RADIAN

STATEMENT OF

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SUBMITTED TO

THE U.S. SENATE
COMMITTEE ON FINANCE
INDIVIDUAL TAX REFORM WORKING GROUP

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Thank you for the opportunity to submit this statement to the Senate Finance Committee Individual Tax Reform Working Group. I am Teresa Bryce Bazemore, and I am submitting this testimony on behalf of Radian Guaranty Inc. ("Radian"), one of the nation's leading private mortgage insurers. Private mortgage insurance ("MI") helps promote and preserve the tradition of home ownership while protecting taxpayers from default-related losses on residential mortgages. For the past 50 years, private MI companies like Radian have helped millions of families achieve the American dream of home ownership. In the past year, private MI helped more than half a million homeowners (598,534) purchase or refinance a mortgage. Nearly half of those served by private MI were first-time home buyers, and approximately 40 percent were borrowers with incomes below $75,000.[1]

Radian applauds the Committee and the Working Group for their leadership on tax reform issues. As you consider the important subject of tax reform, we urge you to consider tax policies that support home ownership and the residential real estate market, which are critical to the strength of the overall economy. In particular, we urge you to make permanent the MI deduction. And, in the interim, the MI deduction should be seamlessly extended as soon as possible.

PRIVATE MI

For many families, the most common hurdle to home ownership is saving enough money for a down payment. The traditional 20 percent down payment is a hardship for many and an impossibility for others. Private MI enables borrowers with less than 20 percent down—typically first-time and low- and moderate-income borrowers—to achieve the dream of home ownership. For example, in today's economy it could take over 20 years for the average firefighter and 18 years for the average school teacher to save even a 10 percent down payment.[2]

When a borrower places less than 20 percent down to purchase a home, the lender is required to obtain a "credit enhancement," usually in the form of private MI, in order for that loan to be eligible to be subsequently sold to Fannie Mae or Freddie Mac ("the GSEs"). Lenders are willing to make low down payment loans, and the GSEs are willing to purchase them because the private MI company will pay a claim to the owner of the loan if the borrower defaults on the mortgage and the subsequent sale or transfer results in a loss. The private MI coverage is typically the first 25–35 percent of the value of the loan—meaning lenders and investors are at risk for only the remaining 68 percent of the loan amount in the event of a loss. This practice of requiring private MI to insure roughly one-third of the amount of the loan reflects the GSEs' prudent determination that this amount of coverage has historically been sufficient to cover costs associated with

[1] U.S. Mortgage Insurers Data Snapshot (December 2014), *available at* http://www.usmi.org/mi-resources/usmi-data-snapshot/.

[2] *See* Center for Responsible Lending, The Negative Impact of a Government-Mandated 10 Percent Down Payment for Qualified Residential Mortgages (August 2012), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/QRM-10percent-issue-brief-Aug16-1-2.pdf.

defaulted loans and any losses resulting from reselling the property for less than the outstanding mortgage loan balance.

Importantly, placing the MI company's private capital at risk in a "first loss" position after the borrower means that both the insurer and the borrower have a vested interest in home loans that are affordable and sustainable not only at the time of purchase, but throughout the years of home ownership. Having their own capital at risk also means that private mortgage insurers have clear incentives to work with lenders, investors, and community groups to help delinquent borrowers stay in their homes.

The private MI industry has covered approximately $44 billion in claims for such losses since the GSEs entered conservatorship, which represents a substantial savings to taxpayers. About $500 billion in GSEs mortgages currently outstanding have protection from MI coverage, reducing taxpayer exposure to mortgage losses in the event of another housing downturn.[3]

The private MI model has stood the test of time and emerged stronger than ever. Looking ahead, private mortgage insurers stand ready, willing and able to play a critical role in the future of housing finance by continuing to safely and soundly enable first-time and lower income families to purchase homes.

THE MI DEDUCTION

The MI deduction was first enacted in 2006, on a broadly supported and bipartisan basis. Under Section 163(h) of the Internal Revenue Code ("IRC"), premiums paid or accrued for qualified MI by a taxpayer in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and, therefore, deductible. The amount allowable as a deduction is phased out ratably for taxpayers with adjusted gross income of $100,000 to $110,000.

Although the legislation first proposing the MI deduction would have made the provision permanent, the MI deduction was enacted on a temporary basis. Consequently, unlike the mortgage interest deduction, the MI deduction regularly expires and must be extended. The MI deduction was most recently extended as part of the Tax Increase Prevention Act of 2014 (Pub. L. No. 113-295); the provision expired again on December 31, 2014.

Notably, Internal Revenue Service data shows that 4.1 million taxpayers benefited from the MI deduction in 2012, making it one of the most relied upon tax extenders. Moreover, the deduction is phased out for those taxpayers with incomes above $110,000, ensuring that the benefit of the deduction accrues to those who need it the most.

[3] U.S. Mortgage Insurers Data Snapshot (December 2014), *available at* http://www.usmi.org/mi-resources/usmi-data-snapshot/ .

NEED FOR PERMANENCE

Permanently extending the MI deduction is consistent with tax reform and advances the objectives of increasing fairness, permanence, and simplicity of tax policy; increasing economic growth; and fostering savings and investment by increasing access to the housing market.

Fairness, Permanence, and Simplicity. Harmonizing the tax treatment of MI with that of mortgage interest would increase fairness, permanence, and simplicity in the tax code.

