September 8, 2014

The Honorable Mel Watt
Director, Federal Housing Finance Agency
4000 7th Street SW, Ninth Floor
Washington, DC 20024

*Re: Private Mortgage Insurer Eligibility Requirements-Request for Input*

Dear Director Watt:

Thank you for the opportunity to submit input regarding the Federal Housing Finance Agency's (FHFA) proposal concerning Private Mortgage Insurer Eligibility Requirements ("PMIERs").

The Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses, and nonprofits and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Chicago.

The input submitted below addresses FHFA's request for input on the proposed PMIERs. We focus our comments on the proposed financial requirements (specifically the available and minimum required assets outlined in section 704) which impose a floor of 5.6% and outline higher requirements for loans with specific characteristics. We appreciate the need for increased requirements for Mortgage Insurance ("MI") companies that protect the GSEs, and ultimately taxpayers, against risk. CRL applauds and thanks FHFA for its recognition of its need to protect the taxpayer from risk and ensure that those from lower wealth communities have access to the market. However, we are deeply concerned that the current proposal would result in costs passed on to lower wealth borrowers that would put place unnecessary restrictions on qualified borrowers with lower FICO scores and modest resources for a down payment. *Coupled with the pending proposal to increase guarantee fees ("g-fees"), we are very concerned about a doubling of fees on lower wealth borrowers by both raising MI requirements and g-fee increases.*

FHFA's authorizing statute, the Housing and Economic Recovery Act of 2008 ("HERA"), requires a duty to ensure that underserved communities have access to credit, which is not congruent with the impact of modifying PMIERs as proposed. Our recommendations include:

- Modify the model to accommodate recent regulatory changes, including those that address CFPB's Qualified Mortgage ("QM") Standards and Captive Reinsurance;

- Reassess risk models to more accurately anticipate reasonable risk given market changes, and account for the likelihood there are particular loans in any portfolio will perform and provide relief for seasoned loans; and
- Reject proposals for deeper MI coverage.

We also concur with several proposals submitted by the Center for American Progress, including their recommendation to increase the transparency of proposed models and coordinate the MI financial requirements with g-fee increases.

## I. CRL urges the FHFA not to propose requirements on MI eligibility that will unnecessarily increase costs for moderate and lower income borrowers with low FICO scores or low down payment needs.

As CRL and others have noted, the obligation of the GSEs to serve the entire market and ensure that low- and moderate-income families have access to responsible forms of mortgage credit is a critical part of the GSEs' mission.[1] We appreciate the steps Director Watt and the FHFA have already taken to acknowledge and accomplish this mission. FHFA and the GSEs have an explicit duty to broadly increase liquidity in the mortgage market and ensure that borrowers from traditionally underserved and/or excluded communities will have access to the mortgage market.[2] In addition to HERA, a series of federal laws, regulations and executive orders form a strong regulatory framework aimed at ensuring non-discrimination in the housing and mortgage markets. These include the Fair Housing Act,[3] the Equal Credit Opportunity Act,[4] the federal charters of Fannie Mae and Freddie Mac[5], the Federal Housing Enterprises Financial Safety and Soundness Act and its implementing regulations, and several Executive Orders. Further, where federal funding is involved, whether in the form of loans, insurance or - as in the case at hand -

[1] Stated in a coalition letter to the Senate Banking Committee, *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/2014-Civil-Rights-Groups-Comments-to-Senate-Banking-Comm-on-Housing-Finance-Reform-Bill-Feb-24.pdf

[2] Housing and Economic Recovery Act of 2008, P. Law 110-289, Section 1229(a)(1)
" Duty to Serve Underserved Markets-
(1) Duty.—To increase the liquidity of mortgage investments and improve the distribution of investment capital available for mortgage financing for underserved markets, each enterprise shall provide leadership to the market in developing loan products and flexible underwriting guidelines to facilitate a secondary market for mortgages for very low-, low-, and moderate-income families….."

[3] 42 U.S.C. 3608(d). The Fair Housing Act makes it clear that all federal agencies that have programs or activities that relate to housing and community development have an affirmative obligation to promote fair housing.

[4] 15 U.S.C. Sec. 1691 et seq. which prohibits discrimination in any credit transaction based on, among other things, race, color, religion, national origin, sex or marital status, age (provided the applicant has the capacity to contract

[5] See Sec. 301(n)(2)(G) of the Fannie Mae charter and Sec. 307((f)(2)(G) of the Freddie Mac charter. According to their charters, the GSEs are also required to "assess underwriting standards, business practices, repurchase requirements, pricing, fees, and procedures, that affect the purchase of mortgages for low- and moderate-income families, or that may yield disparate results based on the race of the borrower, including revisions thereto to promote affordable housing or fair lending."

guarantees, any federal agency administering such funds has an obligation to take affirmative steps to further fair housing. This framework underscores the priority that Congress has placed upon fair access to housing, including mortgage lending. Taken together, these provisions clearly articulate the policy of the United States to ensure that the housing market, including the system for financing housing, operates in a manner that treats people fairly, regardless of their race, gender, national origin or other protected status.

