STATEMENT OF PATRICK SINKS BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES
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I am Patrick Sinks, President and Chief Operating Officer of Mortgage Guaranty Insurance Corporation in Milwaukee Wisconsin. It is a pleasure to be here today to testify on behalf of the Mortgage Insurance Companies of America (MICA), the trade association representing the private mortgage insurance (MI) industry. Mortgage insurers enable home ready borrowers to safely buy homes with less than a 20% downpayment. As a result, we understand the drivers of sustainable, affordable homeownership because our industry has a vested interest in assuring that homebuyers are given mortgages they can afford to pay. Importantly we do not believe affordability and sustainability are mutually exclusive goals. Both can be achieved if the market is structured properly and loans are underwritten prudently. MICA believes that MI is essential to achieving both goals.

The modern MI industry has been in existence since 1957. During the past fifty-three years the industry has enabled borrowers from all walks of life to achieve the dream of homeownership. The credit enhancement we provide has supported the development of the secondary mortgage market, and the industry has withstood a series of regional downturns including the “oil patch” crisis in the early 1980s and the demise of the S&L industry in the late 1980s. The industry is now withstanding the current, unprecedented nationwide downturn in housing, and in fact has raised throughout the mortgage crisis, over $7 billion in capital through new capital and asset sales. We have weathered the storm and we are now adequately capitalized through private capital to meet the expanded needs of first-time homebuyers seeking low downpayment conventional mortgages.

The Role of MI

The primary barrier for most borrowers to buying a home is coming up with a 20% downpayment. That barrier can be overcome in a safe and sound manner by encouraging the use of private mortgage insurance. MI enables borrowers to buy homes with less than a 20% downpayment because MI takes the first loss after the borrower, if the borrower defaults. When the borrower defaults, the MI coverage typically pays the investor 20% to 25% of the loan amount.

Because mortgage insurers are in the first loss position on the mortgages we insure, our interests are aligned with those of both the borrower and the mortgage investor, thus ensuring better quality mortgages. Mortgage insurers act as a second set of eyes by reviewing the credit and collateral risks related to individual loans. This role protects both borrowers and investors by ensuring that the home is affordable at the time of purchase and throughout the years of homeownership.

Borrowers pay for mortgage insurance coverage either through direct premium payments to the mortgage insurer generally included in their monthly mortgage payments or indirectly through Lender Paid Mortgage Insurance (LPMI) where the lender makes the payment but recoups the cost by charging higher interest rates to borrowers. In both cases borrowers pay for the insurance that allows them to receive the loan because the borrowers' ability and willingness to pay the mortgage at a future date is the risk factor in the insurance process. The same is true for FHA mortgage insurance where borrowers pay for the insurance coverage that allows them to receive an FHA-insured loan.

Who MI Serves

Since 1957, the private mortgage insurance industry has helped more than 25 million families buy homes. MI insurance-in-force as of March 31, 2010 was $829 billion, or 8.6 percent of U.S. single family, first liens then outstanding. Since 2007, mortgage insurers have paid over $20 billion in claims and continue to significantly support their insured mortgage lender clients in 2010.

According to the 2008 Home Mortgage Disclosure Act (HMDA) data (the most recent data available), 41% of the borrowers who received mortgages insured by private mortgage insurers to purchase a home made less than area median income and 27% made less than 80% of area median income. The income distribution of mortgage insurers customers combined with the fact that numerous studies have determined that the lack of a substantial downpayment is the major barrier to homeownership leads us to believe that a substantial share of our purchase business is comprised of first-time homebuyers who would not be able to get into an affordable home without the benefit of mortgage insurance**.**

Enabling Low Downpayment Loans to be Sustainable

The recent mortgage crisis has shown the importance of careful underwriting of mortgage loans both with respect to the borrower's ability to repay the loan and with respect to the true appraised value of the house being financed. This is where private mortgage insurers, as second underwriters of low downpayment loans, play an important role in protecting the borrower, lender and the mortgage holder.

