

**Meeting Between Federal Reserve Board Staff
and Representatives of the Mortgage Insurance Industry
March 10, 2011**

Participants: Scott Alvarez, Andreas Lehnert and William Treacy (Federal Reserve Board)

Smith W. Davis (Akin Gump Strauss Hauer & Feld LLP), Christopher S. Nard
(Old Republic International Corporation), Suzanne C. Hutchinson (Mortgage Insurance
Companies of America) and Patrick Sinks (MGIC Investment Corporation)

Summary: Staff of the Federal Reserve Board met with representatives of the mortgage insurance industry to discuss development of the definition of “qualified residential mortgage” under section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The representatives expressed concern about how the definition could impact the demand for private mortgage insurance and the market for non-government guaranteed mortgages generally. A copy of the handout provided by the representatives is attached.



Private Mortgage Insurance Industry Discussion

March 2011

IMPORTANCE OF MI INCLUSION IN QRM DEFINITION

- **Requiring large down payments with no exception for insured loans will deny credit worthy borrowers the opportunity to buy new homes.**
 - **First-time, moderate income and minority homebuyers will be the most adversely affected by this requirement.**

- **The housing market recovery will be impeded because the cost of homeownership will increase. Fewer buyers will be able to move into the market to absorb available inventory or enable existing homebuyers to trade-up.**

- **If MI is not included in the QRM, low down payment loans will be artificially pushed to FHA.**
 - **FHA will grow still larger and present significant taxpayer risk.**
 - **FHA's insurance in force is already projected to be \$1.25 trillion by the end of 2012.**
 - **FHA insurance puts the taxpayer at risk for 100% of the loan amount.**
 - **Private capital will be impeded from returning to the low down payment market.**

PRIVATE MI MEETS POLICY OBJECTIVES

- **Private mortgage insurance is skin in the game on every loan it insures.**
 - Mis take the first loss position after the borrower if a mortgage goes to default.
 - Lenders and other parties also take a loss on loans insured by private Mis because Mis only cover 20%-30% of the loan amount.
 - FHA covers 100% of the loan amount so lenders and others do not have the same skin in the game.

- **Because private mortgage insurers have their own capital at risk they take steps to protect their capital.**
 - Mis review loan underwriting after the originator.
 - FHA completely delegates the underwriting to the lender.
 - Mis work with defaulted borrowers to keep them in their home if possible.

- **Mis raise countercyclical capital so that they have the resources to pay claims in bad economic times.**
 - 50% of all premiums are held in a contingency reserve for 10 years.

