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Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee, thank you for the opportunity to testify on behalf of Arch Capital Group Ltd. (Arch). My name is Andrew Rippert, and I am the Chief Executive Officer of Arch's Global Mortgage Group. In this role, I am responsible for our mortgage guaranty and credit risk transfer operations around the world with an emphasis on the US housing market, and it is in this capacity that I offer my testimony today. I also have over 25 years of experience in real estate finance, and currently serve on the Board of Directors of the Mortgage Bankers Association (MBA), as a voting member of the MBA's Residential Board of Governors and as a member of the Executive Committee of the Housing Policy Council.

Arch's Global Mortgage Group provides mortgage insurance and reinsurance on a worldwide basis, and we are committed to making substantial, long-term equity investments in support of the US housing market. Since entering the US mortgage insurance market in 2010, Arch has recognized that we cannot determine how the housing finance system of the future would operate – that is the job of Congress – but has also known that whatever the structure of the future system, the US mortgage market would need substantial private capital to de-risk taxpayers and help homeowners, and the housing market, recover and thrive in the future. To that end, we sought to build our company on a solid base of equity capital and with an orientation to bearing mortgage credit risk in whatever form it might come, be it traditional private mortgage insurance, or alternative models of credit risk transfer on the front or back-end, in ways that can expand sustainable homeownership.

We operate Arch MI, the largest private mortgage insurance company in the country. At the end of the third quarter, we had over $250 billion of insurance in force (IIF) ($64 billion of risk in force – excluding our CRT transactions) – $54 billion more IIF than the next largest private mortgage insurer.

In addition to our primary mortgage insurance operations, we have led the development of reinsurance executions for Government-Sponsored Enterprise (GSE) credit risk transfer (CRT) transactions under Freddie Mac's Agency Credit Insurance Structure (ACIS). We continue to be a leading participant and innovator in the growing CRT market and engage regularly with regulators, the GSEs, and other market participants on how we can help them accomplish their credit-risk sharing and management objectives.

We believe Arch's mortgage guaranty practice is consistent with the important public policy goal of responsible transfer of risk from taxpayers to the private sector. Our operating model is unique in that it utilizes diverse channels for acquiring risk (including both the private mortgage insurance and CRT models), performs comprehensive assessment of the risk acquired, and then syndicates a portion of that risk on a programmatic basis to achieve price discovery and market validation of our own risk assessments, and to ensure our capacity to support the housing market through a downturn in the housing cycle. This model, which we call "buy-manage-syndicate," is similar to that which the GSEs have evolved under the guidance of the Federal Housing Finance Agency (FHFA) as conservator. We see this evolution, from essentially a model of "accumulate and hold" to a model of "accumulate to distribute," as a critically important advance to put the US housing market on a more sustainable path for the future.

The Committee has requested views and perspectives on three topics: (1) the need to enact comprehensive housing finance reform; (2) the legal, statutory or regulatory impediments to the return of private capital to the housing finance system; and (3) what factors and metrics Congress should consider to reform the housing finance system.

Before addressing the specific topics, I want to take the opportunity to commend the meaningful and significant administrative reforms that FHFA has put in place since 2012. Under both Acting Director DeMarco and Director Watt, FHFA has progressed from a model in which risk was overly concentrated in a limited number of entities to one that – through CRT – has transferred risk to hundreds or perhaps thousands of investors across the reinsurance and capital debt markets. Additionally, through the introduction of the Private Mortgage Insurer Eligibility Requirements (PMIERs), the private mortgage insurers – currently the largest counterparties to the GSEs – have greatly improved their risk and capital frameworks. Finally, important progress has been made in the development of a common securitization platform (CSP) is critical to addressing systemic risk in which the failure of a guarantor could threaten to take down the nation's critical securitization infrastructure.

These actions represent meaningful evolutionary reforms that have reduced taxpayer exposure to mortgage risk, and provided important diversification of private capital sources for the GSEs. But reform remains incomplete, and absent legislative action, we share the concerns of many market participants and other housing stakeholders, that homeowners, taxpayers and the economy remain greatly at risk. We hope that conversations about continued housing finance reform build upon and solidify these advances.

Need to Enact Comprehensive Housing Finance Reform

The status quo in the US housing finance system, as has been widely observed by analysts and policymakers from across the ideological spectrum, is unsustainable and Arch supports comprehensive, housing finance reform legislation as soon as possible. The lack of comprehensive housing finance reform in the aftermath of the financial crisis adversely impacts private investment, economic growth, and the availability of mortgages for creditworthy borrowers. While mortgage credit markets have been healthy in recent years as markets have been recovering from a historic trough, making reform a priority now can help ensure that the system is well prepared to handle an eventual and inevitable market downturn.