Recent analysis of MI insured mortgages versus piggyback mortgages brings to light the importance of private sector capital at risk in a first loss position.[1] Piggyback loans are loans where borrowers have little or no equity in their mortgages. Instead, borrowers get an 80% first mortgage loan and simultaneously get up to a 20% second mortgage. Therefore, the borrowers have little or no equity in their mortgage, but unlike low-dowpayment loans with private mortgage insurance, there is no private sector capital at risk in a first loss position.

An analysis using loan level data on 4.5 million loans originated between 2004 through 2007 compared delinquency and default rates of loans with combined loan to value (CLTV)

[1] *Insured Versus Piggyback Loan Analysis, available at http://www.restorethedream.com/assets/documents/Insured-vs-Piggyback-Loan-Analysis.pdf.*

loans of over 80% that were done as single first lien loans with mortgage insurance to over 80% CLTV loans that were structured like piggyback mortgages with an uninsured first lien coupled with a simultaneous second lien mortgage. Piggyback loans became delinquent or defaulted approximately 1.6 times more often than insured loans with comparable CLTV, borrower credit scores and origination year. This analysis demonstrates that not all low downpayment loans are the same. MI significantly mitigates the risk that a high LTV loan will become delinquent and go to default. The data makes it clear that with proper underwriting and mortgage insurance, low downpayment lending can be done without exposing the borrower, lender or investor to excessive risk. A chart with a summary of the data is the first attachment.

<u>Helping Borrowers Stay in Their Homes</u>

Having our own capital at risk also means that mortgage insurers have very clear incentives to mitigate their losses if loans are in default. The best way to do that, of course, is to avoid foreclosures altogether by working with borrowers to keep them in their homes. Mortgage insurers have a history of partnering with lenders, investors and community groups to work with borrowers in default. This often means that, with the servicers' permission, mortgage insurers counsel the borrowers personally and determine if their financial problems can be resolved.

Mortgage insurers have fully participated in the Administration's loss mitigation programs and others. Over 199,000 trials have been started by mortgage insurers under the HAMP, with 34,945 completed through the first quarter of 2010. Further, the industry has participated in 53,901 approvals under the HARP, with 41,155 closed refinances during this same time period. These efforts combined with other MI-related loan workouts resulted in 374,304 completed workouts from 2008 through the first quarter of 2010 by the MI industry, covering $73.8 billion in mortgage loans.

The Regulatory Strength of MI

MI is a regulated, counter-cyclical source of loan level protection provided for a mortgage loan, based on independent, objective underwriting criteria. It is for this reason that the recent report from the Joint Forum of global banking, securities and insurance regulators endorsed mortgage insurance as an important element of a reformed mortgage origination and securitization framework.[2]

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[2] The Joint Forum, *Review of the Differentiated Nature and Scope of Financial Regulation Key Issues and Recommendations*, January 2010, at p. 17. "*Other factors important to an effective underwriting program:* The following are not substitutes for sound underwriting practices but should be taken into consideration when determining the soundness of an underwriting program. Mortgage insurance provides additional financing flexibility for lenders and consumers, and supervisors should consider how to use such coverage effectively in conjunction with LTV requirements to meet housing goals and needs in their respective markets. Supervisors should explore both public and private options (including creditworthiness and reserve requirements), and should take steps to require adequate mortgage insurance in instances of high LTV lending (*e. g.*, greater than 80 percent LTV)."

The backbone of the industry's financial strength is its state-imposed reserve requirements. The reserve requirements were developed in a model MI act that was established by the National Association of Insurance Commissioners (NAIC) and is primarily enforced by the states where MI companies are domiciled. The requirements are specifically structured to address the long-term nature of MI risk. They enable the industry to withstand a sustained period of heavy defaults arising from serious regional or national economic downturns, as well as routine defaults and claims that occur normally throughout the cycle.

Mortgage insurers are required to keep three types of reserves, the most important of which is the contingency reserve. Half of each premium dollar earned goes into the contingency reserve and generally cannot be touched by the mortgage insurer for a 10-year period. It ensures that significant reserves are accumulated during good times not only to handle claims under stress, but also to avoid boom-bust cycles. The contingency reserves are directly comparable to the "dynamic provisioning" bank regulators now know they need. Mortgage insurers are subject to similar mortgage default risk as banks but only mortgage insurers raise capital counter-cyclically. Bank regulators are only now working to construct a similar system for banks in the U.S.