MI MEETS STATUTORY TEST TO BE INCLUDED IN QRM

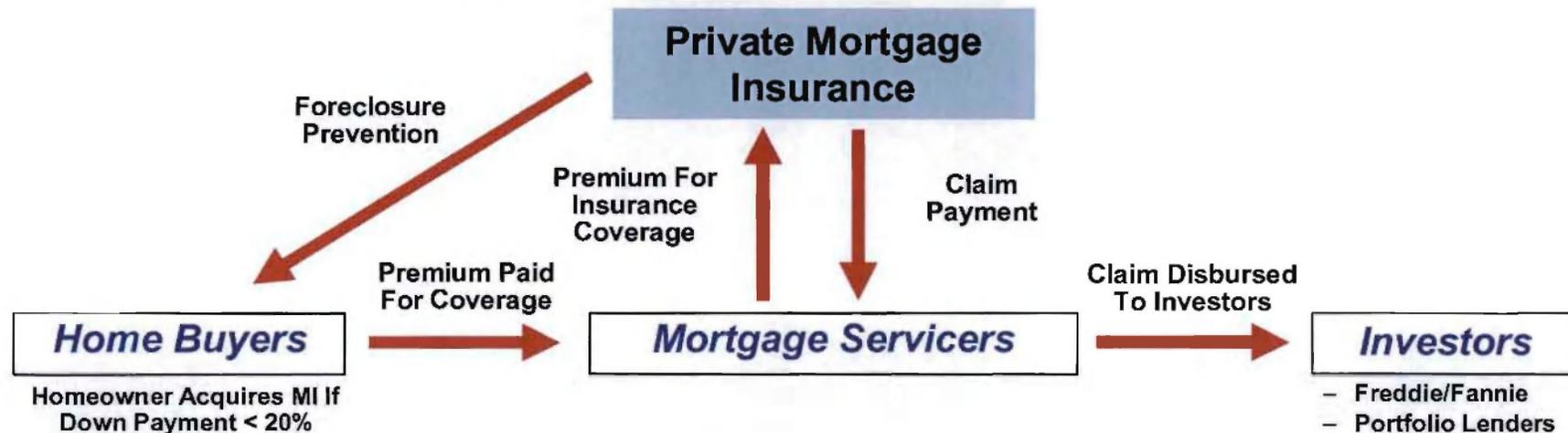
➤ Section 941 of Dodd-Frank -

- directs the agencies to develop a definition of QRM “taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default” and**
- enumerates five factors for the agencies to examine when they develop the QRM definition, one of which is mortgage insurance to the extent that it “reduces the risk of default.”**

➤ The data clearly show that MI reduces historical default risk by comparing insured mortgages and “piggyback” mortgages (uninsured loans with a CLTV above 80%). These data are objective, provided by a third party and available for anyone to analyze.

➤ As a result, mortgage insurance meets the statutory test of having historical loan data that indicates lower default risk.

Private Mortgage Insurance



MI Facilitates Purchase Of Homes With Less Than 20% Down

Pays In a “First Loss” Position After Borrower Equity ... Shielding Banks and Investors from Credit Losses

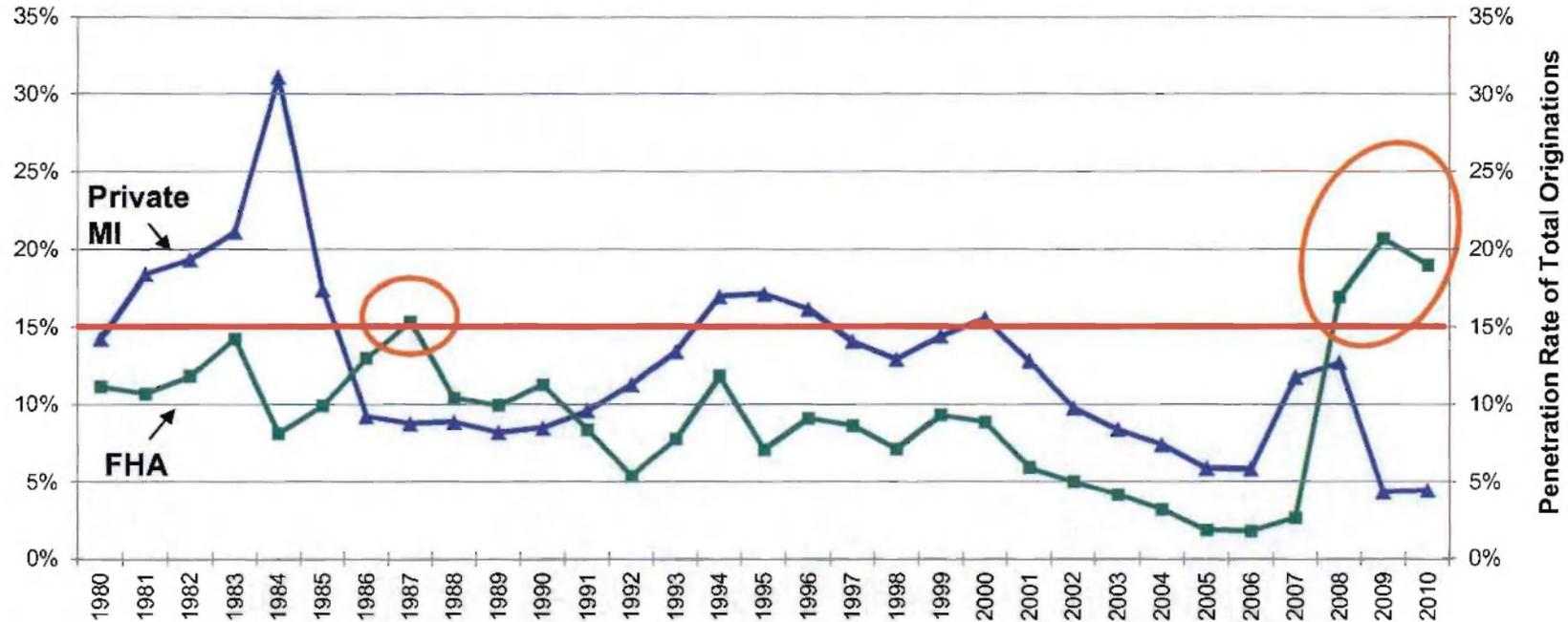
Mis’ Independent Underwriting Standards Provide Credit Risk Discipline

