often hurt. The affordable housing crisis cycle must be broken.

Even though trillions of dollars were pumped into the housing market during the last decade, homeownership rates rose from 67.8 percent in 2001, peaked at 69 percent in 2004, and declined down to 67.4 percent in 2009, less than where they started in 2001. The United States has comparable homeownership rates to other G–7 countries, even though they do not have entities like Fannie Mae and Freddie Mac.

Given that there is a reasonable housing alternative in the form of renting, rather than owning, it is time to rethink the crisis cycle. We can break the cycle by getting private mortgage insurance and banks back in the game and downsize the government involvement in the housing finance area.

The problem is that the Federal Government offers explicit guarantees on residential mortgages, which makes it difficult for the private sector to compete. This crowding-out phenomenon is exacerbated by the raising of the loan limits after the stimulus for the three GSEs to $729,750 in certain areas, which has effectively crowded out the private insurance market.

My recommendations are as follows:

Fannie Mae, Freddie Mac, and the FHA must downsize their market shares to open up the market for the private sector again. This can be done in the short run by curtailing the government purchase and insurance of low-downpayment mortgages and a lowering of loan limits to pre-stimulus levels at first and then a gradual phaseout of government insurance.

Second, alternatives to Fannie Mae and Freddie Mac, such as covered bonds and improvement to private-label securitization, must be implemented.

In order for capital to return to the market, it is necessary to restore confidence. The newly created Bureau of Consumer Financial Protection is generating significant uncertainty in the minds of investors as to how this agency will function. Congress should pass clear guidelines and provide assurances that limit the reach of this new agency.

Fourth, the long-run structure of Fannie Mae and Freddie Mac must be resolved as soon as possible. However, true changes are not possible if the Administration and Congress insist that there must be an explicit guarantee. I do not see any way that the explosive combination of public policy and prudent risk management can work together. It failed in the housing bubble and crash, and nothing has been done to prevent this from occurring over and over again.

Thank you for the opportunity to share my thoughts with you.

[The prepared statement of Dr. Sanders can be found on page 81 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Sanders.

We will now hear from our next witness, Mr. John Taylor, president and chief executive officer of the National Community Reinvestment Coalition.

Mr. Taylor?

STATEMENT OF JOHN TAYLOR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE NATIONAL COMMUNITY REINVESTMENT COALITION (NCRC)

Mr. TAYLOR. Thank you, Chairman Kanjorski, Ranking Member Garrett, and other distinguished members of this subcommittee.

And congratulations to those members of this subcommittee who voted for and passed the Dodd-Frank regulatory reform bill. I think that effort was owed to the American public and bodes well for consumers across the land.

Private mortgage insurance also serves a vital part of America's system of mortgage finance by protecting lenders from losses associated with mortgage defaults. Done responsibly, private mortgage insurance can help those working their way up the economic ladder to achieve the American dream of homeownership. Coupled with the Community Reinvestment Act, private mortgage insurance can help underserved people, including minorities, to gain access to safe, sound, and sustainable mortgages.

Today, the business of mortgage finance has become the business of the Federal Government. Without FHA, VA, Fannie Mae, and Freddie Mac, most mortgage lending in America today would not occur. NCRC is very concerned that the Federal Government is increasingly positioning itself as the sole gatekeeper to homeownership and mortgage lending in America. And much of this is done with the requirement of a government guarantee.

It is imperative that we increase the role of the free market in producing and securitizing mortgages. The private mortgage insurance companies assist in this goal while remaining unsubsidized, without TARP funds—not that they didn't apply—and without government guarantees.

The capitalization and reserve requirements placed on private mortgage insurance companies by the government is a perfect example of how government regulation, coupled with free-market enterprise, can result in healthy and profitable business. In spite of our great recession and the collapse of the mortgage banking sector in America, all the private mortgage insurance companies remain standing, indeed have even expanded their ranks.

Having said all this, there are some improvements that I hope this subcommittee and the Congress might consider making to this industry.

First, regulation of the private mortgage insurance industry occurs on a State level. We believe the industry and consumers would be better served by having Federal standards regulating this industry. Consumers, in particular, would benefit from having these new standards under the purview of the new Bureau of Consumer Financial Protection.

Second, data currently available on the performance of the private mortgage insurance companies is limited and raises more questions than it answers. The FFIEC prepares disclosure, aggregate, and national aggregate data reports on the private mortgage insurance activity. To their credit, the private mortgage insurance companies voluntarily provide data on the disposition of applications for mortgage insurance using some categories of information used on the HMDA, the Home Mortgage Disclosure Act.

In preparation for this hearing, NCRC analyzed the voluntarily provided data. There is enough evidence of disparity in the mortgage insurance access between Whites, Blacks, and Hispanics to suggest that Congress should enhance the data collection and increase the transparency on the performance of this industry.

This data collection should be mandatory and include data on cost of premiums and amount of losses incurred by the various private mortgage insurance companies. Such additional information will assist us all in determining whether the denial disparities are based on sound business practices or have some basis in discriminatory practices. This will ensure fairness in that industry.

NCRC would recommend that the Bureau of Consumer Financial Protection make recommendations on reasonable pricing standards that the private mortgage insurance company industry can employ to ensure that premiums are not keeping working-class, responsible borrowers out of the homeownership market.

Further, we should explore the possibility of the lender sharing in the cost of the private mortgage insurance, since the benefit of insurance really directly accrues to the lender.

Next, when a homeowner has reached the 20 percent equity threshold of ownership in their home, there should be a seamless and automatic allowance for borrowers to withdraw from the mortgage insurance product that is no longer necessary for these borrowers. Currently, some lenders do a better job than others at alerting consumers about their having reached that 20 percent threshold.

Finally, the appraisal methods, including automated valuation models, used by many private mortgage insurance companies ought to be scrutinized. We should learn once and for all from the injury done to our system of mortgage finance by shoddy, quick, and inaccurate appraisals.

In conclusion, private mortgage insurance is vitally important to our national system of mortgage finance and can help refuel our economy by expanding opportunities for safe and sound mortgage lending to those who do not have the ability to make a 20 percent downpayment.

Let me close by saying, to answer your question, Mr. Chairman, I do believe we need a federally sponsored securitization sector. And I think that what is prohibiting, really, the private sector from being successful today, more than anything, more than anything we will talk about today, is the fact that people no longer trust foreign governments, companies' pension funds. They don't trust America now to come and invest in here. We have to change that.

And I think the law you just passed, more transparency, more accountability, sends a very strong message to the world that it is safe to come back and reinvest in America. Because the banks and everybody else do not have the money unless we have investors.

So hopefully, we are beginning to turn the corner and say to the world, our economy is stable, we are bottoming out on housing prices and housing values, and there is more accountability, it is safe to come back to America and reinvest in America's economy. And I think that is going to help to, as much as anything, boost the private sector in being able to provide mortgages and to have the mortgage insurance companies support that.

[The prepared statement of Mr. Taylor can be found on page 101 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Taylor.

Our last witness will be Ms. Deborah Goldberg, hurricane relief program director of the National Fair Housing Alliance.

Ms. Goldberg?

STATEMENT OF DEBORAH GOLDBERG, HURRICANE RELIEF PROGRAM DIRECTOR, THE NATIONAL FAIR HOUSING ALLIANCE

Ms. GOLDBERG. Thank you, Mr. Chairman.

Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee, I want to thank you for the opportunity to testify here today on behalf of the National Fair Housing Alliance.

In the face of our current foreclosure crisis, some say that we put too much emphasis on homeownership. We at NFHA take a different view. We continue to believe that homeownership, done right, can be a viable path to building wealth and economic security. It is one of our most promising tools for eliminating the enormous racial and ethnic wealth disparities in our country.

But we need to understand how to make homeownership both achievable and sustainable, and also understand clearly the forces that have worked to undermine sustainability in recent years. Only then can we avoid repeating our past mistakes.

In this context, we believe that private mortgage insurance has a very important role to play in expanding access to homeownership for those with limited wealth, particularly people of color. The requirement for a 20 percent downpayment on a mortgage is a big barrier for many people who could otherwise be very successful homeowners. Private mortgage insurance makes it possible for families with limited wealth to put less money down and still get a mortgage. This benefits the homeowner, the lender, the investor, and, of course, the private mortgage insurance company.

You asked whether additional consumer protections are needed with respect to the private mortgage insurance industry. And one concern for us is the fact that PMI is sold directly to the lender and not to the borrower. This means that borrowers can't comparison-shop for the best deal. It also gives insurers an incentive to make the product as profitable as possible for their customers, the lenders, rather than as cost-effective as possible for borrowers.

A situation like this calls out for greater transparency and oversight than we have now in the private mortgage insurance market. In other markets, this kind of situation has opened the door to adverse practices and discriminatory treatment. And we urge the subcommittee to make sure that is not happening in this market.

Another issue of great concern to us, from both a fair-housing and a broader consumer perspective, is the use of credit scores for underwriting and pricing private mortgage insurance. We have long had concerns about the impact of credit-scoring models on people of color, who have lacked access to the kind of mainstream financial services that help boost scores.

Recently, we have seen credit scores drop even when consumers continue to make all of their payments on time, as lenders lower credit limits in order to minimize their risk exposure. And research suggests that certain loan features—research that one of my co-panelists has done—certain loan features, such as prepayment penalties and adjustable interest rates, along with loan distribution channels, are more important in explaining loan performance than are borrower characteristics.

But credit-scoring models do not make this distinction between risky borrowers and risky products. This places borrowers of color, whose communities have been targeted for risky products, at a tremendous disadvantage.

We urge the subcommittee to look at this question in more detail. It has profound implications for the future, not just for access to PMI, but also for many other aspects of people's lives.

The Federal Government has a unique relationship to the PMI industry, having done quite a bit to create a market for this product. One example that has been cited by several of my co-panelists is the charter requirement that prohibits the GSEs from purchasing loans with LTVs above 80 percent unless those loans carry a credit enhancement.

The recently enacted Dodd-Frank Wall Street reform bill also creates a carveout for private mortgage insurance. As a result, it is our view that the Federal Government has both an opportunity and an obligation to make sure that the industry operates in a manner that is fair and nondiscriminatory.

In particular, Congress, the public, and ultimately the industry, as well, would all benefit from having access to more detailed information about how private mortgage insurers operate. This includes information about underwriting standards and also where, to whom, and at what price mortgage insurance is being offered.

It could also include information about the impact of mortgage insurance on loss-mitigation outcomes for borrowers facing foreclosure. This is a question the subcommittee raised, but there is no publicly available information on which to base an answer.

Better data on a range of issues related to private mortgage insurance and its impact on the housing finance system would put us all in a better position to have an informed debate about what the system of the future should look like. You can make such data available, and we urge you to consider doing so.

Thank you for the opportunity to testify here today. I look forward to your questions.

[The prepared statement of Ms. Goldberg can be found on page 50 of the appendix.]

Chairman KANJORSKI. Thank you very much, Ms. Goldberg.

I guess I am the first one on the firing pad today, so let me go back and just see if I can pick up.

Could everybody on the panel, just have a show of hands, who would support a secondary market?

Okay.

Oh, a slow "yes."

Mr. SANDERS. Clarification.

Chairman KANJORSKI. I think the impression that I received, at least, from the opening statement of Mr. Hensarling, was that we ought to really do away with the secondary market and government involvement therein. And I think there is a large portion of the American population who are taking that sort of tea-party effect—I am sorry, I didn't want to suggest that comes from a particular element—but that they follow that thought process.

And on the other end—

Mr. GARRETT. Constitutionalist? Is that the word you are looking for?

Chairman KANJORSKI. Constitutionalist? I did not see that in the Constitution, but you may be right.

This morning, I had the pleasure of sitting in on a briefing from Dr. Shiller and Dr. Zandi, which went over and explained the real estate market for the last 40, 50, 60 years, or perhaps 100 years, which was quite revealing and interesting, insofar as the bubble that occurred in 2006 to about 2009 was extraordinary and a one-time deal in the last 100 years. Other than that, real estate was in a relatively staid and standard position without great fluctuation.

And, quite frankly, neither one of them attributed any particular action to that, other than the changing from risk investment in the stock market in equities to risk investment in the real estate market, for one reason or another. And they looked at it as the bubble in the early 1990's and late 1990's and then moving into real estate in the 2004 or 2005 period.

That all being said, everybody is trying to do a postmortem here and find a guilty party. I thought we had one, but that slow motion of the hand said we did not.

In reality, I think we all have to accept the fact that the real estate market is a fundamental part of the American economy. If the real estate market doesn't stabilize and then improve, we do not have a great deal of hope for stabilization of unemployment and for a good recovery to the middle-class economy that we were blessed with for almost 20 years.

Would the panel agree? And if you disagree, speak up as to what your disagreement is.

Nobody heard my question, so they don't know whether they want to commit.

Does George Mason want to speak to that?

Mr. SANDERS. Oh, the guy from George Mason, yes. Thank you.

I agree, the real estate market is a fundamental part of the U.S. economy. I disagree with Mr. Shiller and Mr. Zandi. Again, if you look clearly at the evidence, when we pumped trillions of dollars into the housing market over the 2000's and we, at the same time, lowered downpayment requirements, rates fell, etc., you were going to get a housing bubble, period.

And I don't understand why I haven't talked with Mr. Shiller before about this, and—

Chairman KANJORSKI. If I may interrupt you for a second, though, not too far from where you are sitting, if you moved over to Ms. Ratcliffe's position, about 5 years ago Alan Greenspan testified before our full committee, and he was sitting right in her seat. And he said he was not worried at all about a real estate bubble; it just was not going to occur, did not occur, and it was nothing for us or anyone else in the country to worry about.

That was in 2005. Precipitous, because at that precise moment very strange things were beginning to happen in the real estate market, and all of us were a little worried. But, not having the expertise of Dr. Greenspan, we relied on him for his expert opinion.

Subsequent to that, he has apologized for having been deadwrong on the issue. And I think that shows a big man and a good man, but, nevertheless, he was wrong.

You do not feel that he was wrong? Or do you feel it does not matter? I am not sure I get the—

Mr. SANDERS. Oh, do I think Alan Greenspan was wrong? Two reasons: one, he confessed he was wrong; and two, when all of us looked at the housing prices going up like this, and simultaneously Freddie and Fannie's retained portfolio is going up about the same speed, we all knew that something has to give.

Why Mr. Greenspan didn't choose to recognize that is—who knows? Maybe he thought it was a new plateau. But I can guarantee you other people at the time were scared about what was going on in the market.

Chairman KANJORSKI. Yes, sir?

Mr. TAYLOR. Chairman Greenspan was the ultimate libertarian. And perhaps he was locked into that ideology as a way of not being able to respond to what was going on.

The real estate market is absolutely an important part of our economy, but we need a system of checks and balances. And if we learn nothing else from this hearing today, it is the system of checks and balances over the mortgage insurance industry that required capitalization of 25 to one. Fifty cents of every premium dollar that came in was put into a reserve so that they could survive.

Mr. Hensarling said earlier—I am sorry he is not here; I wanted to get to agree with most of what he said, and that is a rare occurrence for me—that it appears the MIs somehow weathered the storm. It wasn't "somehow." It was because we had regulation that required them to be adequately capitalized.

Had we done that with the rest of the industry, and if there was enough oversight of the rest of the industry, we could have avoided a lot of the problems and still had a healthy real estate practice.

Chairman KANJORSKI. So I am supposed to conclude that regulation may sometimes be a good thing?

Mr. TAYLOR. Yes.

Chairman KANJORSKI. In this era, I do not often hear that.

Ms. Ratcliffe, you were shaking your head. Do you agree with that position?

Ms. RATCLIFFE. I entirely agree. There are a couple of dimensions that are worth exploring. One is the issue of regulatory capital requirements being inconsistent across the industry that led lending to occur in places there were no capital or very cheap capital requirements that led to much of the bubble.

One of the great ironies, I think, given the discussion we are having today, is the issue of AIG who, in their credit default swap business helped inflate the bubble and needed substantial billions of dollars of government support. They are the parent company of a mortgage insurance company who followed these capitalization rules when they took credit risk on mortgages. Right there within one company, you see this example of capital arbitrage that we need to make adjustments for in this. Thinking about the secondary market reform, we have to think beyond whatever quasi-government agency you have to the rest of the playing field.

Chairman KANJORSKI. Should there be a bar to the nexus of those two companies in the same structure?

Ms. RATCLIFFE. I'm sorry?

Chairman KANJORSKI. Should there be a bar to having a nexus or relations between those companies existing in the same structure?

Ms. RATCLIFFE. Again, I think if we set common capital requirements, that wouldn't necessarily be necessary.

Mr. SINKS. If I may take a shot at that, not speaking on behalf of AIG, but speaking on behalf of the mortgage insurance companies, I would submit there is a bar.

The mortgage insurance companies are controlled by the State insurance departments, and they have the ability to control what goes in and out of that company. So despite the fact it was part of the very broad AIG organization, I would submit, again in a general sense, that capital was, in fact, walled off and the policyholders were protected.

Chairman KANJORSKI. Very good. I now recognize the gentleman from New Jersey, since I have also taken additional time.

Mr. GARRETT. Thank you, Mr. Chairman.

Let me start, a quick show of hands, how many think anyone who wants to get a loan, a home loan, should have to, in one way or other, go through the Federal Government, rely upon the Federal Government?

Okay.

And how many think that the Federal Government should essentially be backstopping or underwriting where we are, around 99 percent of loans, high LTV loans or otherwise?

Good. So somewhere in between then. All right.

On your point, Mr. Taylor, that Mr. Greenspan is the ultimate libertarian; I don't know. A lot of people now in retrospect say his monetary policy was one of the reasons that brought us to that bubble that Mr. Sanders was speaking to before. And I think most libertarians would say that the central bank should not be playing that role. But you can debate that.

Professor Sanders, you saw that chart, that is the chart. The blue is showing where 99 percent of the high LTVs are being underwritten by you and I, and everybody else in the room, the American taxpayer. Is that where we want to be? Are you concerned about this?

Mr. SANDERS. The answer is it is not where we want to be, and we should be extremely concerned about this. Again, the same thing I said before, if Genworth or MGIC or one of the other private mortgage insurance companies want to go out and underwrite a 3 percent down mortgage, and they are going to do it and suffer the consequences of their folly if it fails, so be it.

Again, as I said, Fannie, Freddie, and the FHA have this combustible joint process where they are doing public policy and risk management. And guess which one wins out, so we end up with a market capture of 99 percent.

In addition, although you didn't bring it up, if we take a look at the percentage, 99 percent and over LTV occurring now, you have all of the GSEs, doing about 40 percent of their business, is low LTV lending.

Once again, I sympathize with all of the people who say that they would like to see homeowners get that. You just have to understand, that is bubble creating. That creates another one of these incredible wave-type effects, and it is not good for the stability of the economy.

Mr. GARRETT. Mr. Taylor, you talked about the adverse market fees?

Mr. TAYLOR. Am I going to get to respond this time?

Mr. GARRETT. Yes. You discussed the adverse market fees that the GSEs are charging. Can you elaborate on the fees and what that all means?

Mr. TAYLOR. Yes. They have defined that they get to charge 25 basis points in addition to what they define as adverse markets anywhere in the country. We are actually quite concerned about that.

Mr. GARRETT. Why?

Mr. TAYLOR. Because we think it is unfair. The notion that because somebody lives in a declining market, that somehow they have to pay a premium seems fairly anti-American to me. You ought to be able to judge the person on their capability, their individual financial status, and their creditworthiness and so on, not by the neighborhood they necessarily live in. In fact, that is precisely why we created the Fair Housing Act and other laws to prohibit these kinds of discriminatory practices just based on geography.

Mr. GARRETT. What would the GSEs say if they were sitting next to you?

Mr. TAYLOR. That they have an incredibly bad balance sheet, and they are doing everything they can to create strong, positive cash flow that will, when they separate out all of those bad assets, leave them standing.

Mr. GARRETT. Two points. Your one point you make is: Yes, that may be true, but they are making it on the backs of those people. That is your point.

Mr. TAYLOR. I agree, yes. I agree with my point.

Mr. GARRETT. I just wanted to get that out.

The second point here is, how are they using those fees?

Mr. TAYLOR. I think they are using it to create profitability for the GSEs, and hopefully sustain themselves into the future. I'm not sure if that is getting at your point.

Mr. GARRETT. Yes. You can make the argument, hey, we have a bad balance sheet and we want to put this aside as reserves.

Mr. TAYLOR. They are also concentrating on the safest and the easy to make—they have raised their credit scores in terms of who they are willing to make loans to. They are doing stuff that essentially is survival stuff for them.

Mr. GARRETT. Ms. Ratcliffe?

Ms. RATCLIFFE. I wanted to add that not only is it not fair to apply those kinds of pricing factors, but it is procyclical. That is exactly what we have been talking about. If you layer additional costs on in weaker times and take them out in good times, you end up exacerbating upsides and downsides.

Mr. GARRETT. I didn't think about that part of it. Thank you.

Chairman KANJORSKI. In fairness, before I recognize the next individual, the chart was beautiful, Mr. Garrett, except I do want to indicate it is misleading, because I think the chart showed 99 percent or 97 percent, but this morning, Inside Mortgage Finance released facts and information to indicate that it has fallen from 97 percent to 82 percent, and that was an extraordinary period of time that it went up to 97 percent. So I don't think we should allow the impression that it has been and continues to be at 97 percent.

Mr. GARRETT. These are LTV loans, high LTVs. I think they are still at 99 percent. Overall, it has come down, but not the high LTV.

Chairman KANJORSKI. We will check it out. Would it be surprising if they stay up and everything else goes down?

Mr. GARRETT. No. That is part of the consequence, and that is part of the concern.

Chairman KANJORSKI. We will check.

Mr. GARRETT. You put your chart over there. And we will have our chart here.

Chairman KANJORSKI. We will have the war of charts. With that, Mrs. Capito?

Mrs. CAPITO. Thank you, Mr. Chairman.

Mr. Sanders, in my opening statement, I mentioned concerns I have. I am the ranking member on the Housing Subcommittee, and we worked on the FHA reform bill, and have been trying to work on, with the Administration's help, the FHA capital reserve fund. As you know, FHA has played a much, much larger role in mortgage insurance than probably historically. I don't know that, but I assume it is close to that. Have you looked at the announced changes on the premium changes and do you think this will have any effect on FHA market share and open up some of the private markets? Do you have an opinion on that?

Mr. SANDERS. First of all, I also want to point out, not to pick on Mr. Taylor, but when he mentioned Fannie and Freddie have horrible balance sheets, we should ask ourselves: And how did they end up with horrible balance sheets?

What is happening right now is, true, Freddie and Fannie have increased their standards for purchasing loans. However, the FHA has jumped in and filled the void so the whole point is, we still have tons of these low-downpayment loans being made. It just shifted. The FHA is now growing faster than Fannie and Freddie.

But having said that, I think that the proposed legislation on the FHA is a very good thing. I think the fee schedules make a lot of sense. I think even the FHA would agree that they would like to actually have higher downpayment standards. Absolutely. They have some data. They can see how this can happen again.

Mrs. CAPITO. They did raise some of their downpayment requirements for those with FICO scores of 570 or 580.

Mr. SINKS. 580.

Mrs. CAPITO. They raised them up to 10 percent. So I think that is a recognition by the FHA. In your opinion, that may not be enough.

Mr. SANDERS. Baby steps. The direction is great. I love to see it. However, once again, I keep trying to make this clear, the more we rely on low-downpayment loans, while it is very satisfying for many households, and I appreciate it, the slow rental market, it is inflationary in housing prices.

And again, and I want to make this point, I appreciate what the FHA and Fannie and Freddie have done. On the other hand, if you are sitting out in Las Vegas, California, Florida, etc., you have a 3 percent down loan, which you were encouraged to do, housing prices fall 20 percent, how did we help out homeowners by encouraging them to take out a low-downpayment mortgage? These households are devastated.

Again, we have to rethink shoving everyone into low downpayment. To say that the housing market is now stable and will never go up again, like Mark Zandi says, I think that is ridiculous. We have set the table. Warning, we have set the table for another lurch and crash. I don't want to see that again, and I don't think anyone in here really wants to see that either. But I think the FHA is a good step forward.

Mr. SINKS. If I may, first of all, the housing prices have dropped significantly in the markets that Mr. Sanders alluded to. And there is a sense, and Mr. Zandi, for instance, will forecast the drop a little more. But our sense of it at the Mortgage Insurance Companies is that the worst is over in terms of the price drops. From peak to trough, the worst is over, we believe.

The other thing is, I would not overemphasize the importance of downpayment. It is a criteria, and the example used is an important one. However, there are a number of factors that led to what happened.

We talked about low interest rates and we talked about how easy it was to get a mortgage. But also things like instrument types, subprime mortgages, reduced doc loans, things of that nature. It was much more than downpayment.

High-ratio lending can be done properly. It doesn't necessarily equate into high risk. What you have to be careful of is layering risk, where you only have 3 percent down, you have 580 FICO score and a BPI of 45 percent, when you layer all of those things in, that is when you walk into a problem. So downpayment is an important criteria, but we would submit it is not the only criteria.

Mrs. CAPITO. Excellent point. Thank you.

Ms. GOLDBERG. If I may add a comment to that, one of the other things we saw in the dramatic increase in the subprime lending and other kinds of exotic lending was a misalignment of interest between the borrower and the folks on the other side of the table, where people on the other side of the table were getting paid tremendous amounts to put folks in loans that were not sustainable, that had these many layers of risk that several of us have talked about. So it is not like it happened organically. There were profit motives and strong market forces driving people into those loans when they were not really in their own best interest.

Mrs. CAPITO. Thank you. I would add this to that, coming from a State like West Virginia which has some of the highest homeownership in the Nation and some of the lowest foreclosure rates, we don't have the bubble of the real estate. We have responsible borrowers who, when they sit down to pay their bills, they pay their mortgage. That is the first check that they write. And so, there is an element of personal responsibility here that sometimes I think, not to say this is the only thing, and certainly there are people out there taking advantage of other people, absolutely. But the borrower has to take responsibility here.

Part of my frustration has been in some of the foreclosure modifications when we were doing the trial modifications, there was such pressure to get people into trial modifications, they weren't even taking documentation on those. That just exacerbates the problem.

