



The Value of Mortgage Insurance

Supporting sustainable homeownership
that strengthens communities

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I. Introduction	Private mortgage insurers —the housing market’s best defense against volatility.
II. History of the Mortgage Insurance Industry	For 50 years, private mortgage insurance has played an important role in the growth and stability of the American housing market.
III. The Mortgage Crisis	Mass-marketed loan products designed for a comparatively small group of borrowers and diversion from a time-tested lending model precipitated a crisis. Exotic loan products fueled the crisis by creating a false sense of affordability, resulting in spiraling demand and inflated home values.
IV. The MI Business Model	Private mortgage insurance is a well-regulated business sector with strong analytical and capital underpinnings. Even during these times of extreme economic stress, mortgage insurers are continuing to pay claims according to the terms of their policies.
V. The Value of Mortgage Insurance	Mortgage insurance plays a vital role in the smooth functioning of the mortgage finance system, benefiting both borrowers and investors.
VI. Preserving Homeownership	Mortgage insurer PMI is on the forefront of homeownership preservation initiatives, implementing programs to keep people in their homes and minimize loss.
VII. Mortgage Insurance Alternatives	Government-sponsored insurance programs FHA and VA are assuming a larger market share in today’s volatile market.
VIII. Conclusion	A housing market recovery is dependent on both public and private market participants to facilitate responsible and sustainable homeownership.

I. Introduction

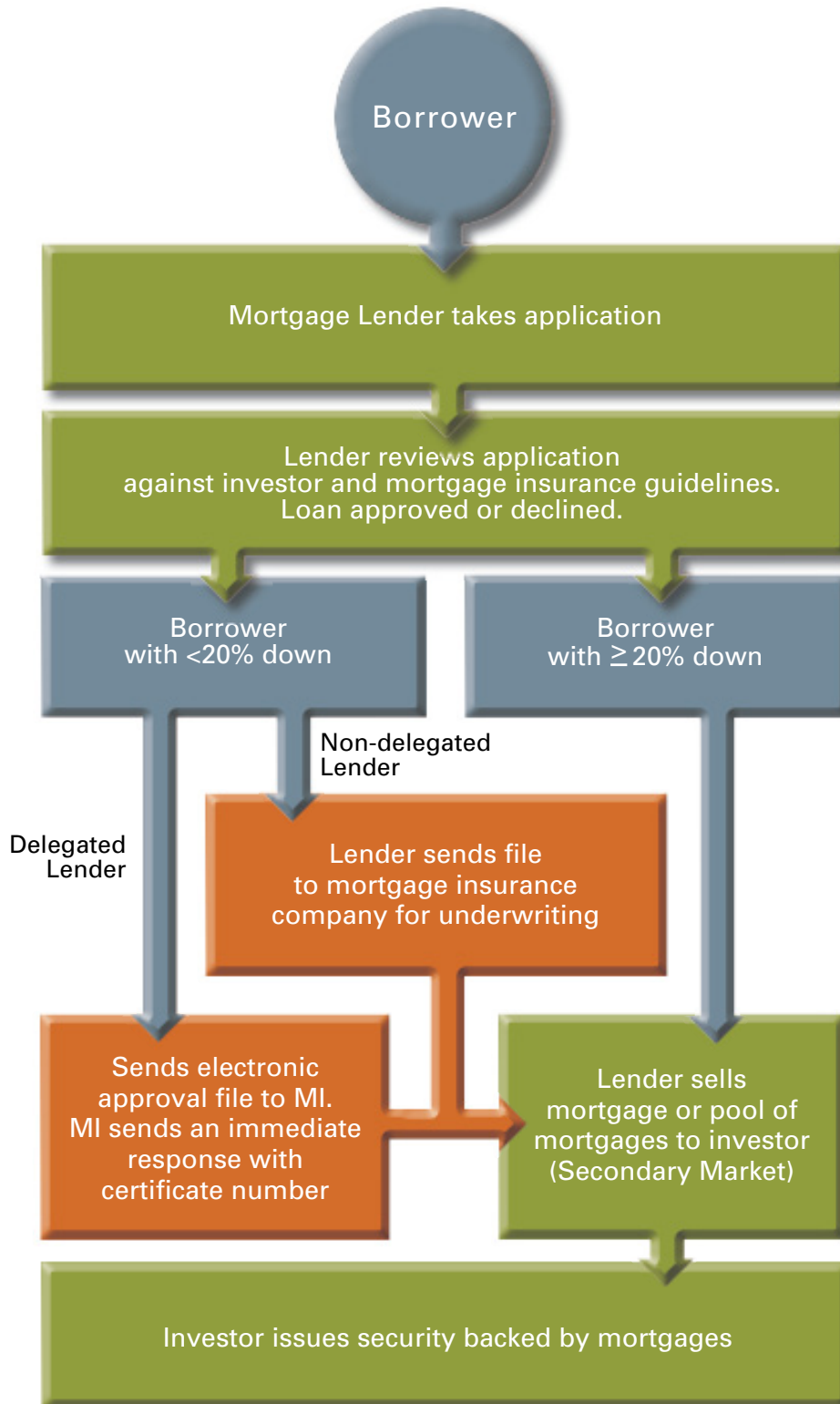
Mortgage insurance has played an important role in the mortgage finance system for nearly half a century. This little-known segment of the insurance industry provides vital support to the U.S. housing market, a critical component of the American economy. As a key support to lenders, borrowers and investors, mortgage insurance is often misunderstood relative to its role in managing mortgage risk and as a catalyst for sustainable homeownership.

