Making Housing Finance More Sustainable with Front End Risk Sharing

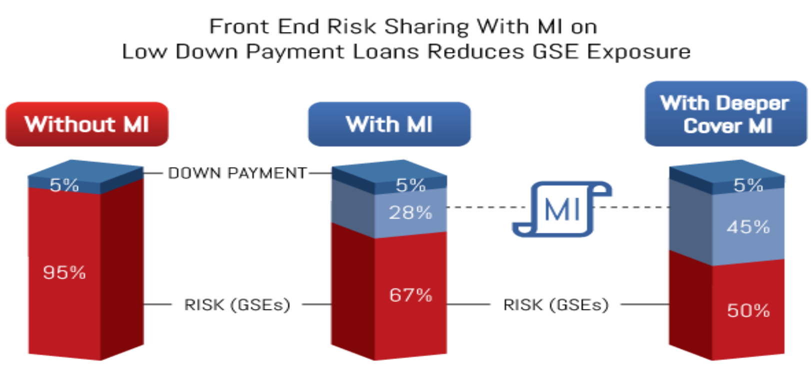
The nation's housing finance system needs to be put on a more sustainable footing so that more Americans will have access to prudent and affordable mortgage credit well into the future and taxpayers are further shielded from risks. Front end risk sharing does just that by making greater use of private capital to "de-risk" the Government Sponsored Enterprises (GSEs) and lower the exposure and costs for GSEs and taxpayers.

Today, private capital in the form of Mortgage Insurance (MI) already provides significant risk protection against losses on low down payment loans. Traditionally, for loans with down payments under 20% of the home value, MI – not taxpayers – covers the first losses if there is a default, up to certain coverage limits.

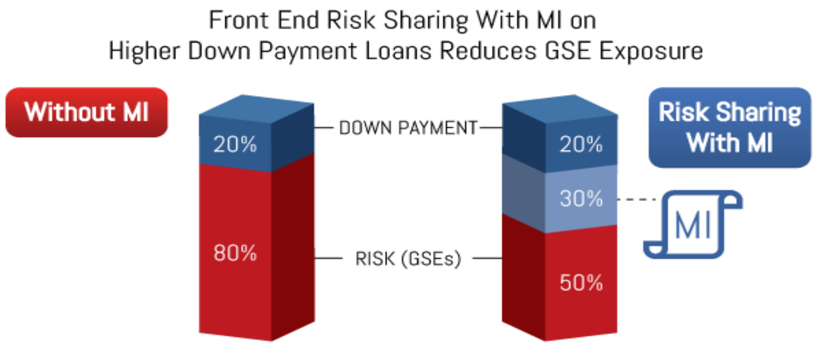
Risk Sharing With MI Can Further Reduce GSE Exposure

The GSEs and the Federal Housing Finance Agency (FHFA) recently finalized Private MI Eligibility Requirements (PMIERs), setting robust operational and financial standards, which provide greater market confidence in the value and role of a strengthened MI industry. The PMIERs establish the foundation for MI to provide greater "front end" risk sharing solutions – transferring credit risk to third parties when the loan is originated, rather through "back end" risk sharing on loans that are already on the GSEs' balance sheets.

In the future, MI could provide even "deeper cover" on low down-payment loans.



This deeper MI coverage would reduce risks to the taxpayers while allowing the GSEs to lower their fees. And with lower GSE fees, this approach would reduce costs to borrowers. In addition, MI can be used to provide front end risk sharing on loans with down payments greater than 20 percent.



Today these loans do not require MI coverage. By using more MI to provide deeper front end risk sharing on these below 80% LTV loans, the GSE and taxpayers would be at a much more remote risk of losses. MI would be in a first loss position, thus putting more private capital at risk ahead of the taxpayer-backed GSEs while lowering costs to borrowers.

In fact, today a prudently underwritten 5% down payment loan with MI actually reduces taxpayer exposure below a comparable 20% down payment loan without MI. By expanding front end risk sharing with MI, the GSEs' risks can be further reduced.

USMI Supports Efforts to Expand Risk Sharing

Fortunately, there is movement on Capitol Hill and by regulators to make progress right now. Legislation recently introduced by Senator Shelby and passed by the Senate Banking Committee includes a provision that would call on the GSEs to engage in front end risk sharing transactions. While the provision requires some additional refinement, the front end risk sharing approach offers the prospect of lower costs to borrowers, and could help to enhance the availability and affordability of mortgage credit. Promotion of greater front end risk sharing with MI is a way to help build a strong, stable housing finance system, provide prudent access to affordable mortgage credit, protect taxpayers, and help ensure the homeownership aspirations of Americans for years to come.

U.S. Mortgage Insurers (USMI) is dedicated to a housing finance system backed by private capital that enables access to housing finance for borrowers while protecting taxpayers. Mortgage insurance offers an effective way to make mortgage credit available to more people. USMI is ready to help build the future of homeownership. Learn more at www.usmi.org.