September 8, 2014

The Federal Housing Finance Agency
Constitution Center
400 7th Street SW
Washington DC 20014
Attn: Mortgage Insurance Eligibility Project

Re: Draft Private Mortgage Insurer Eligibility Requirements: Request For Public Input

Dear Sir or Madam:

Bow Street LLC ("Bow Street" or "we") is writing in response to the request for public input on the draft Private Mortgage Insurance Eligibility Requirements ("PMIERS") dated July 10, 2014. Bow Street is an institutional money manager which invests in a broad range of companies and securities, including private mortgage insurers ("MIs"). We hope our perspective as a manager of private capital will be helpful to the Federal Housing Finance Agency ("FHFA") as it refines the mortgage insurance eligibility requirements.

The financial crisis exposed weaknesses in the capital bases of certain private mortgage insurers. Bow Street supports the FHFA's effort to incorporate these learnings into the PMIERS. Further, strong capital requirements will mitigate future losses to Fannie Mae and Freddie Mac (together the "Enterprises") and ensure residential borrowers maintain access to affordable credit throughout economic cycles. We appreciate the efforts of the FHFA and the Enterprises to engage with stakeholders in a thoughtful manner to address this important issue. Having reviewed the draft PMIERS, we offer the following recommendations:

Pro-Cyclicality: As currently drafted, we believe the PMIERS are overly pro-cyclical. The minimum asset requirements for newly originated loans contemplate a stressed economic scenario. Requiring additional assets for defaulted loans without contemplating a commensurate reduction in the minimum asset requirements for loans which have experienced significant seasoning will force the MIs to build additional capital at the worst possible time (when such capital is likely to be either unavailable or prohibitively expensive). This will result in a higher cost of capital for MIs through all cycles, the cost of which will likely be passed along to borrowers in the form of higher premiums. Incorporating minimum asset relief for seasoned loans would be a prudent and significant step in reducing the pro-cyclical impact of the PMIERS.

Higher-Risk Lending: The minimum asset requirements for loans with less than 740 FICO scores and greater than 90% LTVs are overly onerous in light of historical empirical data, and will result in decreased housing affordability and decreased private capital. As currently contemplated, we do not believe that MIs can earn an adequate return on capital by writing mortgage insurance for less than 740 FICO and 90%+ LTV borrowers without significantly raising premiums. Given the minimum asset requirements needed to insure these loans, we believe it is likely that the Federal Housing Administration ("FHA") will come to dominate this segment of the market. As a matter of public policy, we do not believe that a two-tiered insurance market – with MIs insuring lower risk borrowers and the US

Government (via FHA) insuring higher risk borrowers – is in the Nation's best interest. We suggest that the FHFA work with private mortgage insurers and the Enterprises to review historical stress scenario data to adopt a more realistic set of multipliers for lower credit borrowers.

Asset Eligibility Requirements: We believe that unearned premiums should count towards minimum asset requirements. Unearned premiums represent cash available to pay claims. Utilizing this cash does not reduce counterparty strength any more than utilizing other sources of funds. Additionally, including unearned premiums in the minimum required asset test will encourage competition across a diverse set of premium options for borrowers, thereby reducing premiums and encouraging housing affordability.

Future PMIERS Modifications: As investors, we place a premium on regulatory certainty. The draft PMIERS currently allow for potentially frequent and unilateral changes to capital standards at the sole discretion of the Enterprises. Though the Enterprises may be well-intentioned stewards of this responsibility, uncertainty surrounding future capital standards will serve to increase the MIs cost of capital, which will likely be passed along to borrowers. Establishing a transparent process for changing PMIERS which includes empirical metrics as guideposts, incorporates industry input, and provides for a pre-defined implementation period would reduce the perceived subjectivity of future regulatory changes.

As currently drafted, we believe the PMIERS are likely to both increase the cost of mortgage insurance and reduce the availability of credit to otherwise worthy borrowers. Moody's Analytics estimates that the PMIERS will increase average premiums across all private insured loans by 10 to 15 basis points[1]. This increase will be exacerbated for less-creditworthy borrowers, with estimated premium increases of 20 to 25 basis points for borrowers with 700 FICO scores and 95% LTV, and increases of 60 to 65 basis points for borrowers with 650 FICO scores and 95% LTV[1]. With certain changes, we believe that the PMIERS can both ensure that the MIs are strong counterparties and encourage mortgage affordability without premium increases.

As investors in the mortgage insurance sector, we share FHFA's interest in a healthy and financially strong industry. We believe that our recommendations, combined with the draft PMIERS, will create the framework for capital requirements which will both promote housing affordability and ensure capital adequacy throughout economic cycles.

Sincerely,

Bow Street LLC
(212) 554-5700

[1] Moody's Analytics: *Putting Mortgage Insurers on Solid Ground August 2014*