Chart 2 demonstrates how the MI industry builds its capital base during good times to pay claims in bad times as currently experienced by the housing market. The chart shows yearly industry losses paid as a percentage of premiums earned for each year from 1980 through 2009. It also shows the MI industry's risk to capital ratio for each year and the build-up of premiums available to pay claims over time. As can readily be seen, the fact that mortgage insurers do not earn all of the premiums they receive each year -- but are required to keep a portion of the premiums in a contingency reserve -- means that premiums available to pay claims increase during the good times so that they can be paid out to cover the serious losses that occur during the bad times.

The other two reserves that mortgage insurers must maintain are case-basis loss reserves and unearned premium reserves. Case-basis loss reserves are established for losses on individual policies when the insurer is notified of defaults. Premiums received for the term of a policy are placed in unearned premium reserves. Each state establishes the method by which premiums are earned to match premiums with loss and exposure.

The history of the MI industry proves that we have paid our claims through good and bad economic cycles. For example, in the early 1980s, the mortgage market had to cope with double-digit interest rates and inflation in a period of severe recession and, therefore, introduced many experimental adjustable-rate mortgages. As economic conditions deteriorated -- particularly in energy-oriented regions of the country -- defaults began to rise, resulting in numerous foreclosures. The MI industry paid more than $6 billion in claims to its policyholders during the 1980s. In the early 1990s, the MI industry paid more than $8 billion in claims primarily in California and the Northeast.

The first loss position of MI makes it a valuable offset to mortgage credit risk. This benefit extends to lenders that hold loans in portfolio and in the case of Fannie Mae and Freddie

Mac, to taxpayers who are otherwise exposed to GSE losses. Over the course of the current mortgage crisis, the MI industry estimates that it will pay around $30 billion in claims in front of the taxpayer to Fannie Mae and Freddie Mac. Indeed, since the current mortgage crisis began, Fannie Mae and Freddie Mac have received from mortgage insurers $14.5 billion in claim payments and receivables, equivalent to 10% of the amount U.S. taxpayers have had to spend to date on the GSEs during their conservatorship.

Not only does the MI industry have ample regulatory capital with the three types of reserves discussed above, but it also has been able to attract new capital to the industry. Since the mortgage crisis began, the industry has raised $7.4 billion through new capital and assets sales and investors have provided a further $600 million for a new entrant to the industry. The recent capital inflows to the industry are indicative of investor confidence in the business model and its regulatory construct.

Beyond the reserve requirements, state regulators have established detailed and comprehensive regulations designed to protect policyholders. State insurance regulation addresses among other things, the licensing of companies to transact business, policy forms, claims handling, financial statements, periodic reporting, permissible investments, adherence to financial standards, and premium rates. The premium rates and policy forms are generally subject to regulation in every state and are intended to protect policyholders against the effects of excessive, inadequate or unfairly discriminatory rates and to encourage competition.

The capital and regulatory strength of the MI industry as well as its proven ability to withstand periods of heavy defaults, is in sharp contrast to other forms of external loan-level credit enhancements which are not regulated, well capitalized, and have not demonstrated a capacity to satisfy their obligations and ensure prudent loan originations. In addition, many are not offered by a bona fide third-party unrelated to the originator or securitizer. For example, credit default swaps (CDS) have been a source of profound systemic risk in the current crisis, and the regulatory framework required to correct this problem still must be constructed following the new standards in the Dodd-Frank Act. The Joint Forum paper cited above details an array of supervisory and capital problems in the CDS sector.

MICA does not believe it is prudent to change the regulatory model for the MI industry because the structure has proven to be so successful. While mortgage insurers meet regularly with FHFA to discuss housing market issues and meet regularly with Fannie Mae and Freddie Mac to discuss a variety of business related issues, the industry is very well regulated by the state insurance regulators. As mentioned earlier, the NAIC has a model MI act and the regulatory model that the MI industry has been operating under for over 50 years is one that federal bank regulators are only now working to construct for banks.

