UNITED GUARANTY CORPORATION

June 13, 2014

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
Docket ID OCC-2014-0012

Mr. Robert de V. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R-1488, RIN 7100 AE17

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064–AE1

Ladies and Gentlemen:

United Guaranty Corporation ("United Guaranty") is pleased hereby to provide comments on the notice of proposed rulemaking ("NPR")[1] released by the Board of Governors of the Federal Reserve System ("FRB"), Office of the Comptroller of the Currency ("OCC"), and Federal Deposit insurance Corporation ("FDIC") with regard to the definition of "eligible guarantors" and "eligible guarantees" under the U.S. version of the Basel Committee's capital rules generally known as Basel III.[2] We are grateful that the FRB, OCC, and FDIC (collectively, "the agencies")

[1] FRB, OCC, FDIC, *Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule, Proposed Revisions to the Definition of Eligible Guarantee,* 79 Fed. Reg. 24618 (May 1, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-05-01/pdf/2014-09452.pdf.

[2] OCC, FRB, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and*

are open to changes in these definitions. We believe that the definition should be further clarified to cover monoline insurance companies providing credit-enhancement products, under both the standardized and advanced internal-ratings based ("A-IRB") approaches, as long as these firms meet strict conditions such as incorporation into an FRB-regulated holding company and are thus subject to extensive supervisory and regulatory standards. Specifically, we shall argue here that:

- The definition in the NPR and the Basel III rule defining eligible guarantors was clearly intended to cover monoline guarantors if they are subsidiaries of eligible firms or of similar entities otherwise regulated by the FRB.

- Defining eligible guarantors in this way strengthens the structure of systemic regulation established in the Dodd-Frank Wall Street Reform and Consumer Protection Act[3] ("Dodd-Frank Act") because it reflects the value of FRB and systemic regulation. If subsidiaries of depository institution holding companies ("DIHCs") and non-bank systemically important financial institutions ("SIFIs") are not accorded treatment comparable to that of similarly-regulated institutions (e.g., bank holding companies), the credibility of the SIFI framework may be eroded and entities potentially subject to designation will seek to avoid or evade it. This will heighten systemic risk, as well as increase the incentives for unregulated providers of credit enhancement to compete against regulated firms in a manner that increases overall market and systemic risk.

- Firms like United Guaranty that provide private mortgage insurance ("MI") within the context of a designated SIFI are subject to extensive regulatory requirements and support from the parent firm that enhance the value of a guarantee. The more the regulatory-capital rules recognize robust credit risk mitigation ("CRM") such as that provided by United Guaranty, the greater the alignment of the risk-based capital rules with economic capital. Although United Guaranty is unique in its industry by virtue of its status within a designated SIFI, the regulatory framework governing the entire U.S. private mortgage-insurance industry is being dramatically overhauled in the wake of the recent financial crisis. As a result, monoline providers of mortgage insurance should be generally included in the definition of eligible guarantor for purposes of both the advanced and standardized rules. Recognition of robust, regulated Mis enhances not only macro- and micro-prudential stability, but also credit availability to borrowers who may otherwise be under-served by private capital.

- Use of capitalized, regulated credit protection provided by subsidiaries within firms regulated by the FRB, or otherwise prudentially regulated, reduces incentives to rely

*Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule,* 78 Fed. Reg. 62017 (Oct. 13, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf.

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

on the types of high-cost credit-risk transfer structures cited in recent Basel proposals[4] and a 2013 supervisory letter by the Federal Reserve.[5] As noted in these statements, these structures arbitrage the risk-based capital rules to reduce risk weightings without any actual reduction in economic risk. Scarcity of CRM due to undue limits on eligible guarantors increases incentives for reliance on these high-cost structures.

United Guaranty is a monoline credit-protection insurance company owned by American International Group, Inc. ("AIG"). We are therefore a firm that would be recognized as an eligible guarantor if the overall Basel III rules are clarified as recommended herein in conjunction with this NPR's focus on the definition of "eligible guarantor" for purpose of wholesale exposures held by banking organizations under the A-IRB approach. We below provide the policy and prudential rationale for this clarification, as well as a description of our firm and its current regulatory status.

## I. The Basel III Rules Clearly Intend to Make FRB-Regulated Holding Companies Eligible Guarantors

The final rules cited above stipulate that an "eligible guarantor" includes, "... a depository institution, a bank holding company, a savings and loan holding company, a credit union, a foreign bank, or a qualifying central counterparty."[6] The rule goes on to exclude "an insurance company engaged predominately in the business of providing credit protection (such as a monoline bond insurer or re-insurer)."[7]

Taken together, this language leaves it unclear if an insurance company predominantly engaged in credit protection owned by a bank holding company ("BHC"), savings and loan holding company ("SLHC"), or foreign banking organization ("FBO") would be allowed to serve as an eligible guarantor. Further, the exclusion from the list of directly-eligible guarantors appears inadvertently to exclude DIHCs and firms designated as SIFIs by the Financial Stability Oversight Council ("FSOC"). Including DIHCs, SIFIs, and their subsidiaries would properly reflect the stringent rules required by the Dodd-Frank Act for such companies and would provide competitive parity with similarly-regulated BHCs and SLHCs.