Communities in underserved markets, including rural communities, African-American, Latino, and lower wealth households have been deeply harmed by irresponsible lending in the last decade. In the lead up to the economic and housing crisis, racial minorities were more likely than similarly situated whites to receive mortgages with toxic features, even when also eligible for safer loans.[6] Households from underserved communities suffered massive loss of generational wealth due to reckless and irresponsible lending and the resulting housing crisis. Policymakers responded by putting in place new rules that prevented high-cost, poorly underwritten mortgages from being made in the future, and removed incentives that led lenders to target people of color and low-wealth families for predatory mortgages. However, they have not been able to undo the damage from past loans.

Currently, borrowers from underserved communities, including moderate and lower wealth borrowers, prospective first time homeowners, many millennials, and borrowers of color, still face significant barriers to homeownership.[7] While we understand the need for reevaluating MI requirements, CRL is concerned that by raising MI capital requirements, those individuals in the 80+ LTV categories (who are required to purchase MI) will incur significant and unnecessary increased costs or not be served by private MI companies. Given that moderate and lower wealth communities, many first time homebuyers, and communities of color are more likely to need private mortgage insurance, we are especially concerned that these groups, who cannot afford additional cost burdens, will not have access to the housing market if they cannot afford rising costs associated with acquiring a loan for a mortgage. Unnecessary fee increases like this will result in increased and unnecessary barriers to homeownership for these communities. Further, we are deeply concerned that the proposals around g-fees and MI eligibility taken

[6] For example, African-American and Latino borrowers with FICO scores above 660 were three times as likely to have a higher interest rate mortgage as white borrowers in the same credit range. In addition, based upon 2012 Home Mortgage Disclosure Act ("HMDA") data, only 25% of purchased loans to African Americans and 33% of purchased loans to Latinos were conventional loans, compared to 58% of non-Hispanic Whites. In addition, of the 1.14 million conventional purchase loans, only 2.6% went to African-Americans and 6.0% to Latinos *available at* http://www.federalreserve.gov/pubs/bulletin/2013/pdf/2012_HMDA.pdf

[7] JOINT CENTER FOR HOUSING STUDIES OF HARVARD UNIVERSITY, THE STATE OF THE NATION'S HOUSING 2014, *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/sonhr14-color-full.pdf (Hereinafter "Harvard Study.") According to the recently released State of the Nation's Housing 2014, the average guarantee fee increased from 22 basis points in 2009 to 38 basis points by 2012 and this did not include broad-based utilization of LLPAs, additional upfront fees based on a borrower's credit score, loan-to-value ("LTV"), and other risk factors that could add as much as 325 upfront basis points for moderate income and lower wealth borrowers.

together put affordable conventional mortgages out of reach for many families, forcing borrowers to bear the full and unwarranted costs associated with of prior market failures. Given reports that the majority of first-time home buyers will increasingly be home buyers of color[8], it is important that these current and emerging groups of prospective borrowers have access to participate in the housing market.

## II. Recommendations for Modifying Proposed PMIERs

We recognize that the intent of the PMIERs proposal is to protect the GSEs against losses similar to those faced in the past crisis and to protect the investment of taxpayers in the ongoing GSEs obligations. Access to credit and risk management, however, are not necessarily mutually exclusive goals. Further, low-wealth borrowers and communities of color should not bear the full and unwarranted cost of this risk when better market safeguards could have prevented prior losses and new reforms are already playing this important role in improving the mortgage market. FHFA has the ability to succeed in its obligation to the taxpayers/mitigate risk and perform its duty to underserved communities.

