
Greater Up-front Risk Sharing with Private MI is a Time-Tested Way to Shield American Taxpayers from Mortgage-Related Losses

Use of private mortgage insurance has provided valuable credit risk transfer in the housing finance system for nearly 60 years

MI is a Reliable Form of Front-End Risk Sharing

The use of private mortgage insurance (MI) has been a fixture in the U.S. housing finance system as a protection against first-loss credit exposure for nearly 60 years. During this time, MI has proven to be a reliable method in shielding the government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, as well as American taxpayers from mortgage credit risk. At the same time, MI has facilitated the ability for creditworthy borrowers without large down payments to have access to homeownership.

As the Federal Housing Finance Agency (FHFA) and the GSEs continue to explore ways to share more credit risk with private parties, there have been considerable questions about the benefits and shortcomings of the different forms of credit risk transfer (CRT). Front-end CRT programs, like MI, transfer credit risk to third parties when the loan is originated, compared to “back-end” risk sharing where credit risk is transferred after the GSEs purchase the loans and warehouse those loans for a period of time. To date, over 98 percent of the Enterprises’ CRT activities have consisted of back-end CRT.¹ While the expanded use of front-end risk sharing with MI is under consideration, MI itself is not an untested form of CRT. For six decades, MI has provided significant risk protection against losses on low down payment loans. Generally, for conventional GSE-backed loans originated with down payments less than 20 percent of the home value, MI – not taxpayers – stands in a “first loss” position in the event of a borrower default.

GSEs Should Expand the Use of MI

The GSEs should significantly expand the proportional use of private MI on the front-end as FHFA reviews and analyzes the benefits and risks of various forms of CRT structures. This time-tested method can provide even greater CRT benefits to protect the GSEs from a larger share of losses if a borrower defaults. Right now, MI risk protection is capped at 35 percent of the loan value. Having the GSEs increase that protection coverage would put more private capital at risk—precisely what taxpayers and the economy need.

Front-end Deeper Cover MI Has Many Distinct Advantages

Using MI to provide deeper cover front-end risk sharing on loans the GSEs guaranty will:

- ✓ Reduce taxpayer risk
- ✓ Be economically sensible
- ✓ Create continuity of core business
- ✓ Be repeatable
- ✓ Be scalable
- ✓ Strengthen counterparties
- ✓ Broaden investor base
- ✓ Promote stability through economic and housing cycles
- ✓ Foster transparency—if there is a borrower benefit, it can be known
- ✓ Level the playing field for lenders of all sizes
- ✓ Enhance financial stability
- ✓ Address cyclical

¹ See Federal Housing Finance Agency, Single-Family Credit Risk Transfer Progress Report (June 2016). See Federal Housing Finance Agency, Overview of Fannie Mae and Freddie Mac Credit Risk Transfer Transactions, p. 3 n.2 (Aug. 2015).

Structure of Front-End Risk Share Should Meet Key Principles

Deeper cover front-end risk sharing should meet the following principles:

- **Protect Taxpayers.** Today, private MI stands in front of the GSEs and taxpayers, absorbing first losses on mortgage credit risk. Mortgage insurers covered more than \$50 billion in claims since the GSEs entered conservatorship, resulting in substantial savings to taxpayers. In the future, mortgage insurers can put more private capital in front of the GSEs to decrease taxpayer risk through deeper cover on low down-payment loans. Unlike back-end CRT, this risk can be transferred before the credit risk ever reaches the GSEs' balance sheets.
- **Promote Stability.** Mortgage insurers have a long history of consistently offering MI even during market downturns. Throughout the financial crisis, USMI members never stopped paying claims and never received any bailout money from the federal government. The industry has paid over 96 percent of valid claims, with the remainder due over time. MI companies are strong because they engage in countercyclical reserving—collecting and reserving premium payments during favorable economic conditions so they can pay increased claims during market downturns. New Private Mortgage Insurer Eligibility Requirements (PMIERS), established by the GSEs, created robust standards for the MI industry's capital levels, business activities, risk management, underwriting practices, quality control, lender approval, and monitoring activities. All of this makes MI very different from other CRT structures. Further, MI is private capital dedicated to housing finance, unlike other forms that disappeared during the crisis and have yet to return in any meaningful volume.
- **Ensure Accessibility.** Unlike many other forms of CRT, deep cover MI promotes equitable access to both lenders and borrowers. As loan-level protection against first losses on individual low-down payment loans, deep cover MI promotes broad access to sustainable homeownership for creditworthy borrowers while enhancing stability and liquidity in the housing finance system. Unlike other forms of CRT, deep cover MI would be accessible by lenders of all sizes and types and would be operationally consistent for lenders to use as current MI products.
- **Foster Transparency.** Transparency is a fundamental element to fostering an efficient and effective CRT market. While more work needs to be done, the transparency provided on back-end transactions to date has facilitated investors' appetite for these transactions. Similarly, MI pricing (including deep cover front-end risk share) is transparent because MI rate cards are standardized and published. There is a wealth of information regarding MIs in the form of securities filings, state regulatory filings, and other reports publicly-available to lenders, borrowers, and other industry participants. The MI industry urges transparency on all CRT to better inform all market participants, to make clear if there is any borrower benefit among the different transaction types, to enable the formation of a deep market for these transactions, and to facilitate qualitative and quantitative assessments of housing finance reform based on the performance of various CRT structures.

As policymakers consider ways to share more of the credit risks currently born by the GSEs with private parties, when it comes to de-risking the GSEs and ensuring broad access to sustainable mortgage credit, greater use of private mortgage insurance is an obvious choice and MIs are ready to do more. Not only is MI the only form of risk share being contemplated that is solely designed to take on mortgage credit risk, but it is also the only CRT option that is connected to affordability, helping individuals with less than a 20 percent down payment to achieve homeownership. The time is right for the GSEs to take steps to expand front-end risk sharing with MI—a simple way to help not only build a stronger and more sustainable housing finance system, but also ensure that Americans continue to have access to prudent and affordable mortgage credit.