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September 15, 2014

VIA ELECTRONIC SUBMISSION
www.fhfa.gov

Federal Housing Finance Agency
Office of Budget and Financial Management
400 7th St., SW
Washington, DC 20024

Re: Federal Housing Finance Agency Strategic Plan for Fiscal Years 2015–2019

Ladies and Gentlemen:

United Guaranty Corporation (United Guaranty) is pleased to comment on the Federal Housing Finance Agency's (FHFA) Strategic Plan: Fiscal Years 2015–2019 (Strategic Plan).

I. Background of United Guaranty

Since 1963, United Guaranty has provided insurance products and services to mortgage lenders of all sizes. Subsidiaries of United Guaranty provide mortgage guaranty insurance to protect Fannie Mae, Freddie Mac (together, the Enterprises), and lenders against mortgage credit losses. At the end of the second quarter of this year, United Guaranty had approximately $37 billion of first-lien insurance risk in force in the U.S. In addition to mortgage insurance, United Guaranty offers a wide range of risk management and financial services to help the Enterprises and lenders protect their investments. United Guaranty is a subsidiary of American International Group, Inc. (AIG).

United Guaranty's interests are aligned with the FHFA's in protecting the mortgage market through quality originations, preserving safe and sound business practices and building new infrastructure to ensure opportunities exist to expand private capital and investor interest in the marketplace. United Guaranty writes this letter to (1) express its support of the Strategic Plan; and (2) discuss the best implementation of the risk sharing goals articulated in the Strategic Plan's *Performance Goal 3.2*—the reduction of taxpayer risk from the Enterprises' operations.

II. United Guaranty Supports FHFA's Strategic Plan

United Guaranty commends the FHFA on its strategic goals of: (1) ensuring the safety and soundness of its regulated entities; (2) ensuring liquidity, stability and access in housing finance; and (3) managing the Enterprises' ongoing conservatorships. Each of these goals, and the supporting performance goals articulated in the Strategic Plan, are of critical importance to a sustainable housing market.

United Guaranty fully supports the Strategic Plan. In particular, United Guaranty views *Performance Goal 3.2*, the reduction of taxpayer risk from Enterprise operations, as key to a healthy and functioning market. In this area, FHFA's strengthened eligibility criteria for private mortgage insurance companies (MI Companies) will ensure that the MI Companies can fulfill their obligations even in the midst of significant market stress. Additionally, the establishment of new master policies with enhanced rescission relief options will decrease the level of uncertainty inherent in mortgage lending, as loan owners will have greater certainty of coverage in the event of borrower default. These initiatives, in total, will both protect the assets of the Enterprises, and encourage the return of private capital to the market.

United Guaranty also commends the FHFA for its focus on the establishment of a Common Securitization Platform and Single Security, as articulated in *Performance Goal 3.3*. United Guaranty agrees that the development of a Single Security that is fungible between the Enterprises will allow the Enterprises to shift focus away from pricing competition and towards the critical evaluation of the quality of the collateral underlying the securities.

III. Mortgage Insurance is the Most Effective Method of Private Market Risk Sharing Available to the Enterprises

United Guaranty agrees with the FHFA that private mortgage insurance is a key component to the accomplishment of *Performance Goal 3.2*. United Guaranty also conceptually supports the FHFA's attempts to encourage the use of alternative risk sharing structures, such as the STACR and CAS transactions, in order to draw private capital to the housing market. However, in assessing these new efforts, it is necessary to acknowledge that there are important differences between structures dependent on the capital markets, and the solutions offered by the private mortgage insurance industry.

In United Guaranty's view, there are three risk sharing mechanisms available: (1) capital market structured transactions; (2) excess-of-loss pooled transactions in the insurance or reinsurance market; and (3) primary mortgage insurance. As discussed below, in terms of reliability, cost, and actual risk transferred, primary mortgage insurance is the superior option to achieve FHFA's strategic goals and should be fully utilized in any effort to meet *Performance Goal 3.2*.

