January 16, 2024

Mr. Jerome H. Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R–1813
RIN 7100–AG64

Mr. Michael J. Hsu
Acting Comptroller
c/o Chief Counsel's Office,
Attention: Comment Processing,
Office of the Comptroller of the Currency,
400 7th Street SW, Suite 3E–218
Washington, DC 20219
Docket No: OCC–2023–0008

Mr. Martin J. Gruenberg,
Chairman
Federal Deposit Insurance Corporation
c/o James P. Sheesley, Assistant Executive Secretary, Attention: Comments/Legal OES (RIN 3064–AF29),
Federal Deposit Insurance Corporation,
550 17th Street NW
Washington, DC 20429
RIN 3064–AF29

Re: Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity, Docket ID OCC-2023-0008.

Dear Chair Powell, Chairman Gruenberg, and Acting Comptroller Hsu:

On behalf of U.S. Mortgage Insurers (USMI) and our members companies,[1] we appreciate the opportunity to provide feedback on the Basel III Endgame proposed rule (NPR)[2] issued last year by the Federal Reserve, Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively the Agencies). USMI represents the nation's leading private mortgage insurance (MI) companies and our members are dedicated to a housing finance system backed by private capital that enables access to affordable and sustainable mortgage finance while also protecting taxpayers. As long-term managers of single-family mortgage credit risk, the private MI industry is keenly focused on balancing access and affordability for homebuyers with the safety and soundness of the housing finance system. During the past 67 years, the private MI industry has enabled more than 38 million homebuyers, including many first-time, minority, and low- to moderate-income (LMI) borrowers who lack

[1] USMI membership comprises the following private mortgage insurers: Enact Mortgage Insurance Corporation; Essent Guaranty, Inc.; Mortgage Guaranty Insurance Corporation; National Mortgage Insurance Corporation; and Radian Guaranty, Inc.

[2] 88 Federal Register 64028 (September 18, 2023).

sufficient funds for a 20 percent down payment, to attain the American Dream of homeownership. Private MI has been the most common execution for low down payment borrowers since 2018[3] and, in 2022 alone, more than 1 million borrowers purchased a home or refinanced a loan with private MI, accounting for approximately $402 billion in mortgage origination volume.[4] Nearly 62% of purchase loans with private MI went to first-time homebuyers and more than 34% had annual incomes below $75,000. Currently, more than $1.5 trillion in outstanding mortgages have private MI protection, including approximately $200 billion in portfolio and private-label security (PLS) executions.[5]

USMI supports appropriate capital requirements for the U.S. banking industry. While appropriate capital levels are important for the safe and sound operation of our banking sector, *excessively conservative* capital requirements have a detrimental effect on our economy and reduce the availability and affordability of mortgage credit, especially for LMI households and first-time home buyers. According to the Urban Institute, the proposed changes in the capital rules "would disproportionately disadvantage LMI borrowers and communities, as well as Black and Hispanic borrowers."[6] Therefore, it is critically important that the proposal be modified to ensure that the final rule is based on the actual risks to banks and considers the impact of the new capital requirements on the availability and cost of credit.

USMI recommends that the Agencies preserve banks' ability to consider private MI when calculating the loan-to-value (LTV) ratio of a mortgage for determining risk-based capital, provided the private MI company meets the capital and operational standards required to be an "approved insurer" in compliance with the Private Mortgage Insurer Eligibility Requirements (PMIERs)[7] that are overseen by the Federal Housing Finance Agency (FHFA). This would recognize the value of private MI in reducing credit losses and enhancements both to the private MI and broader mortgage industries since the Great Financial Crisis, as well as avoid the unintended consequences associated with further reducing bank participation in the housing finance system. We urge the agencies' final rule to permit a mortgage loan's LTV to be reduced through MI and qualify for a 50 percent risk weight as is currently allowed.

I. **Executive Summary**

The proposed capital treatment for mortgage loans is excessive and fails to provide the data used to justify the higher capital requirements and the departure from the current treatment of mortgages. The NPR could result in an increase in costs to consumers or a reduction of mortgage credit availability, or both. The adverse consequences are especially acute for low down payment (high LTV) mortgages. The NPR dramatically and unnecessarily increases the

[3] Urban Institute, "Mortgage Insurance Data at a Glance – 2023" (August 21, 2023).
[4] Private MI Company 2022 10-K Filings.
[5] GSE 3Q2023 10-Q Filings.
[6] Urban Institute, "Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios" (September 18, 2023).
[7] Fannie Mae PMIERs available at https://singlefamily.fanniemae.com/mortgage-insurers; Freddie Mac PMIERs available at https://sf.freddiemac.com/general/private-mortgage-insurer-eligibility-requirements-pmiers.

amount of capital required to support these loans[8], which make homeownership possible for many first-time homebuyers, who typically bring a down payment of 8 percent to the closing table.[9] Minority homebuyers often lack access to intergenerational wealth and disproportionately rely on low down payment loans, so the proposal would be particularly harmful to Black, Hispanic, and other historically disadvantaged communities, impeding efforts to close the racial homeownership and wealth gaps.

The proposal wholly ignores the robust first-loss credit protection provided by private MI on high LTV mortgages – an alarming departure from the current rules under which private MI is considered when determining whether a mortgage qualifies for a 50 percent risk weight.[10] The agencies have provided *no data* to show that loans protected by private MI pose higher risks to banks. Data shows that mortgages guaranteed by Fannie Mae and Freddie Mac (collectively the GSEs) and originated between 1994 and 2022 with private MI coverage experienced significantly lower loss severity than loans without private MI.[11]

The proposal's disregard for the credit risk reduction afforded by private MI appears to be based on concerns that private MI companies do not have the financial strength to meet their insurance obligations in the event of an economic downturn.[12] The NPR is wrong about the strength of the private MI industry and mischaracterizes its performance during and after the Great Financial Crisis. The industry has paid nearly $60 billion in claims since 2008 and, unlike many banks and large multi-line insurers, no private MI company received federal or state bailout funds.[13] While three private MI companies (PMI Mortgage Insurance Company, Republic Mortgage Insurance Company, and Triad Guaranty Insurance Corporation) were placed in receivership by their state insurance regulators as a result of losses during the Great Financial Crisis and cannot write new business, they continue to collect premiums, pay claims, and insure existing mortgages.

