MORTGAGE BANKERS ASSOCIATION

September 5, 2014

Federal Housing Finance Agency
Division of Housing Mission and Goals
400 7th St, SW, Ninth Floor
Washington, D.C. 20024
Attn: Mortgage Insurance Eligibility Project

To Whom it May Concern:

On July 10, 2014 the Federal Housing Finance Agency (FHFA) released for comment the draft private mortgage insurer eligibility requirements (PMIERs). The PMIERs, when finalized, will establish capital and other requirements for mortgage insurers (MIs) who provide insurance on loans owned or guaranteed by the GSEs. The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to comment on this critical effort and applauds FHFA for its transparency in soliciting stakeholder comment prior to implementation.

A sound, comprehensive capital framework for the MI industry is critical for market confidence and will serve as the foundation for bringing more private capital into the market, including through up-front risk sharing initiatives that MBA has proposed previously to FHFA. With the implementation of the PMIERs, FHFA will have expressed confidence that MIs will be well-capitalized, strong and stable counterparties. Coupled with the finalized master policies, policymakers can now confidently increase the role for private MIs to bring private capital into the conventional conforming market in scale, reducing taxpayer exposure to mortgage credit risk.

MBA has worked with its members to review the PMIERs draft and provides the following recommendations:

- FHFA should fully recognize the reduced credit losses (both expected losses and economic capital from unexpected losses) from the use of mortgage insurance in their LLPA pricing matrix;

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

- FHFA should adopt a program to allow for deeper MI coverage on high LTV loans, and coverage on loans with LTVs below 80%, accompanied by a reduction in G-fees. Importantly, this would require lowering the floor on loss factors to account for these lower risk loans;

- FHFA should set forth clear, transparent standards for governance and risk sharing contemplated under the PMIERs;

- The PMIERs should not be used to transfer to the GSEs, who are the policy beneficiaries, the rights of MIs to approve appropriate loss mitigation decisions;

- The capital requirements should recognize the reduction in risk as loans season;

- Contractual MI premiums should count toward capital.

FHFA should ensure that the PMIERs are implemented in a way that results in little to no increase in the total cost borne by borrowers. The PMIERs could lead to notable increases in MI premiums. For example, a recent paper by Moody's Analytics estimates that borrowers on average could experience an MI premium increase of fifteen basis points. The same paper estimates that borrowers with lower credit scores who make a 5% down payment could end up paying an additional 70 basis points in MI premiums. Other analysts expect that the potential increase could be much smaller, but would still be positive. FHFA should direct the GSEs to make the appropriate offsets in credit pricing in order to mitigate the impact of the PMIERs on borrowers.

Borrowers focus on their total monthly payment, the sum of principal and interest and mortgage insurance premiums. Potential increases in mortgage insurance premiums should be offset by reducing LLPAs, recognizing that they now have stronger, more stable counterparties. This approach would leave the ultimate cost to the consumer little changed while increasing the amount of private capital backing mortgage lending. FHFA should also carefully consider whether the treatment of delinquent loans results in unnecessarily high costs to borrowers as a result of overly conservative loss factors.

Regardless, if FHFA does not plan to make appropriate offsets upon implementing the PMIERs, MBA would need to reconsider its general support for the PMIERs in light of the potential for a substantial increase in costs borne by consumers.

MBA's general comments are immediately below and are followed by our specific reactions to discrete issues we have identified in the PMIERs.

GENERAL COMMENTS

FHFA Should Fully Recognize the Reduced Credit Losses From the Use of Mortgage Insurance in Setting their LLPA Pricing Matrix

The GSEs play a critical role in providing liquidity to the housing finance market. Strengthening GSE counterparties should work hand-in-hand with faciliating a liquid, competitive national housing market. Full recognition of the protection provided by strong MIs should also lead to a reduction in loan-level price adjustments (LLPAs), which should no longer be impacted by haircuts on MI coverage.

MIs are critical counterparties that stand in front of the GSEs, assuming the initial risk of loss for low downpayment loans often taken by first-time homebuyers. In doing so, they reduce the loss severity experienced by the GSEs if a loan defaults. Thus, the depth of MI coverage and the corresponding strength of the MIs are critical factors in setting the GSEs' LLPAs. MBA believes that the LLPAs are currently too high, in part because the GSEs are discounting the value of MI coverage.[2] The strong capital requirements in the PMIERs justify putting an end to this practice, and FHFA should require that the GSEs reduce LLPAs accordingly to reflect the full value of MI coverage.

While MBA has some specific concerns with discrete terms in the PMIERs, the standards would impose unquestionably strong capital requirements on approved MIs. PMIERs requires minimum asset levels of 5.6% of risk-in-force (RIF).[3] This minimum asset level is augmented by risk-weightings for each loan on which coverage is provided. The primary criteria for risk-weighting of an individual loan is the FICO-LTV combination. Loans originated up to and including 2008 receive higher risk-weightings than loans originated during 2009 and beyond, with the 2005-08 vintages receiving the highest risk-weights. These risk-weights will likely combine in a way as to raise the capital for a typical book of business well above the 5.6% minimum as well as above current baseline levels.