We all want to keep everybody in a home, but at the same time, we can't keep repeating the same mistakes that have led folks to be thrown out of their homes and have led to this crisis. I just wanted to make that point. But I appreciate your remarks.

Mr. TAYLOR. Mr. Chairman, if I may comment, I do think personal responsibility is important, and I think everybody needs to understand that and needs to live by that.

But I think when you see almost 10 million Americans in a situation where they are facing foreclosure, it is not like the American public overnight became personally irresponsible about purchasing things and going into homeownership. What really changed is not the desire for homeownership or the individual personal responsibility of taxpayers or voters, what really changed is the malfeasance of the industry willing to make loans that they didn't care what happened to them because all they cared about was the fee.

There wasn't the regulatory apparatus that ensured integrity and ethics in the industry. That and the piggybacking, as I think Mr. Sinks said, it is the layering of all of these different things on these loans—interest rates, options, payments, changing exploding loans, no documentation, all of these things that they were actually willing to make loans to people they knew didn't have an ability to pay. That is what changed. The industry before that was pretty good at making loans to people who could afford to pay them back. It wasn't that all of a sudden, the American public became irresponsible. That is my perspective.

Chairman KANJORSKI. Thank you, Mrs. Capito.

We will now hear from the gentlelady from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you, Mr. Chairman. Following up on the gentleman who just spoke, that what was happening was that no responsibility was in the process, but just fee-generated activity, could you elaborate? So it was more or less like a casino, and could you elaborate more? And are the safeguards put in the bill adequate with the 5 percent securitization and skin in the game and bringing everyone under regulation, does that, in effect, end these types of abuses, in your opinion?

Mr. TAYLOR. I think the bill will go a long way towards addressing a lot of the abuses. I think what will be important is the real independence of the Bureau of Consumer Financial Protection and its oversight and ability to respond to things.

Look, I think what we had was an industry gone wild on Wall Street that had so much money that was looking for a home. And America had a reputation, you buy these CDOs mortgage-backed securities, you could get good rates of return, and we had rating agencies that were willing to slap AAA ratings on 80 percent of the high-cost loans. AAA rating on 80 percent of the high-cost loans. And you had appraisers—

Mrs. MALONEY. And these mortgage-backed securities had no insurance behind them, and did the public know that, that there was no—

Mr. TAYLOR. The public, I remember sitting with some of the agencies before the crash and asking them, how could they be rating these things at triple A ratings, and sitting across the table, they would tell me, we are not really a due diligence agency.

Mrs. MALONEY. Then what were they?

Mr. TAYLOR. I don't know. I think they were agents of the investment banks because that is who paid them. That is the fundamental problem. I know in the bill, you have language in there to recommend what to do with these agencies.

But listen, it was top to bottom. It was appraisers. It was brokers. It was everybody getting fees, and nobody with the ability to step in and say, we can't have this kind of stuff because it is not sustainable, it is predatory, and it is going to cause problems for everybody, not only homeowners, but the investors. The investors, they are thinking they were buying American triple rated securities that are going to give them double digit, maybe high single digit rates of returns, safe as gold. That is what happened up and down the line.

Hopefully, what you have in passing this financial reform, and God bless you for supporting it, is that you are putting sanity back into this industry, accountability, and you are protecting the American consumer in the process. And hopefully, we will get back to the business of banking in which they made loans to people who could actually afford to pay them back.

Mrs. MALONEY. Mr. Sanders, did you want to comment?

Mr. SANDERS. Thank you. Before we take the rating agency punching bag approach, I want to point out that a lot of investors bought many of these securities, and they didn't even take time to do due diligence and take a look because all of the loan files were available. They could have done their own modeling. I know this for a fact.

Instead they just jumped in, said triple A rated, I will buy it, and then after they lost money, they said, "Oh, my gosh, those damn rating agencies."

From the street, and I am sure if you had Mr. Zandi in here again, most people on the street know rating agencies—ratings don't mean much. They have a 6-month lag when things go back.

I put the onus on the buyers. Buyer beware. Remember that one. I think a lot of times they substituted in a quick decision when they didn't do proper due diligence, and now they want their pound of flesh for doing it.

Mr. TAYLOR. So, personal responsibility of investors.

Mrs. MALONEY. I began this morning at a meeting, a briefing that Chairman Frank had on housing, and he had several economists there. And Mr. Zandi, who was the economist for Senator McCain, testified that housing is roughly 25 percent of the economy. If we don't have a robust housing market, then we are not going to have a recovery and our recovery is still somewhat fragile. One thing that the private mortgage insurance does is help us finance housing and thereby help us dig our way out of this recession.

Would anyone like to comment on the way that the private mortgage insurance business successfully raises millions of dollars for us to finance housing which under the new guidelines is following investment principles? Would anyone like to comment on that?

Mr. SINKS. On behalf of MICA, I would say, first of all I think the attraction of capital to the industry that we have experienced in the last couple of years is a realization that prudent underwriting has returned. While we have the legacy of the older business and how that develops, first and foremost, prudent underwriting has returned. I think that goes a long way towards it.

I also think that the industry has taken numerous steps. One of the key values that we bring, and perhaps lost sight of during a period of time but now bring again is a second set of eyes. We like to use the term "friction." In other words, there is a second set of eyes looking at that loan, looking at that loan file to make sure that it meets the criteria and to make sure that the loan is proper and people can afford the loan, not only at the time they originate the mortgage or day one when they move in the house, but 3 or 4 or 5 years later they can stay in that home. So in many respects, it is back to basics. That is what it is.

Mrs. MALONEY. Back to basics. That is a good ending. My time has expired, but Mr. Taylor has a comment.

Mr. TAYLOR. It is more than a second set of eyes. It is having skin in the game. The MIs know that if that mortgage goes bad, they lose. So they will make sure it is a good loan. That is critical because they have financial skin in the game.

Mrs. MALONEY. My time has expired. I thank the gentleman.

Chairman KANJORSKI. The gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I appreciate the rehashing. We have had a number of hearings where we rehashed what happened. I kind of am more interested in where we go from here because that is what is going to drive the economy, how to get these markets back functioning again and somehow divorce the taxpayers from having to subsidize and backstop these financial markets.

Mr. Sinks, one of the things that people are kicking around is how we get the securitization market back operating again, and certainly the mortgage insurance industry plays an important part of that in the primary origination. One of the things that is being kicked around a little bit is instead of Fannie and Freddie basically securitizing and guaranteeing those portfolios, possibly there is room for private entities to do that.

So instead of MI, you have SI, securitization insurance. Do you think that the industry would embrace a concept where there was another piece of business there where you would not only be, the private mortgage insurance on the underlying mortgages, but also on the securitization piece?

Mr. SINKS. We would embrace it obviously if done correctly. In fact, we have in the past. We did insure private label securities over many, many years. I think the challenge and our position on it is, and we used to ask ourselves this at MGIC, many years in the boom time, is Wall Street patient capital? And they have proven that very well, they are not patient capital, for a variety of reasons.

So to answer your question directly: Would we entertain it? Yes. However, we do believe the government needs to play a role because that ensures liquidity. And as long as there is liquidity in the market, again with proper oversight, with transparency, and the proper regulators, we are better and more in line with kind of a combination of private partner. And by that, I mean two different securitizers, not the Fannie Mae ownership.

Mr. NEUGEBAUER. People talk about how we need the government for liquidity. To me, liquidity is saying, if you need me to loan you some money against your securities for a period of time, I will do that. That provides liquidity.

But then there is another piece of that. Some people say, we need the Federal Government to step in and take some of the risk with us. Certainly, I don't embrace that concept.

We had a private securitized market before the crisis. We need to figure out a way to restore it. As Professor Sanders said, we need the industry to be willing to take risks, do their due diligence and make sure that understand what they are buying. But we also need to make sure that we don't take away the tools for some of those entities that are willing to make a market for those securities, to protect some of that risk. And that comes with hedging and derivatives.

When we talk about liquidity, are we talking about for the Federal Government to take some of the credit risk when you say that?

Mr. SINKS. We are talking in particular about liquidity to be able to move money in the secondary market, the capital markets. It is not so much taking credit risk. I think that is the role the private mortgage insurance companies can play. As I reported earlier, we have great capacity to be able to do it. That doesn't mean that the new entity, the new GSE wouldn't be exposed. It would depend on the layer of private mortgage insurance coverage you have.

So on our terms, it would be more along the lines of the ability to transfer capital from those originating loans to this entity or into the secondary market and free up capital to make more loans.

Mr. NEUGEBAUER. Ms. Rodamaker?

Ms. RODAMAKER. From a community bank's perspective, I would wholeheartedly agree with that. As we originate loans, we need an avenue to sell those into the secondary market to free up capital to originate more real estate mortgages.

We sell about 60 percent of our mortgages that we originate in our communities. We retain 100 percent of the servicing. We still manage those accounts and those customers, but we have to have a vehicle to get that sold and generate the liquidity.

It does help us manage our interest rate risk because we sell our long-term fixed-rate mortgages. However, we utilize the same underwriting as if we were holding those loans in portfolio, and assume that credit risk even though we have sold it to Freddie Mac. I think that is true of most community banks. We are not looking to sell a credit risk; we are looking to generate liquidity.

Mr. NEUGEBAUER. I think that is important. I think everyone agrees that we need to get the secondary market back functioning again. Otherwise, we won't have much of a housing market if we don't have housing credit. And it will be difficult for us to address the Freddie and Fannie issue if we don't have an alternative because it has been pointed out that they are the only game in town right now, on top of FHA.

I want to encourage the panel, as we begin to address Fannie and Freddie, we have to also I think simultaneously be addressing how we get the private securitization market back, started again, because otherwise we will be creating a very difficult situation to bring up any kind of a housing recovery, and really I think a long-term economic recovery for our country. I encourage, if you have some ideas, we will be listening.

I yield back.

Chairman KANJORSKI. Thank you. The gentlelady from New York, Mrs. McCarthy.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman. I apologize that I had to leave. I had constituents coming in that I had to see.

I am hoping that the question I want to ask hasn't already been asked. Mr. Taylor, when I read your testimony, you indicated that the mortgage insurance can play a crucial role to help troubled homeowners. Can you further explain the proposed partnership of the industry with the Administration and explain how further we can work along towards economic recovery? If you have answered that, I have another question.

Mr. TAYLOR. I have, unfortunately, had to be fairly consistently critical of the lack of success of the Administration's HAMP program, considering that 390,000 people got permanent modifications out of the 4 million goal that they set for themselves, from over 16 months of running the program. So, it has been difficult that I have had to take that position.

I have tried to look for creative things that can be done. I think one of them is the role that mortgage insurance companies could play because what is coming now, as of October 1st, is the principal reduction, the call for principal reduction by the lenders on these mortgages to see whether that can save enough borrowers from going into foreclosure. And perhaps the role that the mortgage insurance companies could play is to offer mortgage insurance for those borrowers who are under 20 percent of value, loan to value, and perhaps encourage some of those lenders to be dropping the interest, and if necessary, principal, to reach a point where they are comfortable there will be mortgage insurance in play so if this redefaults, which is a concern for a lot of lenders, if there is a redefault, that there is somebody who can cover some of those defaults.

I think the mortgage insurance companies, it is new. It is novel. I think the mortgage insurance companies, I urge them to work with the Administration and work with the lenders to see whether they can play a role in helping me make HAMP more effective.

The final thing I will say on that is unless and until there is a mandatory requirement for lenders to participate in the HAMP program, as long as it is voluntary, we are going to see the poor numbers that we are seeing in that program.

Ms. GOLDBERG. If I may just add one comment to that, because I think the mortgage insurance industry really deserves credit for stepping forward early on in this HAMP process, to recognize the fact that mortgage insurance exists on the loans, could be effectively the thumb on the scale, tipping the balance in the equation about what is going to be the best return for the investor towards going to foreclosure because that is when the claim, the mortgage insurance claim, is traditionally paid.

I have been in a number of meetings with people from the industry and people from the government where they said this is a potential problem. We need to make sure that it doesn't happen. I think they have been trying very hard to work with servicers and to work with Treasury to prevent that from tipping the balance unfairly because it is not in their interest; it is not in the borrower's interest, and it is certainly not in the community's interest to have the fact that there is a mortgage insurance policy on a loan, make it go to foreclosure, when it could otherwise have been saved. Maybe Mr. Sinks can speak to this.

It is my understanding that they have been trying to work with servicers to do some kind of preclaim advance or a partial payment that would tip the balance toward loan modifications. It is very hard to know how that is working or how widespread the take-up from the servicing industry has been on that possibility.

Mrs. MCCARTHY OF NEW YORK. We had a briefing this morning by Moody's, and they brought up the same exact points that you are bringing up. So the criticism has been out there. Mark Zandi gave us a great briefing. If something is not working, then obviously we have to try to fix it.

Mr. Sinks, do you have anything to add to that?

Mr. SINKS. I would add, we have done a great deal, the mortgage insurance companies, in working with servicers, and in certain cases, working directly with borrowers, to try to keep people in their homes. As we reported earlier, our interests are very much aligned with the servicer and the borrower, so it is important that we do that. The programs have evolved over the last couple of years. I think they got off to a relatively slow start, but we are now seeing more and more programs where the consumer's monthly payment is being reduced and that makes a big difference in keeping them in their home. So we are actively engaged there. I think there are 16 different programs we are involved with.

In addition to that, I know many of the MI companies that actually place people on site at the servicers such that those loans that contain mortgage insurance are getting the attention that they deserve, and we can work them as quickly as we possibly can.

Mrs. MCCARTHY OF NEW YORK. One of the things—I am sorry, my time is up.

Chairman KANJORSKI. I recognize the gentlelady from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman, and thank you for having this hearing.

Mr. Sinks, in your testimony, you say that PMI has saved taxpayers billions of dollars. Do you think that we should require PMI on all loans in excess of 70 percent loan to value?

Mr. SINKS. I wouldn't lock in necessarily on loan to value; but I would tell you that we are prepared to go as deep as necessary and as is prudent, as long as we can protect the policyholders in our capital support. We certainly would entertain that idea.

Mrs. BIGGERT. Some people say FHA's market share has increased because the private mortgage insurers have pulled back. Do you agree with that? Is this a reason for FHA's increased market share?

Mr. SINKS. I think there are a variety of reasons for the increase in market share. I think as the crisis developed in 2007 and 2008, we adjusted, "we" being the private mortgage insurance companies, adjusted our underwriting criteria to reflect the market conditions at that point in time. Since then, as the market has started to recover a little bit, we have adjusted those accordingly. So our underwriting guidelines have adjusted as markets have changed.

But the other key reason why the FHA is getting the market share they are, first and foremost, they generally have pricing lower than we do. They have proposed, and I think it has been approved in the House, that their pricing will increase, and hopefully later this year that will happen. That will make the private mortgage insurance companies much more competitive.

In addition, and it was alluded to earlier by members of the panel, Fannie Mae and Freddie Mac have added adverse market fees. They have loan level price adjustments to try to rebuild their capital base that has made the conventional market less competitive. So if a borrower looks at a monthly payment between the FHA and the private execution, more often than not, they are going to do FHA. It is just simply the borrower picking the best execution for them.

Mrs. BIGGERT. Thank you.

Ms. Ratcliffe, in the aftermath of the financial crisis, the government seems to have taken a dominant role in the single family mortgage market. The Federal Reserve has invested $125 million in mortgage-backed securities, Treasury has injected $145 billion to Fannie and Freddie, and now the FHA insures more than 20 percent of all new mortgages. In your opinion, is it appropriate that the government commit such extensive resources to support the housing market?

Ms. RATCLIFFE. Is it appropriate to what they have done, obviously it seems like in the heat of the moment, and the crisis, certain steps had to be taken. Whether every single investment and dollar put up, I think if I could turn your question a little more to the future and answer a question that has sort of been in the air here all day, whether going forward there should be some place for government in the secondary market.

Mrs. BIGGERT. I guess I would ask then, is that investment sustainable over the long term?

Ms. RATCLIFFE. The current level seems inappropriate and unsustainable over the long term.

Mrs. BIGGERT. What strategies would you suggest then for the private sector's role in the mortgage market?

Ms. RATCLIFFE. The private sector ought to play as big a role as it can while the mortgage industry can function to meet the public policy goal. To some extent, that may require some form of government support to build investor confidence and create constant liquidity and ensure access to standardized mortgage products, particularly the fixed-rate, long-term amortizing mortgage that is the staple of the U.S. market.

But to the extent that the private sector, and mortgage insurance is a perfect example of that, the first loss position is on the private sector. They have skin in the game. They set the standards and they know the customers and the borrowers and the mortgage lenders. So the government role should be minimized. What we have proposed are things like private mortgage insurance, much more capital in front of whatever would replace the GSEs, and something like an FDIC fund before you even would touch a catastrophic government wrap.

Mrs. BIGGERT. Mr. Sinks, to go back and maybe play on that, can you elaborate for us, you said, I think, that the mortgage insurance industry is very well regulated by the State insurance regulators. Are you concerned that there might be inefficiencies and burdens of having to deal with the different regulations and requirements among the States? Or do you still think this is the best way to go?

Mr. SINKS. We still believe in the State regulatory model. It has worked successfully, as we have said. It has worked in good times and bad times. There are mortgage insurance companies over time, going back to the 1980's, for instance, that are no longer in the business because of regular steps, and addressed the situation. It is kind of a sense that the model works very well, and we don't need to fix it. If it is not broke, don't fix it.

Mrs. BIGGERT. Thank you. I yield back.

Chairman KANJORSKI. Thank you very much, Mrs. Biggert.

We have now run out of our first round of questions. I am sure members would have additional questions if we allow it.

So, without objection, I am going to start a second round. We have this bright, anxious, participating panel here, so why not tap them.

My first question would be, looking to the future, how many of you would recommend getting the government totally out of the secondary market and out of the real estate market?

Okay, George Mason has one vote, and five to the contrary.

Let us start with you, Mr. Sanders. Why are you so convinced that it is not advantageous for the entire American economy to keep the real estate market relatively flat and not highly cyclical that would cause this great fluctuation? Or do you see that there would not be fluctuation, because if you do an analysis from the late 1920's until 2004, 2005, the real estate market has been a tremendously flat, stable market, and it only bloated with the bubble right at the end. What are we to think if we go to a total private market again, why should we not be returning to the days prior to 1929 when it was a very, very fluctuating market?

Mr. SANDERS. Mr. Kanjorski, I have seen that same study by Bob Schiller. What is misleading about that is that is a national portfolio of housing. There have been regional bubbles in housing markets all throughout time: Boston; Houston; and Denver. That was the source of my quote in the New York Times where I said don't put lower-income households in low-downpayment mortgages. You are going to hurt them because housing markets, by definition, can be bubblish.

Now, having said that, I would disagree with what Mr. Taylor said. He said, Wall Street gone wild. I would say, government gone wild. We went through a period where government pushed housing over the cliff. And what did we get? We got a bubble; we got a burst; and we have a lot of heartache and pain. It almost crashed the banking industry and the private mortgage insurance companies ratings are not as high as they used to be. That is the downside of it.

Having said that, can't we at least begin to withdraw the government support and go back and let the private mortgage insurance companies or the banks take risks they think are reasonable?

Chairman KANJORSKI. I do not have any question with that. Certainly we have to change the formula, perhaps how much government involvement there is. But to listen to the purists' argument, it is quite disturbing to me because you are willingly putting at risk, it seems to me, the entire economy of the United States since housing represents 25 percent of the economy. If we stay in the state we are in right now, there is literally little or no hope for recovery. That is a heck of a price to test against an economic theory, free market concept. I am glad you are able to make that price and argument, but would you want us to tie all of the support funds that the Federal Government supplies to your university based on that so if you are wrong, your university gets wiped out?

Mr. SANDERS. Absolutely, for the following reason: We are the only country that has Freddie Mac, Fannie Mae, and this extensive subsidization of the housing market. We got there because of that. You are right, if we suddenly removed it, it would be like a drug addict coming off of a heroin shot. We would probably have a terrible time afterwards. We need sort of a methadone period, where we withdraw it over time, say 3 to 5 years. But eventually, we have to let a target, let the private sector make bets and pay the price if they are wrong.

Chairman KANJORSKI. And I can understand that argument, but how do you justify what happened when securitization by Fannie and Freddie really substantially lessened in 2006, 2007, and 2008, and the private market of Wall Street took over, and the descriptions Mr. Taylor made of these people being on all one side of the transaction, getting their commissions and profit, that occurred when Wall Street was doing the securitizations, not when the government-sponsored agencies were doing it.

Mr. SANDERS. Again, I have seen that argument made before. Just using my hands because I don't have graphs, the housing bubble did this; at this point, Freddie and Fannie pulled out of the market and let the private sector come in. That is icing on the cake. This market was bubbled and was overheated before the private sector stepped in with the securitization, the private label market you are talking about.

Mr. TAYLOR. That is not true.

Mr. SANDERS. Yes, it is.

Mr. TAYLOR. Three years ago, FHA only had 3 percent market share.

Mr. SANDERS. We are talking Fannie and Freddie.

Mr. TAYLOR. Let's talk Fannie and Freddie. Mr. Chairman, Fannie and Freddie in 2001 had $2.7 trillion worth of market share of these mortgages. By 2003, they lost a trillion dollars worth of market share to this so-called free market, it was free to abuse and do whatever they wanted, a trillion dollars of market share, that is when Freddie and Fannie got into this both feet, arms, legs, the whole body. That is when they really followed the market into this subprime abyss. But even then they had limits, and they wouldn't take no-documentation loans and they wouldn't do certain things that the market was still doing and willing to do. So let's be clear. We were led down this abyss, all of us, by a market gone wild.

It wasn't low-income people. You look at the people who are in foreclosures, it is not just low-income people. It is all sorts of income levels. They keep blaming low-income people. I don't know what is going on with George Mason. It is simply not what has happened in America to this housing bubble. It wasn't created by low-income people. In fact, low-income people originations amounted to less than 10 percent of all the mortgages that were done in this malfeasant lending period. It had very little to do with lending to low-income people.

Mr. SINKS. I would agree with what Mr. Taylor said here.

When Wall Street came in and it created or extended the "exotic products" and Fannie and Freddie started to lose share, that is when they reacted. That goes to the private-public ownership of Fannie and Freddie, which is a different topic. But they were responding, trying to play to their shareholders, and they grew their share; and, therefore, accepted riskier loans dramatically.

The flip side of that, and it goes back to something I spoke earlier about, is Wall Street patient capital, the answer is flat out no because they have a profit motive. As Mr. Garrett pointed out earlier with his charts, they disappeared and now the government has

99 percent of it, or 83 percent, whatever the right number is. So the pendulum swung completely the other way. And to your point, Mr. Chairman, as much as we want to see the FHA and the GSEs back off a little bit, we wouldn't have a housing market today if they weren't there because the private capital market sure isn't stepping in.

Ms. GOLDBERG. Mr. Chairman, in addition, it is important to stop blaming the low-downpayment loan made to low- and moderate-income people because I think there is a lot of evidence that those loans done properly actually perform quite well, and are very stable over time, at least when the economy is not going whacko, because unemployment now is obviously driving foreclosures at a level that it hasn't before.

I think it is important to be clear about what are the kinds of loans that have caused this crisis, and what are the kinds of loans that haven't, and not just say every loan with a low downpayment is a bad loan that is destined to go back.

One other piece related to that, one of the critical roles for the Federal Government and its involvement in the secondary market and direction of the primary market is to make sure that lending is done fairly so people, not just low- and moderate-income people, people of color, families with kids, women, people with disabilities, that they have access to mortgage credit in a fair and equitable manner, and in a safe and sound basis, which if we go a little ways back in history, we know is not the case with a market left to its own devices. So in terms of that kind of equity, and how we make sure people are treated fairly and have fair access, the government has a really critical role to play as well.

Chairman KANJORSKI. I really need an explanation for the record and that is why I have encouraged you all to go back to what caused this thing. I am firmly convinced that we need to find some way of defining some of the important causes we agree upon. Apparently, here on this panel, we have five witnesses who would agree this is not all of the government's fault, and one witness who says the solution to this would be going back totally to a free market system. Now this panel and the Congress has to write new rules and regulations and decisions need to be made as to whether we have a secondary market. And if so, who is responsible to encourage it, what kind of subsidization should be made for housing, if any, and should we get involved at all? It seems to me we cannot get back to that unless we get more uniform agreement as to what some of the basic causes for the crash were. And then leading off that, what are some of the solutions or cures we can put in place to prevent some of these things.

One question, because we just recently passed the Regulatory Reform Act, do you think we have totally failed in doing the right thing there and we should have done nothing?

Mr. SANDERS. The Regulatory Reform Act?

Chairman KANJORSKI. The Dodd-Frank bill.

Mr. SANDERS. It is all about systemic risk, etc. We don't know what is going to be in the new agency that has been formed up that is going to moderate the markets. And it didn't mention Fannie and Freddie. Congressman Frank says we are going to do this. I say to my friend, Mr. Taylor, and I gave this presentation in front of Mr. Frank, I said we have pumped $8 trillion in money, guarantees and loans into this mortgage market prior to the private sector getting involved. That is bubblish. By the way, I am not saying that the private sector didn't make some mistakes. Absolutely, there were. But what I am saying is, without the public sector's prodding into housing so heavily, we may not have seen that. Would the market have responded that way had they thought there wasn't this huge demand for it? Because remember, I took it out of my testimony for Mr. Taylor. I wish I had put it in. Take a look at the housing prices in cities. In some major cities, housing prices quadrupled during this bubble period. How do we get affordable housing people into those? There is only one way to do it, 3 percent down. And again, I understand that. But that is bubblish.

Chairman KANJORSKI. But we were all worried about the tulips.

Mr. SANDERS. You are absolutely right. The private sector screwed up.

Chairman KANJORSKI. I would like to go on, but I have to let Mr. Garrett have some of the time.

Mr. Garrett?