The NPR fails to recognize the unique cycle-tested features of the monoline private MI business model and the numerous enhancements to the industry in the years following the Great Financial Crisis.[14] The fact that the NPR fails to mention the revised PMIERs standards, Master Policy, and Rescission Relief Principles indicates these developments were not considered when the agencies drafted the NPR. These enhancements were recognized by the FHFA in the Enterprise

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[8] Urban Institute, "Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios" (September 18, 2023). "Loans with LTV ratios from 80 to 90 percent would require the borrower to pay about 12.5 basis points more per year for their mortgage …. For loans with LTV ratios from 90 to 100 percent, the borrower would pay about 25 basis points more than is currently the case."
[9] National Association of REALTORS®, "Profile of Home Buyers and Sellers" (November 13, 2023).
[10] 88 Federal Register 64032 (September 18, 2023). This treatment is retained by banks with less than $100 billion in consolidated assets.
[11] Urban Institute, "Mortgage Insurance Data at a Glance – 2023" (August 21, 2023).
[12] 88 Federal Register 64047 (September 18, 2023). The NPR also noted that private MI does not meet the definition of an eligible guarantor under current capital rules. However, private MI is recognized under the current regulatory capital regime, and under the NPR private MI will continue to be recognized for banks with less than $100 billion in assets.
[13] GSE and Private MI Statutory Filings.
[14] USMI, "Private MI: A Source of Strength & Resiliency in the Housing Finance System" (November 9, 2023). Available at https://www.usmi.org/wp-content/uploads/2023/11/Private-MI-Resiliency-White-Paper-11.08.23.pdf.

Regulatory Capital Framework (ERCF) and the reduced capital charge applicable to the GSEs for loans protected by approved insurers. Considering these enhancements and performance, private MI should receive *more* recognition and credit in the 2023 proposed bank capital rule than it received in the 2013 bank capital final rule. Moreover, ascribing a value of *zero* to private MI for the purposes of establishing risk-based capital requirements for banks is unfounded and not statistically supported.

The capital proposal may increase risk to taxpayers. By disincentivizing portfolio mortgage lending, homebuyers, especially those with smaller down payments, would have fewer options to purchase homes and large banks would retreat from providing affordable home financing solutions. The heightened capital requirements for single-family residential mortgage assets undercuts the objectives of recent Community Reinvestment Act (CRA) reforms[15] by creating capital incentives for large banks to reduce their investments in mortgages and mortgage servicing rights (MSRs). If finalized as currently written, the NPR would cause homebuyers to rely more heavily on mortgage products and programs that are either indirectly or directly backed by the federal government, and therefore American taxpayers. The GSEs, by virtue of the Preferred Stock Purchase agreements (PSPAs) have a contractual financial backstop with the U.S. Treasury. Further, low down payment mortgages backed by the Federal Housing Administration (FHA), Department of Veterans Affairs, Department of Agriculture, and Office of Public and Indian Housing are directly insured or guaranteed by the federal government. Changes to bank capital rules should not simultaneously decrease borrowers' options and shift mortgage credit risk from the private sector to the U.S. taxpayer.

Finally, we note that the Basel capital agreement does not prevent U.S. bank capital rules from considering private MI as a factor in determining a mortgage loan's LTV ratio. Banks with less than $100 billion in consolidated assets receive capital relief for high LTV mortgages that are protected by private MI and this is unchanged by the NPR. These loans are considered to be "prudently underwritten" under interagency lending guidelines[16] and therefore qualify for a 50 percent risk weight. The departure from the current capital treatment is made without supporting justification or data. Therefore, the agencies should retain the current consideration of private MI issued by approved insurers when calculating LTV ratios for purposes of risk weights. This would be consistent with the existing recognition of the risk mitigating benefits of private MI by the agencies and the FHFA, take into account reforms made since the Great Financial Crisis, and avoid unintended consequences to borrowers and the housing finance system.

II. <u>The Proposed Rule Will Harm First-Time, LMI, and Minority Homebuyers</u>

Low down payment mortgages are an important part of the U.S. housing finance system and are particularly important for first-time borrowers, LMI households, and borrowers of color who do not have access to intergenerational wealth to afford large down payments. Mortgages with private MI enable creditworthy homebuyers to qualify for home financing with as little as 3 percent down and our industry plays a critical role in helping millions of families achieve the

[15] https://www.occ.treas.gov/topics/consumers-and-communities/cra/index-cra.html.

[16] "Interagency Guidelines for Real Estate Lending Policies" which may be found at 12 CFR 208, Appendix C.

American Dream of homeownership. Recent analysis of 2020-2021 HMDA and Black Knight data on mortgages in bank portfolios[17] shows that 27 percent of all purchase mortgage loans made to Black and Hispanic borrowers had high LTV ratios, compared with 19 percent of all bank loans. The analysis further showed that 31 percent of all purchase loans made to LMI borrowers (whether or not to minority group members) had high LTV ratios, compared with 21 percent for all bank loans. Consumer advocates and civil rights organizations, including the NAACP and National Urban League, have articulated concerns that "Such a significant increase in capital standards will lead to reduced credit availability for all types of lending and undermine economic growth. If these standards are adopted, they will have a devastating impact on our efforts to increase Black homeownership and disadvantage all first-time, and in particular, first-generation homebuyers who do not have the benefit of multi-generational wealth or higher than average incomes."[18]

Shares of High LTV Bank Loans versus All Bank Loans to Black & Hispanic Borrowers			
		Bank loans with LTV ratios above 80%	All bank loans
Purchase	Jumbo	18%	11%
	Conforming	30%	24%
	All	27%	19%
Refinance	Jumbo	13%	8%
	Conforming	17%	17%
	All	17%	14%
All	Jumbo	17%	9%
	Conforming	26%	19%
	All	22%	14%