MIs Raised Concerns Well Before the Mortgage Crisis Hit

The MI industry was the “canary in the coal mine” for the problems in the mortgage finance system because, in its unique position, it could see early on the problems that were developing. Beginning in 2002 the MI industry raised concerns with financial institution regulators about the underwriting of high-risk mortgage products and the regulatory and capital incentives that existed for the creation of these products. The industry's concern was derived from the economic interests of the industry, its position as the provider of first loss protection on first lien, residential mortgages and the industry's half century of experience in reviewing mortgage underwriting by lenders during good and bad economic times. The industry's initial concern was focused on the growing number of structured finance, or piggyback loans in the market that not only were higher risk loans because the borrower had little or no equity in the property, but – importantly – because there was no private sector capital at risk when the lenders avoided MI by using a piggyback structure. As MICA explained in a December 3, 2002 letter to the Federal Reserve, OCC, OTS and FDIC referring to the use of piggyback structures:

> MICA would remind the agencies that mortgages are a major source of risk to insured depositories. Despite the high quality of the collateral underlying first liens on residential mortgages, these loans were the underlying source of the S&L debacle during the 1980s because thrifts did not hold sufficient regulatory capital against the various risks these assets pose. Mortgages have since become still more risky because of the increasing role of high-LTV mortgages, at the same time that consumer debt-service burdens have reached unprecedented levels despite historic low interest rates. A failure to impose appropriate regulatory capital for the riskiest type of mortgage asset – structured seconds – could expose the nation's financial system to significant risk as interest rates rise, housing markets weaken and consumers struggle to honor their obligations.[3]

Because of the MI industry's position of insuring the first loss on high-LTV mortgages we had good reason to be concerned with what was developing in the mortgage market even though these loans were generally done in a piggyback structure. As we noted in a September 23, 2005 letter to the bank regulators:

> Our concern is based in part on the fact that high-risk products can undermine reliance on proven forms of credit risk mitigation like private mortgage insurance (MI). But, far more disturbing to us is the fact that recent trends could lead to sudden increases in foreclosures, accompanying sharp reductions in the value of residential mortgage collateral. This would, in effect, "pollute the residential mortgage well" – a well of profound importance to the depository institutions you regulate and to the mortgage insurance industry.[4]

Looking back it should not be a surprise that the MI industry was one of the first mortgage market participants to see the rapid deterioration in mortgage underwriting standards that was occurring and the dangers of piggyback mortgages. The MI industry by virtue of its private capital in the first loss position, its role as a reviewer of the underwriting of the loan, its counter-cyclical regulatory capital requirements and its long term view of housing market cycles had in the early 2000s and continues to have today a vested interest in a mortgage market that

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[3] Letter dated December 3, 2002 from MICA to Hon. Susan Bies, Hon. James E. Gilleran, Hon. John D. Hawke, Jr., and the Hon. Donald E. Powell.

[4] Letter dated September 23, 2005 from MICA to Hon. Susan Bies, Hon. John Dugan, Hon. Donald Powell and the Hon. John M. Reich.

gives all parties incentives to put homeowners in mortgages that they can afford to pay over the long term.

MI Going Forward

Private Sector Capital Ready to Make Prudently Underwritten Mortgages Affordable

Today the MI industry is well positioned to help expand affordable housing opportunities in a responsible manner. Under strong capital rules from state insurance regulators, the MI industry has sufficient capital to increase their total insurance exposure by $261 billion a year for the next three calendar years. If this additional volume is realized it would mean that approximately 1.3 million additional mortgages would be insured in each of the years. Because of the nature of who uses MI, many of these new insured mortgages would go to low and moderate income first-time home buyers who do not have the necessary funds to make large downpayments but still have adequate income and credit to enjoy long-term, sustainable homeownership through an insured mortgage. This is an important contribution to the housing recovery because this sector is crucial to the reduction in excess housing inventory which is essential to a full recovery in the housing market.

