Overview of Draft Revised
Private Mortgage Insurer Eligibility Requirements

I. Introduction

The Federal Housing Finance Agency ("FHFA") is seeking public input for itself, the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (together "the Enterprises") on draft revised eligibility requirements the Enterprises would use to approve private mortgage insurers that provide mortgage insurance on loans owned or guaranteed by the Enterprises.

FHFA is the Conservator of each Enterprise. As Conservator, FHFA succeeded to all rights, titles, powers and privileges of the Enterprises. FHFA is authorized to operate each company in conservatorship and carry on the business of the Enterprises. This includes taking actions necessary to put them in a sound and solvent condition and actions that FHFA determines to be in the best interest of the Enterprises.[1]

The Enterprises were chartered by Congress with specific purposes, which include providing liquidity and stability in the secondary market for residential mortgages.[2] Each Enterprise operates under a charter act that requires mortgage loans with an outstanding principal balance exceeding 80 percent of the value of the property to have an acceptable form of credit enhancement.[3] Mortgage insurance is the most commonly used form of credit enhancement. Primary mortgage insurance provides the Enterprises with first loss protection on mortgage loans that exceed an 80 percent loan-to-value ("LTV") ratio and reduces the loss severity exposure of the Enterprises in the event of losses due to borrower default. The Enterprises' charter acts allow each Enterprise to determine whether a mortgage insurer ("MI") is qualified to insure loans purchased by that Enterprise.[4]

Each Enterprise currently has its own set of mortgage insurer requirements that an MI must satisfy to become an approved counterparty ("Approved Insurer"). Fannie Mae and Freddie Mac have not updated their MI eligibility requirements since 2003 and 2008, respectively. The existing Enterprise MI eligibility requirements rely primarily upon an acceptable rating by a major rating agency as opposed to specific counterparty risk and financial standards, as defined by the Enterprise. Additionally, the existing requirements do not adequately consider liquidity of capital. Ensuring that regulated entities maintain strong counterparty requirements, in addition to regulatory requirements, are part of sound risk management by state and federal regulators.

A direct result of the financial crisis was a steep rise in defaults and foreclosures of single-family mortgages, including those owned or guaranteed by the Enterprises. Mortgage insurers and the Enterprises suffered significant losses as a result of these defaults and foreclosures. As the regulation of insurance is conducted primarily at the state level, MIs are subject to state regulatory requirements.

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[1] The duties and authorities of FHFA as Conservator are found primarily at 12 U.S.C. § 4617.
[2] *See* 12 U.S.C. 1451; 12 U.S.C. 1716.
[3] *See* 12 U.S.C. 1454(a); 12 U.S.C. 1717(b).
[4] *See Id*.

To ensure that Approved Insurers possess the financial and operational capacity to withstand a severe stress event, FHFA, as Conservator, directed the Enterprises to update, expand, and align their counterparty risk management standards. The Enterprises, under the oversight of FHFA as Conservator, have revised and aligned their Private Mortgage Insurer Eligibility Requirements ("PMIERs"). The draft PMIERs are intended to mitigate future Enterprise losses, ensure that Approved Insurers maintain sufficient financial strength to withstand a stress macroeconomic scenario and, to the extent possible, create a common set of eligibility requirements for Approved Insurers. Once finalized, each Enterprise will publish its own set of revised PMIERs.

FHFA, Fannie Mae and Freddie Mac consider the aligned, revised eligibility requirements important conditions for doing business with the Enterprises, and FHFA seeks public input on the draft PMIERs. This Overview and accompanying draft of the revised PMIERs are intended to inform the public of the draft revisions and solicit input. FHFA requests responses to specific questions beginning on page 17 of this Overview.

The draft PMIERs should be relied upon for the purposes of public input. This Overview is intended to facilitate the input process by providing additional background and context on five specific areas that are addressed in the draft PMIERs:

1) Business Requirements and Policy Underwriting;
2) Quality Control;
3) Financial Requirements;
4) Failure to Meet Requirements; and
5) Newly Approved Insurer Requirements.

The draft materials should only be relied upon for purposes of public input.

II. <u>Public Input</u>

Submit written responses to:

The Federal Housing Finance Agency
Constitution Center
400 7th Street SW
Washington DC 20014
Attn: Mortgage Insurance Eligibility Project

Or submit your response at www.fhfa.gov/open-for-comment-or-input.

Submitted responses will be posted without change, including personal information such as name, street address, email address and telephone number on *http://www.fhfa.gov*.

The period for public input begins on July 10th, 2014 and ends on September 8th, 2014.

III. <u>Timeframes</u>

All components of the PMIERs would become effective 180 days after the publication date of the finalized PMIERs. During the input period, and until the PMIERs are finalized, any Approved Insurer that does not fully meet each Enterprise's existing eligibility requirements would continue to operate in its current status.

An Approved Insurer that fails to fully comply with the financial requirements would be given a transition period of up to two years from the publication date to fully comply. After the PMIERs have been finalized, an Approved Insurer will have adequate time to assess the revised PMIERs and, if necessary, develop a transition plan to achieve compliance with the financial requirements by the end of its transition period.

