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Before

The United States Senate Committee on Banking, Housing, and Urban Affairs

March 27, 2019

USMI's Thoughts and Recommendations on Chairman Crapo's Outline for Housing Finance Reform

Chairman Crapo, Ranking Member Brown, and the members of the Committee, U.S. Mortgage Insurers (USMI)[1] appreciates this opportunity to come before you to discuss the housing finance system and opportunities for reform—and particularly the opportunity to consider and comment on the housing finance reform outline (the "Outline") released in February by Chairman Crapo. USMI agrees with the Chairman and other policymakers who continue to recognize that, while improvements in the broader mortgage finance system have occurred, meaningful legislative reforms to address the structural problems at Fannie Mae and Freddie Mac (the "GSEs") are still necessary. The Outline represents an important marker in the discussion on housing finance reform because it acknowledges the need to limit the GSEs' market power, better shield taxpayers from mortgage credit risk, and ensure that a reformed system creates incentives for prudent and sustainable mortgage lending. While only Congress can make the permanent structural reforms necessary, the Administration can and should take steps to limit the GSEs' duopoly – focusing their activities to the secondary market and instilling greater transparency in a number of areas. Any actions taken by the Administration should help facilitate, not limit, the ability of Congress to make necessary reforms to the GSEs. USMI is committed to working with lawmakers to shape housing finance reform legislation.

Importantly, the Chairman's Outline recognizes the importance of maintaining a system where private mortgage insurance (MI) bridges the gap of saving 20 percent of the home price for a down payment; a threshold that is out of reach for many home-ready borrowers. Private MI is the form of credit enhancement backed by private capital that works in virtually every construct for housing finance reform, including proposals that rely on a guarantor model such as the one described in the Chairman's Outline, those that rely on Ginnie Mae, or a cooperative model as described in Chairwoman Waters' HOME Forward[2] proposal in 2014. Private MI is a time-tested and sophisticated form of credit enhancement that has provided taxpayer protection and facilitated borrower access to low down payment mortgage credit for more than 60 years. USMI members have decades of experience independently underwriting, insuring, and dispersing mortgage credit risk.

This testimony will cover the following topics:

- Why MI is important for enabling homeownership while protecting taxpayers;
- How key enhancements make private MI a superior counterparty today;
- Areas of the Outline supported by USMI; and
- Recommendations to strengthen the Outline.

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[1] USMI is a trade association comprising the following private mortgage insurance companies: Essent Guaranty, Inc.; Genworth Mortgage Insurance Corporation; Mortgage Guaranty Insurance Corporation; National Mortgage Insurance Corporation; and Radian Guaranty Inc.

[2] "Housing Opportunities Move the Economy Forward Act of 2014." *Available at* https://democrats-financialservices.house.gov/uploadedfiles/media/file/003%20maxine%20waters%20legislation/gse%20bill/waters_046_xml.pdf.

Why MI is Important for Enabling Homeownership While Protecting Taxpayers

MI ensures that home-ready borrowers have sustainable access to prudent and affordable mortgage finance credit. Private MI has been in the market for more than 60 years since the industry was founded in 1957 as an alternative to the Federal Housing Administration (FHA) for borrowers and lenders. While consumers routinely identify the down payment as the biggest impediment to buying a home, and a typical family would need upwards of two decades to save for a 20 percent down payment plus closing costs,[3] conventional loans with private MI allow borrowers to prudently get into homes with down payments as low as three percent. Over the past six decades, the MI industry has helped more than 30 million families attain homeownership in a prudent and affordable manner.

MI reduces taxpayer exposure by transferring, at origination, a substantial portion of mortgage credit risk to MI companies backed by private capital. Private MI is required to be a monoline form of insurance because, unlike other forms of capital markets executions and reinsurance, policymakers wanted to ensure a dedicated form of credit enhancement would be available across all housing market cycles. MI is a source of *permanent* private capital—capital provided through all market cycles—that does not rely on government backing. Throughout our 60-year history, including through the Great Recession, the MI industry *never* stopped paying claims, *never* stopped writing new insurance, and *never* received a "too big to fail" federal bailout. In fact, the MI industry has covered more than $50 billion in claims since Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs), entered conservatorship in 2008.

