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Ms. Sandra Thompson
Acting Director
Federal Housing Finance Agency
400 7th Street, S.W.
9th Floor
Washington, D.C., 20219

Re: Arch MI's response to FHFA's Strategic Plan: Fiscal Years 2022-2026

Dear Acting Director Thompson,

Arch Capital Group Ltd., on behalf of itself and its subsidiaries ("Arch"), submits this letter in response to the Federal Housing Finance Agency's ("FHFA") recently released Strategic Plan for Fiscal Years 2022-2026.

Arch's subsidiaries, Arch Mortgage Insurance Company and United Guaranty Residential Insurance Company, (together "Arch MI") is a leading mortgage insurance provider in the United States. Arch's reinsurance subsidiaries are also leading investors in Fannie Mae and Freddie Mac's (together, the "GSEs" or "Enterprises") credit risk transfer ("CRT") programs. Arch has made a long-term strategic commitment to the U.S. mortgage market, investing in, managing and distributing credit risk in a variety of single family and multifamily executions, and has contributed to deepening and diversifying the base of capital and expertise in U.S. mortgage credit risk to the benefit of consumers, taxpayers, and the general economy. As a leading provider of private mortgage insurance in the United States with $280.9 billion of insurance in-force as of December 31, 2021, and an active participant and innovator in CRT, Arch is well-positioned to provide input on the Plan.

We commend FHFA for its enhanced focus on affordable, equitable and sustainable homeownership. Primary mortgage insurance ("PMI") is more critical than ever to achieve these goals given soaring home prices and the widening wealth gap between white and minority borrowers. It would take the typical American household eight years to save enough money for a 20% down payment on a home purchase.[1] Simply put, PMI breaks barriers to homeownership: roughly 6 in 10 borrowers with loans insured by PMI are first-time home buyers.

[1] Leslie Cook, "A housing economist did the math on how long it takes to save for a down payment – and it's not pretty," Nov. 12, 2021. https://money.com/years-to-save-for-house-down-payment-rising/

In this letter, we are limiting our comments and recommendations to Strategic Goals related to the safety and soundness of the Enterprises (specifically Objective 1.1) and fostering housing finance markets that promote equitable access to affordable and sustainable housing (specifically Objectives 2.1 and 2.5).

Objective 1.1 includes a requirement to "ensure the Enterprises establish and maintain standards for sellers, servicers and counterparties that strengthen the overall functioning and resiliency of the mortgage markets."

As an important counterparty to the Enterprises, Arch has a vested interest in ensuring this objective is met. We recommend that FHFA consider bifurcating its approach to assessing the risk of counterparties, similar to the standardized and advanced/individualized approaches under Basel III. In other words, FHFA should differentiate between creditworthy counterparties that have sophisticated risk management approaches and lower mortgage concentration, and those that don't. Under FHFA's Enterprise Capital Rule Framework, the GSEs primarily evaluate insurance and reinsurance counterparties based on their creditworthiness and mortgage concentration. FHFA should similarly consider creditworthiness/ratings, correlated concentration risk, and risk management practices when determining whether a counterparty should be subject to the standardized or advanced approach. At Arch, our strategies for managing risk have created long-term value for the company through lower volatility and higher returns. A Basel-like approach to counterparties recognizes the best performers and eliminates the need to overlay broad-based limits on every counterparty regardless of their risk-management performance.

As a well-capitalized, highly rated and highly diversified multi-line insurer with an excellent risk management program and expertise in mortgage credit, the counterparty thresholds applicable to Arch should be adjusted relative to strength of such assessment. Meanwhile, less-sophisticated counterparties should be subject to a set of standard criteria and counterparty thresholds.

In short, we encourage FHFA to implement virtuous competition between counterparties that would recognize and reward the best-managed counterparties, leading to stronger and more resilient mortgage markets.

Objective 2.1 calls for FHFA to promote sustainable access to mortgage credit.

Arch MI is eager to partner with FHFA, Fannie Mae and Freddie Mac to grow both credit access and equity in homeownership. We share FHFA's belief that expanding sustainable homeownership must start with prudent risk management and believe those opportunities exist without weakening underwriting standards.

As such, we have undertaken discussions with the Enterprises regarding their purchasing high LTV loans (up to 99% LTV) under a pilot program in select MSAs insured under Arch MI's Equal Access product. Equal Access is targeted at households earning less than or equal to 100% AMI and is currently available to portfolio lenders such as commercial banks and credit unions. The inability of lenders to pair this product with loans sold to the Enterprises severely limits its ability to make a dent in homeownership inequality. Our analysis shows that while the claim rate for Equal Access-insured loans would likely be marginally higher than the bulk of our insured portfolio, it would measurably broaden credit availability with reasonable risk and price parameters.

Moreover, we recognize the need for Arch – together with other providers throughout the mortgage ecosystem including lenders, realtors, appraisers, servicers, GSEs and investors – to accept lower rates of return on products and services designed to achieve equitable homeownership. Creating sustainable solutions to achieve long-term parity requires true partnership and collaboration among the broad set of stakeholders that participate in the housing ecosystem.

Objective 2.5 encourages the use of new technology and data to further promote efficiency and cost savings in mortgage processes, including modernizing the appraisal process and considering new credit score models that can be used by the Enterprises.

Arch MI concurs that the use of innovative technology can broaden the availability of credit and reduce costs. Nevertheless, we are wary of suggestions that desktop appraisals should be expanded beyond the current cap of 90%.

We certainly appreciate FHFA and the Enterprises' efforts to overcome the shortage of residential appraisers by using desktop appraisals rather than the more robust, traditional appraisal to value collateral. But we would caution that, typically, the shortcomings of appraisals fail to become evident in rapidly changing house-price environments such as the one we have been experiencing the past two years. We are particularly concerned about desktop appraisals being used in markets where home-price increases have greatly outpaced wage increases. This treatment is consistent with the countercyclical adjustment in the Enterprise Regulatory Capital Framework. The current guidelines limit desktop appraisals to purchase-money loans and homes with floorplans available online. We would prefer that a property inspection be required, as well.

We also would urge FHFA to make available to the market and broader policymaking community the data being used to assess the quality of appraisals so we can observe results over time and throughout the housing cycle.

Arch is also supportive of FHFA's research into the efficacy of alternative credit scoring models, and we appreciate the thoughtful process in which the Agency engaged to gather broad feedback on implementing new models. Arch encourages the Agency to adopt a single score. Adopting multiple credit scoring models will not only take years to implement, creating sizable implementation costs, but could also incentivize lenders – in their eagerness to close a loan – to expand credit risk too quickly.

Having a single, well-understood score is most conducive to maintaining a highly liquid mortgage market. We would also encourage the FHFA to look at the potential of alternative data, including rental, telecom and utility data. Reliable datasets are essential but incorporating more data into the credit file can only serve to improve insights into a potential mortgage borrower's ability to sustain homeownership, thus improving the confidence of those putting capital at risk and improving the overall availability of credit.

Sincerely,

David Gansberg