If an Approved Insurer requires a transition period, it would remain an Approved Insurer, as is the case today, able to write insurance on loans eligible for delivery to the Enterprise during the development and Enterprise review of a transition plan and, subject to plan approval, during the period in which the plan is in effect. In no instance would a transition period extend beyond two years from the publication date of the finalized PMIERs.

The timeline under consideration is as follows:

PMIERs Implementation Schedule	
180 day period from Publication date to Effective Date	• Each Approved Insurer would conduct a self-assessment of whether it fully complies with the PMIERs and <u>certify</u> to each Enterprise that it satisfies all of the requirements or, alternatively, identify specific requirements not met. • For an Approved Insurer unable to <u>certify</u> that it fully complies with the financial requirements, each Enterprise would require the Approved Insurer to develop a transition plan for Enterprise approval.
Effective Date	• All Approved Insurers must be in full compliance with the PMIERs on the effective date. • If an Approved Insurer fails to fully comply with the financial requirements, it would be given a transition period of up to two years after the publication date to fully comply.
90 Days after the Effective Date	• Due date for the transition plan. • The transition plan would include proposed interim milestones as well as detailed actions

	the Approved Insurer has initiated or would initiate to achieve full compliance.
150 days after the Effective Date	• Each Enterprise would review and either approve or require the Approved Insurer to revise the transition plan.
• Once a transition plan has been approved, each Enterprise would begin monitoring the Approved Insurer's progress against its transition plan milestones, including quarterly submission of a status report detailing the Approved Insurer's progress toward accomplishing its transition plan milestones.	
• A transition framework might include heightened surveillance, increased frequency of management updates, or other actions listed in the section 706 and 901 below.	

IV. Draft PMIERs

1. Business Requirements and Policy Underwriting

The draft PMIERs would implement the following revised business requirements to identify, measure, and manage exposure to counterparty risk. Implementing these business requirements would provide more timely feedback on operational performance of Approved Insurers.

a) Scope of Business (§300)

i. Operational Needs

The PMIERs should establish standards that are designed to ensure that an Approved Insurer has long-term access to staff, services, and technology that meet its operational needs for administering its insurance book of business. Please see Section V, Request for Input, Business Requirements, Question A.1.a for questions related to how the PMIERs may address this risk.

ii. Claims-Paying Ability

The PMIERs should establish standards that are designed to ensure that an Approved Insurer's potential losses from insuring high-risk loan concentrations do not jeopardize its financial ability to pay claims on its lower risk portfolio. Please see Section V, Request for Input, Business Requirements, Questions A.1.b and A.1.c for questions related to how the PMIERs may address this risk.

iii. Other Services

Under the draft PMIERs, an Approved Insurer would not be permitted to:

- Provide contract underwriting or any other service not directly required for providing mortgage guaranty insurance that creates a material, direct or contingent liability for the Approved Insurer; or

- Assume any obligations related to services, including contract underwriting, offered or conducted by any subsidiary or affiliate. An example of such prohibited obligations is an agreement to indemnify an affiliate, providing contract underwriting, from potential losses incurred as a result of defective underwriting services.

b) Other Requirements

i. Enterprise Prior Approval (§307)

As drafted, the PMIERs would restrict Approved Insurers, without prior Enterprise approval, from entering into any agreements for Enterprise loans that:

- Waive, suspend, or otherwise alter an Approved Insurer's right to investigate loans, rescind or deny coverage, or settle claims on one or more specified loans;

- Expand or alter the right to rescind, as in cases where rescission is triggered by an event unrelated to loan eligibility, compliance with underwriting requirements, or breach of policy representations and warranties (e.g., rescission triggered by failure of a seller/servicer to fund a reinsurance entity); or

- Affect one or more loans owned or guaranteed by an Enterprise.

Note that, generally, an Approved Insurer would not need to obtain an Enterprise's prior approval for the settlement of a claim on a single loan in the ordinary course of business, provided that in connection with such settlement, the Approved Insurer does not receive any financial consideration independent of any claim adjustment that is otherwise supported by the terms of the Approved Insurer's master policy.

ii. Diversification Policies (§308)

Under the draft PMIERs, an Approved Insurer would be required to:

- Have a documented risk diversification policy and employ risk management tools and techniques to avoid concentrated risk exposures in the risk in force the Approved Insurer insures. Segments of business for which concentrations should be monitored and managed include, but are not limited to, loan products and programs, geography, customers, and source of business (e.g., retail, wholesale, and correspondent).

- Monitor and report risk concentrations to its senior management and develop an action plan to address breaches of established limits which must be provided to the Enterprise.

iii. Claims Processing and Loss Mitigation (§§309-310)

To ensure that all mortgage insurance claims are processed in a timely manner, an Approved Insurer would be required to either pay or deny a claim or rescind coverage within 180 days of the claim perfection date and rescind or deny any claim not perfected within 120 days from the claim filing date except to the extent a master policy requires an earlier time line.

In cases where an Approved Insurer does not provide full loss mitigation delegations to an Enterprise, the PMIERs would:

- Allow for an assessment of a pricing adjustment when that Enterprise acquires loans insured by the Approved Insurer to compensate for potentially higher loss management costs.