The Need for MI: First, it is important to understand *why* there is a need for private MI. Data demonstrates that borrowers who make larger down payments are less likely to default on their mortgages than lower down payment borrowers. Congress understood the additional risk posed by borrowers with lower down payments and the need to mitigate that risk, but Congress also understood the importance of ensuring that prudent and affordable low down payment options were available to home-ready borrowers. In 1970, Congress included in the GSEs' legislative charters, the requirement to obtain private credit enhancement on loans with down payments less than 20 percent.[4] This credit enhancement can be achieved in several ways—lender recourse, participation, or qualified insurance.

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

1. ***MI makes homeownership possible for creditworthy homebuyers who do not have the resources for a large down payment***. MI has helped millions of Americans become homeowners sooner in both a prudent and affordable way by assuming a portion of the credit risk on their loans. According to research from both the Center for Responsible Lending and USMI, it could take approximately 25 years for the average firefighter or nearly 22 years for the average middle school teacher to save for a 20 percent down payment plus closing costs.[5] Research by the National Association of REALTORS® suggests that Americans continuously cite saving for a down payment as one of the biggest hurdles for

[3] Calculations by USMI using methodology developed by the Center for Responsible Lending (CRL) based on median home price (National Association of REALTORS®), median estimated closing costs (Zillow), median income (U.S. Census Bureau, Historical Income Tables, Table H-6), and annual savings rate (Federal Reserve).
[4] Federal National Mortgage Association Charter Act, 12 U.S.C. 1717(b)(2) and Federal Home Loan Mortgage Corporation Act, 12 U.S.C. 1454(a)(2).
[5] Calculations by USMI using methodology developed by the Center for Responsible Lending (CRL) based on median home price (National Association of REALTORS®), median estimated closing costs (Zillow), median income (U.S. Department of Labor, Bureau of Labor Statistics, Occupational Employment & Wages), and annual savings rate (Federal Reserve).

attaining homeownership and first time homebuyers on average have a down payment of seven percent.[6] Furthermore, the demographic landscape of U.S. homeownership is forecasted to look significantly different than in past decades, with the share of minority households projected to increase from 30 percent in 2010 to 38 percent by 2030[7] and account for approximately 80 percent of household formation for 2015-2035.[8] Due to limited assets and savings for a large down payment, minority families tend to overwhelmingly rely on low down payment mortgage options to secure mortgage financing. Private MI is a reliable and prudent option to enable many of these low down payment borrowers achieve homeownership sooner.

In the past year alone, our industry has helped more than one million families purchase or refinance their mortgage with less than a 20 percent down payment. Nearly 60 percent of purchase borrowers who had private MI were first-time homebuyers[9] and MI is focused on low- to moderate-income borrowers with more than 40 percent of borrowers with MI having incomes below $75,000 per year.[10] And in the event a borrower encounters unexpected hardships, private MIs have a clear incentive to help borrowers avoid foreclosure.

2. ***MI is available to lenders of all sizes and types***. One reason that MI has works so well and plays such a significant role is its ability to be used by an approved lender of *any* size doing business with the GSEs. Private MI has the distinct advantage of being scalable for originators of all types and sizes, including community banks, credit unions, and other small originators. MI serves these institutions by enabling them to originate low down payment loans either to sell to the GSEs, securitize, or hold in portfolio. In the latter case, federal regulators recognize this credit enhancement and reduction in loss severity associated with MI and provide capital relief to financial institutions with its use. MIs have relationships with several thousand financial institutions and compete to deliver world class loan delivery, underwriting, servicing, and training/education to their lender customers.

3. ***Finally***, ***MI serves the GSEs and ultimately protects taxpayers.*** Because MIs stand in a first-loss position on high LTV loans, MIs are motivated to provide an additional layer of strong underwriting and loss mitigation services to the housing finance system. When ultimately called upon, MIs are regulated and capitalized to withstand economic shocks, as evidenced by the more than $50 billion paid in claims since the onset of the financial crisis—a direct benefit to taxpayers.

