



January 17, 2002

Mr. Alfred M. Pollard
General Counsel
Office of Federal Housing Enterprise Oversight
Fourth Floor
1700 G Street, NW
Washington, DC 20552

Re: Risk-Based Capital
66 FR 65146 (December 18, 2001) RIN 2550-AA23

Dear Mr. Pollard:

America's Community Bankers ("ACB")¹ is pleased to comment on OFHEO's proposed amendments to the risk-based capital requirement. These amendments are intended to improve certain measurements and formulas.

General

ACB has followed the extended development of the risk based capital guidelines and has commented on earlier proposals, both formally and informally. ACB supports the concept of a risk-based capital requirement that adequately and accurately measures the risks faced by the government-sponsored enterprises, Fannie Mae and Freddie Mac (the "GSEs") under both positive and adverse scenarios and requires capital to be maintained commensurate with these risks, including the risk of non-performance by counterparties.

We are concerned that certain elements of the current stress test will have unintended consequences for insured depository institutions and others in home mortgage lending activities and are recommending certain changes to the proposed amendments. Specifically, we believe the treatment of counterparty risks from credit enhancements in the form of private mortgage insurance is inconsistent with actual expected risk of loss and could have a measurably negative impact on community bankers and others selling loans to the GSEs. We request that OFHEO amend its risk-based capital regulation by making the cumulative default rate for private

¹ ACB represents the nation's community banks of all charter types and sizes. ACB members, whose aggregate assets exceed \$1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

mortgage insurance contracts five percent for all companies rated AA or higher. With this change, we believe it will not be necessary to extend the phase-in period beyond the current five-year period or the current requirement². OFHEO has attempted to address these concerns, as described below, in the proposal. However we do not believe the proposed amendments properly or adequately address our concerns nor will they eliminate the adverse developments we foresee for the GSEs and those entities from which they purchase loans, including smaller depository institutions.

PMI Haircuts

The more favorable treatment given to credit enhancements, in the case of private mortgage insurance contracts, provided by AAA-rated companies over AA-rated companies will have two undesirable and unintended consequences. First, it will result in the concentration of business with two of the seven private mortgage insurance companies currently operating to the detriment of the remaining five AA-rated companies and other parties involved in the mortgage process. Secondly, we believe the proposal if adopted will disrupt existing business relationships generally and in particular will disadvantage small financial institutions for no constructive purpose.

Claims Payment Ability

The differential treatment accorded AAA-rated private mortgage insurance companies under OFHEO's risk-based capital regulation presumes that there is a difference in the claims-payment ability of more highly rated entities. This is not consistent with the marketplace treatment of the seven companies currently providing private mortgage insurance coverage. We understand that insured depositories regard the two AAA-rated companies no differently than the other five AA-rated providers in this regard. All seven are considered to be equally reliable in their ability to honor obligations under their private mortgage insurance contracts.

None of the institutions represented in the membership group reviewing this issue reported having had difficulty collecting mortgage insurance claims from any of these seven companies. Home mortgage lending is the dominant activity of ACB member institutions and most offer high loan-to-value ratio loans, which are backed by private mortgage insurance in amounts sufficient to cover the excess over traditional loan to value ratios. This experience spans many decades, including periods of stress in housing and housing finance.

Thus we find that the more favorable treatment of the obligations of the more highly-rated companies inappropriately favors these companies and may result in a concentration of business with just two providers; something that will unnecessarily expose the GSEs to additional risks.

Insured depository institutions lend for their own portfolios to a larger extent than any other home mortgage loan originators. Home mortgage loans represent the dominant asset held by ACB member institutions. In originating loans for this purpose, institutions are encouraged by

² Risk-based Capital, 66 FR 47730 (September 13, 2001).

their regulators to purchase private mortgage insurance coverage for high LTV one-to four-family loan transactions under uniform real estate lending guidelines issued by federal banking regulators. The choice of the private mortgage insurance provider is however, a matter of business judgment left to each institution. No additional regulatory capital requirements are imposed on the basis of the specific credit ratings of the insurance providers.

Fannie Mae and Freddie Mac have always allowed their seller/servicers to select the private mortgage insurance provider from an approved list of companies. All of the currently operating private mortgage insurance companies have been regarded as equally acceptable to the GSEs.

Business Disruption

Among ACB members, the choice of a private mortgage insurance provider is generally made on the basis of service, reputation and the underwriting disposition and capacity of the individual company. Because premium rates are fixed by each state, it is the insurance products offered, the provider's ability to underwrite the particular loan products offered by the institution and the responsiveness of their staff that determines which companies receive the institution's private mortgage insurance business.

ACB member institutions are concerned that the more favorable treatment of AAA-rated companies will cause further consolidation in the mortgage insurance industry and result in fewer choices and poorer service, especially for institutions that originate limited numbers of high LTV ratio loans.

Smaller depositories generally do business with one or two private mortgage insurance companies. To the extent that they must direct this business based upon the needs and dictates of the GSEs as a consequence of the less favorable treatment of AA-rated private mortgage insurance companies, the business which they can direct, (portfolio loans and loans to be sold to other investors), will be diluted and with it their ability to choose the best provider and command the level of service needed to meet consumer expectations.

Conclusion

OFHEO has proposed to reduce the amount of the haircut given to obligations of companies rated in the lower rating categories and to extend the period for implementing these elements of the risk-based capital calculation in addition to introducing a loss severity factor. We respectfully suggest that this does not adequately address the issue and the only appropriate way of doing so is to eliminate the difference in the treatment of counterparty risk for private mortgage insurance contracts altogether.

We therefore request that OFHEO amend its risk-based capital rule by making the cumulative default rate for private mortgage insurance contract five percent for all companies rated AA or

higher. If this change is made, we believe it is not necessary to extend the phase-in period beyond the current five-year period or the current requirement.³

The safety and soundness of all entities that hold or invest in home mortgage loans and the interests of consumers are best served by having diversification and freedom of choice in obtaining private mortgage insurance. These considerations outweigh the need for technical compliance with this element of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, which requires the development and adoption of risk-based capital requirement.

The change we are advocating will avoid disruption in a system that has worked well for all parties involved for several decades.

ACB appreciates the opportunity to comment on this important matter. If you have any questions, please contact the undersigned at (202) 857-3121.

Sincerely,

Charlotte M. Bahin
Director of Regulatory Affairs
Senior Regulatory Counsel

³ Risk-based Capital, 66 FR 47730 (September 13, 2001).