- Require the Approved Insurer to provide service-level agreements to the Enterprise that specify acceptable loss mitigation decision timelines.

iv. Policies of Insurance (§ 312)

- An Approved Insurer would be required to maintain business insurance for Fidelity Bond and Errors & Omissions at all times. The coverage amount for each policy must be no lower than $5 million dollars with a deductible amount not to exceed $150,000.

v. Use of Automated Underwriting Systems (AUS) (§404)

Under the draft PMIERs, Approved Insurers using a third-party Automated Underwriting System (AUS) recommendation either, (a) for its own purposes, or (b) as part of a delegated underwriting process of loans insured by the Approved Insurer, would be required to conduct a risk analysis to ensure that recommendations of the AUS are aligned with the Approved Insurer's independent credit risk guidelines.

2. Quality Control

a) <u>Quality Control Program Requirements (§500)</u>

Under the draft PMIERs, each Approved Insurer would be required to maintain a robust quality control (QC) program. Such a program is intended to facilitate the Approved Insurer's monitoring of its adherence to its underwriting and eligibility guidelines, ensure data accuracy, and prevent the insuring of fraudulent mortgages or mortgages with other defects.

The draft PMIERs would require an Approved Insurer to submit to each Enterprise a copy of its QC program annually, with changes noted from the prior year's version.

Further, the draft PMIERs contains the following minimum requirements for an Approved Insurer's QC program:

1. Operate independently from the sales and underwriting functions.

2. Be effective in determining that the insured mortgages were properly underwritten and consistent with the Approved Insurer's underwriting guidelines.

3. Include standard reporting that identifies opportunities for improvement, training, or other corrective actions that are communicated on a regular basis to the Approved Insurer's senior management and its lender customers.

4. Employ a loan selection methodology and frequency of review requirement.

5. Monitor overall quality by source of business (e.g., retail, wholesale, broker).

6. Review declined applications for insurance to determine if there is adequate support for those decisions.

7. Be in writing with documented operating procedures that incorporate the following:

    a) A clearly defined scope and purpose of the review, noting differences between underwriting versus claims reviews.
    b) A red-flag checklist for potential fraud.
    c) A well-defined process for establishing and managing corrective actions such as notification to the Approved Insurer's management, additional training for underwriting staff, or the removal of a lender's delegated underwriting authority.
    d) Utilization of third-party resources that can be applicable to the QC process, such as fraud detection tools.
    e) A threshold QC defect rate that triggers the need for corrective actions.
    f) A clear methodology to establish that a QC defect rises to the level requiring a corrective action.
    g) The prompt identification of loan defects and subsequent actions taken to address and remediate patterns of loan production issues before loans qualify for rescission relief under the Master Policy.
    h) A documented governance criteria and process for making and approving revisions to the Approved Insurer*'s* QC program.

b) <u>Post-Closing Review (§502)</u>

The draft PMIERs require an Approved Insurer to evaluate certain loan documentation as part of its QC process including documentation related to:

- Income;
- Employment;
- Assets to meet reserve requirements;
- Appraisal report or property valuation data; and
- Credit reports.

c) <u>Other QC Requirements (§§503-506)</u>

Other QC requirements contained in the draft PMIERs include:

- The Approved Insurer must select loans on a random (i.e. non-discretionary sample) basis using a sample size sufficient to produce results that have at least a 95% confidence interval with no more than a 2% margin of error (when measured annually). Additionally, an Approved Insurer must perform discretionary loan reviews for 100% of loans that become early payment defaults.

- The Approved Insurer's QC review of loans sampled through its random selection process must be completed within 120 days following the latest insurance coverage effective date of the selected loans.

- The Approved Insurer must establish a QC defect rate threshold for its random loan reviews. The rate is subject to review and periodic reassessment by the Enterprise.

- The Approved Insurer must take prompt action to identify the causes of the breach if the QC defect rate threshold is exceeded and, if necessary, develop an action plan to correct the underlying causes driving the breach.

- The Approved Insurer must provide regular reporting of QC findings to its senior management and quarterly summary reporting to the Enterprise.

- The Approved Insurer must report immediately to senior management any suspected pattern of fraud or similar activity.

- The Approved Insurer must conduct an independent audit of the QC function to confirm compliance with its internal program requirements.

d) Performance Monitoring and Scorecard (§802)

The draft PMIERs provide that each Enterprise would monitor the operational performance of Approved Insurers through a quarterly Operational Performance Scorecard ("Scorecard") that tracks the Approved Insurer's business performance using a set of indicators. These performance indicators are intended to capture front-end quality metrics such as sample rates, QC defect rates, and back-end metrics to monitor claims paying practices, such as rescission and denial rates, and claim processing timelines. If an Approved Insurer were to report poor performance on one or more of the Scorecard metrics, the Approved Insurer would be classified as high, medium, or low risk and would be potentially subject to actions listed in the Remediation section described below or other corrective actions as determined by each Enterprise.

Scorecard thresholds would be developed in the future based on the Enterprises' counterparty risk prudential standards for operational performance, with consideration to the input data provided by the Approved Insurers during the initial build-out of the Scorecard data set. The draft Scorecard would contain data metrics based on the combined Enterprise portfolios and individual Enterprise portfolios. As such, metric targets for individual Enterprise portfolios may be different based upon each Enterprise's individual portfolio experience.