Mr. GARRETT. So the last exchange was I guess interesting and telling that here we are, ending in July, and we still don't know what was the underlying cause, at least have a consensus on what was the underlying cause of the economic morass we were just in. Why that is curious and maybe a little ironic is several weeks ago, we just passed a 2,300 page bill fixing the problem. When we were in this room and I was sitting over there and it was the first day of the first joint conference committee, House and Senate conference committee, and we were ready to start voting on the bill and I asked, may I have a show of hands of anyone in the room who actually has read all 2,300 pages. No one raised their hand on the committee. So what you had was no one actually having read the bill. And as we have seen in this last few minute dialogue, we still don't have a consensus as to what was the cause of it. We have a commission that is out there that is going to be coming up with their interpretation, after exhaustive studies and talking to experts like you and others to tell us what the cause was. That, I understand, is not going to get back to us until some time at the end of the year. But here we are already implementing a bill, 2,300 pages, and to what end. A couple of you already made the comment that what we need is certainty, and we need to get capital back into the marketplace.

In the last week or so, it was reported in the Wall Street Journal that Ford was trying to get more capital into the system. And how did that work for them, as Dr. Phil would say. Not too well. It wasn't because of anything that Ford did, it wasn't because of anything that the private markets did, it was all because of this ill-conceived, not thought out what the ramifications of the bill is, and those are not my words, I am sort of paraphrasing Senator Dodd when he said we have see how this bill passes before we see how it all plays out.

We saw how it played out with Ford. Thank goodness Mary Shapiro was able to come back and fix that situation in a band-aid sort of approach for 6 months. Think about how much uncertainty there is there. Think of with the SEC, we don't even know how many regulations that they have to promulgate. I know someone is saying it is 95 regulations, somebody else says it is 102 regulations at the SEC. We don't know how many regulations they have to promulgate. How can anyone say we have just brought certainty to the marketplace?

We have brought uncertainty into the marketplace, and that is just going to be a detriment for a time to come for your industries and the rest.

I think what all of us want, whether it is the free markets or otherwise, is proper allocation of capital. That is the best way for any economy to perform, is if you have the proper allocation of capital. You have had a misallocation when the government encourages to go in one way when it shouldn't. I will concede with Mr. Taylor and others that there were mistakes made all of the way around, private sector, public sector, individuals, investors, and the like. But you have to, I think, agree that a lot of this was prompted by government activity.

I think Ms. Goldberg was saying it is not the low-income loans and what-have-you, and I think some of the documentation sort of points that out. But you have to see what the government did on this to encourage the high income. Remember what the Federal Reserve up in Boston said several years ago just prior to the collapse, they published a report that says, what, that when you do the underwriting, you no longer have to look at traditional valuations, you no longer have to look at income sources, you can consider welfare payments as a proper source of income in the consideration of developing risk assessment and the like.

They were talking about low-income loans in the urban areas, but what happened right after that or some time after that, they said if you don't have to look at those for low-income loans, okay, because there are no longer the traditional values that banks used to use, you would probably say should we be looking at welfare payments as a proper source of income for a bank loan, you would say probably not. But the Federal Reserve of Boston was saying it was okay to consider it. So if it is okay for the Federal Reserve of Boston to do it on that loan, then you had Bear Stearns and others come out on the private sector saying, hey, we must be able to do it on the middle income and the upper income levels as well. And that then skewed the marketplaces.

Ms. Goldberg, you talked a little bit about the downpayment aspects and what-have-you. Is the percentage of downpayment an appropriate indicator of risk?

Ms. GOLDBERG. Sir, if I can take a second and speak to your previous point briefly, one thing on welfare payments, it is often true that people who get welfare don't have the income to support a mortgage, but it is a steady stream of income. And I am not familiar with the Federal Reserve of Boston's paper on this topic, but I suspect that is what they were getting at. I don't think you would find community advocates suggesting that should be the only underwriting criteria. I think we all want to see that loans are underwritten, looking at the borrower's ability to repay the loan. So it is not just are you getting welfare as a criterion for deciding whether you are eligible or should be eligible for a loan or not. There are a lot of factors that go into it.

Several panelists have spoken, what we saw in the unregulated part of the private market was risk layering with lots of different loan features that together contributed to tremendous risk, loans that were not sustainable, and were not underwritten to the borrower's ability to repay.

Having said that, I forgot what your question was.

Mr. GARRETT. Is downpayment an appropriate indicator of risk? Although now, you say that welfare payments may be appropriate.

Ms. GOLDBERG. I will say that I don't believe my organization has a position on the level of downpayment that ought to be required. But I think we would say that we think it is a good idea for people to have a downpayment and to have, as a borrower, some skin in the game. However, just like with high-income people and lower-income people, that should not be the only factor that is evaluated in deciding whether someone is a good credit risk, and whether the loan product that is being offered to them is the appropriate product for them.

Mr. GARRETT. Do you have an answer?

Ms. RODAMAKER. When we talk about the downpayment, that is absolutely one aspect that we use of underwriting. We have gone through and we study every loss, every foreclosure, everything that happens in our mortgage market. The most common cause of foreclosure in our market is divorce, and you can't use that in underwriting.

Mr. GARRETT. This is not the committee that deals with that.

Ms. RODAMAKER. Right. When a couple comes in and applies for a mortgage, they are happy. When they start making payments, maybe that is when they become unhappy.

Chairman KANJORSKI. So all we have to do is outlaw divorce. That is the solution.

Mr. GARRETT. Just a technical question, Mr. Sinks.

When the person comes in and makes their application to the bank, to your colleague to your left, you are doing all of your underwriting and then paperwork, if she is hooked up with one of your clients and they are doing that, what percentage of the cases that she will be sending, applications that will be coming in for PMI, are accepted on average and what percentage are not? Or is it accepted all of the time with just a higher premium?

Mr. SINKS. I will speak on behalf of MGIC because I don't know the industry statistics, but historically, we would have rejected the application probably 2 or 3 percent of the time. In this environment, because we are so cautious, that number is closer to 25 percent.

Mr. GARRETT. But normally it is 2 or 3 percent?

Mr. SINKS. Yes. As you came through the 1990's and 2000 decade, it would be 2 to 3 percent. As the market changed, and we had to adjust our underwriting guidelines accordingly, it is probably in the neighborhood of 25 percent. The primary reason for that is because of concerns over valuations. It is not the credit score. You can verify income and things like that. It is really about the value of the property; is that appraisal good. And in certain markets, in Iowa, it is just fine. But in other markets, we still have concerns about those. I would expect that over a period of time to revert to the mean.

Mr. GARRETT. I will close, I know a couple of you made the comment as for the need of additional information and uniformity in regulation, and your suggestion was along the line with what the GSE has done in the past. Rest assured, the Frank-Dodd bill takes care of all that. We now have an Office of Financial Research that will get every single piece of information that anyone can possibly conceive of in that agency, and they will be a new systemic risk regulator all unto themselves.

So every bit of information that you have ever been looking for, and any information as far as uniformity will come from them and the CFPA, because ultimately, there is no limitation on their power of information and there is no limitation as far as their power for setting some of the standards you need and inasmuch as these are consumer financial products, we have just created everything you need in this bill. So I will close where I began. We don't understand what caused the problem, but we have solved it.

Chairman KANJORSKI. I guess that office will be able to tell us just who is going to get divorced.

The gentlelady from New York, Mrs. McCarthy.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman, for having a second round. I wish we always had more time to have an open debate. I always feel bad for the witnesses—5 minutes. You travel from all over, and you get 5 minutes. It is not enough for some of us. We would like to go back and forth with questions.

Again, I am going to go basically back to the Moody's report that we got this morning. We might not have solved all of the problems, but going back when we started doing the financial reform, the goal was certainly not to put anybody out of business, but obviously there had to be some rules and regulations. I always said if I could legislate morality, we wouldn't be dealing with a lot of the things that we are doing, mainly because so many of these corporations knew what they were doing. They had been warned by their inner controls, and they ignored it because the money was so good coming in. Having said that, I have absolutely no qualms that what we did was the right thing. Is it perfect, there is no such thing as a perfect bill coming out of Congress. I don't care if you are Republican or Democrat, it just doesn't happen. That means we do corrections as we go along. This committee spent a year-and-a-half going section by section by section, and working hard trying to get it right. I am not going to speak about the Senate. I didn't agree with a lot of things that the Senate did. With that being said, I certainly think that we have put Wall Street and some of the financial industry on notice. We are going to be watching you.

For anyone who was planning on retiring, or those of us who actually grew up with parents who came from the Depression and saved so that I would be ready for my retirement, to see that wiped out when I did nothing wrong, and millions of other people in the same boat; and yes, the homeowners. And I agree, going back in 2002, 2003, 2004, this subcommittee, with a Republican chairman, saw that the subprime and the unlicensed mortgage brokers, what they were doing in this country was wrong. We had a good bipartisan bill that I believe could have possibly prevented a lot of things that happened in the housing market. And it came out of this committee with a good vote. It was never allowed on the Floor.

Everybody wants to blame this side of the aisle, believe me, we tried and a number of Republicans tried back then. With that being said, and we solved those problems with unlicensed subprime mortgage brokers going from State to State, they are not going to be able to do that any more. And I think that is a good thing.

With that being said, and again, I also know we are going to have hearings in September on Freddie and Fannie, basically going a little deeper on exactly what went wrong, and we have a lot of information on that already. But I want to go back to why this hearing is being held. Again, I apologize if it was talked about during the 20 minutes I was gone. If any of you have any ideas about the regulatory or legislation changes that must occur for the private mortgage insurance market to be able to play a larger role in the repair of our housing market, because again that is what we are going to be dealing with, I would certainly take your comments.

Mr. SINKS. I will give the first shot. To make us more competitive and bring more private capital or more private exposure, and kind of bring that chart that Mr. Garrett had back into balance, the first thing we need to do is get the FHA prices back in line and commensurate with the risk that they are taking on. They are underpriced from where the private industry is right now. They have new pricing proposed. We know that we expect it to happen. That will clearly expand the pie, if you will, for the private mortgage insurance sector.

In addition to that, they are planning on loan dollar limits that are a little higher than they should be, we believe. Those dollar limits need to be adjusted. And finally, as I alluded to earlier, the conventional market which is Freddie and Fannie, they have a series of fees on their loans as they attempt to rebuild their capital base that make the private execution versus an FHA execution less competitive. What it comes down to is when you add in the FHA having lower prices, and the fees that the GSEs have on the conventional side, when the consumer gets a piece of paper in front of them that says which is the lowest mortgage payment every month, it is, far and away, the FHA these days.

The private mortgage insurance industry, as we alluded to earlier, has been able to raise billions of dollars worth of capital, and we have the capacity to do it. We are ready, willing, and able as an entire industry. And each company is ready, willing, and able. We just can't compete in the market with that kind of pricing, and we can't control that pricing. So that would be the primary influence on what we need.

Mrs. MCCARTHY OF NEW YORK. Just to follow through, and I don't remember who mentioned it when I was listening to the testimony, the appraisals, the appraisals of homes going back a number of years ago. I used to have the real estate people coming in and saying, what is going on here? I had a woman who basically came in, she was buying a home that she certainly couldn't afford and the house was appraised much, much higher than what it was ever worth. And there was no money down. One of the new exotic pieces to get people to buy homes. She herself backed out. She wouldn't be part of it because she thought it was fraudulent. How do we get the appraisals to be honest? You bring three appraisals in, and I saw that with my son and daughter-in-law. One was the top end, which nobody in the neighborhood had; their house was not any better, if anything, it wasn't updated as some of the other houses. And then a really, really low price. I know everybody goes high, low, and then in the middle. But how do you know you are getting a good appraisal because, you are the insurance, do you use different appraisers?

Mr. SINKS. Yes, we do. We have an approved list of appraisers. This is an issue that has been around certainly since the private mortgage insurance industry has been around. As I said earlier, you can verify income, verify FICOs, but that appraisal is the great unknown. It plays havoc when the market is rising. When you see California double in value over a period of time, or it can have an impact when values are dropping. When you look at Detroit and you see values dropping and someone is trying to buy a home, and what is that house really worth?

I think what needs to be done is, most importantly, it needs to be done locally. You need to have trust in people who are in those local markets and truly understand it. In addition to that, you have to have some other checks and balances, whether it is automatic valuation models and things like that might not be the exact answer, but it gives you a reasonableness check on what that appraised value should be.

Mr. TAYLOR. First and foremost, in FIRREA you mandated there be independence between appraisers and financial institutions, and that never happened. Countrywide had their own appraisal shop. Citi, a number of these financial institutions owned the appraisal units. Yes, the guy who ran the mortgage department didn't oversee the appraisers, but they worked for the same company. There has to be independence in those businesses, so there is an arm's length transaction.

Furthermore, there has to be the independence so you can make an appraisal and the lender simply doesn't turn around and never do business with you again. There has to be a process that allows for fairness, mediation, and oversight that protects the appraisers from giving honest appraisals.

Finally, it has to be in person. These automatic valuations have proven not to be very effective. Yes, they work some of the time, but they don't work a lot of the time. We used to have people come into the house, look at what was going on in that house, not just sit in front of a computer and theorize what the value might be.

One of the biggest overlooked groups in this crisis, this foreclosure crisis, was the appraisal industry. And a lot of the ones who tried to stand up and be independent, they are gone because businesses, banks, stopped doing business with them until they got appraisers who did what they said. You absolutely must fix this. I think in the financial reform bill, there is language that allows oversight for this to happen, and it is critical going forward that we really address this problem.

Ms. GOLDBERG. If I can add one note to that, I completely agree about the need for additional oversight. I want to caution you that while I also agree appraisals in many cases helped to fuel the rise of housing prices in a way that didn't make sense, and bore no relationship to reality, appraisals can also work on the opposite end, to harm neighborhoods where property values are undervalued, underpriced.

One of the footnotes in my testimony, I give some of the history of the appraisal industry predating FHA and applying to FHA where appraisers were actually trained that you could judge the value of the neighborhood based on who lived there. And there was a listing of different racial and ethnic groups according to whether they helped inflate property values or sustain property valuation, or whether they diminished property values. While those standards have been dropped from the industry, the effect of that really institutionalized kind of racial approach to valuing property. It is not really erased from the industry, and we need to make sure that kind of discrimination is not happening in appraisals, as well as the artificial inflating of the property values at the other end of the scale.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman. I thank all of you for coming in and enlightening us.

Chairman KANJORSKI. Now the gentleman from Illinois, Mr. Manzullo.

Mr. MANZULLO. Thank you. Can anybody on the panel advise me if private mortgage insurance had anything to do with the collapse of the real estate market?

Mr. SINKS. The literal collapse of the market?

Mr. MANZULLO. Yes. Did you do anything wrong in your industry, Mr. Sinks?

Mr. SINKS. Sure, we did. I think we are one participant amongst many. We were talking earlier about perhaps we haven't figured out exactly what went wrong. I think fundamentally, what went wrong was that basic principles of risk management were done away with. There was no fear in the market. People had different motivations, whether it be the government wanting to house all of America, whether it wanted to be Wall Street to make a buck as quick as they possibly could. I think everybody who was in that food chain from borrower to servicer, and investor at the end, played some role.

Mr. MANZULLO. The big problem is that the Fed has always had the authority to do two things: number one, govern instruments; and number two, determine the underwriting standards. At least as to those banks that the Fed covered. It wasn't until October of last year that the Fed came out with a written rule that said, voila, you had to have written proof of your earnings. Whenever MI was purchased, if this is within the purview of your knowledge, Mr. Sinks, how far did MI go? Did you actually look at closing statements? Or you just got an order to provide insurance based upon salary and the value of the property?

Mr. SINKS. We did look at the documents. We do underwrite the file and provide the second set of eyes. What happened, I think in a sense was that as the market expanded, as Freddie and Fannie took on a greater role, they expanded the underwriting criteria under which they would buy loans. The old idea of 38 percent—

Mr. MANZULLO. Did that influence your issuance of mortgage insurance?

Mr. SINKS. Yes, it did. The reason it did was because competitively, and we touched on it earlier, what happened was there was an expectation within the lending community, which is our customer base, that if Freddie and Fannie had underwriting guidelines, and I am going to use an example of 45 percent debt to income ratio, then private mortgage insurance, you need to play in that game. For us to remain competitive in that environment and be able to participate in the market, we stretched our underwriting guidelines. We reviewed the file, but we allowed the guidelines to expand due to competitive pressures.

Mr. MANZULLO. Let me go to a second area. On the appraisers, we have heard horror stories from many lenders back home. I remember reading in the Post some time ago where an appraiser from Richmond came to appraise a townhouse, or a stand-alone house in Alexandria, Virginia. And we are getting people from Chicago who are driving to Rockford, Illinois, 80 miles to the west, who know absolutely nothing, nothing, I mean, nothing about Rockford, that are giving appraisals. And the Realtors are scratching their heads and saying: Where did these guys come from? They came from Chicago.

The home valuation code of conduct, we had the hearings on that. I looked at that. I have been through probably a thousand real estate closings myself as a private attorney. In fact, I started practicing before RESPA, and we actually had more honest closings before RESPA. There are eight people at HUD working day and night on trying to revise RESPA at any given time.

Now you have a situation where you have an out-of-town appraiser come in, and he doesn't know the fact that there are rumors that the highway may be expanded in front of the house, or he reads the newspaper and hears about the city council which may exercise powers of condemnation and taking a parcel of property, he knows nothing at all about the locality, and yet he is presumed to be dishonest simply because he is local. That is going to really hurt the real estate recovery as far as I am concerned. John, you are nodding your head. It may be the first thing you and I agree with in a long time. Do you agree with that?

Mr. TAYLOR. The second thing, actually. The lack of government oversight in the Fed to put out rules that prohibited these practices.

Mr. MANZULLO. There you are, John.

Mr. TAYLOR. Yes, I totally agree. It is all about local and having that person who really knows the property, and it is all about that person having the independence from not being overly influenced by the broker or the lender.

You do that, build that, which is what you supposedly built with FIRREA when you created this separation, and we will clean up this mess with the appraisers, notwithstanding Debbie's comments about making sure that it is not done in a discriminatory fashion.

Mr. MANZULLO. The mess is done now. The Realtor goes out there. It is not hard nowadays to get comparables. When I started practicing law, no one had heard about the Internet. You had to research it the old-fashioned way at the courthouse. And that was always interesting because in Illinois, we had the green sheets. The green sheets would tell you which portion of that real estate was actually attributed to personal property.

Mr. Chairman, I wanted to bring that up because I just don't think when the GSEs and FHA adopted the HBCCs by reasons of Attorney General Cuomo somehow forcing them to do that, that is going to help in the real estate recovery; do you agree with that, John?

Mr. TAYLOR. I don't know about Attorney General Cuomo being the one who forced them into that position, but I agree that we need local. These appraisal management companies I think are not a good model to get accurate appraisals. We need inside; somebody needs to go into the house, and somebody needs to know the neighborhood and know what is going on. I think that will get us back to sane, accurate valuations.

Mr. MANZULLO. Do the rest of you agree with Mr. Taylor's statement?

Good. On that note, I will end.

Chairman KANJORSKI. Thank you.

If I may comment, the regulatory reform bill contained about 200 to 300 pages of revolutionary ideas about appraisals and how we handle them. And the bill did not take 18 months; it took 6 or 7 years of bringing that about.

I think we are going to go on for another hour-and-a-half. No, Mr. Garrett has reined me in. I got carried away. A lot of times when we get down to a few members, we get extended questioning periods. I appreciate the response and the back-and-forth nature of the panel. I was hoping we could get everybody to join hands and say we agree on everything, but we probably have failed. We will try that next time, or we will come down hard on the universities again.

Mr. SANDERS. If I may make one closing remark on my behalf, Mr. Garrett asked the question, and I wanted to provide some clarity on it. At one point, believe it or not, I was an advocate for Fannie, Freddie, and the FHA. Unfortunately, something happened at the beginning of the last decade. Freddie and Fannie were the gold standard for underwriting, 20 percent down, we don't need private mortgage insurance for 20 percent down. Everybody believed Freddie and Fannie was right on target. FHA was small.

A question for you: What happened? Why did Freddie and Fannie balloon in size and why did the FHA balloon in size? I think if you are trying to look at a source of what happened in the housing market, why not look at that?

Chairman KANJORSKI. I don't blame the Bush Administration for selling real estate at any price.

I think Mrs. McCarthy put her hands on it. We can sit here forever and blame one political party or another political party, or one Congress or another Congress, or one President or another President. The reality is, I would hope we can get to a common understanding of what happened because until you identify a problem, it is hard to come up with a solution, and we really do have on both sides of the aisle a gross disagreement on what really fundamentally caused this problem.

I am hoping when the Commission gets done, we will come closer together on that issue. Regardless of what happened and what did cause it, it is not going to cure a thing. The future is going to cure something, and I think we should take on the rewriting of what happens to lessen the opportunity. We will never stop risk and we will never stop ridiculousness in a free market society, and we should not, but we can do things to improve it.

The one impression that I may have left that I want to remove, I think the mortgage insurance market has played a very good role in real estate in the United States. But we have to recognize that for 2 decades after the Great Depression, it disappeared. And sometimes market situations will not cause it to come about and come back when there is such a tremendous disruption.

I really do believe Fannie and Freddie fulfilled a great function in our society in the period from the war on until we lost control of them for one reason or another and they went overboard. But they are manmade institutions and therefore correctable and lend themselves to solutions or something similar to an enforced solution.

I think what is important, if we can bring the temperature down and get serious, and I am inviting my friends on the right side to join us in that, and I don't mean right side, it is on my right. What disturbs me the most, and I will shut up after that, is that we have been through a real trauma in the country and the average family has been through a real trauma, and at this point, there is a lot of fear in those families and they are looking for more level heads to prevail. Sometimes we in the Congress do not provide the right image for that level head. I am hoping now we can get down to being levelheaded. If we can, we can solve this problem. I think we are on our way to the solution to the problem. I am absolutely convinced of that. The faster it happens, the better off we are.

I agree with Mr. Zandi. And the fact he work for Moody's and was a Republican and supported Mr. McCain for President, that may be good. Because he did that, he probably should be more reliable to my friends on the other side. Notice I didn't say "right." He basically said we are not going to really resolve this problem on real estate until we resolve the unemployment problem.

Conversely, the real estate problem is going to stabilize the whole economy for a pretty good picture into the future. I tend to agree with that. So I say regardless of what side of the aisle we are on, let's get on with the work.

Let me say, thank you all very much. I was a little annoying and snippy to all of you. I didn't intend to do that, to be that way. I was trying to extract out of you some good comments, and we certainly got some. Mr. Sanders, you and I sparred very well. I appreciate that, with a good sport.

Mr. SANDERS. Mr. Kanjorski, after today's panel, I am changing my name to George Mason.

Chairman KANJORSKI. I had a much stronger comment than that, but I did not use it. Thank you all very much. We hope you still make your planes and trips back. You have done a great service. It is one of the elements that we are going to take up as we are going through the reformations of the GSEs and other problems of establishing a better focus for real estate in the country. Thank you very much.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the record will remain open for 30 days for members to submit written questions to today's participants and to place their responses in the record.

Before we adjourn, the following will be made a part of the record: a letter from Essence Guaranty to Secretaries Geithner and Donovan regarding reform of the housing finance system. Without objection, it is so ordered.

The panel is dismissed, and this hearing is adjourned.

[Whereupon, at 4:35 p.m., the hearing was adjourned.]

A P P E N D I X

July 29, 2010

OPENING STATEMENT OF
CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON THE FUTURE OF HOUSING FINANCE REFORM: THE ROLE OF PRIVATE MORTGAGE INSURANCE

JULY 29, 2010

We meet today to continue our hearings about the future of housing finance. As we work to reform this complex system, we must learn more about private mortgage insurance and determine whether to make changes related to this product. We will therefore examine the structure, regulation, obligations, and performance of mortgage insurers.

Since its creation more than a century ago, private mortgage insurance has, without question, allowed countless families to achieve the American dream of homeownership. It has also worked to safeguard taxpayers by providing a first layer of protection against foreclosure losses for lenders and for mortgages securitized by Fannie Mae and Freddie Mac.

Over the years, the industry has had to respond to significant economic challenges. During the Great Depression, inadequate capital reserves and an inordinate amount of mortgage defaults drove every mortgage insurer into bankruptcy. As a result, the private mortgage insurance industry disappeared for more than two decades.

Many, including me, feared the recent collapse of the housing bubble could produce a similar result. For a while, the industry teetered on the brink of extinction. Some mortgage insurers also sought, but never received, direct TARP assistance.

We had good reasons to worry. Historically, about 4 percent of mortgages guaranteed by mortgage insurers go into default in the average year. During this crisis, however, approximately 1 in 3 mortgages made in 2006 and 2007 and insured by mortgage insurers are expected to go into foreclosure over the life of the loan. As a result, some estimate the industry will lose between $35 billion and $50 billion when all is said and done.

Nevertheless, it appears the industry will survive because of some economic luck, many regulatory waivers, and its distinctive capital structure. In particular, mortgage insurers must maintain contingency reserves of 50 cents on every premium dollar earned for 10 years. Thus, they build up capital in good times in order to pay out claims in rocky financial periods.

While these countercyclical reserves are unique to the mortgage insurance industry, they provide an important model for Congress to consider in reforming the structure of the housing finance system. If Fannie Mae and Freddie Mac had held similar reserves, both enterprises may have weathered the recent financial hurricane much better.

Still, the industry's performance has been far from perfect during this crisis. Some have questioned whether mortgage insurers held enough capital, because they had to seek regulatory forbearance and curtail underwriting. This reduction in new business has probably slowed the recovery of our housing markets. Others have raised concerns about whether mortgage insurers have increased the government's costs related to the conservatorship of the enterprises.

Specifically, mortgage insurers only pay claims on foreclosed homes. They have no affirmative obligation to prevent foreclosures. As a result, Fannie Mae and Freddie Mac, rather than mortgage insurers, have often had to bear the financial losses related to loan modifications. Mortgage insurers exist to provide the first level of protection against losses and should not evade their responsibilities by contractual technicalities. We must review this arrangement.

We also need to explore the present credit enhancement requirements under the charters of Fannie Mae and Freddie Mac. While the standard U.S. mortgage insurance policy indemnifies against losses created by a default in an amount equal to the first 20 to 30 percent of the lost loan principal, an Australian policy covers 100 percent of the home loan amount.

