



Insuring the American Dream

As a lifelong baseball fan, I love the movie *Field of Dreams*. Near the end of the film, James Earl Jones delivers a monologue that I find inspiring each time I hear it:

“The one constant through all the years . . . has been baseball. America has rolled by like an army of steamrollers. It’s been erased like a blackboard, rebuilt, and erased again. But baseball has marked the time. This field, this game, is a part of our past. It reminds us of all that once was good, and it could be again.”

Every time I hear those lines, I think about baseball—but also about homeownership and the business that I run. If there is anything more American than baseball, it’s the freedom to own a home of your own. And, for the last 51 years, mortgage insurance has been expanding the opportunity to access that dream for more Americans.

A brief history of mortgage insurance

The modern mortgage insurance industry got its start in the 1950s, but its roots were planted in 1904 when the state of New York authorized the insuring of mortgages. The industry was relatively unnoticed until real estate values collapsed during the Great Depression, causing the entire industry to collapse due to a lack of experience in underwriting and thin capitalization.

The government’s response to the housing fallout during the Great Depression was the creation of the Federal Housing Administration (FHA), which guaranteed full repayment to lenders if borrowers defaulted on their home loans. FHA returned confidence to mortgage lending and stimulated investment in housing at a critical time in the country’s history.

By the 1950s, lenders had begun to look for alternatives to FHA-insured loans, which imposed ceilings on mortgage interest rates. Lenders instead turned to conventional mortgages, which lowered default risk by requiring large down payments. But the need for large down payments made it hard for moderate-income families to buy homes.

It was at that time that the mortgage insurance industry as we know it today was born. State regulatory structures for the private mortgage insurance industry were established, and required a unique capital structure to recognize the catastrophic nature of mortgage default risk. This ensured that companies entering the business were committed for the long term.

Why is a long-term commitment important?

Since the founding of the first mortgage insurance company, the industry has helped more than 25 million American fami-

lies buy homes, build their personal wealth and endure times of financial crisis.

In the early 1980s, double-digit interest rates and inflation caused the housing industry to turn to new types of financing to help more people qualify for mortgages. Low-down-payment loans were paired with experimental new products like adjustable-rate mortgages (ARMs), initial “teaser rates,” negative-amortization mortgages and graduated-payment mortgages. When economic conditions deteriorated, particularly in the “Oil Patch” states of Texas, Oklahoma and Louisiana, as well as Alaska, people lost their jobs and foreclosures ensued.



If there is anything more American than baseball, it’s the freedom to own a home of your own.

During this period, mortgage insurers paid more than \$6 billion in claims to policyholders, protected companies that provide mortgage capital from extensive losses and helped prevent a Depression-like collapse of the country’s financial markets.

At the same time, mortgage insurance companies were innovating to find creative solutions that kept people in their homes. In 1983, PMI Mortgage Insurance Co. created a program called Saving Homeownership And Repayment Plans (SHARP), which helped borrowers who had become delinquent on their mortgages but had the desire and ability to stay in their homes. The SHARP program, which PMI still uses, advances a partial claim to borrowers to cure their delinquency and avoid foreclosure.

A continued commitment to a sustainable housing market and the contingency reserve and capital requirements structure of mortgage insurers helped the country endure a similar regional decline in the housing market during the 1990s, and it will help us endure the crisis we’re in today.

A sustainable housing market

At PMI, I speak often of our efforts to foster a healthy, sustainable housing market. We know from experience that the healthiest housing markets grow at a moderate pace, and that when housing growth occurs at a sustainable pace, everyone involved



REPRINTED WITH PERMISSION FROM
THE MORTGAGE BANKERS ASSOCIATION (MBA)

benefits. In contrast, housing booms—such as the one we saw from 2002 to 2005—can leave disastrous fallout in their wake.

After the Great Depression, the governor of New York commissioned a study to determine why the mortgage insurance industry of the day had collapsed. The study—known as the *Alger Report*—recommended that, in the future, the welfare of mortgage insurers be aligned with the welfare of homeowners in order to avoid conflicts of interest. It also called for stringent capital and reserve requirements, and the adoption

Housing markets have been erased like a blackboard, rebuilt and erased again. But mortgage insurance has stood the test of time.

of sound appraisal, investment and accounting procedures.

That is the model the mortgage insurance industry has followed for 51 years, and it is why we remain the sole, non-government, risk counterparty functioning in today's distressed mortgage finance market. Piggyback loans and structured investment vehicles have come and gone, while the mortgage insurers continue to pay claims, insure against risk and expand homeownership opportunities.

I can't help but feel a little like James Earl Jones when I say that, for more than 50 years, one constant in a sustainable housing market has been mortgage insurance. Housing markets have been erased like a blackboard, rebuilt and erased again. But mortgage insurance has stood the test of time. This business, in this industry, protects the American dream, which reminds us of all that once was good, and could be again.

Steve Smith is chief executive officer, president and chief operating officer of The PMI Group Inc., Walnut Creek, California, and chairman of the board and chief executive officer of PMI Mortgage Insurance Co. He can be reached at pmi@pmigroup.com.