NATIONAL COMMUNITY REINVESTMENT COALITION

NCRC

Testimony

Testimony of
John Taylor, President and CEO

On behalf of the
National Community Reinvestment Coalition

On the topic of
**"The Future of Housing Finance:
The Role of Private Mortgage Insurance"**

Submitted to the
**United States House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets, Insurance,
and Government-Sponsored Enterprises**

Thursday, July 29, 2010

National Community Reinvestment Coalition

727 15th Street, N.W.
Suite 900
Washington, D.C. 20005
www.ncrc.org

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

John Taylor
President & Chief Executive Officer
National Community Reinvestment Coalition
Testimony before the House Financial Services Committee
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
"The Future Of Housing Finance: The Role Of Private Mortgage Insurance"

Introduction

Good afternoon Chairman Kanjorski, Ranking Minority Member Garrett, and other distinguished Members of the Committee. My name is John Taylor, President and CEO of the National Community Reinvestment Coalition (NCRC). On behalf of our coalition, I am honored to speak with you today concerning the about the future of housing finance and the role of private mortgage insurance (MI).

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

NCRC was formed in 1990 by national, regional, and local organizations joined together by a common mission: to increase the flow of private capital into traditionally underserved communities, in a manner consistent with safety and soundness concerns. In light of the current economic crisis, this mission has become even more critical as America's working families continue to struggle with lingering unemployment, volatile home values, and an unhealthy freeze of credit, all of which drastically limit opportunities for growth in their communities.

I would like to congratulate the Committee for its prompt action on the recently enacted Dodd-Frank Regulatory Reform Bill and for your insight in creating the much needed Consumer Financial Protection Bureau. However, more work needs to be done to restore access to credit for America's working families and small businesses. From expanding the Community Reinvestment Act (CRA) to promoting the role of proven and effective tools such as private MI, we can help restore the dream of homeownership, trust in the financial system, and stem the tide of foreclosures.

Private MI serves a vital function in today's housing market and is a classic example of a private sector innovation that helps expand access to homeownership in a safe and sound manner. When attached to responsibly underwritten loans, such as those covered by the Community Reinvestment Act, private MI can help leverage CRA's success to help underserved minority and low- and moderate-income communities realize the American Dream of homeownership. It is an effective private sector product that expands access to credit for many borrowers.

Private MI can and should play a critical role in resuscitating the market and ensuring access to responsible credit. It can be helpful to first time homebuyers, consumers seeking to refinance out of a non-traditional loan, and even consumers who are facing foreclosure and have had no or limited success with their mortgage servicer under the Home Affordable Mortgage Program (HAMP) or the Home Affordable Refinance Program (HARP) as administered by Fannie Mae and Freddie Mac.

The "Great Recession" & Its Impact

In the words of Nobel Prize-winning economist Joseph Stiglitz, the financial system discovered there was money at the bottom of the wealth pyramid and it did everything it could to ensure that it did not remain there. Stated in plainer language, the business model for many financial institutions was to strip consumers of their wealth rather than build and improve their financial security. This "greed and malfeasance," to quote Federal Reserve Chairman Greenspan, spread to every aspect of the mortgage marketplace - from non-prime to non-traditional lending – and created the foreclosure tsunami that is sweeping the nation and destabilizing tax bases in cities and states nationwide.

Ironically, most solutions to date have focused on rewarding the financial firms (and their executives) that created this crisis. In spite of more than $23 trillion of financial support in the form of loans, investment, and guarantees, provided to the financial system, this approach has not worked because consumers continue to struggle in a virtual sea of mortgage debt, and we continue to see a financial system that is unaccountable and unreceptive to the credit needs of the American public and business.

More than two years of voluntary mortgage modification programs have demonstrated that they will not work, no matter how skilled and thoughtful the legislation and program design. Financial institutions are not responding sufficiently to make a significant impact. The result is continued wealth destruction for the American public.

Now is the time to shift the focus away from Wall Street and onto Main Street by addressing, in a broader manner, the growing foreclosure crisis and its contagion effects on national home prices and the overall economy.

