STATEMENT OF ROHIT GUPTA BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
Hearing on the Essentials of a Functioning Housing Finance System for Consumers
October 29, 2013

Chairman Johnson and Ranking Member Crapo, my name is Rohit Gupta, President of Genworth Financial's U.S. Mortgage Insurance business in Raleigh, North Carolina. Genworth is one of seven private mortgage insurers active in the U.S. today. We operate in all 50 states, and are part of Genworth Financial, a global insurance company with established mortgage insurance platforms in the U.S., Canada, Australia and Europe. I am pleased to be here today to discuss the role of private mortgage insurance in ensuring consumer access to mortgage credit as part of housing finance reform. Private mortgage insurers' sole business is insuring lower down payment mortgages. We make sustainable home ownership possible for many first time homebuyers, homebuyers with moderate incomes and members of underserved communities.

Mortgage insurers enable home-ready borrowers to safely buy homes without having to take as long as a decade to save for a high down payment. As others testifying before you today will affirm, even a ten percent down payment requirement would have the effect of making home ownership impossible for many creditworthy, responsible borrowers. That is not to say that the amount of a down payment has no effect on the way a loan is expected to perform. When lower down payment loans default, the risk of loss to the lender or investor is greater. However, that is precisely where mortgage insurance comes into play. Our role is to mitigate that loss, and to make homeownership attainable on terms that are affordable over the life of the loan. A majority of our business is insuring 30-year, fixed rate mortgages – mortgages that are central to the functioning of a stable housing finance system (including a strong TBA market). We do this with a product that is understood and widely used in the market, available across cycles and affordably priced. We have decades of experience – and data – focused on understanding and managing mortgage risk. Our independent credit underwriting criteria helps to bring greater risk discipline to the mortgage market via the MIs' "second set of eyes." If a loan is not sustainable, the capital of a mortgage insurance firm is at risk because it must pay a claim – that is a strong incentive to maintain risk and price discipline.

Congress and regulators have taken important steps toward ensuring that residential mortgages will be safe and sustainable. Dodd Frank's QM and QRM provisions were designed to make sure that one of the key lessons of the housing crisis – risky mortgages make for bad housing policy – would be embedded in our housing finance system going forward. The final QM rule published by the CFPB represents a significant milestone, and we, along with other members of the Coalition for Sensible Housing Policy, are pleased that the rule discourages risky products and encourages sound credit underwriting and access to credit. When properly underwritten and with appropriate loan level credit enhancement, QMs (and likely, QRMs, assuming that the final rule aligns QRM with QM) are the types of mortgages that our system should always encourage.

In this testimony, I will discuss (i) the current affordability and availability of credit for single family homes, (ii) the impact housing finance proposals will have on affordability and the cost of mortgage finance for consumers, including the role that private mortgage insurance can play in ensuring affordability and access for consumers, and (iii) whether underwriting criteria should be established in statute. In addition, I will provide background on the role of MI and the fundamentals of the mortgage insurance business model, including an update on the state of the industry following the housing crisis.

Mortgage Credit Today

Today, as a result of historically low home prices and interest rates, we are still at record levels of affordability in the U.S.[1] And yet, many borrowers who are "home ready" are finding it hard to get a mortgage.[2] For others, the costs are prohibitively high or their only affordable option is an FHA loan – which puts even more housing risk on the government's balance sheet. Mortgage credit remains overly tight, and certain investor fees are adding significant costs for borrowers. Some of this is because lenders remain concerned about buy back demands from investors. Many mortgage market participants are struggling to understand and implement an unprecedented amount of new regulation. In addition, GSE loan level fees remain very high, and guarantee fees are being increased as part of their Conservator's strategy to deemphasize their role in housing finance. These fees add to borrower costs. Another factor is GSE credit policy, such as the decision to stop purchasing loans with LTVs above 95%, even when backed by private MI.

For housing to continue to recover, we must do more to incent responsible mortgage financing. Genworth and others in our industry understand this and we are doing our part. Our credit policy guidelines are prudent but not prohibitive. Our underwriting takes into consideration a range of compensating factors to ensure that responsible borrowers can get affordable, sustainable mortgages. This is exactly the kind of underwriting that should be part of our housing finance system going forward. But the reality is that if investors refuse to purchase certain loans, then those loans will not get made, even if an MI is willing to insure them.

Lower Down Payment Lending and The Role of MI

[1] According to the National Association of Realtor's Home Affordability Index, home affordability for both first time and repeat home buyers remains well above historical averages.
[2] According to FHFA's Quarterly Performance Report of the Housing GSEs for the Second Quarter of 2013, Fannie Mae and Freddie Mac average LTVs are 68%, and average FICO scores are above 750 (excluding HARP loans). Available at http://www.fhfa.gov/webfiles/25515/2Q2013QuarterlyPerformanceReport091913.pdf.