3. Financial Requirements

MIs are regulated by state insurance regulators that seek to ensure the MI companies have adequate claims-paying ability and can meet their obligations by, among other things, establishing contingency reserves, capital requirements, and permitted investment guidelines. MIs generally are required to keep contingency reserves of 50% of premiums for ten years to help bolster the MIs' financial standing in cycles of high defaults, which typically coincide with a stressed economic environment. Current state regulatory capital standards generally limit the amount of risk exposure an MI can write to a multiple of its regulatory capital. In most states, this limit is twenty-five dollars of risk in force (RIF) for every dollar of regulatory capital. Ensuring that regulated entities maintain strong counterparty requirements, in addition to regulatory requirements, are part of sound risk management by state and federal regulators.

a) General Requirements (§704)

The draft PMIERs seek to ensure that Approved Insurers have adequate liquidity and claims-paying capacity during periods of economic stress. Under the draft PMIERs, the liquid assets of an Approved Insurer (i.e., Available Assets) need to be greater than or equal to a minimum required asset level (i.e., Minimum Required Assets), defined as the greater of:

- The Total Risk-Based Required Asset Amount, which is a risk-based standard representing claims from the Approved Insurer's book of business forecast to be paid over the remaining life of existing policies under a stress economic scenario, or

- A floor minimum requirement of $400 million as a condition of on-going approval

b) Risk Based-Required Assets Factors (Exhibit A)

The draft PMIERs define the Total Risk-Based Required Asset Amount as the projected claims for each Approved Insurer using a grid of factors based on vintage (origination year), original loan-to-value ratio (LTV) and credit score for performing loans, and the depth of delinquency for non-performing loans. The grid approach, as currently configured, would take into account the following risk characteristics:

- The original LTV of the loan. For loans refinanced through the Home Affordable Refinance Program (HARP), the original LTV as of the HARP refinance date;
- The original credit score of the borrower(s). For loans refinanced through the Home Affordable Refinance Program (HARP), the original credit score is measured as of the HARP refinance date;
- The vintage classification (Pre-2005, 2005-2008, Post 2008), based upon the note date of the insured loan;
- Whether the loan was originated pursuant to the HARP refinance program;
- The loan payment and/or policy claim status; and
- Certain risk features.

The factors in the grids would be updated, as needed, to reflect changes in the risk dynamics of loans with mortgage insurance and in the macroeconomic environment. Exhibit A of the draft PMIERs contains the grids and additional details on their application.

The grids generally would follow this format:

	Original Credit Score Classification				
Original LTV Classification	**<= 620**	**621- 680**	**681 - 740**	**741 - 780**	**781 - 850**
LTV <= 85	x%	x%	x%	x%	x%
85 < LTV <= 90	x%	x%	x%	x%	x%
90 < LTV <= 95	x%	x%	x%	x%	x%
LTV > 95	x%	x%	x%	x%	x%

Each factor in the grid would represent the aggregate remaining life of coverage claims as a percentage of aggregate RIF adjusted for ceded risk, subject to a 1% floor. The aggregate projected claims for each cell in the grid would be the sum of the projected loan-level claims for each loan matching the risk characteristics for that cell. For performing loans, the loan-level claims for each cell would be projected using the FHFA Mortgage Analytics Platform,[5] employing detailed loan-level data on Enterprise loans with mortgage insurance (and excluding loans insured by previously Approved Insurers currently in run-off). For delinquent loans, the grid factors would be a simple average of the Enterprises' and FHFA's projections of loan-level claims on delinquent loans.

While the grids would be estimated using Enterprise loans with mortgage insurance, they would be applied to both Enterprise and non-Enterprise loans. However, for certain non-Enterprise loans originated after 2008 that have high-risk features, the draft PMIERs apply multipliers to the grid factors. If a loan does not meet any of the following criteria at the time of origination, its factor from the grid would be increased by applying each of the applicable multipliers in Table 1 below:

Criteria

- Eligible for sale to Fannie Mae, Freddie Mac, or any of the Federal Home Loan Banks;
- Meets the requirements of either Enterprise Selling Guide, except those related to loan amount;
- Originated under a state housing finance agency program; or
- Meets the requirements of a qualified mortgage under 12 C.F.R. § 1026.43(e) or (f)

High Risk Feature Multipliers

Risk Feature	**Multiplier**
Not Underwritten with Full Documentation	3.00
Not Owner-occupied at Origination	3.00
Underwritten with a Monthly Debt-to-Income Ratio > 43%	2.00
Mortgage Payment is not Fully Amortizing	1.50

Recognizing that the application of these multipliers may result in a factor greater than 100%, the draft PMIERs cap the factor at 100%.

