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Mortgage Insurance Companies of America (MICA)

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MICA

Mortgage Insurance Companies of America

2009-2010 Fact Book & Member Directory

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Introduction

Founded in 1973, Mortgage Insurance Companies of America is the trade association representing the private mortgage insurance (PrivateMI) industry. MICA's members expand homeownership opportunities by enabling home buyers to purchase homes with low down payment mortgages.

MICA acts as an educator and conduit of information on legislative and regulatory changes and represents the industry's positions on Capitol Hill. The association also serves as a liaison to other housing trade organizations and the federal secondary mortgage market agencies. MICA strives to enhance the general public's understanding of the vital role PrivateMI plays in housing Americans.

The PrivateMI industry's mission is to help put as many people as possible into homes they can afford and to ensure that they stay in those homes. By insuring conventional low down payment home mortgages, MICA's members have made homeownership a reality for more than 25 million families.

MICA's 2009-2010 Fact Book and Member Directory explains the PrivateMI industry and introduces its participants. The following sections detail what PrivateMI is and how it works, the nature of mortgage default risk, the market for PrivateMI, the industry's financial performance and the challenges that lie ahead for housing.

WHAT IS PrivateMI?

Traditionally, lenders have required a down payment of at least 20 percent of a home's value. For most first-time home buyers, saving money for such a sizeable down payment is the greatest barrier to homeownership. Lenders will approve a mortgage with a smaller down payment, however, if the mortgage is covered by PrivateMI.

PrivateMI, also known as mortgage guaranty insurance, protects a lender if a homeowner defaults on a loan. Lenders generally require mortgage insurance on low down payment loans because studies show that a borrower with less than 20 percent invested in a house is more likely to default on a mortgage. In effect, the mortgage insurance company shares the risk of foreclosure with the lender. Low down payment loans also are referred to as high-ratio loans (loan-to-value ratio), indicating the relationship between the amount of the mortgage loan and the value of the property.

The home buyer and the mortgage insurer share a common interest in the mortgage financing transaction because they each stand to lose in the event of default. The borrower will lose the home and the equity invested in it, and the mortgage insurer will have to pay the lender's claim on the defaulted loan. Thus, both the insurer and the borrower are concerned that the home is affordable not only at the time of purchase, but throughout the years of homeownership.

PrivateMI is the private sector alternative to non-conventional, government-insured home loans. Mortgages backed by the government are insured by the Federal Housing Administration or guaranteed by the Department of Veterans Affairs or the U.S. Department of Agriculture's Rural Housing Service.

Generally, home buyers must make a down payment of at least 5 percent of a home's value to be considered for PrivateMI. PrivateMI is available on a wide variety of conventional mortgages, including most fixed and adjustable rate home loans, giving borrowers the freedom to choose the type of loan that best suits their needs. Both private and government mortgage insurance premiums are tax deductible for many borrowers who purchase or refinance a home between January 1, 2007 and December 31, 2010.

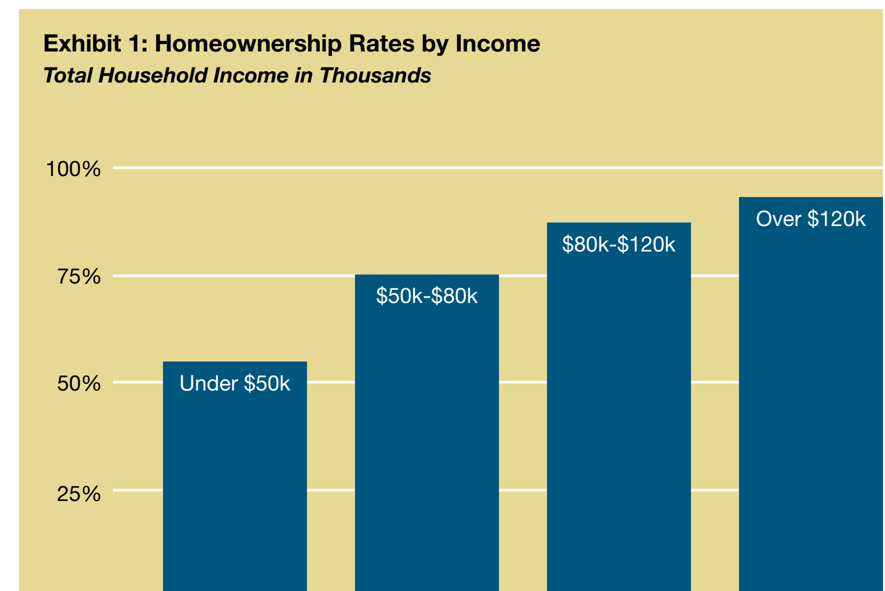
PrivateMI should not be confused with mortgage life insurance, which pays an outstanding mortgage debt if the borrower holding the insurance policy dies.