Shares of High LTV Bank Loans versus All Bank Loans to LMI Borrowers			
		Bank loans with LTV ratios above 80%	All bank loans
Purchase	Jumbo	3%	4%
	Conforming	38%	31%
	All	31%	21%
Refinance	Jumbo	6%	4%
	Conforming	24%	23%
	All	21%	17%
All	Jumbo	3%	4%
	Conforming	34%	26%
	All	28%	18%

In its review of the proposed rule, the Urban Institute concluded that "In short, the level of capital that banks would be required by the NPR to hold against mortgage loans held in portfolio

[17] Urban Institute, "Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios" (September 18, 2023).
[18] Letter to the Agencies from the National Housing Conference, Mortgage Bankers Association, NAACP, National Association of REALTORS®, and National Urban League (July 24, 2023). Available at https://nhc.org/wp-content/uploads/2023/07/Housing-Groups-Letter-re-Bank-Capital-7.25.23.pdf.

is excessive, at all LTV levels, and is likely to discourage bank mortgage lending. The NPR's impact on lending to LMI borrowers and communities and to borrowers of color is particularly perverse in the face of efforts by the bank regulators and other government agencies to encourage banks to increase their lending to precisely these borrowers and communities."[19] It is unclear why the agencies would issue this NPR after having recently joined guidance[20] encouraging lenders to implement Special Purpose Credit Programs (SPCPs)[21] that are designed to overcome the discriminatory policies that have created wide and persistent homeownership and wealth gaps. The Biden Administration has routinely stressed its commitment to promoting access to affordable housing and homeownership[22] and, unfortunately, the NPR represents a complete misalignment that could undercut those initiatives.

The NPR would disincentivize low down payment balance sheet loans and reduce homebuyers' mortgage options to be served by commercial banks. Creditworthy borrowers should have access to multiple options when purchasing their homes and borrowers who lack the resources for a large down payment should not be confined to specific markets. A level playing field across all mortgage executions would promote the ability for banks to meet their obligations under the CRA and facilitate homeownership opportunities in underserved communities. Federal housing policy, including bank capital regulations, should not arbitrarily carve up the housing market and reduce borrowers' mortgage options. This is especially true in a market where prospective homebuyers are facing elevated interest rates, high home prices, and low supply.

III. The Proposed Capital Treatment for Mortgage Loans is Excessive.

Bank capital requirements should be risk-based, analytically justified based on historical analysis, and completely transparent to the market, including the models, assessments, and assumptions used to arrive at the risk weights and capital levels. The current proposal, however, does not contain the necessary analytical information or a clear rationale to justify the significantly higher capital requirements and the departure from the current treatment of mortgages held on bank balance sheets.

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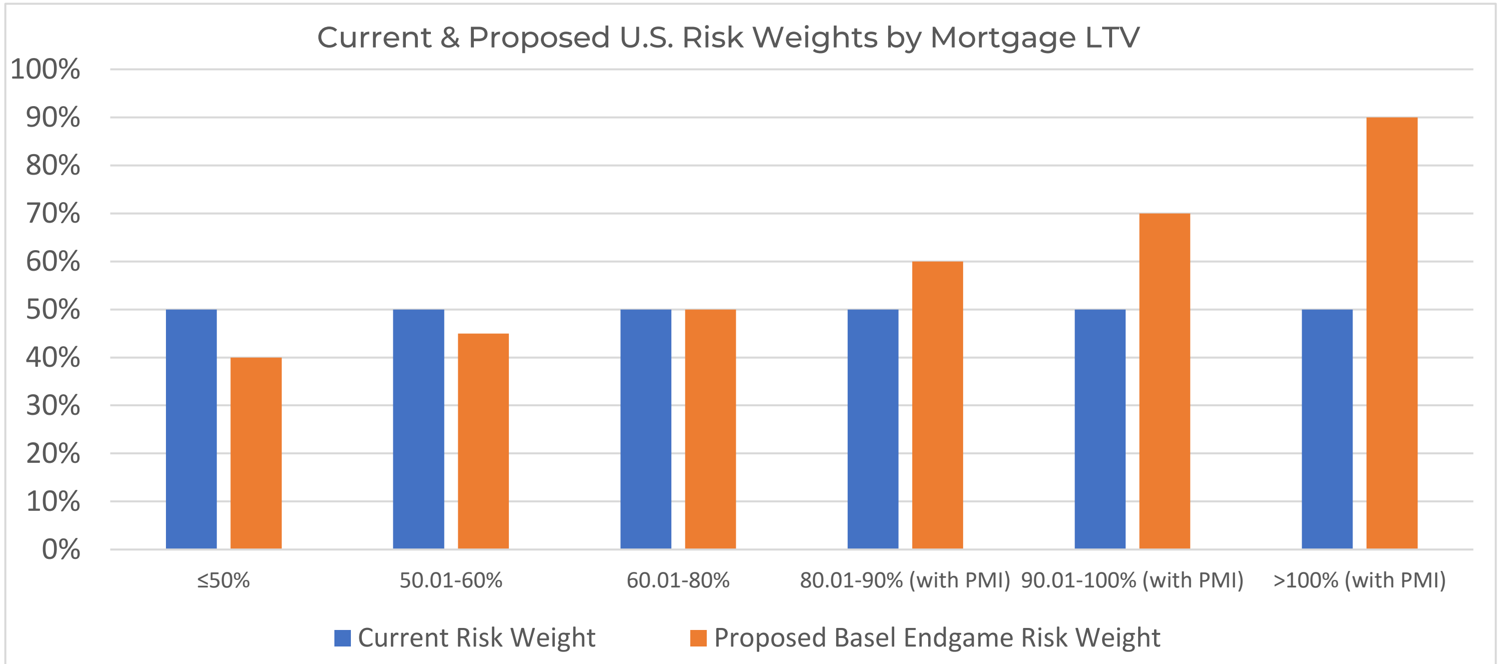
[19] Urban Institute, "Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios" (September 18, 2023).

