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UNITED GUARANTY CORPORATION

September 8, 2014

The Federal Housing Finance Agency
Constitution Center
400 7th Street SW
Washington, DC 20014

Attn: Mortgage Insurance Eligibility Project

Submitted VIA Web Portal; Case Number 2014-N-9

United Guaranty Residential Insurance Company and United Guaranty Mortgage Indemnity Company ("United Guaranty") appreciate the opportunity to provide input to Fannie Mae and Freddie Mac (together, the "GSEs") and the Federal Housing Finance Agency ("FHFA") in response to the draft Private Mortgage Insurer Eligibility Requirements released for comment on July 10, 2014 (the "Eligibility Requirements") and the related overview document. United Guaranty would first like to commend the GSEs and the FHFA for their efforts to establish one set of revised Eligibility Requirements. This is an important initiative, and similar to landmark regulatory reform stemming from the financial crisis, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] ("Dodd-Frank Act") and the Ability-to-Repay and Qualified Mortgage Standards regulation[2], the Eligibility Requirements aptly focus on prudent risk management and capital requirements to ensure the long-term stability of the housing market.

United Guaranty agrees with much of the Eligibility Requirements as drafted. Even so, we think it critical to implement two important revisions that are necessary to attain the appropriate balance between ensuring that an *approved insurer* possesses the financial and operational capacity to meet its obligations and withstand future severe stress events, while preserving the availability of mortgage insurance and conventional mortgages to low and moderate income borrowers. United Guaranty makes these comments to assist Fannie Mae and Freddie Mac in this important initiative and is committed to working with the GSEs to ensure the successful implementation of the Eligibility Requirements.

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

[2] Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z), 78 FR 6407 (2013).

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United Guaranty is a monoline mortgage guaranty insurance company owned by American International Group, Inc. ("AIG"). AIG is a designated Systemically Important Financial Institution ("SIFI") subject to systemic regulation established in the Dodd-Frank Act. By virtue of its status as a subsidiary within a designated SIFI, United Guaranty is subject to SR 12-17 and systemic regulation by the Federal Reserve Bank ("FRB") and has since 2012 undertaken a series of major risk-management and governance improvements including Comprehensive Capital Analysis and Review ("CCAR") stress testing.

1. Revise the *Available Assets* calculation to account for all available sources and uses of capital over the planning horizon, similar to CCAR.

In general, the draft Eligibility Requirements measure financial adequacy by comparing *available assets* to *minimum required assets*.[3] More specifically, an *approved insurer* must maintain *available assets* in excess of its *minimum required assets*. To determine the *minimum required assets*, the GSEs generated grids of risk-based loss factors based on the loss outputs expected under the same defined macroeconomic assumptions that the FRB uses in its CCAR stress testing, which is applicable to the largest bank holding companies, depositories, and to SIFIs. The GSEs apply the CCAR Severely Adverse scenario to loans insured after 2008, and the CCAR Baseline scenario for loans insured prior to 2009. In United Guaranty's view, using a CCAR approach is prudent, as it allows the GSEs and the FHFA to incorporate attributes of a model already in use today in the mortgage finance system. And as expected given the reliance on the CCAR macroeconomic inputs, the losses generated under the risk-based grids in the Eligibility Criteria are similar to those generated under CCAR stress testing.

However, while the losses under each approach are similar and establish the *minimum required assets* in the Eligibility Requirements, the assets available to pay the stressed losses differ significantly. Unlike CCAR, the Eligibility Requirements consider only selected cash flows and do not include all future sources and uses of capital over the planning horizon. More specifically, the Eligibility Requirements consider only losses and net premium earned on coverage issued prior to 2009 while ignoring expenses, taxes, debt costs, investment income, and future earned premium on business written after 2008. Failing to account for all revenue, losses and expenses in the calculation of *available assets*—as is mandated in CCAR stress testing—creates a capital requirement well in excess of that required to ensure an *approved insurer's* financial capacity to withstand the stressed losses.