How Key Enhancements Make Private MIs Superior Counterparties Today

Simply put, the MI industry is not the same as it was 60 years ago. In fact, even within the last 10 years the industry has been significantly strengthened and improved through enhanced capital and regulatory requirements, underwriting, and technology investments. Serving as one of the only forms of private capital available through the financial crisis, the industry fully understands what it takes to withstand a significant downturn. MIs took the lessons from the financial crisis to heart by making several very significant updates: 1) the MI industry has drastically improved claims paying ability through new capital and operational standards, the Private Mortgage Insurer Eligibility Requirements (PMIERs), which

[6] National Association of REALTORS, *2018 Profile of Home Buyers and Sellers* (October 29, 2018)
[7] Urban Institute, "Can the mortgage market handle the surge in minority homeownership?" (July 1, 2015).
[8] Harvard Joint Center for Housing Studies, *Updated Household Projections, 2015-2035: Methodology and Results* (December 12, 2016).
[9] GSE Aggregate Data
[10] USMI member data.

have nearly doubled the required capital for MIs to do business with the GSEs; 2) the industry updated its Master Policy contracts to provide more clarity regarding how and when an MI pays a claim; and 3) the industry continues to expand its use of credit risk transfer (CRT) to manage its own risk exposure by dispersing mortgage credit risk to the global markets.

Enhanced and Increased Capital Standards – PMIERs. In addition to an ongoing effort to update the state insurance regulatory framework for MI,[11] MIs have new capital and operational standards under PMIERs issued by the GSEs in conjunction with FHFA. These increased capital requirements are more risk sensitive and the GSEs conduct regular monitoring of capital and operational compliance. MIs' minimum surplus and reserve requirements cause MIs to retain premiums earned during periods of economic expansion in order to be able to cover losses during downturns. Under the new risk sensitive requirements, most MIs have current asset requirement over seven percent with a minimum 5.6 percent risk-in-force.

[12]

PMIERs are expressly designed to measure, monitor, and control MI counterparty risk by establishing robust standards for the companies' capital levels, business activities, risk management, underwriting practices, quality control, and lender approval and monitoring activities. PMIERs are also updated —most recently in September 2018[13]—to address any new concerns that arise in the markets. USMI members have maintained capital levels significantly over the PMIERs minimum requirements and, as of the end of 2018, USMI members collectively held approximately $3.4 billion in excess of these requirements.[14] **The combination of PMIERs and state regulation—including state's approval of pricing, capital rules, and their solvency requirements—results in a level of oversight that is significantly more robust and granular than that of other GSE counterparties.**

Updated Master Polices for MIs. New MI Master Policies went into effect in October 2014, following substantial input from FHFA. These Master Policies increase clarity of terms and streamline the payment of claims to ensure that, in the event of borrower default, the MI results in reliable and predictable claims payments. These new policies articulate in much greater detail the conditions, in some cases tied to quantitative

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[11] The National Association of Insurance Commissioners (NAIC) is currently in the process of modifying its *Mortgage Guaranty Insurance Model Act* to revise areas of solvency regulation for mortgage insurers, particularly minimum capital and surplus requirements.
[12] PMIERs capital sufficiency ratio based on USMI member company 4Q2018 SEC filings.
[13] Federal Housing Finance Agency, *Fannie Mae and Freddie Mac Update The Private Mortgage Insurer Eligibility Requirements* (September 27, 2018). *Available at* https://www.fhfa.gov/Media/PublicAffairs/Pages/Fannie-Mae-and-Freddie-Mac-Update-Their-Private-Mortgage-Insurer-Eligibility-Requirements.aspx.
[14] USMI member company 4Q2018 SEC filings.

thresholds, that must be met before coverage on an insured loan may be rescinded. The new Master Policies ensure timely, consistent, and accurate policy and claim administration, creating high visibility and responsiveness for performing loss mitigation (workouts for borrowers who become late on their payments). MIs work with investors and servicers to help homeowners facing foreclosure. The industry's business model aligns with borrowers, investors and servicers not only to help put borrowers into homes, but to keep them there.

Use of Credit Risk Transfer and Improved Underwriting Standards. The traditional, pre-crisis "buy and hold" MI model has evolved. Today, MIs have an even greater ability to limit their downside risk exposure by selling a portion of the risk they insure through the use of reinsurance contracts and credit linked notes. These transactions enable USMI member companies to free up capital to back more low down payment loans. USMI members have decades of experience using reinsurance markets and more recently have transferred credit risk to the capital markets through insurance-linked notes. Finally, improvements in origination quality through the implementation of the Ability-To-Repay/Qualified Mortgage Rule (ATR/QM Rule)[15] and changes to lender representations and warranties on the quality of mortgages acquired by the GSEs have resulted in an overall stronger mortgage finance system. Each of these post-crisis market enhancements have contributed to stabilizing the housing finance system and improved the quality of mortgage credit products to the benefit of borrowers, lenders, and taxpayer.

