U.S. MORTGAGE INSURERS

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PRIVATE MI: A SOURCE OF STRENGTH & RESILIENCY IN THE HOUSING FINANCE SYSTEM

Coming out of the 2008 financial crisis, all mortgage market participants needed to make enhancements to ensure the industry was better positioned to withstand market downturns and maintain the sustainable availability of mortgage credit going forward. Fifteen years later, combined with updated regulatory requirements, these enhancements have dramatically strengthened the mortgage finance system, providing prudent access to mortgage finance credit and safeguarding the housing and broader financial system. **Today, private mortgage insurance (MI) stands as a strong, resilient, and reliable component of America's low down payment mortgage market, serving as the first layer of protection against undue credit risk and supporting homebuyers, lenders, the government-sponsored enterprises (GSEs), and taxpayers.**

Facilitating access to home financing for first-time and low- to moderate-income (LMI) homebuyers while providing stability to the nation's housing finance system remains a top priority for federal policymakers and industry stakeholders. This mission is shared by the private MI industry. The aftermath of 21st century economic crises, including those of 2008 and the COVID-19 pandemic, have underscored: 1) the benefits of private capital serving as a first layer of protection against undue credit risk in front of taxpayers and the federal government, and 2) the need for sustainable access to low down payment lending in the conventional market to serve borrowers who face homeownership affordability challenges.

MARKET & REGULATORY ENHANCEMENTS POST-CRISIS	
Private MIs	In addition to higher capital and more robust operational standards through PMIERs and updates to the Master Policy, private MIs now conduct much more diligence, even on delegated underwriting loans, than was previously done. In fact, a significant increase in the industry's business is through non-delegated underwriting compared to the MI industry's historical rate of 10%-15% prior to the financial crisis. In addition, through private MI's Rescission Relief Principles, lenders have certainty from day one regarding the clarity and certainty of private MI coverage.
Statutory and regulatory underwriting guardrails	Loan quality has vastly improved, with single family serious delinquency rates staying below 1% for Fannie Mae and Freddie Mac.[1] Much of this is the result of enhanced lending standards stemming from the Dodd-Frank Act and implementation of the Ability to Repay/Qualified Mortgage (ATR/QM) requirements.
Representations and Warranties (R&W) Framework	FHFA and the GSEs engaged in a multi-year effort beginning in 2012 to improve the R&W Framework. Prior to this effort, the GSEs had significant discretion to determine whether or not a loan had underwriting defects and what constituted an appropriate remedy for a defective loan.
Lenders	Mortgage originators have made vast investments in all aspects of mortgage credit risk management including upgrading the risk management skill base; investing in analytical resources; introducing new processes, including pre-funding quality assurance (QA); and strengthening existing post-close QA.
GSEs	The GSEs have made enhancements to their underwriting engines (DU and LP) and underwent a fundamental re-rationalization of credit policy, devoting attention and upgrading skills in QA areas, with multiple data integrity and quality checks. These efforts have created key credit guardrails that preserve the quality of business. They have also instituted industry standards through the R&W framework and GSE quality control (QC) processes.

The housing market currently presents many challenges for first-time, LMI, minority, and younger prospective homebuyers trying to access homeownership. These challenges include high home prices in many geographies, significantly elevated interest rates compared to just two years ago, and constrained housing inventory. The private MI industry is dedicated to serving low down payment borrowers while ensuring safety and soundness in the housing finance system. To continue achieving this, we are committed to supporting initiatives and policies that promote affordable and sustainable homeownership for all home-ready borrowers.

For over 65 years, the private MI industry has served lenders, the GSEs and, since 2008, taxpayers as an effective and resilient form of private capital, standing as the first layer of loss-absorbing protection against undue credit risk and mortgage defaults. **Private MI has enabled affordable homeownership for more than 38 million people**[2] over the past nearly seven decades. Since the financial crisis of 2008, private MI has become more resilient with enhanced capital and operational standards, as well as increased distribution of credit risk, which has put the industry in a strong position to actively manage mortgage credit risk, meet borrower demand, and serve as a source of reliability and resiliency for the housing finance system across all economic cycles.