- *Modify the model to accommodate recent regulatory changes, including those that address CFPB's QM Standards and Captive Reinsurance.*

The Consumer Financial Protection Bureau (the "CFPB") recent implementation of the QM rule similarly set much higher and safer standards for lending, and places great quality control on the types of loans that GSEs may insure. Given that the rule incorporates a well-defined Ability-to-Repay standard, the concern of borrowers taking on loans they will not be able to pay is already inherently addressed in the mortgage market. Our research has shown that these rules will significantly improve mortgage performance for low-wealth borrowers. For example, while recognizing the higher FICO score bracket of the performance of QM-like loans, a Self-Help study found that default rates were vastly lower after the toxic loans were eliminated from the market and loans similar to or more stringent than QM loans were the primary types of loans used.[9]

The reforms of The Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),[10] the creation of the CFPB, and the placement of Fannie Mae and Freddie Mac into conservatorship at the (then) newly created FHFA have since all but abolished the above

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[8] Id.
[9] CENTER FOR COMMUNITY CAPITAL, BALANCING RISK AND ACCESS, UNDERWRITING STANDARDS AND QUALIFIED RESIDENTIAL MORTGAGES 15 *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/Underwriting-Standards-for-Qualified-Residential-Mortgages.pdf. This paper is an analysis of the Self-Help Community Advantage Program.
[10] Pub.L. 111–203

mentioned toxic loans that caused the housing meltdown and economic crisis in the first place. Even if FHFA has eliminated the toxic loans that created the 2008 housing crisis from its future modeling, we still find it inappropriate to model future stress tests after a time period (2007-2008) so greatly impacted by these now defunct loans. Toxic loans such as subprime, Alt-A, "low-doc," and "no-doc" loans dominated the market, along with reckless and poor underwriting. Even though these loans are no longer in the marketplace, their impact resonated with the larger economy. For instance, while Self-Help's mortgages did well, they were still substantially harmed by the sharp decline in housing prices and broader economic recession triggered by the bad mortgages. Mortgage lenders across the country suffered substantial losses even with well performing mortgages, because the plunge in home values and the loss of jobs triggered by the collapse of bad mortgages negatively impacted borrowers across the board. System wide changes, such as more detailed reporting and compilation of mortgage data, tighter regulation of all mortgage lenders, prohibitions against steering or payments to steer borrowers to riskier loans, the creation of new systemic requirements, and broad recognition of the importance for the whole economy of ensuring a safe mortgage finance system inherently address and correct weaknesses or flaws that lead to default. Any forward looking stress test or modeling should thoroughly and completely take into account that the likelihood of a massive loan default analogous to the most recent housing crisis is reduced given the implementation of the regulatory reforms described above.

In addition, Section 709 of the proposed PMIERs rightly requires that approved insurers may not enter into any new lender captive reinsurance contract or cede additional risk to existing arrangements, and must seek written approval from the GSE for changes to existing arrangements. Captive reinsurance was a revenue sharing device that undermined the financial stability of the MIs industry. These revenue sharing devices diverted large parts of the premiums, leaving MI companies with far less capital than there should have been otherwise. The CFPB and the Department of Housing and Urban Development ("HUD") have eliminated revenue sharing devices, of which captive reinsurance has been the leading device. For example, the CFPB has brought six enforcement actions regarding captive reinsurance. [11] Five of these actions have resulted in prohibiting the private mortgage insurer from entering captive reinsurance agreements for a period of ten years, one is still in administrative proceedings.[12] Given the strong suggestion that captive reinsurance agreements with affiliates of mortgage

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[11] Several of these actions were initiated by the Department of Housing and Urban Development, who had jurisdiction under the Real Estate Settlement Procedures Act and then transferred to the CFPB under the Dodd Frank Act in 2011.

[12] See *CFPB Takes Action Against Mortgage Insurers to End Kickbacks to Lenders* (April 4, 2013), *available at* http://www.consumerfinance.gov/newsroom/the-cfpb-takes-action-against-mortgage-insurers-to-end-kickbacks-to-lenders; (November 15, 2013), *available at* http://www.consumerfinance.gov/newsroom/the-cfpb-takes-action-against-mortgage-insurer-to-end-illegal-kickbacks-to-lenders/; and *CFPB Takes Action Against PHH Corporation for Mortgage Insurance Kickbacks* (January 29, 2014), *available at* http://www.consumerfinance.gov/newsroom/cfpb-takes-action-against-phh-corporation-for-mortgage-insurance-kickbacks.

lenders violate the Real Estate Settlement Procedures' Act ("RESPA") prohibition against illegal kickbacks, the risk that such agreements also weaken the capital stability of the private MI companies is also greatly reduced. We strongly urge the FHFA to factor this significant policy reform into its model in setting eligibility requirements.

- *Reassess risk models to more accurately anticipate reasonable risk given market changes, account for the likelihood that particular loans in any portfolio will perform and provide relief for seasoned loans*

The proposed PMIERs lay out a risk-based approach to setting capital requirements for MI portfolios. Unfortunately, the assumptions and inputs to the model were not made available. The likely impact of these requirements will be higher premium prices for consumers, in particular for lower FICO borrowers with high LTV loans.