MEETING THE AFFORDABILITY CHALLENGE

Even with home prices declining, affordability continues to be a problem for many prospective home buyers, especially those seeking to purchase a home for the first time. The mortgage insurance industry plays a vital role in helping low and moderate income families become homeowners. Mortgage insurance aids affordability because it allows families to buy homes with less cash. A home purchase can be made years sooner with PrivateMI, typically with as little as 5 percent down for qualified borrowers.

Over two-thirds of the families in the United States own their own homes, but a look at the rate of homeownership broken down by income levels reveals an interesting picture. As Exhibit 1 shows, homeownership in America is skewed toward those with household incomes of more than $50,000.

Statistics show that high-income households constitute a clear minority of U.S. households and most people in these categories already own homes. According to the most recent national figures available from the American Housing Survey, 12 percent of U.S. households had annual incomes above $120,000, and 92 percent of them owned homes. Fifteen percent of households earned $80,000 to $120,000, and 86 percent owned homes. Twenty-one percent had incomes between $50,000 and $80,000, and 75 percent owned homes. In contrast, 52 percent of households had annual incomes below $50,000, but only 55 percent owned homes.



Source: 2007 American Housing Survey

Private Insurers Step In To Help

For years, members of the Mortgage Insurance Companies of America have worked with the secondary market agencies, mortgage lenders and local consumer groups across the country to identify ways to better serve low- and moderate-income home buyers. These partnerships have increased the mortgage insurance industry's awareness of the unique needs of borrowers at the local level. They have also aided mortgage insurers in the development of special offerings to help low and moderate income families qualify for financing. These programs demonstrate that by working together, communities, lenders, insurers and investors can expand homeownership opportunities for low and moderate income families.

A FINANCIAL INDUSTRY SUCCESS STORY

The modern PrivateMI industry was born in the 1950s, but the industry's roots go back to the late 1800s and the founding of title insurance companies in New York. The state passed the first legislation authorizing the insuring of mortgages in 1904.

In 1911, the law was expanded to allow title insurance companies to buy and resell mortgages—comparable to today's secondary mortgage market. To make loans more marketable, companies offered guarantees of payment as well as title, thus establishing the business of mortgage insurance. In addition to insuring mortgages, companies began offering participations, or mortgage bonds. These bonds allowed multiple investors to hold a mortgage or group of mortgages.

During the 1920s, rising real estate prices allowed most foreclosed properties to be sold at a profit, and more than 50 mortgage insurance companies flourished in New York. Since mortgage insurance was considered a low-risk business, the firms were virtually unregulated and thinly capitalized. Most had little experience with sound credit underwriting. This situation went relatively unnoticed until the Great Depression.

With the catastrophic collapse of real estate values in the 1930s, New York's entire mortgage insurance industry folded. As a result, the governor commissioned a study to examine the problems that had developed in mortgage lending and insurance. The study—known as the Alger Report—recommended prohibiting conflicts of interest; setting stringent capital and reserve requirements; and adopting sound appraisal, investment and accounting procedures. The report became a blueprint for a strong post-World War II mortgage insurance industry built on new regulations and financial structures. The industry's sound regulatory and financial foundation has ensured that even during difficult economic times, lenders are able to continue making low down payment loans backed by mortgage insurance.

FHA Lends A Hand

During the Depression, the need to stimulate housing construction by encouraging mortgage investment became evident. The federal government entered the mortgage insurance business in 1934 with the creation of the Federal Housing Administration. With its promise of full repayment to lenders if borrowers defaulted on their home loans, the FHA home loan insurance program created new confidence in mortgage instruments and stimulated investment in housing.

To direct government assistance to those most in need, the FHA imposed ceilings on the insurable loan amount for single-family homes. After World War II, the government's mortgage insurance role expanded with a Veterans Affairs mortgage guarantee program to help veterans in their transition to civilian life. The FHA and VA insurance programs have helped stimulate the housing market for several decades.

FHA, VA and private mortgage insurers play similar roles in making housing more affordable. PrivateMI is basically the private sector alternative to FHA insurance, but there are several differences between the two. Unlike FHA, PrivateMI companies do not insure the total loan balance. The mortgage insurance industry shares the risk of default with the financial institution, secondary market investor and the homeowner. Sharing the risk provides incentive for all parties to keep the loan payments current. In addition, there are specific loan amount limits for FHA-insured mortgages and VA home loans.