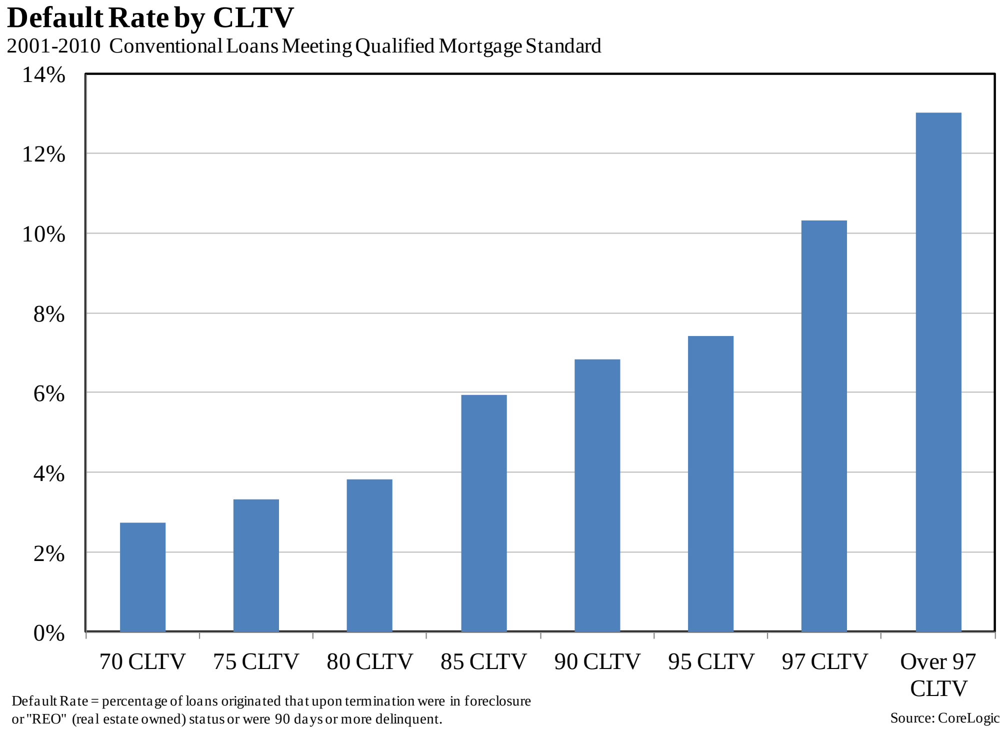
The biggest hurdle for most home-ready consumers considering buying a home is whether they will be able to get a mortgage they can afford without having to amass a prohibitively large down payment. For decades, our housing finance system has ensured that consumers have that access in large part by relying on private mortgage insurance to mitigate credit loss by assuming a first loss position in the event of a default. MI does this in a cost effective, consistent way that works seamlessly for originators, investors and servicers. Even during the worst of the housing crisis, Genworth and other MIs continued to insure new mortgages in all 50 states.

Because mortgage insurers are in the first loss position, our interests are aligned with those of borrowers, lenders and mortgage investors. Our business model relies on insuring mortgages that are well underwritten (which is why we rely on our own credit underwriting guidelines). We assume first risk of loss, so our business revolves around our ability to understand and manage credit risk. Our goal is to make sure that borrowers get mortgages that are affordable on day one and throughout their years of homeownership, including 30 year fixed rate mortgages that are central to our housing finance system.

Having access to lower down payment mortgages is especially important for first time homebuyers, moderate income homebuyers and members of underserved communities. For example, half of first time homebuyers with loans purchased by Fannie Mae and Freddie Mac made down payments of less than 20%, and over 90% of those first time homebuyers made down payments of less than 30%. Almost half of borrowers who received loans with private MI in 2012 had low-to-moderate incomes.[3]

As seen in the chart below, the data make it very clear that the amount of a down payment does matter when it comes to loan performance. Loans with higher combined loan to value ratios ("CLTVs") experience higher default rates than lower CLTV loans. But the data also make it very clear that there is a responsible way to offer high CLTV loans. The key is to make sure that they are prudently underwritten and have the benefit of credit loss mitigation (usually MI) in the event of default. This kind of lending is not new or exotic – in fact, it is how many of us in this room today first became home owners. Over the past fifteen years, nearly one quarter of the mortgage market has relied on loans with down payments of less than 20% -- representing over $8 trillion of mortgages that performed well across good and bad cycles. Lower down payment loans are especially important to ensuring that creditworthy first time homebuyers and underserved borrowers have access to home ownership.

