September 8, 2014

The Hon. Melvin W. Watt
Director
Federal Housing Finance Agency (FHFA)
Constitution Center
400 7th Street, S.W., 9th Floor
Washington, D.C. 20024

Re: 2014-N-9

Dear Director Melvin W. Watt:

The Association of Mortgage Investors (AMI) appreciates the Federal Housing Finance Agency's (FHFA) interest in the role of the Private Mortgage Insurance (PMI) in the current and the future housing finance system. We applaud the FHFA's continued efforts toward the development of a healthy and responsible mortgage market -- which recognizes PMI as a critical source of private capital and as an important component of a reformed, safe, and sustainable system, complementary of other pending financing reforms. Our member investors have long sought to bring more private capital to the U.S. mortgage market, thereby increasing both housing finance credit availability and affordability.

Introduction

The AMI was organized as the primary trade association representing investors in mortgage-backed securities, including university endowments and pension funds. The AMI was founded to play a primary role in the analysis, development, and implementation of mortgage and housing policy to help keep homeowners in their homes and provide a sound framework that promotes continued home purchasing. Since its formation, the AMI has been developing a set of policy priorities that we believe can contribute to achieving this goal. We are an investor-only group comprised of a significant number of

substantial institutional investors in commercial and residential mortgage-backed (RMBS) and other asset-backed securities (ABS).

I. Background

Mortgage investors fully endorse Director Watt's statement, *"Mortgage insurance counterparties must be able to fulfill their intended role of private capital even in adverse market conditions."* We fully appreciate that a direct result of the financial crisis was a steep rise in defaults and foreclosures of single-family mortgages, including those owned or guaranteed by Fannie Mae and Freddie Mac (GSEs). Lenders, MIs, and the GSEs suffered significant losses as a result of these defaults and foreclosures.

AMI and its members acknowledge the important role of mortgage insurers in a healthy, sustainable housing finance system. Mortgage Insurance is one of the major forms of credit enhancement in our system, particularly for many first-time home owners with moderate incomes and members of underserved communities. As "mortgage insurers enable home-ready borrowers to safely buy homes without having to take an unduly long time to save for a high downpayment."[1] As was further noted before the Senate Banking Committee, the MI industry enables "insuring 30-year, fixed rate mortgages – mortgages that are central to the functioning of a stable housing finance system (including a strong TBA market)."[2]

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[1] Statement of Rohit Gupta, President, Genworth Financial U.S. Mortgage Insurance, before, the Senate Banking Housing, and Urban Affairs Cmte., hearing on the "*Essentials of a Functioning Housing Finance System for Consumers"* (October 29, 2013) (page 8). See, banking.senate.gov (http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=def8b8ec-055a-4153-84de-0ffd273477fc).

[2] *Id.*

Further, PMIs have historically accounted for 64% of high LTV insurance but now account for only 39% (as shown in Chart 1 below). The PMIERs as currently drafted could discourage private mortgage insurers from writing high LTV mortgage insurance, potentially exposing taxpayers to future losses.

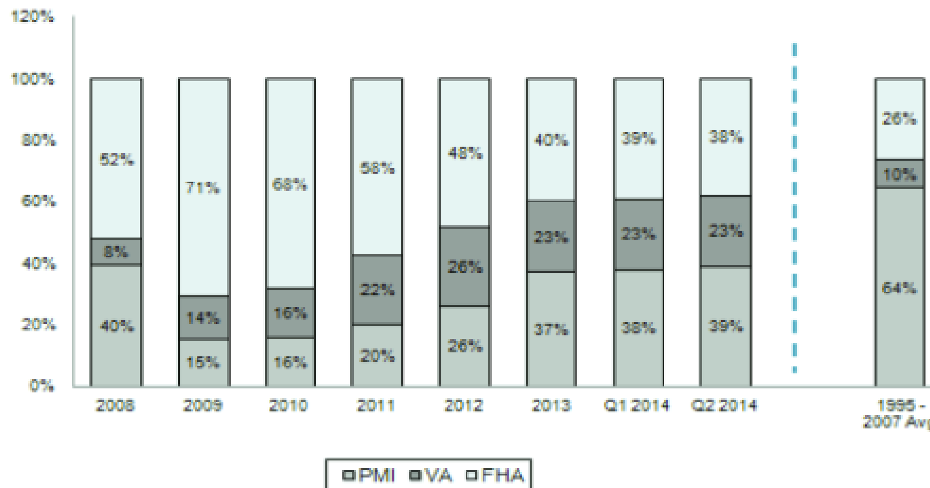

Chart 1. Market Share of Public and Private Mortgage Insurance (PMI)[3]