The continued conservatorship of the GSEs creates systemic risk and policy uncertainty that is keeping private capital on the sidelines. This has contributed to a more anemic housing recovery and homeownership levels than we might have otherwise experienced. The reality is that even with the risk syndication initiatives of the GSEs, there exists a duopoly in which two companies control the entire secondary market infrastructure for the conforming market. They remain prime examples of "too big to fail."

Several models have been proposed to reform the current structure of the GSEs. We believe that a multiple guarantor model would best diversify risk and permit greater competition on operations, system development, customer service, production and pricing. Additionally, a multiple guarantor

model that includes private sector guarantors, coupled with programmatic syndication of risk to third parties, would continue the precedent established through CRT of shifting first loss risk away from government exposure.

The work done to transfer risk through the CRT programs developed by the Enterprises with the support of FHFA has been significant in bringing private capital to bear in the market and the GSEs should continue to expand to new innovative structures and ideas. However, it should be noted that these programs are not statutory in nature. Therefore, one of the biggest regulatory risks we see is the potential for the progress made over the past five years to be abandoned in the absence of a statutory change. Arch recognizes that the FHFA Director is invested with an enormous amount of power over what is arguably the second largest financial market in the world, and pending regime change at the Agency has the potential to contribute to additional market uncertainty.

Legislation is the only way to ensure that these policies have permanence and consistency. All participants in housing finance reform should support ways to “lock in” the advances of the past five years to avoid the possibility of reverting to previous counterproductive practices.

Finally, comprehensive housing finance reform is necessary to structurally shift more first loss risk from the government. For all of the merits of the current CRT programs, the GSEs still hold significant first loss exposure concentrated on two highly leveraged balance sheets with explicit taxpayer backstops. By fundamentally changing the structure to include multiple guarantors, or instituting a government guarantee similar to that provided by Ginnie Mae, the current proposals structurally shift first loss exposure to private market participants.

Until such structural changes are made, the GSEs should continue to engage and expand their utilization of back-end transactions, including CRT and reinsurance transactions, such as Fannie Mae’s Credit Insurance Risk Transfer (CIRT) and Freddie Mac’s ACIS. Reinsurers offer a highly rated, well-capitalized and more diverse private capital option – therefore broadening the base of available global capital and providing greater taxpayer protections. Reinsurance is a long-standing means for various industries to transfer both catastrophic and non-catastrophic risk. In addition to reducing risk exposure, another benefit of risk syndication is the price discovery that it provides. By receiving real-time price discovery, the syndicator of risk can assess whether it is adequately underwriting and pricing its risk. This type of feedback can help inform policymakers, consumers and other key stakeholders to determine if the market may be getting overheated. Additionally, if used appropriately, this information can inform consumers, investors and policymakers of developing bubbles, and ultimately help temper some of the historical boom and bust cycles that have had a negative effect on homeownership rates, wealth accumulation and wealth inequality.

In parallel, the GSEs should expand their utilization of front-end transactions including the use of mortgage insurance with greater coverage percentages than currently required by the Enterprises on loans with loan-to-value (LTV) ratios greater than 80%, as well as on loans with below 80% LTV ratios (Deep Cover MI). For example, the GSEs could engage in CRT transactions using a combination of Deep Cover MI and reinsurance options offered through well-capitalized global reinsurers. Each option has

significant merit, and a combination of them will better serve the interests of taxpayers, consumers, and economic growth broadly.

Legal, Statutory or Regulatory Impediments to the Return of Private Capital to the Housing Finance System

Arch believes that the most important thing Congress – and only Congress – can do to address the legal, statutory or regulatory impediments to the return of private capital to the housing finance system is pass comprehensive housing finance reform legislation attending to the uncertainty of the unsustainable conservatorships. Our recommendation is, through legislation, to affirm that programmatic CRT will be a permanent feature of the housing finance system of the future. It takes a substantial commitment of both human and financial capital to participate in these markets, and while the CRT market is flourishing, we believe more participants will emerge once it is clear that these successful pilot programs are a permanent feature of the housing finance system.

As previously noted, with CRT as a permanent feature, private capital will make the levels of investment necessary to prudently and proactively underwrite mortgage credit risk across all market conditions, thereby providing well-informed, timely and valuable feedback on the level of risk in the market. We believe such feedback will provide tremendous value to policymakers, market participants and consumers alike.