Additionally, we should examine consumer protection issues, the State regulation of the industry, and its indirect Federal regulation. The problems of Fannie Mae and Freddie Mac resulted, in part, from the competing mandates of two regulators. As we reform our housing finance system, we may therefore want to streamline the oversight of mortgage insurers.

In sum, all options for reforming our housing finance system are on the table, including those related to private mortgage insurance. I anticipate a fruitful and productive discussion around these and other issues today.

NFHA
National Fair Housing Alliance

Testimony of Deborah Goldberg, National Fair Housing Alliance
On Private Mortgage Insurance
Before the House Financial Services Committee Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
July 29, 2010

Good afternoon. On behalf of the National Fair Housing Alliance (NFHA), I want to thank you for the opportunity to testify today about private mortgage insurance. Founded in 1988, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. NFHA uses comprehensive education, advocacy and enforcement programs to provide equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation. My name is Deborah Goldberg, and I am the director of NFHA's Hurricane Relief Project. I am also involved in NFHA's public policy work on a range of financial services issues, including lending, insurance and foreclosures.

Introduction

NFHA commends the Financial Services Committee for holding this series of hearings on the future of the nation's housing finance system, and the Subcommittee for holding this hearing on the role of private mortgage insurance in the housing market. We believe that homeownership is an important path to building wealth, and done correctly, can be a mechanism for eliminating much of the considerable racial and ethnic gap in wealth that divides our country.[1]

In the face of the foreclosure crisis we are currently facing, some may conclude that our housing policies have gone too far in promoting homeownership, and that we should pull back from that goal. Having watched this crisis unfold in communities of color all across the country, we come to a different conclusion. We believe that it is critical to understand the extent to which the crisis has been fueled by a misalignment of interests

[1] See Edward N. Wolff, "Recent Trends in Household Wealth in the United States: Rising Debt and the Middle-Class Squeeze—An Update to 2007," Levy Economics Institute of Bard College Working Paper No. 589, March 2010, which compares income, net worth, non-home wealth and homeownership rates for Non-Hispanic Whites, Non-Hispanic African-Americans and Hispanics from 1983 to 2007. Using data from the Federal Reserve Board's Survey of Consumer Finances, Wolff found that the mean non-home wealth for Non-Hispanic whites in 2007 was $495,300. For Non-Hispanic African-Americans, the mean non-home wealth was $70,700, and the mean for Hispanics was $96,300. Homeownership rates for these groups were 74.8%, 48.6% and 49.2%, respectively.

between borrowers and lenders, brokers, investors and servicers, which created financial incentives to put borrowers in unsustainable loans. It is also critical to understand the types of loan products which are – and are not – sustainable, the protections needed to prevent unsustainable products from flooding the market, and the mechanisms like private mortgage insurance that can be used to mitigate against mortgage risk.

My testimony today will address the questions raised by the Subcommittee, including:

- The role and importance of private mortgage insurance to consumers;
- The impact of private mortgage insurance on loan modifications;
- Whether private mortgage insurance benefits borrowers and alternatives that may be available;
- The need for additional consumer protections related to private mortgage insurance; and
- How private mortgage insurance should be paid for.

The Role and Importance of Private MI Companies

The primary beneficiaries of private mortgage insurance are the originating lender and the investor in the loan. The former gains the ability to sell the loan, freeing capital to make more loans. The latter gets protection against the risk of default, without having to pay for the insurance policy. The mortgage insurance premium is paid by the borrower, who gets no benefit in the event of a default.

That is not to say that private mortgage insurance has no benefits for borrowers. To the contrary, private mortgage insurance makes it possible for people to buy a home with a down payment of less than 20%. In that sense, mortgage insurance is a win-win proposition. It protects the lender and investor, is profitable for the insurer, and puts homeownership within reach for the borrower. Without private mortgage insurance, the requirement for a large down payment would be an impossible barrier to homeownership for many people of color and low- and moderate-income people, who have less accumulated wealth than white households or higher income households. When combined with solid underwriting and sustainable loan terms, loans with low down payments carrying private mortgage insurance have shown stable performance.

The federal government's mortgage insurance programs, particularly the Federal Housing Administration (FHA), have also made homeownership possible for many families of color and many with modest incomes. FHA, developed in 1934 to jump start the housing market during the Great Depression, provided the model upon which today's private mortgage insurance industry is based, and demonstrated that it was possible to make homeownership work for families with modest income. The MI industry has provided an important private sector alternative to that mortgage insurance program, creating competition for FHA and other government programs, and providing choice for borrowers. This competition has been critical to the health of many communities.

Private Mortgage Insurance and Loan Modifications

The presence of private mortgage insurance on a loan, and the opportunity for a servicer to file a claim for the covered portion of the loan balance, could tip the scales in favor of moving forward to foreclosure. In this situation however, the interests of the borrower and the private mortgage insurer are aligned. They both benefit if foreclosure can be avoided. The borrower gets to keep his or her home and the insurer gets to avoid paying a claim. Neighboring homeowners also benefit when foreclosure is avoided, as does the community as a whole.

Efforts by private mortgage insurance companies to help prevent foreclosure are not merely charitable; they also serve the companies' bottom lines. Nonetheless, we commend the industry for stepping forward early on to raise concerns about the potential for this "thumb on the scale" effect, and for working with the Treasury Department, servicers and borrowers to try to prevent foreclosures.

One option the industry has put forward is the pre-claim advance, through which the private mortgage insurer makes a partial payment to the servicer before the loan goes to foreclosure in order to make a loan modification viable. Where this can be used, it has the potential to keep the borrower in the home, save money for the mortgage insurer, and provide a favorable economic return to the investor.

Unfortunately, the impact of these and other private mortgage insurance industry loss mitigation efforts is unclear. Borrowers may not be aware that their loan carries mortgage insurance, and are even less likely to know whether or not their servicer has filed a claim or how that claim was resolved. As a result, borrower advocates have little evidence about how private mortgage insurance is affecting foreclosure prevention efforts.

We are not aware of any comprehensive data tracking the number of mortgage insurance claims paid as the result of foreclosures, the number of loan modifications made where pre-claim advances were involved, and the number of modifications that were able to be accomplished without intervention from the MI company. In order to fully understand the role that private mortgage insurance plays in loan modifications, it would be very helpful to have data on these issues. Such data should also include information about any patterns that are developing based on borrower characteristics, loan characteristics, geographic location, investor requirements or other factors affecting the outcome. We encourage the Subcommittee to explore these questions in more depth.

Alternatives to Private Mortgage Insurance

There are a number of alternatives to private mortgage insurance, some of which are more beneficial to borrowers than others. In the subprime market, for example, it was not uncommon to see so-called "piggy-back loans," where the first mortgage was limited to 80% of the purchase price, but the borrower took out a second loan for 10% to 20% of the remaining amount. This kept the first mortgage down to 80%, but left the borrower with a combined loan-to-value ratio of 90-100%. Such a high level of housing debt proved unsustainable for many borrowers.

On the other hand, the community development world has crafted a number of alternative credit enhancements that have benefited borrowers, lenders and investors. For example, some non-profit organizations have developed extensive homeowner and credit counseling programs, sometimes with substantial requirements for one-on-one counseling sessions, that can serve as an alternative form of credit enhancement. This homebuyer education process gives borrowers the information necessary to manage the costs and responsibilities of homeownership, and connects them to resources that can help them through any unexpected difficulties. Because it can, in some cases, eliminate the need for private mortgage insurance, it is less costly for the borrower. At the same time, it gives lenders and investors confidence that the borrower will make payments in a timely manner.[2]

A variation on this approach is the sweat equity model used by Habitat for Humanity, which requires potential homeowners to spend a specific number of hours working on the construction of their homes. The investment of time and labor by the homeowner minimizes the likelihood that he or she will default. In some places, local Habitat programs have been able to partner with lenders to provide homebuyers with mortgages that rely on this sweat equity as a credit enhancement, rather than requiring private mortgage insurance.

"Earned equity" is another form of credit enhancement that has been used in the community development world. This is a type of rent-to-own arrangement, where a portion of the tenant's monthly rent payment is set aside in an escrow account controlled by a non-profit organization. If the tenant makes rent payments on a timely basis for a specified period of time, he or she obtains a loan to purchase the property, and when the tenant assumes ownership, the funds in the escrow account are converted into a down payment-like equity investment on his or her behalf.

Another approach is for a third party, generally a community development corporation or other non-profit organization, to set up a reserve account that is held against specific loans. If any of the borrowers whose loans are backed by the reserve account should default, the reserve funds are used to make the lender whole.

Often, these credit enhancements are layered, so that sweat equity, earned equity or a third party reserve account would be combined with extensive borrower education. A drawback to these approaches, as compared to private mortgage insurance, is that they lack standardization. As a result, their use is relatively limited. And to the extent that they are used in conjunction with loans that are held in portfolio by the originating lender, their volume is necessarily constrained.

[2] One example of a program using this model is the Anti-Predatory Lending Remediation Program developed by the Toledo Fair Housing Center in partnership with Fannie Mae. Other organizations have used a similar model.

We commend the Subcommittee for considering alternative forms of credit enhancement as part of its deliberations about the future of the housing finance system, and encourage you to look for ways to expand the use of credit enhancements that lower costs to the borrower while providing protection for the lender and investor.

Protections for Consumers: Fair Housing Concerns

a. The Federal Government Has an Interest and Obligation to Ensure the Private Mortgage Insurance Industry Operates Fairly

The PMI companies have benefited tremendously from federal requirements imposed on the Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac. According to the terms of their charters, the GSEs cannot purchase loans with down payments smaller than 20% unless they have some form of credit enhancement. Private mortgage insurance has been the primary mechanism through which the GSEs have met this requirement. Without this requirement, there is little question that the private mortgage insurance industry would be much smaller.

In addition, the risk retention provisions of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act also create a carve-out for private mortgage insurance.[3] Thus, regardless of what the future may hold for the GSEs, the private MI industry will continue to benefit from federal regulatory requirements. Together, these federal regulatory requirements have played an essential role in creating a market for the industry. As a result, the federal government has both a special interest and a special obligation to ensure that the industry is operating in a manner that is fair and non-discriminatory, as well as safe and sound.

b. MI Companies Are Subject to the Fair Housing Act

The federal Fair Housing Act[4] makes it illegal to discriminate on the basis of race, color, religion, national origin, sex, familial status or disability in all real-estate related transactions. Among other provisions, Sec. 804. [42 U.S.C. 3604] of the Act makes it unlawful:

> (a) To refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, *or otherwise make unavailable or deny*, a dwelling to any person because of race, color, religion, sex, familial status, or national origin. (emphasis added)

Sec. 805. goes on to say:

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[3] The Dodd-Frank Wall Street Reform and Consumer Protection Act addresses risk retention requirements in Sec. 941. The law directs federal regulators to define a "qualified residential mortgage," and set risk retention requirements taking into consideration, among other things, " mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risk of default."

[4] 42 U.S.C. 3601 et seq.

(a) In General.--It shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.

(b) Definition.--As used in this section, the term "residential real estate-related transaction" means any of the following:

(1) The making or purchasing of loans or providing other financial assistance--

(A) for purchasing, constructing, improving, repairing, or maintaining a dwelling; or

(B) secured by residential real estate.

The Act covers mortgage insurance transactions, just as it does mortgage lending and homeowners insurance. This means that private mortgage insurance companies may not deny coverage or offer coverage on different terms and conditions to borrowers based on their membership in any of the classes protected under the Act. They may not treat borrowers differently, nor may they institute policies that have a disparate impact on members of protected classes.

c. The Industry's Lack of Transparency Creates Fair Housing Concerns

Relatively little detailed information is available to the public about many of the operations of the private mortgage insurance industry, including its underwriting standards, the characteristics of the borrowers to whom it provides insurance and the geographic location of the properties securing the loans insured. Eight companies voluntarily submit aggregate information to the federal banking regulators in conjunction with the Home Mortgage Disclosure Act. These data provide a high level overview of activity by these particular companies, but not the level of granularity needed to determine fair lending compliance. They do not include data at the loan or census tract level, for example, which would be necessary for fair housing compliance purposes. This lack of transparency raises concerns about potential fair housing and other consumer protection problems in the industry.

d. The Problem of Adverse Competition

This concern is compounded by the fact that borrowers do not obtain private mortgage insurance directly. Rather, when it is required, it is arranged by the lender. This means that mortgage insurers compete for the lender's business, not the borrower's business, creating the conditions in which adverse competition can take place. Private MI companies have an incentive to make their product as attractive, and as profitable, to lenders as possible. They have very little incentive to attract borrowers through lower prices or more competitive terms and conditions. This may or may not result in terms, conditions or prices that disadvantage members of protected classes, but more transparency in this area would enable the agencies responsible for ensuring Fair Housing

Act compliance and members of the public to determine whether or not problems do exist.

Because borrowers do not shop for private mortgage insurance directly, they have no basis for comparing their private MI coverage with that of others who are similarly situated. This makes it nearly impossible for them to determine whether they have been treated fairly, and underscores the importance of oversight by the government. Unfortunately, in our experience, fair housing compliance is not an area in which most state insurance regulators have significant expertise, nor do they make it a focus of their market conduct examinations. The federal government could play a very useful role to protect consumers if it stepped in to ensure fair housing compliance by mortgage insurance companies.

Our concern about these fair housing issues is also based on the history of racial redlining and other forms of discrimination in the real estate industry overall, many of which were institutionalized by the federal government in the early days of the Federal Housing Administration.[5] While the discriminatory policies of the FHA have long since been

[5] At the time FHA was established, real estate, lending and appraisal manuals embraced the idea that racial homogeneity was key to sustaining home value and that the racial characteristics of the neighborhood affected real estate value and, therefore, loan risk. In one appraisal treatise, the author indicated the significance race played in property valuation. Frederick Babcock wrote in chapter 7, "Influence of Social and Racial Factors on Value" of his appraisal manual, *The Valuation of Real Estate* (New York: McGraw, 1932)

> "Among the traits and characteristics of people which influence land values, racial heritage and tendencies seem to be of paramount importance. The aspirations, energies, and abilities of various groups in the composition of the population will determine the extent to which they develop the potential value of the land." (pg. 86)

> "Most of the variations and differences between people are slight and value declines are, as a result, gradual. But there is one difference in people, namely race, which can result in a very rapid decline. Usually such declines can be partially avoided by segregation and this device has always been in common usage in the South where white and Negro[sic] populations have been separated." (pg. 91)

Indeed appraisal manuals created by the American Institute of Real Estate Appraisers listed a ranking of races and nationalities to indicate their impact on real estate value. The most favorable groups were listed at the top. The least favorable groups were listed at the bottom. One of the rankings appeared as follows:

1. *English, Germans, Scotch, Irish, Scandinavians*
2. *North Italians*
3. *Bohemians or Czechs*
4. *Poles*
5. *Lithuanians*
6. *Greeks*
7. *Russians, Jews (lower class)*
8. *South Italians*
9. *Negroes*
10. *Mexicans*

eliminated, their impact lingers in the market place, and we are still struggling to overcome them. In the absence of a rigorous system of fair housing oversight and enforcement for the private mortgage insurance industry, it is difficult to have confidence that its policies and procedures have been subjected to the necessary fair housing compliance evaluation.

e. Reliance on Credit Scores May Disadvantage Protected Classes

Another area of concern from a fair housing perspective is the industry's use of credit scores for determining whether to offer mortgage insurance to a particular borrower, and what price to charge. This concern is based on two primary factors. First, the use of credit scores tends to disadvantage people of color, women, and others whose scores are often lower than those of white borrowers. This may be due to their lack of access to mainstream sources of credit and their resulting reliance on sources of credit that affect credit scores negatively, like finance companies and payday lenders.

Second, there is growing concern about how useful credit scores are for predicting loan performance and whether the financial sector is placing too much reliance on credit scores rather than other risk factors such as loan terms. Recently, many consumers with perfect payment records have found that lenders have lowered their credit limits in order to reduce the lenders' own exposure. The resulting increase in credit utilization has led to plummeting credit scores, even while the consumers continue to make timely payments. Such changes raise the question of whether the consumer's previous (higher) credit score was accurate, whether the current (lower) score is accurate, or whether neither is an accurate measure of the credit risk he or she poses.

f. The Need to Distinguish Between Risky Loans and Risky Borrowers

In the mortgage arena, research conducted by the Center for Community Capital at the University of North Carolina indicates that loan characteristics, including prepayment penalties, adjustable interest rates and origination channel (i.e., broker originated loans

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This concept was not only embraced and perpetuated by the private sector but, was fully adopted by the government as the Home Owners Loan Corporation, the Federal Housing Administration, and the Veterans Administration all based their underwriting guidelines on these biased viewpoints.

The Home Owners Loan Corporation, founded in 1932, created a series of color-coded maps indicating the level of risk presented by each neighborhood. Race was a key factor in determining the risk level of neighborhoods evaluated by the HOLC. (See Hillier, Amy, *Residential Security Maps and Neighborhood Appraisals: The Home Owner's Loan Corporation and the Case of Philadelphia*, Duke University Press, 2005) The HOLC institutionalized the practice of lending redlining within the federal government. This served to sanction discriminatory policies and practices that were already being perpetuated by the private sector. Because racially mixed neighborhoods and predominately African-American communities were graded as the areas with the highest degree of risk, very few loans were approved in these areas.

By the time the FHA and VA programs were established, lending redlining was a systemic function of the federal government. The FHA and VA utilized the same restrictive and discriminatory policies that had been adopted by the HOLC. The FHA referenced minorities as adverse influences upon a neighborhood.

vs. retail loans) are better indicators of loan performance than borrower characteristics.[6] Unfortunately, credit scoring systems do not make this distinction, a problem with profound implications. Nearly 3 million households have gone through foreclosure since 2007, and millions more face foreclosure in the next few years. Many of these families were sold inappropriate and unsustainable loans, whose risky features doomed them from the outset. Had they been placed in loans without the same risk characteristics, they might well still be in their homes and making timely mortgage payments.

Communities of color, which were targeted for abusive loan products, have been particularly hard hit by the foreclosure crisis. In particular, African-American and Latino borrowers received a disproportionate share of sub-prime, higher cost and unsustainable loans.

- African-Americans and Latinos are more likely to receive payment-option and/or interest-only mortgages than their White counterparts. [7]
- African-Americans and Latinos are much more likely to receive a subprime loan than their White counterparts according to HMDA data. Roughly 54% of African-Americans and 47% of Latinos received subprime loans compared to approximately 17% of Whites.
- Even higher income African-Americans and Latinos receive a disproportionate share of subprime loans. According to one study that analyzed more than 177,000 subprime loans, borrowers of color are more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in creditworthiness.[8]
- An analysis by the Center for Responsible Lending shows that borrowers residing in zip codes whose population is at least 50 percent minority are 35 percent more likely to receive loans with prepayment penalties than financially similar borrowers in zip codes where minorities make up less than 10 percent of the population.[9]

Moreover, a recent study by the Center for Responsible Lending demonstrates that African-Americans, Latinos and Native-Americans are more likely to experience foreclosure than their White counterparts. The study reveals that African-Americans are 76% more likely, Latinos are 71% more likely and Native Americans are 31% more likely than their White counterparts to experience foreclosure[10].

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[6] Lei Ding, Roberto G. Quercia, Wei Li, and Janneke Ratcliffe, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models," May 17, 2010, Forthcoming in *Journal of Real Estate Research*, available at *http://www.ccc.unc.edu/abstracts/091308_Risky.php.*
[7] *Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumers and Lenders*. Consumer Federation of America, May, 2006.
[8] See Bocian, D. G., K. S. Ernst, and W. Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending, May 2006, p. 3.
[9] Bocian, D.G. and R. Zhai, *Borrowers In Higher Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans*, Center for Responsible Lending, January 2005.
[10] Bocian, et. al., "Foreclosures by Race and Ethnicity: The Demographics of a Crisis", July, 2010. http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf

To the extent that risky loan features were responsible for these foreclosures, failure to distinguish between risk associated with the loan product and risk associated with the borrower may unfairly increase disparities in credit scores between people of color and others. Continued use of credit scores under these circumstances, by private mortgage insurers and others, raises significant fair housing concerns. We urge the Subcommittee to explore this issue in greater detail, and to take any steps necessary to ensure that the use of credit scores for mortgage insurance underwriting and/or pricing does not disadvantage people of color and others protected under the Fair Housing Act.

Paying for Private Mortgage Insurance

The cost of private mortgage insurance is commonly built into the borrower's monthly mortgage payment. Other arrangements do exist, but they are used much less extensively. Under federal statute, when a borrower can demonstrate that the loan-to-value ratio has dropped below 80%, he or she can request the servicer to cancel the private mortgage insurance coverage, and the monthly premium is no longer collected by the servicer. Further, when the outstanding loan balance drops below 78% of the original loan balance, the servicer is required to cancel the mortgage insurance policy. Because the payments are made monthly, rather than rolled into the principal balance, cancellation under either of these circumstances is relatively easy.

It is critical that any alternative payment arrangement the Subcommittee might consider be structured so that it can be cancelled when coverage is no longer required. Any arrangement that rolls the premiums into the loan balance works to the disadvantage of the borrower, who will be forced to pay interest on that coverage for the life of the loan, even if the coverage is no longer in force.

Conclusion

Once again, I thank the Subcommittee for holding this hearing and for inviting me to testify. As you consider the future of the housing finance system, it is important to think about the need for credit enhancements to expand homeownership options and to consider whether alternatives to private mortgage insurance can and should be explored. It is also important to ensure that the industry operates in a manner that is fair and non-discriminatory. If the Subcommittee can obtain some of the data discussed here, it will help to ensure that the debate about these very complex questions is better informed. NFHA will be happy to assist you in your investigation of these questions in any way that we can, and I look forward to your questions.

Statement of Janneke Ratcliffe

Associate Director

UNC Center for Community Capital

Before the

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

United States House of Representatives

Hearing on

Future of Housing Finance: The Role of Private Mortgage Insurance

July 29, 2010

Good morning Chairman Kanjorski, Ranking Member Garrett and members of the subcommittee. I am Janneke Ratcliffe, associate director for the Center for Community Capital at the University of North Carolina at Chapel Hill and also a Senior Research Fellow in Housing Policy at the Center for American Progress Action Fund.

I am honored to have the opportunity to share some thoughts on the future of the housing finance system, in particular, the role of private mortgage insurance. Your inquiry sheds light on an important, but often obscure, part of the mortgage business. Private mortgage insurance has long played an important role in facilitating home ownership, and has recently provided an element of stability to the market. An examination of this particular industry holds lessons that can inform the overall mortgage finance system.

The importance of high loan-to-value lending

A discussion about the role of mortgage insurance must begin by stressing the importance of giving families the opportunity to buy homes when they do not have enough accumulated wealth to make a big down payment, which is what primary mortgage insurance exists to do. This is not about speculative, "no money down" schemes; this is about the first step to building family economic security and realizing the long-term benefits of homeownership. Surely many of us and our family members have started up the homeownership ladder with a modest down payment and a loan made possible because of some form of mortgage insurance: be it private mortgage insurance, Federal Housing Administration (FHA) insurance, or the Veteran Affairs (VA) program for servicemen and women. I, for one, relied on private mortgage insurance to buy my first home.

Access to this type of financing is critically important because home ownership continues to be the cornerstone of household wealth in the United States. At a macro level, real estate holdings comprise the largest element of household assets in the United States.[1] Its value to individual families is equally profound, and increases as you go down the income spectrum, with home equity comprising more than three quarters of the wealth of low-income families.[2] Among families earning between $20,000 and $50,000, those who own homes have 19 times the wealth of those who rent.[3]

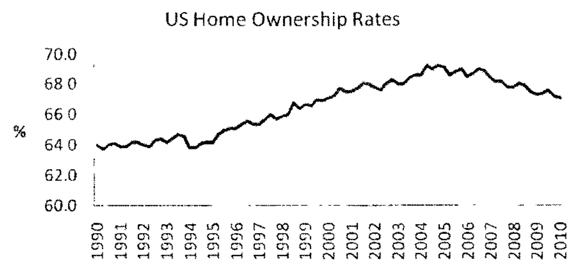
Homeownership continues to be one of the best potential answers to the persistent racial wealth gap. The median wealth of black families is a fraction of that of the median white family ($5,000 vs. $100,000, respectively as of 2007).[4] This gap is echoed in homeownership rates: As of the end of 2009, roughly 72 percent of white households owned their own homes, less than half of African-American and Hispanic households owned theirs. Among Hispanic and Black households, owners have 39 and 85 times the wealth of renters, respectively.[5]

Historically, and even today, as a leveraged investment, (with even modest appreciation and a built-in savings mechanism), homeownership represents the best way for households to build wealth and long-term assets. However, this requires access to responsible financing, which can be barred by income, credit, and asset requirements that either lock people out of the market, or leave them open to higher-cost lenders. We have long recognized that among those three primary constraints, reducing the down payment barrier is the best way to increase ownership opportunity for more low-income or minority households.[6] The median sales price of a single-family home in the US in 2009 was $172,100;[7] making a 20 percent down payment required $34,420 in assets, greater than the entire annual income of roughly a third of all U.S. households.[8]

In the average year, of all the home mortgages made, nearly one-third are to families with less than 20 percent equity, and among these are families who will later buy another house, perhaps yours or mine.

There is a right way to do high loan-to-value lending

It is well understood that low equity is associated with higher risks; if a borrower with little home equity loses their job, for example, they cannot easily sell the house to pay off the mortgage. This basic understanding is part of why FHA/VA insurance was developed, why the government sponsored enterprises charter requires certain other forms of credit enhancement to buy loans with loan-to-value above 80 percent, and why banks are required to hold more capital for the higher loan-to-value mortgages they hold. Even in the wake of the foreclosure crisis, we have evidence that this risk can be managed through financing that has enabled hundreds of thousands of working families with modest incomes to become successful homeowners. This was accomplished not through exotic mortgages that created only an illusion of homeownership, but through consumer-centric policies and practices that removed barriers to homeownership for first-time, minority and low-income families, responsibly. These programs did not develop out of financially engineered sleight of hand that failed to account for risk. They evolved through decades of careful innovation, such as Community Reinvestment Act lending programs, new approaches introduced by the MI companies and GSEs, adjustments to underwriting guidelines, pre-purchase counseling, and down payment assistance programs.[9] These efforts paid off in a steady increase in homeownership rates between 1995 through their peak in 2004. Note that the subprime boom was just getting into full swing then, and that during the peak years in 2004 – 2007, homeownership rates actually leveled off and started to decline through the foreclosure crisis.