[5] The Federal Housing Finance Agency (FHFA) maintains a proprietary Mortgage Analytics Platform to support the Agency's strategic plan. The platform is one of the tools the FHFA uses in policy analysis. In the case of the PMIERs, FHFA used the platform to project remaining life of coverage claims on Enterprise loans with mortgage insurance. The projected claims were disaggregated into segments based on vintage, credit score, and LTV. The risk based required asset factors in Exhibit A were calculated as the projected claims in each segment divided by the risk-in-force for that segment. A description of the platform is available at FHFA Mortgage Analytics Platform.

c) Macroeconomic Scenarios

A macroeconomic scenario is a critical model input for projecting mortgage insurance policy claims that are used to generate the Risk Based-Required Assets Factors. The scenario includes projected house prices, interest rates, unemployment rates, and other factors. In developing the draft PMIERs, consideration was given to macroeconomic forecast scenarios available from commercial vendors, FHFA's Countercyclical Capital Regime[6], and the Federal Reserve Board's Comprehensive Capital Analysis and Review (CCAR) exercise.[7]

The draft PMIERs apply the CCAR Severely Adverse stress scenario (excluding the Global Market Shocks) for loans insured after 2008 to maintain rough consistency with the stress tests of the federal financial regulators. For most policies written before 2009, the draft PMIERs use the CCAR Baseline scenario because the associated loans have already been subjected to significant economic stress. The draft PMIERs use only the house price, interest rate and unemployment rate projections from the CCAR scenarios needed to model mortgage insurance claims. The draft PMIERs do not apply the full CCAR exercise. The CCAR exercise is used by the Federal Reserve Board to evaluate the earnings and capital of banks, both from a quantitative and qualitative perspective.

There are two technical limitations to using the Federal Reserve Board's CCAR scenarios in projecting claims:

1. The CCAR scenarios contain only national house price projections, which do not capture regional variations.

2. The CCAR scenarios contain projections for only thirteen quarters. To project claims on mortgage insurance policies, CCAR scenarios need to be extended.

To address these limitations, the national CCAR house price paths would be disaggregated to the state level and extended to 30 years.

The national CCAR house price path would be disaggregated, or apportioned, to each of the 50 states plus the District of Columbia based upon the ratio of each state's House Price Index (HPI) to the national HPI under FHFA's countercyclical scenario described in FHFA working paper 12-2, *Countercyclical Capital Regime: A Proposed Design and Empirical Evaluation*.[8] CCAR's national unemployment scenario would be disaggregated, or apportioned, in a similar manner.

To extend the HPI, interest rates, and unemployment stress paths to 30 years, the CCAR scenarios would be transitioned to long-run equilibriums (as specified in FHFA working paper 12-2) beginning in year three of the projection. By year ten, these scenarios represent long-run trend HPI, average interest

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[6] http://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/2012-04_WorkingPaper_12-2_508.pdf.
[7] http://www.federalreserve.gov/bankinforeg/ccar.htm.
[8] http://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/2012-04_WorkingPaper_12-2_508.pdf

rates between 1994 and 2000, and the latest estimate of the natural rate of unemployment from the Federal Reserve Bank of St. Louis.

d) Prudential Floor (Exhibit A)

For performing loans, the draft PMIERs add a prudential floor requirement of 5.6% of primary mortgage insurance RIF (adjusted for ceded risk) to address a concern that a pure risk-based approach may establish an inappropriately low Risk-Based Required Asset amount for a book of business, that is heavily weighted with higher quality loans, in the event that the model-based forecast turns out to be overly optimistic. The Risk-Based Required Asset Amount for primary mortgage insurance covering performing loans would be the greater of:

- The requirement for performing loans calculated using the grids, or
- 5.6% of performing primary mortgage insurance RIF adjusted for ceded risk.

Risk of default for loans with two or more missed monthly payments would not be subject to a prudential floor for the Risk-Based Required Assets requirement because their grid factors already reflect a high likelihood of claim.

e) Pool Policies (Exhibit A)

Under the draft PMIERs, pool policies would be treated similarly to primary mortgage insurance policies. Each loan covered by a pool policy would be assigned a Risk-Based Required Asset Amount using the grids. The Risk-Based Required Asset Amount for a pool policy would be the lesser of:

- The aggregate Risk-Based Required Asset Amount for both the performing and non-performing loans covered by the policy; or
- The net remaining stop loss for the policy, defined as the initial stop loss amount, net of any pool policy deductible and any benefits paid to date.

f) Available Assets (§704)

The draft PMIERs require an Approved Insurer to hold Available Assets at a level that meets or exceeds Minimum Required Assets. Available assets would be composed of liquid capital investments readily available to pay claims, including the most liquid investments of an Approved Insurer and liquid capital investments of subsidiaries.

Available assets for an Approved Insurer would be calculated as the sum of its:

- Cash (such as those currently listed on an Approved Insurer's Statutory Statement of Assets, [line 5] in its convention statement).
- Bonds (such as those currently listed on an Approved Insurer's Statutory Statement of Assets, [line 1] in its convention statement).

- Common and preferred shares (included at their market capitalization value discounted by 25%) only if:
    - The stock is publicly traded, and
    - The Approved Insurer has complete control and authority to sell the shares.

- Receivables from investments (such as those currently listed on an Approved Insurer's Statutory Statement of Assets, [line 14] in its convention statement).

- Dividends of subsidiaries to be paid (with Enterprise prior written approval) to the Approved Insurer over a time period that is no greater than:
    - Two years, if unconditionally guaranteed by a strongly capitalized company, as determined by the Enterprises with at least an A- rating from either S&P or Fitch, or A2 from Moody's; or
    - One year, if unconditionally guaranteed to the satisfaction of the Enterprise by a strongly capitalized company as determined by the Enterprises with at least an BBB- rating from either S&P or Fitch, or Baa2 from Moody's; or
    - Another period as approved by the Enterprise.

