Mortgage Insurance Companies of America

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Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
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Ladies and Gentlemen:

The Mortgage Insurance Companies of America (MICA) is pleased to comment on the Basel Committee on Banking Supervision's latest consultative paper on "Strengthening the resilience of the banking sector."[1] In this letter, we shall focus on aspects of the consultative paper affecting regulatory capital; a separate letter provides our views on liquidity-risk management.

MICA represents the interests of the United States private mortgage insurance (MI) industry, which currently insures $850 billion of residential mortgages with high loan-to-value ratios[2] in the United States. Although MICA's focus is on U.S. matters, we would note that MI is an important feature not only in the United States, but also in other developed and developing national mortgage markets. MICA has a keen interest in ensuring that bank lending and securitization practices in the residential-mortgage sector are prudent and support sustainable home ownership that protects borrowers, lenders, investors and communities. Regulatory-capital requirements are, of course, a critical determinant of prudent lending and securitization practice – when risk-based capital appropriately reflects real risk, it aligns capital incentives with broader prudential ones. However, when capital incentives are misaligned, significant damage may result, as has proved to be the case with residential mortgage loans in recent years. Further, as the Basel Committee on Banking Supervision (the Committee) recognizes, inappropriate capital requirements are procyclical and those imposed on mortgages have unfortunately contributed to the boom-bust cycle now wreaking so much havoc in both the United States and the global financial system.

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[1] Basel Committee on Banking Supervision [BCBS], *Strengthening the Resilience of the Banking Sector*, Consultative Document (December, 2009), *available at* http://www.bis.org/publ/bcbs164.pdf?noframes=1.

[2] Residential mortgage loans where the borrower has made a cash downpayment which results in the ratio of the mortgage loan amount to the appraised value of the house above 80%.

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Anticipating this, MICA has filed a series of comment letters with the Committee and U.S. regulators since the first consultative paper in 1999, providing an array of data to urge appropriate risk-based capital requirements that account for residential-mortgage credit risk over the full business cycle. The Basel Committee of course has letters to the Committee on file, but we would be pleased to provide copies of these or other letters to regulators and expand on our prior comments. These have focused on recognizing the vital importance of equity in mortgage lending (that is, the fact that loan-to-value (LTV) ratios are a prime credit-risk determinant), the need for higher asset-correlation factors for high-LTV mortgages, the vital importance of appropriate stress testing and, finally, the value of MI as a form of credit risk mitigation (CRM) that should be reflected in the risk-based capital regime

In this letter, MICA will make the following points:

- MI is a proven, transparent form of CRM with counter-cyclical capital that backs its commitments under a stringent regulatory framework that ensures meaningful credit-risk protection. MI is not vulnerable to the wrong-way risk recently experienced in monoline bond insurance or the trading risks and similar hazards found with regard to credit default swaps (CDS). Because MI is private capital at risk throughout the origination and securitization process, MI incentives are aligned with those of borrowers and investors, avoiding the need for costly risk-retention or similar requirements that could suppress otherwise-prudent market activity. In fact, mortgage insurance meets the credit risk transfer (CRT) standards detailed in the recent report on this topic by the Joint Forum.[3] Third-party capital from capitalized, regulated CRM providers like mortgage insurers will supplement banking-industry capital resources and permit rapid implementation of a robust regulatory-capital regime with minimal, if any, adverse credit-availability or macroeconomic consequences.

- MICA supports the thrust of the consultative paper, but we urge caution and careful calibration to ensure that the rules do not adversely affect credit availability and thus undermine market recovery. If the rules are so strict that the Basel Committee and national regulators are compelled to phase them in over many years, then the rules will have little impact and could in fact lay the foundation for another

[3] The Joint Forum, *Review of the Differentiated Nature and Scope of Financial Regulation*, Key Issues and Recommendations (Jan. 2010), *available at* http://www.bis.org/publ/joint24.pdf?noframes=1.

boom-bust cycle. Thus, the capital regime should be balanced and rely to the greatest extent on regulated, capitalized providers of CRM like MI.