[20] Federal Reserve Board, FDIC, OCC, National Credit Union Administration, CFPB, Department of Housing and Urban Development, Department of Justice, and FHFA, "Fair Lending: Interagency Statement on Special Purpose Credit Programs" (February 22, 2022). Available at https://www.occ.treas.gov/news-issuances/bulletins/2022/bulletin-2022-3.html.

[21] *Id.*

[22] "Biden-Harris Administration Announces New Actions to Build Black Wealth and Narrow the Racial Wealth Gap" (June 1, 2021). Available at https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/01/fact-sheet-biden-harris-administration-announces-new-actions-to-build-black-wealth-and-narrow-the-racial-wealth-gap/.

Under the standardized approach, a mortgage loan held by a bank with a LTV ratio that equals or exceeds 90 percent is given a risk weight of 50 percent if the loan is protected by private MI.[23] The NPR does not recognize private MI, and would give a mortgage loan with an LTV that exceeds 90 percent a risk weight of 70 percent. In addition, the NPR applies an operational risk charge that would increase the effective risk weight for low down payment mortgages loans by approximately 25 percentage points,[24] resulting in an effective capital charge for high LTV loans approaching 90 percent.



There is no data provided in the NPR to justify this treatment and large increase in capital requirements for low down payment balance sheet mortgages. The current proposal is significantly higher than the mortgage capital charges prescribed in the international Basel agreement. The NPR would apply risk weights that are 20 percent higher than for jurisdictions that choose to adopt and implement the Basel agreement, even for loans that are protected by private MI. Further, the NPR fails to explain why the risk weights agreed to by the world's leading Central Banks and bank regulatory agencies are wrong. This is especially confusing since the Agencies were heavily involved in the development of the Basel framework, approved

[23] 12 CFR part 34, Subpart D, Appendix A; 12 CFR § 3.32(g).

[24] Urban Institute, "Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios" (September 18, 2023); Bank Policy Institute, "The Basel Proposal: What it Means for Mortgage Lending" (September 30, 2023). "The credit risk weight for balance sheet mortgages would increase from 50 percent currently to as high as 90 percent. The add-ons for operational risk and the stress test would contribute an additional 25 percentage points to those risk weights, raising the total, all-in risk weight from 65 percent to 115 percent."

the international proposal, and reaffirmed their position in June, 2023.[25] The NPR fails to explain why the U.S. agencies determined that the Basel agreement's capital risk weights were consistent with safety and soundness internationally, but not domestically. The imposition of capital charges more stringent than agreed to internationally is not explained, and is another indication that the NPR failed to provide the information and data necessary to permit *meaningful* public comment.

According to a study prepared by the Urban Institute, the proposed capital levels exceed what would be needed even to protect banks from a repeat of the Great Financial Crisis.[26] However, the losses experienced during the Great Financial Crisis were caused, in large part, due to poor mortgage underwriting standards and risky product features. Under the reforms made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and the subsequent regulations issued by the Consumer Financial Protection Bureau (CFPB), mortgage lenders must meet new regulatory underwriting standards and cannot include terms and conditions that were found to be problematic during the Great Financial Crisis. Importantly, these reforms include the Ability-To-Repay/Qualified Mortgage (ATR/QM Rule) that helped reshape credit risk in the post-crisis era, and the Risk Retention Rule, which requires issuers of PLS backed by single-family residential mortgages to retain a meaningful tranche of credit risk to ensure "skin in the game." From a credit risk perspective, mortgage loans originated today are far less risky and, according to the Urban Institute,[27] post-crisis borrower risk remains low and product risk, generally defined as features that increase borrower payment shock or accelerate repayment, is virtually nonexistent.

The collective impact of post-crisis reforms should be taken into full account when considering appropriate risk-based capital requirements. Applying the proposed capital requirements to the post-Dodd-Frank Act mortgage underwriting ecosystem fails to recognize those reforms and results in excessively high capital charges for post-Dodd-Frank Act mortgage loans.

IV. <u>The NPR Fails To Accurately Value Private MI</u>

The NPR does not recognize *any* credit risk protection afforded by private MI companies. There may be a misconception that private MI companies do not have the financial strength to honor their insurance commitments in the event of a severe downturn in the housing markets, but this is

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[25] According to a speech given in 2018 by Stefan Ingves, the then Chairman of the Basel Committee on Banking Supervision, the 2017 amendments to the Basel framework were agreed to unanimously. Available at https://www.bis.org/speeches/sp180129.pdf. More recently, in June, 2023, the Basel Committee stated that "Members unanimously reaffirmed their expectation of implementing all aspects of the Basel III framework in a full and consistent manner…" Available at https://www.bis.org/press/p230606.htm.
[26] Urban Institute, "Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios" (September 18, 2023).
[27] Urban Institute, "Housing Credit Availability Index – Q3 2023" (October 24, 2023).

unfounded given the private MI companies' performance following the Great Financial Crisis and the industry enhancements that have been undertaken since.[28]

A. <u>Business Model is Built to Withstand Economic Cycles</u>

Private MI is a monoline industry established for the sole purpose of absorbing single-family residential mortgage credit risk. Founded in 1957, the private MI industry has evolved through several economic and real estate cycles, all while remaining exclusively dedicated to the U.S. single-family housing finance system. The private MI industry benefits from strong prudential regulatory oversight through state commissioners of insurance, capital and operational requirements imposed by the GSEs under the supervision of the FHFA, and a unique loss reserving framework that has stood the test of time and played a critical role in the private MI industry's strong claims paying track record. To write business in the U.S., a private MI company must have a monoline structure and meet stringent regulatory requirements that recognize the unique and cyclical nature of single-family residential mortgage credit risk.

The monoline private MI model ensures that the capital to pay claims exists during times of economic stress when other industry participants may retreat from the mortgage market.[29] Further, the statutory regulatory framework for monoline private MIs is comprehensive and cycle-tested, ensuring that private MIs can serve as a source of strength and resiliency across all housing cycles and continuously serve borrowers and lenders throughout the country.