The desire to create healthy, sustainable homeownership is at the heart of the values that drive the mortgage insurance industry. Mortgage insurers work closely with lenders and investors across the country to design loan products and underwriting guidelines with the goal of both helping borrowers achieve homeownership and supporting long-term success. A simplistic explanation of the mortgage insurance industry's value proposition is that it enables qualified borrowers to purchase homes with less than the traditional 20% down payment by sharing the mortgage risk with the lender. This gives lenders the confidence to make loans that otherwise would be viewed as high risk, and at the same time, helps creditworthy borrowers achieve homeownership earlier.

A few years ago, the mortgage industry moved away from traditional lending practices and mortgage insurance was often replaced by riskier products such as "piggyback" loans. The market expanded aggressively without the discipline that mortgage insurers traditionally applied. Now, the mortgage industry is the epicenter of the global economic meltdown. While the mortgage insurance industry has not escaped the impact of the financial crisis, it is doing exactly what it was designed to do - paying valid claims. Today, the mortgage insurance industry is absorbing billions of dollars in losses due to home foreclosures, losses that would otherwise flow through Fannie Mae, Freddie Mac, and other mortgage investors. These losses are being absorbed by private capital, not taxpayer funds. Unlike other private risk counterparties, the capital structure of mortgage insurers - required by state insurance regulation and rating agencies - provides the necessary reserves that have allowed mortgage insurers to continue paying claims during this most challenging of times.

Steve Smith, Chairman and CEO of PMI Mortgage Insurance Co., said, "Nobody called this one 100 percent right. Mortgage insurers are taking major losses and there is no guarantee that all of the players will be here when this crisis is over. But what I also know to be true is that a vibrant housing market depends on sustainable homeownership. Private mortgage insurers are the housing market's best defense against volatility because we're invested in - and we profit from - healthy, sustainable growth. It's in our best interest to make sure the borrower, the mortgage broker, the lender and the investor are successful."

Private MI's place in the origination process

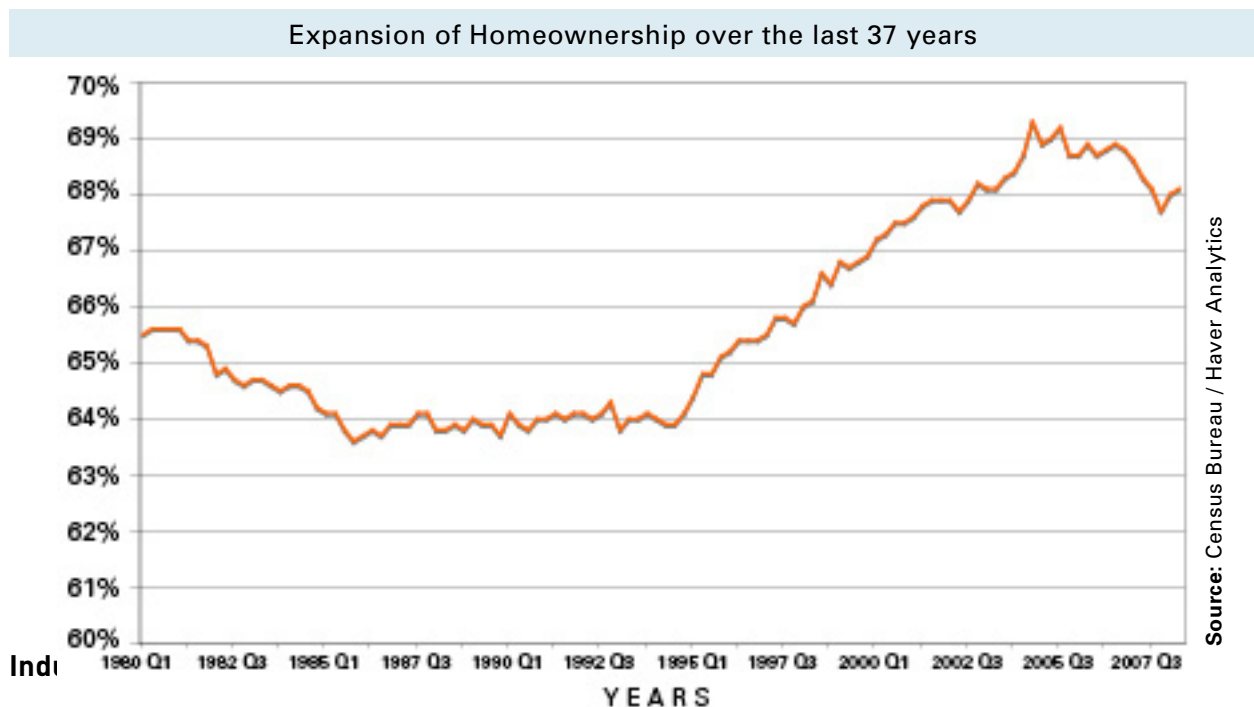


II. History of the Mortgage Insurance Industry

The Early Years of Mortgage Finance

Seeking to revive the housing industry during the Depression, the government created the Federal Housing Administration (FHA) to provide insurance on loans that guaranteed full repayment to lenders if borrowers defaulted. In 1938, the government created the Federal National Mortgage Association (Fannie Mae) to purchase mortgages from banks, freeing capital and allowing new loans to be made. After World War II, the government again acted, creating the Veterans Administration (VA) loan guaranty program for veterans.

