The Role of Mortgage Insurance in Developing a Mortgage Market

Dubna, Russia
February, 2004
Canada Mortgage and Housing Corporation (CMHC)

- A federally owned corporation established in 1946: public housing agency with a private sector culture/structure
- Has a commercial mandate to promote:
  - Housing affordability and choice
  - Housing construction, repair and modernization
  - Improvements to overall living conditions

- Industry leader in Mortgage Insurance and Mortgage Securitization
- Mortgage Insurance mandatory in Canada for high (75%+) LTV loans

- **CMHC International** has worked with governments and private companies across the globe to help them improve their housing conditions and implement innovative housing finance strategies.
Mortgage Insurance

• What is Mortgage Insurance?
• Value of Mortgage Insurance
• Challenges to Introducing Mortgage Insurance
• Lessons Learned
What is Mortgage Insurance?

• Mortgage Insurance protects lenders against a portion of the costs related to homeowner mortgage defaults or foreclosures.
  • Typically paid for by the borrower
  • Typically a shared risk with lenders
  • Credit Enhancement

• Enhanced risk management
  • Promotes prudent high Loan To Value (LTV) lending
  • Third-party / independent evaluation of all insured loans
Value of Mortgage Insurance

Why Is Mortgage Insurance Worth Discussing?
Mortgage Insurance Works At Many Levels
Value of Mortgage Insurance

**Direct Benefits**
- Protects lenders
- Improves risk management
- Improves mortgage process management
- Minimizes loan losses and reduces capital requirements

**Indirect Benefits**
- Promotes safety and soundness
- Encourages lenders to fulfill housing policy without increasing risk in financial system
- Improves access to affordable mortgage lending.
- Promotes effective property valuation, credit information and default management
- Improves confidence in the system
Mortgage Insurance Benefits the Financial System

- Enhances **access to affordable housing** for much of the population.
- Enhances **mortgage lending** and **standardization** in housing finance.
- Acts as a **credit enhancement** and audit verification to support **securitization** – which increases liquidity in the financial system and promotes lower funding costs.
- Promotes fair and **transparent lending practices** and improves the **quality of housing** by working with other agencies to enforce building codes and standards.
- Brings the benefits of **global risk management expertise**.
- Encourages **increased investment** in housing finance.
Risk Management Benefits for the Market

- **Risk Management** – Mortgage insurance companies can promote movement toward Advanced Risk Management Techniques.
- **Standardization** – Can specify standards and ensure uniformity.
- **Spreading Of Credit Risk** – Credit risk is transferred outside the financial system to better diversify credit risk and reduce systemic risk.
- **Credit Enhancement** – Mortgage insurers can help with Capital Market Solutions.
- **Supervisory Role** – Since mortgage insurers are sharing the risk, they are motivated to demand quality credit information, property valuations, underwriting standards, and delinquency management.

Provides transparent credit risk mitigation that is well understood by regulators and investors.
Mortgage Insurance Benefits the Financial System

1. Manages and Stabilizes Risk
2. Promotes Housing Finance Access
3. Deepens Capital Markets
4. Enables Securitization
5. Leads to Housing Finance Efficiencies
What are some of the Common Challenges Facing Emerging & Transitional Mortgage Markets?

- **Legal/Regulatory**: Framework often sub-optimal.
- **Foreclosure**: An issue everywhere. Cultural sensitivity to the concept.
- **Title Registration**: Complex, lengthy, costly or ineffective.
- **Experience**: Experienced lenders limited; limited appetite.
- **Long Term Funding**: Unavailable or very limited.
- **Historic Data**: Very limited or unavailable.
- **Professional Services**: Credit bureau and real estate professionals very limited.
- **Market Analysis**: Very limited everywhere.
**Model – Liquidity Facility and Mortgage Insurer**

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<thead>
<tr>
<th>Ownership</th>
<th>Public/Private Partnership</th>
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<td>Challenges</td>
<td>Mortgage lending non-existent.</td>
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<td>Lack of long term funds for mortgage lending</td>
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<td>Ongoing political instability, affecting housing affordability</td>
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<td>Limited registered land available</td>
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<td>Objectives</td>
<td>A commercially viable organization that improves the affordability of home purchasing by increased access to financing</td>
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<td>Institutional strength</td>
<td>Public-Private and Domestic-Foreign collaboration</td>
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<td>Housing Finance Corporation increases long term funding available</td>
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<td>Mortgage Insurance Fund reduces default risk to banks</td>
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<td>Direct development of mortgage market</td>
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<td>Government support</td>
<td>Palestinian Authority and IFI investment</td>
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<td>Regulatory support</td>
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<td>Results and Impacts</td>
<td>Created mortgage market in difficult environment; raised awareness about housing finance</td>
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<td>Developed future opportunities through registering properties and new partnerships</td>
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## Proposed Model - Guarantee Agency

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<th>• Public/Private Partnership</th>
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| Challenges      | • High demand for access to affordable funds.  
|                 | • Exuberant lending, limited loan security, and lack of credit data and standardization pushing risk high in housing loan sector  
|                 | • Weak regulatory and legal framework for mortgage lending and mortgage insurance |
| Objectives      | • Improve risk management  
|                 | • Increase housing accessibility and affordability for low and middle-income families  
|                 | • Promote increased funding for housing finance through Mortgage-Backed Securities (MBS) |
| Institutional strength | • Public-Private and Domestic-Foreign collaboration  
|                 | • Promotes better Risk Management of High LTV lending |
| Government support | • Government and IFI minority investment  
|                 | • Government developing supportive Regulatory environment |
| Expected Results and Impacts | • Promotes Sound Growth and Expansion of Housing Finance into untapped Markets |
Lessons Learned

- Need to be pragmatic.
  - What is possible?
  - What is feasible?
- Mortgage Insurance needs to be specifically designed to meet each specific circumstance of the market.
- Crucial to share the risk.
- There are important roles for both the private and public sectors.
- Public-Private Partnerships can be very effective.
Lessons Learned

- Success of advanced systems built over time:
  - Not all system requirements need to be fully in place to start mortgage default insurance systems.
  - Successful systems in Canada, US, Europe and Asia have learned from experience.
  - Systems and institutions evolve.
Thank You