Immediately Commits Private Capital Against Each Loan – “Skin in the Game”

Countercyclical Model ... Capital Builds via Requirement to Hold 50% Of All Premiums Received in Reserve

Interests Directly Aligned With Borrowers and Investors ... Proactively Works With Borrower and Servicer to Prevent Foreclosure

Private MI & FHA Penetration Comparison



Total MI & FHA

25% 31% 39% 22% 19% 20% 17% 29% 25% 20% 24% 15% 11% 8% 30% 23%

Prudent Low Down Payment Lending Critical to Recovery

Significant Imbalance Between Government Backed and Private Mortgage Insurance

Risk Retention and Qualified Residential Mortgage

- **Dodd-Frank Wall Street Reform and Consumer Protection Act Creates New Obligation for Securitizers to Retain Interest in Securitized Assets**
- **Bill Directs Regulators to Exempt Qualified Residential Mortgages (QRM)**
- **Regulators Must Define a QRM Taking into Consideration Underwriting and Product Features That Result in a Lower Risk of Default Such as:**
 - Documented and verified financial resources
 - Standards for: a) residual income after meeting all obligations; b) ratio of housing payment to income; c) ratio of all installment payments to income
 - Standards and features that mitigate the payment shock of ARMs
 - Mortgage guaranty insurance (or other insurance or credit enhancement) obtained *at the time of origination* to the extent such insurance/credit enhancement reduces the risk of default.
 - Prohibitions/restrictions on balloon payments, negative amortization, prepay penalties, interest only & other similar high risk features