Source: Current Population Survey/Housing Vacancy Survey, Series H-111 Reports, Bureau of the Census.

One example of what we know about the right way to finance affordable homeownership is the Community Advantage Program, or CAP. Launched in 1998, by Self-Help in partnership with Fannie Mae and the Ford Foundation, this program has funded more than 50,000 mortgages nationwide. The median borrower earned $33,000; about forty percent of the mortgages are to single female-headed households, and about forty percent are to minority borrowers. The risk profile of these mortgages looks daunting, especially by today's standards: 44 percent had a Fair Issac & Company score at origination of 660 or less and 90 percent of the borrowers put down less than 10 percent, including 69 percent who put down less than 5 percent. Yet to date, fewer than 4 percent of the loans have ended in foreclosure, The CAP borrowers received fixed-rate, thirty-year, amortizing mortgages at prime-market pricing, fully underwritten by the originating lenders following guidelines approved by Self-Help. Our research found that borrowers who received a subprime loan were three to five times as likely to default as CAP borrowers with the same risk profile.[10] Meanwhile, the median CAP owner accumulated more than $20,000 in equity through the end of 2009, more than she would have earned following the Dow Jones Industrial Average and, when you consider the modest equity investment made, that represents a double digit return on investment annually. CAP demonstrates that high loan-to-value lending makes sense for lenders and for households, when done right.

Why the private primary mortgage insurance model works

The private mortgage insurance model provides, on a much larger scale, another answer as to the right way to support high loan-to-value lending. An industry built on insuring mortgages with low down payments has weathered the mortgage crisis, paid substantial claims without any federal support, and even managed to attract new capital.

In simple terms, private primary[11] mortgage insurance is required by many investors and lenders when funding higher loan-to-value mortgages. It covers the amount of the loan that is above some threshold percentage of the value of the property, and puts the mortgage insurer in first loss position.[12] In the event of default, after being paid by the insurer, the lender/investor can expect to recover much, if not all, of the remaining balance from sale of the property. The lender/investor is the beneficiary, however, the insurance is typically paid for by the borrower as part of their monthly mortgage payment. Traditionally, mortgage insurance premiums vary by loan-to-value and a few other factors.[13] Private mortgage insurance rates must be filed with and approved by state insurance regulators.

The mortgage insurance industry only insures a portion of the high loan-to-value, single family mortgages made in the US.[14] These loans can also be facilitated through FHA/VA/Ginnie Mae, banks making high loan-to-value mortgages without insurance, or lenders securitizing them through private-label securities, which theoretically would be structured to absorb all default risks including those associated with low equity. Another mechanism that was particularly popular in the mid 2000's was the combination of an 80 percent first mortgage with a purchase money second lien for 10 percent to 20 percent. These second liens can be retained by the originating lender (typically depositories), or securitized along with the first lien. But unlike MI, in the last few years, many of the alternatives have fallen short or required direct or indirect taxpayer support.[15]

1. Regulated institutions with countercyclical capital at risk

Mortgage insurance rates are relatively static. Mortgage insurers must obtain state regulator approval to change rates in many states and this can be a slow process. More importantly, state regulators mandate high capital and reserving requirements, which imposes a natural price floor.

By contrast, during the build up of the mortgage bubble, less regulated, alternative sources of credit enhancement became increasingly cheap relative to the institutional monoline sources (primary mortgage insurance and FHA insurance). While FHA holds a record high market share today (21 percent for 2009), at the height of the subprime boom (2005 and 2006), FHA share dwindled to a mere 2.6 percent, and that of private mortgage insurer's likewise fell below 9 percent to a long-term low.[16]

On the other hand, because of regulatory and GSE requirements, the mortgage insurance companies had a decent level of reserves heading into the crisis. While they are paying a huge amount of claims—including an estimated $30 billion to Fannie Mae and Freddie Mac that directly offsets taxpayer exposure—they point to their countercyclical capital requirements as key to their value in a volatile industry, and the reason they have not required public capital or support.[18] In the overheated markets leading up to the mortgage crisis, lack of consistent oversight enabled risk to be laid off where low or no capital requirements existed. At the time this looked like innovation, but in hindsight it was recklessness. The lesson learned is that an effective and responsible mortgage finance system must consider total system capital at risk on each loan and inhibit capital arbitrage.

2. Standards

Another virtue of the mortgage insurance industry is its expertise in setting risk standards. As an industry that understands the risks and invests capital, it has an important role in developing underwriting and product standards. We now are all too familiar with how the underwriting rule book was thrown out the window with such products as option arms and stated income loans. On the other hand, mortgage insurance companies with their institutional knowledge of high loan to value lending engendered a better understanding of the true risks posed and how to mitigate them. Moreover, with their own capital at risk, they live or die by whether they get the standards right.

This issue of standards also applies to loss mitigation. Because foreclosure is likely to be the most costly outcome for the mortgage insurer, the insurer's interest is often aligned with keeping the borrower in the home. And because the mortgage insurer bears the first loss in event of foreclosure, they hold some sway in establishing delinquent loan management standards. Historically, they have been innovators in developing foreclosure avoidance strategies.

3. Risk pooling and management of specialized risks

A third virtue of the mortgage insurance industry lies in its role as a pooler of risk. For example, if you want a group of lenders to be able to withstand losses to some statistically derived level based on historical experience (say 8 percent), then each institution is required to hold 8 percent capital against their loans. Theoretically that makes sense, but in reality, only some of the portfolios will get into trouble and these will lose more than they reserved and will fail, while the others will over-reserve. But to prevent ANY failures, each lender would have to hold more than 8 percent, which would be more costly and inefficient. Instead, when risks are transferred, a few mortgage insurance companies can absorb losses from the high-loss lenders using surpluses generated by the low-loss lenders and the overall capital required to assure systemic soundness is reduced. This is a basic principal of insurance.

Pooling risk also has benefits when applied across geographic regions of the country, or across individual securities. This also works across time, as demonstrated by the fact that mortgage insurers set aside capital in the good years to draw upon in the lean. The alternative is pro-cyclical, serving to amplify volatility. For example, in 2004, expectation of high appreciation led other market participants to under price risk, thus encouraging excessive risk taking. But mortgages have a long cycle and big risk tails. When the market turned, much of the market for credit enhancement froze, exacerbating the ensuing downturn.

The same principal applies across market segments. If the market penalizes underserved groups and communities by limiting access to capital, or by targeting them with costly and risky products, it reinforces weakness in those segments. Here, mortgage insurance differs from other kinds of insurance. Paying high auto insurance premiums does not increase one's likelihood of having an accident. However, mortgage borrowers who are charged high rates find it harder to make payments and, in communities where credit is more costly, property values are likely to be weighed down.

The mortgage insurance companies, and for that matter Fannie and Freddie, smooth out and pool mortgage risks across time and across securities, lenders, regions, and borrowers. Thus they provide more consistent access to financing, ideally in a manner that does not overheat strong markets and worsen weak markets.

Implications

A regulatory success story

These days, we hear a lot about regulatory failures, but mortgage insurance is one story of regulatory success. At a centralized level, the GSE's (and their regulator and counterparty risk requirements) set de facto regulations. At the same time, the role of state insurance regulators is vital to the outcomes we are discussing today. Among these regulatory mechanisms, the higher standard generally prevails, thus preventing regulatory arbitrage. This regime stands in stark contrast to that of the broader mortgage market, where federal preemption and regulatory gaps allowed lenders to go around the rules.[17]

The evidence strongly suggests that the state regulatory system, combined with a federal oversight role, led to systemic safety and soundness, at least within the privately-insured market, and that its principal elements should be preserved.

The need to ensure broad access

Justifiably, private mortgage insurance has special consideration in the GSE charter and as a "qualified residential mortgage" factor that can offset risk retention requirements.

This special consideration has implications, as the mortgage insurance industry will play a central role in determining who gets access to homeownership. In the past, mortgage insurance companies have shown leadership in developing products that enabled the GSEs to expand their affordable housing lending. But we face even bigger challenges today.

If anything, barriers to homeownership are growing, as are the gaps. It is estimated that among families who owned their homes in 2006, 7 percent of non-Hispanic white households have lost their homes or are expected to. While this number is disturbing, an even greater proportion of African-American families (11 percent) and Latino households (17 percent) are in the same situation, disproportionately wiping out family wealth.[18] For example, we found that among 25 foreclosed Latino families surveyed, the average wealth loss was $90,000.[19]

To make matters worse, these problems are not randomly distributed, but geographically concentrated. Entire communities have been impacted by wealth-stripping predatory lending, high cost subprime loans, and now, defaults. Looking beyond the crisis, it is reasonable to expect that access to prime credit in these communities is likely to remain scarce, due to weak appraisals and other neighborhood conditions classified as "risky."

Unfortunately, income losses from the recession are also disproportionately affecting minorities. For example, the median income for black families has fallen from 65 percent of that of white families in 2000 to 61.6 percent in 2008, and the African-American unemployment rate is currently nearly double that of whites.

Further, the loss of homes, wealth and income will impact credit scores for years to come. Thus we are facing a perfect storm where all three of the key constraints to homeownership—down payment, income, and credit—are tightening and putting homeownership further out of reach. As prime credit options shrink we are likely to see a re-widening of the homeownership gap between the haves and have-nots. Rebuilding our hardest hit communities will require the affirmative involvement of all market participants.

Today is for retrenching. Underwriting guidelines are justifiably conservative. But we must make sure that the pendulum hasn't swung too far and that we are able to accurately distinguish real risks from perceived risks going forward. To that end, mortgage insurers must also be held accountable to public policy goals of enabling access to safe mortgage products.

This caveat applies not just to underwriting, but also to pricing as well. Mortgage insurance embeds a basic level of risk-based pricing: borrowers with less money down have to buy an insurance product. Currently, Fannie and Freddie and the mortgage insurers may add a number of price adjustments based on characteristics of borrowers, properties, and/or weaker markets. The cumulative result runs the risk of replicating subprime pricing while lacking transparency to the borrower. Two of the key lessons that we should carry forward from the financial crisis are the importance of transparency in pricing, and the fact that adding costs to more vulnerable borrowers or those in weaker markets can actually contribute to weaker performance.

Further, how can one judge risk in markets that are *underserved*? As we have shown from the CAP program, expanding access to safe and affordable mortgage products with careful underwriting can support profitable lending to populations otherwise perceived to be high risk. In fact, the mortgage programs lenders used to originate CAP loans were not to GSE standards and most of the loans did not have mortgage insurance.

What am I suggesting? Perhaps some kind of public purpose role for mortgage insurers, or some provisions included in secondary market reform. For example, a proposal by the Mortgage Finance

Working Group[20] lays out a framework for a "Housing Innovation Finance Fund." Through partnerships between public and private providers, the fund would find new ways to expand mortgage access to underserved markets.

In conclusion, when done right, high loan-to-value mortgages are essential for the US housing system to offer opportunities and a pathway to the middle class. Mortgage insurance brings significant value to the industry by deploying private capital while conducting safe and sustainable high loan-to-value lending. Principals that contribute to their value include: long term countercyclical capital, proven standards for safe and sound lending, and pooled risk. The overlay of state regulation and federal oversight has played a critical role in maintaining systemic stability within this industry.

Going forward, private primary mortgage insurance should have an important role in the market. At the same time three key provisos should be observed: First, policy makers should see that a level regulatory playing field is maintained, one that considers long-term system-wide risk taking capacity and avoids a race to the bottom. Second, mortgage insurers (among others) must be held accountable through balanced and transparent pricing, leadership in foreclosure prevention, and providing broad access to good loans. Finally, alternatives should be cultivated to foster innovation and increased access to safe mortgages for underserved markets.

Thank you for the opportunity to testify this afternoon. I would be happy to answer any questions.

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[1] Board of Governors of the Federal Reserve, "Balance Sheet of Households and Nonprofit Organizations" (2010) available at http //www federalreserve gov/releases/z1/Current/z1r-5 pdf

[2] Di, Zhu Xiaou "Housing Wealth and Household Net Wealth in the United States: A New Profile Based on the Recently Released 2001 SCF Data" (Cambridge: Joint Center for Housing Studies, Harvard University, 2003).

[3] Joint Center for Housing Studies, Harvard University, "State of the Nation's Housing 2009; Appendix W-5" (2009).

[4] Thomas M. Shapiro, Tatjana Meschede, and Laura Sullivan, "The Racial Wealth Gap Increases Fourfold." (Waltham: Institute on Assets and Social Policy, 2010).

[5] Joint Center for Housing Studies, Harvard University, "State of the Nation's Housing 2009; Appendix W-5" (2009).

[6] Roberto G. Quercia, George W. McCarthy, and Susan M. Wachter "The Impacts of Affordable Lending Efforts on Homeownership Rates," *Journal of Housing Economics* 12 (1) (2003): 29-59.

[7] National Association of Realtors®

[8] U.S. Census Bureau 2010 Statistical Abstract. 35.5 percent of U.S. households earned less than $35,000 (2007 dollars).

[9] David Abromowitz and Janneke Ratcliffe, "Homeownership Done Right: What Experience and Research Teach Us," (Washington: Center for American Progress, 2010).

[10] Lei Ding and others, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Matching,"(Journal of Real Estate Research, forthcoming).

[11] These comments do not deal with several ancillary issues related to this industry such as pool insurance and reinsurance that ultimately bear further discussion. It focuses on the traditional, loan-level, primary mortgage insurance product.

[12] In a stylized example, where a borrower is buying a $100,000 home with a 5 percent down payment and the lender wants to be exposed to no more than 75 percent of value, the borrower will be

required to purchase mortgage insurance for 20 percent of the loan ($95,000 – $75,000), which is restated as 27 percent of the loan. In the event of default, the insurer will pay the investor 27 percent of the outstanding loan balance plus qualified expenses.

[13] MI premiums most commonly run from 0.3 percent to 1.9 percent of the loan amount per annum. By comparison, FHA insurance typically costs 2.25 percent up front and 0.55 percent annually for the highest LTV bucket. Examples of typical MI premiums can be found on websites of the companies, such as http://www.pmi-us.com/media/pdf/rates/pmi_monthlynumonthly.pdf; http://www.mgic.com/pdfs/71-61210_natl_bpmi_monthlies.pdf; and https://www.ugcorp.com/rates/043010/Borrower-PaidMonthly.pdf. FHA premium information is available at Holden Lewis, "FHA Loan Costs to Increase," *Bankrate.com*, January 25, 2010, available at http://www.bankrate.com/finance/mortgages/fha-loan-costs-to-increase.aspx.

[14] Hutchinson, Suzanne, Mortgage Insurance Companies of America. Letter re: request for comments on reform of the housing finance system. July 21, 2010. http://www.regulations.gov/search/Regs/home.html#documentDetail?R=0900006480b1e23a.

[15] FHA insurance is by definition a form of public support. However, FHA is a self-funding agency.

[16] *Inside Mortgage Finance*, 27 (6) (2010); Federal Housing Finance Administration, "State of the Private Mortgage Insurance Industry: Implications for U.S. Mortgage Markets and the Enterprises" (2009), available at http://fhfa.gov/Default.aspx/webfiles/14779/MMNOTE_09-04%5B1%5D.pdf.

[18] Hutchinson, Suzanne, Mortgage Insurance Companies of America. Letter re: request for comments on reform of the housing finance system. July 21, 2010. http://www.regulations.gov/search/Regs/home.html#documentDetail?R=0900006480b1e23a

[17] See our related research on state antipredatory lending laws and the effects of federal preemption at http://www.ccc.unc.edu/abstracts/preemptionEffect.php.

[18] Debbie Gruenstein Bocian, Wei Li, and Keith S. Ernst, "Foreclosures by Race and Ethnicity: The Demographics of a Crisis," (Oakland: Center for Responsible Lending, 2010).

[19] Janis Bowdler, Roberto Quercia, and David Smith, "The Foreclosure Generation: The Long Term Impact of the Housing Crisis on Latino Children and Families," (Washington: The National Council on La Raza, 2010).

[20] See http://www.americanprogress.org/issues/2009/12/housing_finance.html.

INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Testimony of

Marti Tomson Rodamaker

President, First Citizens National Bank
Mason City, Iowa

On behalf of the

Independent Community Bankers of America

Before the

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises

Hearing on
"Future of Housing Finance: The Role of Private Mortgage Insurance"
July 29, 2010
Washington, DC

Chairman Kanjorski, Ranking Member Garrett, and Members of the Subcommittee, I am Marti Rodamaker, President of First Citizens National Bank in Mason City, Iowa and chairwoman of the Lending Committee of the Independent Community Bankers of America. First Citizens is a federally-chartered community bank with $925 million in assets. I am pleased to represent community bankers and ICBA's nearly 5,000 members at this important hearing on the "Future of Housing Finance: The Role of Private Mortgage Insurance." Residential mortgage lending – supported by conservative underwriting – is a staple of community banking, and mortgage insurance is an indispensable risk management tool. ICBA also has a captive mortgage insurance program with MGIC, who is also represented on this panel, in which my bank participates. I bring the perspective of a participant in that program to my testimony as well.

Community banks will play a key role in the housing recovery through prudent but not restrictive lending and properly managed risk. We're anxious to serve our customers – who also happen to be our friends and neighbors – when they're ready to purchase a new home by extending loans we are confident they can repay. Until lenders are ready and willing to serve their customers, with appropriate risk management, home sales will not resume and the market will not recover. A functional market for private mortgage insurance (MI) will be a key ingredient in the recovery.

The MI business model has been tested by the housing crisis, with repercussions for all participants in the lending process. I expect that it will emerge from the crisis looking significantly different than it has in the past, as a result of business imperatives but also as a result of policy decisions made by Congress. Any reform of MI must be made in coordination with reform of other elements of housing finance, notably the housing GSEs. ICBA hopes to participate in all aspects of housing finance reform, in which our members and their customers have so much at stake.

MI Expands the Reach of Homeownership

MI is used by lenders to insure mortgages of greater than 80 percent loan-to-value (LTV) ratio. It enables lenders to reach those borrowers who cannot make a 20 percent down payment – a sizeable portion of today's market – and only during the limited period when the LTV exceeds 80 percent and a loan is most vulnerable to default. During this period, a troubled borrower may not be able to recover enough from the sale of a property, net of transaction costs, to pay off the loan balance. Borrowers can discontinue MI after the LTV falls below 80 percent either through pay-down of the loan or property appreciation or a combination of both. But the limited coverage MI provides is a condition to making high LTV loans.

Traditionally, mortgage insurance has been very important to serving younger, first-time home buyers, for whom a 20 percent down payment would be an insurmountable barrier to homeownership. In today's environment, even current homeowners who want to move may not have enough equity in their homes to sell and make a 20 percent down payment on a new home. The recession has also drained the savings accounts of many Americans, depleting another source of down payments. Given these circumstances, MI will be used to serve a broader segment of homebuyers than ever before. Without MI, the housing recovery will take longer; with MI, the recovery can be managed prudently.

From the lender's perspective, perhaps the most significant function of MI is to allow for the sale of high LTV loans to Fannie Mae or Freddie Mac, who require insurance for such loans. Fannie and Freddie provide secondary market access and critical funding to community bank mortgage lending. Community banks – indeed all lenders – need MI to access that funding. Whatever succeeds Fannie and Freddie – and some entity or entities, in whatever form, will need to fill the role of facilitating mortgage sales into the secondary market – there will likely be a role for MI in distributing risk for high LTV mortgages. Lenders who hold high LTV loans in portfolio also require mortgage insurance because our regulators apply a higher capital charge to uninsured, high LTV loans.

In sum, the only practical means of making high LTV loans, whether they're sold or held in portfolio, is with the credit enhancement provided by MI. While policy makers are revisiting underwriting standards in the wake of the crisis, and the Dodd-Frank Act contains new standards, no one has ever proposed limiting mortgage loans to 80 percent LTV. High LTV loans can be prudent, conservative loans whose underwriting relies on credit history, documented income, expected future income, and in the case of community banks, personal knowledge of the borrower. In addition to this underwriting, MI helps lenders and investors to distribute and manage the residual risk. If high LTV loans can't be made, the market will not recover, consumer's options will be more limited, and banks will have fewer lending options. If it becomes more difficult to obtain mortgage financing, property values are likely to keep falling. As we have seen during the recent crisis, falling property values drive more foreclosures and destabilize neighborhoods.

Alternatives to MI

There are alternatives to MI for high LTV loans, but none of them are sustainable in the long-term. The primary alternative right now is government insured loans – Federal Housing Administration, Veterans Administration, and USDA Rural Housing. FHA allows for down payments as low as 3 percent; VA and USDA allow for 0 percent down payments. These programs have filled the gap as private mortgage insurers have pulled back during the crisis. During the first quarter of 2010, FHA held nearly 75 percent market share of new primary insurance, while MI market share was under 12 percent, a record low. FHA was never intended to hold such a large market share and has become a source of inappropriate risk for the government. In response to this risk, FHA has tightened their requirements for borrowers and raised their premiums, creating a space for MI to return to the market.

Another alternative to mortgage insurance is the use of a "second trust," colloquially known as a "piggy back" loan, in which the borrower takes out an 80 percent first-lien loan and a 10 percent second-lien loan for a shorter term and at a higher rate, and puts the remaining 10 percent down. Second trust loans were popular during the 1990s and the early 2000s, when rising property values made it possible for the borrower to refinance the first loan with cash out to pay off the second loan relatively quickly. The principal advantage to using a second trust over mortgage insurance, especially for higher income borrowers, was the tax deduction for interest paid on the second trust. That advantage was obviated in 2007 when Congress made mortgage insurance premiums deductible as well. Since the decline of the housing market, second trusts have virtually disappeared as lenders have been unwilling to underwrite the additional risk. No satisfactory, sustainable alternative has emerged to MI.

MI in the Crisis

Unfortunately for all parties, the MI market was severely disrupted during the housing crisis. Mortgage insurance companies took on too much risk, experienced severe losses, and are only now beginning to stabilize. The MI companies have tightened their underwriting requirements in response to market conditions and have exited certain loan products such as investor loans and cash out refinances in certain markets.

As a consequence, MI underwriting has fallen out of lockstep with GSE underwriting. Before the crisis, approval by Fannie or Freddie implied approval by the insurer, a linkage that greatly facilitated loan processing. The breakdown of this linkage has impeded the recovery. We need to achieve a new consensus in which lenders, mortgage insurers, and Fannie and Freddie are using the same underwriting and appraisal standards. This new consensus may not be achievable until the housing market stabilizes.

Before the crisis, with property values on the rise, MI companies collected premiums and received few claims. Having been tested by the crisis, they appear to be seeking a sustainable business model. They've introduced new products featuring finer risk calibration, for example by providing credit-tiered rates. From our prospective as lenders, this is a positive development that will reduce rates for our best customers and encourage their reentry into the market.

Unfortunately, they've also responded to the crisis by disputing claims. Denied MI claims on defaulted loans sold to the GSEs have become increasingly common. Generally, a denied MI claim will lead to a buyback request (or demand) from either Fannie Mae or Freddie Mac. While some of these claim denials are supportable, a significant portion of these denials are based on aggressive interpretations of underwriting guidelines, dubious forensic appraisals that challenge the properties original value, or post-hoc determination by the GSE that a loan didn't comply with underwriting guidelines in effect at the time of origination. These claim denials have been extremely challenging for community banks who have always underwritten mortgage loans in a careful and conservative manner.

As a banker, I understand the reality of higher defaults and losses during difficult economic times. It's the part of the price of doing business. However, high levels of denied MI claims and GSE buybacks have put an additional strain on all market participants, including community banks.

Who Should Pay MI Premiums

During your reconsideration of the role of mortgage insurance in housing finance, I expect that some will raise the idea of shifting the cost of mortgage insurance from the borrower to the lender. In fact, both borrower-paid and lender-paid products currently exist in the market, and both have trade-offs. The advantage of borrower-paid insurance is that the borrower can cancel it when the LTV drops to 80 percent. Lender-paid insurance, by contrast, exists for the life of the loan. While borrower-paid insurance carries a higher premium while it is in effect, lender-paid insurance translates into a higher interest rate for the borrower as the lender must cover its costs.

MI and GSE Reform

As I have described, MI is interlinked with the GSEs and any reform of MI must be coordinated with reform of the GSEs. Community banks have a great deal at stake in the future of the GSEs. We have benefited greatly by the liquidity they have provided and by the robust secondary mortgage market they have created. Over the years Fannie Mae and Freddie Mac have enabled community banks to offer mortgage products to their customers and invest in mortgage-backed securities. The GSEs have made it possible to combine wholesale funding with community bank service at the local level. The nation's housing finance system must continue to be flexible enough to provide a variety of finance options to meet the needs of different consumers, housing types and locations. I attach ICBA's July 21 comment letter to Treasury and HUD in which we detail our view on the future of housing finance, including a set of principles we've developed for the future of the secondary market.

Closing

In closing, ICBA appreciates the opportunity to participate in this Subcommittee's review of MI and hopes that our perspective is helpful. The recent dislocation in the MI industry has only underscored the critical role that it plays in housing finance. Restoration of a strong and competitive MI industry will be a critical part of the housing recovery. We would be pleased to comment on any proposals to reform MI that emerge from this Subcommittee, and we hope to have the opportunity to share our views on other aspects of housing finance reform as well.

Attachment: July 21, 2010 ICBA Comment Letter on the Future of Housing Finance

ICBA
INDEPENDENT COMMUNITY BANKERS *of* AMERICA®

July 21, 2010

Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

RE: eDocket Number: TREAS-DO-2010-0001
RE: eDocket Number: HUD-2010-0029

Dear Sir or Madame:

The Independent Community Bankers of America[1] (ICBA) welcomes the opportunity to provide its views on establishing a more stable and sound housing finance system. The comments that follow reflect our current positions, but ICBA continues to discuss these complex issues with its members and would be pleased to share additional thoughts and suggestions as the debate goes forward.