B. <u>Financial Strength</u>

Regarding the financial strength concern, the proposal ignores the fact that since the Great Financial Crisis, private MI companies have to meet new, stringent financial, capital, operational, and quality control standards in order to be "approved insurers" and conduct business as counterparties to the GSEs. These standards, the PMIERs, were implemented at the direction of the FHFA in its role as conservator and regulator of the GSEs and have been periodically updated to respond to market conditions and macroeconomic developments.

[28] 88 Federal Register 64047 (September 18, 2023). "Not recognizing private mortgage insurance would be consistent with the current capital rule's definition of eligible guarantor, which does not recognize an insurance company engaged predominately in the business of providing credit protection (such as a monoline bond insurer or reinsurer) and also reflects the performance of private mortgage insurance during times of stress in the housing market. The agencies do not intend the proposed risk weights to be applied to LTVs that include private mortgage insurance."

[29] Monoline MIs are required to contribute 50 percent of earned premiums to a contingency reserve that cannot be withdrawn for a period of 10 years except as permitted by insurance regulations, for example, to pay claims. In addition to the contingency reserve, case-based reserves and loss adjustment expense reserves are established when notices of delinquency on insured mortgage loans are received. Case reserves are established by estimating the number of loans in the delinquency inventory that will result in a claim payment, which is referred to as the claim rate (incidence), and further estimating the amount of the claim payment (severity), wherein incidence multiplied by severity equals expected loss. Adjustments to reserve estimates are typically reflected in the financial statements in the years in which the adjustments are made.

According to FHFA, the revised standards are designed so "approved MIs possess the financial and operational capacity to withstand a financial crisis or severe downturn going forward."[30]

Among other safeguards, PMIERs ensures that approved private MI companies have the financial capacity, including the necessary liquidity, to meet all insurance obligations, to obtain additional capital if needed, and to remain adequately capitalized at all times. Approved private MI companies are subject to stress tests using macroeconomic assumptions that are consistent with the "severely adverse scenario" used by the Federal Reserve. PMIERs also requires private MI companies' capital plans to include specific contingencies for how the companies would raise additional capital if there is a shortfall, such as an unconditional standby letter of credit triggered by financial distress, or a reinsurance agreement with an approved entity. Capital adequacy is reviewed quarterly and approved private MIs must have at least one credit rating from a recognized credit rating agency.

PMIERs also provides that if an approved private MI company falls below required minimums, it could be subject to various enforcement actions, including a prohibition on paying dividends, investing in affiliated or non-affiliated companies, or assuming any non-mortgage insurance obligations. Approved private MI companies must also obtain advance approval before taking corporate actions that could affect their ability to meet all insurance obligations.

Private mortgage insurers subject to PMIERs now hold 69 percent more capital than the required regulatory threshold. The industry collectively holds nearly $11 billion in excess of PMIERs requirements, representing a 169% sufficiency ratio.[31] The private MI industry has consistently raised capital and since the beginning of the COVID-19 pandemic, USMI members raised more than $2.8 billion using equity and debt offerings and added $715 million in access to new or expanded credit facilities.[32]

The financial strength of approved private MI companies has also been recognized in several independent studies. A recent Urban Institute report analyzed the improvements made in the private MI industry since the financial crisis, and concluded that private MIs are in a *much stronger position* due to higher capital required under the PMIERs standards, the imposition of more robust underwriting, improved risk management, and revisions to the master policies that enhance contractual certainty on how and when a claim is paid.[33] The 2023 report issued by the Urban Institute[34] again found that that private MI "is highly effective in reducing losses to the GSEs." According to the report, total loss severity for the 1994-2022 origination period of GSE loans without private MI was 37.6% while loans with private MI was 26.4%, meaning loans without private MI experienced a 42.4% higher rate of loss severity when compared to the loss severity rate of loans with private MI during this time period.

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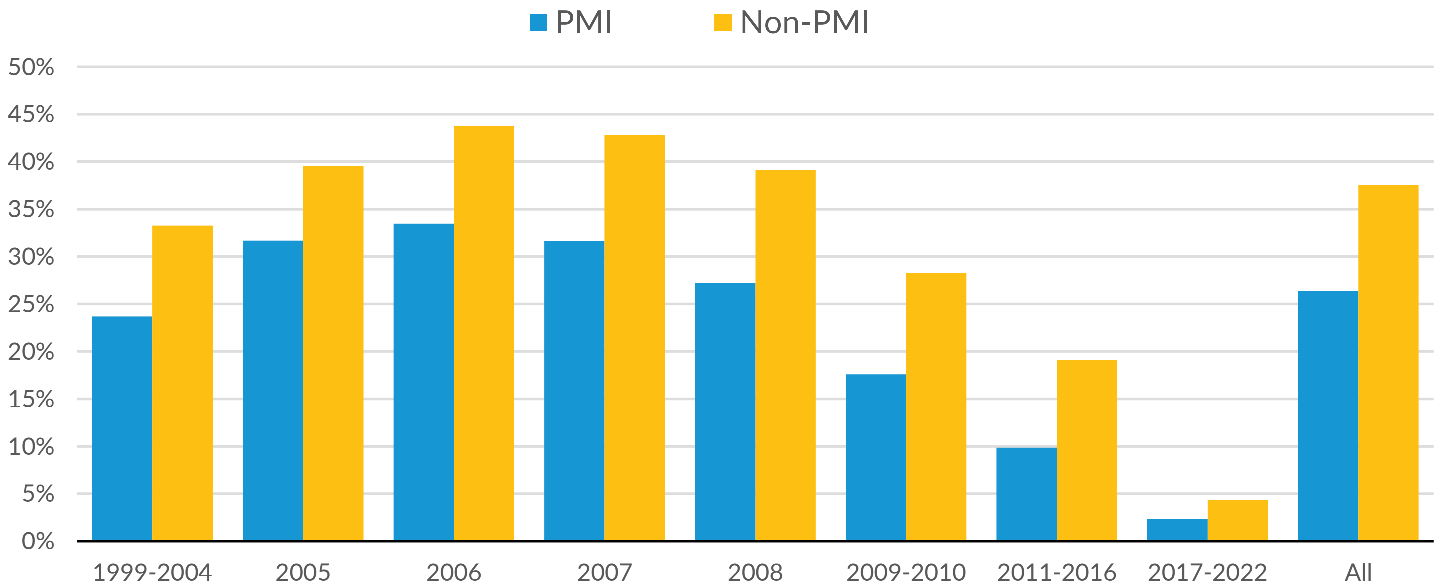
[30] https://www.fhfa.gov/Media/PublicAffairs/Pages/Fannie-Mae-and-Freddie-Mac-Issue-Revised-Private-Mortgage-Insurer-Eligibility-Requirements-4-17-2015.aspx
[31] Private MI 3Q2023 10-Q Filings.
[32] USMI Member Company SEC Filings and Press Releases.
[33] Urban Institute, "Mortgage Insurance Data At A Glance – 2023" (August 21, 2023).
[34] *Id.*