When the mortgage finance and the housing market collapsed two years ago, lenders reacted by tightening standards to the point of strangling credit opportunities. Out of necessity, the federal government stepped forward as one of the few institutions willing to extend credit in order to keep our financial system afloat. This, along with other critical government actions, helped bring our economy back from brink of total collapse.

To add to the challenges facing working class Americans, the racial wealth gap (between white and non-white households) has more than quadrupled between 1984 and 2007, according to new research from Brandeis University's Institute on Assets and Social Policy.[1] Other research has revealed that:

[1] See http://iasp.brandeis.edu/pdfs/Racial-Wealth-Gap-Brief.pdf

- While the national poverty rate is now 13.2 percent, nearly a quarter of African-Americans and Hispanics live in poverty.[2]

- As many as one-third of all African-American households, and more than 40 percent of Latino households, are at risk of falling out of the middle class and into poverty.[3]

- According to the U.S. Census Bureau, by the end of 2009, the overall U.S. homeownership rate was 67.2 percent.[4] While the homeownership rate for whites was 74.5 percent, African-Americans and Latinos experience homeownership rates of 46 percent and 48.4 percent, respectively.[5]

- During the economic crisis, from 2006 to 2009, homeownership decreased overall by 1.7 percent. However, whites experienced a decrease in homeownership of only 1.5 percent, while African-Americans saw a decrease of 2.6 percent.

- Over 25 percent of mortgage holders reside in homes where the amount owed on the mortgage is now greater the value of the property.[6] Billions of dollars of equity has been lost.

However, there is hope. Today, we are beginning to see the first tentative steps by the private sector to reenter the market. This new opportunity is due to the intervention of the GSE's and FHA, and brings with it increased opportunities for consumers to obtain credit.

In my testimony, I hope to shed further light on how private mortgage insurance (MI) can help refuel our economy by expanding safe and sound opportunities for homeownership in low- and moderate-income communities.

Specifically, I will respond to the questions put before me including: 1) The role and importance of private MI; 2) The effect of private MI on loan modifications; 3) The need for additional consumer protections; and 4), Alternatives to the current payment structure. In addition, this testimony includes practical recommendations for ensuring improved access and affordability to private MI while protecting consumers from potential abuse.

---

[2] http://www.washingtontimes.com/news/2009/sep/10/census-40m-us-now-live-poverty/
[3] http://www.faireconomy.org/files/pdf/state_of_dream_2009.pdf
[4] http://www.census.gov/hhes/www/housing/hvs/qtr409/files/q409press.pdf
[5] http://www.census.gov/hhes/www/housing/hvs/qtr409/files/q409press.pdf
[6] http://www.nytimes.com/2010/01/10/magazine/10FOB-wwln-t.html

I. The Role of Private Mortgage Insurance

Expanding Access to Homeownership

Private mortgage insurance (MI) is extra insurance that lenders require from most homebuyers who obtain loans that are more than 80 percent of the home's value. In other words, buyers with less than a 20 percent down payment are normally required to purchase private MI in order to obtain the mortgage loan.

While private MI primarily protects lenders from losses associated with mortgage defaults, private MI does enable greater access to homeownership. With private MI, responsible consumers who are able to pay their mortgage payments on time can buy a home without having to wait years to accumulate a 20 percent down payment. Private MI therefore ensures access to traditionally underserved populations that may not have large saving accounts, but nevertheless have a strong record of paying their mortgage on time.

By joining private MI with "qualified" mortgages, as defined under the recent Financial Reform legislation, Fannie Mae, Freddie Mac, and other lenders, can effectively jump start access to credit and private sector secondary market liquidity in order to promote homeownership in a manner consistent with safety and soundness. Just as the Community Reinvestment Act has leveraged substantial amounts of loans and investments in low- and moderate-income communities, and has had a broader impact on the overall economy through job creation, affordable housing, and small business development, the growth of private MI can also help reinvigorate our economy.