The New Secondary Market

MICA believes that a re-energized secondary, conventional mortgage market with new entities is necessary to provide sustainable homeownership. As Congress considers the structure of the new entities, MICA believes that the federal government must assume a role in ensuring that the new secondary market entities fulfill their secondary market functions. However, it must be done with no or with minimal risk to U.S. taxpayers and without creating risk to the financial system. This will, in part, be helped by assuring that the new entities focus exclusively on mortgage securitization for sustainable, prudently underwritten mortgages. It also will depend on the new entities having adequate capital ratios, meaningful and consistent underwriting standards for securitized mortgages and restrictions against the assumption of excessive risks. MICA also believes that fees charged by the government as securitizer and by the new conventional securitizing entities should be fully commensurate with the risk of the underlying loans but only after taking into account adequate insurance coverage on high LTV loans.

A liquid secondary mortgage market is critical to providing borrowers with the lowest mortgage interest rates possible. It is also essential to ensuring a standardized market as well as a robust market for affordable, prudently underwritten mortgages. Low downpayment mortgages are a critical part of this market because they enable first-time and lower income families to buy homes. Therefore, the new secondary market entities must provide liquidity for both lower downpayment and higher downpayment mortgages while limiting the credit risk they assume.

In addition, the new entities should be held to corporate governance standards which are at least as high as those imposed on the financial services industry and enforced through a comprehensive federal regulatory structure. In this regard, the new entities should be required to comply with securities laws and their securities reporting and registration requirements should be the same as those required of private issuers including the improved availability and quality of information disclosed regarding the underlying mortgage assets.

Finally, there should be an explicit role for private sector capital in every sector of the mortgage process – primary, secondary, MBS, insurance, appraisals, etc. Private capital at risk ensures market discipline and incentive alignment that will protect both taxpayers and mortgage borrowers. In this regard, loans with low levels of borrower equity should have private capital in a first loss position to provide increased protection for the new entities and taxpayers.

MICA believes policy makers may choose from among three basic approaches in deciding what role the federal government should play in ensuring that the secondary mortgage market achieves these goals. While there may well be sub-options within these basic options, the government still will have to decide which of these three approaches will serve as its guiding role in establishing a dynamic secondary mortgage market. MICA believes that not all of these approaches will serve the interests of taxpayers and mortgage borrowers to the same extent.

The three basic options are first, the government can be the sole guarantor of mortgage credit risk as this risk is transferred through mortgage securitizations or retained on the books of the loan originator. Second, the government can share the guarantee function with various sources of private capital. Third, the government may choose to play no role in guaranteeing mortgage credit risk.

With the first option where the government would bear all the risk, significant problems could arise because there is no private sector capital at risk. First, private capital as "skin in the game" is essential to good quality originations as the U.S. financial regulators are coming to realize. Second, a complete government guarantee of a loan without any private capital at risk removes the incentive for changes in the housing market -- e.g., rising or falling house price assumptions -- to be reflected in lending standards. That is, a complete government guarantee with no shared private risk means that the loan originator effectively has little or no skin in the game once the government guarantee has been applied. As a result, they may disregard signals concerning rising risk levels that would otherwise have changed the underwriting of the loan if private capital -- such as MI -- remained at risk on the loan. Finally, having the government serve as the sole credit risk guarantor puts the U.S. taxpayer at risk for the first dollar of loss on each and every mortgage.

With the second option the government and private capital share the risk. The most logical way to do this is to put private capital in the first loss position. First, this structure allows the mortgage market to adjust risk factors to what is happening in the housing market. It also allows the private market to develop safe and sustainable mortgage products in a timely fashion but with government oversight. Second, it will generate lower mortgage rates for borrowers. Finally, it will allow taxpayers to rely less on the adequacy of a fee charged by the government for a back-up guarantee as compared to a first loss position for the government.

