Mortgage Insurance Companies of America

Suzanne C. Hutchinson
Executive Vice President

July 10, 2006

Hon. Sheila Bair
Chair
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Hon. Ben S. Bernanke
Chairman
Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Hon. Susan S. Bies
Governor
Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Hon. John C. Dugan
Comptroller of the Currency
250 E Street, S.W.
Washington, DC 20219

Hon. John M. Reich
Director
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552

Dear Sir or Madam:

The Mortgage Insurance Companies of America (MICA) has long been strongly supportive of the banking agencies' work to ensure appropriate prudential standards for mortgage risk. Mortgage insurers of course have all of their risk concentrated in this area, and we are deeply concerned about the potential

1425 K Street, NW
Suite 210
Washington, DC 20005
(202) 682-2683
Fax (202) 842-9252

contagion effect from poorly-underwritten or unsuitable mortgages and home-equity loans. We hope the agencies will soon finalize the draft guidance released last December on non-traditional mortgages [70 FR 77249], in part because the most recent market trends show alarming signs of ongoing undue risk-taking that puts both lenders and consumers at risk.

Below, I would like quickly to note some recent mortgage-market data that support the proposed guidance and argue for rapid action. MICA has been particularly concerned that the guidance make clear that loans with simultaneous second liens are risky in and of themselves, with these risks of course heightened when they are "layered" with other non-traditional features such as payment-option and interest-only structures. Key recent findings include:

- In June, Standard and Poors (S&P) decided to revise its ratings criteria for mortgages with simultaneous second liens, often called "piggyback" mortgages.[1] This decision brings the S&P rating into alignment with the more conservative one by Moody's and confirms the higher risks posed by these structures. S&P based its decision on research confirming that, holding credit scores equal, mortgages in which the borrower finances the down payment are more likely to default than loans with cash down payments. S&P also concluded that housing markets are likely to experience more stress than originally anticipated, heightening the risk for borrowers with no cash downpayment and, therefore, no equity in their homes.

- The most recent data available from a survey conducted by the National

[1] *S&P's Rating of Mortgage Pools Is Revised Amid Exotic Lending*, Dow Jones Newswire, June 15, 2006.

Association of Realtors[2] shows that first-time homeowners - 40% of all borrowers in 2005 - had an average down payment of only 2% on homes costing $150,000, but 43% of these homeowners had no down payment at all.

- In general, non-traditional mortgages have become a still more significant part of the market, despite the cautionary note in the proposed guidance.[3] First-quarter data indicate that interest-only and payment-option products now account for 26% of mortgage loan originations - a sharp increase from last year.[4] Even more striking, a recent Fitch report notes that 40-year mortgages with payment-option features now account for 8% of total securitized mortgage volume, up from 2% for all of last year.[5] Subprime mortgages with fixed rates for two years and variable ones for the following 38 years account for 8% of total subprime originations in the first quarter of 2006, up from 2% in all of 2005.[6] Fitch notes particular concern with loans like this because of "double-teaser" clauses.

MICA has noted that industry practice did not change as significantly as required following the final guidance in 2005 on home-

---

[2] *Home Buyer and Seller Survey Shows Rising Use of Internet, Reliance on Agents,* January 17, 2006 press release, National Association of Realtors, http://www.realtor.org/PublicAffairsWeb.nsf/Pages/HmBuyerSellerSurvey06.

[3] See *Inside Mortgage Finance*, February 24, 2006, p.3-6. "Conventional Conforming Market Continued to Decline in 2005 as Nontraditional Mortgage Products Boomed." ARMs totaled $1.49 trillion in 2005 and that was about 47.8 percent of total mortgage originations in 2005. IO and option ARMs together totaled $575 billion of originations which comprised 38.6% of the total ARM business.

[4] *Inside Mortgage Finance*, June 2, 2006, p.4-6, citing statistics from its affiliated publication *Inside Alternative Mortgages* that during the first quarter of 2006 IO loans and option ARMs "accounted for a hefty 26.4 percent of first quarter originations."

[5] *Fitch Ratings*, "40-, 45-, and 50-Year Mortgages: Option ARMs, Hybrid ARMs, and FRMs," June 19, 2006.

[6] Ibid.

equity loans.[7] Although the non-traditional guidance is now only in draft form, one would have expected a far slower growth in industry reliance on non-traditional products in anticipation of final standards with far-reaching market impact. The fact that this did not occur reinforces the suggestion in our earlier comment letter[8] that the final guidance be accompanied by clear language regarding not only consistent enforcement by the agencies, but also clear penalties for those who disregard it.

We would be pleased to provide additional background on the findings noted above or any other market analysis that would be of assistance as your agencies finalize the non-traditional mortgage guidance.

Sincerely,

Suzanne C. Hutchinson

Cc: Mr. Scott M. Albinson
Mr. Tom Boemio
Mr. Jason C. Cave
Ms. Kathryn E. Dick
Ms. Virginia Gibbs
Mr. Daniel L. Pearson

---

[7] *Credit Risk Management Guidance for Home Equity Lending*, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and National Credit Union Administration, May 16, 2005.

[8] March 29, 2006, http://www.ots.treas.gov/docs/9/962356.pdf.