

September 5, 2014

By electronic delivery to: [www.fhfa.gov](http://www.fhfa.gov)

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

RE: Docket No. : 2014-N-9, Fannie Mae and Freddie Mac Draft Private Mortgage Insurer Eligibility Requirements: Request for Public Input

Dear Ladies and Gentlemen:

Wells Fargo appreciates the opportunity to offer comments in response to the Federal Housing Finance Agency's (FHFA's) Request for Input (RFI) on its draft private mortgage insurer eligibility requirements (PMIERS) that the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (Fannie Mae and Freddie Mac collectively, GSEs) would use to approve private mortgage insurers (PMIs) that provide mortgage insurance on loans owned or guaranteed by GSEs (Approved Insurers). We offer the following general comments in response to the questions posed in the RFI.

I. Introduction

Counterparty risk management is and ordinarily should be the business of the company taking on the risk. Therefore, Wells Fargo views the PMIERS as part of the GSE's' risk management and would normally not comment on this part of their risk management systems. However, private mortgage insurance is the key to accessing the conventional market for those with limited down payments (loan-to-value ratio greater than 80%). Because of the GSEs' charter requirement for credit enhancements, the ability for Wells Fargo to extend credit to higher loan-to-value borrowers in the conventional market depends on the availability (and reliability) of private mortgage insurance. It is important that risk management controls are well designed in order to assure broad access to credit.

II. Contracting and Governance

*The GSEs' reservation of the right to interpret contracts will inhibit the PMIs' ability to operate effectively.* The current structure of the PMIERS allows GSEs discretion to unilaterally change the rules in the future without notice or comment. Investors in PMI companies need confidence that the "rules of the road" are going to apply to the PMIs consistently. The uncertainty in the PMIERS should be removed or it will be difficult for PMIs to raise capital in equity markets as needed, maintain and attract investors,

or be viable mortgage insurers in the future. Such “sole discretion” clauses in the PMIERS create inconsistency between GSEs regarding the decisions both to change and to enforce individual requirements.

*The PMIERS should require the GSEs to establish clear and consistent contracts rather than allow reliance on vagueness and uncertainty.* The PMIERS provide the GSEs with the authority to establish and monitor unspecified scorecards and performance goals for Approved Insurers. If the unspecified goals are not met, the GSEs have the right to demand a remediation plan that allows for broad GSE control over Approved Insurers’ business operations. The PMIERS don’t allow for an appeal process. The GSEs can suspend a PMI even if the GSE merely suspects that the PMI is “about to violate” any of the PMIERS. This should be addressed and corrected. Suspension or termination of a PMI should only be for capital inadequacy and not solely for an alleged or confirmed contract or process requirement violation.

### III. Business and Operational Requirements

*The PMIERS must not unfairly advantage the GSEs over non-GSE PMI customers and the priority of state regulators must be clearly established.* The National Association of Insurance Commissioners is currently working with state regulators on updating mortgage insurer regulations<sup>1</sup>. These regulations, alongside the PMIERS, have the potential for significant conflict or overlap (where one standard is clear and the other vague). Moreover, while the GSEs are careful to repeat that the PMIERS are not regulations per se since the GSEs are not regulators, nonetheless, the PMIERS create and retain significant ability for the GSEs to advantage their claims (ahead of, for example, HFAs, private-label securitizations, etc.) in the event of a mortgage insurer credit event. Managing PMIERS and state regulatory requirements may create duplicative business and management processes within the PMIs, resulting in unnecessarily added costs to the system, ultimately borne by potential homebuyers. Additionally, because the GSEs may exist in a different legal structure in the future, overlapping PMIERS and state regulations should be considered carefully, with conflicting requirements eliminated, overlapping processes harmonized and priority of state regulations clearly established.

*The PMIERS require certifications that cannot be made.* According to Section 100 of the proposal, “an authorized officer of the approved insurer’s senior management must provide an annual written certification that the approved insurer has met all the requirements of these PMIERS.” The proposal contains many additional examples of eligibility requirements that include vague requirements that are impossible for a PMI to certify against. Examples include Section 401, Evaluation of Loan Eligibility and Borrower Credit-Worthiness and Section 402, Property Valuation (among others). The requirement to certify against uncertain standards can ultimately result in lack of business control by the PMI or program termination, which can lead to unnecessary market instability and investor reluctance to invest. Further, lenders need to change how they conduct business with PMIs going forward so that the PMI can

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<sup>1</sup> [http://www.naic.org/cipr\\_topics/topic\\_mortgage\\_insurance.htm](http://www.naic.org/cipr_topics/topic_mortgage_insurance.htm)

attempt to be compliant with the mandated certifications. This change in business process will be costly and inefficient for lenders and consumers, which could impact overall usage of certain PMIs.