[3] Fannie Freddie first time homebuyer data based on data published by Fannie Mae and Freddie Mac for GSE MBS issued between July 2012 and September 2013. MI data based on MICA industry data for 2012.



<u>Housing Finance Reform</u>

Historically, detailed underwriting criteria have been established through regulation, investor guidelines and market practice, and generally have not been set in statute. The unprecedented housing crisis has caused some policy makers to question this approach. Genworth believes that today, regulators have a much clearer legislative mandate that will help them guard against a repeat of the bad products and lax standards that led to the housing crisis. In addition, certain broad underwriting criteria that define the "outer edges" of loans with a government backstop could be written into statute (such as limiting the term of a mortgage, requiring a minimal down payment so that all borrowers have some "skin in the game", or including a limitation on very high debt to income ratios (DTIs)). We caution however, that an overly prescriptive approach could have the effect of unnecessarily limiting credit for responsible borrowers. Also, locking too many underwriting requirements into statute could make it cumbersome to make appropriate adjustments to underwriting over time; as a result, a clear grant of regulatory discretion to make such adjustments should be included with any hard-wired statutory requirements. Many proposals for housing finance reform contemplate requiring a "QM" or "QRM" standard for loans subject to government support. Genworth generally agrees with this approach, with the caveat that it will be important to have credit enhancement such as private MI assuming first loss on lower down payment loans in order to ensure that the likelihood of calling upon any government support is truly remote.

In the current system, the GSE charters require credit enhancement for loans with a down payment of less than 20%, and private mortgage insurance is the means most often used to meet this requirement. To satisfy the charter, the MI coverage must be sufficient to reduce remaining exposure to a maximum of 80%. This minimum coverage option is known as "*charter coverage*" because it is set at levels that satisfy the legal charter requirement.

However, while charter coverage is legally sufficient, it does not afford any additional economic protection against loss from default, and is not commonly used in the market today. Instead, the GSEs and their regulator require greater coverage (generally referred to as *Standard Coverage*) in amounts that vary based on LTVs, but that are always greater than minimal coverage mandated in the GSE charters.[4] Standard coverage provides significant protection even in the event of housing market downturns. During the housing crisis, home prices in many markets declined more than 30% from the market peak. If there had only been "charter coverage" on most loans, there would have been far less private capital in a first loss position, and far less economic protection for federal tax payers (and Fannie and Freddie).

MI at standard coverage is the prevailing form of credit enhancement in the market today. Standard coverage MI is relied upon by large and small lenders, by national banks, community banks and by credit unions. And it enables consumers to get affordable lower down payment mortgages.

Genworth strongly supports S. 1217's (the Housing Reform and Taxpayer Protection Act of 2013) inclusion of standard coverage MI. Private mortgage insurance at standard coverage levels can and should be an important part of a reformed housing finance system because it will ensure that there is meaningful private capital ahead of any government exposure. At standard coverage levels, an investor's loss exposure for a 90% LTV loan goes down to 67%. That means that, if that loan defaults, an investor is better off with that 90% LTV MI loan than it would be on an 80% LTV loan without MI. Private MI promotes market stability, especially when compared to other forms of credit enhancement that can be subject to volatile pricing and rapid market retreats. And private MI has minimal impact on consumer economics.

As this Committee continues to work on housing finance reform, we urge you to consider the role the USMI industry can play not only through standard coverage loan level MI, but also by providing credit enhancement at the MBS level, whether in connection with S.1217's bond guarantor provisions or other similar approaches. Sound housing finance policy should encourage reliance on well capitalized entities on a level playing field. Borrowers, investors, lenders and taxpayers will all benefit when the right kinds of credit protection play a meaningful role in the new system.

MI Regulation

Private mortgage insurers are subject to extensive state insurance regulation specifically tailored to the nature of the risk insured – long-duration (our insurance remains in place until

[4] The GSEs charge significant Loan Level Price Adjustments in those limited instances when only shallow charter level mortgage insurance is obtained. .

loans amortize down to specified levels), long-cycle (housing market performance generally performs in ten-year cycles) mortgage credit risk. State laws impose loan-level capital and reserve requirements that are held long term. In addition, MI providers are subject to strict limits on investments and limitations on dividend payments, and to provisions designed to address potential operational risk. Many states have adopted a version of the National Association of Insurance Commissioners ("NAIC") Model Mortgage Guaranty Insurance Act (the "Model Act"), which, in addition to imposing strong financial controls, requires that mortgage insurers only engage in the business of mortgage insurance, and imposes limitations on risk concentrations. The NAIC is in the process of updating the Model Act, including reconsideration of existing capital and reserving requirements.