- The following liquid assets owned by an exclusive affiliated reinsurer, if the exclusive affiliated reinsurer is both (a) a U.S. domiciled corporation that is regulated as an insurance company; and (b) writes only mortgage guaranty insurance or mortgage guaranty reinsurance:
    - Cash, and
    - Bonds.

- The trust balance for any lender captive reinsurer, related to loans insured by the Approved Insurer.

- 210% of the Approved Insurer's mortgage guaranty insurance premium net of any amount ceded to a non-affiliated reinsurer or non-exclusive affiliated reinsurer earned in the prior 12 months on policies written before 2009 (including those subsequently refinanced through the Home Affordable Refinance Program). (See Discussion on Including Future Premium Income below.)

Less,

- The Approved Insurer's unearned premium reserves (such as currently listed on an approved insurer's Statutory Statement of Liabilities, Surplus and Other Funds [line 9] in its convention statement).

g) <u>Including Future Premium Income (§704)</u>

For operational simplicity, the draft PMIERs would estimate three years of future premium revenue on pre-2009 policies by using the premium income on pre-2009 policies earned in the past twelve months, multiplied by three and applying a reduction, or "haircut," of thirty percent to estimate run-off (i.e., 210%). Premiums ceded under reinsurance arrangements would not be included in this calculation. Premiums from policies on loans refinanced through the HARP program would be treated as pre-2009 premiums for purposes of this calculation, if not already reported in that manner. This limited inclusion of premium income phases out as the pre-2009 policies run-off.

Post 2008 future premiums would not be included in Available Assets to avoid a mismatch of premiums and losses and to ensure that Approved Insurers are able to honor obligations as they come due. During the recent financial crisis, three MIs were placed in run-off by their state regulators due to actual or imminent statutory insolvencies – which by definition do not include future premium income – and the Enterprises' claims were paid on a partial basis under Deferred Payment Obligations (DPO). If the draft PMIERs were to include future premiums in Available Assets while state regulators did not include future premiums in statutory capital, the Enterprises would remain exposed to the risk of statutory insolvencies and DPOs.

To avoid a recurrence of a statutory insolvency, the draft PMIERS require Approved Insurers to hold sufficient liquid assets to pay claims throughout the life of an insured loan. Additionally, including future premiums in Available Assets would be undesirable as it could create a potential incentive for an Approved Insurer to write new business on uneconomic terms in order to increase premium income in the short term to pay legacy claims.

h) Limitations for Approved Insurers with an Available Assets Shortfall (§706)

After the effective date of the financial requirements, Approved Insurers would be required to maintain Available Assets that equal or exceed their Minimum Required Assets. An Approved Insurer with a shortfall of Available Assets relative to Minimum Required Assets would be required to obtain the Enterprise's approval before:

- Entering into any new capital support agreement or modifying an existing capital support agreement;
- Entering into an assumption of liabilities agreement or guaranty agreement (except for contractual agreements in the normal course of business);
- Making any new arrangements under tax-sharing, and intercompany expense-sharing agreements;
- Making any investment in affiliates, subsidiaries, or non-affiliated entities; or
- Entering into any new risk novation or commutation transaction or any new reinsurance arrangement or structure.

4. Failure to Meet Requirements

a) Remediation Options (§901)

If an Enterprise deems that an Approved Insurer is not in full compliance with any part of the PMIERs, the draft PMIERs establish that the Enterprise may require the Approved Insurer to provide an action plan acceptable to the Enterprise that contains specific completion timeframes.

In addition, under the draft PMIERs upon the effective date of the PMIERs, if an Approved Insurer is not in full compliance with all components of the PMIERs, including the financial requirements, or an Enterprise has concerns regarding the Approved Insurer's: i) ability to honor obligations to the Enterprise, ii) ability to continue to write new business, or iii) ability to maintain adequate operational performance, the Enterprise may take action(s), including, but not limited to, the following:

1. Engage in more frequent dialogue or visits.
2. Require the Approved Insurer to provide additional information and data.
3. Impose new business volume or risk limits for loans insured by the Approved Insurer and delivered to the Enterprise.
4. Limit the risk characteristics of loans to be acquired by the Enterprise and insured by the Approved Insurer.
5. Increase frequency of QC reviews.
6. Restrict delegated underwriting.
7. Increase the Minimum Required Assets.
8. Further limit the types of assets that may be considered Available Assets.
9. Require the Approved Insurer to raise or infuse additional capital.
10. Obtain parental or other capital support.
11. Commute or restructure existing risk-in-force.
12. Limit variances to the Approved Insurer's underwriting guidelines.
13. Limit or deny acceptability of an affiliate's product or services in connection with the Enterprise's business.
14. Restrict or deny participation in new products, initiatives or programs offered by the Enterprise.
15. Notify Approved Insurer's regulator and rating agencies of remedial actions.
16. Differentially price insured loans acquired by the Enterprise, based upon the Approved Insurer.

17. Decline insurance renewal or exercise other policy cancellation provisions of loans owned or guaranteed by the Enterprise, or so instruct servicers of Enterprise loans, and then transfer insured business to another Approved Insurer.