Indeed, the regulation of designated SIFIs is as robust as the regulation of other entities by the FRB. In 2012, the FRB issued SR 12-17,[8] which established a major body of micro- and macro-prudential rules for the largest BHCs, SLHCs, DIHCs, and designated SIFIs – rules that ensure

---

[4] Basel Committee, *Recognizing the cost of credit protection purchased – consultative document* (Mar. 22, 2013), *available at* http://www.bis.org/publ/bcbs245.pdf.

[5] FRB, *SR 13-23: Risk Transfer Considerations When Assessing Capital Adequacy – Supplemental Guidance on Consolidated Supervision Framework for Large Financial Institutions (SR letter 12-17/CA letter 12-14)* (Dec. 20, 2013), *available at* http://www.federalreserve.gov/bankinforeg/srletters/sr1323.pdf.

[6] 78 Fed. Reg. at 62162.

[7] *Id.*

[8] FRB, *SR 12-17: Consolidated Supervision Framework for Large Financial Institutions* (Dec. 17, 2012), *available at* http://www.federalreserve.gov/bankinforeg/srletters/sr1217.pdf.

stress-testing, governance, capital, liquidity, resolvability, and other standards above and beyond those applicable to other eligible guarantors. It would thus be illogical to exclude SIFIs and their subsidiaries from the definition of eligible guarantor. By virtue of its status as a subsidiary within a designated SIFI, United Guaranty is subject to SR 12-17 and has since 2012 undertaken a series of major risk-management and governance improvements described in Section III below.

**II. Recognition of Monoline Insurers within Designated SIFIs Reflects the Value of Systemic Regulation and Promotes Credit Availability**

In general, expanding the pool of eligible guarantors to include monoline insurance companies housed in entities regulated by the FRB will have the following systemic and prudential-risk benefits:

- Enlarging the pool of eligible guarantors reduces reliance on sovereign and agency guarantors (e.g., U. S. government-sponsored enterprises), and in turn reduces taxpayer risk related to private-sector transactions;

- Expanding the pool of eligible guarantors beyond banking organizations reduces interconnectedness because new guarantors can assume risk and thus diversify it;

- Providing capital incentives for reliance on appropriately-regulated counterparties increases incentives to be properly regulated; and

- Enlarging the number of guarantors and the robust CRM they provide enhances "substitutability" – that is, the ability of financial institutions to find a new provider of critical services so that regulators can rely on market, not taxpayer, resolution facilities and thus diminish the prospect that any firm is too big to fail.

Interconnectedness and substitutability are critical determinants of systemic risk in the criteria used by the FSOC to designate SIFIs.[9] They also determine designation of global systemically-important banks ("G-SIBs") by the Financial Stability Board ("FSB")[10] and global systemically-important insurers ("G-SIIs") by the International Association of Insurance Supervisors ("IAIS").[11] Thus, the more the U.S. rules governing eligible guarantors increases reliance on additional providers of CRM that are well-regulated and capitalized, the less systemic risk in both the U.S. and the global financial system. This reduces "macro-prudential" risk – that is, contagion risk across the financial system that can contribute to a crisis akin to that of 2008.

[9] FSOC, *Final Rule on Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. 21637 (Apr. 11, 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-04-11/pdf/2012-8627.pdf.

[10] FSB, *2013 update of global systemically important banks* (Nov. 11, 2013), *available at* http://www.financialstabilityboard.org/publications/r_131111.pdf.

[11] IAIS, *Global Systemically Important Insurers: Initial Assessment Methodology* (Jul. 18, 2013), *available at* http://www.iaisweb.org/view/element_href.cfm?src=1/19151.pdf.

Further, reliance on regulated providers of mortgage insurance, especially firms that, like United Guaranty, are housed within FRB-regulated SIFIs, reduces "micro-prudential" risk – that is, the risk that any individual financial institution will fail. This is because such firms have the resources to honor claims even under stress, thus creating a critical level of double-default protection. This means that a banking organization absorbs credit risk only if both a credit exposure enters default and, then, its CRM provider fails to honor a claim. Without the CRM provider, the banking organization takes a loss upon default. When the CRM provider is able to handle claims and is legally obligated to do so as also required in the Basel III rules through the definition of an "eligible guarantee,"[12] then loss is significantly reduced regardless of the probability of default on the underlying asset.