Chairman Crapo's Outline for Housing Finance Reform

Chairman Crapo's Outline underscores the importance of legislatively reforming the nation's housing finance system. The Outline builds on the work of previous proposals and offers a reasonable approach to addressing many of the structural issues in the current system. The Outline is consistent with USMI's principles for a reformed housing system, as further discussed below.

1. **Protect Taxpayers**. The Outline recognizes the value of private MI as a permanent source of private capital to actively manage and reduce losses in the housing finance system. We applaud the specific requirement for loan-level coverage MI (insuring individual loans) for high LTV mortgages at standard coverage levels—up to 35 percent of the loan value. The Outline also provides for an opportunity for MIs and other market participants to guaranty mortgage-backed securities (MBS). Further, USMI supports the concept of requiring that mortgages meet standards akin to today's ATR/QM Rule.
2. **Promote Stability**. The Outline also recognizes that to maintain stability in the secondary market and to sustain access to 30-year fixed rate mortgages, it is necessary to have an explicit guaranty by the federal government on timely payments of principal and interest on qualifying MBS. Further, the Outline promotes stability within the marketplace by incorporating parts of the mortgage finance system that exist and work well—notably by using the existing infrastructure of Ginnie Mae, preserving the requirement for loan-level credit enhancement and ensuring market access to tools and systems that support a large and liquid secondary market for housing.
3. **Ensure Accessibility**. The Outline makes the government guaranty available to lenders regardless of the size of the institution or its market share. The Outline requires FHFA to "charter, regulate, and supervise guarantors"—a significant improvement over today's marketplace where the GSEs set often set the standards for counterparties that they then compete against.
4. **Foster Transparency**. The Outline seeks to promote transparency in the marketplace by making all GSE loan-level data publicly available. As further discussed below, USMI agrees with these measures in the

[15] Ability to Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6407 (January 30, 2013).

Outline and believes that even more can be done to promote transparency around pricing and underwriting.

Recommendations to Strengthen the Crapo Outline

<u>Recommendation 1</u>—To Better Protect Taxpayers and Promote Stability in the Conventional Market the Outline Should Require:

- **All "Eligible Mortgages" Should Have Minimum Down Payment of Three Percent.** Decades of market experience and data confirm that down payments do matter for performance of mortgage loans. The recognition that borrowers with lower down payments pose additional risk was the driving force behind requiring the GSEs to credit enhance these borrowers' mortgages. USMI supports a statutory minimum down payment and it is critical that policymakers understand that prudent and affordable low down payment lending is possible in conjunction with the proper form and source of credit enhancement. MIs have served as entity-based, loan-level credit enhancement for more than 60 years and the industry is highly regulated and capitalized. Access to prudent, affordable low down payment mortgage finance is critical for the housing market, especially first-time homebuyers, nearly 80 percent of whom have relied on low down payment mortgages to purchase their homes in 2018.[16]