The Urban Institute's report also found that mortgages backed by private MI have been the most common execution for low down payment borrowers since 2018.[35]

Further, S&P Global Ratings upgraded the long-term insurer financial strength and issuer credit ratings for all USMI member companies in January 2024, an indication of the industry's capital adequacy, strong underwriting, and performance.[36]



Importantly, private MI companies are not subject to a bank run type event and the private MI companies have access to ready liquidity and assets. Claims develop slowly with transparency around the expected cash outflows arising from the progression of loans through loss mitigation to potential private MI claims. Private MI companies receive monthly default and loss mitigation reporting from mortgage servicers and regularly exchange loan-level information. The data show that claims are presented, on average, to private MI companies approximately 18 to 48 months after initial default. During this time, in the ordinary course of their business, private MI companies will have substantial cash resources from which to pay claims including policy premiums and reinsurance contracts, as well as investment portfolio assets.

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[35] Urban Institute, "Mortgage Insurance Data At A Glance – 2023" (August 21, 2023).

[36] Enact (January 9, 2024), https://ir.enactmi.com/news-releases/news-release-details/enact-receives-ratings-upgrade-sp-global-ratings-0; Essent (January 9, 2024), https://ir.essentgroup.com/news/news-details/2024/Essent-Announces-Upgraded-Financial-Strength-Ratings-from-SP-Global-Ratings-to-A-/default.aspx; MGIC (January 8, 2024), https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/type/HTML/id/3107944; National MI (January 11, 2024), https://ir.nationalmi.com/news-releases/news-release-details/nmi-holdings-inc-announces-upgraded-sp-financial-strength-rating; and Radian (January 10, 2024), https://www.radian.com/news-and-knowledge/news?id=23271.

Private MI is an important source of private capital that stands in the first loss position on insured mortgages, protecting bank lenders and the FDIC for balance sheet mortgages, and the GSEs and the American taxpayers for conventional mortgages. USMI's members are strong sources of "permanent capital," meaning they are available to assume first loss credit risk throughout market cycles. This function is critical to ensuring that private capital will be available through mortgage cycles, and equally important, that borrowers continue to have access to low down payment financing from the regulated banking system. Further, private MI companies independently underwrite the loans that they insure and make a determination to place their capital in first-loss position, thereby reducing risk in the banking system.

C. <u>Changes to Master Policies</u>

1. Master Policy Updates

In 2013, FHFA, as conservator and regulator for the GSEs, required private MIs to develop new Master Policies that conform to detailed FHFA-prescribed specifications. After these policies were approved at the federal level, they were submitted to state insurance departments for approval. New Master Policies became effective on October 1, 2014 and in 2019 USMI members developed a common Master Policy that became effective on March 1, 2020.

The new Master Policy includes increased clarity of terms coupled with more streamlined claims payments, to ensure that reliable and predictable insurance payments are made on valid claims when a mortgage fails. The new Master Policy articulates in much greater detail the conditions, in some cases tied to quantitative thresholds, that must be met before certain errors and omissions can become grounds for cancellation of insurance. In the case of rescission, the defect in the mortgage must be so great that insurance would not have been written on the loan if the defect had been disclosed to the private MI company before the insurance was granted. Thus, minor errors in the loan documents cannot be the basis for rescinding coverage. Finally, the new Master Policy contains requirements for the private MI company to engage in visible and responsive loan loss mitigation efforts, including allowing delinquent homeowners workout opportunities to bring the loan current. In addition, private MI companies work closely with investors and servicers to help homeowners prevent foreclosure.

2. Rescission Relief Principles

Rescission relief refers to provisions in the Master Policy that, once satisfied, limit a private MI company's ability to rescind coverage, even if there are defects in the mortgage that would have made it uninsurable had the defects been known. Under the rescission relief provisions a private MI company will not cancel a policy after 36 timely mortgage payments have been made, unless there is credible evidence of an intentional and knowing material misrepresentation. In addition, the private MI companies have an option to provide rescission relief after only 12 timely payments if a full file review is conducted.

Further, private MI companies have significantly increased the share of non-delegated underwriting (currently 30-40 percent) compared to the historical rate of 10-15 percent prior to the Great Financial Crisis and expanded post-close review. Both of these changes dramatically improved loan manufacturing and sustainable homeownership while reducing loan defects that could result in a rescission.

D. Mortgage Insurers Programmatically Transfer Credit Risk

Private MI is one of the most stable and reliable sources of private capital that assumes mortgage credit risk through all market cycles and, in recent years, the industry has implemented innovative tools and structures to help better insulate the housing finance system from the cyclical nature of the mortgage market. In doing so, private MIs have enhanced their ability to be more stable, long-term managers and distributors of risk. The industry now uses a combination of capital markets-based and traditional reinsurance executions to reduce volatility and exposure of mortgage credit risk within the mortgage finance system, including to the GSEs and therefore taxpayers.