Therefore, it is understandable that the financial requirements contained in the Draft PMIERs are intended to mitigate future GSE losses and to ensure that MIs maintain the sufficient financial strength to withstand a stress macroeconomic scenario. The MI industry has risen to past challenges, having paid approximately $40 billion in claims from 2007-2012.[4] From 2008 through 2013, PMIs have paid 96% of total claims due to Freddie Mac in cash.[5] We also wish to highlight that the MI industry has raised over $8.9 billion in new private capital since 2008.[6]

AMI believes that the proposed increases to the capital requirements are highly onerous and clearly inconsistent with the FHFA's stated goals of expanding the availability and affordability of

[3] MGIC response to FHFA comment inquiry, at page 12, chart 5.

[4] *Gupta Banking Committee testimony*.

[5] Per Freddie Mac SEC filings as referenced in MGIC response to FHFA comment inquiry, at page 19.

[6] *Gupta Banking Committee testimony, at 9.*

mortgage credit, as well as, reducing the risk to the taxpayer through encouraging more private capital in the mortgage market. Accordingly, a well-designed, balanced PMIERs rule will help the stated goals supporting the housing recovery. As key stakeholders[7] have noted:

- *"[The PMIERs] are inconsistent with what we believe constitutes a sound capital requirement framework. Many such items, if not changed, could have the impact of either raising MI pricing and/or reducing access to credit for a worthy low-downpayment homebuyer or forcing such business to be done by FHA [Federal Housing Administration] or as piggyback loans, which will place the U.S. taxpayers at much greater risk."*[8]
- *"We do believe that these proposed requirements, if not modified, have the potential to increase the cost of borrowing for future homebuyers, and could also restrict access to credit. This may impact many low- to moderate-income, deserving borrowers, including certain minority groups, who are particularly vulnerable today based on lower credit scores and limited savings for a downpayment."*[9]
- *"If the Draft PMIERs were implemented in the form released for public input, we believe they would: restrict access to credit and/or increase the cost of homeownership for creditworthy borrowers; increase taxpayer risk as private mortgage insurance loses market share to less regulated, or non-regulated, credit enhancements or to FHA insurance; and discourage private capital from investing in housing finance due to the mismatch between risk and return on the capital that would be required."*[10]

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[7] Note: AMI's membership does not comprise any PMI companies; it is strictly institutional investors who support the future of the housing market.

[8] Radian Business Update Call, July 10, 2014.

[9] Radian Comments on Impact of Draft PMIERs July 10, 2014 (Press Release at http://www.radian.biz/page?name=NewsReleaseItem&theitem=a0eC0000007FjznIAC&newsyear=).

[10] MGIC Comments on Draft GSE Mortgage Insurer Eligibility Requirements, July 10, 2014.

II. *Credit Availability*

AMI and its members wish to be as resource as you develop the rules and guidance for the MI market. In particular, we wish to highlight the following issues which bear on the health and sustainability of the system as we finally move past the worst of the financial crisis. As credit has tightened, illustrated below, it has become more difficult for first-time and average home buyers to enter the housing market. Accordingly, U.S. home ownership rates have dropped, purchase originations are near a 15-year low and mortgage credit outstanding continues to decline.