Factors and Metrics Congress Should Consider to Reform the Housing Finance System

Arch recommends that Congress consider the following key factors as it seeks reforms to bring certainty and stability to the housing finance system:

1. Private capital should be positioned ahead of taxpayers in a meaningful way.
2. The regulatory framework for any future system should require mortgage guarantors to follow a countercyclical capital model that is responsive to the dynamic nature of housing market risk. Participants should be required to hold capital in proportion to that risk in order to keep the government and taxpayers in a risk-remote position.
3. The regulatory framework for any future system should require mortgage guarantors to follow an "accumulate to distribute" model to ensure a diverse pool of private capital – including equity capital, debt off the balance sheet, and true credit risk transfer through the capital and reinsurance markets. This "accumulate to distribute" model will ensure ongoing price discovery, important risk and capital management information and that the most efficient form of private capital is regularly made available to the US housing finance system.
4. Reform should encourage additional transparency into the cost of credit and collateral risk associated with CRT.
5. FHA reform to eliminate negative competition.

We provide additional detail on each of these factors below.

1. Since the GSEs entered conservatorship, and with bipartisan support from Congress and successive Presidential administrations, the GSEs' strategic model has evolved from "buy and hold" risk to "accumulate to distribute" risk across multiple balance sheets in the reinsurance and capital markets – primarily through CRT programs. This emphasis on additional private capital is positive for the industry in that it has reduced the GSEs' overall risk exposure, and by extension, lessened the risks to taxpayers, homeowners and the economy as a whole.

   Additional work should be done to better protect the US taxpayer vis a vis housing risk on LTV ratios below 80% where the GSEs continue to hold a significant amount of first loss risk. Private capital continues to look for opportunities to take some of this risk from the taxpayer.

2. Critical to the long-term success of any housing reform is the development and implementation of a clear, transparent, risk-based countercyclical capital model. A countercyclical framework is sustainable through economic cycles to support a strong guarantor and will help ensure effective risk management by market participants.

   Current capital models such as the PMIERs are not countercyclical as they do not encourage counterparties to either raise capital or reduce the amount risk they are aggregating when market fundamentals indicate a riskier market with the potential for more severe losses. Several proposed capital models, including that of the National Association of Insurance Commissioners, include elements that increase capital requirements for mortgage credit risk when properties become over-valued. In a countercyclical capital model, mortgage insurers would be incentivized to minimize exposure to riskier loans because capital requirements for those mortgages would be higher.

   Pursuing a clear, transparent set of countercyclical capital requirements on mortgage risk counterparties could help dampen market bubbles and reduce the risk of dramatic downturns in the housing cycle with the attendant negative consequences for households and the economy as a whole.

3. Diversified sources of capital and options for placing risk are critical to housing reform. While Congress debates statutory reform, the GSEs and FHFA should continue engaging in back-end CRT transactions while expanding their focus to front-end transactions. Accessing a broad set of private capital sources, including private mortgage insurance, reinsurance and the capital markets is a proven and effective way to reduce concentration risk and lessen taxpayer exposure to the housing market.

4. We believe that the GSEs need to continuously evaluate and price the risk of loss to ensure that loans do not present an unacceptable risk to families and taxpayers. In addition, the GSEs should report on the cost of the credit and collateral risk associated with their lending programs, as well as any subsidization necessary to maintain affordability. This added transparency will enable the FHFA to confirm that the GSEs are serving their intended purpose without imposing excessive risks on borrowers, taxpayers or the economy as a whole. It will also ensure that the GSEs are better

prepared to weather all economic cycles. Additionally, added transparency is essential to permit private market participants to effectively price mortgage credit risk, and to arm Congress and policymakers with the information they need make effective decisions on affordable housing subsidization.

5. Finally, as part of any potential housing finance reform we believe it is imperative for FHFA to consider the strategic initiatives and loan programs offered by the FHA, which help ensure broader access for qualified borrowers. Coordination is necessary to eliminate any negative competition or unnecessary overlap between the government programs, which could lead to the accumulation of excess risk for consumers and taxpayers in the housing finance system. Controlling these excessive risks is critical to protecting individual borrowers, helping keep credit affordable for aspiring homeowners and ensuring stability through credit cycles across the broader market.

Conclusion

The evolution of the US housing finance market calls for a significant increase in the volume of private capital as well as access to additional diverse sources of capital that provide first loss coverage on mortgage credit risk. Equally as necessary, the solution should reduce taxpayer risk, lower cost to all borrowers and reduce operational costs for lenders, large and small alike. At a minimum, Congress should pass legislation to secure the positive gains made in the area of CRT by the FHFA and the Enterprises over the past five years by requiring greater levels of both back-end and front-end risk transfer with mortgage insurers, reinsurers and the capital debt markets in a variety of forms.

Ideally, more comprehensive legislation will be achieved that addresses the additional issues of "too big to fail," completing the work on the CSP and a Single Security, and ultimately separating the critical secondary market infrastructure from the risk-taking guarantor function, requiring a prudential capital framework for mortgage guarantors based on a countercyclical capital model, implementing reporting requirements to ensure transparency of costs related to CRT versus front-end guaranty fees, and addressing FHA reform to eliminate negative competition.