In addition, the use of private MI serves as alternative to the widespread use of "toxic" or abusive products, including "piggyback" loans or Home Equity Lines of Credit (HELOC) that combine teaser rates with "no doc" or "Pay Option ARM" lending. These loans, often securitized by Wall Street, were not sustainable and have devastated millions of homeowners who are facing foreclosure, destabilizing the communities that they live in.

For these reasons, NCRC has long championed making private MI tax deductible, and encourages Congress to make this tax benefit permanent.

Restoring Balance to Housing Finance

Private MI expands access to homeownership e while reducing over-reliance on government-insured FHA loans or Fannie Mae and Freddie Mac underwriting. This is incredibly important in light of the heavy shift toward government lending in the aftermath of the current economic crisis. For example, the FHA has taken on increasing importance since the subprime mortgage crisis hit: it not only has continued its primary mission of providing mortgage financing for underserved constituencies, but is also issuing low down-payment loans for other Americans who would have had access to private lending in the past.[7] Overall, the FHA along with Fannie

[7] http://money.cnn.com/2010/07/16/real_estate/tighter_FHA_requirements/

Mae and Freddie Mac now account for nearly all the mortgage lending activity in the nation today.[8]

As the Honorable David Stevens, Assistant Secretary of Housing and Urban Development and Federal Housing Administration Commissioner stated in his testimony before the Senate Appropriations Subcommittee on Transportation, Housing and Urban Development, and related agencies in May of this year, "the increased presence of FHA and others in the housing market, including Fannie Mae and Freddie Mac, has helped support liquidity in the purchase market, helping us ride through these difficult times until private capital returns to its natural levels." While these government or government-sponsored institutions are serving their critically needed counter-cyclical role, by temporarily providing necessary liquidity at times when private sector lending is frozen, nearly all experts agree that a robust private sector must return to the lending space.

The reemergence of private MI in the marketplace, therefore, bodes well for our economic recovery by protecting investors and taxpayers alike from unnecessary risk or exposure to loss. In addition, it signals a reinvigoration of private sector lending and credit opportunities. And now that the federal government has successfully brought our financial system back from the brink of disaster, the private sector must be encouraged to reenter the market and to return balance to our economic system. It is in this way that private MI can serve as a means to jumpstart our economy.

Supporting and expanding the use of responsible private sector lending, therefore, is necessary for a robust and vibrant system of housing finance. Reliance on government-funded housing solutions alone is too risky: we have witnessed in the past that commitment to government-funded housing solutions has waxed and waned with different administrations. Therefore, if government agencies were to become the primary vehicle for housing finance, the opportunities for minority and working-class Americans to participate fully in the market will be too exposed to political whims. A financially inclusive society and economy simply cannot prevail without meaningful participation of the private financial sector.

In addition, the government should not become the lender of only resort for consumers, as a matter of equity and efficiency. Even with the most generous funding, government resources will not be sufficient to meet the capital and credit needs of underserved communities. Therefore, the role and responsibility of the private financial services sector to address the mortgage needs of all classes of creditworthy Americans cannot be understated.

II. Private Mortgage Insurance and Loan Modifications

In March 2010, NCRC testified before the House Financial Services Committee regarding the impact of the Administration's foreclosure prevention program, Making Home Affordable, which includes both the Home Affordable Modification Program (HAMP) the Home Affordable Refinance Program (HARP) and made suggestions for improvements. At that time, NCRC

[8] http://money.cnn.com/2010/07/16/real_estate/tighter_FHA_requirements/

expressed deep concern and frustration that despite the Home Affordable Modification Program's (HAMP) goal of assisting 3 to 4 million homeowners, only 170,000 trial modifications had become permanent.

While a considerable improvement over the previous administration's programs, the Obama Administration's programs are still not keeping pace with foreclosures. More than one year after its inception, the HAMP program has converted only 390,000 trial modifications into permanent modifications.

One reason that there are too few permanent modifications is that homeowners are placed in trial modifications that are still unsustainable. It is in this way that private MI is currently underutilized.

Because their own capital is at risk, private mortgage insurance companies have strong 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.