"PMI has been the most common execution for low-down payment borrowers since 2018." ***– Urban Institute (2023)***

In 2022 alone, **more than 1 million borrowers purchased a home or refinanced a loan with private MI,**[3] **accounting for approximately $402 billion in mortgage volume.**[4] **Nearly 62% of purchase loans with private MI went to first-time homebuyers**[5] **and more than 34% had annual incomes below $75,000.**[6] **There are nearly $1.4 trillion in mortgages guaranteed by the GSEs with private MI protection.**[7] 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, securitization, or portfolio status, until cancellation or automatic termination occurs after sufficient equity is established, unlike the government forms of MI that typically persist for the life of the loan.

MAKING PRIVATE MI STRONGER AND MORE RELIABLE

After assessing past operational practices and the causes and implications of the 2008 downturn, the private MI industry took appropriate steps to strengthen its business model to better serve low down payment borrowers. With that goal, some of the enhancements made include:

PAST	PRESENT
Exposure-based capital (Statutory)	Risk-based capital (PMIERs)
Less Granular, relatively static pricing	More granular, risk-based and dynamic pricing
Manage risk through credit policy	Manage risk through credit policy and pricing
Focus on avoiding adverse credit selection	Proactive portfolio selection based on economic value
“Buy and hold” risk-taking	Active risk manager (aggregate, manage, and distribute risk)

MORTGAGE INSURERS' ABILITY TO PAY CLAIMS:
Private Mortgage Insurer Eligibility Requirements (PMIERs)

PMIERs consist of operational and capital requirements for private mortgage insurers to be approved to insure loans acquired by the GSEs. These were significantly updated in 2015, and in 2018, the revised PMIERs 2.0 further addressed the lessons learned from the housing downturn and provided greater confidence to market participants and policymakers. These new requirements delivered exactly what they were seeking in the role of private MI—greater confidence as a permanent, dedicated source of first-loss credit risk protection and as a trusted "second pair of eyes" to protect long-term value in the housing finance system.

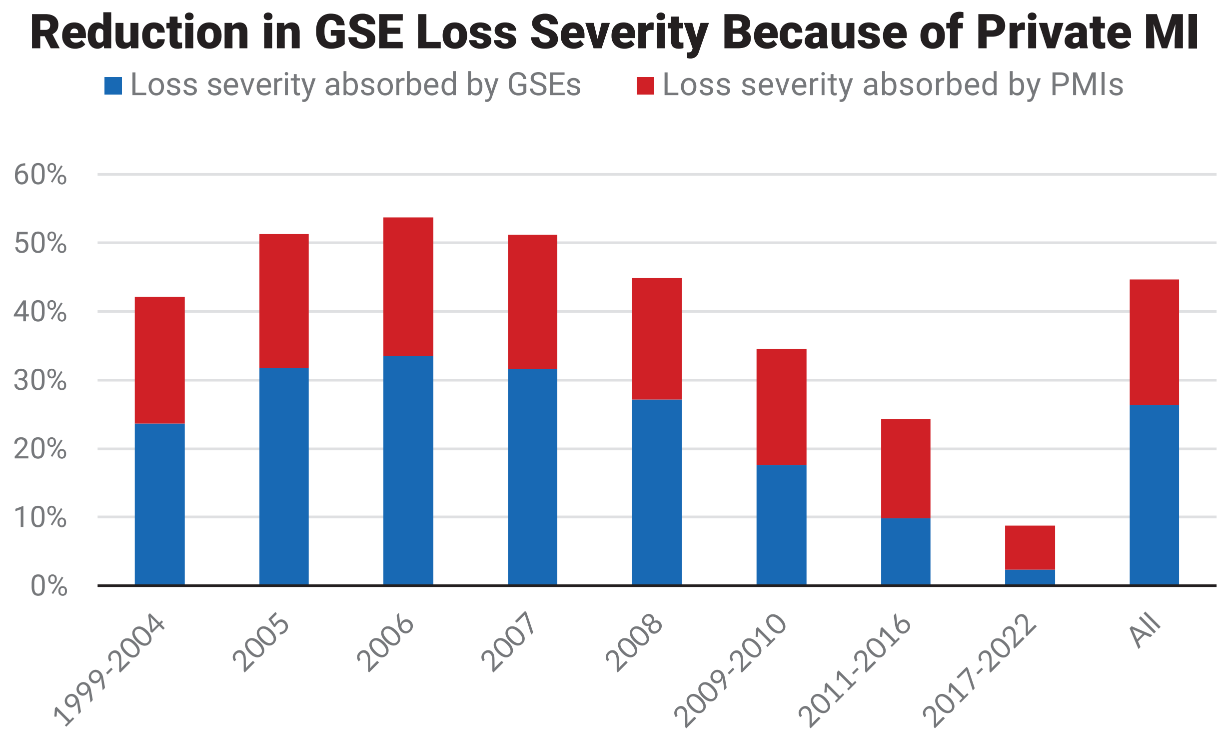
Since PMIERs were significantly revised in 2015, private mortgage insurers hold 69% more capital than the required regulatory threshold.[8] USMI member companies have maintained levels significantly above the PMIERs requirements, and **USMI members collectively hold $11 billion in excess of these requirements, representing a 169% sufficiency ratio.**[9] 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.[10]

