Statement of Seth D. Appleton

President of U.S. Mortgage Insurers

Before

The United States House of Representatives Committee on Financial Services

Subcommittee on Housing and Insurance

December 6, 2023

"Housing Affordability: Governmental Barriers and Market-Based Solutions"

Chairman Davidson, Ranking Member Cleaver, Members of this distinguished Subcommittee, thank you for inviting me to testify for this hearing on behalf of U.S. Mortgage Insurers (USMI). As a longtime staffer for a former Chairman of this Subcommittee, Mr. Luetkemeyer, it is a privilege to be invited to discuss how the private sector can support access to affordable homeownership. USMI's members do just that: they are in the market every day, deploying private capital to provide access to affordable and sustainable mortgage credit, primarily to first time and low- and moderate-income homebuyers, while simultaneously protecting taxpayers from undue credit risk.

Today, my testimony will focus on the following topics:

- The role of private mortgage insurance (MI) in enabling access to homeownership for borrowers without tens of thousands or even hundreds of thousands of dollars in cash for a large down payment, while protecting lenders, the government-sponsored enterprises (GSEs), and taxpayers;
- The borrowers we serve who are primarily first-time, low- and moderate-income homebuyers who lack wealth for a large down payment, but benefit from sustainable homeownership and the opportunity to create intergenerational wealth;
- The strength and resiliency of today's private MI sector and how it contributes significantly to the overall stability of the housing finance system; and
- Steps that policymakers could take to ensure that prospective homebuyers can continue to realize the American Dream of homeownership, including:
    - Promoting coordinated housing finance policies to ensure that private capital is not unnecessarily or inappropriately crowded out of the marketplace by government-backed programs;

- Ensuring faithful implementation of the Prior Approval of Enterprise Products Rule[1] to protect taxpayers from unnecessary risk in connection with GSE pilot programs;
- Reconsidering the mortgage risk weight framework in the proposed Basel III Endgame rulemaking[2]; and
- While outside the jurisdiction of this Committee, restoring and making permanent the individual income tax deduction for MI premiums.

The Role of Private Mortgage Insurance

Private mortgage insurance (MI) has been an important component of the U.S. housing finance system for 66 years; first, as a means to help millions of home-ready borrowers access affordable mortgage financing with low down payments; and second, as the first layer of protection for lenders, the GSEs, and taxpayers from undue mortgage credit risk.

Facilitating Borrower Access to Affordable and Sustainable Homeownership

The role of private MI is more important today than ever before. While USMI's members cannot solve for the scarcity of affordable housing supply or the high interest rates that have impacted affordability, they can solve for what has historically been the primary impediment for first-time and low- and moderate-income borrowers seeking to enter homeownership: the need for a large cash down payment.

Homeownership that requires a 20% down payment is simply out of reach for many Americans, particularly the first-time homebuyers who have traditionally propelled the market forward. According to a recent report from the National Association of REALTORS® covering July 2022 to June 2023, the first-time buyer share of the market was 32%, well below the average of 38% since 1981, and their typical down payment was 8%.[3] Even more striking is that it would take a household earning the national median income of $70,784 in 2022 35 years to save a 20% down payment plus closing costs for a $392,800 home, the median sales price for a single-family home in 2022.[4] That's $90,334 in cash that a borrower would need to bring to the closing table.

With private MI, however, potential homebuyers can put down as little as 3%, eliminating one of the largest hurdles to homeownership today. Furthermore, research from Fannie Mae finds that private MI is a small component of the overall cost of buying and owning a home.[5] A

[1] 12 C.F.R. 1253.
[2] 88 Federal Register 64028 (September 18, 2023).
[3] National Association of REALTORS®, "2023 Profile of Home Buyers & Sellers" (November 13, 2023).
[4] USMI analysis based on the following data points: median household income according to data from the U.S. Census Bureau); median sales prices for a single-family home in 2022 according to National Association of REALTORS®; and median savings rate in 2022 according to data from the Federal Reserve.
[5] Fannie Mae, Economic and Strategic Research Group, "Mortgage costs as a share of housing costs – placing the cost of credit in broader context" (released March 9, 2022 and updated March 17, 2023).

recent Urban Institute report found that a conventional mortgage backed by private MI has been the most common source of financing for low down payment borrowers since 2018.[6] In 2022, that translated to private MI helping more than 1 million borrowers secure mortgage financing, representing $402 billion in mortgage originations, more than 97% of which were for purchases.[7] 62% of purchasers with private MI in 2022 were first-time homebuyers and more than 34% had annual incomes below $75,000[8]. In the Chairman's home state of Ohio, private MI helped more than 40,000 borrowers in 2022, 62% of whom were first-time buyers, with an average loan amount of $232,278.[9]