The Private Sector Emerges

In 1957, a Milwaukee lawyer named Max Karl founded the first modern PrivateMI company, Mortgage Guaranty Insurance Corporation, making the conventional low down payment mortgage a viable product for mortgage lenders. A regulatory framework for PrivateMI was established that included strong conflict of interest provisions and a one-line-of-business structure to ensure that mortgage insurers' reserves would not be mixed with reserves for other lines of insurance. In addition, a unique contingency reserve system and capital requirements were established to recognize the catastrophic nature of mortgage default risk and prevent companies from entering the mortgage insurance business without long-term commitments. This regulatory framework provided a foundation for establishing additional PrivateMI companies.

Housing's Heyday

The 1960s saw expansion of the modern PrivateMI industry, followed by dramatic growth in the early 1970s in conjunction with the emerging dominance of the secondary mortgage market. All mortgages originate in the primary mortgage market. In the secondary mortgage market, existing mortgages are bought, sold and traded to other lenders, government agencies or investors.

The federal government chartered two special-purpose organizations to enhance the availability and uniformity of mortgage credit across the nation. Those organizations, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corp. (Freddie Mac), provide direct links between the primary mortgage markets and the nation's capital markets. Fannie Mae, a government-sponsored but privately owned corporation established in 1938, creates mortgage-backed securities backed by FHA, VA and conventional loans. Freddie Mac, created in 1970, is structured and operates in a manner similar to Fannie Mae.

The demand by mortgage investors for investment-quality mortgage loans expanded the need for mortgage credit enhancement. Indeed, the Fannie Mae and Freddie Mac charters require that they carry one of three forms of credit enhancement on low down payment loans they purchase, one of which is PrivateMI. The PrivateMI industry has helped fill this credit enhancement role, enabling Fannie Mae and Freddie Mac to buy and securitize low down payment conventional loans. As a result, loans secured with low down payments steadily increased as a percentage of total mortgage originations. Secondary market purchases of low down payment loans helped fuel the tremendous expansion in home construction and sales during the 1970s and '80s, aiding many first-time and other home buyers. Privately insured mortgage loans became an increasingly important part of the mortgage finance system.

Put To The Test

The 1980s wrote a new chapter in the history of mortgage insurance. The first challenge of the early '80s was helping homeowners, lenders, real estate agents and builders cope with double-digit interest rates and inflation in a period of severe recession. To help qualify more borrowers, conventional low down payment loans were paired with experimental adjustable-rate mortgages and features such as initially discounted "teaser rates," negative amortization and graduated payment increases. By 1984, more than half of all insured mortgage loans had down payments of less than 10 percent, and many of these were adjustable-rate mortgages.

As economic conditions deteriorated—particularly in energy-oriented regions of the country—defaults began to rise, resulting in numerous foreclosures. The mortgage insurance industry paid more than $6 billion in claims to its policyholders during the 1980s. Policyholders included commercial banks, savings institutions, institutional mortgage investors, mortgage bankers, Federal Deposit Insurance Corp., Federal Savings and Loan Insurance Corp., Fannie Mae and Freddie Mac. Mortgage insurance protected all these mortgage and capital providers from extensive losses on high-ratio loans. Even in the prosperous economic times of the 1990s, the mortgage insurance industry paid more than $8 billion in claims, once again demonstrating its ability to function as designed in both good and bad economic climates. More recently,

as the housing market collapsed in 2007 and 2008, mortgage insurers paid approximately $15 billion in claims and continue to significantly support their lender clients.

The Critical Role of the Third-Party Insurer

Mortgage insurers were designed to be review underwriters. Because they are in the first loss position on insured mortgages, they are the second set of eyes looking at potential loans to check and see if it is safe for both the investor and the borrower. Only third-party insurers can effectively disperse risk nationally, collecting premiums in strong markets while supporting policyholders in weaker markets. The unique and stringent capital and catastrophic loss reserve requirements that mortgage insurers must maintain passed the test of severe economic stress during the 1980s. The high level of claim payments made by the PrivateMI industry during that period, coupled with its continued financial health, proved that lenders and investors can rely on mortgage insurance for credit enhancement and default protection. Even in today's declining market environment, mortgage insurers continue to pay claims as they come due, precisely the role they were designed to play. While mortgage insurers were circumvented in recent years as exotic and risky loan structures flooded the market, there is now a return to quality for lenders, borrowers and investors which will ensure a prominent role for private mortgage insurance in the years ahead. The claims-paying ability of the industry remains solid, reflecting the strong position of mortgage insurers to handle current and anticipated claims, for which they have built up ample reserves over time.

HOW MORTGAGE INSURANCE WORKS

The purpose of mortgage insurance is to protect lenders from default-related losses on conventional first mortgages made to home buyers who make down payments of less than 20 percent of the purchase price. Without mortgage insurance, lenders would suffer significant losses on defaulting loans with high loan-to-value ratios.