- Based on the above, MICA urges care with regard to the leverage standard. If the final Basel II rules include a leverage standard, as proposed, it should reflect guarantees provided by regulated, capitalized CRM providers. To keep this simple (as required for a leveraged, not risk-based, approach), credit in the leverage rule would be provided only for simple, first-loss, loan-level guarantees and only to the extent of the guarantee.

- MICA supports the elimination of credit rating agency (CRA) criteria for certain CRM recognition, but we urge parallel treatment for insurers with bank or securities-firm guarantors. Insurance firm CRM is, like that provided in MI, backed by regulated institutions with specific capital requirements supported by meaningful enforcement sanctions (including the power to shut down an under-capitalized provider). It thus is at least as proven a form of CRM as that provided by banks and securities firms. Indeed, it is more reliable than that provided by these entities. As the Basel Committee knows all too well, bank guarantees have to date been backed by little, if any, regulatory capital because of their off-balance sheet treatment. While the Committee is working hard to remedy this failure, bank capital for guarantees has yet to rise to levels already held by MIs for comparable risk. Further, securities firms in many jurisdictions lack any capital to back guarantees, as broker-dealer net capital requirements or similar standards do not recognize credit risk taken in the form of guarantees. As a result, such securities-firm guarantees are essentially uncapitalized, in contrast to those provided by regulated insurers. Comparable treatment for insurers is also compatible with the recent directive from the Group of Twenty (G-20) to global regulators to provide comparable regulatory treatment across financial sectors to the greatest degree possible.[4]

- We also urge the Committee to delete provisions that allow recognition of CRM provided by parent firms or affiliates

[4] G-20, Working Group 1, *Enhancing Sound Regulation and Strengthening Transparency*, Final Report (Mar. 25, 2009), *available at* http://www.g20.org/Documents/g20_wg1_010409.pdf.

due to the conflicts of interest that result and the lack of real risk reduction in such arrangements.

- MICA strongly supports proposed strengthened stress-testing and similar concepts to ensure regulatory capital is ample over the full life of a loan, not just as determined under benign conditions. This builds on our public comment letter issued before the current mortgage-market crisis and we are pleased now that the consultative paper proposes several ways to enhance counter-cyclical capital reflecting real risk. In our technical comments, we propose how this should be done with specific regard to residential-mortgage risk on high LTV loans.

It is our understanding that the Basel Committee, in conjunction with the International Organization of Securities Commissions (IOSCO), is working on draft principles to ensure appropriate asset securitization. MICA endorses this effort and looks forward to working with you to enhance global standards in this vital area. In promulgating these standards, MICA urges the Basel Committee to ensure appropriate coordination between securitization requirements and the capital, liquidity and other prudential standards now in development to ensure that all rules are appropriately calibrated and balanced to permit ongoing securitization that includes a vital role for private capital. Absent careful consideration of the vital role of private capital, asset securitization, especially in the mortgage sector, could become an entirely government-dominated one, which is not appropriate in light of the need to have private-sector housing finance instead of putting taxpayers at risk when private capital stands ready to engage in appropriate, prudential market activity.

To enhance the role of private capital in mortgage finance, MICA also draws the Committee's attention to the discussion of global mortgage underwriting and securitization standards in the recent Joint Forum statement noted above.[5] These standards would reflect not only the prudential concerns reflected in the Basel Committee's risk-based capital regime, but also vital consumer-protection ones specific to the mortgage sector. Action on them will enhance national standards in this vital sector, ensuring a consistent framework that enhances credit availability for sustainable home ownership around the world.

I. Current Structure of Private Mortgage Insurance

As noted, private mortgage insurance is a prominent feature not only in the United States mortgage market, but also in other nations,

[5] *See supra* note 2.

especially those focused on ensuring that low-down payment mortgages – especially important to low- and moderate-income individuals and/or first-time home buyers – are an important part of their national housing-finance system. The World Bank, International Finance Corporation and other multinational development banks have likewise shown consistent interest in the use of MI in emerging housing finance systems. National regulatory schemes for MI vary, but in all cases a strong regulatory framework is essential for a prudential MI system upon which the banking sector of a nation depends. MICA believes that the U.S. regulatory framework for MI has proven to be valuable in ensuring a sound, capitalized form of credit risk mitigation in the U.S. Our comments below will thus generally focus on U.S. developments. We would note, however, that the Joint Forum of global banking, securities and insurance regulators has recently taken a favorable view of the importance of MI for international mortgage markets, noting that:

> Mortgage insurance provides additional financing flexibility for lenders and consumers, and supervisors should consider how to use such coverage effectively in conjunction with LTV requirements to meet housing goals and needs in their respective markets. Supervisors should explore both public and private options (including creditworthiness and reserve requirements), and should take steps to require adequate mortgage insurance in instances of high LTV lending (e.g. greater than 80 percent LTV).[6]

As noted, creditworthiness and reserve requirements are vital to ensuring that MI is robust mortgage CRM. These demonstrably exist in the U.S. regulatory structure for private mortgage insurance, as evidenced by the fact that private MIs have absorbed over $15 billion in losses since the start of the current U.S. mortgage crisis. In fact, even as the crisis continues, private capital is coming into the U.S. MI industry, demonstrating not only MI resiliency, but also investor confidence in it.

To be sure, recent events have strained the industry in general and some firms in particular, but a unique feature of U.S. MI capitalization has ensured ongoing claims-paying capacity. This is the “contingency reserve,” a form of capital analogous to the counter-cyclical capital structures extensively discussed in the consultative paper. In the U.S., mortgage insurers are generally required to hold half of every premium dollar in this reserve for ten years to ensure that firms can withstand even catastrophic-risk scenarios such as the one recently experienced in

[6] *See supra* note 2, at page 17.

the U.S In Australia, Canada and elsewhere MI premiums are paid up front, so the catastrophic reserves are essentially held in unearned premium reserves.

MIs are distinguished not only by counter-cyclical capital, but also by regulatory policy that prevents specific wrong-way risk. Simply put, U.S. MIs are not permitted by applicable state insurance law or rule to invest in mortgage-related assets. MIs are monoline insurers – they may provide only protection for residential mortgages but, in sharp contrast to monoline bond insurers – which in fact invested in precisely the same complex structured investments that they insured – MIs may hold only resources with minimal correlation to the mortgage risk they insure. This buttresses counter-cyclical capital to ensure claims-paying capacity under stress because wrong-way risk is averted.

In addition to their capital resources with which to honor claims, MIs can also play a critical role in providing market discipline (that is, Pillar 3) support for prudent mortgage practices. Because MI is generally in a first-loss position, considerable care needs to be taken at loan origination to ensure that mortgages in fact meet all the terms and conditions appropriate for insurance coverage. When properly implemented by both the MI and the lender, this second underwriting can help to ensure that insured loans sold into secondary markets or held in bank portfolios meet designated underwriting criteria.

The monoline structure also provides MIs with another prudential benefit: the franchise value of each mortgage-insurance firm relies on its claims-paying capacity and – importantly – its willingness to honor all valid claims. If MIs failed to meet their valid commitments, they would find themselves frozen out of the mortgage-insurance business and, as monolines, they would thus cease to exist. We understand that some have suggested that MIs are shirking claims-paying responsibilities as rescissions have recently risen, but MICA strongly refutes this suggestion. Rescission – denial of claim – is not only legally appropriate, but also a sound prudential response when fraud or similar gross negligence has occurred. Were MIs to pay claims even for fraudulent mortgages, it would create the same heedless risk-taking incentives that property-and-casualty insurers rightly address when they refuse fire-damage claims resulting from arson. If moral hazard is not to become the watchword of mortgage finance, rescission must occur by any party with legal rights to do so related to counterparty failures.

Finally, it is important that banks have a reliable form of credit risk mitigation tailored to the needs of residential mortgage loans. The appropriate CRM should be well capitalized and proven to withstand historic stress situations as are now being experienced in the United

Stated. In this regard, the CRM also should not exacerbate market volatility. MICA notes that MI is not a traded, uncapitalized instrument like credit default swaps (CDS) and similar instruments. It thus plays no role in market volatility, as evidenced in recent sovereign-debt arenas that have sparked calls in the European Union for a flat ban on CDS trades by dealers without the capital to honor any credit-risk commitment related to the CDS should it fall to them to do so. The United States, European Union and Financial Stability Board have embarked on a reform agenda designed to ensure that CRM provided through risk-transfer structures like CDS are reliable, capitalized and transparent. Unless and until such reforms are enacted and, then, proven under stress, the Basel Committee should not permit banks to reduce risk-based capital based on nominal support through CDS or other structures.