KEY COMPONENTS OF PMIERs	
Financial Requirements	Ensure "[a]pproved insurers have adequate liquidity and claims-paying capacity during periods of economic stress"
Risk-Based Capital Standard	Establishes minimum required assets of 5.6%
Business/Operational Requirements	Identify, measure, and manage exposure to counterparty risk
Quality Control Requirements	Set for underwriting and eligibility guidelines, data accuracy, and fraud prevention
Dictate Allowable Timeframes	For document request, claim perfection, and decision of claims

PMIERs created a strong foundation for efforts to further "de-risk" the GSEs through expanded use of private capital with MI. This builds on the industry's track record of providing dedicated private capital ahead of the GSEs and taxpayers, **as evidenced by the nearly $60 billion in claims paid since the GSEs entered conservatorship in 2008.**[11] However, PMIERs available assets are only one source of private capital that is available to pay claims during times of economic stress. Other sources of private capital that exist and are first used to shield the government and taxpayers from credit risk include future premiums, reinsurance recoverables, and funds booked from single premium plans. Notably, private MIs work closely with servicers and the GSEs to offer loss mitigation solutions to borrowers experiencing financial hardship to promote home retention.

Urban Institute's recent report, "Mortgage Insurance Data at a Glance-2023,"[12] 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]."** The chartbook also noted that "the reduced loss severity for the GSEs attributable to [private MI] holds across all origination years."

"The presence of [private MI] reduces the losses the GSEs experience on loans with LTV ratios above 80 percent to the same levels as the losses they experience on loan with LTV ratios up to 80 percent. This indicates that [private MI] is highly effective in reducing losses to the GSEs." ***– Urban Institute, 2023***



MORTGAGE INSURERS' OBLIGATION AND COMMITMENT TO PAY CLAIMS: New Master Policy & Rescission Relief Principles

NEW MASTER POLICY

The MI Master Policy, which governs claims paying policies and procedures, underwent significant changes in 2013 with substantial input from the Federal Housing Finance Agency (FHFA). **Changes included an increased clarity of terms, which streamlined the payment of claims to ensure, in the event of borrower defaults, that MI results in reliable and predictable payments to lenders.** These new policies articulate in much greater detail the conditions, in some cases tied to quantitative thresholds, that must be met before certain errors and omissions can become grounds for rescission.

The new Master Policy **ensures timely, consistent, and accurate policy and claim administration.** It creates high visibility and responsiveness for performing loss mitigation, including through workouts for homeowners who become delinquent on their payments. In addition, private MI companies work with investors and servicers to help homeowners prevent foreclosure.

In 2019, USMI members developed a common Master Policy, which became effective on March 1, 2020.

RESCISSION RELIEF PRINCIPLES

The Rescission Relief Principles were first published in 2013, and the GSEs issued Revised Rescission Relief Principles in December 2017. The revisions sought to align the principles with updates to the GSE R&W framework. The introduction of rescission relief has been well-received by the industry, and includes automatic relief after 36 timely payments, addressing the concern of lenders, with early relief available after 12 timely payments with a full file review. It also provides private MI companies with the ability to offer increased rescission relief.