Future of Housing Finance

Our housing finance system must continue to be sufficiently flexible that it provides a variety of finance options to meet the needs of different consumers, housing types, and locations. One size does not fit all. Some community banks have sufficient mortgage volume to sell mortgages directly to Fannie Mae or Freddie Mac, others do not and use a conduit or aggregator to facilitate mortgage lending, while others hold all mortgage loans in portfolio until they are repaid or mature. Funds to support our housing finance system come from a variety of sources: from local bank deposits, state and local government programs, federal programs, domestic and international investors, public and private sectors.

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing over 300,000 Americans, ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

INDEPENDENT COMMUNITY BANKERS *of* AMERICA *The Nation's Voice for Community Banks®*
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As we look at reforms of the housing finance system, we must be very careful that any changes do not disrupt its recovery. Not all parts of the system are functioning well yet and its recovery must not be jeopardized lest it further impact millions of current and future homeowners and renters and the investors of existing debt and asset-backed securities. It would also greatly impact financial institutions that are recovering from the economic downturn along with companies that are directly or indirectly involved in the housing finance system.

Clearly changes are needed so that the recent housing finance problems are not repeated. Fortunately, a renewed focus has been placed on the traditional "common sense" underwriting practices long embraced by community banks—making sure the loan is affordable for the borrower and the borrower has the ability to repay the loan. Community banks generally did not make subprime loans with the characteristics that have led to recent problems, such as "teaser" rates, lack of appropriate documentation and very high or unlimited reset payments and interest rates. As responsible community-based lenders, community banks require appropriate documentation of borrower income and do not make loans that compel borrowers to refinance or sell in order to remain solvent. Community banks do not have aggressive subprime marketing programs targeting particular low-income areas or low-income borrowers. However, they do help borrowers with non-traditional credit histories or imperfect credit. Commonly, community bank loans to these borrowers are not sold into the secondary market, but are kept in portfolio, thus the bank has every incentive to ensure is not a predatory loan. This also permits the bank and the borrower to work out a solution early on if repayment problems arise.

Future of the GSEs

ICBA has been a strong supporter of Fannie Mae, Freddie Mac and the Federal Home Loan Banks (FHLBanks) because of the services they have provided community banks. Community banks across the nation have benefited greatly by the liquidity these entities provide and by the robust secondary mortgage market they have created which over the years has enabled community banks to offer mortgage products to their customers and invest in mortgage-backed securities. These government sponsored enterprises (GSEs) have made it possible to combine wholesale funding and community bank service at the local level.

Though very different in key respects, all three housing GSEs provide community banks with irreplaceable access to money markets. This access allows community banks to offer the same home mortgage products to their customers that the largest firms offer to theirs. Without the GSEs, community banks would be unable to offer their customers long-term fixed rate mortgages. In addition, the FHLBanks provide members advances for liquidity, asset/liability management, and to fund long-term loans to small businesses and other customers. It is critically important that the GSEs remain reliable sources of funding and liquidity and continue to support a residential mortgage secondary market for our nation's community banks.

A number of policy proposals have surfaced recently to reform the GSEs, ranging from abolishing Fannie and Freddie and allowing the private securitization market to take over, to restoring Fannie and Freddie to their former selves. Other ideas include creating a covered bond market that would allow banks to issue mortgage-backed debt to finance mortgage loans, or allowing each of the twelve Federal Home Loan Banks to securitize loans. Some favor a plan that would allow financial institutions to charter their own GSE-type units with the government providing a guarantee for the securities.

Corporate Structure, Governance and Mission

Critical questions must be addressed relating to corporate structure, governance, and mission. These are crucial issues that will require careful study as the solutions will have long-term effects.

What should the corporate structure of the secondary market be? Of the structures currently under debate, the cooperative structure or that of a public utility appears to be the most suitable for the needs of community banks. The cooperative structure has served the FHLBanks well as its users also provide capitalization that is at risk. If the secondary market is capitalized by private, non-user capital, the private utility structure may be appropriate to set pricing and control undue risk taking. In making any changes to the GSEs, the Administration and Congress need to be mindful of the significant costs to community banks and other market participants to change operational processes, computer systems and re-training of staff if the future secondary market is operationally different than the current system. For example, just changing the GSEs' names would entail a significant re-write of most mortgage processing, underwriting and servicing technology platforms.

What should be the ownership structure of the secondary market? Should the users be the owners such as in the FHLBank and Farm Credit systems? Should they provide all of the capital or should there be outside shareholders? Public ownership and the need to maximize shareholder wealth created problems for Fannie Mae and Freddie Mac as they sought to regularly increase earnings to meet or exceed investment analyst expectations. Full or partial ownership by users would move the focus away from profits and more toward the attractive pricing of loans sold and securitized, a benefit to users and their customers. Community banks have long told ICBA that although they appreciate the dividends they receive on their FHLBank member stock, their priority is low advance rates. Due to the losses taken on Fannie Mae and Freddie Mac preferred stock (described more in detail later), community banks could shy away from new stock purchases to capitalize a new secondary market; however they likely would be willing to provide capital to a secondary market if it ensured them access. Ownership structure is an issue that ICBA will continue to discuss with its members in the coming months.

What should the governance structure be? Should users elect directors (some users, some outside independent directors)? Should there be presidentially appointed directors? ICBA continues to discuss what an appropriate governance structure should be as we discuss corporate structure. Regardless of structure, all users should be fairly represented.

What should the mission be? The primary mission of Fannie Mae and Freddie Mac is to provide stability to the secondary market for residential mortgages, access to mortgage credit throughout the nation, to increase the liquidity of mortgage investments and to improve the distribution of investment capital for residential mortgage financing. Should this be changed? Are there other functions the secondary market entities could take on to help community banks and their customers?

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Key Principles
ICBA continues to study these proposals and consider these questions. What is clear is that community banks need a stable secondary market for residential mortgages. Without a reliable secondary market for residential mortgage loans, many community banks would be unable to offer this service to their customers. As the Administration and Congress considers how to resolve the conservatorship of Fannie Mae and Freddie Mac, and re-build America's housing finance system, ICBA has developed the following key principles that we believe must be reflected in the future structure of the secondary market for residential mortgages.

The secondary market for residential mortgages must be impartial. The secondary market must provide equitable access and pricing to all lenders regardless of size or volume. Lenders large and small need secondary market access and consumers benefit by their activity in the mortgage market. Some proposals for change would result in further dominance of the housing finance system by a handful of large financial institutions. Recent history has demonstrated that there needs to be less, rather than more concentration in the housing finance system of we are to avoid "too big to fail" institutions controlling the housing finance system. The only entrance to the secondary market for smaller lenders must not be through their direct competition.

The secondary market must be financially strong and reliable. Legislation in 2009 established a world class regulator for Fannie Mae and Freddie Mac; strong regulatory oversight must be maintained to ensure that the secondary market operates within its mission and in a safe and sound manner.

The secondary market entities must have a limited mission focused on supporting residential and multifamily housing in all communities in the U.S. Resources should be focused on supporting housing finance. Fannie Mae and Freddie Mac created uniformity in the market through the underwriting and processing systems they developed. The secondary market entities should continue to develop technical innovations that can be shared with their users to the ultimate benefit of consumers.

The secondary market entities need to have the operational flexibility to hold some mortgages in portfolio when market conditions dictate, along with their securitization authorities. Recent market events demonstrate the important role Fannie Mae and Freddie Mac have played in providing liquidity and market stability when other sectors of the market cease to function. The ability to hold a certain level of mortgages in portfolio during disruptions in the market is an important tool in keeping a secondary market functioning. It is our understanding that the ability to hold loans in portfolio also has helped the two GSEs serve smaller lenders that can only offer a secondary market relatively low volume. Portfolio levels can be controlled through regulations and regulatory oversight.

The conflicting requirements of a public mission with private ownership must be eliminated. Fannie Mae and Freddie Mac had aggressive housing goals for the purchase of mortgages from underserved populations and in underserved areas that some have suggested supported loans that were unaffordable for borrowers. The effort to reconcile these goals with the demands of maximizing shareholder wealth created an environment where the two GSEs took on inordinate amounts of risk. This conflict must be eliminated going forward.

Congress should consider requiring the secondary market entities to dedicate a portion of their earnings to support housing programs in a form such as the FHLBank Affordable Housing Programs in return for the benefits of GSE status and in the place of the current housing goals. While legislation created a housing fund for Fannie Mae and Freddie Mac, it has not come to fruition due to their financial difficulties. The FHLBank Affordable Housing Program has a long history as a very successful vehicle to help support affordable housing in a very structured, regulated manner. Dedicating a percentage of income to such a program would provide a return benefit to the public for the benefits of GSE status.

An appropriate capital structure, including the accumulation of retained earnings must be an important component of the secondary market structure to attract and maintain capital and to protect user or private capital. Many community banks were encouraged by regulators to purchase preferred stock in Fannie Mae and Freddie Mac and lost essentially all of their investment. A strong financial condition, which includes retained earnings held by the GSEs, will help to attract needed equity capitalization going forward.

Congress must ensure that a secondary market with government ties continues to exist. Whether the Fannie Mae and Freddie Mac charters are retained or a new secondary market is created, it must have some government tie going forward to ensure continued steady and favorable access to the capital markets. The government ties to Fannie Mae and Freddie Mac kept money flowing through the conforming mortgage market when other sectors, such as the jumbo mortgage market stopped functioning. Government ties have also attracted a wide array of investors, including insured depository institutions with limited investment options.

Any changes to the GSEs should not impact the trillions of dollars of GSE mortgage-backed securities (MBS) outstanding. Most community banks invest in GSE MBS and any major market disruption could impact the values of those securities which would impact the capital positions of community banks. Also, currently, agency MBS carry a 20% risk weighting therefore less capital is held for them.

More than one secondary market entity should exist in the future. The existence of more than one secondary market entity fosters competition, providing better access for community banks and lowering mortgage rates and closing costs for consumers.

The function of Fannie Mae and Freddie Mac should not be incorporated into the FHLBank system. There has been a suggestion that Fannie Mae and Freddie Mac be split up and incorporated into the FHLBank system. While the FHLBanks have had a limited secondary market function, one that has benefitted community banks, the focus of their business must remain that of providing liquidity to their members to support housing, economic development, small farm, small agribusiness and small business lending.

Importance of the FHLBanks

The vast majority of community banks are FHLBank members and are active advance users or look to them an alternative source of liquidity. The FHLBanks must remain a strong, stable, reliable source of funding for community banks. Initial results of a survey ICBA is conducting of its membership show that liquidity and advances of various maturities continue to rank at the top of the list of products and services the FHLBank members find most important. As the financial crisis has moved through the financial system, many of the FHLBanks have suffered financial stress too, as mark-to-market accounting forced them to write down the value of securities, and debt issuance spreads widened increasing the cost of funds to members. Yet, throughout the financial crisis, the FHLBanks continued to provide advances to their members without disruption, while other segments of the capital markets ceased to function. Daily, community banks depend on their FHLBanks for liquidity, asset/liability management and to enable them to match fund longer term loans.

As the Administration and Congress consider changes to the housing finance system, the FHLBanks must remain a healthy, stable, reliable source of funding, liquidity and other products to serve the needs of all member-owners and help them provide lendable funds for the local communities they serve. Some FHLBank members have had dividends cut and stock redemptions restricted or eliminated as their FHLBanks rebuild after facing financial difficulties. It is important that the FHLBanks continue to take the steps necessary to regain their full financial strength.

The FHLBanks have been repaying their REFCORP obligations more quickly than expected due to strong earnings. This rapid pay-off has caught the attention of some who look at the FHLBanks as a potential source of funds for other purposes. There are already suggestions that the FHLBanks should continue to make the payments once the obligations are completely repaid. Once the FHLBanks complete their REFCORP payments, the earnings that would otherwise go to them should be kept in the FHLBank system to build retained earnings and protect the system's financial condition. The recent problems in our financial system underscore the need to ensure that the FHLBanks, along with other financial institutions, have the strength to face future challenges. Once the system has built sufficient safeguards to protect it against future financial challenges, funds may be used within the system for programs that help members serve their communities. The FHLBanks, their members and the consumers and businesses they serve across the country should not be penalized because the FHLBanks paid off their debts early.

ICBA continues to study the role the FHLBanks should play in facilitating a secondary market for residential mortgages. In a 2009 report, the Congressional Research Service suggested that Fannie Mae's and Freddie Mac's mortgage portfolios and other assets be divided among the FHLBanks. ICBA does not believe this is the right solution to the resolution of the two housing GSEs. Further, we would have significant concerns about any proposal to incorporate the function of Fannie Mae and Freddie Mac into the FHLBank system. While community banks have benefitted from the existing FHLBank secondary market programs, the primary business of the FHLBanks must remain advances. When surveyed, ICBA members have consistently said that advances are by far the most important reason why they are FHLBank members.

ICBA continues to support the regional structure of the FHLBanks as it best suits member needs. ICBA members see great benefit in the local knowledge and personal touch fostered by a regional FHLBank structure. Regional FHLBanks are better able to understand the environment in the communities their members serve, particularly the special needs of rural communities.

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GSE Preferred Shareholders Must Be Made Whole

An unfortunate by-product of the government's take-over of Fannie and Freddie was that the value of GSE preferred shares plummeted, injuring more than a thousand community banks that purchased these shares with the encouragement of their regulators. Banks are generally prohibited from investing in the stock of other corporations, making AAA-rated GSE preferred shares an attractive option, and one that Treasury and the regulators promoted.

The actions of then, Treasury Secretary Paulson, primarily to protect the interests of the Chinese government (as he admitted in his book On the Brink), resulted in an "ambush" of preferred shareholders by placing the preferred shares in a second position and eliminating all dividend payments. Despite earlier warnings by ICBA, Paulson's actions sent the entire market for financial preferred shares into a freefall, making it even more difficult for community banks to raise needed capital when additional capital was desperately needed.

Notably, nearly $36 billion in Fannie Mae and Freddie Mac preferred stock was outstanding prior to Fannie Mae and Freddie Mac being placed into conservatorship. An estimated $15 to $20 billion of that was held by the banking sector and almost one-third of banks reported holdings including many community banks. This action has directly resulted in the failure of many banks by wiping out any excess capital that may have been available prior to the normal losses experienced in the recession. These actions continue to have detrimental consequences on many community banks today by driving down capital levels and reducing the amount of available credit.

As the Administration considers the future of housing finance, ICBA urges you to ensure that this injustice is corrected by restoring the dividend payments on Fannie Mae and Freddie Mac preferred shares and paying injured holders the amount of suspended dividends since September 7, 2008, on an estimated $20 billion in GSE preferred holdings. As options are being considered to lift Fannie Mae and Freddie Mac out of conservatorship, ICBA urges that it be done in a way that will restore a reasonable value to the preferred shares. Helping restore the $15 to $20 billion in community bank capital value crushed by the unwarranted Treasury actions can foster $150 to $200 billion in new lending as banks leverage this capital.

Conclusion

Our housing finance system must continue to be sufficiently flexible to provide a variety of finance options to meet the needs of different consumers, housing types, and locations. Changes are needed so that the recent housing finance problems are not repeated. The renewed focus on the traditional "common sense" underwriting practices must continue, practices long embraced by community banks. But care must be taken that the changes are not so dramatic that they disrupt the still fragile current housing finance system and hurt its investors. Community banks rely on Fannie Mae and Freddie Mac to provide a reliable secondary market for residential mortgage loans they offer to their customers. Community banks rely on the FHLBank system to provide liquidity, asset/liability management and long-term funding. Access to these GSEs is vital to the ability of community banks to provide financing options to meet the needs of the customers and communities they serve.

Thank you for your consideration. ICBA looks forward to working with you on these important housing finance policy issues.

Sincerely,

/s/

Camden R. Fine
President and CEO

Testimony of Dr. Anthony B. Sanders
Before the House of Representatives Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Topic: "The Future of Housing Finance: The Role of Private Mortgage Insurance"

July 29, 2010

Mr. Chairman, and distinguished members of the Committee, my name is Dr. Anthony B. Sanders and I am the Distinguished Professor of Finance at George Mason University and a Senior Scholar at The Mercatus Center. It is an honor to testify before you today.

The Federal government purchases or insures over 90% of the residential mortgages originated in the United States. The proliferation of government programs for homeownership, purchase/insurance of low down payment loans by the GSEs and tax incentives for home ownerships were largely responsible for the housing bubble that occurred during the 2001-2006 period.[1] [See Figures 1 and 2] The problem is that public policy and risk management are intertwined resulting in bubbles and devastating bursts.[23] And the most vulnerable households are the ones most often hurt.[4]

The "Affordable Housing Crisis Cycle" must be broken. Even though trillions of dollars were pumped into the housing market during the last decade, homeownership rose from 67.8% in 2001, peaked at 69.0% in 2004 and declined down to 67.4% in 2009 – less than where they

[1] See Figure 1 for the Case Shiller 10 City Index that demonstrates that house prices (as measured by the CS index) rose from 78.23 [Oct '96] to 226.17 [June 2006]. Not surprising after the GSEs added $8 trillion for housing finance over this time period.
[2] For a discussion of government intervention in the housing market, see Darrell Issa, "Unaffordable Housing and Political Kickbacks Rocked the American Economy," Harvard Journal of Law & Public Policy, Vol. 33. **www.harvard-jlpp.com/33-2/407.pdf**
[3] See Ed Pinto, "Government Housing Policies in the Lead-up to the Financial Crisis: A Forensic Study." 2010.
[4] In 1988, I was quoted in the New York Times as advising against putting lower income households at risk of being financially damaged due to a declining housing market. Unfortunately, the government continues to encourage lower income households to own housing when renting is the more financially viable alternative http://www.nytimes.com/1988/10/11/us/dukakis-in-levittown-offers-a-plan-to-help-young-families-buy-homes.html?pagewanted=2

started in 2001. [See Figure 3] The U.S. has comparable homeownership rates to other G7 countries, even though they do not have entities like Fannie Mae and Freddie Mac. [See Table 1] Given that there is a reasonable housing alternative in the form of renting (rather than owning), it is time to rethink the Crisis Cycle.[5]

We can break this cycle by getting private mortgage insurers and banks back in the game and down size government involvement in the housing finance area.[6]

The problem is that the Federal government offers explicit guarantees on residential mortgages which make it difficult for the private sector to compete.[7] This crowding out phenomenon is exacerbated by the raising of the loan limits after the stimulus for the three GSEs to $729,750 which effectively has crowded out the private insurance market. [See Figure 4]

My recommendations are as follows:

1. Fannie Mae, Freddie Mac and the FHA must downsize their market shares to open up the market to the private sector again. This can be done, in the short run, by curtailing the government purchase/insurance of low down payment loans and the lowering of loan limits down to pre-stimulus levels at first and then a gradual phase out of government insurance.

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[5] Raphael Bostic, a Senior Official at HUD, acknowledges that homeownership is not for everyone and the pursuit of homeownership rates is misguided. http://www.washingtonpost.com/wp-dyn/content/article/2010/07/20/AR2010072005946.html

[6] See Gerald Hanweck and Anthony B. Sanders, "Six Reasons Why Banks Aren't Lending to Business."

[7] Stuart Gabriel and Stuart Rosenthal found that the GSEs were responsive to HUD Affordable Housing Goals, but that the GSEs crowded out private lenders in that these loans were not held on bank balance sheets. See "HUD Purchase Goals and Crowd Out: Do the GSEs Expand the Supply of Mortgage Credit?"

2. Alternatives to Fannie Mae and Freddie Mac, such as covered bonds and improvements to private label securitization must be implemented.[8]
3. In order for capital to return to the market, it is necessary to restore confidence. The newly created Bureau of Consumer Financial Protection is generating significant uncertainty in the minds of investors as to how this Agency will function. Congress should pass clear guidelines and provide assurances that limit the reach of the new agency.
4. The long run structure of Fannie Mae and Freddie Mac must be resolved. However, true change is not possible if the Administration and Congress insist that there must be an explicit guarantee. I do not see any way that the explosive combination of public policy and prudent risk management can work. It failed in the housing bubble and crash and nothing has been done to prevent this from occurring over and over again.

Thank you for the opportunity to share my thoughts with you.

[8] See Andrew Davidson and Anthony B. Sanders, "Securitization After the Fall" for a discuss of recommendations to help return the securitization market.
http://merage.uci.edu/ResearchAndCenters/CRE/Resources/Documents/Davidson-Sanders.pdf

Figure 1. The Case Shiller Ten City Index.

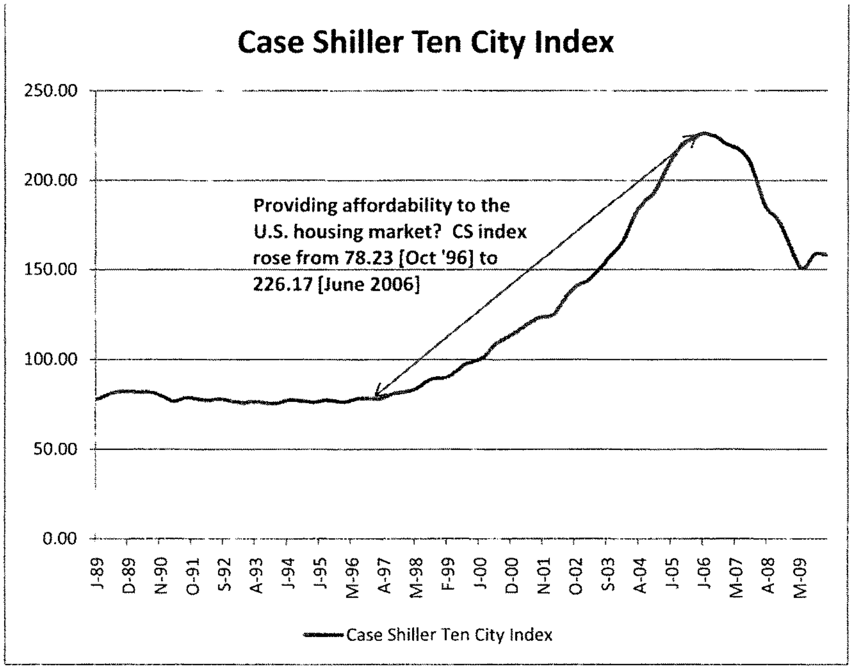
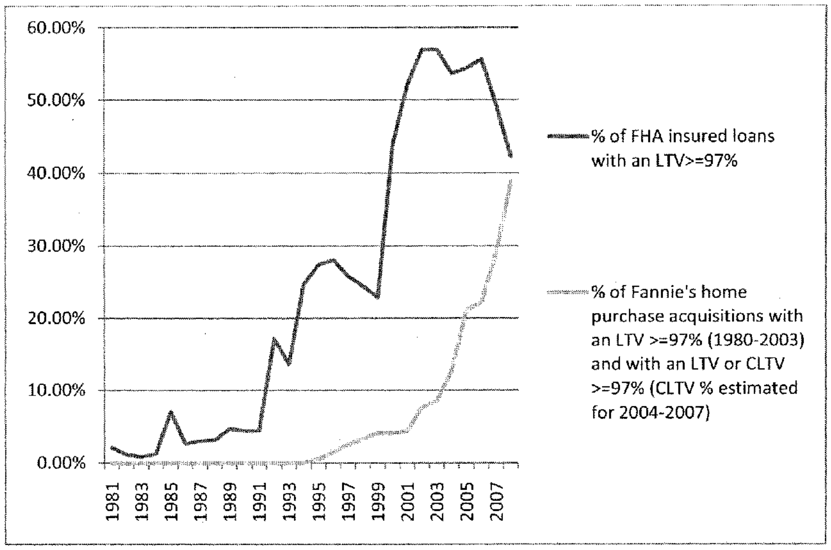
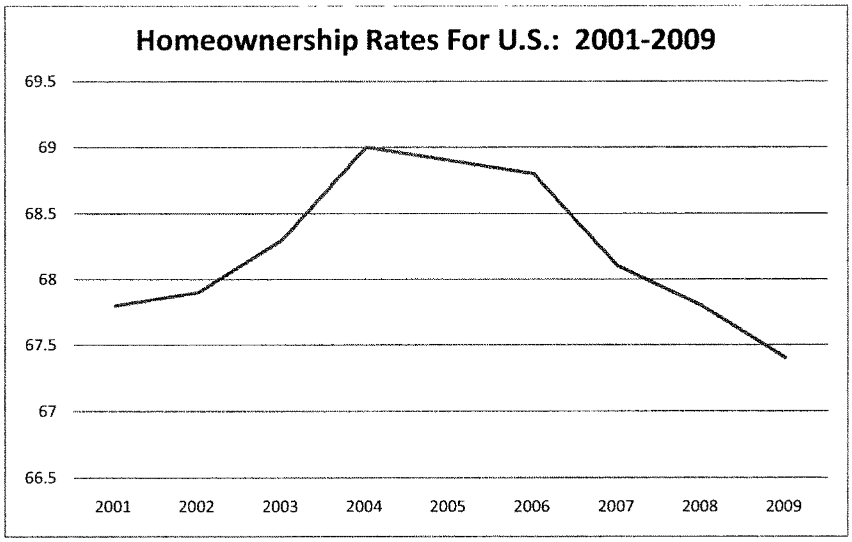


Figure 2. Low Down Payment Loans for FHA and Fannie Mae



Source: Ed Pinto, "Government Housing Policies in the Lead-up to the Financial Crisis: A Forensic Study." 2010.