18. Implement restrictions on business practices or charge financial penalties for failing to satisfy requirements or agreed upon remediation actions.

19. Issue a demand for any other specific corrective action.

20. Suspend approval status.

21. Terminate approval status.

b) Suspension or Termination (§902)

Under the draft PMIERs the Enterprise may arrange for transfer of the existing mortgage guaranty insurance RIF to another Approved Insurer or, if such coverage is not available, make alternative arrangements consistent with the terms of the Enterprise's charter.

c) Appeals Process[9]

To support resolution of issues prior to certain remediation actions by the Enterprise, an appeals process will be established. This process will be designed in a manner that supports a neutral fact-finding process to resolve factual disputes.

5. Newly Approved Insurer Requirements

The draft PMIERs establish specific criteria for MIs requesting to become an Approved Insurer. The key consideration of the draft PMIERs is that an Approved Insurer would need sufficient resources to support the Enterprise book of business within a reasonable period of time after Enterprise approval, such that the costs of administering its mortgage insurance business would be competitive and not exhaust claims paying resources.

a) Financial and Rating Requirements for New Approved Insurers (§203)

The draft PMIERs requires that newly Approved Insurers:

- Demonstrate initial capital funding in an amount not less than $500 million, which may include contributions already made and/or provisions for start-up and formation costs such as those associated with either the acquisition or development of an operating/technology platform;

- Obtain a rating agency rating as soon as practicable but no later than 3 years after Enterprise approval; and

[9] An appeals process currently is not reflected in the draft PMIERs. This process is presently under development.

- For the first 3 years after Enterprise approval, a newly Approved Insurer would be:

    - Prohibited from paying dividends to its affiliates or its holding company, or making any investment, contribution or loan to any subsidiary, parent or affiliate; and
    - Required to obtain approval from each Enterprise before engaging in other enumerated activities as specified within the PMIERs.

b) <u>Scope of Application (§203)</u>

Generally, the requirements for newly Approved Insurers would apply to the following:

- A newly Approved Insurer; and

- An Approved Insurer that experiences a material change in ownership, control or organization, or a formerly Approved Insurer requesting reinstatement following suspension or termination, may, at the discretion of the Enterprise, be treated as a newly Approved Insurer for some or all of the newly Approved Insurer criteria.

V. <u>Request for Input</u>

FHFA, in its capacity as Conservator of the Enterprises, requests input for itself and the Enterprises on the draft PMIERs. FHFA seeks comments on all aspects of the draft PMIERs and, in particular, is interested in responses to the following questions:

A. Business Requirements

1. Scope of Business:

    a. How can the PMIERs ensure that Approved Insurers have long-term access to staff, services and technology that meet their operational needs for administering their insurance book of business?

    b. How can the PMIERs ensure that potential losses from insuring high-risk loan concentrations do not jeopardize an Approved Insurer's financial ability to pay claims on its lower risk portfolio?

    c. Should Approved Insurers have separately funded affiliates for insuring higher-risk products?

2. Should the adequacy of each Approved Insurer's risk-adjusted rates of return be measured? If so, what would be the appropriate calculation method for this measure?

3. If the Enterprises, in the interest of establishing strong counterparty financial requirements, expect an Approved Insurer to maintain "adequate" risk-adjusted rates of return for New Insurance Written (NIW), what might be benchmarks for the Enterprises to establish a reasonable range of such expected returns? Should the benchmark also be inclusive of the Approved Insurer's entire portfolio of Insurance in Force (IIF), or only a defined portion?

4. What counterparty risks might be raised by an Approved Insurer maintaining inadequate risk-adjusted rates of return on capital across its expected business profile?

5. Should an Approved Insurer be required to validate a third-party AUS prior to using the recommendations from these systems? If so, what type of analysis would be appropriate to sufficiently validate that the credit decisions from the AUS are in line with the Approved Insurer*'s* credit underwriting requirements?

6. Are there other Approved Insurer Operational Performance Scorecard metrics that should be considered?

7. How should Operational Performance Scorecard thresholds be determined?

8. How should Approved Insurers be rated under the Operational Performance Scorecard?

9. How would Operational Performance Scorecard thresholds be applied?

B. Newly Approved Insurer Requirements

10. What would be the impact of the $500 MM requirement for newly Approved Insurers? Should the requirement reflect the start-up costs to scale a competitive mortgage insurance business? Are there other appropriate requirements or controls that should be established to ensure that start-ups are held to more stringent requirements?

C. Settlements and Changes to Enterprise Rights

11. Section 307 contains requirements relating to the ability of Approved Insurers to enter into agreements with servicers or originators. Should the PMIERs contain provisions relating to agreements entered into between Approved Insurers and originators or servicers? If so, what provisions should be in place?

D. Claims Processing and Loss Mitigation

12. Should the Enterprises impose pricing adjustments for acquired loans where an Approved Insurer does not provide a full delegation of loss mitigation? Does a lack of full delegation unnecessarily expose the Enterprises to foreseeable costs? Should there be exceptions to what constitutes full delegation of loss mitigation?

E. Policies of Insurance

13. Should self-insurance be an appropriate method for Approved Insurers to meet the requirements for Fidelity Bond and E&O insurance?