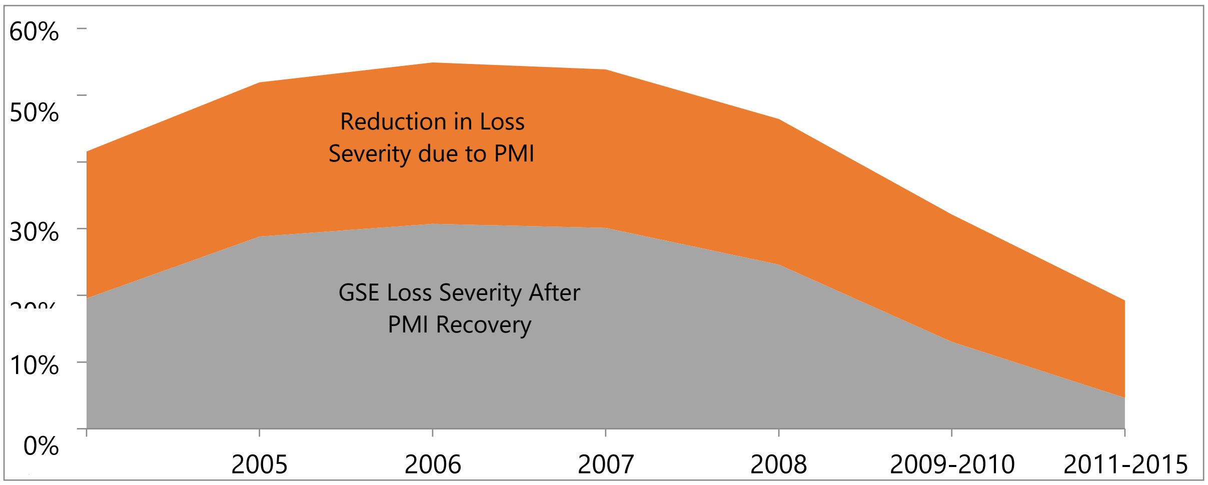
- **Credit Protection Should be Loan Level and Provided at the time of Origination by Entities Available Through All Economic Cycles.** USMI commends the Outline's approach to use the Ginnie Mae platform. While Ginnie Mae would need additional resources—including staff and tools—to accommodate supporting the conventional market, Ginnie Mae can provide a seamless transition to a reformed system due to its globally-recognized brand and a scalable platform. In addition, this approach should separate the roles of issuer and guarantor, which reduces systemic risk without reducing borrower or lender access. Ginnie Mae has long recognized through their existing government insurance programs (FHA, Veterans Administration (VA) and Rural Housing Services (RHS)) that loan-level credit enhancement is needed to *actively manage* credit risk. *After* this loan-level protection is provided by FHA, VA, or RHS, then Ginnie Mae serves to guaranty the securities. Loan-level insurance reduces losses at the individual borrower level, affords lenders the flexibility for secondary market execution, provides borrowers with easier access to workouts/modifications, and ensures quality in loan manufacturing. Simply put, this would modify Ginnie Mae's current operating model by substituting these private entities for the FHA, VA, or RHS as the primary insurers for conventional mortgages. Furthermore, we recommend expanding this approach for the conventional mortgage market by requiring all loans (not just those above 80 percent LTV) to have private, entity-based loan-level credit enhancement providers that are subject to robust regulation and sufficiently capitalized to cover *all* expected losses.

- **A Government Guaranty Should be Conditional on Private Capital Covering All but Remote Credit Loss – Drawn on Only in Catastrophic Scenarios.** To achieve this, it is essential that as a condition to receive the government's explicit guaranty, all loans must be credit enhanced—through a combination of a borrower's equity and first loss risk protection from an entity-based credit enhancer—to cover *all* expected losses. One of the principle aims of housing finance reform should be to increase the permanent sources of private capital standing in front of the government and taxpayers. While FHFA or Ginnie Mae should establish what is "expected loss," data from the recent financial crisis suggests that if permanent private capital covers roughly 40 percent of first loss risk in all markets, the government and taxpayer exposure is virtually eliminated. One of the most efficient, effective, accessible, and transparent means of achieving this credit protection is through use of greater credit enhancement—such as private MI that covers 40

[16] Genworth Mortgage Insurance, "First-Time Homebuyer Market Report – 4Q2018" (February 28, 2019).

percent or 50 percent of the value of the loan—to reduce credit risk exposure to the most remote catastrophic risk. Today, private MI covers between six and 35 percent of the value of a loan depending on the size of the down payment, covering on average 25 percent of the value of a loan. According to the recent independent analysis by Urban Institute, the GSEs' overall risk exposure on "30-year fixed rate, fully documentation, fully amortizing mortgages, the loss severity of loans with PMI is 40 percent lower than that without, despite the higher LTV of mortgages with PMI."[17]

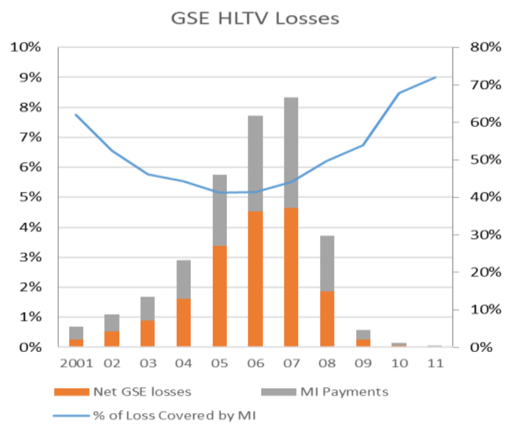
GSE Loans with PMI: Reduction in Loss Severity Because of PMI, by Origination Year Groupings