Since these principles were first published 10 years ago, the private MI industry has remained committed to supporting borrowers who face challenging circumstances. During the COVID-19 pandemic, each private MI company released announcements concerning the treatment of loans impacted by the economic downturn, and in recent natural disaster events, the private MI industry has supported guidance issued by the GSEs, U.S. Department of Housing and Urban Development (HUD), FHFA, and others.

- *Automatic relief after 36 timely payments, with early relief available after 12 timely payments with a full file review*
- *Allow for private MIs to offer day one certainty to lenders of coverage*

MORTGAGE INSURERS ARE ACTIVE MANAGERS OF MORTGAGE CREDIT RISK: MI Credit Risk Transfer (MI-CRT) Structures

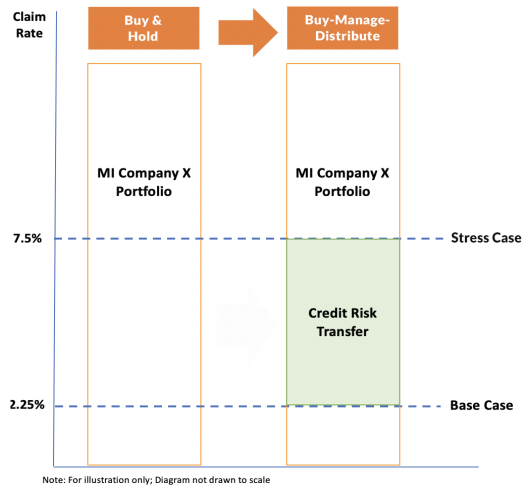
Private MI is one of the most stable and reliable sources of private capital that assumes mortgage credit risk through all market cycles, and in recent years, the industry has implemented innovative tools and structures to help better insulate the housing finance system from the cyclical nature of the mortgage market. In doing so, private Mis have enhanced their ability to be more stable, long-term managers and distributors of risk. The industry now uses a combination of capital markets-based and traditional reinsurance executions to reduce volatility and exposure of mortgage credit risk within the mortgage finance system, including to the GSEs and, therefore, taxpayers.

The private MI industry has demonstrated a commitment to effective capital management through both traditional reinsurance transactions with rated counterparties and capital markets-based Insurance-Linked Note (ILN) issuances, which have enabled private MIs 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.

Urban Institute's chartbook also highlighted that "private mortgage insurers have become increasingly proactive in managing and distributing credit risk," noting the industry's performance in managing risk since 2015. "In 2015, the industry expanded its credit risk transfer capabilities and issued $298.9 million in insurance-linked notes (ILNs), covering $32.4 billion of insurance in force. By 2021, the annual issuance increased to $6.3 billion, protecting $652.2 billion in mortgage loans."[13]

MI-CRT structures have developed and grown in the housing market since 2015, transforming the MI business model from "Buy-and-Hold" into "Aggregate-Manage-Distribute." MI-CRT demonstrates that private MI 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.

TRANSFORMATION OF THE PRIVATE MI INDUSTRY



- Given the cyclical and long-tail nature of the private MI business, **the industry has evolved from a "Buy-and-Hold" approach into a more proactive and sophisticated "Aggregate-Manage-and-Distribute" operating model** by laying off risk whenever presented with a favorable risk-reward trade-off.
- Deploying MI-CRT allows private MIs to **hedge against adverse losses and mitigate volatility through housing and business cycles.**
- The private MI industry's comprehensive CRT strategy, which combines Insurance-Linked Notes (ILNs) with traditional third-party reinsurance, **not only positions the industry well in the current economic environment but also ensures it will continue to operate as a going concern through future economic stress cycles,** making private MIs strong and stable counterparties to the GSEs and investors.
- Transferring credit risk is not only an effective hedge to exposure to cyclical mortgage risk but can also be **accretive to returns by freeing up capital at a fraction of the cost of equity capital without adding financial leverage to the balance sheet.**

