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CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON THE FUTURE OF HOUSING FINANCE REFORM: THE ROLE OF PRIVATE MORTGAGE INSURANCE

JULY 29, 2010

We meet today to continue our hearings about the future of housing finance. As we work to reform this complex system, we must learn more about private mortgage insurance and determine whether to make changes related to this product. We will therefore examine the structure, regulation, obligations, and performance of mortgage insurers.

Since its creation more than a century ago, private mortgage insurance has, without question, allowed countless families to achieve the American dream of homeownership. It has also worked to safeguard taxpayers by providing a first layer of protection against foreclosure losses for lenders and for mortgages securitized by Fannie Mae and Freddie Mac.

Over the years, the industry has had to respond to significant economic challenges. During the Great Depression, inadequate capital reserves and an inordinate amount of mortgage defaults drove every mortgage insurer into bankruptcy. As a result, the private mortgage insurance industry disappeared for more than two decades.

Many, including me, feared the recent collapse of the housing bubble could produce a similar result. For a while, the industry teetered on the brink of extinction. Some mortgage insurers also sought, but never received, direct TARP assistance.

We had good reasons to worry. Historically, about 4 percent of mortgages guaranteed by mortgage insurers go into default in the average year. During this crisis, however, approximately 1 in 3 mortgages made in 2006 and 2007 and insured by mortgage insurers are expected to go into foreclosure over the life of the loan. As a result, some estimate the industry will lose between $35 billion and $50 billion when all is said and done.

Nevertheless, it appears the industry will survive because of some economic luck, many regulatory waivers, and its distinctive capital structure. In particular, mortgage insurers must maintain contingency reserves of 50 cents on every premium dollar earned for 10 years. Thus, they build up capital in good times in order to pay out claims in rocky financial periods.

While these countercyclical reserves are unique to the mortgage insurance industry, they provide an important model for Congress to consider in reforming the structure of the housing finance system. If Fannie Mae and Freddie Mac had held similar reserves, both enterprises may have weathered the recent financial hurricane much better.

Still, the industry's performance has been far from perfect during this crisis. Some have questioned whether mortgage insurers held enough capital, because they had to seek regulatory forbearance and curtail underwriting. This reduction in new business has probably slowed the recovery of our housing markets. Others have raised concerns about whether mortgage insurers have increased the government's costs related to the conservatorship of the enterprises.

Specifically, mortgage insurers only pay claims on foreclosed homes. They have no affirmative obligation to prevent foreclosures. As a result, Fannie Mae and Freddie Mac, rather than mortgage insurers, have often had to bear the financial losses related to loan modifications. Mortgage insurers exist to provide the first level of protection against losses and should not evade their responsibilities by contractual technicalities. We must review this arrangement.

We also need to explore the present credit enhancement requirements under the charters of Fannie Mae and Freddie Mac. While the standard U.S. mortgage insurance policy indemnifies against losses created by a default in an amount equal to the first 20 to 30 percent of the lost loan principal, an Australian policy covers 100 percent of the home loan amount.

Additionally, we should examine consumer protection issues, the State regulation of the industry, and its indirect Federal regulation. The problems of Fannie Mae and Freddie Mac resulted, in part, from the competing mandates of two regulators. As we reform our housing finance system, we may therefore want to streamline the oversight of mortgage insurers.

In sum, all options for reforming our housing finance system are on the table, including those related to private mortgage insurance. I anticipate a fruitful and productive discussion around these and other issues today.