Further, private mortgage insurers are critical partners to the GSEs, mortgage lenders, and state housing finance agencies (HFA) on initiatives and product development to sustainably expand access to homeownership, especially for first-time and low- to moderate-income buyers, as well as borrowers who have been historically underserved by the broader housing market. The private MI industry is actively engaged in supporting the GSEs' flagship affordable products (Fannie Mae's HomeReady and Freddie Mac's Home Possible), Duty to Serve programs, HFA products, and partnering with lenders and the GSEs on mortgage products that target specific geographies and homebuyers. USMI's members are committed to helping homebuyers sustainably purchase homes and also ensuring that they can remain in their homes. All of USMI's members offer homebuyer education resources to increase consumer knowledge of the homebuying process and work closely with mortgage servicers to assist borrowers through loss mitigation solutions.

Critical Risk Protection to Promote a Safe and Sound Housing Finance System
Private MI is also unique in its scalability as a form of credit enhancement, availability to lenders of all sizes and types, with tailored product/plan options based on a borrower's specific financial situation. Whether a large money center bank, community bank, credit union, independent mortgage bank, or other type of institution, private MI is available to help lenders serve customers without large down payments on a capital efficient basis. Today, more than $1.5 trillion in mortgages are backed by private MI.[10] There is good reason for this – while private MI provides borrowers access to affordable mortgage credit, it simultaneously protects lenders, the GSEs, and taxpayers from undue credit risk by deploying private capital that stands in a first loss position and absorbs default-related losses before others in the system.

Private MI is one of the only forms of credit risk transfer (CRT) that begins on day one when the borrower assumes a mortgage and persists regardless of execution, including acquisition by a GSE, private securitization, or portfolio status. One prominent example is the way that private

[6] Urban Institute, "Mortgage Insurance Data at a Glance – 2023" (August 21, 2023).
[7] GSE Aggregate Data and Private MI 10-K Filings.
[8] GSE Aggregate Data and HMDA Data.
[9] GSE Aggregate Data.
[10] Private MI Companies 3Q2023 10-Q Filings.

MI has helped de-risk the GSEs: since the GSEs entered conservatorship in 2008, private mortgage insurers have paid nearly $60 billion in claims.[11] Every claim dollar paid by a private mortgage insurer is a credit loss that neither Fannie Mae, Freddie Mac, nor, ultimately, the taxpayers who stand behind them need to pay. Analysis from the Urban Institute[12] found that, "the presence of [private MI] reduces the losses the GSEs experience on loans with loan-to-value (LTV) ratios above 80 percent to the same levels as the losses they experience on a loan with LTV ratios up to 80 percent. This indicates that [private MI] is highly effective in reducing losses to the GSEs." Furthermore, the same report noted that once loans were more than 180 days delinquent and were liquidated, "the loss severity the GSEs experience is lower for loans with [private MI] than for those without, because mortgage insurance recoveries reduce losses." The report also examined the 1994-2022 origination period and found that "the loss severity of GSE loans without [private MI] was 37.6 percent, higher than the 26.4 percent severity for loans with [private MI]." Urban goes on to say "...the reduced loss severity for the GSEs attributable to [private MI] holds across all origination years." To that end, if Congress takes up GSE reform, maintaining the Congressional charter provision related to private MI and establishing standard coverage as a requirement of a reformed housing finance system would be an important step to ensuring that private capital can continue to promote safety and soundness in the system.

Strength and Resiliency of the Private MI Sector

Private MI stands as a strong, resilient, and reliable component of America's low down payment mortgage market, attracting and deploying private capital to support the housing finance system in all economic cycles. After assessing past operational practices and the causes and implications of the Great Financial Crisis, the private MI industry took steps to enhance its business model to better serve the marketplace. Today, private MIs are subject to robust capital, financial, operational, and quality control standards. These standards, the Private Mortgage Insurer Eligibility Requirements (PMIERs), were developed and periodically updated jointly by the GSEs and overseen by the Federal Housing Finance Agency (FHFA). As of the third quarter of 2023, private mortgage insurers held 69% more available assets than required under PMIERs and the industry collectively holds $11 billion in excess of the requirements.[13] In addition, the private MI industry has consistently raised capital, and since the beginning of the COVID-19 pandemic, USMI members raised more than $2.8 billion using equity and debt offerings and added $715 million in access to new or expanded credit facilities.[14]

