NAIC & The CENTER for INSURANCE POLICY and RESEARCH
National Association of Insurance Commissioners

September 8, 2014

The Honorable Melvin L. Watt
Director
Federal Housing Finance Agency
Constitution Center
400 Seventh Street SW
Washington, DC 20014

Re: Federal Housing Finance Agency Public Notice No. 2014-N-9: "Fannie Mae and Freddie Mac Draft Private Mortgage Insurer Eligibility Requirements."

Dear Director Watt:

We write on behalf of the National Association of Insurance Commissioners (NAIC)[1] regarding the Federal Housing Finance Agency (FHFA) draft Private Mortgage Insurer Eligibility Requirements (PMIERs). The NAIC appreciates the opportunity to provide public comment on the PMIERs, and respectfully submits the following response to the notice of draft requirements and request for input published in the July 22, 2014 issue of the Federal Register.

State insurance regulatory requirements for private mortgage insurance (PMI) are designed with the important dual responsibilities of a state regulator in mind: protecting policyholders and ensuring available and affordable coverage in competitive insurance markets. It is this dual mission that informs our comments, which we hope will be helpful as you give further consideration to more suitable standards for PMI providers doing business with Fannie Mae and Freddie Mac, the government sponsored enterprises (GSEs). We appreciate the extent to which your staff has already engaged with our technical experts on calls and at recent NAIC meetings, and we remain ready to answer additional questions about our regulatory regime as you move forward with finalizing the PMIERs. We are also working with your staff and the GSEs to schedule a meeting in Washington, DC to discuss our specific recommendations.

It is evident that the PMIERs are the product of an intense and comprehensive effort on the part of your agency and the GSEs. While we recommend a number of important changes that we believe are necessary, the PMIERs, in large measure, constitute a valuable and reasonable reform effort, and are compatible with and complementary to the reforms of the *Mortgage Guaranty Insurance Model Act (#630)* currently being undertaken by the NAIC.

[1] The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

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We are in agreement that mortgage guaranty insurers must have strong underwriting and quality assurance functions. In fact, the most recent draft revisions to the aforementioned NAIC model act contain a framework for such functions. We are also in accord with the Section 309 requirements regarding timely decisions on perfected claims, as well as the implicit requirements imposed on financial institutions.

Our principal recommendations for continued improvement to the PMIERs are as follows:

1. If the severely adverse stress scenario of the Federal Reserve Board's Comprehensive Capital Analysis and Review (CCAR) is the standard to be used, it should be applied in a manner that recognizes how a mortgage guaranty insurer would be expected to fare under such an economic scenario.

2. A mortgage guaranty insurance company should not be required to limit its business solely to the needs of the GSEs.

3. There should be no arbitrary discount on publicly-traded common and preferred stock for minimum available asset requirement purposes.

4. Affiliated investments should be included in computing the amount of available assets to meet the minimum asset requirement, albeit with some reasonable discount to reflect liquidity concerns.

<u>Appropriate application of the CCAR requires consideration of insurer business model</u>

We believe that continuous application of the severely adverse stress scenario of the Federal Reserve Board's CCAR exercise at all times throughout the economic cycle as the basis of the minimum asset requirement is excessive and will have adverse consequences for the access of worthy borrowers to credit. In relation to mortgage guaranty insurers, states have employed severe recession scenarios for contingency planning and monitoring purposes, but never as a basis for a minimum capital standard.

If the severely adverse stress scenario of the CCAR is to be used as the standard, then it should be applied in a manner that recognizes how a mortgage guaranty insurer would be expected to fare under such an economic scenario. Insurance is not banking and banking is not insurance. For example, the reason that many banks pass the stress test is due to the assumed natural interest rate hedge inherent in the test. The yield curve assumes very low short rates, but long rates that are substantially higher in relative terms, allow for greater spread advantages. Mortgage guaranty insurers do not have this assumed natural hedge, but they would have some advantages of their own under such an economic scenario.

Stricter underwriting and quality assurance standards are more important and more useful than capital requirements for protection of the public. The severity of the recent economic crisis had more to do with the course of conduct of the participants in the housing finance system than the level of capital required of them.

In connection with the imposition of higher capital requirements, it should be noted that mortgage guaranty insurers are not effectively permitted to invest assets associated with their reserves in the manner that other insurers generally may. While insurers generally may invest all of their assets for a productive return, mortgage guaranty insurers in practice are obliged to invest assets related to their contingency reserves in zero-yield tax and loss bonds issued by the United States Treasury. We think that it would be appropriate to permit mortgage guaranty insurers the same freedom of investment as insurers generally. While such changes are not within the purview of the FHFA, we believe that the agency should be supportive of reasonable changes in federal tax code that would complement the changes to standards that it is pursuing.

PMIs should not be restricted or customized to the needs of the GSEs

We disagree that the sole purpose of an insurance company should be permanently customized solely to the needs of the GSEs. It would be altogether legitimate for a mortgage guaranty insurer to underwrite commercial mortgages, mortgages on apartment buildings, and to insure leases, all within a company that principally insures one to four family residential mortgage loans.

There are sound public policy grounds upon which we believe your proposed limitations are too restrictive. The housing market is broader than the limited objectives of the GSEs and insurers are needed to support those other markets as well, as long as they satisfy the capital standards and the underwriting and quality assurance requirements for the GSEs' business.

Arbitrary discounts on publicly traded common and preferred stock are not necessary for minimum asset calculations

Publicly-traded common and preferred stocks fluctuate enough on their own without requiring a 25% discount for minimum asset requirement purposes. In determining an optimal asset allocation, each mortgage guaranty insurer will have to take into account their minimum asset requirement under the PMIERs and expectations for price fluctuation in whatever assets they hold. State capital standards, state investment laws for insurers, and the PMIERs minimum available asset requirement already impose a sufficient inducement toward conservatism. An arbitrary discount in the instance of an asset for which a fair value may be readily determined is unnecessary and will discourage optimal investment decisions. This is detrimental to the interests of the GSEs, since unnecessarily reduced investment returns needlessly reduce the assets and income streams available to meet obligations to the GSEs.

Affiliated Investments

We are concerned that the disallowances for affiliated investments in computing the amount of available assets to meet the minimum asset requirement are unduly restrictive. Affiliated investments should be included in computing the amount of available assets to meet the minimum asset requirement, albeit with some reasonable discount to reflect liquidity concerns. Affiliated investments were of constructive assistance during the recent financial crisis for some of the mortgage guaranty insurers. It is best to maximize, rather than reduce, potential options in economic hard times.

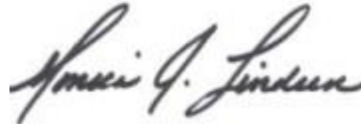
Conclusion

Thank you for your time and consideration of these comments. We appreciate your continued engagement and the opportunities afforded for our membership to review and discuss the PMIERs with you, given their important implications for our work as state regulators with an obligation to protect policyholders while making sure coverage is affordable and available. We remain committed to

working constructively with you and your agency in our joint efforts to promote the safety and soundness of America's housing finance system. Should you wish to discuss this letter or any other matter relating to the NAIC's views on mortgage insurance, please do not hesitate to contact Ethan Sonnichsen, Director of Government Relations, at (202) 471-3980 or Mark Sagat, Counsel and Manager, Financial Policy and Legislation, at (202) 471-3987.

Sincerely,

Adam Hamm
NAIC President
North Dakota Insurance Commissioner



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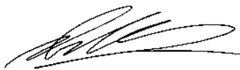

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