Private MI uniquely aligned with both the interests of the borrower and the investor, and therefore can help to ensure better quality mortgages. Because private mortgage insurance companies must review underwriters for the credit and collateral risks, private mortgage insurance companies effectively act as a second set of eyes. Ideally, a private mortgage insurance company would be weary to extend insurance to a loan that, because of its terms and conditions, is unsustainable. This is true regardless of whether the insurance is obtained at origination, refinance, or modification.

Therefore, private mortgage insurance companies can play in ensuring the sustainability of individual mortgages. This role could protect both borrowers and investors and help to ensure that the loan is sustainable, not only at the time of purchase, but throughout years of homeownership.

Private MI can also play a critical role with the Home Affordable Refinance Program. By coupling principal reduction with private MI, the Administration can ensure that homeowners are finally placed in mortgages that are sustainable.

Finally, NCRC lauds private mortgage insurance companies for their efforts in a variety of different foreclosure prevention programs. Private mortgage insurance companies report that from 2008 to 2009 mortgage insurers have completed over 290,000 workouts representing $56 billion in loans.

III. Ensuring Basic Consumer Protections

State and Federal Regulation

The current economic crisis has proven that the failure to implement consumer protections undermines the soundness of the financial system. Today, regulation of the private MI industry largely occurs on the state level. However, in light of the financial crisis and the recent establishment of the Consumer Financial Protection Bureau, NCRC believes that the federal government should play a larger role in ensuring basic consumer protections for financial products.

As such, NCRC supports federal regulation of private MI. However any federal regulation of this product must fall under the purview of the newly-established Consumer Financial Protection Bureau.

While federal regulations will ensure a basic standard of consumer protections are afforded to all consumers, states must be permitted to provide additional protections as needed.

Data Enhancement

Currently, the Federal Financial Institutions Examination Council (FFIEC) prepares national aggregate data reports on private MI activity from data submitted by the Private Mortgage Insurance Companies of America. On a voluntary basis, eight private mortgage insurance companies provide data on the disposition of applications for MI, using some of the same categories of information as those established for lenders under the Home Mortgage Disclosure Act (HMDA).

NCRC applauds these eight private mortgage insurance companies for their efforts to provide the public with such critical data. Private mortgage insurance companies voluntarily maintain excellence performance data which could, and should, be used in the future by more financial institutions in order to restore trust in our broken financial system.

The importance of transparency in lending practices cannot be over-estimated. Over the years, community organizations and concerned citizens have made used HMDA data to help determine which banks are lending in their communities and to find new opportunities for collaboration. The importance of data disclosure is just as important for private mortgage insurance lending because private MI often allows responsible homebuyers to more readily realize the American Dream.

However, a number of improvements to the FFIEC's data disclosure are needed to ensure that private mortgage insurance companies are lending to minority and low-income communities in a non-discriminatory manner. Congress should enhance data requirements by making such disclosure mandatory and expanding disclosure requirements to include geographic data and data on the cost of premiums and the amount of losses incurred by the private mortgage insurance company.

In preparation for this hearing, NCRC conducted an initial analysis of data voluntarily submitted by private mortgage insurance companies to the FFIEC in 2008.[9] Our initial analysis of such data indicates that African-Americans and Hispanic consumers, across all income levels, are

[9] http://www.ffiec.gov/hmdaadwebreport/nataggwelcome_mica.aspx

experiencing higher denial rates than their white counterparts (See Table 1). In order to determine whether this denial disparity is due to discrimination or to more benign reasons, more data must be available on losses incurred by private mortgage insurance companies. While there may be reasonable business justifications that explain this disparity, the findings require further investigation and additional disclosure, which should be modeled on the Home Mortgage Disclosure Act.

With regular and comprehensive disclosure, the public will be able to rigorously scrutinize fairness in lending practices, adding a measure of transparency and accountability. This has become incredibly important in light of the failures of the financial system which led to our current economic crisis.