By the 1950s, as homebuyers desired larger homes and prices escalated, lenders began looking for alternatives to FHA-insured loans. Lenders began increasingly turning to non-government insured mortgages (conventional mortgages), such as those purchased by Fannie Mae. Unlike FHA, conventional mortgages did not have ceilings on mortgage interest rates and they provided relatively larger loan amounts. However, these conventional mortgages required larger down payments, usually 20%, making it difficult for moderate-income families to buy homes. As a result, a demand for an alternative to FHA insurance was created. Fannie Mae's charter required that mortgages with high loan-to-value ratios (80% or greater) have some type of third-party credit enhancement, and private mortgage insurance became the most commonly utilized form. Private mortgage insurance filled a growing demand, helping to support a historic 30-year housing expansion.



For more than 50 years, mortgage insurers have followed stringent capital and reserve requirements, which is why they are able to continue paying valid claims without government support even in today's distressed mortgage finance market.

If a borrower cannot make a 20 percent down payment on a home, lenders often permit a smaller down payment with private mortgage insurance. The insurance protects the lender/investor from loss if the borrower defaults on the loan. Private mortgage insurance is issued to the lender/investor by a private company, and is typically paid monthly with the borrower's mortgage payment. The mortgage insurance provider takes what is known in the industry as "first loss" in the event of borrower default. In other words, the insurer is the first line of defense protecting investors against loss by covering a percentage of the loan amount.

The percentage the mortgage insurer covers depends on the amount of coverage purchased by the lender. Loans purchased by either Fannie Mae or the Federal Home Loan Mortgage Corporation (Freddie Mac) generally require 30% coverage if the borrower makes a 5% down payment, 25% coverage with 10% down and 12% coverage with 15% down. For example, if a borrower made a 5% down payment and ultimately defaulted on the mortgage, the mortgage insurer could pay a maximum claim in the amount of 30% of the loan amount, plus certain claimable expenses such as unpaid interest, legal and property preservation expenses. Since mortgage insurers do not cover the entire loan amount, there are incentives for the lender to adopt prudent lending practices. The amount covered by the mortgage insurer is considered the most likely, or "expected loss" amount.

Mortgage insurers operate under monoline licenses issued by state insurance departments that only permit them to write mortgage insurance policies covering the risk of borrower default on residential mortgage loans which exclude coverage for material fraud, negligent misrepresentation or negligence. Consequently, mortgage insurance does not cover the risk of loss arising from fraud. These exclusions for material fraud and negligence are another feature of the industry that encourages lenders to implement strong quality-control practices. The shared risk features of the mortgage insurance model can play an important role in discouraging fraudulent behavior by loan originators. Preventing fraud is important to restoring and maintaining the confidence of investors and, ultimately, the sustainability of the entire financial system.

III. The Mortgage Crisis

Recent Events

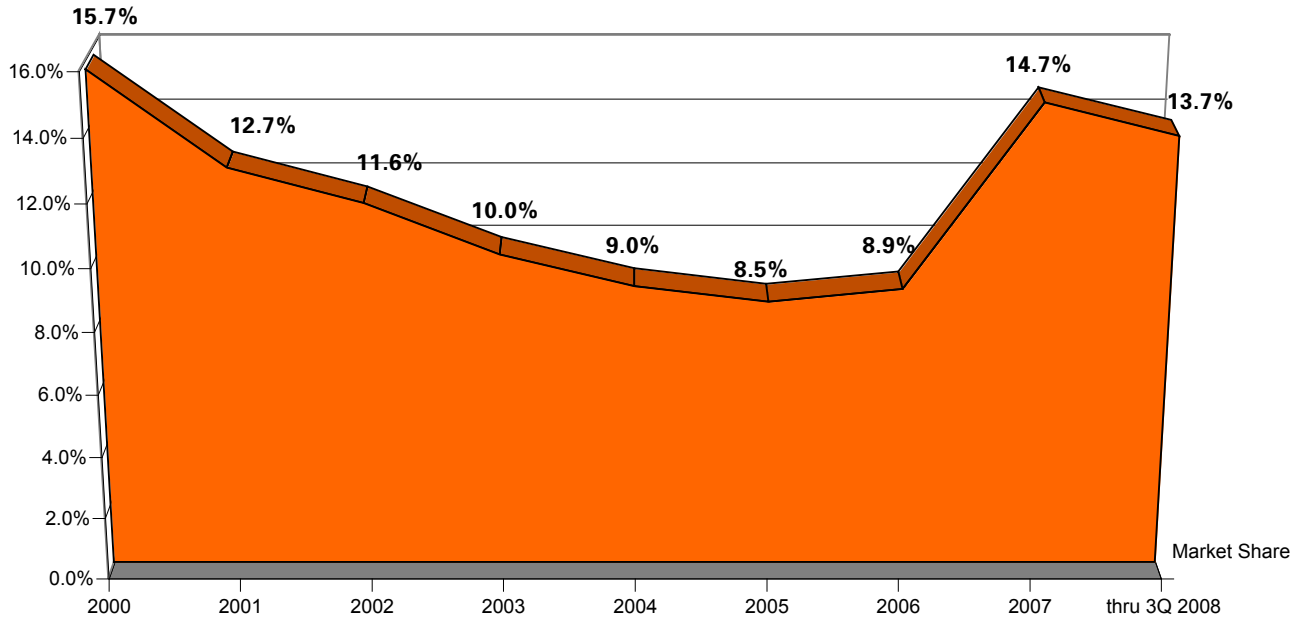
In 2003, mortgage originations reached a peak of \$3.9 trillion, with private mortgage insurance covering approximately 10 percent of new mortgages. Over the next three years, as loans such as “Alt-A” (limited documentation), “piggybacks” and subprime grew, private mortgage insurers’ market share fell.