Many expenses accompany a default. Interest charges accumulate during the delinquent period, as well as during foreclosure, a period that can total a year or more. Other costs include legal fees, home maintenance and repair expenses, real estate brokers' fees and closing costs. These costs generally total 15 percent or more of the loan amount. Another frequent loss occurs when the foreclosed property is resold for less than its original sales price.

PrivateMI companies insure against the losses associated with defaulted loans by guaranteeing payment to the lender of the top 20 to 30 percent of the claim amount, and in some circumstances, even more. One of the mortgage insurer's key roles is to act as a review underwriter for credit and collateral risks related to individual loans, as well as for local, regional and national economic risks that could increase the loss from mortgage defaults.

Recognizing the near certainty of losses on most foreclosures, the major investors who supply liquidity to the mortgage market-—such as Fannie Mae and Freddie Mac—require credit enhancements such as mortgage insurance on all low down payment loans. The two agencies generally require that mortgages with loan-to-value ratios higher than 80 percent have insurance coverage on the amount of the loan greater than 70 percent of value.

The Claims Process

The type and amount of coverage selected by the lender determine how much the private mortgage insurer will pay if the borrower defaults and the lender must foreclose. The claim amount filed with the mortgage insurer generally includes principal and delinquent interest due on the loan, legal expenses incurred during foreclosure, the expense of maintaining the home and any advances the lender made to pay taxes or insurance.

Private mortgage insurers have increasingly sought to intervene and help counsel borrowers if they happen to hit a rough patch in their financial life and are seeking solutions to avoid foreclosure. Over the years, thousands of homeowners have benefited from this kind of assistance and protected their credit rating.

Generally, after a lender has instituted foreclosure and acquired title to the property, it can submit a claim to the insurance company. The insurer has two options to satisfy the claim:

- Pay the lender the entire claim amount and take title to the property.
- Pay the percentage of coverage of the total claim amount stated in the policy (generally 20 to 30 percent) and let the lender retain title to the property.

Before making a decision, an insurer generally will try to determine the potential resale price of the property and the expenses resulting from the resale, including the real estate agent's commission and other settlement costs.

A more detailed description of how mortgage insurance operates is contained in the master policies of individual companies. Master policies, which differ from company to company, are contracts issued to lenders that formally set out the conditions of the insurance. They define the procedures lenders must follow to insure a loan, what to do if borrowers become delinquent on their payments, and how to make a claim. They also define how the lender and insurer must manage mortgage default risk. Master policies are tailored to individual state regulations and incorporate the rights and responsibilities of the policyholder and the insurer. They are enforced in the same manner as other business contracts.

MANAGING RISK IN A VOLATILE ENVIRONMENT

The business environment changes constantly, and mortgage insurance is no exception. Deregulation of financial services, globalization of the economy, increased securitization of mortgage products and various legislative initiatives have increased the risk of mortgage lending for lenders, insurers and investors.

The major factors on which mortgage default risk is based include:

- Size of the down payment.
- Potential for property appreciation or depreciation.
- Borrower's credit history.

Other risk factors include:

- Purpose of the loan.
- Type of mortgage instrument.
- Whether the borrower will occupy the home.
- Interest rate.

The most unpredictable risk factor, by far, is the stability of the property's value. Mortgage insurers constantly monitor local, regional and national economic conditions. By studying population growth, employment growth, the supply of existing housing, housing starts and other economic factors, insurers can better evaluate the sensitivity of local economies to downturns as well as upturns.

Long-Term Protection

Risk management is vital to the long-term protection of policy holders' reserves because of the unique nature of mortgage default risk. The risk cycle for mortgage insurance is significantly longer than for other property-casualty insurance products. Although lenders may decide to cancel insurance when the default risk has been sufficiently reduced, coverage and risk can run for many years.

Mortgage insurance remains renewable at the option of the insured lender or investor and at the renewal rate quoted when the policy commitment was issued. Mortgage insurers cannot raise premiums or cancel policies if risk increases over time. Because mortgage insurers make a long-term commitment on each loan they insure, a long-term risk management perspective is essential to protect policyholders' interests.

Risk Dispersion

Mortgage insurance helps lenders and investors balance the short-term need for increased mortgage originations with the long-term need for investment-quality business. Mortgage insurers offer the risk dispersion and pooling of risk that few individual mortgage lenders or investors could accomplish on their own.

Geographic Distribution: Mortgage insurers operate on a national basis, which provides the geographic dispersion necessary to protect policyholders during regional economic cycles. Exhibit 2 illustrates the geographic distribution of new mortgage insurance written in 2008.