Table 1: Private Mortgage Insurance for Conventional Home Loans by Race and Income

Race and Income	Denial Rate	Disparity Ratio
Low-income white (non-Hispanic)	7.36%	1
Low-income African-American	9.06%	1.23
Low-income Hispanic	13.03%	1.77
Moderate-income white (non-Hispanic)	6.17%	1
Moderate-income African-American	8.37%	1.36
Moderate-income Hispanic	10.14%	1.64
Mid-income white (non-Hispanic)	5.91%	1
Mid-income African-American	9.22%	1.56
Mid-income Hispanic	9.29%	1.57
Upper-income white (non-Hispanic)	6.87%	1
Upper-income African-American	9.99%	1.46
Upper-income Hispanic	9.55%	1.39

**Low-Income is defined as less than 50% of MSA/MD median income levels. Moderate-Income is 50-79% of MSA/MD median income levels. Mid-Income is 80-119% of MSA/MD median income levels. Upper-income is greater than 119% of MSA/MD median income levels.

Affordability and Accessibility

In order to fulfill its crucial role in providing responsible consumers the opportunity to become homeowners, private MI must affordable. Access to homeownership, particularly by responsible consumers in low- and moderate-income communities, depends directly on the affordability of this product.

However, NCRC has voiced concern in the past about private MI being too expensive and leaving many consumers with only Federal Housing Administration lending as an alternative. This concern still remains and more must be done to ensure that private MI is within the reach of millions of Americans.

As such, reasonable pricing standards should be developed by the Consumer Financial Protection Bureau to ensure that premiums are more accessible to consumers. Private MI typically costs between 0.5 percent to 1 percent of the entire loan amount on an annual basis, however some private mortgage insurance companies represent that their fees average between 0.5 percent to 0.75 percent.[10] On a $100,000 loan this means the homeowner could be paying as much as $1,000 a year, assuming a 1 percent private MI fee. For a home priced at $250,000, families will spend more than $200 a month on the insurance.

Most importantly, however, private mortgage insurance companies must fully disclose costs to consumers. Without full disclosure, consumers are at serious disadvantage because they may not understand what they are paying for and are therefore unable to make sound financial decisions.

It is important to note, however, that private mortgage insurance companies have been largely able to resist the temptation to follow the GSE's decision to add an adverse market fee of 25 basis points to all loans. NCRC has grave concerns that this fee will limit access to credit for many consumers and may disproportionately impact protected classes under federal Fair Housing Act.

In addition, sometimes there can be some problems when a homeowner attempts to cancel PMI. Usually when a homeowner's equity builds to 20 percent, he or she is no longer required to have private MI. However, consumers are often unaware of the fact that they are no longer required to have private MI, and others often experience delays in cancellation. Many lenders require the homeowner to draft a letter requesting that the private MI be canceled, as well as receive a formal appraisal of the home prior to its cancellation. All in all, this could take several months, depending upon the lender.

The appraisal methods used by many private mortgage insurance companies, including the use of automated valuation models (AVMs), also raise serious concerns about accuracy. In 2005 NCRC established the Center for Responsible Appraisal and Valuation (CRAV) to represent the interests of those responsible market players committed to independent and fair valuation practices along with regulators, legislators, and the public.[11] At the time of formation, the appraisal industry was under enormous pressure from the lending community to provide improper and unlawful appraisals and valuations.[12] Recognizing the threat inaccurate and inflated property valuations posed to the safety and soundness of the residential real estate market and our financial system, CRAV and NCRC warned that without swift action to ensure independence and accuracy in the valuation market, the effects would be disastrous.[13]

[10] http://www.investopedia.com/articles/pf/07/avoid_pmi.asp
[11] http://www.ncrc.org/index.php?option=com_content&view=article&id=37:center-for-responsible-appraisals-and-valuations-crav&catid=87:responsible-appraisals
[12] http://money.cnn.com/2005/05/23/real_estate/financing/appraisalfraud/index.htm
[13] See NCRC's report, *Predatory Appraisals: Stealing the American Dream*, June 2005

The troubling effects CRAV and NCRC had foreseen and warned against are now widely understood. Artificially inflated housing prices contributed to the growth and collapse of the housing bubble, bringing our entire financial system to the brink of disaster and imposing the greatest economic crisis on American families since the Great Depression.