State Departments of Insurance have significant power of oversight. They perform regular, detailed examinations of mortgage insurers, and monitor and enforce insurers' compliance with financial standards. In addition, FHFA and the GSEs undertake regular assessments to determine which mortgage insurers are eligible to provide MI for the mortgages the GSEs purchase or guarantee with LTVs above 80%. Accordingly, they provide additional oversight of a mortgage insurer's operational risk capacity, credit underwriting standards and claims paying ability. Other federally regulated financial institutions also evaluate the financial condition and operational expertise of insurers that provide MI for their loans.

There are two primary regulatory capital requirements for mortgage insurers. First, a mortgage insurer must maintain sufficient capital such that its risk to capital ratio (ratio of risk-in-force to statutory capital (which consists of its policyholders' surplus and contingency reserve)) cannot exceed 25:1 or it may not write any new business absent the consent of the applicable state insurance regulator. Second, in addition to the normal provision for losses,[5] mortgage insurers are required under insurance statutory accounting principles to post contingency reserves, which are funded with 50% of net earned premiums over a period of ten years. The contingency reserve is an additional countercyclical reserve established for the protection of policyholders against the effect of adverse economic cycles.

The risk to capital ratio is one of many tools state insurance regulators use to evaluate MI providers. The comprehensive nature of state regulatory oversight enables regulators to retain the flexibility to exercise appropriate discretion regarding the ongoing operations of insurers subject to their jurisdiction. In recent years, several states have used that discretion to issue revocable, limited duration waivers of the 25:1 cap on the risk to capital ratio. Those decisions were made based on extensive actuarial analysis conducted under the supervision of the state of domicile to assess our ongoing solvency. States still retain the ability to deem an MI provider to be in "hazardous financial condition." A finding of hazardous financial condition could lead to the revocation of an MI provider's license to insure new business. State Departments of Insurance, including North Carolina, Genworth's state of domicile, actively monitor MI providers' operations and financial condition.

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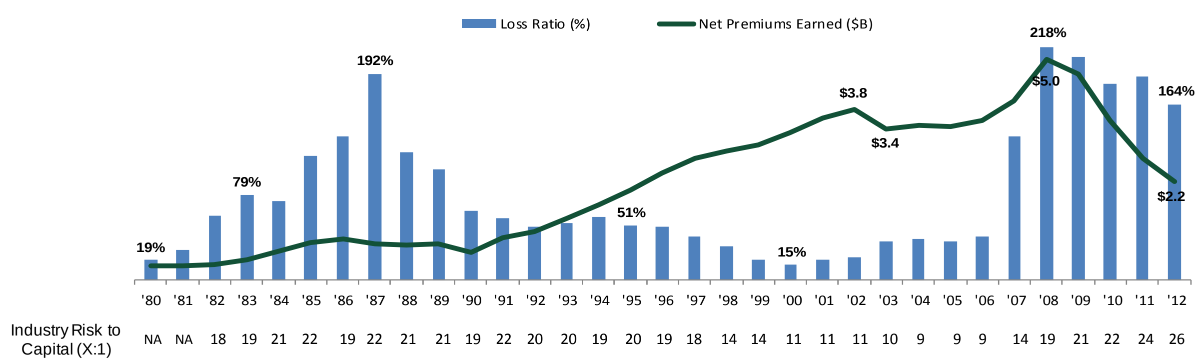
[5] MIs are required to provision for (i) case basis reserves for loans that are currently delinquent and reported as such by the lender or loan servicer and (ii) incurred but not reported loss reserves (for loans that are currently delinquent but not yet reported as such).

These countercyclical capital and reserve requirements mean that the MI industry holds significant capital against each loan insured throughout the time a loan is outstanding, and should have the resources necessary to pay claims. In this regard, MI is significantly different from other types of investment and credit enhancement. One of the lessons learned from the housing crisis is that housing markets are not well served by capital markets instruments and other credit enhancement structures that encourage short-term investment without adequate regulatory oversight and capital and reserve requirements. MI represents material amounts of private capital and reserves in a first-loss position that are committed for the long term.