Given the practical difficulty in requiring the mortgage insurance industry to adopt CCAR in totality, United Guaranty respectfully submits the following approach for consideration. First, the calculation of the *total risk-based required asset amount* in Exhibit A should be revised to include only required assets, free of any adjustments for future premium (for example, currently, 210% of future premium on policy years written prior to 2009 is deducted from the

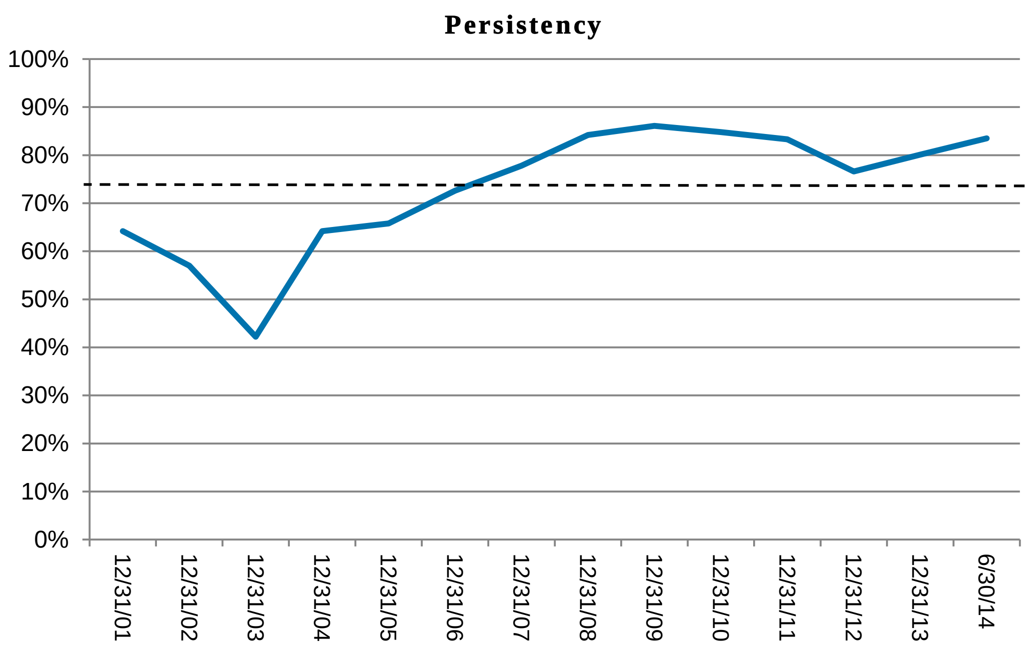
[3] See Section 704.

required asset amount). Next, the *available assets* in Section 704 should be revised to include all cash inflows and outflows, similar to the CCAR methodology.

Available Assets

(+) Liquid Assets
(–) Unearned Premium Reserve (if on an income basis)
(+) Net Earned Premium (300% of total Net Earned Premium in past 12 months)
(–) Operating Expenses (25% of Net Earned Premium)
(–) Debt Costs
(+) Net Investment Income
(–/+) Income Taxes

It is appropriate to include net earned premium net of operating expenses for all policy years, as this represents a stable prospective cash flow that the *approved insurer* will be able to use to cover stressed losses. During the actual stress of the recent financial crisis, the persistency of risk in force was higher than expected. This sensitivity makes practical sense, as borrowers with high loan-to-value ("LTV") mortgages face significantly greater challenges in refinancing than other borrowers when property values decrease and unemployment increases. United Guaranty's actual experience drives a critical assumption when running the CCAR Severely Adverse scenario, which includes similar macroeconomic assumptions relating to home prices and unemployment as experienced during the financial crisis. The chart below illustrates by calendar year the persistency of United Guaranty's book of business, including strong persistency during the financial crisis.



Further bolstering the stability of the cash flows from future premiums is the fact that paying premium is a contractual obligation. If the Insured fails to pay premium on a loan, coverage lapses under the insurance policy and the *approved insurer* would not suffer losses with respect to that loan. Earned premium has also historically been a material source of liquidity. Between 2002 and 2009, when United Guaranty's market share was flat, United Guaranty earned $1.4 billion of premium from 2002–2005 and $1.7 billion of premium from 2006–2009. United Guaranty acknowledges there is some uncertainty regarding the amount of ultimate future premiums a mortgage insurer will collect on its in-force policies. United Guaranty's insured loan portfolio has an estimated average remaining life of 4.4 years; therefore, United Guaranty recommends adding 300% of net earned premiums in the past 12 months as reasonable.