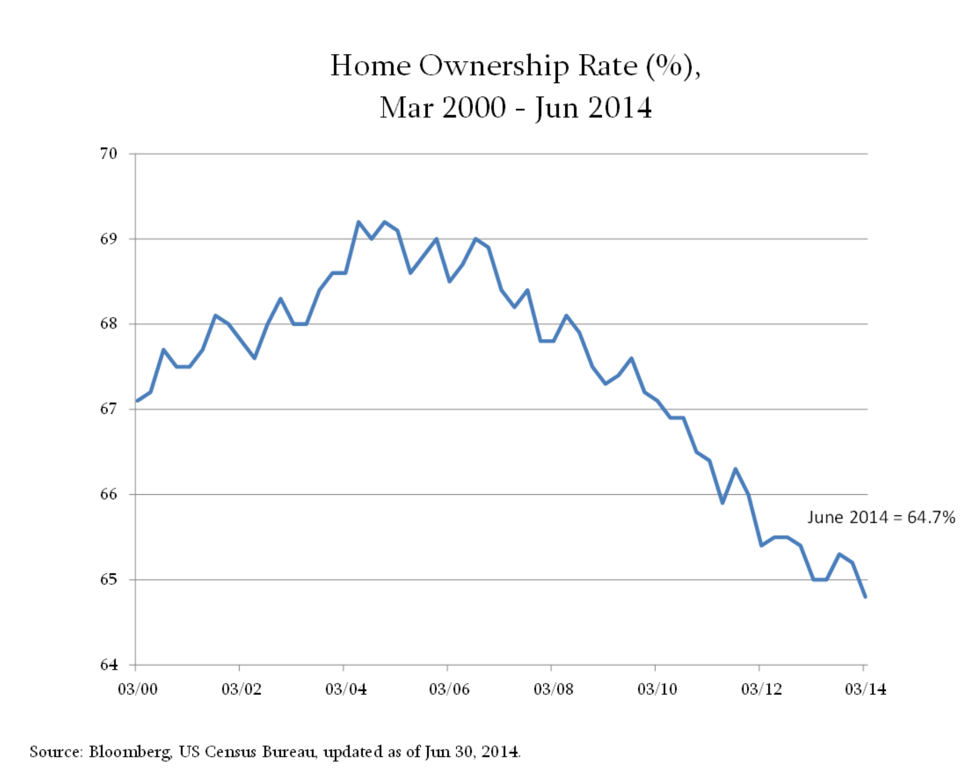


Chart 2: Home Ownership Rates (2000 – 2014).

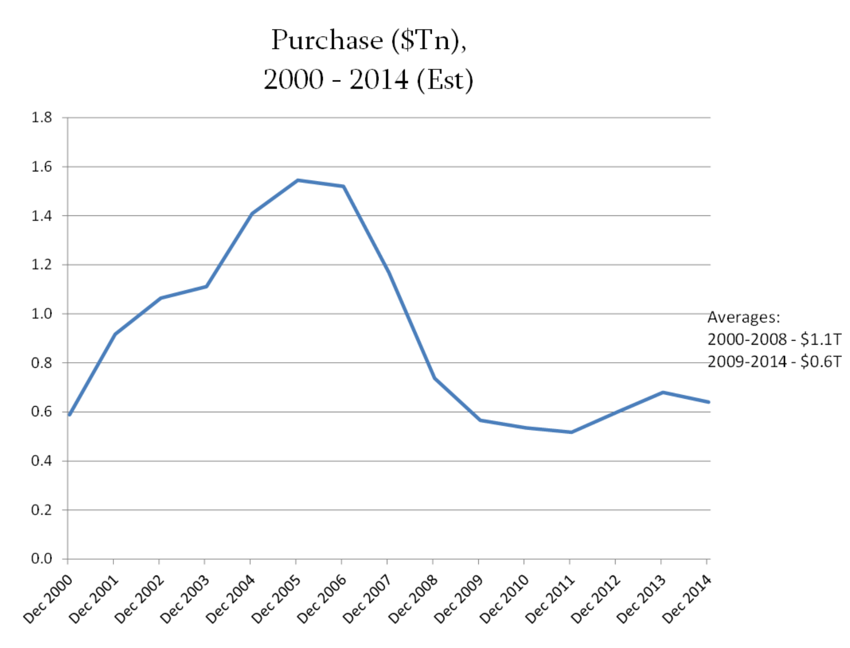


Chart 3: Single-Family Home Originations.

From 2000 to 2008, the average annual purchase originations were $1.1 trillion. However, from 2008 to 2014(E), the average purchase originations have declined by almost 50% to $600 billion.