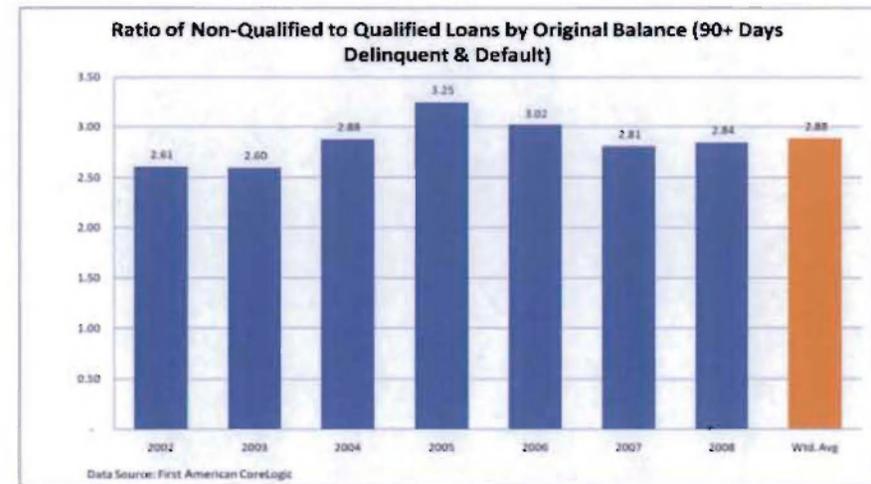
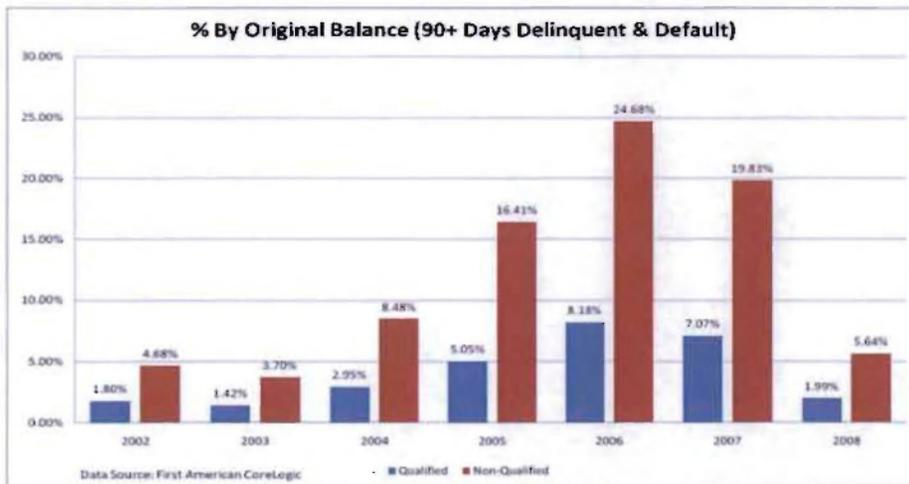
Data Clearly Demonstrates:

- **A Qualified Mortgage standard mitigates the risk of default**
- **On low down payment loans, Insured Loans have a lower risk of default than comparable Piggyback (uninsured) Loans**

Qualified Mortgage Study

➤ A Study of Performance by Vertical Capital Solutions using CoreLogic Servicing Dataset Reveals that “Qualified Mortgages” Significantly Outperformed “Non-Qualified Mortgages”, Based on the Underwriting Standards Below:

- Fully Documented Income & Assets;
- Total Debt-To-Income $\leq 41\%$;
- 7/1 ARM's & Greater or Fixed Rate;
- Loans with a CLTV $>80\%$ must carry MI
- No Balloon; No Interest Only; No Negative Amortization; Term ≤ 360 months