Since 2015, private MI companies have transferred nearly $73.8 billion in risk on more than $3.4 trillion of insurance-in-force (IIF).[14] The overall and transaction structure-specific numbers reflect the initial amount of risk transferred and IIF covered. 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, the industry introduced MI ILN programs beginning in 2015. Since then, **private MIs have issued 56 ILN transactions, transferring nearly $22.3 billion of risk on more than $2.3 trillion of notional mortgages.**[16]

Private MIs underwrite and actively manage mortgage credit risk, ensuring quality control and a "second pair of eyes" on risk within the financial system and for end-investors. Through CRT, private MIs are able to access global financial markets to distribute risk while not diluting their role in underwriting mortgage credit risk or serving as entity-based capital. The private MI industry has demonstrated a commitment to effective capital management through both reinsurance and programmatic ILN issuances, which have enabled private MIs to become the strongest and most stable counterparties to the GSEs and investors and to play a greater role in supporting the U.S. housing finance system.

PRIVATE MI BUSINESS MODEL TRANSFORMATION

	HISTORICAL MODEL: PRE-FINANCIAL CRISIS	EVOLVING MODEL: BUY-MANAGE-DISTRIBUTE
HOW RISK IS PRICED	Published rate cards were more widely utilized with price based on broad LTV ranges leading to: • mispriced credit tails • limitations in swiftly changing price in down cycles • reduced competitive advantage given published pricing • weakness in allocating capital based on individual borrower and loan attributes • limited ability to shape portfolio's risk and return profile • published industry pricing allowed for minimal opportunity to adjust pricing	Deployment of more sophisticated risk-based pricing delivered through automated pricing engines: • enables pricing based on additional risk attributes • operationally, rates can be efficiently changed (providing a strong defense in a down cycle) • provides best rate to borrower based on their credit and loan attributes • enables shaping of the portfolio based on target credit and return profiles • supports "best execution" lender strategies
HOW RISK IS MANAGED	The private MI industry did not utilize reinsurance in a manner consistent with P&C and Life insurers: • portfolios comprised long tail mortgage credit risk (typically with a 5-7 year life) • the private MI industry was significantly levered to U.S. housing and economic cycles • portfolios with uncapped liability were exposed to significant franchise and return volatility during down cycles • relied on equity as primary source of capital with minimal opportunities to diversify capital sources	Deployment of programmatic CRT transactions, such as ILN, XOL, and QSR agreements: • provides a layer of protection against adverse credit risk leading to a more sustainable franchise • minimizes franchise and return volatility during down cycles • provides 3rd party mortgage credit risk price discovery that can be incorporated back into front end risk-based pricing • provides additional sources of capital making for a stronger and more stable counterparty

Housing finance stakeholders have recognized the industry's innovation, expanded capabilities to expertly manage and distribute risk, and the benefits associated with MI-CRT programs. In 2018, the Urban Institute stated that "these transactions give the mortgage insurers information that is valuable for pricing the MI, through both the deal pricing and through discussions with investors," adding that MI-CRT will "also reduce the volatility of earnings, providing greater resiliency for the mortgage insurers under adverse market conditions."[17]

"The mortgage insurance stands in front of and takes the first loss position, so it reduces losses to the enterprises. The mortgage insurance companies are capitalized, they've got liquidity and, at the end of the day, we're transferring the first loss credit risk to the private sector, which helps protect the enterprises."

– FHFA Director Sandra Thompson, May 23, 2023[18]

BENEFITS OF MI-CRT

TO THE MI COMPANIES	TO THE HOUSING FINANCE SYSTEM
• Diversifies capital beyond entity-based equity capital	• Strengthens private MIs as counterparties
• Protects portfolio against adverse losses in housing downturns	• MIs underwrite/actively manage the mortgage credit risk, ensuring quality control and a "second pair of eyes" on risk within the financial system and for end-investors
• Enhances counterparty strength	• Reduces investor risk exposure because private MIs typically hold the first 185-250 basis points (bps) of risk for ILN and XOL transactions, ensuring alignment of incentives to instill quality underwriting
• Provides capital credit for PMIERs, rating agencies, and state regulatory requirements	• Offers significant potential for growth, deepening pool of liquidity for the market and options for investors in mortgage finance credit
• Cost-effective source of funding that allows private MIs to hold excess capital	