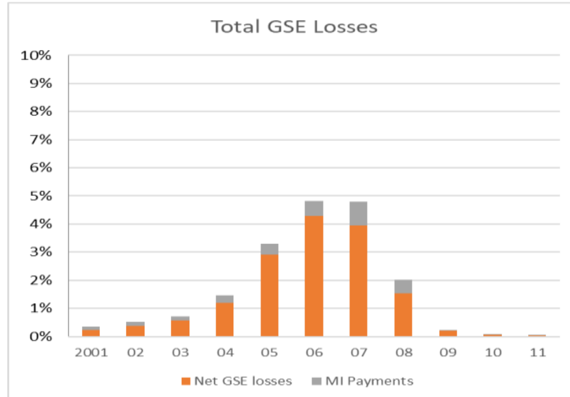
Sources: Fannie Mae, Freddie Mac, and the Urban Institute.
Note: GSE = government-sponsored enterprise; PMI = private mortgage insurance. The GSE credit data are limited to 30-year fixed- rate, full documentation, fully amortizing mortgage loans. Adjustable-rate mortgages and Relief Refinance Mortgages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

Further, as reported by Fannie Mae in a 2017 CRT investor presentation, standard coverage mortgage insurance covered over 40 percent of losses on high LTV loans during the recent financial crisis and covered roughly 70 percent of losses in recent book years.[18] It is essential that first loss risk be borne by private entities that meet strict capital and operational standards, that are able to underwrite mortgage credit risk, and that can be available throughout market cycles, ensuring that taxpayers are truly placed in a remote risk position.

[17] Urban Institute, *Sixty Years of Private Mortgage Insurance in the United States* (August 22, 2017).
[18] Fannie Mae Connecticut Avenue Securities (CAS) Investor Presentation (December 2017).



- **Standard MI covered over 40% of the losses** on high LTV loans in the crisis. ***Standard has covered approximately 70% for more recent book years.***
- Standard MI **should reduce GSEs' capital requirement by a minimum of 40%.**
- Deep cover MI (2x Standard) should reduce capital requirement by 80%.



- Overall losses hit a high of 4.8% in 2006-2007.
- Losses in the 60-80LTV bucket hit a high of 4.2% in 2006.

While the reforms in the mortgage finance system to date (such as the ATR/QM Rule) should make future downturns in housing less severe and the system generally more resilient, another downturn is inevitable. Because of our monoline nature, MIs have a direct interest in being available to take mortgage credit and absorb mortgage losses through *all* credit cycles—something that is different from other forms of credit enhancement being explored today. Nearly all other forms of private capital taking mortgage credit risk prior to the financial crisis ceased to exist during the financial crisis. In contrast, private MI has *never stopped writing new business and never stopped paying claims* throughout its 60-year history. Private MI understands what it takes to be durable through cycles as the industry is one of the *only* time-tested, *permanent* sources of private capital that serves to protect lenders, the GSEs, and taxpayers against first-loss credit risk. The MI industry, as evidenced by its performance through the unprecedented downturn of the recent housing crisis, has demonstrated both its utility and resiliency.

Finally, it is important for any credit enhancement or CRT to be a ***reliable*** source of loss absorption when needed, ahead of the GSEs, it must be consistently ***available*** as a form of risk transfer, including during volatile mortgage credit markets, and it must be sourced at the time a mortgage is originated to ensure that borrowers are charged no more than the actual cost of purchasing the coverage. Entity-based private credit enhancers, including MIs, should be required to underwrite loans they insure, hold capital against those loans and should be encouraged to seek ways to achieve capital efficiency, including through reinsurance and other risk transfer transactions. ***In this regard, it is appropriate that the Outline encourage entities holding first loss credit risk to diversify risk on the back-end when these markets are available.***

The MI industry has decades of experience participating in reinsurance transactions in the normal course of business, a practice that allows MIs to disperse risk and manage capital efficiently. In recent years, all USMI member companies have participated in various capital markets transactions, including a series of credit linked notes, that have expanded the industry's ability to lay off credit risk to other private market participants. Since 2013, USMI members have transferred to the global capital and reinsurance markets $34 billion of risk, covering $160 billion of primary risk written.[19]

[19] USMI member data.