F. Quality Control

14. What are the relative costs and benefits for Approved Insurers to implement the draft quality control requirements in the PMIERs?

15. Do the draft quality control standards present any unintended consequences?

G. Financial Requirements

Grids

16. What comments or suggestions are there related to the grid framework for performing loans in calculating the Financial Requirements?

17. What comments or suggestions are there related to including LTV and credit score as the primary factors in the grid framework for performing loans?

18. What comments or suggestions are there related to the treatment of HARP loans in calculating the Financial Requirements?

19. What comments or suggestions are there related to the treatment for non-performing loans in calculating the Financial Requirements?

20. Is the segregation of books of business by vintages appropriate?

21. How often should the grids be updated?

22. What comments or suggestions are there related to employing a remaining life of coverage loss horizon in calculating the grids?

23. What comments or suggestions are there related to the use of multipliers for certain loans with certain high risk features?

24. It is common underwriting practice to consider additional factors that help reduce or offset risks associated with higher DTIs (often described as compensating factors). Should the Enterprises take compensating factors into consideration when determining risk multipliers as described in Exhibit A, table 3a? How should compensating factors be incorporated into table 3a?

25. An alternative would be to have several DTI risk multipliers, for example, 43%, 45%, 47% and greater than 50%. What are the merits or drawbacks of this approach?

Macroeconomic Scenarios

26. What comments or suggestions are there related to using the house price, interest rate and unemployment rate projections from the CCAR Baseline scenario for calculating the grids for Pre-2009 and delinquent policies?

27. What comments or suggestions are there related to using the house price, interest rate and unemployment rate projections from the CCAR Severely Adverse scenario for calculating the grids for non-HARP Post-2008 policies?

28. What comments or suggestions are there related to using the house price, interest rate and unemployment rate projections from the CCAR Baseline scenario for calculating the grid values for loans refinanced through HARP?

Available Assets

29. What is the appropriate frequency for an Approved Insurer's senior management team to certify compliance with the available and minimum required asset provisions of Section 704?

30. What suggested changes are there to the categories either included or excluded from the definition of Available Assets?

31. What comments or suggestions are there related to the proposed treatment of premium income in Available Assets?

32. Should the proposed treatment of premium income in Available Assets be aligned with the exclusion of premiums that currently occurs as part of state regulatory calculations?

33. Should premium income for the Post-2009 vintages be included in the calculation of Available Assets, and if so, should the inclusion of this premium income be limited to the transition period, or should it extend beyond the transition period? What would be an appropriate phase-out and/or haircut for premium income credit given during the transition period?

34. Should unearned premium reserves (UPR) be included in the calculation of Available Assets? Should there be different treatment of refundable versus non-refundable premium?

Alternative Approaches

35. Should an alternative approach to determining Minimum Required Assets be considered in the future? If so, please describe the approach.

Limitations Triggered by a Minimum Required Assets Shortfall

36. What comments or suggestions are there related to the limitations triggered by an Available Assets shortfall to the Minimum Required Assets Amount described in Section 706 if they were expanded to include:

    a. Paying dividends, making any payments, or pledging or transfer asset(s) to any affiliate or investor; and

    b. Assuming any obligations or liabilities other than those arising from mortgage guaranty insurance policies.

Risk Sharing and Reinsurance

37. Should risk sharing or reinsurance transactions that do not receive full credit for the risk transferred under GAAP or SAP be permitted, and, if so, what limitations should there be on such transactions?

38. What would be the impact of the draft Financial Requirements, if any, on Approved Insurers who are considering writing pool level insurance on pools with LTVs below 85 percent?

Third-Party Opinion and Risk Analytics

39. Should the requirements of a third party opinion or analysis in Section 703 be restricted to a particular purpose, triggering event, and/or frequency?

Overall Impact

40. What may be the impact, if any, on high LTV borrowers of the draft PMIERs?

41. What may be the impact, if any, on low credit score borrowers of the draft PMIERs?

42. What may be the impact, if any, on Seller/Servicers of the draft PMIERs?

43. What may be the impact, if any, of the draft PMIERs on Approved Insurers who are considering writing forms of insurance that are different from the traditional loan-level, borrower-paid mortgage insurance (BPMI) ?

H. Failure to Meet Requirements (Post-Transition Process)

44. Are the remediation measures sufficiently comprehensive? Should the number of measures be reduced, expanded or refined and, if so, how?

45. Do the remediation measures present any unintended consequences or operational constraints?

46. Are there remediation frameworks that would serve as an alternative to the proposed approach?

47. Should the PMIERs include an appeals process to provide an Approved Insurer with a means to dispute remediation actions taken by the Enterprises? If so, what should that process consist of and should it apply to all remediation actions or to a subset?

I. Newly Approved Insurers

48. What financial and business requirements should be placed upon new entrants? How would such requirements affect the market for mortgage insurance?

J. Transition Process

49. What would be the appropriate length of time for Approved Insurers to fully comply with the Financial Requirements of the revised PMIERs?

50. Should the duration of a transition period for full compliance with the Financial Requirements of the revised PMIERs be consistent for all Approved Insurers or varied depending on each company's unique circumstances?