The growth in these exotic loan products, and the associated drop in private mortgage insurance’s market share, was largely fueled by rapid growth in the Wall Street private securities markets. Newer, riskier products began to replace loans with private mortgage insurance primarily due to the ease with which these loans could be obtained and profitably sold in the secondary market. Knowledge@Wharton reported that in 2005, about 22 percent of new home mortgages were subprime, up from 8 percent in 2003. Packaging these loans into securities produced high returns for the Wall Street firms. Investors were hungry for the high yields these securities produced, while the perception of their risk was vastly underestimated. In addition, the U.S. had not seen a national decline in home prices since the Great Depression, contributing to the lack of caution surrounding the risks inherent in these securities.

Early in this decade, mortgage insurance was increasingly eclipsed by alternative structures like “piggyback loans,” designed to avoid mortgage insurance and in the case of larger loan sizes avoid jumbo loan pricing. Piggyback loans featured two mortgages – an 80 percent first mortgage and a second mortgage for 10, 15 or even 20 percent of the purchase price. This structure typically combined a conforming fixed-rate or adjustable-rate first mortgage with either a closed-end second lien or a home equity line of credit (HELOC), originated simultaneously with the first lien. Interest rates on the HELOC mortgage usually change monthly and typically have a life-time cap, but no limits on the amount the rate can change in any given adjustment. As a result, piggyback borrowers utilizing HELOC second liens were subject to even greater risks of rapidly rising interest rates and increasing monthly payments.

SMR Research Corporation reported that from 2001 to 2004, piggyback lending grew at a rapid rate. Piggyback loans accounted for 20 percent of home purchase mortgage dollars in 2001; that figure reached almost 40 percent during the first half of 2004. The piggyback share of all loan dollars, including both home purchase and refinance transactions, nearly doubled from 12 percent in 2001 to 22 percent in 2004. Since lenders were using piggybacks as a means of avoiding GSE credit-enhancement requirements, mortgage insurance use declined. The mortgage insurance industry’s market share stood at 12.8 percent in 2001 and slipped to 8.5 percent by the second quarter of 2004, as reported by several industry sources.

Private MI market share as a percent of total originations*

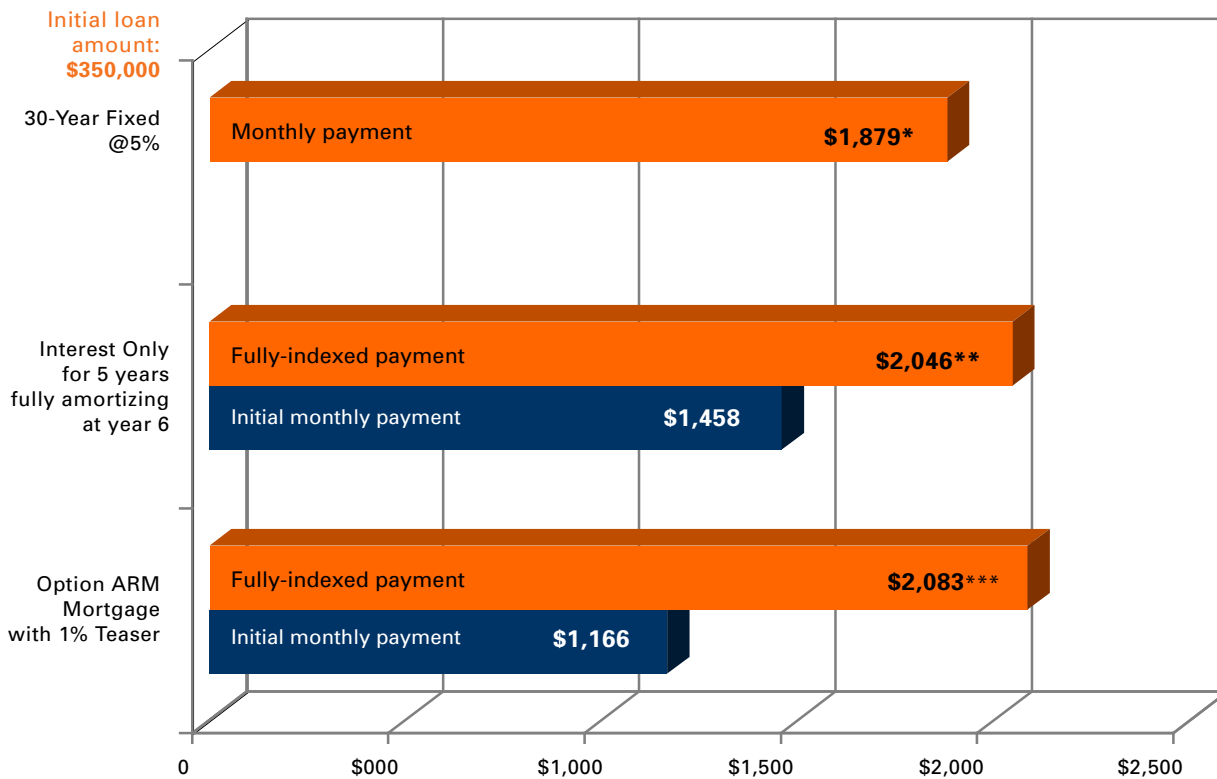


*Source: Inside Mortgage Finance estimates.