Qualified Mortgages Clearly Have Lower Risk of Default

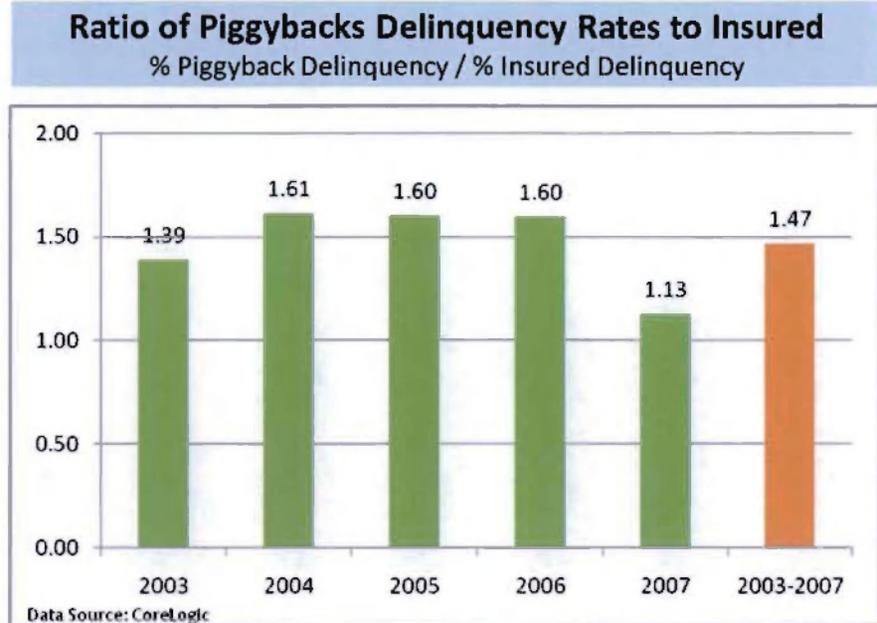
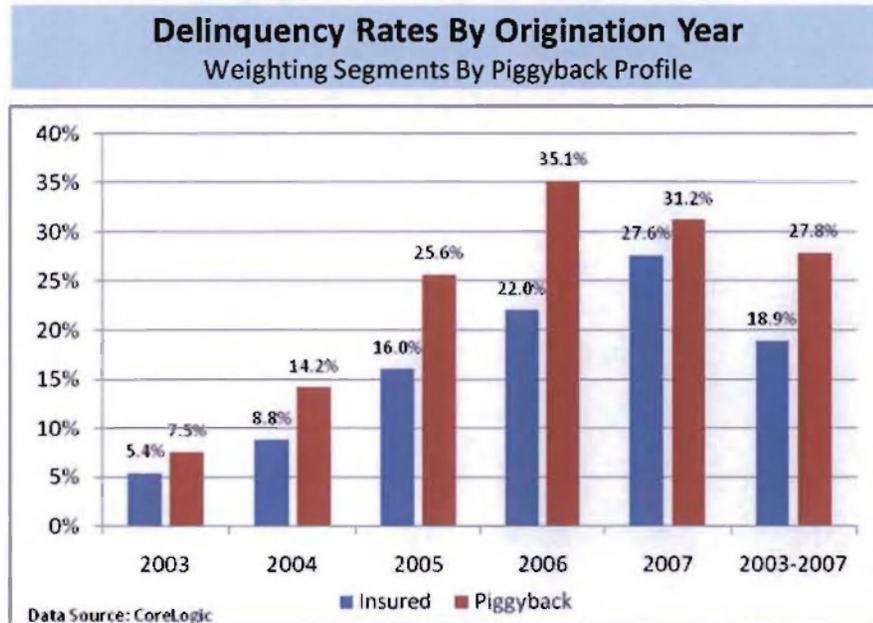
Piggybacks Versus Insured Loan Study

- MICA set out to compare default performance of Insured loans to comparable Piggyback Loans to support the inclusion of a Mortgage Insurance requirement in the Qualified Residential Mortgage definition
- Used CoreLogic Servicing Database of over 120 Million Loans
- Extracted high CLTV loans and divided them into two Populations:
 - Insured Loan = loan with mortgage insurance (3.8mm loans)
 - Piggyback Loan = uninsured loan where 1st lien LTV = 80% and CLTV >80% (1.1mm loans)
- Examined Performance Data as of June 30, 2010 and segregated each population into 5040 segment combinations of:
 - 5 Origination Years (2003-2007)
 - 7 FICO score ranges
 - 4 Combined Loan-To-Value (CLTV) ranges
 - 9 US Census Regions
 - 2 Loan Purpose Categories
 - 2 Documentation Levels
- Delinquency, Cure & Non-Performing data normalized to the distribution of the Piggyback population across all 5040 segments & compared performance

Findings: Insured Loans Became Delinquent 32% Less Frequently, Cured 54% More Frequently and Have Performed 65% Better than Comparable Piggyback Loans

Piggybacks Versus Insured Loans

DELINQUENCY PERFORMANCE*



Insured Loans Have Significantly Lower Incidence of Delinquency than Comparable Piggyback Loans