Figure 3. Homeownership Rates for U.S. 2001-2009



Source: U.S. Census Bureau

Figure 4. GSE vs FHA Loan Limit: Pre Stimulus and Current

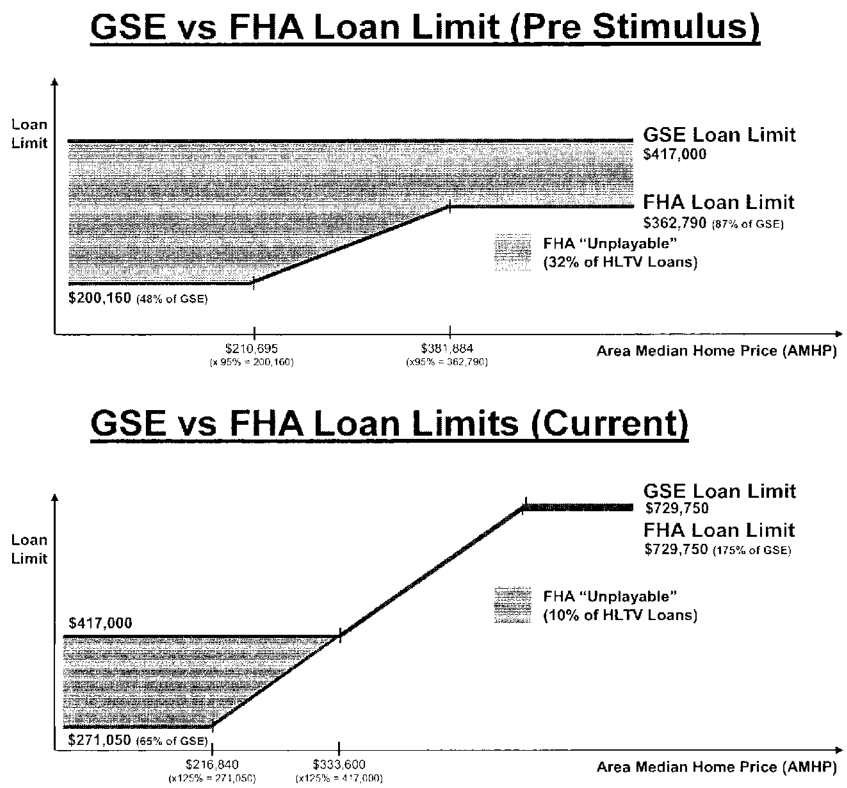


Table 1. Other (G-7) countries have similar home ownership rates without Fannie Mae and Freddie Mac

G-7 country	2009 homeownership rate
Italy	81.7%
United Kingdom	73.4%
Canada	68.7%
United States	**67.3%**
France	65.5%
Japan	61.2%
Germany	55.6%

Source: "Homeownership Rate Declines", Wall Street Journal, February 3, 2010, p. A2

STATEMENT OF PATRICK SINKS BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES
July 29, 2010

I am Patrick Sinks, President and Chief Operating Officer of Mortgage Guaranty Insurance Corporation in Milwaukee Wisconsin. It is a pleasure to be here today to testify on behalf of the Mortgage Insurance Companies of America (MICA), the trade association representing the private mortgage insurance (MI) industry. Mortgage insurers enable home ready borrowers to safely buy homes with less than a 20% downpayment. As a result, we understand the drivers of sustainable, affordable homeownership because our industry has a vested interest in assuring that homebuyers are given mortgages they can afford to pay. Importantly we do not believe affordability and sustainability are mutually exclusive goals. Both can be achieved if the market is structured properly and loans are underwritten prudently. MICA believes that MI is essential to achieving both goals.

The modern MI industry has been in existence since 1957. During the past fifty-three years the industry has enabled borrowers from all walks of life to achieve the dream of homeownership. The credit enhancement we provide has supported the development of the secondary mortgage market, and the industry has withstood a series of regional downturns including the "oil patch" crisis in the early 1980s and the demise of the S&L industry in the late 1980s. The industry is now withstanding the current, unprecedented nationwide downturn in housing, and in fact has raised throughout the mortgage crisis, over $7 billion in capital through new capital and asset sales. We have weathered the storm and we are now adequately capitalized through private capital to meet the expanded needs of first-time homebuyers seeking low downpayment conventional mortgages.

The Role of MI

The primary barrier for most borrowers to buying a home is coming up with a 20% downpayment. That barrier can be overcome in a safe and sound manner by encouraging the use of private mortgage insurance. MI enables borrowers to buy homes with less than a 20% downpayment because MI takes the first loss after the borrower, if the borrower defaults. When the borrower defaults, the MI coverage typically pays the investor 20% to 25% of the loan amount.

Because mortgage insurers are in the first loss position on the mortgages we insure, our interests are aligned with those of both the borrower and the mortgage investor, thus ensuring better quality mortgages. Mortgage insurers act as a second set of eyes by reviewing the credit and collateral risks related to individual loans. This role protects both borrowers and investors by ensuring that the home is affordable at the time of purchase and throughout the years of homeownership.

Borrowers pay for mortgage insurance coverage either through direct premium payments to the mortgage insurer generally included in their monthly mortgage payments or indirectly through Lender Paid Mortgage Insurance (LPMI) where the lender makes the payment but recoups the cost by charging higher interest rates to borrowers. In both cases borrowers pay for the insurance that allows them to receive the loan because the borrowers' ability and willingness to pay the mortgage at a future date is the risk factor in the insurance process. The same is true for FHA mortgage insurance where borrowers pay for the insurance coverage that allows them to receive an FHA-insured loan.

Who MI Serves

Since 1957, the private mortgage insurance industry has helped more than 25 million families buy homes. MI insurance-in-force as of March 31, 2010 was $829 billion, or 8.6 percent of U.S. single family, first liens then outstanding. Since 2007, mortgage insurers have paid over $20 billion in claims and continue to significantly support their insured mortgage lender clients in 2010.

According to the 2008 Home Mortgage Disclosure Act (HMDA) data (the most recent data available), 41% of the borrowers who received mortgages insured by private mortgage insurers to purchase a home made less than area median income and 27% made less than 80% of area median income. The income distribution of mortgage insurers customers combined with the fact that numerous studies have determined that the lack of a substantial downpayment is the major barrier to homeownership leads us to believe that a substantial share of our purchase business is comprised of first-time homebuyers who would not be able to get into an affordable home without the benefit of mortgage insurance.

Enabling Low Downpayment Loans to be Sustainable

The recent mortgage crisis has shown the importance of careful underwriting of mortgage loans both with respect to the borrower's ability to repay the loan and with respect to the true appraised value of the house being financed. This is where private mortgage insurers, as second underwriters of low downpayment loans, play an important role in protecting the borrower, lender and the mortgage holder.

Recent analysis of MI insured mortgages versus piggyback mortgages brings to light the importance of private sector capital at risk in a first loss position.[1] Piggyback loans are loans where borrowers have little or no equity in their mortgages. Instead, borrowers get an 80% first mortgage loan and simultaneously get up to a 20% second mortgage. Therefore, the borrowers have little or no equity in their mortgage, but unlike low-dowpayment loans with private mortgage insurance, there is no private sector capital at risk in a first loss position.

An analysis using loan level data on 4.5 million loans originated between 2004 through 2007 compared delinquency and default rates of loans with combined loan to value (CLTV)

[1] *Insured Versus Piggyback Loan Analysis, available at http //www.restorethedream com/assets/documents/Insured-vs-Piggyback-Loan-Analysis pdf.*

loans of over 80% that were done as single first lien loans with mortgage insurance to over 80% CLTV loans that were structured like piggyback mortgages with an uninsured first lien coupled with a simultaneous second lien mortgage. Piggyback loans became delinquent or defaulted approximately 1.6 times more often than insured loans with comparable CLTV, borrower credit scores and origination year. This analysis demonstrates that not all low downpayment loans are the same. MI significantly mitigates the risk that a high LTV loan will become delinquent and go to default. The data makes it clear that with proper underwriting and mortgage insurance, low downpayment lending can be done without exposing the borrower, lender or investor to excessive risk. A chart with a summary of the data is the first attachment.

Helping Borrowers Stay in Their Homes

Having our own capital at risk also means that mortgage insurers have very clear incentives to mitigate their losses if loans are in default. The best way to do that, of course, is to avoid foreclosures altogether by working with borrowers to keep them in their homes. Mortgage insurers have a history of partnering with lenders, investors and community groups to work with borrowers in default. This often means that, with the servicers' permission, mortgage insurers counsel the borrowers personally and determine if their financial problems can be resolved.

Mortgage insurers have fully participated in the Administration's loss mitigation programs and others. Over 199,000 trials have been started by mortgage insurers under the HAMP, with 34,945 completed through the first quarter of 2010. Further, the industry has participated in 53,901 approvals under the HARP, with 41,155 closed refinances during this same time period. These efforts combined with other MI-related loan workouts resulted in 374,304 completed workouts from 2008 through the first quarter of 2010 by the MI industry, covering $73.8 billion in mortgage loans.

The Regulatory Strength of MI

MI is a regulated, counter-cyclical source of loan level protection provided for a mortgage loan, based on independent, objective underwriting criteria. It is for this reason that the recent report from the Joint Forum of global banking, securities and insurance regulators endorsed mortgage insurance as an important element of a reformed mortgage origination and securitization framework.[2]

[2] The Joint Forum, *Review of the Differentiated Nature and Scope of Financial Regulation Key Issues and Recommendations*, January 2010, at p. 17. "*Other factors important to an effective underwriting program:* The following are not substitutes for sound underwriting practices but should be taken into consideration when determining the soundness of an underwriting program. Mortgage insurance provides additional financing flexibility for lenders and consumers, and supervisors should consider how to use such coverage effectively in conjunction with LTV requirements to meet housing goals and needs in their respective markets. Supervisors should explore both public and private options (including creditworthiness and reserve requirements), and should take steps to require adequate mortgage insurance in instances of high LTV lending (*e. g.,* greater than 80 percent LTV)."

The backbone of the industry's financial strength is its state-imposed reserve requirements. The reserve requirements were developed in a model MI act that was established by the National Association of Insurance Commissioners (NAIC) and is primarily enforced by the states where MI companies are domiciled. The requirements are specifically structured to address the long-term nature of MI risk. They enable the industry to withstand a sustained period of heavy defaults arising from serious regional or national economic downturns, as well as routine defaults and claims that occur normally throughout the cycle.

Mortgage insurers are required to keep three types of reserves, the most important of which is the contingency reserve. Half of each premium dollar earned goes into the contingency reserve and generally cannot be touched by the mortgage insurer for a 10-year period. It ensures that significant reserves are accumulated during good times not only to handle claims under stress, but also to avoid boom-bust cycles. The contingency reserves are directly comparable to the "dynamic provisioning" bank regulators now know they need. Mortgage insurers are subject to similar mortgage default risk as banks but only mortgage insurers raise capital counter-cyclically. Bank regulators are only now working to construct a similar system for banks in the U.S.

Chart 2 demonstrates how the MI industry builds its capital base during good times to pay claims in bad times as currently experienced by the housing market. The chart shows yearly industry losses paid as a percentage of premiums earned for each year from 1980 through 2009. It also shows the MI industry's risk to capital ratio for each year and the build-up of premiums available to pay claims over time. As can readily be seen, the fact that mortgage insurers do not earn all of the premiums they receive each year -- but are required to keep a portion of the premiums in a contingency reserve -- means that premiums available to pay claims increase during the good times so that they can be paid out to cover the serious losses that occur during the bad times.

The other two reserves that mortgage insurers must maintain are case-basis loss reserves and unearned premium reserves. Case-basis loss reserves are established for losses on individual policies when the insurer is notified of defaults. Premiums received for the term of a policy are placed in unearned premium reserves. Each state establishes the method by which premiums are earned to match premiums with loss and exposure.

The history of the MI industry proves that we have paid our claims through good and bad economic cycles. For example, in the early 1980s, the mortgage market had to cope with double-digit interest rates and inflation in a period of severe recession and, therefore, introduced many experimental adjustable-rate mortgages. As economic conditions deteriorated -- particularly in energy-oriented regions of the country -- defaults began to rise, resulting in numerous foreclosures. The MI industry paid more than $6 billion in claims to its policyholders during the 1980s. In the early 1990s, the MI industry paid more than $8 billion in claims primarily in California and the Northeast.

The first loss position of MI makes it a valuable offset to mortgage credit risk. This benefit extends to lenders that hold loans in portfolio and in the case of Fannie Mae and Freddie

Mac, to taxpayers who are otherwise exposed to GSE losses. Over the course of the current mortgage crisis, the MI industry estimates that it will pay around $30 billion in claims in front of the taxpayer to Fannie Mae and Freddie Mac. Indeed, since the current mortgage crisis began, Fannie Mae and Freddie Mac have received from mortgage insurers $14.5 billion in claim payments and receivables, equivalent to 10% of the amount U.S. taxpayers have had to spend to date on the GSEs during their conservatorship.

Not only does the MI industry have ample regulatory capital with the three types of reserves discussed above, but it also has been able to attract new capital to the industry. Since the mortgage crisis began, the industry has raised $7.4 billion through new capital and assets sales and investors have provided a further $600 million for a new entrant to the industry. The recent capital inflows to the industry are indicative of investor confidence in the business model and its regulatory construct.

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

The capital and regulatory strength of the MI industry as well as its proven ability to withstand periods of heavy defaults, is in sharp contrast to other forms of external loan-level credit enhancements which are not regulated, well capitalized, and have not demonstrated a capacity to satisfy their obligations and ensure prudent loan originations. In addition, many are not offered by a bona fide third-party unrelated to the originator or securitizer. For example, credit default swaps (CDS) have been a source of profound systemic risk in the current crisis, and the regulatory framework required to correct this problem still must be constructed following the new standards in the Dodd-Frank Act. The Joint Forum paper cited above details an array of supervisory and capital problems in the CDS sector.

MICA does not believe it is prudent to change the regulatory model for the MI industry because the structure has proven to be so successful. While mortgage insurers meet regularly with FHFA to discuss housing market issues and meet regularly with Fannie Mae and Freddie Mac to discuss a variety of business related issues, the industry is very well regulated by the state insurance regulators. As mentioned earlier, the NAIC has a model MI act and the regulatory model that the MI industry has been operating under for over 50 years is one that federal bank regulators are only now working to construct for banks.

MIs Raised Concerns Well Before the Mortgage Crisis Hit

The MI industry was the "canary in the coal mine" for the problems in the mortgage finance system because, in its unique position, it could see early on the problems that were developing. Beginning in 2002 the MI industry raised concerns with financial institution regulators about the underwriting of high-risk mortgage products and the regulatory and capital incentives that existed for the creation of these products. The industry's concern was derived from the economic interests of the industry, its position as the provider of first loss protection on first lien, residential mortgages and the industry's half century of experience in reviewing mortgage underwriting by lenders during good and bad economic times. The industry's initial concern was focused on the growing number of structured finance, or piggyback loans in the market that not only were higher risk loans because the borrower had little or no equity in the property, but – importantly – because there was no private sector capital at risk when the lenders avoided MI by using a piggyback structure. As MICA explained in a December 3, 2002 letter to the Federal Reserve, OCC, OTS and FDIC referring to the use of piggyback structures:

> MICA would remind the agencies that mortgages are a major source of risk to insured depositories. Despite the high quality of the collateral underlying first liens on residential mortgages, these loans were the underlying source of the S&L debacle during the 1980s because thrifts did not hold sufficient regulatory capital against the various risks these assets pose. Mortgages have since become still more risky because of the increasing role of high-LTV mortgages, at the same time that consumer debt-service burdens have reached unprecedented levels despite historic low interest rates. A failure to impose appropriate regulatory capital for the riskiest type of mortgage asset – structured seconds – could expose the nation's financial system to significant risk as interest rates rise, housing markets weaken and consumers struggle to honor their obligations.[3]

Because of the MI industry's position of insuring the first loss on high-LTV mortgages we had good reason to be concerned with what was developing in the mortgage market even though these loans were generally done in a piggyback structure. As we noted in a September 23, 2005 letter to the bank regulators:

> Our concern is based in part on the fact that high-risk products can undermine reliance on proven forms of credit risk mitigation like private mortgage insurance (MI). But, far more disturbing to us is the fact that recent trends could lead to sudden increases in foreclosures, accompanying sharp reductions in the value of residential mortgage collateral. This would, in effect, "pollute the residential mortgage well" – a well of profound importance to the depository institutions you regulate and to the mortgage insurance industry.[4]

Looking back it should not be a surprise that the MI industry was one of the first mortgage market participants to see the rapid deterioration in mortgage underwriting standards that was occurring and the dangers of piggyback mortgages. The MI industry by virtue of its private capital in the first loss position, its role as a reviewer of the underwriting of the loan, its counter-cyclical regulatory capital requirements and its long term view of housing market cycles had in the early 2000s and continues to have today a vested interest in a mortgage market that

[3] Letter dated December 3, 2002 from MICA to Hon. Susan Bies, Hon. James E. Gilleran, Hon. John D. Hawke, Jr., and the Hon. Donald E. Powell.

[4] Letter dated September 23, 2005 from MICA to Hon. Susan Bies, Hon. John Dugan, Hon. Donald Powell and the Hon. John M. Reich.

gives all parties incentives to put homeowners in mortgages that they can afford to pay over the long term.

MI Going Forward

Private Sector Capital Ready to Make Prudently Underwritten Mortgages Affordable

Today the MI industry is well positioned to help expand affordable housing opportunities in a responsible manner. Under strong capital rules from state insurance regulators, the MI industry has sufficient capital to increase their total insurance exposure by $261 billion a year for the next three calendar years. If this additional volume is realized it would mean that approximately 1.3 million additional mortgages would be insured in each of the years. Because of the nature of who uses MI, many of these new insured mortgages would go to low and moderate income first-time home buyers who do not have the necessary funds to make large downpayments but still have adequate income and credit to enjoy long-term, sustainable homeownership through an insured mortgage. This is an important contribution to the housing recovery because this sector is crucial to the reduction in excess housing inventory which is essential to a full recovery in the housing market.

The New Secondary Market

MICA believes that a re-energized secondary, conventional mortgage market with new entities is necessary to provide sustainable homeownership. As Congress considers the structure of the new entities, MICA believes that the federal government must assume a role in ensuring that the new secondary market entities fulfill their secondary market functions. However, it must be done with no or with minimal risk to U.S. taxpayers and without creating risk to the financial system. This will, in part, be helped by assuring that the new entities focus exclusively on mortgage securitization for sustainable, prudently underwritten mortgages. It also will depend on the new entities having adequate capital ratios, meaningful and consistent underwriting standards for securitized mortgages and restrictions against the assumption of excessive risks. MICA also believes that fees charged by the government as securitizer and by the new conventional securitizing entities should be fully commensurate with the risk of the underlying loans but only after taking into account adequate insurance coverage on high LTV loans.

A liquid secondary mortgage market is critical to providing borrowers with the lowest mortgage interest rates possible. It is also essential to ensuring a standardized market as well as a robust market for affordable, prudently underwritten mortgages. Low downpayment mortgages are a critical part of this market because they enable first-time and lower income families to buy homes. Therefore, the new secondary market entities must provide liquidity for both lower downpayment and higher downpayment mortgages while limiting the credit risk they assume.

In addition, the new entities should be held to corporate governance standards which are at least as high as those imposed on the financial services industry and enforced through a comprehensive federal regulatory structure. In this regard, the new entities should be required to comply with securities laws and their securities reporting and registration requirements should be the same as those required of private issuers including the improved availability and quality of information disclosed regarding the underlying mortgage assets.

Finally, there should be an explicit role for private sector capital in every sector of the mortgage process – primary, secondary, MBS, insurance, appraisals, etc. Private capital at risk ensures market discipline and incentive alignment that will protect both taxpayers and mortgage borrowers. In this regard, loans with low levels of borrower equity should have private capital in a first loss position to provide increased protection for the new entities and taxpayers.

MICA believes policy makers may choose from among three basic approaches in deciding what role the federal government should play in ensuring that the secondary mortgage market achieves these goals. While there may well be sub-options within these basic options, the government still will have to decide which of these three approaches will serve as its guiding role in establishing a dynamic secondary mortgage market. MICA believes that not all of these approaches will serve the interests of taxpayers and mortgage borrowers to the same extent.

The three basic options are first, the government can be the sole guarantor of mortgage credit risk as this risk is transferred through mortgage securitizations or retained on the books of the loan originator. Second, the government can share the guarantee function with various sources of private capital. Third, the government may choose to play no role in guaranteeing mortgage credit risk.

With the first option where the government would bear all the risk, significant problems could arise because there is no private sector capital at risk. First, private capital as "skin in the game" is essential to good quality originations as the U.S. financial regulators are coming to realize. Second, a complete government guarantee of a loan without any private capital at risk removes the incentive for changes in the housing market -- e.g., rising or falling house price assumptions -- to be reflected in lending standards. That is, a complete government guarantee with no shared private risk means that the loan originator effectively has little or no skin in the game once the government guarantee has been applied. As a result, they may disregard signals concerning rising risk levels that would otherwise have changed the underwriting of the loan if private capital -- such as MI -- remained at risk on the loan. Finally, having the government serve as the sole credit risk guarantor puts the U.S. taxpayer at risk for the first dollar of loss on each and every mortgage.

With the second option the government and private capital share the risk. The most logical way to do this is to put private capital in the first loss position. First, this structure allows the mortgage market to adjust risk factors to what is happening in the housing market. It also allows the private market to develop safe and sustainable mortgage products in a timely fashion but with government oversight. Second, it will generate lower mortgage rates for borrowers. Finally, it will allow taxpayers to rely less on the adequacy of a fee charged by the government for a back-up guarantee as compared to a first loss position for the government.

The third option is to eliminate any role for the federal government. The absence of any role for the federal government in mortgage securitization will have negative effects for mortgage investors, borrowers and taxpayers. This approach requires investors to rely totally on private guarantees which inevitably will result in higher interest rates for borrowers than if the government applied its own guarantee to the mortgage securitization. Also, it is unclear that a totally private market for residential mortgages can re-emerge anytime soon without some government role. This is especially the case if the government chooses to retain a government guaranteed market that operates in competition with or supplemental to the private market.

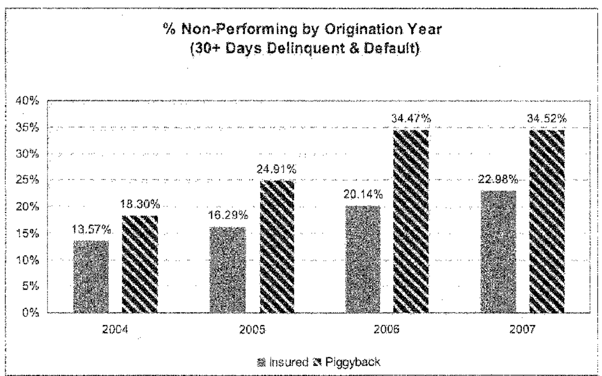
Conclusion

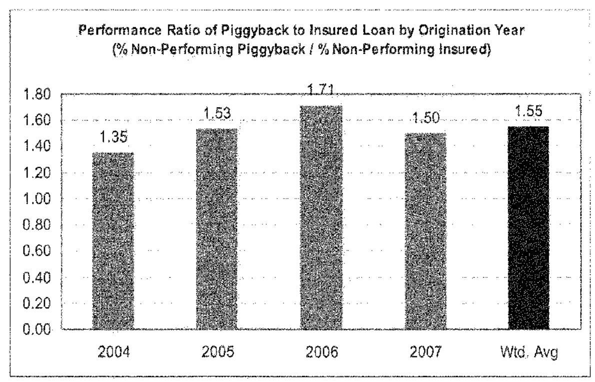
In summary, the private mortgage insurance model has stood the test of time. We have helped house America for more than 50 years. We have been there through the tough times of the regional recessions of the 1980's and 1990's and of course through this recent national housing crisis. We will continue to work closely with borrowers, servicers and others to help people stay in their homes. Finally, we stand ready to play a critical role in the future of housing finance by safely and soundly enabling first-time and lower income families purchase homes.