Origins of the Crisis

It is not too simple to say that today's troubles started in part because the mortgage industry deviated from the long-held basics of mortgage lending (i.e., sufficient verified income and assets to meet mortgage obligations) by mass-marketing loan products (e.g. Alt-A, No Asset, No Income loans) originally designed for a small subset of financially savvy borrowers. By obscuring for a short time the fact that these borrowers were unable to meet their obligations, exotic loan products, such as interest only and negative amortizing loans, contributed to the crisis. For example, an artificially low initial interest rate allowed many borrowers to purchase and make payments in the short-term on houses that in the long run they could not afford. When these loans were originally underwritten, the borrower's ability to pay the fully adjusted payment had not been assessed, and in fact, the borrower often had insufficient income to pay the debt or was unable to manage credit. Once the interest rates adjusted to the true long-term rate, borrowers began to default. Unfortunately, these borrowers were not only unprepared for the long-term cost of homeownership, but also for the risk inherent in their loan programs. There were certainly other factors that fueled the mortgage crisis, including weak appraisals and poor quality-control practices that enabled fraud.

The True Borrowing Cost



* Payment based on 30-year, fixed-rate, fully amortizing loan.

** Payment based on 5% interest-only payment through year 5. At year 6, assumes fully amortizing 5% fixed rate, 25-year term.

*** Assumes initial payment based on 1% teaser rate, annual payment adjustments can not exceed 7.5% of prior period payment and \$6,369 of deferred interest.

The seemingly limitless availability of financing also served to fuel home price appreciation. In many parts of the U.S., home prices increased by more than 20 percent in 2004 alone. They were up by 25 percent in California, Florida and a few other areas.

Today, the mortgage industry has returned to fully documented income and assets, standard loan products, and improved quality control and underwriting practices. The data show a clear swing away from exotic loan products and back to traditional first mortgages with some type of mortgage insurance, either private or government-sponsored. The Mortgage Bankers Association (MBA) reported in July of 2008 that fixed-rate loans made up 63.6 percent of first mortgages in the second half of 2007, compared to 53.4 percent in the first half of that year. Only 7.5 percent of originations were for non-prime loans, compared with 10.4 percent for the first half of 2007. Alt-A fell to 7.8 percent from 15.8 in the first half of 2007. In addition, the MBA reported that almost 80 percent of all origination dollars were for prime loans, compared with 70 percent in the first half of 2007.

As the nation struggles with the impact created by exotic loan products, one fact is clear: the private mortgage insurance industry continues to perform, paying valid claims and, at the same time, continuing to play an important role in making homeownership a reality for millions of Americans. During this severe economic downturn, private mortgage insurers are also making significant contributions to preventing foreclosures.

IV. The MI Business Model

The challenges facing mortgage insurers only serve to validate the industry's underlying strength, derived from a strong regulatory framework and rigorous third-party scrutiny. State insurance regulators require mortgage insurers to hold significant contingency reserves and meet stringent risk-to-capital ratios. These capital standards are extremely demanding, both in terms of the minimum capital required to become an industry participant and the ongoing requirements. In addition, rating agencies apply an equally stringent stress test to mortgage insurers' portfolios before issuing ratings.

Laws governing mortgage insurance require adequate capital relative to the risk insured, and state insurance regulators monitor to ensure there are funds available to back the risk and pay claims for the protection of policyholders and the public. Insurance regulators examine quarterly financial statements and company operations to ensure sufficient capital is available to pay claims even during periods of severe economic stress. Because mortgage insurers are in first-loss position on low down payment mortgages, their operations are carefully scrutinized.

Another unique feature of mortgage insurance is the contingency reserve. Essentially, the contingency reserve exists to store away premium dollars during good times so that reserves are available to pay claims during downturns. State insurance law requires mortgage insurers to set aside 50 cents from every premium dollar earned and hold it for 10 years. However, these contingency reserves may be released with the approval of the state insurance regulator in any year in which the mortgage insurer's loss ratio (losses as a ratio of premiums earned during a reporting period) exceeds 35 percent. These kinds of loss ratios are usually seen only during high-stress loss periods, such as the current environment.

The reserves are released exclusively to pay claims, and only to the extent to which the loss ratio exceeds 35 percent. The rationale of this regulation is that contingency reserves are built up during good times when borrower defaults and claims are relatively low, and drawn down during difficult times when claims are high. In addition, insurance regulations severely restrict the types of

investments in which reserves can be held, thereby encouraging mortgage insurance premiums to reflect the risks they are intended to cover and discouraging speculative investing.

Rating agencies, such as S&P and Moody's, are also conscious of the potential market volatility that mortgage insurance companies must absorb. The rating agencies' 10-year stress test is based on a tumultuous environment similar to the Great Depression, assuming a continuous, nationwide depression-like economy lasting for a full decade. As a further check on the adequacy of mortgage insurers' capital levels, rating agencies, regulators and the mortgage insurance companies themselves have developed models that subject the mortgage insurer's portfolios to simulated 10-year stress scenarios. These models rely on actual loan performance data from past periods of severe housing stress, such as the "Oil Patch" crisis in Texas and Oklahoma in the mid-1980s and the early 1990s defense industry closures in Southern California.

The combination of the capital requirements and the 10-year contingency reserves, minimum risk-to-capital levels imposed by state mortgage insurance regulations, and the 10-year stress models developed by the mortgage insurers and rating agencies, have all led to continued claims-paying abilities. Unlike companies that issued unregulated insurance contracts, such as Credit Default Swaps (with none of the reserve requirements and scrutiny outlined above), mortgage insurance is designed to better protect policy holders during times of extreme economic stress.