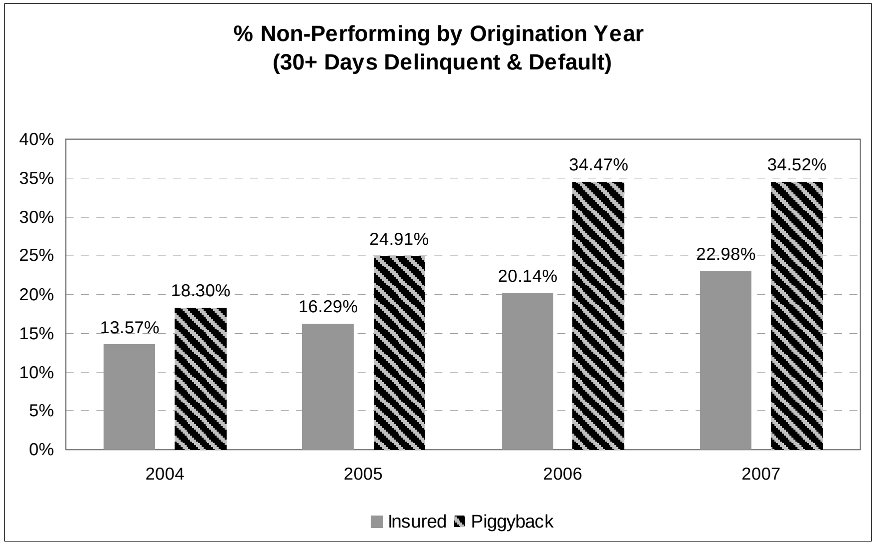
The third option is to eliminate any role for the federal government. The absence of any role for the federal government in mortgage securitization will have negative effects for mortgage investors, borrowers and taxpayers. This approach requires investors to rely totally on private guarantees which inevitably will result in higher interest rates for borrowers than if the government applied its own guarantee to the mortgage securitization. Also, it is unclear that a totally private market for residential mortgages can re-emerge anytime soon without some government role. This is especially the case if the government chooses to retain a government guaranteed market that operates in competition with or supplemental to the private market.

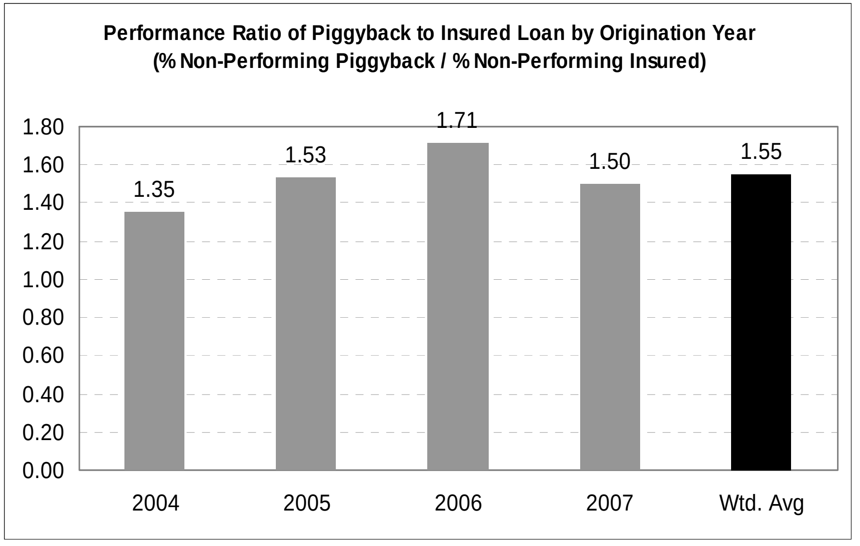
Conclusion

In summary, the private mortgage insurance model has stood the test of time. We have helped house America for more than 50 years. We have been there through the tough times of the regional recessions of the 1980's and 1990's and of course through this recent national housing crisis. We will continue to work closely with borrowers, servicers and others to help people stay in their homes. Finally, we stand ready to play a critical role in the future of housing finance by safely and soundly enabling first-time and lower income families purchase homes.

