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September 8, 2014

The Honorable Melvin L. Watt
Director
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20024

Dear Director Watt:

I am writing on behalf of the over one million members of the National Association of REALTORS® (NAR) to respond to the Request for Input on the draft Private Mortgage Insurer Eligibility Requirements (PMIERs) for companies that insure mortgage loans owned or guaranteed by Fannie Mae or Freddie Mac (the Government Sponsored Enterprises, or GSEs). Since private mortgage insurance is often required for borrowers with down payments less than 20 percent[1], the proposed requirements are important to our members and our organization.

NAR is America's largest trade association, including our eight affiliated Institutes, Societies and Councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,400 local associations or boards, and 54 state and territory associations of REALTORS®.

NAR supports strong capital requirements for the mortgage insurance industry and agrees with the goals behind the proposed eligibility requirements. The recent financial crisis illustrates the need for a strong capital backstop for mortgage insurers that provide the GSEs protection against losses, particularly in adverse market conditions. NAR commends FHFA for the comprehensive approach, and agrees with many of the guidelines contained in the draft eligibility requirements. Proper risk management practices are needed to ensure mortgage insurance companies have the ability to pay claims, particularly in periods of market stress.

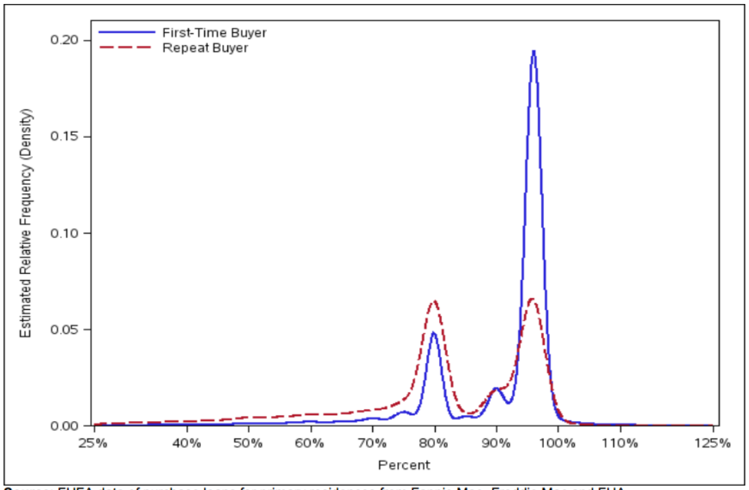
FHFA Should Ensure Limited Impact on Creditworthy Borrowers

While it is important to certify that the insurers guaranteeing coverage on loans are well capitalized, FHFA must also consider how the proposed requirements will affect the availability of sustainable, and affordable, mortgage credit to the broadest possible segment of responsible borrowers.

NAR is concerned about the potential impact the required mortgage insurer asset calculations will have on first time homebuyers and other traditionally underserved borrowers. First time homebuyers typically have smaller down payments than other borrowers [Exhibit 1], while also having lower credit scores [Exhibit 2], often due to credit reports that do not reflect their history of payments toward housing expenses. Under the proposed requirements, these two factors could lead to considerable increases in the cost of required mortgage insurance coverage, over and above investor credit protection borrowers pay for in the form of guarantee fees (g-fees) and upfront loan level pricing adjustment fees (LLPAs) paid directly to the GSEs. If FHFA were to raise or maintain ongoing g-fees, while simultaneously adopting private mortgage insurance eligibility requirements that raise the cost of private mortgage insurance, these families would likely experience a significant increase in fees and mortgage rates.

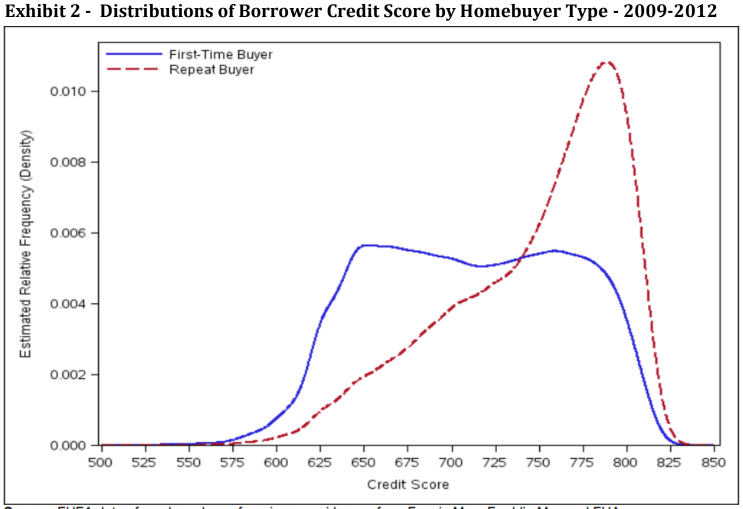
[1] 12 U.S.C. 1454(a); 12 U.S.C. 1717(b).