II. Capitalized CRM Promotes Prudent Implementation of the Revised Risk-Based Regime

As the foregoing demonstrates, MI is a proven, regulated and well-capitalized form of credit risk mitigation structured to absorb even the catastrophic risk now evident in U.S. and other mortgage markets. As a result, MI is an example of the third-party capital available to absorb risk in banking organizations that, if properly reflected in the revised Basel II Accord, will minimize reductions in credit availability and any resulting slowdowns in economic recovery from revised, rightly-tightened regulations.

The consultative paper rightly notes problems that could ensue if the regulatory-capital rules are not carefully calibrated and then phased in with requisite transitions.[7] MICA concurs with this, noting the adverse impact a sudden reduction in mortgage credit availability would have in the U.S.'s ongoing recovery. However, we would also note that deferred regulatory-capital regulation may deny ultimate reform because, by the time current reforms are finally implemented, markets will have restructured and taken on new risk. An over-long transition period also creates undue incentives for banking organizations to take risks not appropriately captured in current rules in hopes that these will bolster profits or enhance competitiveness before new rules take effect – in essence, gambling with current capital in hopes of being ready for new rules down the road.

Determining the precise point at which implementation of the new rules will curb abuse and yet not prevent recovery is, of course, a difficult decision. The Basel Committee is thus correct to undertake the parallel quantitative impact surveys and calibration exercises now

[7] See *supra* note 1, paragraph 10.

under way in conjunction with the consultative paper. MICA urges, however, that the Basel Committee propose a final, unconditional implementation deadline for the new risk-based capital regime in the final set of new standards, ensuring appropriate recognition of third-party, robust CRM in the rules to cushion any adverse impact on any banking organizations that remain under-capitalized at that time.

III. Leverage Ratios Should Reflect Robust CRM in a First-Loss Position

MICA has long been concerned that a simple leverage ratio would undermine the appropriate incentives of a well-calibrated risk-based capital regime. We have commented to this effect in both U.S. and Basel Committee statements, noting in part that the fact that extremely prudent, low-LTV mortgages carried the same minimum capital requirement in the United States without appropriate risk-based differentiation was a major capital incentive that drove high-risk activities such as huge portfolios at large banking organizations in second-lien mortgages.

MICA understands that the Basel Committee has now determined to include a leverage standard in the revised global Accord.[8] We commend the decision to do so with caution, adopting the leverage standard only as a Pillar 2 standard to enhance the discipline of the risk-based rules and address any problems resulting from the models risk that may be found in the way banks implement the advanced options under the new Accord. We would recommend another consultative paper and very careful review in advance of any decision to consider transferring the leverage standard from Pillar 2 to Pillar 1.

We would also recommend revision to the leverage standard to limit its adverse impact as a driver of perverse incentives to take risk. As in the mortgage case cited above, a leverage rule that does not reflect risk will lead banks to take it, especially if risk-based standards do not fully reflect risk mitigation. Because the risk-based rules provide only limited recognition for proven forms of CRM like private mortgage insurance the leverage rule could lead banks to rely on self-insurance or even no insurance for high-risk positions to "game" the leverage requirement. To prevent this and yet retain the simplicity associated with a leverage standard, MICA urges the Basel Committee to revise the consultative paper. As proposed, the leverage standard would in no way recognize CRM. MICA believes it should be revised to permit deduction from the leverage standard of any asset backed by a qualified, capitalized and regulated CRM provider up to the amount of any irrevocable first-loss credit risk transfer commitment.

[8] See *supra* note 1, paragraphs 202-238.

This change would not only prevent perverse-incentive results from the leverage rule, but also encourage reliance on third-party capital to promote rapid implementation of critical risk-based capital reforms without adverse market macroeconomic impact. In many nations – throughout the European Union, for example – the leverage proposal is perhaps the most problematic of all those in the consultative paper because no comparable requirement now exists. To mitigate unnecessary harm and ensure quick implementation of the Accord as a whole, the leverage standard should be adjusted as noted to reflect the value of third-party credit risk mitigation.