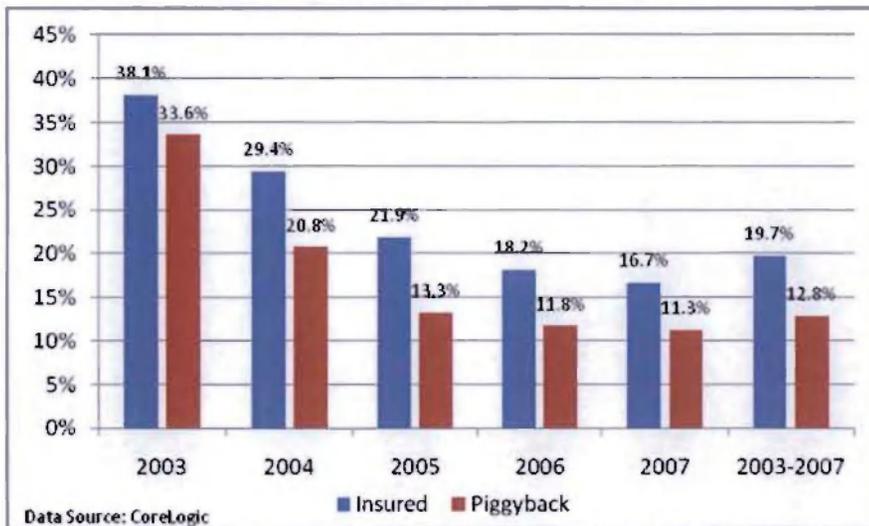
* Ever 90 Day Delinquency Rate: # of loans that ever went 90 or more days delinquent / original number of loans

Piggybacks Versus Insured Loans

CURE PERFORMANCE*

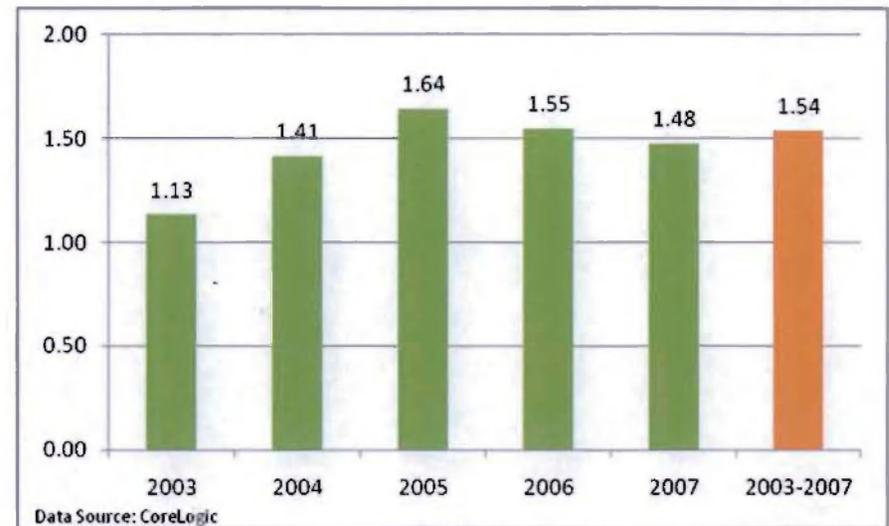
Cure Rates On Delinquent Loans By Origination Year