Chart 1

Piggybacks Versus Insured Loans

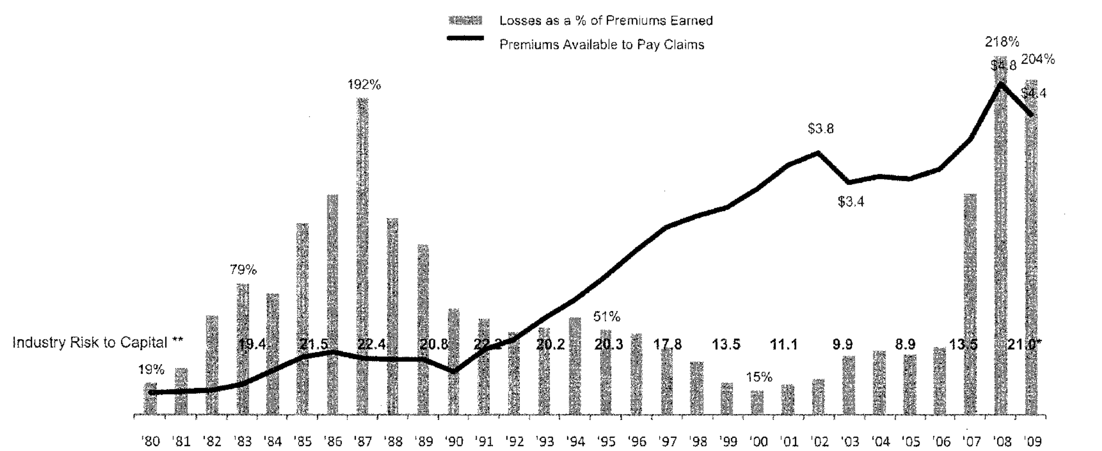
- Genworth compared performance of Insured loans with combined loan to value ratios above 80% (High CLTV) to High CLTV Piggyback loans (uninsured 1st liens with simultaneous 2nd liens)
  - CoreLogic Servicing Database
  - Origination years 2004 – 2007
  - Total # Loans = 4.5 million (0.9mm Piggyback; 3.6mm Insured)
  - Performance data for each normalized to the FICO & LTV distribution of the total population
  - Compared Percentage of Non-Performing Piggyback loans to Non-Performing Insured Loans by Origination Year, FICO group, CLTV and Geography





Insured Loans Perform ~60% Better Than Comparable Piggyback Loans

Chart 2
MIs Build Capital in Good Times to Pay Claims in Bad Times



Source: MICA Reports & Statutory Filings

- **Mortgage insurance is priced for long-term cycles.**
- **New business in recovery phase rebuilds capital base and replenishes contingency reserves.**

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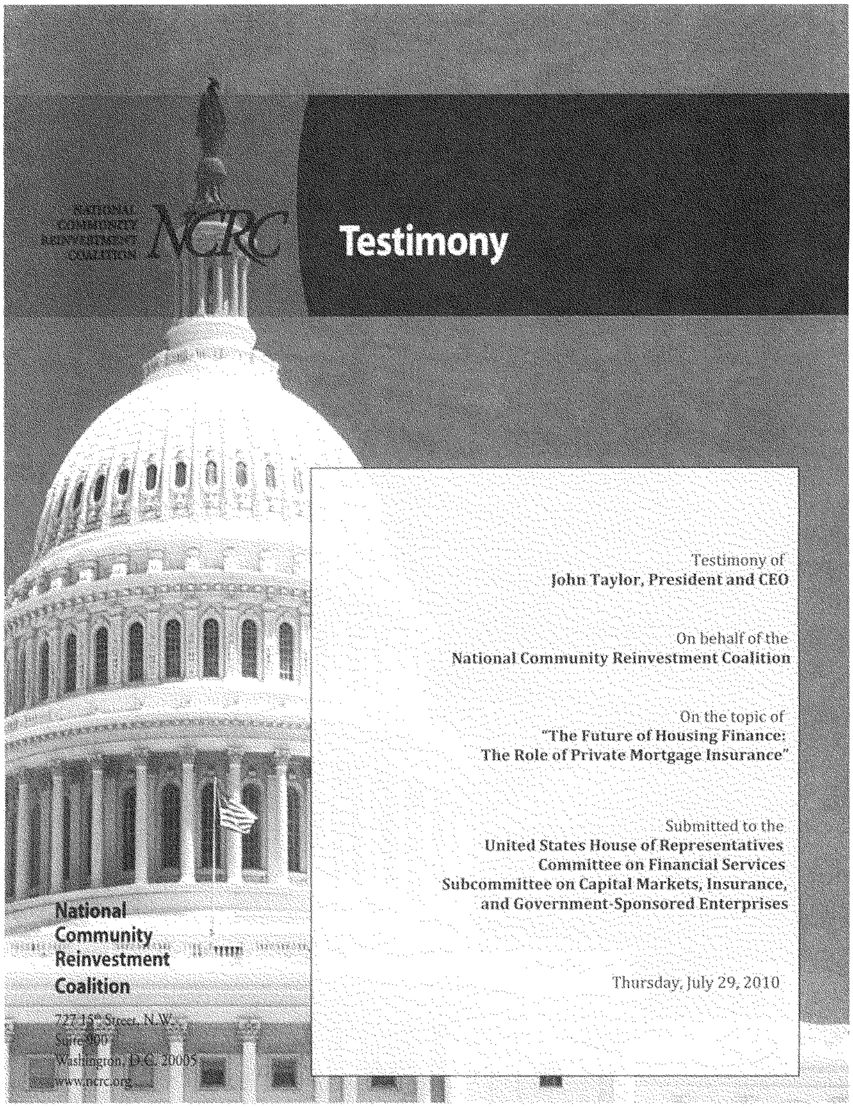
*2009 Includes new entrant capital (Essent Guarantee)

**Dollar Amount of Industry Net Risk on Insured Mortgages Divided By Industry Regulatory Capital



NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Testimony of
John Taylor, President and CEO

On behalf of the
National Community Reinvestment Coalition

On the topic of
**"The Future of Housing Finance:
The Role of Private Mortgage Insurance"**

Submitted to the
**United States House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets, Insurance,
and Government-Sponsored Enterprises**

Thursday, July 29, 2010

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John Taylor
President & Chief Executive Officer
National Community Reinvestment Coalition
Testimony before the House Financial Services Committee
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
"The Future Of Housing Finance: The Role Of Private Mortgage Insurance"

Introduction

Good afternoon Chairman Kanjorski, Ranking Minority Member Garrett, and other distinguished Members of the Committee. My name is John Taylor, President and CEO of the National Community Reinvestment Coalition (NCRC). On behalf of our coalition, I am honored to speak with you today concerning the about the future of housing finance and the role of private mortgage insurance (MI).

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

NCRC was formed in 1990 by national, regional, and local organizations joined together by a common mission: to increase the flow of private capital into traditionally underserved communities, in a manner consistent with safety and soundness concerns. In light of the current economic crisis, this mission has become even more critical as America's working families continue to struggle with lingering unemployment, volatile home values, and an unhealthy freeze of credit, all of which drastically limit opportunities for growth in their communities.

I would like to congratulate the Committee for its prompt action on the recently enacted Dodd-Frank Regulatory Reform Bill and for your insight in creating the much needed Consumer Financial Protection Bureau. However, more work needs to be done to restore access to credit for America's working families and small businesses. From expanding the Community Reinvestment Act (CRA) to promoting the role of proven and effective tools such as private MI, we can help restore the dream of homeownership, trust in the financial system, and stem the tide of foreclosures.

Private MI serves a vital function in today's housing market and is a classic example of a private sector innovation that helps expand access to homeownership in a safe and sound manner. When attached to responsibly underwritten loans, such as those covered by the Community Reinvestment Act, private MI can help leverage CRA's success to help underserved minority and low- and moderate-income communities realize the American Dream of homeownership. It is an effective private sector product that expands access to credit for many borrowers.

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Private MI can and should play a critical role in resuscitating the market and ensuring access to responsible credit. It can be helpful to first time homebuyers, consumers seeking to refinance out of a non-traditional loan, and even consumers who are facing foreclosure and have had no or limited success with their mortgage servicer under the Home Affordable Mortgage Program (HAMP) or the Home Affordable Refinance Program (HARP) as administered by Fannie Mae and Freddie Mac.

The "Great Recession" & Its Impact

In the words of Nobel Prize-winning economist Joseph Stiglitz, the financial system discovered there was money at the bottom of the wealth pyramid and it did everything it could to ensure that it did not remain there. Stated in plainer language, the business model for many financial institutions was to strip consumers of their wealth rather than build and improve their financial security. This "greed and malfeasance," to quote Federal Reserve Chairman Greenspan, spread to every aspect of the mortgage marketplace - from non-prime to non-traditional lending – and created the foreclosure tsunami that is sweeping the nation and destabilizing tax bases in cities and states nationwide.

Ironically, most solutions to date have focused on rewarding the financial firms (and their executives) that created this crisis. In spite of more than $23 trillion of financial support in the form of loans, investment, and guarantees, provided to the financial system, this approach has not worked because consumers continue to struggle in a virtual sea of mortgage debt, and we continue to see a financial system that is unaccountable and unreceptive to the credit needs of the American public and business.

More than two years of voluntary mortgage modification programs have demonstrated that they will not work, no matter how skilled and thoughtful the legislation and program design. Financial institutions are not responding sufficiently to make a significant impact. The result is continued wealth destruction for the American public.

Now is the time to shift the focus away from Wall Street and onto Main Street by addressing, in a broader manner, the growing foreclosure crisis and its contagion effects on national home prices and the overall economy.

When the mortgage finance and the housing market collapsed two years ago, lenders reacted by tightening standards to the point of strangling credit opportunities. Out of necessity, the federal government stepped forward as one of the few institutions willing to extend credit in order to keep our financial system afloat. This, along with other critical government actions, helped bring our economy back from brink of total collapse.

To add to the challenges facing working class Americans, the racial wealth gap (between white and non-white households) has more than quadrupled between 1984 and 2007, according to new research from Brandeis University's Institute on Assets and Social Policy.[1] Other research has revealed that:

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[1] See http://iasp.brandeis.edu/pdfs/Racial-Wealth-Gap-Brief.pdf

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- While the national poverty rate is now 13.2 percent, nearly a quarter of African-Americans and Hispanics live in poverty.[2]

- As many as one-third of all African-American households, and more than 40 percent of Latino households, are at risk of falling out of the middle class and into poverty.[3]

- According to the U.S. Census Bureau, by the end of 2009, the overall U.S. homeownership rate was 67.2 percent.[4] While the homeownership rate for whites was 74.5 percent, African-Americans and Latinos experience homeownership rates of 46 percent and 48.4 percent, respectively.[5]

- During the economic crisis, from 2006 to 2009, homeownership decreased overall by 1.7 percent. However, whites experienced a decrease in homeownership of only 1.5 percent, while African-Americans saw a decrease of 2.6 percent.

- Over 25 percent of mortgage holders reside in homes where the amount owed on the mortgage is now greater the value of the property.[6] Billions of dollars of equity has been lost.

However, there is hope. Today, we are beginning to see the first tentative steps by the private sector to reenter the market. This new opportunity is due to the intervention of the GSE's and FHA, and brings with it increased opportunities for consumers to obtain credit.

In my testimony, I hope to shed further light on how private mortgage insurance (MI) can help refuel our economy by expanding safe and sound opportunities for homeownership in low- and moderate-income communities.

Specifically, I will respond to the questions put before me including: 1) The role and importance of private MI; 2) The effect of private MI on loan modifications; 3) The need for additional consumer protections; and 4), Alternatives to the current payment structure. In addition, this testimony includes practical recommendations for ensuring improved access and affordability to private MI while protecting consumers from potential abuse.

[2] http://www.washingtontimes.com/news/2009/sep/10/census-40m-us-now-live-poverty/
[3] http://www.faireconomy.org/files/pdf/state_of_dream_2009.pdf
[4] http://www.census.gov/hhes/www/housing/hvs/qtr409/files/q409press.pdf
[5] http://www.census.gov/hhes/www/housing/hvs/qtr409/files/q409press.pdf
[6] http://www.nytimes.com/2010/01/10/magazine/10FOB-wwln-t.html

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I. The Role of Private Mortgage Insurance

Expanding Access to Homeownership

Private mortgage insurance (MI) is extra insurance that lenders require from most homebuyers who obtain loans that are more than 80 percent of the home's value. In other words, buyers with less than a 20 percent down payment are normally required to purchase private MI in order to obtain the mortgage loan.

While private MI primarily protects lenders from losses associated with mortgage defaults, private MI does enable greater access to homeownership. With private MI, responsible consumers who are able to pay their mortgage payments on time can buy a home without having to wait years to accumulate a 20 percent down payment. Private MI therefore ensures access to traditionally underserved populations that may not have large saving accounts, but nevertheless have a strong record of paying their mortgage on time.

By joining private MI with "qualified" mortgages, as defined under the recent Financial Reform legislation, Fannie Mae, Freddie Mac, and other lenders, can effectively jump start access to credit and private sector secondary market liquidity in order to promote homeownership in a manner consistent with safety and soundness. Just as the Community Reinvestment Act has leveraged substantial amounts of loans and investments in low- and moderate-income communities, and has had a broader impact on the overall economy through job creation, affordable housing, and small business development, the growth of private MI can also help reinvigorate our economy.

In addition, the use of private MI serves as alternative to the widespread use of "toxic" or abusive products, including "piggyback" loans or Home Equity Lines of Credit (HELOC) that combine teaser rates with "no doc" or "Pay Option ARM" lending. These loans, often securitized by Wall Street, were not sustainable and have devastated millions of homeowners who are facing foreclosure, destabilizing the communities that they live in.

For these reasons, NCRC has long championed making private MI tax deductible, and encourages Congress to make this tax benefit permanent.

Restoring Balance to Housing Finance

Private MI expands access to homeownership e while reducing over-reliance on government-insured FHA loans or Fannie Mae and Freddie Mac underwriting. This is incredibly important in light of the heavy shift toward government lending in the aftermath of the current economic crisis. For example, the FHA has taken on increasing importance since the subprime mortgage crisis hit: it not only has continued its primary mission of providing mortgage financing for underserved constituencies, but is also issuing low down-payment loans for other Americans who would have had access to private lending in the past.[7] Overall, the FHA along with Fannie

[7] http://money.cnn.com/2010/07/16/real_estate/tighter_FHA_requirements/

Mae and Freddie Mac now account for nearly all the mortgage lending activity in the nation today.[8]

As the Honorable David Stevens, Assistant Secretary of Housing and Urban Development and Federal Housing Administration Commissioner stated in his testimony before the Senate Appropriations Subcommittee on Transportation, Housing and Urban Development, and related agencies in May of this year, "the increased presence of FHA and others in the housing market, including Fannie Mae and Freddie Mac, has helped support liquidity in the purchase market, helping us ride through these difficult times until private capital returns to its natural levels." While these government or government-sponsored institutions are serving their critically needed counter-cyclical role, by temporarily providing necessary liquidity at times when private sector lending is frozen, nearly all experts agree that a robust private sector must return to the lending space.

The reemergence of private MI in the marketplace, therefore, bodes well for our economic recovery by protecting investors and taxpayers alike from unnecessary risk or exposure to loss. In addition, it signals a reinvigoration of private sector lending and credit opportunities. And now that the federal government has successfully brought our financial system back from the brink of disaster, the private sector must be encouraged to reenter the market and to return balance to our economic system. It is in this way that private MI can serve as a means to jumpstart our economy.

Supporting and expanding the use of responsible private sector lending, therefore, is necessary for a robust and vibrant system of housing finance. Reliance on government-funded housing solutions alone is too risky: we have witnessed in the past that commitment to government-funded housing solutions has waxed and waned with different administrations. Therefore, if government agencies were to become the primary vehicle for housing finance, the opportunities for minority and working-class Americans to participate fully in the market will be too exposed to political whims. A financially inclusive society and economy simply cannot prevail without meaningful participation of the private financial sector.

In addition, the government should not become the lender of only resort for consumers, as a matter of equity and efficiency. Even with the most generous funding, government resources will not be sufficient to meet the capital and credit needs of underserved communities. Therefore, the role and responsibility of the private financial services sector to address the mortgage needs of all classes of creditworthy Americans cannot be understated.

II. Private Mortgage Insurance and Loan Modifications

In March 2010, NCRC testified before the House Financial Services Committee regarding the impact of the Administration's foreclosure prevention program, Making Home Affordable, which includes both the Home Affordable Modification Program (HAMP) the Home Affordable Refinance Program (HARP) and made suggestions for improvements. At that time, NCRC

[8] http://money.cnn.com/2010/07/16/real_estate/tighter_FHA_requirements/

expressed deep concern and frustration that despite the Home Affordable Modification Program's (HAMP) goal of assisting 3 to 4 million homeowners, only 170,000 trial modifications had become permanent.

While a considerable improvement over the previous administration's programs, the Obama Administration's programs are still not keeping pace with foreclosures. More than one year after its inception, the HAMP program has converted only 390,000 trial modifications into permanent modifications.

One reason that there are too few permanent modifications is that homeowners are placed in trial modifications that are still unsustainable. It is in this way that private MI is currently underutilized.

Because their own capital is at risk, private mortgage insurance companies have strong incentives to mitigate their losses if loans are in default. The best way to do that, of course, is to avoid foreclosures altogether by working with borrowers to keep them in their homes.

Private MI uniquely aligned with both the interests of the borrower and the investor, and therefore can help to ensure better quality mortgages. Because private mortgage insurance companies must review underwriters for the credit and collateral risks, private mortgage insurance companies effectively act as a second set of eyes. Ideally, a private mortgage insurance company would be weary to extend insurance to a loan that, because of its terms and conditions, is unsustainable. This is true regardless of whether the insurance is obtained at origination, refinance, or modification.

Therefore, private mortgage insurance companies can play in ensuring the sustainability of individual mortgages. This role could protect both borrowers and investors and help to ensure that the loan is sustainable, not only at the time of purchase, but throughout years of homeownership.

Private MI can also play a critical role with the Home Affordable Refinance Program. By coupling principal reduction with private MI, the Administration can ensure that homeowners are finally placed in mortgages that are sustainable.

Finally, NCRC lauds private mortgage insurance companies for their efforts in a variety of different foreclosure prevention programs. Private mortgage insurance companies report that from 2008 to 2009 mortgage insurers have completed over 290,000 workouts representing $56 billion in loans.

III. Ensuring Basic Consumer Protections

State and Federal Regulation

The current economic crisis has proven that the failure to implement consumer protections undermines the soundness of the financial system. Today, regulation of the private MI industry

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largely occurs on the state level. However, in light of the financial crisis and the recent establishment of the Consumer Financial Protection Bureau, NCRC believes that the federal government should play a larger role in ensuring basic consumer protections for financial products.

As such, NCRC supports federal regulation of private MI. However any federal regulation of this product must fall under the purview of the newly-established Consumer Financial Protection Bureau.

While federal regulations will ensure a basic standard of consumer protections are afforded to all consumers, states must be permitted to provide additional protections as needed.

Data Enhancement

Currently, the Federal Financial Institutions Examination Council (FFIEC) prepares national aggregate data reports on private MI activity from data submitted by the Private Mortgage Insurance Companies of America. On a voluntary basis, eight private mortgage insurance companies provide data on the disposition of applications for MI, using some of the same categories of information as those established for lenders under the Home Mortgage Disclosure Act (HMDA).

NCRC applauds these eight private mortgage insurance companies for their efforts to provide the public with such critical data. Private mortgage insurance companies voluntarily maintain excellence performance data which could, and should, be used in the future by more financial institutions in order to restore trust in our broken financial system.

The importance of transparency in lending practices cannot be over-estimated. Over the years, community organizations and concerned citizens have made used HMDA data to help determine which banks are lending in their communities and to find new opportunities for collaboration. The importance of data disclosure is just as important for private mortgage insurance lending because private MI often allows responsible homebuyers to more readily realize the American Dream.

However, a number of improvements to the FFIEC's data disclosure are needed to ensure that private mortgage insurance companies are lending to minority and low-income communities in a non-discriminatory manner. Congress should enhance data requirements by making such disclosure mandatory and expanding disclosure requirements to include geographic data and data on the cost of premiums and the amount of losses incurred by the private mortgage insurance company.

In preparation for this hearing, NCRC conducted an initial analysis of data voluntarily submitted by private mortgage insurance companies to the FFIEC in 2008.[9] Our initial analysis of such data indicates that African-Americans and Hispanic consumers, across all income levels, are

[9] http://www.ffiec.gov/hmdaadwebreport/nataggwelcome_mica.aspx

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experiencing higher denial rates than their white counterparts (See Table 1). In order to determine whether this denial disparity is due to discrimination or to more benign reasons, more data must be available on losses incurred by private mortgage insurance companies. While there may be reasonable business justifications that explain this disparity, the findings require further investigation and additional disclosure, which should be modeled on the Home Mortgage Disclosure Act.

With regular and comprehensive disclosure, the public will be able to rigorously scrutinize fairness in lending practices, adding a measure of transparency and accountability. This has become incredibly important in light of the failures of the financial system which led to our current economic crisis.

Table 1: Private Mortgage Insurance for Conventional Home Loans by Race and Income

Race and Income	Denial Rate	Disparity Ratio
Low-income white (non-Hispanic)	7.36%	1
Low-income African-American	9.06%	1.23
Low-income Hispanic	13.03%	1.77
Moderate-income white (non-Hispanic)	6.17%	1
Moderate-income African-American	8.37%	1.36
Moderate-income Hispanic	10.14%	1.64
Mid-income white (non-Hispanic)	5.91%	1
Mid-income African-American	9.22%	1.56
Mid-income Hispanic	9.29%	1.57
Upper-income white (non-Hispanic)	6.87%	1
Upper-income African-American	9.99%	1.46
Upper-income Hispanic	9.55%	1.39

**Low-Income is defined as less than 50% of MSA/MD median income levels. Moderate-Income is 50-79% of MSA/MD median income levels. Mid-Income is 80-119% of MSA/MD median income levels. Upper-income is greater than 119% of MSA/MD median income levels.

Affordability and Accessibility

In order to fulfill its crucial role in providing responsible consumers the opportunity to become homeowners, private MI must affordable. Access to homeownership, particularly by responsible consumers in low- and moderate-income communities, depends directly on the affordability of this product.

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However, NCRC has voiced concern in the past about private MI being too expensive and leaving many consumers with only Federal Housing Administration lending as an alternative. This concern still remains and more must be done to ensure that private MI is within the reach of millions of Americans.

As such, reasonable pricing standards should be developed by the Consumer Financial Protection Bureau to ensure that premiums are more accessible to consumers. Private MI typically costs between 0.5 percent to 1 percent of the entire loan amount on an annual basis, however some private mortgage insurance companies represent that their fees average between 0.5 percent to 0.75 percent.[10] On a $100,000 loan this means the homeowner could be paying as much as $1,000 a year, assuming a 1 percent private MI fee. For a home priced at $250,000, families will spend more than $200 a month on the insurance.

Most importantly, however, private mortgage insurance companies must fully disclose costs to consumers. Without full disclosure, consumers are at serious disadvantage because they may not understand what they are paying for and are therefore unable to make sound financial decisions.

It is important to note, however, that private mortgage insurance companies have been largely able to resist the temptation to follow the GSE's decision to add an adverse market fee of 25 basis points to all loans. NCRC has grave concerns that this fee will limit access to credit for many consumers and may disproportionately impact protected classes under federal Fair Housing Act.

In addition, sometimes there can be some problems when a homeowner attempts to cancel PMI. Usually when a homeowner's equity builds to 20 percent, he or she is no longer required to have private MI. However, consumers are often unaware of the fact that they are no longer required to have private MI, and others often experience delays in cancellation. Many lenders require the homeowner to draft a letter requesting that the private MI be canceled, as well as receive a formal appraisal of the home prior to its cancellation. All in all, this could take several months, depending upon the lender.

The appraisal methods used by many private mortgage insurance companies, including the use of automated valuation models (AVMs), also raise serious concerns about accuracy. In 2005 NCRC established the Center for Responsible Appraisal and Valuation (CRAV) to represent the interests of those responsible market players committed to independent and fair valuation practices along with regulators, legislators, and the public.[11] At the time of formation, the appraisal industry was under enormous pressure from the lending community to provide improper and unlawful appraisals and valuations.[12] Recognizing the threat inaccurate and inflated property valuations posed to the safety and soundness of the residential real estate market and our financial system, CRAV and NCRC warned that without swift action to ensure independence and accuracy in the valuation market, the effects would be disastrous.[13]

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[10] http://www.investopedia.com/articles/pf/07/avoid_pmi.asp
[11] http://www.ncrc.org/index.php?option=com_content&view=article&id=37:center-for-responsible-appraisals-and-valuations-crav&catid=87:responsible-appraisals
[12] http://money.cnn.com/2005/05/23/real_estate/financing/appraisalfraud/index.htm
[13] See NCRC's report, *Predatory Appraisals: Stealing the American Dream*, June 2005

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The troubling effects CRAV and NCRC had foreseen and warned against are now widely understood. Artificially inflated housing prices contributed to the growth and collapse of the housing bubble, bringing our entire financial system to the brink of disaster and imposing the greatest economic crisis on American families since the Great Depression.

Today, the excessive reliance on automated valuation models (AVMs) in place of independent appraisals should sound alarms. The purpose of an appraisal, first and foremost, must be to provide homeowners and investors with a true reflection of the property's market value. NCRC and CRAV firmly believe that independent appraisers are critical to ensuring that homeowners and investors have accurate information about the value of their home in order to make good financial decisions. However, by replacing the professional appraiser with automatic valuation models (AVMs), private mortgage insurance companies are often leaving homeowners and investors with inaccurate data.

IV. Alternatives to the Current Payment Structure

NCRC was asked to discuss whether an alternative to the current payment model for private MI should be explored and specifically, whether lenders should pay the premiums for this insurance. Because private MI primarily protects lenders from losses associated with mortgage defaults, new payment models, in which lenders pay for private MI premiums or in which the cost of premiums are shared between lender and homebuyer, should be explored.

However, any payment structure must guard against the risk that lenders will merely pass the cost of such premiums onto the consumer, or that lenders refuse to cancel the insurance policy once the homeowner has reached the 80 percent loan-to-value ratio, which was created for the benefit of the consumer.

Other new and innovative products, including a product recently developed by Home Value Protection, can also augment private MI, to the benefit of consumers. This product protects the homeowner, not the lender, from swings in home values. It also has the benefit of incentivizing homeowners to not walk away from the property as soon as home values drop; it prevents the domino effect documented in this economic crisis, in which neighborhoods are destroyed by cascading foreclosures, short sales, and walk-aways.

V. Conclusion

In conclusion, private MI can help refuel our economy by expanding safe and sound opportunities for homeownership in low- and moderate-income communities. When attached to responsibly underwritten loans, such as those covered by the Community Reinvestment Act, private MI can help leverage CRA's success to help underserved minority and low- and

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moderate-income communities realize the American Dream of homeownership. It is an effective private sector product that expands access to credit for many borrowers.

In addition, private MI should be upheld as a signal of a reinvigoration of private sector lending and credit opportunities. After having successfully brought our financial system back from the brink of disaster, the government must do more to encourage the private sector to reenter the market and to return balance to our financial system.

Private MI is also currently underutilized by the Making Home Affordable programs. Private MI is uniquely aligned with both the interests of the borrower and the investor, and therefore can help to ensure better quality mortgages. Because private mortgage insurance companies must review underwriters for the credit and collateral risks, private mortgage insurance companies effectively act as a second set of eyes. Ideally, a private mortgage insurance company would be weary to extend insurance to a loan that, because of its terms and conditions, is unsustainable.

However, a number of practical recommendations are necessary to ensure improved access and affordability, while also protecting consumers from potential abuse. NCRC strongly believes that any federal regulation of this product must fall under the purview of the newly-established Consumer Financial Protection Bureau. While federal regulations will ensure a basic standard of consumer protections are afforded to all consumers, states must be permitted to provide additional protections as needed.

Specifically, Congress should enhance data requirements by making such disclosure mandatory and expanding disclosure requirements to include data on the cost of premiums and the amount of losses incurred by the private mortgage insurance company. Without such information, we cannot know with certainly whether disparities in denial rates are due to discrimination.

In addition, reasonable pricing standards should be developed by the Consumer Financial Protection Bureau to ensure that premiums are more accessible to consumers, costs must be fully disclosed to consumers, and cancellations of such insurance should minimize delays. The appraisal methods, including use of automated valuation models (AVMs), used by many private mortgage insurance companies to determine whether the 80 percent loan-to-value threshold has been met, also raise serious concerns about accuracy.

Finally, alternative payment structures should be explored. However, any payment structure must guard against the risk that lenders will merely pass the cost of such premiums onto the consumer, or that lenders refuse to cancel the insurance policy once the homeowner has reached the 80 percent loan-to-value ratio, which was created for the benefit of the consumer.