Also appropriate is inclusion of investment income as an available source of assets, particularly in light of the long-tail claim emergence of mortgage insurance claims. Unlike auto or homeowners insurance companies, which experience immediate claims in a catastrophic event, mortgage insurance claims emerge over a much longer time horizon, allowing the mortgage insurer sufficient time for liquidity planning. The investment portfolio will continue to generate profit over this longer horizon.

United Guaranty's proposed revisions to the *available assets* calculation explicitly include certain conservative assumptions to ensure that *approved insurers* have sufficient assets to pay claims, on time, during future stress events.

- First, United Guaranty suggests operating expenses be based on the expense ratio of a going concern company (including policy acquisition costs) instead of a runoff entity, even though the *available assets* calculation does not include premium for future writings.
- Second, United Guaranty recommends 300% of net earned premium, even though the estimated average remaining life is north of 400%.
- Finally, there is no credit for external support agreements under the Eligibility Requirements. United Guaranty has had an uncapped support agreement in place with AIG since 2003. In addition to creating a legal obligation for AIG, the agreement provided a strong incentive for AIG to enable United Guaranty to write business throughout the recent crisis.

Based on the foregoing, United Guaranty respectfully requests that the GSEs revise the *available assets* calculation as described herein to account for all available sources and uses of capital over the planning horizon.

2. Revise the *risk-based required asset* factors to distinguish on the basis of loan term, loan age, and seasoning.

The *risk-based required asset amount* in Exhibit A is determined by vintage classification (pre-2005, 2005-2008 and post 2008), original LTV and credit score for performing loans, and delinquency status for non-performing loans, which is a tremendous improvement from the existing requirements. However, United Guaranty respectfully submits that the GSEs distinguish the loan factors further by making three revisions to Exhibit A.

- First, Exhibit A should be revised to include loan factors that distinguish on the basis of loan term in addition to LTV and credit score. Loan term is predictive of loan performance, outside of LTV and credit score. For example, a 30 year mortgage with 95% LTV / 700 credit score is more than three times as likely to go to claim as a 15 year loan with a 95% LTV / 700 credit score. Given the predictability of loan term and the relative ease of incorporating this additional industry accepted variable into Exhibit A, United Guaranty recommends the Eligibility Criteria be revised as follows:

30-Year Term

Original Credit Score

Original LTV	621–680	681–740	741–780	781–850
LTV ≤ 85	6.9%	4.0%	2.5%	1.8%
85< LTV ≤ 90	9.9%	6.2%	3.8%	2.9%
90< LTV ≤ 95	13.1%	8.4%	5.4%	4.1%
95< LTV ≤ 100	14.0%	9.1%	6.4%	4.9%

15-Year Term

Original Credit Score

Original LTV	621–680	681–740	741–780	781–850
LTV ≤ 85	1.2%	1.0%	0.7%	0.5%
85< LTV ≤ 90	2.3%	1.8%	1.1%	0.7%
90< LTV ≤ 95	3.8%	2.4%	1.5%	1.0%
95< LTV ≤ 100	5.1%	2.7%	1.7%	1.2%

- Second, the GSEs should consider replacing the distinctions between vintages (pre-2005, 2005–2008, and post-2008) with distinctions based on the age of the loan since origination. The vintage distinctions will become obsolete over time, and absent action by the GSEs to update Exhibit A, only the post-2008 tables will be applicable. Distinguishing on the basis of age of the loan since origination in the final Eligibility Requirements will alleviate the need to update them for this in the near term.

- Finally, United Guaranty suggests that the GSEs consider adding seasoning factors by loan age for loans that have never been more than 60 days delinquent, as well as for current loans that have been delinquent in the past, but have since cured. Generally, the probability of foreclosure of current loans decreases over time as the LTV decreases due to amortization of principal and increases in home prices. Historical industry data suggest the following seasoning adjustments to unseasoned loan factors.

Seasoning Factors

Age (in months)	Never Delinquent	Re-Performing
0–12	100%	100%
13–24	91%	95%
25–36	84%	89%
37–48	78%	86%
49–60	77%	82%
>60	75%	75%

The existence of seasoning adjustments would eliminate the need to revise factor tables each year as the mix of loan ages changes. Seasoning adjustments would also ensure adequate capital for new business and would reflect more precisely an individual company's loan age mix.

Thank you for your consideration of these comments. We would be pleased to discuss these topics with you further as you work to finalize the Eligibility Requirements.

Sincerely,

Donna DeMaio, CEO
United Guaranty Corporation