Common Misperceptions

Mortgage insurance is not a particularly well-known industry—let's look at some of the common misunderstandings.

PERCEPTION:

Mortgage Insurance isn't tax-deductible.

REALITY: Borrower-paid mortgage insurance became deductible in 2007 for borrowers with annual incomes up to \$109,000. Depending on incomes and other eligibility criteria, today borrowers can deduct up to 100% of the cost of mortgage insurance premiums on their federal income taxes¹. The original law was extended for three years, effective for mortgages issued after December 31, 2006 and before January 1, 2011. It does not apply to mortgage insurance policies in place prior to the legislation's passage. Some industry experts anticipate that Congress will extend the deduction or make it permanent.

¹ Subject to restrictions under the Internal Revenue code. Taxpayers should consult their own tax advisers concerning the applicability of the deduction to their particular circumstances under applicable tax codes.

PERCEPTION:

Borrowers are stuck with mortgage insurance payments for as long as they own their home.

REALITY: Most lenders permit borrowers to cancel borrower-paid mortgage insurance by demonstrating that they have a loan-to-value of 80 percent or less with the condition that the borrower has a good payment history. In addition, under federal law, mortgage insurance must be cancelled automatically when the borrower has paid the loan down to 78 percent of the original value.

PERCEPTION:

Borrowers receive no benefit from mortgage insurance.

REALITY: Borrowers benefit by having mortgage insurance as it allows the lender to make a loan with less than a 20% down payment, which permits borrowers to buy a home sooner and start building equity. Additionally, if the homeowner is delinquent, the institution servicing the loan may rely on the mortgage insurance company as a resource to help work through various options to avoid foreclosure.

PERCEPTION:

Having mortgage insurance on a loan delays the approval process and is generally a hassle for the borrower.

REALITY: As the mortgage industry has evolved, so have mortgage insurance companies. Mortgage insurers now offer delegated approval authority to most lenders, electronic processing of most applications, and a choice of payment options to meet different needs.

PERCEPTION:

When times are tough, mortgage insurance companies find ways to avoid paying claims.

REALITY: Mortgage insurers are careful to ensure claims are fairly reviewed and that all valid claims are paid according to the terms of the policy. In 2008, PMI's US mortgage insurance operations paid over \$800 million in claims, versus \$362 million in 2007.

In reality mortgage insurance is beneficial to both lender and borrower. For that reason, Susan Wachter, a finance professor at the Wharton School at the University of Pennsylvania, urges borrowers to “consider mortgage insurance, which can help them obtain a single, low down payment mortgage without any unnecessary added risk.”

V. The Value of Mortgage Insurance

Despite the current financial turmoil, mortgage insurance continues to play a vital role in helping to ensure the smooth functioning of the mortgage finance system.

Working with Lenders to Help Borrowers

- Mortgage insurance works for the borrower. In a troubled market, the interests of mortgage insurers may align with all parties – servicers, mortgage insurers and borrowers – work proactively to avoid foreclosure. The mortgage insurer has a direct interest in engaging with both the borrower and lender to prevent default and mitigate a potential claim payment. Unlike loan servicers that must serve many constituents – bond trustees, investors and borrowers – mortgage insurers have a targeted focus: keeping borrowers in their homes to avoid claims. Mortgage insurance companies working directly with loan servicers have the latitude to directly make decisions to support loan modifications, or advance a portion of a claim possibly avoiding a foreclosure, and keeping borrowers in their homes.

Depth of Expertise

- As monoline insurers, mortgage insurance companies may only write mortgage insurance policies. With this exclusive focus comes a thorough understanding of mortgage risk. Unfortunately, over the past few years many participants entered the mortgage field that didn't have the same depth of expertise and appreciation for risk. New players like the Wall Street investment banks brought creative, but untested risk “management” and dispersion methods. Complex structured finance vehicles promoted by investment banks, such as CDOs (Collateralized Debt Obligations), left anonymous investors around the world saddled with risk for which they had little appreciation or understanding.

Keeping the System Functioning

- Mortgage insurers help stabilize markets by taking a first-loss position. Acting as a shock absorber, mortgage insurers add stability to the mortgage finance system by allowing the transfer of some risk out of the banking and financial system into the insurance markets. The essence of insurance is the transfer and dispersion of risk. Mortgage insurers are the first line of defense to keep the system running smoothly by putting private capital at risk.

With Fannie Mae and Freddie Mac currently under federal conservatorship, the mortgage insurance industry is also serving as a buffer between losses that ultimately would flow to the taxpayers by continuing to pay claims due to the GSEs.

Bringing Innovation to Mortgage Finance

- Mortgage insurance is a force of innovation. Through competition, the market benefits from having several mortgage insurance firms with different strengths bring new ideas to the mortgage finance system.
- An example of this innovation is PMI Mortgage Insurance Co.'s development of the cutting-edge Automated Underwriting Risk Assessment (AURA) system to better assess and quantify the combined risk associated with a borrower's credit profile and geographic real estate risk.