*The PMIERS contain eligibility requirements that may conflict with PMI Master Policy now and over time.* Most notable is Section 405, Independent Validation for Early Rescission Relief. When granting relief an Approved Insurer must ensure each loan is reviewed by a qualified underwriter who has no association of any kind with the loan, the loan's prior underwriting, or the lender. "Independent Validation" is already a defined term in the new (GSE approved and directed) Master Policies. Including this reference in the PMIERS will create a dual requirement that has different levels of clarity that will create confusion and generate inconsistency. It is inappropriate for requirements of the Master Policy to be captured in the PMIERS. Furthermore, this requirement is either impractical or impossible to meet, will add significant cost to the transaction and is another example of requirements that may be impossible to certify against.

*The PMIERS contain manufacturing and quality control requirements that are unnecessarily manual, inefficient, inhibit competition and add costs to the loan transaction.* A notable example includes Section 404, which addresses use of automated underwriting systems by an approved insurer or delegated underwriter. The PMIERS require either advanced processes of statistical validation of AUS models or manual re-underwriting of AUS files for system due diligence germane to any subsequent AUS version model updates. Similar inefficiencies persist in the Pre- and Post-Closing QC review requirements noted in Sections 500-505. A PMI underwriting/delegated underwriting program based on quality upfront loan manufacturing processes and automated underwriting backed by strong, clear, and enforceable contractual representations and warranties is a vastly more efficient system that will meaningfully reduce costs for consumers. Alternatively, there may be cases where a PMI chooses to engage in 100% due diligence but in exchange offers better terms for sun-setting representations and warranties. Lenders and PMIs should be able to establish counter-party quality control mechanisms and contractual requirements that make sense to them and would be approved by the GSEs as applicable, as opposed to being forced to comply with requirements that are set administratively and will add costs to the loan origination process.

#### IV. Financial Requirements

*Setting both capital standards and expected rates of return undermines healthy competition and will be costly to consumers.* While the adequacy of capital standards will likely be addressed by the PMIs, the GSEs and FHFA also contemplate<sup>2</sup> "expect(ing) an Approved Insurer to maintain 'adequate' risk-adjusted rates of return". By setting both capital requirements and target rate of returns, the GSEs are overstepping their authority and removing the PMIs' flexibility to manage their own businesses by, in effect, setting prices. Setting prices in this way, in a competitive industry, is entirely inappropriate.

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<sup>2</sup> Questions 2 and 3 of the FHFA's "Overview of Draft Revised Private Mortgage Insurer Eligibility Requirements"

*Strong capital standards and adequate management of risks by PMIs need to coexist while being appropriately balanced.* Capital levels need to be robust enough to ensure that GSEs are comfortable with a PMI's ability to repay its claims and FHFA is comfortable with the GSEs counterparty exposure. Once this is achieved, the GSEs and FHFA should focus on risk management practices that have a material impact to the PMIs' ability to meet the prescribed capital levels and be less concerned with the level of administrative control, contractual vagueness, and onerous certification requirements reflected in the comments above.

#### V. Summary

Wells Fargo agrees that strong capital requirements are critical to ensuring the safety and soundness of the industry going forward, while still allowing for vibrant competition. However, Wells Fargo is concerned with the structure of contracting being deployed by FHFA and the GSEs, as set forth in the above examples. The use of contracts of adhesion generally dictates that the interpretation of the document will be "against the drafter" to, among other reasons, mitigate the perceived one-sidedness in take-it-or-leave-it contracts. The draft PMIERS very clearly fall within the definition of a contract of adhesion, and by asserting too much authority, invite litigation that could introduce uncertainty not only for the GSEs ability to manage counterparty risk but also the greater mortgage finance system. In addition, Wells Fargo believes that PMIERS unnecessarily rely on outmoded manual underwriting and due diligence procedures that will only serve to raise costs for homeowners.

Ultimately, private mortgage insurance is an essential precondition for many low-wealth families, including first-time homebuyers, and families whose home values have greatly depreciated. Prudent counterparty risk management must be carefully structured to avoid adding unnecessary costs to the system at the expense of market access for these households.

Wells Fargo thanks the FHFA for this opportunity to provide input on the mortgage insurance process, and looks forward to collaborating with the FHFA and other stakeholders in creating long-term solutions that benefit all consumers.

Sincerely,

John P. Gibbons  
Executive Vice President – Capital Markets  
Wells Fargo Home Mortgage