<u>Recommendation 2</u>—**To Further Protect Taxpayers, the Outline Should Establish a Coordinated and Consistent Housing Policy Between the Conventional and Government Insured Markets**

- **The Outline Should be Expanded to Include FHA Reforms.** Reforming the GSEs should not be done in a vacuum and any comprehensive housing finance reform proposal should include FHA Reform considering it represents approximately 24 percent of the insured mortgage market.[20] Any changes to reduce the conventional market (e.g., increasing down payment requirement from three percent to five percent) should also be done for FHA, or else this business will simply go to the 100 percent taxpayer-backed FHA. Without addressing the conventional and FHA markets together, the Outline would merely shift, rather than reduce, mortgage credit risk in the housing finance system.

- **Establish a Consistent and Coordinated Housing Policy.** For the long-term stability of the nation's housing finance system, it is critical that federal policymakers take a holistic approach to reform in order to create a coordinated housing policy. Federal policy should clarify which borrowers should be served by the conventional market and which are better served by government insurance programs.

<u>Recommendation 3</u>—**To Promote Stability and Fair Competition the Outline Should Establish a Level Playing Field and Increase Transparency and Accountability**

- **Recommendation for the GSEs Post Conservatorship**. The separation of issuer and credit enhancer roles is a critical first step that must be applied to the GSEs post-conservatorship as well. While the outline does prohibit "insured depositories" from becoming guarantors it does not prohibit the guarantors from originating or servicing loans. Further, the Outline leaves open the possibility of a guarantor, including the GSEs, being the issuer for the mortgages it purchases through the cash window. USMI believes that the best way to avoid conflicts of interest, ensure a level playing field, and make sure that the broadest swath of home ready borrowers is served by a reformed system is to prohibit guarantors from engaging in other lines of business.[21] Given recent proposals in both the Senate and House envision some role for the GSEs going forward, USMI offers two observations. First, the GSEs have clearly been government instrumentalities since their inception, having been chartered by Congress in 1938 and 1968. Over the years, the GSEs have developed additional public policy objectives and functions. Second, during their more than 10 years in conservatorship, the GSEs have made significant investments in proprietary systems and technologies that have made the mortgage finance system even more reliant on the GSEs. As more proposals envision the GSEs existing in a future state, there seem to be two possible options—the first is to allow for greater competition, most notably what has often been referred to as a "multiple guarantor" model building on some of the work done by Senators Bob Corker (R-TN) and Mark Warner (D-VA) and the second, a utility construct for the GSEs themselves. We provide observations and recommendations on both of these approaches.

- ***Multiple Guarantor Model.*** The primary rationale provided for using a "multiple guarantor" model has been that it decreases the GSEs' duopoly by increasing competition with other FHFA-approved and regulated private guarantors. USMI supports competition and the free market. Under Chairman Crapo's Outline, in addition to providing loan-level first-loss risk protection in the high LTV market, private MIs could also serve as guarantors in a reformed system. However, there are significant challenges to enabling

[20] Inside Mortgage Finance, *Primary Mortgage Insurance Activity*.

[21] Private mortgage insurers are monoline entities that are only permitted to insure mortgage credit risk, meaning that MIs are sources of private financial and human capital dedicated exclusively to residential mortgage markets and available across market cycles.

competition in a system that allows the GSEs to exist in a future state and simultaneously allows for or mandates more competition. The GSEs have decades of government-conferred advantages, including lower borrowing rates, thousands of lender relationships, intellectual capital, historic loan performance data, and proprietary technologies—all creating significant barriers for new guarantors into the market. Since being placed in conservatorship, the GSEs have made substantial investments, at the expense of tax payers, in technology and systems to support their business operations and the broader housing finance industry. These include the Common Securitization Platform (CSP), the Single Security Initiative, and Day One Certainty/Loan Product Advisor. USMI agrees that all GSE technology and systems should be made available to Ginnie Mae (or whatever successor entity provides the government guarantee). However, even after sharing access to the GSE "infrastructure" there will be questions about a level playing field given the decades of experience and relationships that reside in both GSEs.