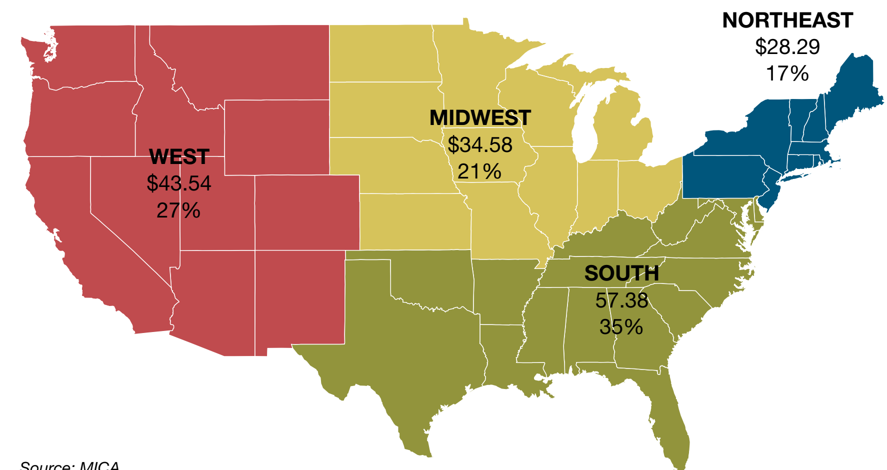
Temporal Distribution: Mortgage insurance also provides a reserve system that accumulates policyholders' reserves over time. Under today's business conditions, it is not possible for individual lenders and investors to accumulate similar reserves.

Loan-to-Value Distribution: Because risk increases as the loan-to-value ratio increases, mortgage insurers seek to balance their mix of 95 percent, 90 percent and lower loan-to-value ratio loans.

The mortgage insurance industry's sound underwriting and risk dispersion practices serve to produce higher quality originations for mortgage lenders and higher quality investments for investors.

Exhibit 2: Georgraphic Distribution of New Insurance Written in 2008

$ in Billions



Source: MICA

THE EXPANDING MARKET FOR MORTGAGE INSURANCE

The market for mortgage insurance changed dramatically during the 1980s, resulting in a much stronger, healthier mortgage insurance industry in the 1990s. The industry overcame many problems that hampered it in the '80s, including increased self-insurance, restructuring within the industry and uncertain economic conditions.

The industry's volume of business has continued to grow through the 1990s and beyond.

A number of factors contributed to the industry's success, including:

- Increased industry presence in the low- and moderate-income market.
- Increased lending in inner cities.
- Enhanced marketing efforts by individual companies and the industry as a whole.
- Single-digit interest rates drawing first-time home buyers into the market.
- Greater public awareness of the availability of PrivateMI.
- Greater emphasis on the use of mortgage insurance as a credit enhancement to meet risk-based capital requirements for banks and savings institutions.
- Increased use of mortgage insurance by first-time and move-up buyers.

The 2005-2008 volume of insurance for MICA's members is shown in Exhibit 3, with 2008 statistics broken down by quarter. The numbers include primary traditional and bulk, but not pool, insurance activity. From 1988 to 1991, new insurance written remained relatively constant at around $40 billion. New insurance written topped the $100 billion mark in 1992 and has remained above it since then. In 1993, it jumped to nearly $137 billion and remained between $121 billion and $131 billion until 1998 when new insurance written was more than $187 billion. Between 1998 and 2007 new insurance written by MICA's member firms exceeded $200 billion a year.

The PrivateMI industry had a record year for new insurance volume in 2007. MICA's members issued nearly 2 million new certificates in 2007 resulting in total new insurance written of over $300 billion for the first time. Additionally, insurance in force rose to over $800 billion at year end 2007 reflecting a 22.7% increase over the previous year's total. In 2008, during a severe economic downturn, new insurance written fell 46% to $162 billion, while insurance in force rose to over $950 billion, an increase of 16.1% compared with the previous year.

CANCELLATION AND THE LAW: THE HOMEOWNERS PROTECTION ACT

PrivateMI makes it possible for potential home buyers to become homeowners sooner, for less money down. Federal law assures consumers that they can enjoy the benefits of PrivateMI knowing that lenders will cancel it when it is no longer needed.

Exhibit 3: Primary Insurance Activity*
$ in Millions

Quarter	Number of Applications	Number of Certificates	New Insurance Written	Insurance In Force
1st	451,604	406,025	$61,861.4	$848,145.8
2nd	328,349	273,502	$48,989.8	$863,146.1
3rd	214,489	173,909	$30,604.1	$801,346.9
4th	155,780	118,159	$20,763.3	$952,196.2
2008	1,150,222	971,595	$162,218.6	$952,196.2
2007	2,079,364	1,979,074	$300,052.2	$819,812.1
2006	1,507,965	1,444,330	$226,076.0	$668,398.9
2005	1,635,458	1,579,593	$225,023.6	$615,081.9

Source: MICA

The law includes two basic consumer protections:

- It requires lenders to inform home buyers — both at closing and annually — about their right to request mortgage insurance cancellation and how to do it.
- It requires lenders to automatically cancel insurance for those who do not request cancellation.