Today, the excessive reliance on automated valuation models (AVMs) in place of independent appraisals should sound alarms. The purpose of an appraisal, first and foremost, must be to provide homeowners and investors with a true reflection of the property's market value. NCRC and CRAV firmly believe that independent appraisers are critical to ensuring that homeowners and investors have accurate information about the value of their home in order to make good financial decisions. However, by replacing the professional appraiser with automatic valuation models (AVMs), private mortgage insurance companies are often leaving homeowners and investors with inaccurate data.

IV. Alternatives to the Current Payment Structure

NCRC was asked to discuss whether an alternative to the current payment model for private MI should be explored and specifically, whether lenders should pay the premiums for this insurance. Because private MI primarily protects lenders from losses associated with mortgage defaults, new payment models, in which lenders pay for private MI premiums or in which the cost of premiums are shared between lender and homebuyer, should be explored.

However, any payment structure must guard against the risk that lenders will merely pass the cost of such premiums onto the consumer, or that lenders refuse to cancel the insurance policy once the homeowner has reached the 80 percent loan-to-value ratio, which was created for the benefit of the consumer.

Other new and innovative products, including a product recently developed by Home Value Protection, can also augment private MI, to the benefit of consumers. This product protects the homeowner, not the lender, from swings in home values. It also has the benefit of incentivizing homeowners to not walk away from the property as soon as home values drop; it prevents the domino effect documented in this economic crisis, in which neighborhoods are destroyed by cascading foreclosures, short sales, and walk-aways.

V. Conclusion

In conclusion, private MI can help refuel our economy by expanding safe and sound opportunities for homeownership in low- and moderate-income communities. When attached to responsibly underwritten loans, such as those covered by the Community Reinvestment Act, private MI can help leverage CRA's success to help underserved minority and low- and moderate-income communities realize the American Dream of homeownership. It is an effective private sector product that expands access to credit for many borrowers.

In addition, private MI should be upheld as a signal of a reinvigoration of private sector lending and credit opportunities. After having successfully brought our financial system back from the brink of disaster, the government must do more to encourage the private sector to reenter the market and to return balance to our financial system.

Private MI is also currently underutilized by the Making Home Affordable programs. Private MI is uniquely aligned with both the interests of the borrower and the investor, and therefore can help to ensure better quality mortgages. Because private mortgage insurance companies must review underwriters for the credit and collateral risks, private mortgage insurance companies effectively act as a second set of eyes. Ideally, a private mortgage insurance company would be weary to extend insurance to a loan that, because of its terms and conditions, is unsustainable.

However, a number of practical recommendations are necessary to ensure improved access and affordability, while also protecting consumers from potential abuse. NCRC strongly believes that any federal regulation of this product must fall under the purview of the newly-established Consumer Financial Protection Bureau. While federal regulations will ensure a basic standard of consumer protections are afforded to all consumers, states must be permitted to provide additional protections as needed.

Specifically, Congress should enhance data requirements by making such disclosure mandatory and expanding disclosure requirements to include data on the cost of premiums and the amount of losses incurred by the private mortgage insurance company. Without such information, we cannot know with certainly whether disparities in denial rates are due to discrimination.

In addition, reasonable pricing standards should be developed by the Consumer Financial Protection Bureau to ensure that premiums are more accessible to consumers, costs must be fully disclosed to consumers, and cancellations of such insurance should minimize delays. The appraisal methods, including use of automated valuation models (AVMs), used by many private mortgage insurance companies to determine whether the 80 percent loan-to-value threshold has been met, also raise serious concerns about accuracy.

Finally, alternative payment structures should be explored. However, any payment structure must guard against the risk that lenders will merely pass the cost of such premiums onto the consumer, or that lenders refuse to cancel the insurance policy once the homeowner has reached the 80 percent loan-to-value ratio, which was created for the benefit of the consumer.