In addition to holding 169% of required available assets, private MIs have adopted other enhancements to provide stability to the housing market. These include a new Master Policy to ensure timely, consistent, and accurate policy and claim administration and that private MI results in reliable and predictable claim payments to lenders and the GSEs in the event of borrower default. The industry has also adopted Recission Relief Principles that align with the

[11] Private MI Statutory Filings.
[12] Urban Institute, "Mortgage Insurance Data at a Glance – 2023" (August 21, 2023).
[13] Private MI Companies 3Q2023 10-Q Filings.
[14] USMI Member Company SEC Filings and Press Releases.

GSEs' Representations and Warranties framework to provide lenders with certainty and clarity of MI coverage on day one, which has been well-received by lenders.

In order to participate in the market through all economic cycles, USMI member companies must be - and are - sophisticated managers of long-term mortgage credit risk. USMI member companies have demonstrated a commitment to effective capital management through both traditional reinsurance transactions with highly rated counterparties and capital markets-based issuances, which have enabled USMI member companies to become some of the strongest and most stable counterparties to the GSEs and investors and to play a greater role to support the U.S. housing finance system.

MI-CRT structures have been utilized in the housing market since 2015, transforming the MI business model from "Buy-and-Hold" credit risk into "Aggregate-Manage-Distribute." MI-CRT demonstrates that USMI member companies are sophisticated experts in pricing and actively managing mortgage credit risk, which further cements the stability private MI provides in the mortgage finance system.

Since 2015, private MI companies have transferred nearly $73.8 billion in risk on more than $3.4 trillion of insurance-in-force (IIF). In the reinsurance markets, private MIs have executed 53 deals using Quota Share Reinsurance (QSR) and Excess of Loss (XOL) transactions, ceding $51.5 billion of risk to the traditional reinsurance market.[15] As for using the capital markets to distribute risk, since the industry introduced Mortgage Insurance-Linked Notes (MILNs) in 2015, private MIs have issued 56 MILN transactions, transferring nearly $22.3 billion of risk on more than $2.3 trillion of notional mortgages.[16] Transferring credit risk to reinsurers and capital markets investors is not only an effective hedge to cyclical mortgage exposure, but also efficiently expands the capital sources of the MI industry to serve the growing demand for low down payment financing.

I also want to take this opportunity on behalf of our member companies to thank members of this Committee for their work[17] to ensure that the Securities and Exchange Commission's (SEC) recently finalized rule[18] concerning conflicts of interest in securitizations included a clarification to ensure that the capital markets-based reinsurance sourced by private MIs would not be unintentionally impaired by that rulemaking. USMI appreciates your engagement on this issue and we are pleased that the SEC was responsive to Congressional and stakeholder feedback in issuing a final rule that allows for the continued use of MILNs to meet the need for affordable mortgage financing for low down payment borrowers without disruption.

---

[15] MI Company CRT Transaction Data through September 30, 2023.

[16] MI Company CRT Transactions Data through November 30, 2023.

[17] Bipartisan House Financial Services Committee Letters from May 23, 2023 and October 31, 2023 are available at https://www.sec.gov/comments/s7-01-23/s70123.htm.

[18] Securities and Exchange Commissioner, Press Release 2023-240, "SEC Adopts Rule to Prohibit Conflicts of Interest in Certain Securitizations" (November 27, 2023).

In addition to serving as stable, longer-term entity-based capital, private MIs underwrite and actively manage credit risk, ensuring quality control and a trusted "second pair of eyes" on risk within the financial system and for end investors. This expertise creates added value and stability for the rest of the housing finance system.

Proactive Federal Policies to Address Homeownership Affordability

As noted above, the private MI industry is a strong, resilient, and reliable component of America's housing finance system and USMI's members help enable homeownership for borrowers without large down payments while protecting lenders, the GSEs, taxpayers, and the mortgage finance system from credit risk. Policymakers, including the Congress, where appropriate, could take several steps to ensure that this critical source of private capital in the housing system can play an even more impactful role in the future.

Promote a Coordinated Housing Finance Policy

While conventional mortgages backed by private MI have been the most utilized option for low down payment borrowers since 2018, several U.S. government agencies directly insure or guarantee low down payment mortgage loans, most notably the Federal Housing Administration (FHA), a component of the U.S. Department of Housing and Urban Development, which insures up to 96.5% of the LTV of a mortgage. USMI recognizes the targeted role of FHA and the presence and depth of its taxpayer-funded backstop. It is an important complement to private MI's work particularly in serving those who may not have access to homeownership through the conventional market.