The MI Model and Experience Across Cycles

Mortgage insurance premium income, capital and reserve requirements combine to provide countercyclical protections against housing downturns. As illustrated in the graph below, during times of market stress (for example, the "Oil Patch" in the mid 1980s), mortgage insurers experience high levels of losses and their risk to capital ratios rise accordingly. As markets stabilize, higher earned premiums and lower claims paid typically enable the industry to replenish its capital base. This countercyclical model was severely tested by 2008's unprecedented crisis, and, as expected, risk to capital ratios rose in the face of unprecedented losses. In recent years, housing markets have begun to recover, loan performance has improved, and revisions to mortgage insurance guidelines and pricing have taken effect. Those factors, together with recent capital raises, have resulted in improved risk to capital ratios. Today, the mortgage insurance industry is well positioned, with the capital to pay claims and to write new business.

Countercyclical Capital Model



*Loss Ratio & Net Premiums earned for years 2005-2007 confirmed with MICA 2009/2010 fact book, 2008-2010 updated with 2011/2012 MICA fact book, updated 2011 & 2012 MICA 4 Report. Industry RTC obtained from MICA fact book or company estimate.

Private mortgage insurers (unlike the FHA) do not insure against 100% of loss. Typically, mortgage insurance provides first-loss coverage of approximately 25 - 30% of the unpaid loan balance (plus certain additional expenses) of a defaulted loan. By assuming a first-loss position, private mortgage insurance dramatically offsets losses arising from a borrower default. By design, however, the product does not completely eliminate the risk of loss. Private mortgage insurance is designed to be "skin in the game" that offers real economic benefit to lenders and investors while still incenting them to carefully underwrite mortgage loans and holding them accountable for fraud, misrepresentation and lack of compliance in the origination process.

When a loan goes to foreclosure, the private mortgage insurer is responsible for paying a claim. As a result, mortgage insurers have a clear financial incentive to work to keep borrowers in their homes. This directly aligns the interest of the mortgage insurer with the best interest of the borrower, and the MI industry has developed expertise in loss mitigation that is evidenced by its decades-long track record of actively working to keep borrowers in their homes. From 2008 through the second quarter of 2013, the industry facilitated loan workouts with approximately 660,000 borrowers on mortgage loans with an aggregate principal balance of approximately $130 billion.[6] Genworth has invested significantly in resources, tools and technology focused on keeping borrowers in their homes. We have workout specialists who work directly with borrowers and servicers to facilitate the best outcomes for homeowners at risk of foreclosure, and use programs that include borrower outreach as well as programs targeted to borrowers at risk of imminent default and borrowers who have received loan modifications and are at risk of re-default. From 2008 through the second quarter of 2013, Genworth has helped over 130,000 homeowners avoid foreclosure, facilitating nearly 105,000 home retention workouts and nearly 30,000 short sales and deeds-in-lieu of foreclosure.

<u>Mortgage insurers pay claims pursuant to the terms of their master policies</u>

Mortgage insurers paid approximately $40 billion in claims from 2007 to 2012, $35 billion of which was paid on loans purchased or guaranteed by Fannie Mae and Freddie Mac. In the first half of 2013, MIs paid an additional $4 billion in claims to the GSEs. From 2007 through the second quarter of 2013, Genworth paid approximately $5.4 billion in claims on nearly 120,000 defaulted mortgage loans.

It has always been Genworth's practice to pay claims in full when a loan was properly originated, underwritten, and serviced. We rescind coverage (and refund premiums paid) on loans that do not qualify for insurance; typically rescissions occur following review of a loan when it becomes seriously delinquent. The extraordinary circumstances that led to the collapse of the housing market, and the unprecedented levels of mortgage market fraud and misrepresentation in the years leading up to that collapse, increased the incidences of rescissions. Genworth, along with other MIs, has taken significant steps in recent years to clarify our claims paying practices, providing greater clarity and transparency for lenders and investors.

[6] Based on Mortgage Insurance Companies of America (MICA) member company data.

MI claims paying policy going forward

Notwithstanding the extraordinary experience of the housing crisis, the MI industry has attracted over $8.9 billion in new capital since 2008, including capital raised by two new entrants, both of which have filed registration statements with the SEC for initial public offerings. The recent capital inflows to the industry are indicative of investor confidence in the business model and its regulatory construct.

Conclusion

Genworth commends the hard work of the Senate Banking Committee to tackle one of the most complex and emotionally charged issues that legislators have faced in many years. We believe that keeping the interests of home buying consumers and taxpayers in the forefront of deliberations will help us all arrive at a plan for a sustainable and fair housing finance system. We applaud the ten Senators on this Committee who have crafted and supported S.1217. The provisions regarding private MI thoughtfully incorporate a prevailing market standard that is well known and easy to execute for consumers, lenders and investors. Importantly, this approach does not introduce any new costs for consumers, while at the same time it helps distance future losses from the federal government backstop. We at Genworth and other USMI companies appreciate the work of this Committee, and look forward to continuing to engage with you as your important work continues.