A. MI Companies are Reliable Counterparties in Risk Sharing Transactions

Capital market transactions are, by their very nature, speculative, and the participation of Wall Street investors in risk sharing transactions is driven by factors that cannot be predicted with certainty. Counterparties that are willing to invest in risk sharing transactions during benign periods of risk cannot be relied upon to similarly participate during housing market downturns. By the same token, the FHFA has no specific insight into these companies because it does not regulate them, nor does it engage with them on a regular basis. In United Guaranty's view, the opaqueness and speculative nature of capital market participation in risk sharing arrangements cannot be the basis of a housing market that is healthy and sustainable.

MI Companies, on the other hand, are constant and reliable participants in the mortgage market and, with enhanced eligibility criteria and capital standards, the MI Companies are stronger counterparties than ever. Capital market participants, as shown by recent history, will flee in times of stress, while the opposite is true of the MI Companies. MI Companies are incentivized to remain invested in the mortgage market even through a downturn because of the need to replenish the very reserves that become depleted during such a period.

Critically, the mortgage insurance industry is in constant dialogue with the FHFA and the Enterprises through their ongoing counterparty evaluation. This engagement touches on all aspects of the MI Companies' business, from capital requirements to the language of the master policies. This relationship, and the resulting transparency it brings, ensures that the MI Companies are best situated to reliably and consistently accept the Enterprises' mortgage credit risk.

B. Capital and Reinsurance Market Structures Do Not Provide Risk Transfer Comparable with Mortgage Insurance

Whether through the capital markets, as with the STACR and CAS structures, or the reinsurance market, the risk sharing transactions that do not involve private mortgage insurance have actually transferred relatively little credit risk. While the pools of mortgages referenced by these transactions can be quite large—$20 to $60 billion—the potential risk being absorbed by the private sector is comparatively small—2% to 3%—and is in <u>second</u> position behind the first loss position retained by the Enterprises. The Enterprises' first loss position is sized to approximate the "expected loss" of the mortgage pool; meaning that the Enterprises themselves, not the private sector, will be absorbing mortgage losses. This is in contrast to the structure employed by private mortgage insurance in which private capital absorbs the first loss on loans with the Enterprises in the second position. Only this latter structure is consistent with *Performance Goal 3.2*—the reduction of taxpayer risk from the Enterprises' operations.

Furthermore, private mortgage insurance absorbs much more of the risk. As designed, private mortgage insurance generally takes on approximately 25% of a mortgage loss with no aggregate cap, meaning that private mortgage insurance could absorb significantly more credit risk than the mere 2% to 3% alternative structures allow. Importantly, despite providing substantially more credit protection to the Enterprises, private mortgage insurance actually costs the Enterprises less than these alternatives, as the cost is paid by a third party rather than the Enterprises themselves.

IV. Conclusion

Primary mortgage insurance is the most effective and cost efficient mechanism for putting private capital in front of the taxpayer to absorb mortgage credit losses. Consequently, United Guaranty recommends that, while mortgage insurance has typically been written on above 80% loan-to-value (LTV) loans, the FHFA should expand the role of mortgage insurance beyond the charter requirement. This could take the form of either expanded coverage for above 80% LTV loans and/or the addition of coverage on loans below 80% LTV. Expanded capacity within the industry, both in the form of additional capital raised and new entrants into the market, illustrates that private capital is readily available to be utilized in this manner.

In sum, United Guaranty strongly supports the Strategic Plan. United Guaranty agrees with the FHFA that risk transfer away from taxpayers is key to the future of the housing market. MI Companies are the best-situated counterparties to reliably provide these necessary risk sharing mechanisms. We appreciate the opportunity to comment on the Strategic Plan and we welcome further dialogue with FHFA regarding the future role of MI Companies in the mortgage market.

Sincerely,

Donna DeMaio

Donna DeMaio, CEO
United Guaranty Corporation