Even without the law, PrivateMI generally is cancelable once the homeowner builds up enough equity in the home. In fact, 90 percent of borrowers cancel their PrivateMI within 60 months. Investors set their own cancellation requirements. The mortgage insurance company does not make the decision to cancel insurance.

How the Law Works

The law is designed to demystify the PrivateMI cancellation process in the following ways:

- Initial disclosure — For loans originated on or after July 29, 1999, lenders must give borrowers a written notice at closing that explains they have PrivateMI on their mortgage and that they have the right to have it canceled at a certain point.
- Annual disclosure — Lenders must send borrowers an annual reminder that they have PrivateMI and have the right to request cancellation once they've met cancellation requirements. This requirement applies to all loans with cancelable PrivateMI, not just those obtained after July 29, 1999.
- Borrower-initiated cancellation — For most loans originated on or after July 29, 1999, a lender must cancel PrivateMI at the request of a borrower whose mortgage balance is 80 percent of the original value of the house. The borrower must be up to date on mortgage payments and have no other loans on the house. The lender must be satisfied that the property value has not declined.
- Automatic termination — For most insured loans originated on or after July 29,1999, PrivateMI will be canceled automatically when the mortgage balance is at 78 percent of the original value of the house. The borrower must be up to date on mortgage payments. Otherwise, insurance will be canceled automatically once the borrower becomes current.

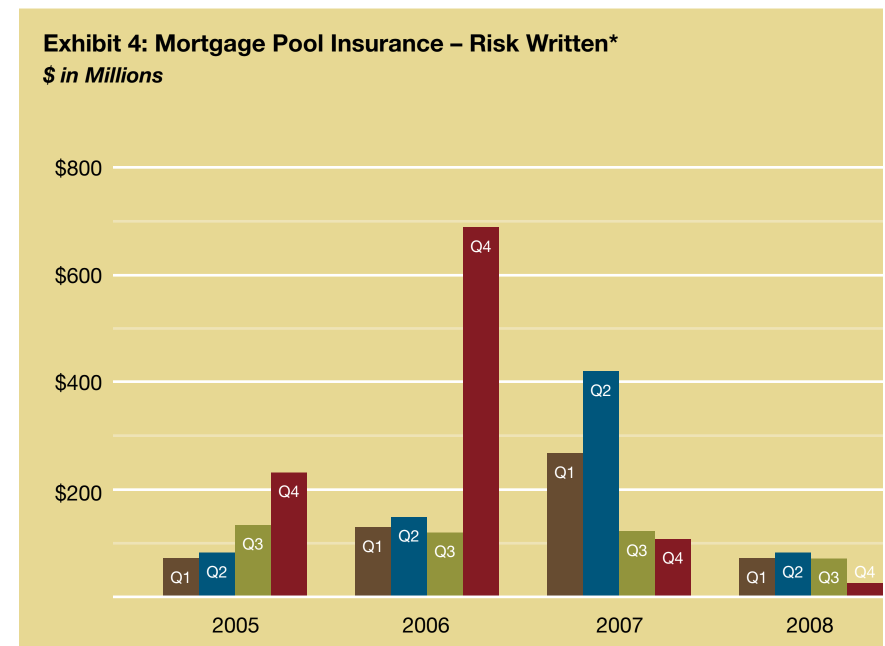
Exception: For mortgages defined as high risk, the lender will automatically cancel the PrivateMI at the mid-point of the loan. On a 30-year mortgage, for example, insurance will be canceled after 15 years.

MORTGAGE POOL INSURANCE EXPLAINED

In addition to insuring individual mortgage loans, mortgage insurers insure pools of mortgages. Mortgages are pooled so they can be sold in the secondary market and can receive an investment grade rating. Securities backed by mortgages are a significant tool for attracting capital to home financing, especially for the riskier loans.

Pools can be formed with loans that may or may not have primary insurance. In most cases, pool insurance includes a liability limit for the mortgage insurer of 5 to 25 percent of the original principal balance of the mortgage pool. For example, a $10 million pool could incur default losses of $500,000 to $2.5 million without loss to the investor.

Pool insurance activity is reflected in Exhibit 4.