USMI encourages FHA to continue efforts to maintain and strengthen the fiscal health of the Mutual Mortgage Insurance Fund in order to promote a healthy housing market and responsibly facilitate access to homeownership opportunities. As a government agency fully backed by taxpayers, FHA's cost of capital and required capital levels are significantly different than those of the private sector. As a result, it is important for policymakers to promote a clear, consistent, and coordinated approach to housing finance policy, including when reviewing and implementing changes to GSE and FHA pricing. A goal of this clear, consistent, and coordinated policy should be to prevent undue competition between government programs and the private sector. When private capital is needlessly crowded out of the marketplace by government-backed programs, it leads to increased risks for taxpayers.

Ensure the GSEs Comply with FHFA's Prior Approval of Enterprise Products Rule

In the conventional market, GSE pilot programs can also shift risks to taxpayers that would otherwise be borne by private capital. During their 15 years in conservatorship, the GSEs have significantly expanded their role in the housing finance system by developing and introducing numerous new products and activities, including via "pilots," without meaningful transparency into their economics, risks, or consumer impacts. While innovation can certainly play a role in better serving homebuyers, it is critical that new GSE pilots, products, and activities are subject to a transparent assessment that provides stakeholders with the opportunity to comment on the potential impacts to both consumers and non-GSE market participants.

USMI was pleased that FHFA proposed under Director Calabria and finalized under Director Thompson a rule on "Prior Approval of Enterprise Products," a rule in which members of this Committee took interest. While it has only been operational since this spring, we believe faithful implementation of this rule will result in proper oversight of GSE pilots, a more transparent and objective process for approving new GSE products and activities, and a more robust housing finance system through its consideration of the impacts new GSE products may have on GSE and non-GSE market participants.

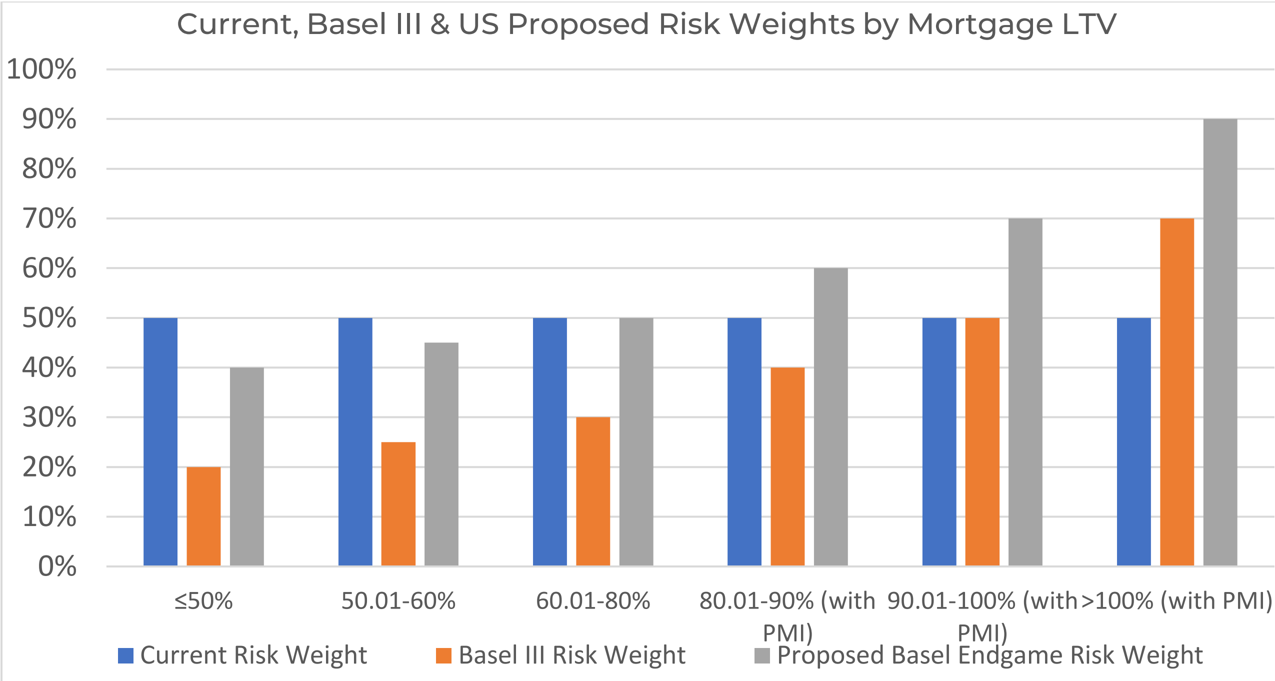
Reconsider the Proposed Basel III Endgame Rulemaking

