AMERICAN BANKER®

MONDAY DECEMBER 4, 2015 THINKBANK AMERICANBANKER.COM

Congress Has Not Acted, So Here's a Simpler GSE Plan

By Lindsey Johnson

The likelihood of meaningful congressional action on reforming our housing finance system is still very low for the foreseeable future. But if one objective of reform is to put more private capital at risk in front of the taxpayer, a surprisingly simple answer is in plain sight.

Private mortgage insurance already provides significant risk protection against losses on low-down payment loans before those loans even reach the government-sponsored enterprises Fannie Mae and Freddie Mac. We fully support recent Senate GSE reform bills, including the proposal by Sens. Tim Johnson and Mike Crapo, and the one from Sens. Bob Corker and Mark Warner. Both would put the housing finance system on a more sustainable path. But modest, incremental progress toward the same goals of recent GSE legislative proposals, which have failed to garner enough support, could be done administratively by sanctioning deeper mortgage insurance coverage.

As directed by Fannie and Freddie through their oversight from the Federal Housing Finance Agency, private MI coverage on loans with down payments below 20% of home values is now capped at 35% of the loan value. Having the GSEs increase that coverage to 50% would be fully consistent with the Senate bills in terms of putting more private capital at risk, and can be viewed as akin to a down payment on future legislative efforts.

Despite the congressional stalemate, a number of reforms are already being implemented in the interim by the administration, via the FHFA, which is working to de-risk the GSEs through expanded risk sharing.

Deeper MI coverage should be part of that conversation. To test this concept, USMI commissioned Milliman Inc. – one of the world's largest providers of actuarial analysis – to examine the costs of providing deeper MI and the impact on a borrower's home ownership costs. The study found that covering additional mortgage credit risk with MI would almost double the loss protection amount afforded to the GSEs and taxpayers, allow the GSEs to reduce their guarantee fees and, as a result, lower average borrower costs approximately $2,300 over the expected life of a mortgage loan.

Beyond taxpayer, borrower, and lender benefits, what makes MI such an obvious part of the solution? Private mortgage insurers are reliable counterparties for bearing housing finance risks. The MI industry has covered more than $50 billion in claims to the GSEs since the beginning of the financial crisis, resulting in substantial taxpayer savings. Even at the height of the housing crisis, USMI member companies never stopped paying claims, and never stopped writing new coverage.

The MI industry's safety and soundness has also been enhanced in recent years. It has attracted over $9 billion in new capital since the crisis, and is well positioned to raise additional capital. Insurers have new higher capital standards and are subject to rigorous operational oversight under the Private Mortgage Insurer Eligibility Requirements issued by the GSEs. They also implemented new master policies that provide greater clarity and assurances about the consistent handling and payment of MI claims, bringing greater transparency to contractual protections for lenders and investors.

Further, while other forms of private capital exited the housing market during times of stress, and have not returned in meaningful volume since, MI has been a consistent presence in the market for nearly 60 years.

As the GSEs experiment with credit risk transfers, the effort has been modest to date. And while volumes are increasing, most risk-sharing efforts have been directed to the "back end" – after the GSEs have already assumed the risk of loans they guarantee. In doing so, the added benefits of front-end risk sharing are lost. To that end, Senate Banking Committee Chairman Richard Shelby included a provision to promote more front-end risk sharing as part of his regulatory relief bill that passed the committee in May.

As policymakers continue to work toward derisking the GSEs in the absence of comprehensive reform, expanding front-end risk sharing with MI is an obvious choice.

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