VI. Preserving Homeownership

“Devastating things happen to families when they lose their homes,” says David Katkov, Chief Business Officer of PMI Mortgage Insurance Co. “For homeownership to be successful, it has to be sustainable.” Katkov adds, “Our work in loss mitigation and homeownership preservation benefits our policyholders and shareholders, but it’s also vital to sustaining the fabric of our society. If you travel to some of these communities, as I have, you can see how devastating foreclosures can be. Some of these neighborhoods only have one occupied home on the entire street; the rest are vacant and often vandalized. Vacant properties become blighting influences on the neighborhoods, driving down values of the remaining occupied homes. The few families struggling to hang on to the homes they worked so hard for can quickly find themselves living in an abandoned, dangerous neighborhoods. There is simply no upside to having people lose their homes.”

John Jelavich is Vice President of Homeownership Preservation Initiatives (HPI) at PMI, managing the HPI team that reaches out to lenders and borrowers to try to find creative solutions to keep borrowers in their homes.

“Think of a funnel as the infrastructure that the lenders’ servicers have in place to help people in trouble with their mortgages. When these defaults started flooding in, the funnel just wasn’t big enough to catch everything,” Jelavich said. “We’re invested in the success of these loans, so we’re very strategic about how we can help our customers prevent more foreclosures and rescue homeowners who otherwise might have slipped through the cracks.”

One effective effort, initiated by PMI, is the placement of loss mitigation representatives in the offices of lenders' loan servicing centers. This allows HPI members to see where bottlenecks might be developing and quickly develop solutions to smooth them out.

Because of the increasing number of problem loans, lenders' servicing staff are spread thin. Jelavich says, "Today, to ensure that loans with PMI coverage receive needed attention, we ask our customers if we can help. The cost to service a delinquent loan is huge. By providing assistance, we have better control over the ultimate disposition of PMI-insured loans."

Jelavich describes unique workouts that are only available on loans insured with mortgage insurance. "Let's say a borrower is five-months delinquent. But he's back on his feet and has corrected the reason for the default. These are typically the borrowers we can help with something PMI developed in the early '80s called the Saving Homeownership and Repayment Program (SHARP)." SHARP is one of many programs PMI has implemented to minimize losses in the current crisis.

"In some cases, we may advance a portion of our claim in the form of a loan to the borrower, which covers missed payments and penalties," Jelavich says. "That stops the foreclosure and lets the borrower keep their home. Then we work with the borrower to repay this claim advance through a zero-interest note with very flexible payment terms. If that borrower eventually defaults, what we advanced is netted out of the lender's ultimate claim."

"We recently helped a borrower trying to avoid foreclosure who had done all of the right things. He'd handed in all the right paperwork and was simply waiting to hear from his lender. In a routine follow-up, we learned that the lender had not received his pay stubs and had begun foreclosure proceedings. The borrower had no idea. We stepped in, had him resubmit his pay stubs, and followed up to make sure they arrived at the lender's office. All it took were three phone calls to save this man's house and avoid a needless claim. We also saved our lender/customer from having to take over and sell the property."

PMI was also the first mortgage insurer to become a member of the Hope Now Alliance organized by Financial Services Roundtable, comprised of top U.S. lenders, servicers, and mortgage insurers.

"Right now, we're participating in community outreach events around the country to help troubled borrowers. Although we can't directly modify loans with borrowers to prevent a foreclosure, the lenders have to do that, but we provide on-site logistical support. We also invite borrowers to attend these events through direct mail, phone calls and outreach to local media."

VII. Mortgage Insurance Alternatives

FHA Loans

FHA insurance generally covers mortgages that require smaller down payments and employs more flexible guidelines when assessing the borrower creditworthiness. Among other things, FHA programs allow financing a portion of closing costs and the upfront mortgage insurance premium.

With lenders and mortgage insurers tightening guidelines and raising prices, the FHA is taking a larger share of the housing market. Citing a report from Inside Mortgage Finance, The Wall Street Journal noted that FHA's share of new insured mortgages has jumped from a low of 1.8 percent in 2006 to 23 percent in July 2008. Many private market investors are concerned about future losses in the housing market and are leery of lending money for new high loan-to-value mortgages, let alone refinance those in trouble. Therefore the FHA is being asked to do more, such as providing refinancing options for those homeowners hardest hit by the mortgage and credit crisis, creating significant exposure to the taxpayer.

Some experts, such as Douglas Elmendorf, a Senior Fellow at the Brookings Institution, gave strong support to the FHA in testimony to the U.S. Senate Committee on Banking, Housing and Urban Affairs in April 2008. He said, "First, the FHA's traditional mandate is to assist individuals underserved by the traditional mortgage market, and it has many years of experience doing so. Given the pullback in private mortgage lending and securitization, it is natural to increase the FHA's role as a counterweight."

However, the FHA's growing influence is not without controversy. Economist Ann Schnare, a former executive at Freddie Mac, wrote in a column for Reuters.com in August 2008, "The mortgage market, we now know, is risky business. With billions of taxpayer money at stake, is it really wise to ask the FHA – chronically underfunded, buffeted by the whims of politicians, delegated too little authority – to succeed where they (GSEs) have failed?" Schnare, as have others, notes that the "FHA is light years behind the (mortgage) industry in its management systems, and its ability to attract and retain qualified staff."

VA Loans

Much like the FHA, the Veterans Administration does not make loans. Instead, it guarantees or insures loans as a benefit to those having served in the US Armed Forces. In some cases, a borrower can receive a VA-insured loan of more than \$350,000 while making no down payment. Applicants must have an acceptable credit rating.