In addition to the continued use of traditional reinsurance with highly-rated counterparties, MI credit risk transfer (MI-CRT) structures have developed and grown in the housing market since 2015, transforming the private MI business model from "Buy-and-Hold" into "Aggregate-Manage-Distribute." MI-CRT demonstrates that private MI companies are sophisticated experts in pricing and actively managing mortgage credit risk, which further cements the stability private MI provides in the mortgage finance system. Since 2015, private MI companies have transferred more than $73.8 billion in risk on more than $3.4 trillion of insurance-in-force (IIF).[37] In the traditional reinsurance markets, private MIs have executed 53 quota share (QSR) and excess of loss (XOL) transactions ceding $51.5 billion of risk.[38] As for using the capital markets to distribute risk, the industry introduced mortgage insurance linked notes beginning in 2015. Since then, private MIs have issued 56 mortgage insurance-linked note (ILN) deals, transferring nearly $22.3 billion of risk on more than $2.3 trillion of notional mortgages.[39]

Private MIs underwrite and actively manage mortgage credit risk, ensuring quality control on risk within the financial system and for end-investors. Through CRT, private MIs are able to access global financial markets to distribute risk, while not diluting their role in underwriting mortgage credit risk or serving as entity-based capital. The private MI industry has demonstrated a commitment to effective capital management through both reinsurance and programmatic ILN issuances, which have enabled private MIs to become the strongest and most stable counterparties to the GSEs and investors and to play a greater role in supporting the U.S. housing finance system.

Housing finance stakeholders have recognized the industry's innovation, expanded capabilities to expertly manage and distribute risk, and the benefits associated with MI-CRT programs. In

[37] Private MI CRT Transaction Data.
[38] Private MI CRT Transaction Data, as of 9/30/2023.
[39] Private MI CRT Transaction Data, as of 12/31/2023.

2018, the Urban Institute stated that "these transactions give the mortgage insurers information that is valuable for pricing the MI, through both the deal pricing and through discussions with investors," adding that MI-CRT will "also reduce the volatility of earnings, providing greater resiliency for the mortgage insurers under adverse market conditions."[40]

E. Bank Capital Regulations Should Reflect the Uniqueness of the U.S. Housing Finance System

In order to best calibrate regulations to balance borrower access to affordable, sustainable mortgage products and safety and soundness, U.S. bank capital requirements should recognize the unique nature and robust regulation of the U.S. housing finance system. Accounting for unique elements of the American housing finance system includes recognizing the role of private MI in serving first-time and LMI homebuyers while also providing meaningful credit risk protection.

While the Basel agreement establishes minimum aggregate capital requirements, it does not preclude the U.S. from considering the benefits of private MI as long as the overall capital required under the U.S. rules require at least as much overall capital as would be required under the international framework. Private MI is a more fully developed industry in the United States than elsewhere, and generally does not exist in the same form in countries where there is a mortgage insurance program.

U.S. capital rules since 1989 have permitted the consideration of private MI for determining if a high LTV mortgage qualifies for the 50 percent basket.[41] The NPR would not change the treatment of private MI for banks with less than $100 billion in consolidated assets and they would continue to recognize private MI for determining whether a low down payment mortgage is eligible for a 50 percent risk weight. It is inconsistent to argue that Basel prohibits the consideration of private MI, while at the same time provide lower capital requirements for high LTV loans protected by private MI solely due to the fact that the loans are held by smaller banks.

In sum, permitting the use of private MI to allow U.S. banks to receive a 50 percent risk weight on high LTV mortgages is not violative of the Basel agreement and USMI encourages the agencies to ensure that bank capital rules fully recognize the uniqueness of the U.S. housing finance system, especially as it pertains to the current recognition of private MI for calculating LTV ratios and risk weights.

V. The NPR is Inconsistent with FHFA's Capital Rule

As the regulator for the GSEs and the Federal Home Loan Bank System, FHFA has unrivaled experience and expertise in residential mortgages, and in particular the credit risks that they

[40] Urban Institute, "Credit Risk Transfer: A Fork in the Road" (June 2018).
[41] 12 CFR part 3, Appendix A (1989 ed.)

present. The residential mortgage assets subject to FHFA supervision total nearly $8.9 trillion dollars.[42]

In 2020 FHFA promulgated a new risk-based capital rule for the GSEs to "ensure that each Enterprise operates in a safe and sound manner and is positioned to fulfill its statutory mission to provide stability and ongoing assistance to the secondary mortgage market across the economic cycle, in particular during periods of financial stress."[43] Importantly, the final rule adjusts the loan-level capital requirements for the Enterprises to reflect the credit protection afforded by private MI.[44] The rationale was explained in the NPR: [45]

> "The Enterprises are exposed to credit risk through their ownership of single-family whole loans and the guarantees they issue on MBS. The Enterprises may incur a credit loss when borrowers default on their mortgage payments, so the Enterprises attempt to mitigate the likelihood of incurring such a loss in a variety of ways. One way to reduce potential credit losses is through the use of credit enhancements such as primary mortgage insurance."

On January 19, 2023, FHFA revised the GSEs' upfront guarantee fee schedule for single-family mortgage purchases, the "Single-Family Pricing Framework."[46] The framework provides for a risk-based pricing of the GSE's guarantee fees based on loan and borrower characteristics. Private MI is explicitly considered in this framework as a valuable risk mitigator, and the FHFA provided for a reduced upfront guarantee fee for mortgages covered by private MI. On May 23, 2023, FHFA Director Thompson testified before the House Committee on Financial Services and explained: [47]

> "MI coverage absorbs first losses and reduces the total loss exposure of the [GSEs] because the approved insurance providers bear much of these losses in the event of default. Absent MI, the [GSEs] would assume a far greater proportion of the losses associated with defaults on these loans. For borrowers making a down payment smaller than 20 percent of the home's value, the costs of the required credit enhancement, such as MI, contribute to the overall cost of their loan. As such, any analysis of guarantee fees without consideration of MI or other credit enhancement costs is incomplete—both from the perspective of the borrower and from the perspective of the [GSEs]."