Weighting Segments By Piggyback Profile



Weighted Ratios Of Insured Cure Rates To Piggybacks

Insured Cure Rate % / Piggyback Cure Rate %



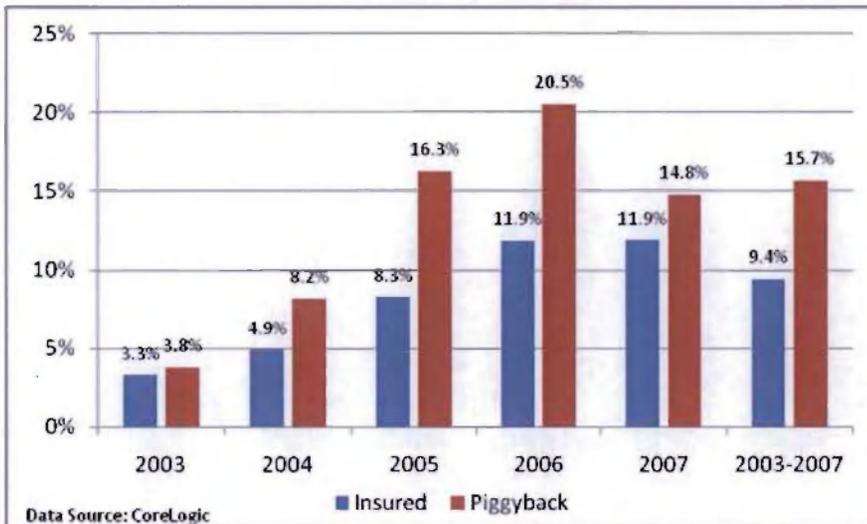
Once Delinquent, Insured Loans Cure 54% More Frequently Than Piggybacks

* Cure Rate: # Ever 90 Day Delinquent loans that subsequently became current / total number Ever 90 Day delinquent loans

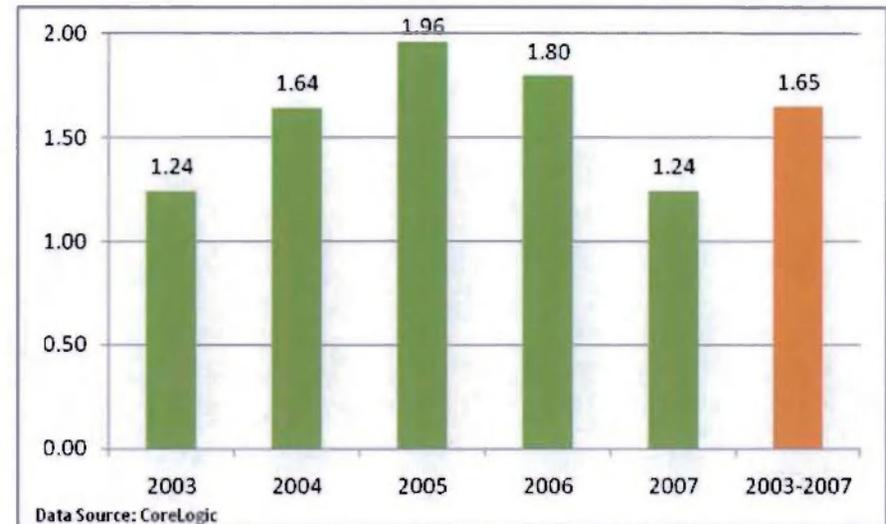
Piggybacks Versus Insured Loans

NON-PERFORMING RATES*

Non Performing Rates By Origination Year
(Currently 90+ Days Delinquent & Defaults)



Ratios Of Piggyback Non-Performing Rates To Insured
Piggyback Non-Performing / Insured Non-Performing Rate