MI premiums are the economic equivalent of mortgage interest. Paying MI premiums has a direct and quantifiable impact on interest expense. Without the insurance purchased by those premiums, interest charges would be much higher as a result of the much higher credit risk.

Although the use of the mortgage interest deduction is more prevalent than the use of the MI deduction, the former is skewed more toward higher-income taxpayers. The MI deduction, in its current form, is tailored to serve modest-means households, especially considering that it is only available to households earning less than $110,000 per year. The numbers bear out this reality: 65% of taxpayers who claim the MI deduction earn less than $75,000 per year. For these borrowers, the MI deduction saves them between $800 to $2700 each year they are insured.[4]

Consequently, the MI deduction effectively provides fairness to those homeowners who rely on MI to finance their down payments by offsetting some of the costs associated with purchasing a home with less than a 20% down payment. Moreover, equalizing the tax treatment of MI and mortgage interest has the added benefit of increasing the permanence of and simplifying the tax code.

Economic Growth. The MI deduction increases economic growth and reduces risks associated with the residential real estate market by disincentivizing the use of riskier "piggy-back loans," also known as simultaneous second-lien loans. Piggyback or second-lien loans are loans where the borrower is given two mortgages to cover the acquisition of a house with a small cash down payment. The second lien effectively serves as a substitute for a large down payment, and consequently, has a much higher interest rate than the prevailing rates for most mortgages. From a tax perspective, in the case of a piggyback loan, the interest on both the first lien and the higher-interest rate second lien is deductible.

Simultaneous second-lien loans increase not only the frequency, but also the severity of losses to primary (or first lien) mortgage lenders and the real estate market in general in at least two ways. First, home buyers who take out a second mortgage to

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[4] The modest benefit of the MI deduction is in contrast to the more generous benefits associated with the mortgage interest deduction. For example: only about 30% of taxpayers claiming the mortgage interest deduction earn less than $60,000 per year.

finance their down payment on their first mortgages are subject to increased financial burdens and increased monthly cash outlay obligations due to the higher-interest second loan, leading to a higher probability of default. While these piggyback loans are still low down payment loans when appropriately viewed based on the outstanding obligation of both the first and the second liens, the ultimate investor as well as the lender does not have the benefit of any credit enhancement that it would otherwise have with private MI. During the last housing crisis, many of the loans purchased by the GSEs, that also had a second lien, defaulted and left the GSEs with inadequate protection against losses, which further exacerbated the already fragile state of the GSEs.

Second, these piggyback loans do not have the benefit of being assessed to determine whether the homeowner has the ability to repay the loan under the private MI's underwriting guidelines. During the housing crisis of 2008, it became clear that it was more difficult, if not impossible, to help troubled borrowers with piggybacks since the loans are often owned by two different investors and the second investor does not have an incentive to write off their loan. This is in contrast to the private mortgage insurer whose interests are aligned with the troubled borrower to modify loans. In fact, the private mortgage insurers have a proven record of active participation in both government and private programs to help troubled homeowners.

Third, because most second-lien/piggyback lenders also serve as mortgage servicers, they have an incentive to maximize the value of their smaller, high-interest loans at the expense of first-lien mortgages on the same residence, according to a study by the Federal Deposit Insurance Corporation.[5] In contrast to second-lien/piggyback lenders, private MI companies are incentivized to ensure that homeowners can afford to maintain their mortgage obligations, modify the loan when necessary to avoid foreclosure, and ultimately stay in their homes. As was all too frequent in the last crisis, the only way a second-lien/piggyback lender would benefit from a home that had missed a number of mortgage payments was through foreclosure, rather than negotiating a workable refinance. Many second-lien lenders were barriers to homeowners' ability to refinance or modify.

The value of this credit enhancement and the second look at underwriting by private MI companies combined with the fact that MI business interests align with sustainable home ownership, means that MI is a better option for the safety and soundness of the housing finance system, which, in turn, is essential to spurring economic growth. The MI deduction puts the tax treatment of MI premiums on par with the tax treatment of piggyback or second-lien loans, thus leveling the playing field and introducing independent verification of prudent underwriting standards for low down payment lending.

[5] *See* Sumit Agarwal et al., Federal Deposit Insurance Corporation, Second Liens and the Holdup Problem in First-lien Mortgage Renegotiation (Sept. 2012), *available at* https://www.fdic.gov/news/conferences/consumersymposium/2012/Second%20Liens%20and%20the%20Hold%20Up%20Problem.pdf.

Additionally, it is important not to overlook the impact of the MI deduction on the housing market, which is currently still undergoing a fragile recovery. With the grave state of the housing sector in recent years, extensions of the provision have ensured that there continue to be provisions aimed at stabilizing and strengthening the housing market in a responsible way.

Savings and Investment by Increasing Access. The MI deduction helps families of modest means offset the cost of monthly or annual MI premiums. Maintaining home ownership incentives for these borrowers is important to ensuring continued access to the housing market, which is an important source of savings, investment, and wealth accumulation for these families.

CONCLUSION

Our strong hope is that the MI deduction is made permanent as part of tax reform; in the interim, the MI deduction should be seamlessly extended as soon as possible.

Radian greatly appreciates the opportunity to submit this statement. We are pleased to serve as a resource to the Working Group and the Committee on these and related matters. We look forward to our continued work together on these important issues.