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[42] Federal Reserve Bank of St. Louis Economic Data, as of 3Q2023. Fannie Mae's assets were $4.329 trillion, Freddie Mac's assets were $3.208 trillion, and the Federal Home Loan Bank System's assets were $1.332 trillion. Data available at https://fred.stlouisfed.org/tags/series?t=assets%3Bbalance+sheet%3Bgse.
[43] 85 Federal Register 82150 (December 17, 2020).
[44] *Id.*
[45] 83 Federal Register 33335 (July 17, 2018).
[46] https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Updates-to-Enterprises-SF-Pricing-Framework.aspx.
[47] House Financial Services Committee, "FHFA Oversight: Protecting Homeowners and Taxpayers" (May 23, 2023).

The NPR does not contain any analysis or commentary regarding why the Agencies are taking a divergent view of credit risk with respect to private MI than the FHFA. The financial strength of approved private MI companies is recognized by the FHFA and in the banking agencies' current supervisory guidance on real estate lending[48] and should also be recognized in any changes to bank capital rules.

Moreover, analysis[49] conducted by one USMI member on a pool of 2023 purchase mortgages acquired by the GSEs with a mix of credit scores and LTV ratios consistent with GSE deliveries would require approximately 70 percent more risk-based capital under the NPR than under the ERCF. For lower LTV ratios, the NPR's base risk weights are multiples higher than the ERCF's and for higher LTV ratios, the proposed exclusion of private MI from the LTV calculation results in the NPR requiring substantially more risk-based capital than the ERCF requires for a high-LTV loan with private MI. In fact, the analysis reveals that, under the ERCF, the risk weight for loans with LTV ratios exceeding 90 percent with private MI averages out to approximately 50 percent which aligns with the current standard under the standardized approach that has been in place since 1989.

VI. The NPR Will Negatively Impact the Housing Finance System

The excessive capital requirements proposed in the NPR will negatively affect both consumers and the safety and soundness of the broader housing finance system. Any revisions to the capital framework should reduce *overall* risk in the housing finance system and not simply shift risk from one market to another. If enacted as written, the proposal would cause mortgage loans, especially high LTV mortgages to first-time and LMI homebuyers, to flow from bank portfolios to other executions. This will have the effect of increasing the credit risk for the taxpayers, who directly back the default risk on FHA-insured mortgages. Provisions in the NPR could diminish taxpayer protection by eliminating relief when credit risk is assumed by private MI and banks that would traditionally hold mortgage loans on their books would be encouraged to sell these mortgages to the GSEs to obtain capital relief.

Ironically, banks that continue to participate in mortgage finance may be incentivized to make riskier, higher yield loans to obtain the earnings necessary to justify the excessive proposed capital charges, thereby increasing the risk profile of the banking industry. The NPR seems to suggest that holding this additional capital will bolster a bank's ability to lend by requiring the holding of additional capital, and therefore more capital resource would result in more lending. This is flawed logic, however, since the increase in requirements will impact decision making by banks on which business lines they participate in or withdraw from. This could have the effect

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[48] See "Interagency Guidelines for Real Estate Lending Policies." Available at 12 CFR 208, Appendix C.

[49] Analysis of risk-based capital requirements for single-family purchase mortgages under the NPR and ERCF with the following assumptions: 1-unit single-family residential property; primary residence, owner-occupied; 30-year fixed-rate fully-amortizing mortgage; not "interest only"; traditional detached home; fee simple transactions; full documentation; retail origination; first lien with no subordination; loan age less than 24 months; 25-40 percent debt-to-income (DTI) ratio; W-2 income; guide-level private MI coverage subject to termination under the *Homeowners Protection Act of 1998*; and private MI assumed to be a "High Mortgage Concentration Risk and Approved Insurer" with a Counterparty Rating of 2.

of stunting macroeconomic growth by reducing banks' participation as single-family and commercial/multifamily lenders, servicers, and as providers of warehouse lines of credit and mortgage servicing rights financing.[50]

The market is already seeing an exit of bank activity from the mortgage market. Banks now account for only 28 percent of all mortgage originations for home purchases, while between 1995 and 2007 they accounted for 70 percent.[51] There is little justification for adding additional incentives for this trend to continue. It is important to recognize that bank participation in mortgage lending fills a market gap for mortgages for LMI borrowers that otherwise might not qualify for loans in other markets.[52]

It is imperative that the agencies also recognize the downstream impacts of these additional capital standards on the overall housing and mortgage market, including IMBs, affordable housing developers, community developers, community banks, and other industry stakeholders. It is not merely banks that will feel the impact of Basel III Endgame changes, but the whole of the housing market that is already battling unaffordability due to ongoing lack of supply and elevated interest rates, among other headwinds. For the single-family mortgage market, the Federal Reserve's steady increase of the target federal funds rate has already resulted in extraordinary increases in mortgage interest rates, with many rates nearing 8 percent in October 2023[53] and making homeownership increasingly unaffordable. The consequences of the Basel proposal will only add to the costly barriers that drive first-time homebuyers out of the market.

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USMI and its member companies appreciate the opportunity to provide feedback and recommendations on the agencies' proposed capital requirements for large banking organizations and we look forward to continued engagement to promote regulations that appropriately balance access to affordable mortgage credit with safety and soundness in the U.S. housing finance system. Please feel free to reach out to me directly at sappleton@usmi.org or 202-280-1820 if you have any questions or should you need any further information.

Sincerely,

Seth D. Appleton
President, USMI

[50] Testimony of Robert Broeksmit, House Financial Services Committee Subcommittee on Financial Institutions and Monetary Policy, "Implementing Basel III: What's the Fed's Endgame" (September 14, 2023).
[51] Testimony of Greg Baer, House Financial Services Committee Subcommittee on Financial Institutions and Monetary Policy, "Implementing Basel III: What's the Fed's Endgame" (September 14, 2023).
[52] Urban Institute, "Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios" (September 18, 2023).
[53] Freddie Mac Primary Mortgage Market Survey®.