Chart 1
Piggybacks Versus Insured Loans

- **Genworth compared performance of Insured loans with combined loan to value ratios above 80% (High CLTV) to High CLTV Piggyback loans (uninsured 1st liens with simultaneous 2nd liens)**
  - **CoreLogic Servicing Database**
  - **Origination years 2004 – 2007**
  - **Total # Loans = 4.5 million (0.9mm Piggyback; 3.6mm Insured)**
  - **Performance data for each normalized to the FICO & LTV distribution of the total population**
  - **Compared Percentage of Non-Performing Piggyback loans to Non-Performing Insured Loans by Origination Year, FICO group, CLTV and Geography**

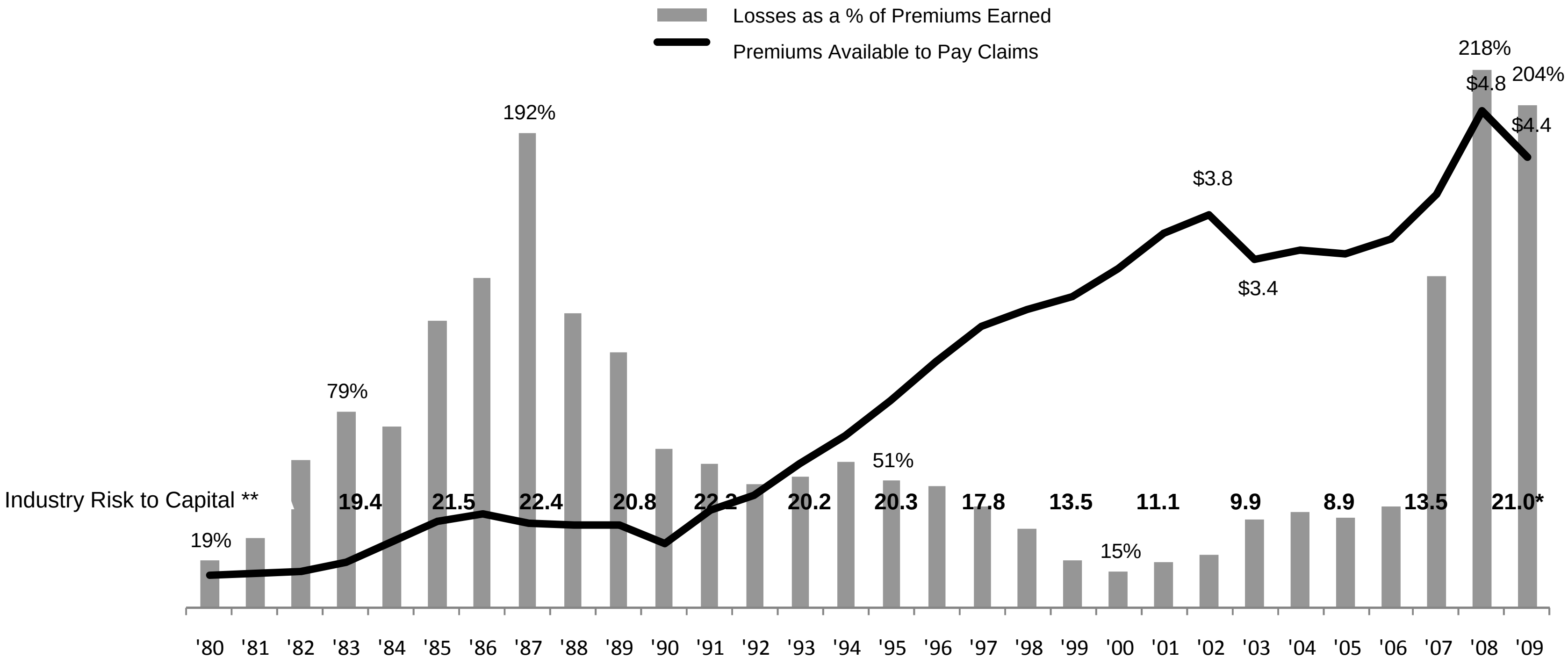




Insured Loans Perform ~60% Better Than Comparable Piggyback Loans

Chart 2

MIs Build Capital in Good Times to Pay Claims in Bad Times



Source: MICA Reports & Statutory Filings

- **Mortgage insurance is priced for long-term cycles.**
- **New business in recovery phase rebuilds capital base and replenishes contingency reserves.**

*2009 Includes new entrant capital (Essent Guarantee)

**Dollar Amount of Industry Net Risk on Insured Mortgages Divided By Industry Regulatory Capital