October 13, 2016

Federal Housing Finance Agency
Office of Financial Analysis and Modeling
400 7th Street, S.W., 9th floor
Washington, D.C., 20219

Re: United Guaranty Corporation's Response to the FHFA's Single-Family Credit Risk Transfer Request for Input

Ladies and Gentlemen:

United Guaranty Corporation (United Guaranty) is pleased to comment on the Federal Housing Finance Agency's June 2016 Single-Family Credit Risk Transfer Request for Input (RFI). United Guaranty's position on credit risk transfer is largely in accord with the FHFA's. However, as set out in this letter, United Guaranty believes that the credit risk transfer principles, as articulated in the RFI, should be modified to further emphasize the need for private capital availability at all stages of the housing finance cycle.

I. Introduction and 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, (collectively, "the Enterprises"), investors, and lenders against mortgage credit losses. At the end of the second quarter of this year, United Guaranty had approximately $48.4 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 submits this letter at the request of the FHFA to address the questions posed in the FHFA's June 2016 RFI. United Guaranty supports a diverse array of structures and executions to accomplish the transfer of mortgage risk to the private sector. However, each execution must be consistent with the core underlying principles of the reduction of taxpayer risk, and stability/availability throughout housing cycles. With this view in mind, United Guaranty addresses the FHFA's questions below.

II. United Guaranty's RFI Responses

Question A1: Are there credit risk transfer principles that FHFA should consider in evaluating front-end credit risk transfer transactions that are not listed in Section II? Similarly, are there significant risks that FHFA and the Enterprises should consider in evaluating credit risk transfers

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structures that are not included in Section III? Please also provide any comments or views about the principles and risks described in Section II and III.

Response: The core purpose of any CRT transaction executed by the Enterprises must be to shift risk from the United States government—risk borne ultimately by the taxpayers—to private companies. Therefore, the first principle articulated by the RFI, "Reduce taxpayer risk", must be strengthened to expressly state that private capital must always be preferable to public capital.

The RFI does not uniformly adhere to this principle. For example, it contemplates that the Enterprises could sell mortgage credit risk during good economic times and during bad times "the Enterprises could retain credit risk for a period of time and then subsequently transfer it to private investors when more normal market conditions return." RFI at pg. 4. This sentence should be struck in its entirety from the "stability through economic and housing cycles" principle. The regime described—under which the Enterprises hold mortgage risk during bad times, and sell during good—would privatize profits, and socialize losses. Additionally, the government has repeatedly shown that it is slow to respond to overheating markets and their inevitable downturns (the housing finance crisis being a particularly poignant example of such limitations), and thus relying on the government's ability to adroitly adjust policies on the fly during turbulent market conditions should be dismissed as a prudent approach to maximizing taxpayer interests. Rather, emphasizing the use of countercyclical forms of private capital should be the preferred approach.

Question A2: How would proposed front-end credit risk transfer structures meet and balance the principles outlined in Section II and address the risks outlined in Section III?

Response: "Market Risk" as defined in the RFI is the greatest threat to any proposed front-end risk transfer regime. The fixed income market appetite for mortgage risk is notoriously fickle. In fact, private RMBS volume has yet to materialize post crisis in spite of the sterling credit quality of current originations[1].

Mortgage insurance transactions—particularly deep MI transactions covering risk below 80 LTV—are a good solution for market risk, as such companies are monoline and therefore must continue to write business during all portions of a credit cycle in order to remain in business. The new PMIERs regime coupled with the counter-cyclical capital regime, (e.g., the contingency reserve requirements contained in state mortgage insurance statutes), long-tailed premium income streams, and the monoline structure ensure an MI's participation in the market through a credit cycle.

The utility of mortgage insurance transactions as a source of private capital must be balanced against Concentration risk, as outlined in section III(C) of the RFI. Therefore, the Enterprises should consider the financial strength of each MI in allotting risk transfer transactions. Over-concentrated MIs have the option of laying off risk through reinsurance

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[1] Non-agency RMBS is still less than 10% of what it was pre-2008. See Attachment A, Inside Mortgage Finance MBS Database Chart. PMI volume of NIW, on the other hand, has largely recovered from its post-crisis dip. See Attachment B, Inside Mortgage Finance Mortgage Origination Indicators Chart.

transactions with multiline reinsurers or through capital market transactions such as United Guaranty's Bellemeade bonds. The maximization of MI solutions, balanced with the principles of counterparty strength and concentration risk—as defined in the RFI—will provide a sturdier bedrock for credit risk transfers than other forms of capital, which are more likely to withdraw from the market during periods of stress.[2]

Question A3: In considering proposed front-end credit risk transfer transaction structures, how should FHFA and the Enterprises manage the counterparty risk involved in these transactions?

Response: Although United Guaranty does not oppose collateral requirements as a method of controlling counterparty risk, there must be a reasonable relationship between any collateral requirements and capital requirements imposed on counterparties through regulatory structures and PMIERS. MI companies, for example, already hold significant capital in reserve due to PMIERS, and thus less collateral should be required than from non-MI counterparties. This also furthers the "level playing field" goal articulated in the RFI.

Question B1: What credit risk transfer strategies work best for small lenders? Why?

Question B2: Do other types of front-end credit risk transfer work better for small lenders than collateralized recourse transactions? How so?

Response: Deep MI transactions that allow coverage on a loan-by-loan basis would be the easiest solution for small lenders to implement, as small lenders are already familiar with MI transactions and the relevant systems to implement the transactions already exist. MI transactions do not have the volume or aggregation requirements necessary for the implementation of many of the pooling arrangements currently in the market or under development.

III. Conclusion

With its CRT initiatives and the benefit of wisdom received from the financial crisis, the FHFA has an opportunity to take a long view with respect to the inclusion of private capital in the housing regime. Such a view requires the identification and cultivation of preferred sources of private capital long before the emergence of troubled market conditions. Insurance based solutions, which are not cyclical by nature, are among the best sources of private capital to accomplish the FHFA's CRT goals.

[2] For more information on the benefits of Deep MI Transactions, please see United Guaranty's August 28, 2015 Letter to the FHFA on the Advantages of Deeper Mortgage Insurance Coverage, annexed as Attachment C.

We appreciate the opportunity to share these comments with the FHFA and invite further discussion on any of the topics discussed herein.

Sincerely,

Brian M. Gould
Chief Operating Officer