Recent analysis by Moody's estimates the effect of the new financial requirements.[13] The increases are estimated to be as much as 70 basis points for borrowers with a FICO of 650 and a 95% LTV loan. These unnecessary increases will make private mortgage insurance more expensive relative to FHA's pricing pushing more of these borrowers out of the conventional market.

Table 1: Estimated effect of proposed financial requirements on MI premiums and comparison with FHA pricing.

| Change in MI Premium with delinquency adjustments (bps) | | | Conventional or FHA mortgage? based on estimated costs | |
|---|---|---|---|---|
| | **90% LTV** | **95% LTV** | **90% LTV** | **95% LTV** |
| 650 | 48 | 70 | FHA | FHA |
| 700 | 17 | 28 | Tie | FHA |
| 750 | 2 | 9 | Conventional | Conventional |
| 800 | -7 | -5 | Conventional | Conventional |

Source: Zandi, Parrot, and DeRitis (2014)

The justification for such pricing is the risk modeling referenced in the PMIERs. We question the reasonableness of these models and urge FHFA to revise the models in the following ways:

- Provide more transparency about the models and the assumptions underlying the stress cases.

[13] Mark Zandi, Jim Parrott, and Christian DeRitis, *Putting Mortgage Insurers on Solid Ground* (Moody's Analytics: 2014), *available at* http://www.urban.org/UploadedPDF/413213-Putting-Mortgage-Insurers-on-Solid-Ground.pdf

- Reassess the risk factors by FICO and LTV in light of more reasonable stress scenario given recent regulations that reduce risk in the mortgage market.
- Incorporate anticipated premiums as a source for funding losses.
- Relax risk-factors as loans age.

First, while analysts can speculate on the stress case models, FHFA provides only the results of the risk modeling not a description of or information about the main assumptions driving the model's results. Given the scale of the possible impact of the model's results, more information should be shared publically and the public given an opportunity to assess and question the modeling assumptions.

Second, the results of the model strongly suggest that the FHFA has chosen a catastrophic stress scenario, similar to the historic experience of 2007 mortgages. However, as discussed in the previous section, the likelihood and scale of a housing crisis are much reduced given recent regulations that safeguard the mortgage market. In particular the QM and Ability to Repay provisions in Dodd-Frank have eliminated the most toxic mortgages from the marketplace. Risk projections should not include loans that would not meet this current standard and should account for the fact that a mortgage market without these loans harbors much less overall risk.

Third, much as banks can rely on retained earnings in addition to their reserves to fund predicted losses, MI companies should be able to consider existing premium earnings as assets towards capital requirements. Even in a catastrophic stress scenario there are some loans that will continue to pay premiums and these funds will be available in addition to assets set aside to cover losses. As discussed in the Moody's paper, there are ways to structure including premium income to reasonably account for the funds the companies will have on hand in a crisis and ensure they are not overly reliant on this source in a crisis.[14]

Finally, the risk factors outlined in the proposed PMIERs do not account for the natural decrease in risk loans present as they age. The risk factors are based only on origination information and year of origination. However, the risk that a performing loan poses declines as the loan ages. The model should take this into account and offer a mechanism for by which  minimum required asset amount also declines as a performing portfolio ages.

- *Reject proposals for requiring deep private mortgage insurance*

While not specifically proposed in its request for input, we strongly encourage the FHFA to maintain PMIERs at charter level requirements. We believe the GSEs are already well-protected from losses given the proposal that it has put forward, with the modifications we recommend, and are far better suited to cover risks. The GSEs are in a better position because the GSEs are involved in deeper national markets, have more diversity, and are in a better position to pool and

[14] Id.

absorb risk. The GSEs also have greater transparency, better data, and are less subject to the pressure of lenders than MI companies have been as evidenced by now illegal revenue sharing devices. For these reasons, FHFA should not encourage or give credit for the MI companies taking on greater risk, as this is less effective to meet FHFA's goals and it undercuts the FHFA's efforts to make sure that the MIs are reliable guarantors for the charter risk they cover. Additional mortgage insurance beyond the charter level is even more expensive for borrowers and is likely to eliminate more borrowers from the mortgage market who could otherwise qualify and repay.

Finally, as noted in the introduction, we also concur with several proposals submitted by the Center for American Progress, including the need to increase the transparency of the risk models used by the FHFA so that they can properly be examined. We also agree with their recommendation that Enterprise g-fee risk-based pricing grids be coordinated with PMIERs, especially in light of our overall concern about the high levels of both charges and their impact on lower wealth borrowers.

**Conclusion**

We thank FHFA once again for the opportunity to submit input on this very critical subject. We hope that FHFA will continue to work to keep MI and other fees associated with homeownership as low and manageable as possible for communities that it has a duty to reach.