The strengthening of MI capital ensures that the GSEs will have well-capitalized counterparties that have sufficient claims paying resources to cover their RIF during periods of deep economic strees and should lead to an immediate reduction in LLPAs to account for the reduced risk. This reduction is justified on two grounds. First, the PMIERs would leave no doubt that the GSEs were firmly in a second-loss position by ensuring that each MI would have robust claims paying resources available to cover potential losses during periods of economic stress.[4] Second, the GSE attachment point

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[2] *See* FHFA, Mortgage Analytics Platform

[3] This results in a maximum leverage ratio of 17.86:1. Historically, the industry has generally maintained leverage multiples in the mid-teens to low-20s.

[4] Typically, GSE contractual coverage would not apply unless total loss severity exceeded 33% of the purchase price of the home.

is remote enough that the required return on capital for insuring that risk should be well below the returns assumed by the GSEs, even in a competitive market environment.[5]

Coupled together, full recognition of MI would provide the GSEs with more than sufficient space to reduce LLPAs to better reflect the true risk to which they are subject.

FHFA should adopt a program to allow for deeper MI coverage on high LTV loans, and coverage on loans with LTVs below 80%, accompanied by a reduction in G-fees.

MBA has argued previously that FHFA should direct the GSEs to implement an up-front risk sharing program, highlighted by deeper MI coverage on higher LTV loans and coverage of lower LTV loans, e.g. coverage for a 70% LTV loan down to an effective LTV of 50%. Under this proposal, a lender could seek loan-level coverage from an MI and in turn receive commensurately lower G-Fees and LLPAs from the GSEs. MIs could potentially insure down to an effective LTV of 50%, leaving the GSEs covering only a pure catastrophic risk position. The market would benefit from competition and increased price transparency, and consumers would likely benefit through lower costs. Indeed, as MBA has mentioned previously, there are currently cases where the GSEs charge more through G-Fees and LLPAs for their second-loss position than MIs charge for their first-loss position.[6]

In order to make coverage of lower LTV loans economically viable, FHFA should add factors for original LTV categories down to 60% and lower the floor for loss factors, which under PMIERs is set at 1%. Loans with original LTVs below 80% have loss rates that are a fraction of loans with higher LTVs. These lower loss rates should be reflected in lower factors. The floor on required assets of 5.6% should also be adjusted for loans with LTVs of 80% or less given the lower risk of these loans. The overall effective floor would be calculated on a risk-weighted basis by applying 5.6% to above 80% LTV loans and the lower factor on loans with 80% LTV and below.

With stronger private capital counterparties ready to invest in mortgage credit risk, there should be no reason for delay in implementing this proposal.

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[5] *See* FHFA, *Fannie Mae and Freddie Mac Guarantee Fees: Request for Input*, available at: http://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/GfeeRFI060514F.pdf
[6] *See* MBA response to G-Fee RFI

FHFA Should Set Forth Clear, Transparent Standards for Governance and Risk Sharing Contemplated under the PMIERs

As written, the PMIERs are overly reliant upon ad hoc approval from the GSEs for many aspects of MI operations and business decisions. Clear guidelines and standards should be published for each of the issues discussed below.

One aspect of the PMIERs that is particularly concerning to MBA is the ambiguity or outright lack of clear standards for managing critical aspects of MIs' day-to-day business. This is most problematic in the case of remedial action, whereby the GSEs assert the right to take "remediation actions," such as exercising direct control over business operations of an MI, without affording the MI the opportunity to contest the underlying allegations.[7]

MBA understands that FHFA is working to develop an appeals process that would apply in cases where the GSEs seek to utilize remedial actions. While this is encouraging, MBA is concerned that the framework itself, and in particular the remedies afforded to the GSEs, include provisions that go far beyond counterparty risk management and are more akin to regulatory actions. As insurance companies, MIs are subject to a long-standing body of regulation by experienced state insurance commissions that should be taken into account. Further, as policy-holders of MI coverage the GSEs should not be in a position to regulate or direct the operations of an MI firm.

The PMIERs also fail to set forth standards for capital relief from entering into re-insurance and other permitted risk-sharing transactions, creating substantial uncertainty and opening the door for potentially arbitrary action with respect to the approval and total impact of these agreements. In particular, FHFA should set forth clear and transparent standards for re-insurance structures that provide capital relief, rather than requiring MIs to seek approval in each individual case.

MBA is also concerned regarding the provisions with respect to loss mitigation standards. In addition to being vague, the loss mitigation provisions in the PMIERs grant inappropriate authority to the GSEs to direct loss mitigation activities. The GSEs are beneficiaries of MI policies, and it would be contrary to long-established insurance practices for an insured party to exercise control over the preservation and/or disposition of the collateral in question.