Exhibit 1 - Distributions of Loan-to-Value Ratio by Homebuyer Type - 2009-2012



Source: FHFA data of purchase loans for primary residences from Fannie Mae, Freddie Mac and FHA.

Exhibit 2 - Distributions of Borrower Credit Score by Homebuyer Type - 2009-2012



Source: FHFA data of purchase loans for primary residences from Fannie Mae, Freddie Mac and FHA.

Private Capital Requires Substantial Return on Equity

As companies that provide private capital to the mortgage market, mortgage insurers must sustain a high level of return on capital to meet investor demand and expectations. NAR supports the presence of private capital in the mortgage market, but is cautious about the potential implications that the PMIERs will have on mortgage insurance rates assuming mortgage insurers maintain their historical before-tax return on capital of nearly 24 percent.[2] In order to maintain this level of return, the PMIERs proposal will leave private mortgage insurers with either a decision to raise rates to homebuyers who have a down payment less than 20 percent, or alternatively, accept a lower return on capital to maintain a competitive pricing advantage. In periods of market stress, both equity and debt investors in mortgage insurance companies will demand higher levels of return, seemingly coinciding with higher liquidity requirements for the companies. These factors will exacerbate cyclicality and upward pressure on mortgage insurance pricing. FHFA should monitor the market impact of the PMIERs on mortgage insurance companies should private investors continue to expect the companies to achieve substantial return on equity. Our expectation is that this will lead to higher mortgage insurance rates at times when continued liquidity is most needed. NAR will also continue to study market dynamics on required capital levels, return on equity, and the impact on monthly mortgage payments.

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[2] http://www.urban.org/UploadedPDF/413213-Putting-Mortgage-Insurers-on-Solid-Ground.pdf The authors cite a historical after-tax ROE 15%. Accounting for a 37% tax rate results in a 23.8% pre-tax ROE.

Regulatory Changes Limits Bubbles Based On Unsustainable Lending

PMIERs were designed to limit GSE exposure to losses during market downturns, such as the severe stress the economy experienced in the last financial crisis. However, it is important that the shifting regulatory landscape of mortgage finance be considered in conjunction with required asset calculation guidelines in the PMIERs draft. NAR has analyzed, commented, and continues to monitor the impact of changes in the mortgage finance arena since the implementation of the regulations required by the Dodd-Frank Wall Street Reform Act and other reforms. These new laws, regulations, and market adaptations will limit the type of housing market bubbles that are based on unsustainable lending, which significantly contributed to the most recent financial crisis. NAR fully supports credit models and market valuations based on economic fundamentals, not on the availability of credit to borrowers without verified documentation of their ability to repay or mortgage products that have predatory features and terms. The PMIERs asset and liquidity requirements should also be based on the performance of traditionally underwritten mortgage products and stress environments that reflect new reforms, not on economic and housing conditions that incorporate the performance and indirect impact of the very risky mortgages that led to dramatic swings in housing prices experienced over the last decade.

Conclusion

NAR appreciates the opportunity to respond to FHFA's Request for Input on the draft Private Mortgage Insurer Eligibility Requirements. The proposed requirements are an important aspect in ensuring that mortgage insurance companies have the operational and financial capacity to pay claims in periods of economic stress. Most importantly, NAR believes it is vital that FHFA fully analyze the likelihood of mortgage insurance premium increases for insured loans, paying particular attention to the impact on first time home buyers, minorities, and other underserved groups. Additionally, NAR suggests that FHFA monitor the market impact of the PMIERs on mortgage insurance companies should private investors continue to expect the companies to achieve substantial returns on equity. It is likely that mortgage insurance rates to borrowers with down payments of less than 20 percent will have to rise to meet this expected return on capital. Finally, a more prudent approach would be to base assumptions used to model the PMIERs capital and liquidity requirements on the economics of housing markets operating under a mortgage finance regulatory environment that will limit the extent of housing bubbles based on unsustainable lending.

If you have any questions or would like to meet to discuss these concerns, please feel free to contact Charlie Dawson, NAR's Senior Policy Representative for Financial Services, at 202.383.7522 or cdawson@realtors.org.

Sincerely,

Steve Brown
2014 President, National Association of REALTORS®