Communication Between Federal Reserve Board Staff and Akin Gump Strauss Hauer & Feld LLP (Akin Gump) February 18, 2011

Participants: Scott Alvarez (Federal Reserve Board)

Smith Davis (Akin Gump)

Summary: Staff of the Federal Reserve Board received from Representatives of Akin Gump, on behalf of the mortgage insurance industry, a summary of arguments for the inclusion of mortgage insurance in the risk retention requirements under section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. A copy of the summary provided by Akin Gump is attached below.

DRAFT – 2/4/11

PMI Should Be Included in the QRM Proposed Rule

Background

- As you know, Dodd-Frank imposes new risk retention requirements on certain loan securitizations. Securitizations will be exempt from this new requirement if they are comprised exclusively of mortgages that have product features that make them less likely to default. While Congress provided some specific examples of the features that should make up these "qualified residential mortgages" or QRMs, they left it to the Administration to determine the exact definition.

- One of the specific features that Congress said that the Administration must consider including in the QRM definition is private mortgage insurance ("PMI").

- As you are well aware, PMI competes for business with the federal government, primarily via mortgages that are insured by the Federal Housing Administration ("FHA"). Since FHA insured loans are already statutorily exempted from the new risk retention requirements, it is critical that privately insured mortgages receive the same level of protection in the proposed rule. Otherwise, lenders that want to sell their loans to securitizers will effectively be forced to use government issued mortgage insurance.

Policy Implications

- As you know, FHA insured loans are backed 100 percent by the federal government. Therefore, if the Administration's proposed rule tilts the playing field in favor of FHA, taxpayers will be subject to a greater level of default risk than they are today.

- Increasing potential taxpayer exposure is unnecessary because the private sector is well-positioned to take on at least some of this risk. In fact, private mortgage insurers have capital available to support over 1.3 million new mortgages annually, so long as they are allowed to compete fairly for that business.

- If the proposed rule doesn't give lenders the option to choose PMI, the Administration will effectively be federalizing the mortgage market because the proposed rule will drive more and more business to FHA, and potentially create another "money pit" with taxpayers ultimately on the hook for future program losses.

Conclusion

- The Administration can avoid this situation by following congressional guidance and including PMI in its proposed QRM definition. Independent industry data which I understand has been provided to the Fed staff shows that PMI plays a critical role in minimizing the risks associated with low down payment mortgages by encouraging underwriting discipline. Properly underwritten, low down payment mortgages are sustainable and will be key to the recovery of the housing finance market.

- Including PMI right out of the box is important. PMI needs to be in the proposed rule because if it isn't, the financial consequences for the industry will be immediate and significant. We should be doing all we can to encourage private sector capital to return to the housing market.

- As the Administration moves forward on this issue, I hope you will forcefully advocate that PMI be included in the proposed QRM rule.