March 9, 2000

Alan Pollard, Esquire
General Counsel, Office of General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street, NW, 4th Floor
Washington, DC 20552

Re: Triad Guaranty Insurance Corporation ("Triad") Comments to the Office of Federal Housing Enterprise Oversight ("OFHEO") Second Notice of Proposed Rulemaking on Risk-Based Capital Regulation ("NPR2").

Dear Mr. Pollard:

Triad appreciates the opportunity to comment on the proposed rule. As a monoline mortgage guaranty insurer, Triad is dedicated to improving home affordability and promoting home ownership by insuring low down payment loans. In fact, both Triad's charter and state insurance law prohibit Triad from engaging in any other line of insurance. Because of this singular focus on home ownership, and because the majority of low down payment loans insured by Triad are sold to the government sponsored enterprises ("GSEs") affected by this rule, Triad has an acute interest in it.

Triad has reviewed NPR2 independently and in conjunction with the Mortgage Insurance Companies of America ("MICA"), our trade organization. Our review indicates that the proposed risk-based capital model is comprehensive and essentially sound. However, there are certain enhancements and revisions which we believe can improve the accuracy and efficiency of the Model. These enhancements and revisions are discussed in detail in MICA's response to NPR2 and will not be addressed here with the exception of two issues directly affecting mortgage guaranty insurers which we believe merit additional comment.

First, the model fails to distinguish between the ability of a monoline mortgage guaranty insurance company to absorb credit risk and the ability of a non-mortgage guaranty insurance counterparty to absorb mortgage credit risk. Mortgage guaranty insurers have a singular mission and are highly regulated businesses. They are required by the various insurance laws to maintain capital dedicated to mortgage credit risk, to establish catastrophic loss reserves and to maintain a regulated investment portfolio to assure the availability of assets to pay future claims. In addition, in the event of liquidation, strong preferences are given to the beneficiary of the insurance coverage, the policyholder. Non-mortgage guaranty insurance counterparties are not subject to these requirements which are critical to a counterparty's ability to fulfill its future obligations.

These distinctions are both quantifiable and meaningful as demonstrated in MICA's response. As a result of these differences, Triad strongly believes that private mortgage insurers whose financial strength rating is at least 'AA' (meaning at least 'AA' – by Standard & Poor's or 'Aa3' by Moody's) should receive lesser haircuts than any non-mortgage insurance credit risk counterparty that is not subject to such comprehensive regulation.

The second issue which merits additional comment is the proposed haircut differential between ‘AAA’ and ‘AA’ mortgage insurers. In NPR2, OFHEO is proposing to assign a significant counterparty credit haircut differential to mortgage insurance companies with a ‘AA’ versus ‘AAA’ insurer financial strength rating. Triad believes the haircut differential OFHEO is proposing between ‘AA’ and ‘AAA’ mortgage insurance companies is both unwarranted and unnecessary for reasons which include the following:

- In rating mortgage securities, S&P does not distinguish between ‘AA’ and ‘AAA’ mortgage insurers providing standard primary mortgage insurance benefits. This is true even if the highest rated bonds in the mortgage securitization transaction are ‘AAA.’ S&P only recognizes differences in ratings of mortgage insurers rated ‘AA’ or better on that portion of the mortgage insurance coverage which is either greater than “standard” primary coverage or which represents pool insurance coverage. Even in these situations, this distinction is only relevant if the highest rated bonds in the transaction are to be ‘AAA.’

- A mortgage insurance company may be rated less than ‘AAA’ for reasons unrelated to its ability to pay its obligations in a stress scenario, which is the focus of NPR2. In fact, some mortgage insurance companies with ‘AA’ ratings, including Triad, are able to meet more than 100 percent of their obligations (Capital Adequacy Ratio) in S&P’s 10-year “South Central Stress Scenario”. S&P acknowledges this in its evaluation of mortgage insurers’ capital adequacy under its 10-year “South Central Stress Scenario”. The conclusion is that there is very little or no real difference between the ability and actual capital sufficiency of ‘AA’ versus ‘AAA’ mortgage insurance companies to withstand S&P’s very severe stress test.

  It should be noted that every ‘AAA’ rated mortgage insurer has obtained its ratings on the basis of some type of parental support agreement rather than on a stand alone basis. The proposed rule requiring a ‘AA’ haircut could have the effect of forcing many ‘AA’ rated mortgage insurers to wind down their operations or merge into another company to obtain a ‘AAA’ rating even though their capital is very adequate under a severe stress test. This could have the unintended effect of reducing competition and weakening the financial strength of the industry.

- The rating agency stress tests that mortgage insurance companies are subjected to are more severe than the OFHEO stress test outlined in NPR2. Mortgage insurers rated ‘AA’ or better would meet their obligations under OFHEO’s stress scenario and, therefore, should receive as much credit as a ‘AAA’ mortgage insurance company in any haircut calculation. A mortgage insurance haircut should only relate to mortgage insurers rated less than ‘AA.’ There is no need for a differential between ‘AA’ and ‘AAA.’

- For many years the GSEs have only required a ‘AA–’ financial strength rating or better for a mortgage insurer to be deemed a “qualified” mortgage insurer. The GSEs have never made a distinction in their preference for or acceptability of ‘AAA’ vs. ‘AA’ mortgage insurers. This practice resulted in the growth and development of a financially strong mortgage insurance industry. OFHEO has shown no good reason to change this structure, but it would be significantly altered if a ‘AA’-rated mortgage insurer received a haircut greater than a ‘AAA’-rated mortgage insurer. Any such change would be unfair to the industry and may jeopardize the financial strength of the industry and the security provided to its policyholders, of which the GSEs are the two largest. In addition, such a change may disadvantage borrowers who obtain low down payment loans in the future because either the cost of mortgage insurance would have to increase or the GSEs would have to charge more for loans insured by mortgage insurers without a 'AAA' rating.

- According to a study done for OFHEO by S&P in February 1997, the GSE "standalone" financial strength ratings at that time were no more than 'AA.' It is general rating agency practice to only discount financial guarantor benefits if the financial guarantor rating is below the targeted rating level. For example, in a mortgage securitization structure, S&P will assign no discount to any mortgage insurance benefits from a 'AA' mortgage insurance company if the highest rated bonds in the transaction are to be 'AA.' Therefore, if the GSEs are essentially 'AA' entities, then standard rating agency practice would result in no discount being assigned to mortgage insurance benefits payable to the GSEs from either a 'AAA' or 'AA' rated mortgage insurer.

In conclusion, Triad supports OFHEO's efforts to implement a comprehensive and meaningful risk based capital model. We believe that the revisions and enhancements proposed by MICA will strengthen the model and make it more accurate. In this regard, for the reasons noted above, Triad strongly supports the proposition that private mortgage insurers whose financial strength rating is at least "AA" should receive lesser haircuts than any non-mortgage insurance credit risk counterparty. Furthermore, both the S&P stress test and the OFHEO stress test outlined in NPR2 indicate very little, if any, difference in the ability of 'AA' and 'AAA' mortgage insurers to withstand a severe and sustained economic downturn. These results, coupled with traditional rating agency practice, support eliminating the proposed haircut differential between 'AAA' and 'AA' mortgage insurers.

Thank you in advance for your consideration of our comments. Please fell free to contact us if you have questions and we will make every effort to address them in a timely and responsive manner.

Sincerely,

[signed: Darryl W. Thompson]

Darryl W. Thompson
President and CEO