MBA recommends that FHFA clarify the rules of the road in a way that MIs and other stakeholders can rely on going forward. MBA also strongly objects to the notion that the GSEs have any right to exercise direct control over their counterparties' business activities, particularly where there is an existing regulatory framework in place. The

[7] *See generally*, PMIERs Section 900

GSE approval standards and corresponding enforcement tools are more than sufficient for ensuring that the GSEs are protected from counterparty risk, and there is no need for the GSEs to attempt to supplement them with quasi-regulatory powers.

In addition to the issues highlighted above, MBA recommends FHFA establish clear guidelines covering the following key issues:

- The terms, if any, by which an MI or affiliate/subsidiary may engage in contract underwriting services for lenders;

- The process and standards by which the capital requirements can be changed in the future, in particular during economic cycles;

- The due diligence which is required when approving lenders as counterparties, in particular where the lender will be delegated underwriting authority. MBA notes that the lenders themselves are subject to approval by the GSEs as well.

Providing clear, transparent rules will be critical in ensuring that the PMIERs fulfill FHFA's goal of strengthening the housing finance system.

The PMIERs Should Consider Reducing the Risk-Weight for Loans Originated During and After 2014 due to the ATR/QM Standards

In January of this year, the Consumer Financial Protection Bureau fulfilled a requirement under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and implemented the ability-to-repay rules, including the Qualified Mortgage underwriting standards (QM). Loans that meet the QM standards are presumed to comply with the stringent ability-to-repay underwriting requirements.

The PMIERs do not take the QM standards into account in crafting the risk-weights or capital requirements, even for loans meeting the QM safe harbor or loans which are QM independent of the GSE "patch." The resulting impact on capital, and thus cost to the borrower, is felt most acutely in those LTV and FICO buckets most applicable to first-time homebuyers and the underserved – precisely the borrower segments for whom the GSEs' mission is most important.

MBA suggests that the impact of the QM standard on expected loan performance should result in reduced risk and less required capital – in particular for loans that meet the safe harbor. FHFA should consider creating a separate table for loans originated during and after 2014 that meet the QM standard.

SPECIFIC COMMENTS

The Capital Requirements Should Recognize the Reduction in Risk as Loans Season

As mentioned above, the PMIERs create a risk-weight schedule based on the FICO and LTV of the loan. This risk-weight is determined based on the factors at the time the loan was originated. However, performing loans receive no reduction in risk-weight as the loans season despite the declining risk. MBA recommends that FHFA include a seasoning provision that would reduce the capital that must be held against a loan as the loan performs. There are simple approaches to modeling capital release with seasoning that could be easily added to this framework without delaying implementation. Importantly, the impact of seasoning should not be accompanied by adjustments to the other draft factors that would mitigate or eliminate the impact of seasoning factors on capital. Additionally, the seasoning approach should be formulaic and known at PMIERs' inception so MIs can know and plan for the resulting capital release.

Contractual MI Premiums Should Count Toward Capital

MIs rely on a flow of premiums over time to absorb potential losses from their books of business. However, the PMIERs, as drafted, do not include any premium income for loans originated during or after 2009 in calculating MI capital.[8] MIs are, however, allowed to count toward capital 210% of premiums received in the prior 12 months from loans originated prior to 2009. No principled reason exists for this difference in treatment. Indeed, the GSEs appropriately use a stress scenario similar to the Federal Reserve's Comprehensive Capital Analysis and Review (CCAR), yet do not adopt CCAR's recent changes which allow certain income projections to be counted toward capital.

MBA recommends allowing for up to two years of premium income to be counted toward capital.[9] This amount can be limited to a certain percentage of an MI's overall capital to reduce the risk of overreliance on this particular asset. MBA also urges FHFA to ensure that any methodology for including premium income be done in a way that treats all forms of premium income, whether up-front or on-going, on an economically equivalent basis.

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[8] *See* Section 700.

[9] Typically, MIs model 4 years of premium income from a loan. *See* Moody's Analytics, *Putting Mortgage Insurers on Solid Ground*, at 4; August 2014.

CONCLUSION

The PMIERs would, if implemented, require the GSEs' MI counterparties to have a more robust capital base from which to pay potential claims. The risk faced by the GSEs would thus be reduced, providing an opportunity for reducing LLPAs and increasing private capital participation.

The GSEs' mission of facilitating a competitive, liquid national housing market requires a careful balance between counterparty security and the need to provide liquidity to the mortgage market as a whole. Under the proposed structure, this balance is not achieved absent adjustment to the LLPAs. A more balanced system that increases competition would provide far greater benefits to borrowers, and the improved price transparency would be a benefit to the market as a whole.

MBA applauds FHFA for their transparency in publishing the PMIERs for public comment, and we look forward to working together to improve and implement these long-awaited standards. For more information on this topic, please contact Dan McPheeters at (202) 557-2780 or dmcpheeters@mba.org; or Jim Gross at (202) 557-2860 or jgross@mba.org.

Sincerely,

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