Source: MICA

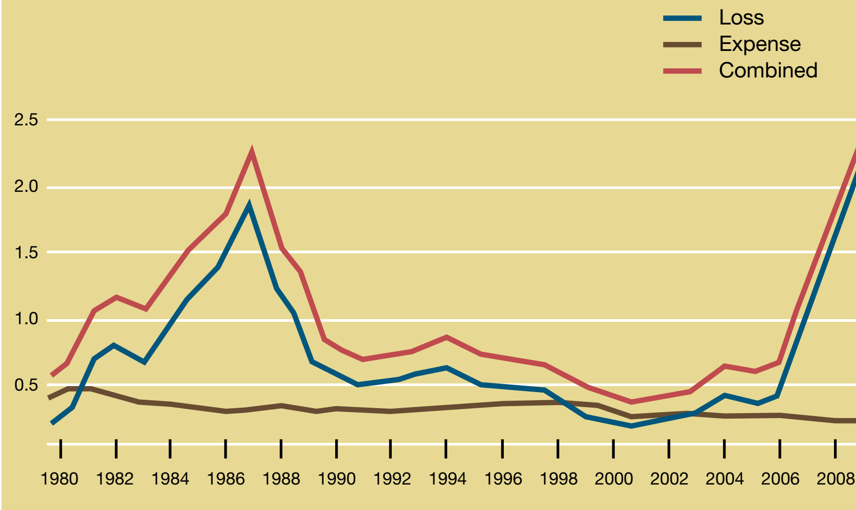
OVERVIEW OF INDUSTRY PERFORMANCE

One indicator of the mortgage insurance industry's financial capacity is the combined ratio, which is the percentage of a company's premium income that it pays out in claims and expenses.

As Exhibit 5 illustrates, MICA's members have recently seen a sharp increase in the combined ratio. This increase reflects the challenging market conditions that the mortgage industry experienced. Despite the recent up tick in losses, the PrivateMI industry continues to promote sound underwriting and risk dispersion, as well as advanced market analysis, risk monitoring programs and management reports. In addition, the industry's expense ratio has remained steady for two decades, reflecting the industry's ability to limit expenses.

The underwriting experience for MICA's members over the past four years is detailed in Exhibit 6. Premiums climbed to over $5 billion in 2008 for the first time in the industry's history. The increased premium revenue helps to offset future losses, increase reserves, and enhances an insurer's ability to pay claims. The industry's operating income is detailed in Exhibit 7.

It is important to note that industry trends are aggregate numbers and that individual company results will vary. The claims-paying ability ratings of individual mortgage insurance companies are available from bond rating agencies.



Source: MICA

Exhibit 6: Industry Underwriting Experience*
$ in Thousands

	2005	2006	2007	2008
Net Premiums Written	$3,480,174	$3,541,558	$4,180,226	$5,034,188
Net Premiums Earned	$3,454,232	$3,584,255	$4,019,423	$4,952,113
Losses	$1,251,554	$1,461,243	$5,412,163	$10,815,723
Expenses	$842,483	$858,599	$807,643	$977,959
Underwriting Income/(Loss)	$1,360,195	$1,264,413	($2,200,384)	($6,841,569)
Loss Ratio	36.23%	40.77%	134.65%	218.41%
Expense Ratio	24.21%	24.24%	19.32%	19.43%
Combined Ratio	60.44%	65.01%	153.97%	237.84%

Source: MICA

Exhibit 7: Industry Pre-Tax Profit (Loss)*
$ in Thousands

	2005	2006	2007	2008
Underwriting Income/(Loss)	$1,360,195	$1,264,413	($2,200,384)	($6,841,569)
Investment Income**	$822,060	$905,824	$809,974	$1,020,944
Other Income	$4,171	$16,069	$16,260	$5,909
Operating Income/(Loss)	$2,186,428	$2,186,304	($1,449,315)	($5,814,717)

Source: MICA

FINANCIAL STRENGTH OF THE SYSTEM

Recent trends in industry profitability provide a graphic picture of the cyclical risks of mortgage lending. It is against this pattern of peaks and valleys that mortgage insurance was designed to protect lenders.

The backbone of the industry's financial strength is its unique reserve system. This system is designed to enable the industry to withstand a sustained period of heavy defaults arising from serious regional or national economic downturns, as well as routine defaults and claims that occur normally throughout the cycle.

Under the system, mortgage insurers are required to maintain three separate reserves to ensure adequate resources to pay claims:

Contingency reserves, required by law, protect policyholders against the type of catastrophic loss that can occur during a depressed economic period. Half of each premium dollar earned goes into the contingency reserve and cannot be touched by the mortgage insurance company for a 10-year period unless losses in a calendar year exceed 35 percent of earned premiums, depending on the state. Contingency reserves allow insurers to build reserves during the valley of the risk cycle to cover claims during peak years.

Case-basis loss reserves are established for losses on individual policies when the insurer is notified of defaults and foreclosures. This reserve account also includes a reserve for losses incurred but not reported.

