



**Mortgage
Insurance
Companies
of America**

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Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel, Switzerland

Ladies and Gentlemen:

The Mortgage Insurance Companies of America (MICA) is pleased to comment on the Basel Committee's consultative paper on liquidity risk management. In general, we urge its rapid completion and quick adoption by national authorities.

In this regard, we think it essential not only that appropriate liquidity risk standards apply to banks, as proposed, but also to securities firms. As you know, investment banks have played a major role in the U.S. and global mortgage and structured finance markets, issuing high risk products now contributing to the financial system's profound problems. If necessary and sometimes costly liquidity risk requirements apply only to commercial banks, then financial activity will move to the "shadow banking system" now the subject of urgent attention. At the least and at the outset, standards comparable to those proposed by the Committee should apply to regulated securities firms which are critical systemic risk entities, even as consideration continues on additional measures to stabilize financial markets.

With specific attention to issues in the consultative paper that affect private mortgage insurance, MICA has the following comments:

- We urge adoption of the proposed treatment for recourse, guarantee and similar off balance sheet obligations (Paragraph 31), as these risks are painfully apparent in current financial markets but ill captured under current capital and risk management requirements. It is critical that all commitments not only have capital at risk to ensure they can be met, but also be backed by funds with which to meet unexpected market demands under stressed conditions.
- We urge more specific attention to any liquidity risk requirements applicable to "monoline insurers" (Paragraph 40). We recognize that issues in the monoline bond insurance sector have been seriously problematic, but

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private mortgage insurance derives its strength from its monoline structure. In sharp contrast to bond insurance, mortgage insurance under U.S. insurance regulation (as imposed under applicable state law) is capitalized to handle catastrophic mortgage related claims, may not be associated with high risk; non-traditional activities and is capitalized by assets without correlation risk to residential mortgages. Undifferentiated liquidity risk requirements applicable to all monoline insurers will unduly deter reliance on proven forms of credit risk mitigation, increasing banking and financial system risk.

I. Off balance Sheet Commitments

MICA would like to commend the Committee for its proposed standards that recognize the liquidity risk associated with recourse, guarantees and similar arrangements and urge its inclusion in the final liquidity risk requirements. We also ask the Basel Committee to emphasize this issue in its final document to highlight its importance for national supervisors and ensure it is addressed in implementing regulations around the world.

The Basel II standards have significantly improved capital recognition of the credit and operational risks associated with recourse and other off balance sheet structures. However, current market developments make clear that off balance sheet risks are often a proxy form of credit risk mitigation structured to promote fee income without full anticipation of actual risk exposure through disciplined underwriting. The proposed liquidity risk standards are thus essential. However, they should also be supplemented by additional supervisory standards, most notably with regard to the reputational risk issues mentioned in the consultative paper in numerous places.

On balance sheet credit risk mitigation - including that offered by private mortgage insurance (MI) - is capitalized to ensure that all commitments can be met under even catastrophic stress scenarios, with full attention not only to credit risk requirements, but also to liquidity and other strains. These bulwarks of course come at a cost, but they ensure reliable risk mitigation. This in turn not only protects those purchasing credit risk mitigation, but also the financial system more generally. As a provider of credit risk protection meets its obligations, markets are insulated from stress and even panic, preventing contagion risk in individual nations and across the global financial system. Thus, the Basel Committee should ensure that off balance sheet risk transfer structures are as prudentially capitalized and funded as other forms of risk mitigation. It should finalize its proposal and work with national

supervisors to ensure its broad adoption in strong and enforceable terms.

II. Monoline Insurance

As noted, MICA understands that recent experience related to monoline bond insurance has troubled global regulators. However, we would note a critical difference between private mortgage insurance which in the U.S. must be provided in monoline companies and bond insurance: MI may not be associated with high risk, non-traditional products. For example, monoline bond insurers used "transformer" structures to put high risk credit derivatives in affiliates outside their regulatory capital and prudential limits even though the bond insurer was actually liable for the risk. Mortgage insurers are prohibited from doing this. In addition, many bond insurers held capital in assets directly correlated with those of the non-traditional obligations for which they provided a financial guarantee. Thus, when a loss on an investment was realized by an investor and a claim was placed on the bond insurer, the insurer was likely to hold a comparable investment that increased its loss exposure and simultaneously reduced its capitalization. This too is prohibited for private mortgage insurance.

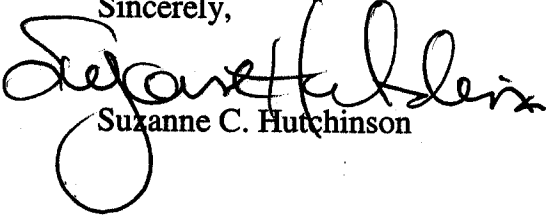
MI is required under applicable regulation to hold capital sufficient to meet commitments even under catastrophic risk scenarios. As of year-end 2007, MICA's members held \$13.6 billion in total capital and \$8.5 billion in loss reserves positioned against \$185.4 billion of insurance risk in force. MIs are subject by law to a uniquely strong reserve requirement that adds to basic capital standards since mortgage losses tend to concentrate during periods of high default rates. The law requires that fifty percent of every premium dollar generated by mortgage insurers be put into a contingency reserve and generally not accessed for 10 years. This system has allowed mortgage insurers to build reserves over the last fifteen years. As a result, MIs have a capital to risk ratio of 7.3 percent without taking into account the loss reserves – a ratio that compares very favorably to that at insured depositories for mortgage assets.

Thus, we urge the Committee to delete from the final guidance a generic statement related to monoline insurance risk and replace that with a provision requiring banks to evaluate all credit risk counterparties and hold liquidity sufficient to anticipate claims paying capacity under rigorous stress scenarios.

MICA very much appreciates the Basel Committee's attention to liquidity risk and the rapid pace at which final standards may be

released. We would be pleased to provide whatever additional assistance we can in this urgent effort.

Sincerely,

A handwritten signature in black ink, appearing to read "Suzanne C. Hutchinson". The signature is fluid and cursive, with a large loop at the end of the last name.

Suzanne C. Hutchinson