- ***Utility Model.*** Recent legislative proposals[22] envision a role for the GSEs in a future housing system that supports an explicit government guaranty at the security level, call for the GSEs to ensure access for smaller lenders, and include affordable housing requirements. These proposals signify that Congress feels there are critical functions at the GSEs and deem these functions/features necessary in a future housing finance system—either within the GSEs or placed in a separate utility of public exchange.

  Further, Congress benefits from the multitude of proposals from both progressive and conservative organizations on housing finance reform. These proposals—including from industry trades, consumer organizations, and think tanks—have one critical similarity among them—the vast majority of perspectives on both comprehensive legislative and/or Administrative reform is the recognition that policymakers must reduce the GSEs' duopolistic market dominance to create long-term safety and soundness in the housing finance system. And, while different reform proposals may call it different things and rely specifically on different infrastructures to achieve it, many of the leading legislative and Administrative proposals for GSE reform have leaned on some utility-like secondary mortgage market function to reduce the GSEs' current duopoly and market power in the mortgage finance system. Nearly all proposals call for Fannie Mae and Freddie Mac to have capped rates of return, be limited in their scope of activities, and be more open and transparent to the private market, policymakers, and consumers. Perhaps a simpler approach—and as a means to help transition to a comprehensively reformed system—is rather than creating an entire new utility to transfer the critical systems and functions of the GSEs to immediately, the GSEs themselves could be turned into highly regulated utility-like entities, with transparent capital and pricing, explicit and limited functions in the secondary market, and open-access and transparent underwriting engines and systems. These steps could be taken by incremental legislation or by Administrative actions.

- **FHFA should set comparable standards for market participants using a transparent Administrative Procedure Act (APA)[23] process.** It is appropriate that the Outline requires the FHFA to promulgate prudential standards for guarantors and it should further require the FHFA to establish strong risk-based capital and operational standards for *<u>all</u>* first loss credit enhancement providers. However, *<u>all</u>* credit enhancement providers should have these same standards to ensure the availability of loan-level first-loss credit enhancement across market cycles, and to avoid any temptation to engage in capital arbitrage. Further, FHFA should issue these requirements only after following APA guidelines for public notice and comment. It is important that the FHFA/regulator create uniform and transparent standards that promote a level playing field that doesn't advantage a certain class of entities over others.

[22] "Bipartisan Housing Finance Reform Act of 2018" discussion draft (Hensarling-Delaney-Himes) and Chairman Crapo's Housing Reform Outline.
[23] 5 USC § 553.

While real reforms require Congressional action, many important steps can be taken by the Administration to better establish a level playing field, limit the GSEs' activities and footprint to the secondary market, and create better transparency in the GSEs' operations, capital and pricing. USMI outlines many of these specific steps in our *Recommendations for Administrative Reform* white paper.[24]

Looking Ahead: Making a Stronger Tomorrow for Housing

To summarize, as Congress debates the many complex issues around the different important elements of housing finance, we are encouraged that there continues to be strong bipartisan support in the Senate and House for increasing private capital ahead of government and taxpayer risk exposure and we believe Chairman Crapo's Outline represents a meaningful step in identifying ways to create a system that puts consumers and taxpayers' interests first.

I am very proud to represent an industry that for more than 60 years has provided substantial private capital in front of a government guaranty, has durably served the market place, and has prudently helped millions of families realize the dream of homeownership. USMI strongly believes that the reform efforts this Committee is considering to housing finance are critical and we believe much more can be done to reduce the risk to the federal government, make taxpayer risk exposure even more remote, and ensure that creditworthy borrowers have prudent access to mortgage credit. This can be done by:

- Increasing *permanent* private capital ahead of government and decreasing taxpayer risk exposure by requiring the use of entity-based loan-level credit enhancement at origination;
- Reducing taxpayer risk exposure by promoting coordinated and consistent housing policy between the conventional market backed by private capital and 100 percent taxpayer-backed FHA; and
- Establishing a level playing field among market participants to increase transparency, stability, and accountability.

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

[24] U.S. Mortgage Insurers, *Areas of Alignment for Administrative Reform* (October 2018) available at http://72nut3mk2z64bywh6c1thwjy.wpengine.netdna-cdn.com/wp-content/uploads/2019/01/White-Paper_Areas-of-Alignment-for-Administrative-Reform.pdf.