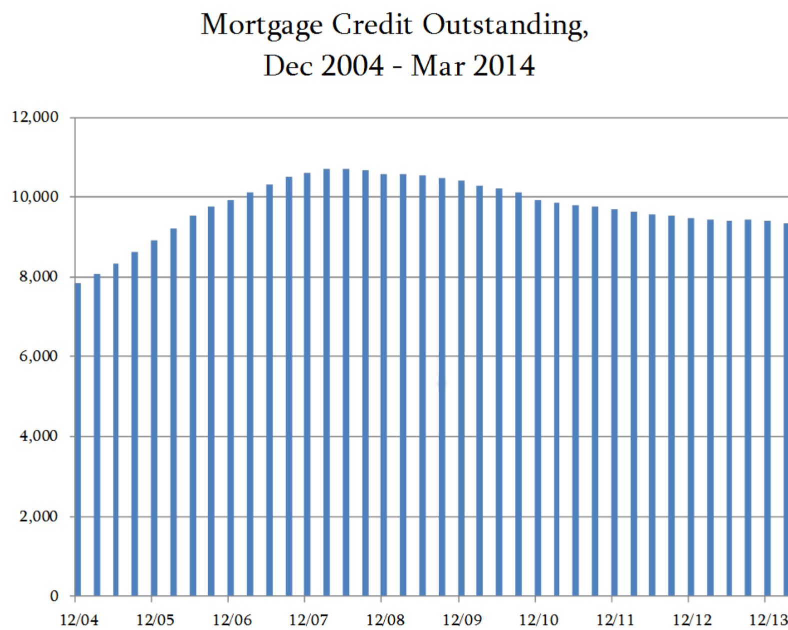


Chart 4. U.S. Outstanding Mortgage Credit

Generally, in response to FHFA's proposed rule, we wish to make the following global remarks concerning the role of government, MIs, and the future of private mortgage capital. As the previous charts illustrate, the simple fact is that mortgage credit is at its lowest since the height of the financial crisis. Hence, a poorly constructed rule can lead to the unintended consequence of making mortgage credit more expensive and less available for first-time home borrowers and minorities.

III. Negative Consequences Flowing from the Currently Proposed Rule

We fully support the FHFA's stated goal that the Draft PMIERs to "seek to ensure that Approved Insurers have adequate liquidity and claims-paying capacity during periods of economic stress." However, we believe that the Draft PMIERs go far beyond requiring "adequate liquidity and claims-paying capacity." As a result, the draft proposal is clearly at odds with the long-standing housing policy goals that many in the public- and private-sector believe are critical to ensuring that a safe, affordable and sustainable housing market exists.

According to Moody's research,[11] the Draft PMIERs, as written, will result in a risk-to-capital ratio of 12:1 after accounting for non-performing loans. This proposal is more than twice as robust as 25:1 as has been historically regulated by state laws. It is also 50% stronger than the industry's current 17:1 from the seven active MI companies. The PMIERs treatment of non-performing loans is geared more towards an ultimate default of a delinquent loan; however, the industry's current reserving policy provides for a more realistic default to claim ratio based on the current market environment.

Using the PMIER methodology will result in a much higher capital charge compared to the industry's current reserving policy. The industry carefully accounts for a borrower's probability of reinstatement from a delinquency status based on recent borrower behavior.

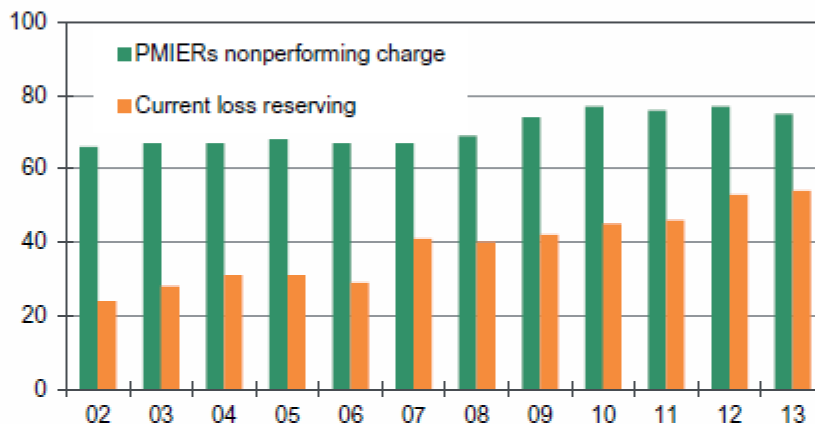


Chart 5. Capital for NPLs under PMIERs

IV. The Concept of Increased Capitalization Requirements is Prudent; however, the Proposed Rule is Overly Burdensome and Excessively Harmful