Premiums received for the term of a policy are placed in unearned premium reserves. Each state establishes the method by which premiums are earned to match premiums with loss and exposure.

Fannie Mae, Freddie Mac and Wall Street analysts closely monitor the industry's financial strength and have a keen financial interest in the industry's long-term health.

Assets and reserves are important elements in measuring the industry's claims-paying ability. The industry's financial standing for the past four years is detailed in Exhibit 8.

A Solid Capital Base

Mortgage insurers operate within a conservative risk-to-capital ratio, with capital guidelines established by state insurance departments. Mortgage insurers must operate within a 25-to-1 ratio of risk to capital, which means they set aside $1 of capital for every $25 of risk they insure. Insured risk is defined as the percentage of each loan covered by an insurance policy. By adhering to such strict criteria, mortgage insurers have been able to guarantee a continued source of capital for home buying, even in difficult times.

Exhibit 8: Industry Assets and Reserves*
$ in Thousands

	2005	2006	2007	2008
Admitted Assets	$20,243,363	$20,829,004	$21,964,280	$27,313,994
Unearned Reserve Premium	$444,138	$433,118	$595,148	$913,979
Loss Reserve	$2,158,579	$2,336,041	$5,957,196	$13,400,525
Contingency Reserve	$11,197,751	$14,018,383	$11,108,950	$7,127,809

Source: MICA

The industry's capital position, shown in Exhibit 9, is another measure of its ability to pay claims. The exhibit displays net risk in force for MICA's members, which includes both primary insurance and reinsurance commitments and deducts ceded insurance risk that companies outside the industry have assumed. This measure resembles that used by the financial rating agencies. Exhibit 9 still provides only a partial measure, however, for evaluating the industry's capacity to write mortgage insurance.

Reinsurance—insuring the risk of one insurance company (the reinsured) by another company (the reinsurer—helps a company reduce its loss exposure. Under a reinsurance agreement, the reinsurer participates proportionally in the reinsured's premium and potential losses. State regulations normally do not allow mortgage insurers to write insurance coverage of more than 25 percent on any individual loan amount. If an insurer wishes to offer coverage above 25 percent, it must reinsure the additional portion so another company holds the risk.

Rating agencies use financial models that specify a level of loss tolerance for a mortgage insurance company to ensure that adequate funds will be available over time to cover claims. The evaluation of capital adequacy for individual mortgage insurers is typically conducted on the basis of depression-level projected losses. In most cases, the rating process takes into consideration capital made available from a parent company support agreement and reinsurance relationships.

Exhibit 9: Net Industry Risk/Capital*
$ in Thousands

	2005	2006	2007	2008
Net Primary Risk in Force	$141,278,085	$149,195,674	$185,359,987	$219,015,800
Net Pool Risk in Force	$8,714,852	$8,822,209	$8,417,159	$8,713,900
Total Net Risk in Force	$149,992,937	$158,017,883	$193,777,146	$227,729,700
Policyholders Surplus	$5,645,758	$3,469,930	$3,242,741	$4,848,589
Contingency Reserve	$11,197,751	$14,018,383	$11,108,950	$7,127,809
Total Capital	$16,843,509	$17,488,313	$14,351,691	$11,976,399
Risk-to-Capital Ratio	8.91	9.04	13.50	19.01

Source: MICA

INDUSTRY OUTLOOK: ENHANCING HOMEOWNERSHIP OPPORTUNITIES

The housing market in the United States is in the midst of a serious downturn. The proliferation of exotic and risky mortgages left many borrowers with no financial stake in their home. That lack of equity has been a significant contributing factor to the massive foreclosures we are seeing today. Still, there are encouraging signs that the U.S. housing market is returning to the fundamental practices that have been its hallmark. Interest rates remain in the single digits, many properties are available and safe and secure financing options exist. Combined, these factors make it an opportune time for first-time home buyers to enter the market and trade-up buyers to make their move. As more people become homeowners, many will take advantage of PrivateMI to buy a home with a low down payment.

Private mortgage insurers helped nearly one-million families finance their own homes in 2008, many of them first-time home buyers. Mortgage insurers are continually creating new ways to reach out to low-income borrowers, helping families access the mortgage market and providing more opportunities for homeownership. The Mortgage Insurance Companies of America will continue its role of helping the industry anticipate opportunities to enhance homeownership and explain the benefits of low down payment financing to the public.

Data represents the following private mortgage insurers: Genworth Mortgage Insurance Corporation, Mortgage Guaranty Insurance Corporation, PMI Mortgage Insurance Co., Radian Guaranty Inc., Republic Mortgage Insurance Company, Triad Guaranty Insurance Corporation and United Guaranty Corporation.

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