VIII. Conclusion

The prescription for a strong, stable housing market is clear: a return to fundamentals. Private mortgage insurance is the natural vehicle for insuring loans because of its strong, well-established regulatory structure that has worked for nearly five decades. Mortgage insurers have a focused knowledge of the industry and repeatedly have shown the value of their products. Although mortgage insurance is principally designed to protect the lenders and investors, the reality is that the insurers act as an independent third-party with a vested interest in the loan's performance and, therefore, are also aligned with investors and the borrower. As such, the insurer's independence in approving underwriting guidelines from the lender plays a vital role in fostering a healthy housing market and protecting the financial system.

The return to a vibrant housing market requires sound and rigorous lending standards, accurate appraisals, and a desire on the part of originators to put borrowers into homes they can afford for the long-term. A healthy private mortgage insurance industry will help ensure these principles are followed in a restructured mortgage finance system.

In these times of serious economic upheaval, the mortgage insurance industry's financial and regulatory underpinnings provide a sound foundation for future growth. The regulatory requirements, such as contingency reserve and minimum capital levels, combined with the rating agencies' 10-year stress test, support the viability of the mortgage insurance business model in respect to claims-paying ability. The recovery of the US housing market is dependent on both public and private participants to facilitate responsible and sustainable homeownership.

Specific citations available upon request.

Assistance in developing this paper was provided by James K. Gentry.

James K. Gentry, Ph.D., professor and former dean at the University of Kansas School of Journalism and Mass Communications.

Glossary of Terms

Appraised Value – The fair market value an appraiser assigns to a particular property, based on his knowledge, experience, and analysis of the property in question, and the market conditions in the area.

ARMs (*Adjustable Rate Mortgages*) – A mortgage loan or deed of trust which allows the lender to periodically adjust the interest rate in accordance with a specified index.

A-Quality Loans – Loans with credit scores of 680 and greater and fully documented income and assets.

Alt-A Loans – A loan that has certain characteristics such as reduced or no documentation concerning the borrower's income, assets, deposit information and/or employment.

Credit Default Swap (CDS) – A form of credit protection, where the seller of the swap guarantees the creditworthiness of the product. Under this contract, the risk of default is transferred from the holder of the security to the seller of the swap. For example, the buyer of a credit swap is entitled to the par value of the bond by the seller of the swap, should the bond default. These contracts have significantly less regulation and capital requirements as compared to activities of mortgage insurance companies.

Default – The non-payment of a mortgage or other loan in accordance with the terms as specified in the note.

Fannie Mae/Freddie Mac (*Government Sponsored Enterprises – GSEs*) – Mortgage investors created by the U.S. government to support the mortgage purchase and securitization programs. By purchasing mortgages, these entities provide lenders with the cash to make additional loans.

FICO score – The most widely known type of credit score used in the United States. FICO scores range from 300 to 850 with 60% of scores between 650 and 799. The median score is approximately 720 (half of scores above and below) and the average credit score is approximately 678.

Foreclosure – A legal procedure in which a mortgaged property is sold in a legal process to pay the outstanding debt in case of default.

Interest Only Loans – Loans that do not reduce principal during the initial deferral period (usually between two and ten years) and, therefore, do not accumulate equity through loan amortization during the initial deferral period.

Insurance in Force (IIF) – The current principal balance of all outstanding mortgage loans with insurance coverage as of a given date.

Less-than-A Quality Loans – Generally loans with credit scores of 619 or below.

Loan to Value (LTV) ratio – The ratio of the amount of the loan to the appraised value or sales price of real property (expressed as a percentage).

New Insurance Written (NIW) – The original principal balance of all loans that receive new primary mortgage insurance coverage during a given period.

Payment Option ARMs (*Negative Amortization Loans*) – Loans that provide the borrower an option every month to make a payment consisting of principal and interest, interest only, or an amount established by the lender that may be less than the interest owed.

Piggyback loan – Loan in which the buyer takes a first mortgage to finance part of the value of the property and a second mortgage to finance another part of the property's value. The two mortgages together are called a piggyback loan.

Pool Insurance – Insuring a collection of mortgage loans with coverage that pays after any primary coverage. Pool coverage is usually accompanied by a stop-loss which limits the aggregate policy exposure; and may include per incident coverage limits, as well as a deductible. Pool insurance may be used in tandem with primary mortgage insurance or may be placed on loans that do not require primary insurance.

Primary Insurance – Mortgage insurance placed on a loan-by-loan basis and providing first-loss coverage.

Risk in Force (RIF) – The aggregate dollar amount of the current principal balance of each insurer's mortgage loans multiplied by the insurance coverage percentage specified in the policy.

Secondary Mortgage Market – The buying and selling of existing mortgages, readily traded through securities. GSEs are the primary purchasers.

Servicer – Entity responsible for administering mortgage loans. This includes sending coupons/ invoices, collecting payments, escrow administration, collections and foreclosures.

Structured Investment Vehicle (SIV) – A type of structured credit product that invests in a range of asset-backed securities.

Subprime Mortgage – Mortgage offered to borrowers with lower credit scores; typically below 600. Borrowers with lower credit ratings usually don't qualify for conventional mortgages because the lender views the borrower as having a higher-than-average risk of defaulting on the loan. Lending institutions often charge interest on subprime mortgages at a rate that is higher than a conventional mortgage in order to compensate for carrying more risk.

Underwriting – The process of evaluating a loan application to determine the risk involved for the lender. Underwriting involves an analysis of the borrower's creditworthiness and the property itself.

2/28's - 30-year residential mortgages with a low fixed interest rate for the first two years of the loan, followed by an adjustable rate for 28 years. This type of loan was typically sold to Alt-A and subprime borrowers.