**III. Regulated MIs are Robust CRM Providers**

In the U.S., monoline insurance companies are typically regulated by state insurance commissions or similar entities. In the wake of the financial crisis, questions have been raised about the robustness of these rules. However, with regard to MI, several critical actions under the auspices of the Federal Housing Finance Agency ("FHFA") have been taken. These include the establishment of revised "master policies" – agreements to which MIs are required to bind themselves in order to provide MI on loans eligible for purchase by the U.S. government-sponsored enterprises ("GSEs")[13] – that include safeguards such as incontestability provisions that limit rescissions. The FHFA and the GSEs are also in the process of revising the eligibility criteria an MI must meet to ensure that an MI is financially able to pay its obligations when due, even in times of stress[14], creating an important industry regulatory standard that should limit the concerns over MI claims-paying ability. State insurance regulators are also revising the model act applicable to MIs to improve their requirements and enforcement capacity in the wake of the financial crisis.

To be sure, the FHFA and state rules for Mis remain incomplete. Therefore, we urge reliance on the standards established by the FRB for DIHCs and SIFIs, and specifically on the provisions of SR 12-17 and related prudential standards, as well as to the broader array of requirements the Federal Reserve will mandate once it completes the framework of systemic rules required by Sections 165 and 166 of the Dodd-Frank Act. Requirements to which United Guaranty is subject include:

- Corporate-governance requirements, including a series of risk-appetite and related standards subject to independent assessment and challenge by a chief risk officer and a significant new risk-management and internal-control infrastructure;

---

[12] *Id.* at 7.

[13] Press Release, FHFA Announces Overhaul of Fannie Mae and Freddie Mac Mortgage Insurance Master Policy Requirements (Dec. 2, 2013), *available at* http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Overhaul-of-Fannie-Mae-and-Freddie-Mac-Mortgage-Insurance-Master-Policy-Requirements.aspx.

[14] 2014 Scorecard for Fannie Mae, Freddie Mac and Common Securitization Solutions (May 2014), at 4, *available at* http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2014Scorecard051314FINAL.pdf.

- CCAR stress testing, which includes tests for levels of stress, controls, infrastructure and general robustness;

- Resolvability criteria, which will govern AIG not only under the new framework being developed by the FRB and FDIC pursuant to the sections of the Dodd-Frank Act noted above, but also under resolution criteria being developed by the FSB and IAIS for designated G-SIIs.[15]

- Source-of-strength requirements, under which AIG is required to support United Guaranty under capital maintenance agreements if its capital falls below a 21:1 ratio; and

- Liquidity standards.

We recognize that one criterion in the Basel III rules reflected in the NPR is that the risk that the guarantor may not pay claims must not be correlated with underlying assets. We note here that United Guaranty does not directly invest in residential-mortgage assets, a prohibition stipulated in state law to prevent correlation risk.

## IV. Credit-Availability Benefits

We believe that clarifying the definition of eligible guarantor as recommended herein will significantly reduce interconnectedness and increase substitutability, as well as enhance credit availability for otherwise under-served borrowers. United Guaranty currently provides mortgage insurance to borrowers seeking high loan-to-value ("LTV") mortgages that may then be sold to the GSEs or held in portfolio by banking organizations or other financial institutions. We currently have approximately $37 billion of risk-in-force – that is first-lien mortgages against which we provide first-loss protection up to certain LTV thresholds. This credit-risk protection creates a robust buffer that encourages extension of credit to borrowers – especially first-time homeowners – who may lack a large downpayment but are otherwise able to repay. In the absence of private mortgage insurance, these borrowers in the U.S. would be forced to rely on bank portfolio lending – problematic in light of new capital rules and an array of prudential requirements – or the Federal Housing Administration, a program that operates at taxpayer risk.

## V. Conclusion

In conclusion, we urge the agencies to clarify the definition of "eligible guarantor" within the Basel III rules to make clear that a monoline provider of credit protection is an eligible guarantor so long as it is a subsidiary of a DIHC or SIFI that is subject to FRB prudential regulation. We believe this clarification is consistent with the meaning of the current rules and thus should apply to banking organizations using both the standardized and A-IRB approaches

---

[15] FSB, *Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions* (Aug. 12, 2013), *available at* http://www.financialstabilityboard.org/publications/r_130812a.pdf.

and across the spectrum of assets governed by the overall rules addressed by the eligible-guarantor definition, not just wholesale exposures.

We would be pleased to provide additional information on United Guaranty, the risk-mitigation and internal-governance standards now being required of us and our parent, and otherwise support the agencies as they finalize this rule.

Sincerely,

Donna DeMaio
President & CEO

cc: Ms. Rachel Ackmann, FDIC
Mr. Bobby R. Bean, FDIC
Mr. Ryan Billingsley, FDIC
Mr. Thomas Boemio, FRB
Mr. Benedetto Bosco, FDIC
Mr. Mark Buresh, FRB
Ms. Christine Graham, FRB
Mr. Mark Handzlik, FDIC
Ms. Anna Lee Hewko, FRB
Ms. Constance M. Horsley, FRB
Mr. Carl Kaminski, OCC
Mr. Benjamin McDonough, FRB
Ms. Justyna Milewski
Mr. Michael Phillips, FDIC
Ms. Margot Schwadron, OCC
Ms. April C. Snyder, FRB
Mr. Roger Tufts, OCC
Mr. Andrew Willis, FRB