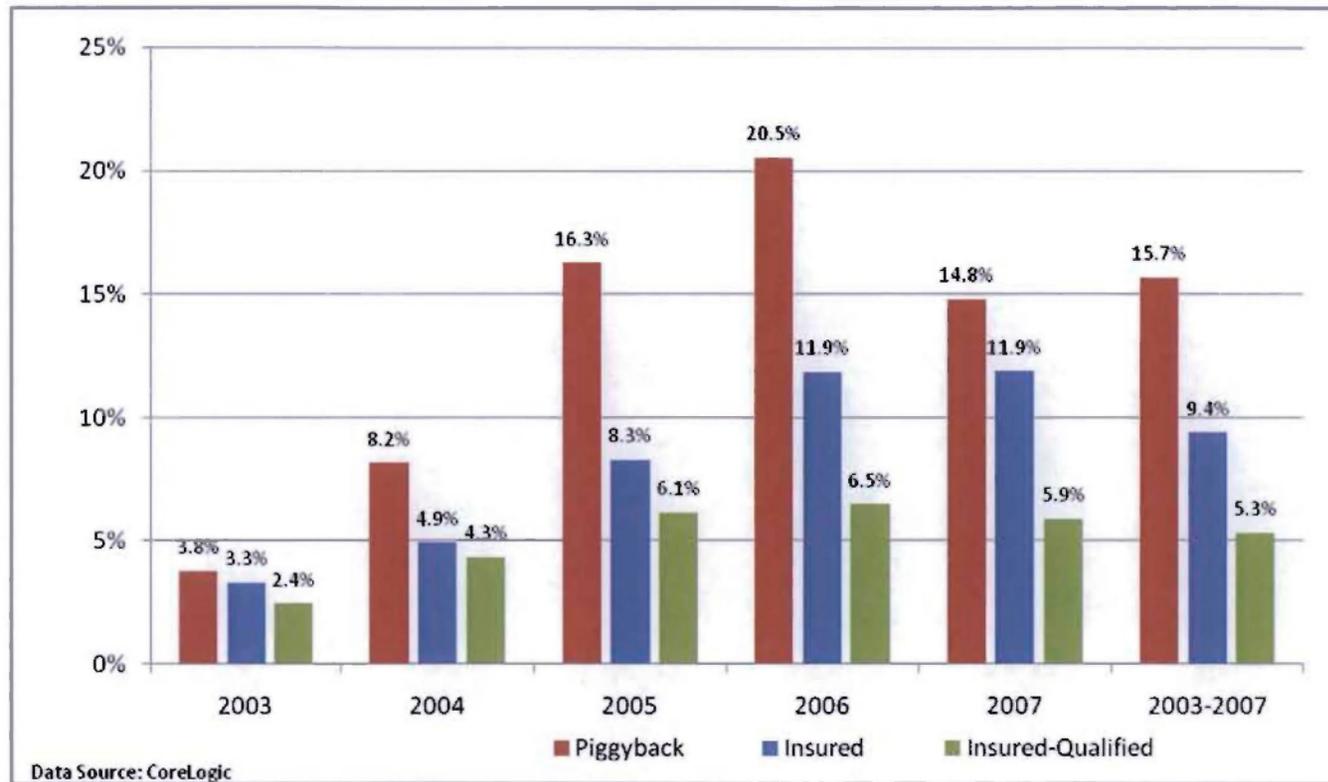


End Result ... Insured Low Downpayment Loans Have Lower Risk of Default than Comparable Piggyback Loans

* Non-Performing Rate: (# Loans Currently 90 or more days delinquent + loans that terminated in default) / original number of loans

Qualified Insured Loan Performance

NON-PERFORMING RATES*



“Qualified” Insured Loans Have Performed Well Through the Downturn

* Non-Performing Rate: (# Loans Currently 90 or more days delinquent + loans that terminated in default) / original number of loans

The Case For Private Mortgage Insurance

QRM Exemption is Based on Prudent Underwriting Practices Including MI as a Risk Mitigant on Low Downpayment Mortgages

Loans With Mortgage Insurance Meet the Bar of Lowering Risk of Default as Required Under Dodd-Frank

Current Housing Policy Debate Centered Around Traditional MI Strengths

- Significant and Transparent Private Capital ... Skin In the Game on Every Loan
- Countercyclical Reserving Methodology ... 50% Of All Premiums Earned Held to Pay Claims During Downturns
- Coverage Provides Loss Mitigation and Capital Relief For Lenders and GSEs
- Interests Directly Aligned With Borrowers and Investors ... Independent Underwriting and Intense Foreclosure Prevention
- Available Capacity to Increase the Private Industry's Support of Housing

Premiums, Losses & Capital



Mortgage Insurance is Priced For Long Term Cycles

Countercyclical Model ... Mis Build Capital In Good Times to Pay Claims During Economic Downturns

Current Downturn Is The Most Severe Ever Experienced

Model Working Exactly As Designed

[†] Includes new entrant capital (Essent Guarantee)