AMI's response to the request for comments is limited to what we believe are the most important issues – the Financial Requirements of the Draft PMIERs. We will address the expected incompatibility of the Draft PMIERs with housing policy goals. Specifically, we will address the following issues:

A. Credit for future premiums, including those collected but not earned are excluded from Available Assets;
B. The required asset factors for new business are established to withstand a stress loss scenario at the time the insurance is written, meaning the factors already anticipate that there will be delinquent loans. However, as loans become delinquent, the Draft PMIERs require additional assets to be held for these loans;
C. Further, these factors do not decline for non-delinquent loans as a book of business seasons; and,
D. The frequency and methodology of updating grids should be transparent.

A. Credit for Future Premiums, Including those Collected but Not Earned are Excluded from Available Assets

The Draft PMIERs require MIs to hold unnecessarily excessive "Available Assets" (as defined within the said draft), which may drive up the price of mortgage insurance or reduce its availability in certain markets. A possible solution to these negative results would be to include, as Available Assets, a certain

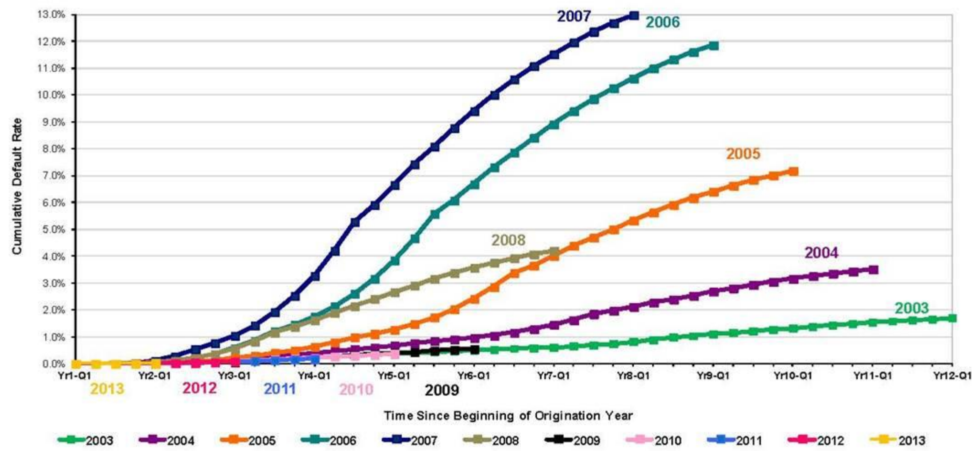
percentage of future contractual premiums on all policies, not just the policies written in 2008 and prior, as currently contemplated by the draft PMIERs.

As demonstrated by the Fannie Mae default curves by vintage (see following chart), any loans that may default will start to become delinquent two to six years after origination. All premiums reasonable expected to be earned should count towards Available Assets. To protect the GSEs from an instance of statutory insolvency, the allowance of future premiums as an Available Asset could be limited to those MIs with a minimum level of statutory capital.

It is appropriate to consider a percentage of all future premiums regardless of policy year, just as the Draft PMIERs consider all future off balance sheet liabilities from future policy claims. While we acknowledge that state regulators do not routinely consider future premiums in the normal course of regulating MIs, we understand they do in fact consider future premiums in periods of economic stress.

We are also concerned that premiums that are collected but are "unearned," due to accounting rules or timing nuances, are not being included in Available Assets. These collected premiums are liquid and immediately available to pay claims, and therefore we believe they should be included in Available Assets.

Cumulative Default Rates of Single-Family Conventional Guaranty Book of Business by Origination Year



Note: Defaults consist of loan liquidations other than through voluntary pay-off or repurchase by lenders and include loan foreclosures, short sales, sales to third parties and deeds-in-lieu of foreclosure. Cumulative Default Rate is the total number of single-family conventional loans in the guaranty book of business originated in the identified year that have defaulted, divided by the total number of single-family conventional loans in the guaranty book of business originated in the identified year.

Data as of March 31, 2014 is not necessarily indicative of the ultimate performance of the loans and performance is likely to change, perhaps materially, in future periods.