EVOLUTION OF THE INDUSTRY:
Trends among the Private MI Companies

Through significant enhancements to its capital structure and a more precise and certain Master Policy, the industry has become stronger and better prepared for future downturns. The industry has demonstrated an ability to tap multiple available sources of capital, including equity, debt, traditional reinsurance, and capital markets-based reinsurance to distribute risk. It has also shown its ability to work with lenders of all sizes and types, from the largest money center banks to small community banks, credit unions, and independent mortgage banks. This has created a wide array of trends and practices that further enhance the industry.

TREND	DESCRIPTION
Dynamic Industry Pricing	Allows companies to better price for mortgage credit risk and tailor their own risk profile through pricing.
Regular QA audits	Private MIs conduct regular QA audits to monitor manufacturing quality and provide timely feedback to lenders and underwriters.
Financial Strength Ratings	Private MIs are highly rated by Moody's, S&P, Fitch, and A.M. Best, and several companies have been upgraded over the past several years.
Risk Management Advocacy	Regular dialogue with the GSEs on credit guideline development, servicing practices, and emerging risk trends.
RMBS Rating Methodologies	Several rating agencies, including Moody's, S&P, and DBRS Morningstar, have proposed and/or implemented improved treatment of credit for private MI as part of their RMBS ratings methodologies.
Higher credit scores, lower LTVs, and lower debt-to-income (DTI) ratios than FHA and VA borrowers	Urban Institute's 2023 private MI report details that conventional loans with private MI have lower LTV ratios and higher FICO credit scores than Federal Housing Administration (FHA) or Department of Veteran Affairs (VA) loans. Post-crisis, conventional loans with private MI have exhibited lower DTI ratios than loans insured by FHA and VA. Additionally, GSE loans with private MI have lower loss severities than GSE loans without private MI, despite their higher LTV ratios.

CONCLUSION

Private MI is a critical feature of the housing finance system that enables homeownership for millions of Americans—and protects the GSEs, lenders, taxpayers, and mortgage finance system from undue mortgage credit risk. After the financial crisis of 2008, the private MI industry worked in partnership with FHFA and the GSEs to strengthen its safety and soundness through enhanced capital and operational standards to be more resilient and withstand severe economic stress, and thus is an essential check on mortgage credit quality through the financial system, reducing systemic risk in the housing and financial markets.

Our nation's mortgage finance system must balance access to mortgage credit for consumers while also shielding taxpayers. Fortunately, private MI is uniquely and permanently dedicated to serving both objectives through all economic cycles. Today, the private MI industry continues to be strong, resilient, and reliable, ensuring the industry is poised to enable homeownership for borrowers without large down payments while protecting the GSEs, American taxpayers, and the mortgage finance system at large from mortgage credit risk in the future.

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[1] Fannie Mae Monthly Summary Reports and Freddie Mac Monthly Volume Summary Reports.
[2] USMI Member Company Data and GSE Aggregate Data.
[3] GSE Aggregate Data.
[4] MI company data and *Inside Mortgage Finance*, Primary Mortgage Insurance Activity.
[5] GSE Aggregate Data.
[6] HMDA Data.
[7] GSE SEC Filings as of September 30, 2023.
[8] MI Companies' SEC Filings as of September 30, 2023.
[9] MI Companies' SEC Filings as of September 30, 2023.
[10] USMI Member Company SEC Filings and Press Releases.
[11] GSE statutory filings and MI Company Filings.
[12] Urban Institute, "Mortgage Insurance Data At A Glance-2023" (August 2023).
[13] Urban Institute, "Mortgage Insurance Data At A Glance-2023" (August 2023).
[14] MI Company CRT Transaction Data.
[15] MI Company CRT Transaction Data, as of September 30, 2023.
[16] MI Company CRT Transaction Data, as of November 2, 2023.
[17] Urban Institute, "Credit Risk Transfer: A Fork in the Road." (June 7, 2018).
[18] FHFA Director Sandra Thompson during a U.S. House Financial Services Committee hearing on "FHFA Oversight." May 23, 2023.