One area of concern is the recently proposed Basel III Endgame regulation,[19] in which members of this subcommittee have taken a keen interest. While appropriate capital levels are important for the safe and sound operation of our banking sector, *excessive* capital requirements have a detrimental effect on our economy and consumers' access to financial products such as mortgages. In this instance, excessive capital requirements will reduce the availability of credit, especially for low- and moderate-income households and first-time homebuyers. Consumer groups, mortgage market participants, and members of this Committee have observed that the proposal would negatively impact the ability of certain banks to originate and hold high LTV mortgages in portfolio, service mortgages, and even finance warehouse lines for lenders, including independent mortgage banks. All of these are important issues for the Committee and policymakers to explore, though I will focus my comments on the impact on the low down payment market.

U.S. financial regulators last updated bank capital requirements[20] prior to the private MI industry's adoption of many of the enhancements mentioned earlier in my statement. Under the "standardized approach," a prudently underwritten mortgage loan held by a bank with a LTV ratio that equals or exceeds 90% is given a risk-weight of 50% if the loan is protected by private MI and the effective LTV after considering the MI coverage is under 90%. In contrast, the Basel III Endgame NPR does not recognize private MI at all and would assign a 70% risk weight to a mortgage above 90% LTV for a bank subject to the proposal, regardless of the risk and capital benefits of private MI coverage.

[19] Office of the Comptroller of the Currency, Federal Reserve System, and Federal Deposit Insurance Corporation, "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity," 88 Federal Register 64028 (September 18, 2023).

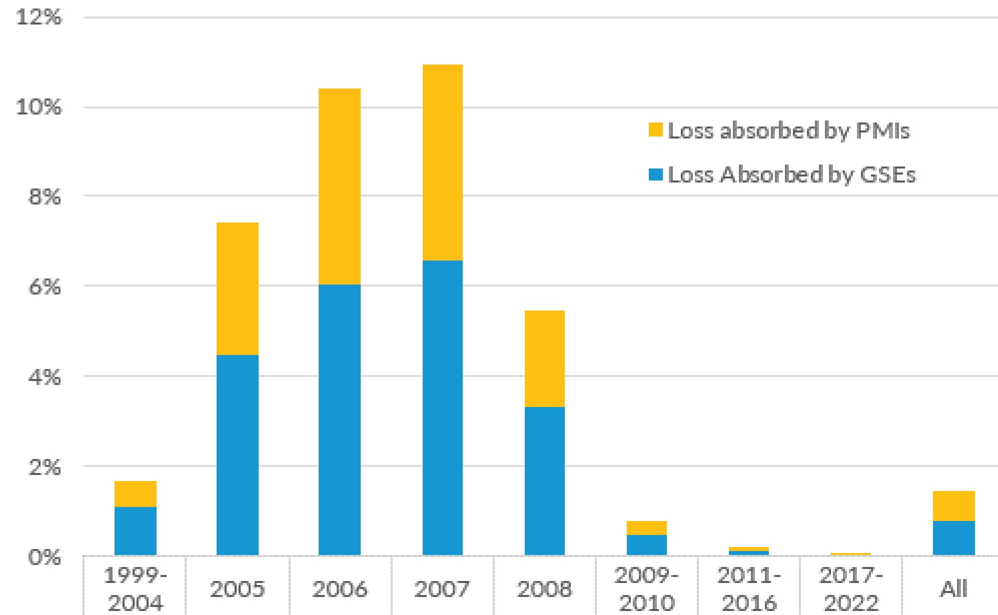
[20] Office of the Comptroller of the Currency, Federal Reserve System, and Federal Deposit Insurance Corporation, "Regulatory Capital Rules: regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule" 78 Federal Register 62018 (October 11, 2013).