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Chart 6

B. ***The Required Asset Factors for New Business are Established to Withstand a Stress Loss Scenario at the Time the Insurance is Written. This Means that the Factors Already Anticipate that there will be Delinquent loans. However, as loans become delinquent, the Draft PMIERs require additional assets to be held for these loans.***

We are also concerned about potentially double-counting as the proposed grid factors on performing loans are meant to account for capital needs driven by future delinquencies. As loans become delinquent, however, incremental capital is required against these delinquent loans, effectively double-counting the potential effects of delinquencies both prospectively and retrospectively.

We also believe that the projected claim rates specifically for the performing 2005 to 2008 loans that have never been delinquent are excessive, given the fact that these loans have fully performed throughout the recent housing market collapse. The draft PMIER matrix results in a “cliff effect” that overstates capital needs for the 2005-2008 vintages.

	Pre - 2005	2005 - 2008	Multiple
LTV	680-740	680-740	680-740
90 - 95	2.3%	16.6%	7.2x

The default curves for the 2005, 2006 and 2007 have flattened substantially. By following the curve’s shape over future years demonstrates that the expected additional default rate may be 2% - 4%. Therefore, the matrix for these vintages seems substantially overstated.

C. ***Factors Do Not Decline for Non-Delinquent Loans as a Book of Business Seasons.***

As long-time mortgage investors, we have lived and breathed the books of business during good and bad times. We fully understand that the current delinquency environment has changed in the past decade. With that understanding, we appreciate that after a certain period after origination, the probability of defaults decreases. Accordingly, we are regrettably critical of the grids currently proposed. We would join with those stakeholders who recommend grids that take into account seasoning factors, decreasing the required capital in line with the declining probability of default as loans season, as evidenced by precedent (*see the Fannie Mae default curves above*).

D. ***Frequency and Methodology of Updating Grids should be transparent.***

Finally, in addition to concern about the draft PMIERs requiring MIs to hold unnecessarily excessive assets, the draft PMIERs would also allow changes to the grid-based asset requirements with seemingly little warning or discussion. This inserts unnecessary uncertainty into the forward business operations and capital plans for MIs and makes a private capital investment decision more difficult to assess. We recommend that a predictable and transparent methodology be defined to allow changes to the grid-based capital requirements, and that this process include input of stakeholders, including the MIs. This methodology could consider among other items home price appreciation or depreciation that has occurred relative to the initial stress environment contemplated in the original grids.

As one stakeholder explained: *"It is a concern that [the PMIERS] could be updated. And there's not a lot of transparency into how they will be updated over time. And that does create some issues in terms of capital planning, because there is no certainty with respect to it. That's why from our perspective, rather than try to adjust the grid factors for seasoning over time, we proposed that it's embedded day one, and becomes more formulaic, so it does not create that uncertainty, and everyone knows what field they're playing in, in terms of capital requirements."*[12]

[12] Radian Business Update Call (July 10, 2014).

V. Conclusion

In summary, AMI and its members are eager to work with you on the development of a balanced, responsible PMIERs rule. AMI has long advocated for long term, responsible policies to create affordable homeownership opportunities, restore private capital to the U.S. mortgage market, and protect taxpayers. However, the currently proposed rule must be adjusted to achieve these important goals.

We believe our proposed changes will:

- continue to provide the GSEs the necessary liquidity and protection from the potential statutory insolvency that they seek;
- continue to attract private capital to take first loss positions ahead of the taxpayer; and,
- help ensure access to credit at an affordable cost.

AMI appreciates FHFA's work to develop the Draft PMIERs. We commend your effort to improve the counterparty requirements for MIs. However, we strongly urge that FHFA restructure the Draft PMIERs to allow for the proposals we discussed above.

Regrettably, the likely consequences of the currently proposed rule for private capital investment are negative for both investors and consumers alike. These negative consequences range from chilling the return of private capital to the mortgage market, to uncertainty for market participants, to fewer housing opportunities, to lesser housing affordability, especially for first-time borrowers. It is unlikely that we will have a return to the once-healthy mortgage market as we knew it until a more carefully balanced rule is developed. Simply, it threatens the American dream of a 30-year fixed mortgage.

Please do not hesitate to rely on us as a resource as you continue this process. Thank you.

Sincerely,

Chris Katopis
Executive Director
Association of Mortgage Investors