In addition to disregarding the enhanced capital and operational standards adopted by the industry since the last bank capital regulatory update, the Basel III Endgame proposal also diverges from the FHFA's own Enterprise Regulatory Capital Framework (ERCF), which recognizes the value of and provides capital relief to the GSEs for loans that are covered by private MI. FHFA's approach rightly recognizes that private MI stands in the first loss position and will absorb credit losses before others in the system, including lenders, the GSEs, and taxpayers. Private MI standard coverage insures up to 35% of the value of a loan (plus allowable interest and expenses) and increases based on the borrower's LTV ratio to ensure that the risk exposure is remote. This coverage reduces the effective LTV of a loan with private MI to well below 80%.

OLTV	**Portion of Losses Covered by PMI** (standard cover)	**Private MI Net Impact on LTV**	**Effective LTV**
90%	25.0%	-22.5%	67.5%
95%	30.0%	-28.5%	66.5%
97%	35.0%	-34.0%	63.1%

Further, the risk mitigating benefits of private MI are present throughout the economic cycle as the presence of private MI has been shown to reduce GSE losses on loans with LTV ratios above 80% to the same levels as the losses on loans with LTV ratios up to 80%. GSE data from 1999 through 2022 in the graph below demonstrates that private MI is highly effective in reducing mortgage credit losses to the GSEs.[21]



	1999-2004	2005	2006	2007	2008	2009-2010	2011-2016	2017-2022	All
Loss absorbed by PMIs	0.6%	2.9%	4.4%	4.4%	2.2%	0.3%	0.1%	0.0%	0.7%
Loss Absorbed by GSEs	1.1%	4.5%	6.0%	6.6%	3.3%	0.4%	0.1%	0.0%	0.8%

The end result of the Basel III Endgame rulemaking would be fewer, yet more expensive options for borrowers without large down payments to be served by commercial banks and they may be confined to mortgage options that are entirely or partially backed by the government. Instead, U.S. bank capital rules should recognize the risk mitigating benefits of private MI and promote a level playing field between GSE, government program, and bank portfolio executions. The risk weights for mortgages held in portfolio should be appropriately calibrated to encourage banks to engage in low down payment lending, backed by private capital; promote innovation in portfolio lending; and ensure that first-time, low- and moderate-income, and minority homebuyers without large down payments have access to a variety of options to obtain sustainable mortgage credit.

<u>Restore and Make Permanent the Individual Income Tax Deduction for Mortgage Insurance Premiums</u>

One other action Congress could take, though outside of this Committee's jurisdiction, is to restore and make permanent the individual income tax deduction for MI premiums that was available for tax years 2007-2021. This deduction allowed eligible low- and moderate-income homeowners to deduct from their federal income taxes the MI premiums paid to private MI companies and government agencies, including FHA, the U.S. Department of Veterans Affairs (VA), the U.S. Department of Agriculture (USDA), and HUD's Office of Public and Indian Housing

[21] Urban Institute analysis of Fannie Mae data (loans originated 1Q 1999- 4Q2022, performance data through 4Q 2022) and Freddie Mac data (loans originated 1Q 1999 through 3Q 2022, performance data through 4Q 2022).

(PIH). From 2007 to 2020, an average of 3.3 million low down payment homeowners annually claimed the deduction (for a total of approximately 43 million times the deduction was claimed) and they've received, on average, an annual deduction of $1,427 in tax relief as a result.[22] In 2020, the last year for which Internal Revenue Service (IRS) data is available, nearly 1.4 million low down payment households benefitted from this tax provision for an average deduction of $2,133.[23] This tax deduction directly benefited qualifying low- and moderate-income homeowners and its restoration, permanency, and an increase in its adjusted gross income cap from its 2007 level would provide meaningful tax relief to millions of American homeowners. USMI thanks Congressmen Buchanan of Florida and Panetta of California for introducing legislation to do just that, H.R. 4212, the Middle Class Mortgage Insurance Premium Act of 2023, of which several members of this committee are co-sponsors. We also thank Senators Hassan of New Hampshire and Tillis of North Carolina for leading a companion measure in the Senate.

Conclusion

Chairman Davidson and Ranking Member Cleaver, thank you again for the opportunity to testify today on this important topic before the Subcommittee on Housing and Insurance. In conclusion, USMI encourages policymakers to pay close attention to the households served by the private MI industry and ensure that the housing finance system continues to recognize its role in promoting a housing market in which access to affordable and sustainable homeownership promotes safety and soundness through the deployment of private capital. This approach will ensure that first-time buyers can continue to reliably participate in the American Dream, while protecting lenders, the GSEs, and taxpayers from unnecessary credit risk. I would be pleased to answer your questions.

[22] Internal Revenue Service, Statistics of Income (SOI), Historic Table 2.
[23] *Id*.