IV. CRM Providers Should Not be Judged by CRA Rating and Be Fairly Reflected in the Capital rule

A. CRA Standards

Paragraph 198 of the consultative paper would revise paragraphs 195 of the current Accord to delete the A or equivalent rating requirement from the current eligibility requirement for credit risk mitigation providers. Instead of the A or equivalent rating, the CRM provider would need only to have a lower risk weight under the Accord than the obligation being covered. As noted in the consultative paper, this would address the "cliff effect" observed when CRM ratings fall and banking organizations are thus faced with sharp, sudden need to raise capital or divest assets. MICA supports this change, with the additional revision discussed below. We concur that the cliff effect has exacerbated recent financial-market strains.

However, we would add more broadly that the Basel standards, like all national and global rules, should rely to the least possible extent – if at all – on credit rating agencies. The U.S. Securities and Exchange Commission (SEC) has recently noted that regulatory-reliance on CRAs creates an "official seal of approval" for CRAs that leads investors and even regulators to neglect their own credit-risk analytics.[9] The SEC expressed this concern despite numerous reforms prompted in part by new standards from IOSCO[10] making clear that regulators believe that even recent reforms are not enough to ensure appropriate protection from CRA conflicts of interest, methodology problems or other concerns. Of course, the more investors rely on CRAs, the greater the "cliff effect," contributing to the market power that has led

[9] Securities and Exchange Commission, *References to Ratings of Nationally Recognized Statistical Rating Organizations*, Final Rule 74 Fed. Reg. 52358 (Oct. 9, 2009), *available at* http://edocket.access.gpo.gov/2009/pdf/E9-24364.pdf.
[10] IOSCO, *Code of Conduct Fundamentals for Credit Rating Agencies* (May 2008), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf.

many CRAs to abuse their status and provide AAA or similar ratings for very high-risk obligations structured solely to win CRA approval.

B. Treatment of Insurance CRM

However, while we support the general revision related to CRAs for credit risk mitigation, the consultative paper should be revised to provide this treatment to all regulated CRMs that provide robust, capitalized credit-risk protection. Paragraph 198 would not revise paragraphs 195 and 302 of the current Accord, which limit preferential CRM recognition to sovereigns, public-sector entities (PSEs), banks and securities firms. Indeed, this favorable approach applies not only to CRM provided in the form of capitalized guarantees and similar structures, but also if a bank or securities firm offers CDS or similar credit derivatives. As has been amply demonstrated in the current financial-market crisis, many of these structures are trading instruments, not legitimate CRM and all too many entities offering them – even if housed in banks or securities firms – lack the capital to honor their commitment.

In fact, as noted above, many securities firms are not subject to regulatory capital designed to handle credit risk. It is thus most unclear why securities firms should be granted equivalent treatment to sovereigns, PSEs and banks even as insurance companies – where regulatory capital is of course required to ensure claim-paying ability – are excluded. In the United States, for example, securities broker-dealers are subject only to a net capital requirement[11] designed to ensure that broker-dealers can handle day-to-day transaction obligations, not long-term credit risk mitigation commitments. Many other nations lack even these capital requirements, an issue IOSCO is now beginning to address. Unless or until securities firm capital is revised to ensure robust capitalization related to credit-risk commitments, any such guarantees should not be granted treatment preferential to that of insurance firms.

We have above detailed the capital, supervisory and other criteria that cover private mortgage insurance. These make clear why, in the mortgage sector, MI should be granted treatment comparable with that of banks, especially given that MIs have even higher capital capacity to honor claims than many banks. This results because of the unique counter-cyclical capital structure and other prudential requirements detailed above.

Recognition of insurance CRM on terms at least comparable to that of banks and securities firms is not only appropriate because of the

[11] Net capital requirements for brokers or dealers, 17 C.F.R. 240.15c3-1 (2009).

regulated, capitalized structure of insurance, but also desirable on policy grounds. As noted above, the Group of 20 has recently called on global regulators – including the Basel Committee – to make financial-sector standards as comparable as possible across the banking, securities and insurance sector. As the Joint Forum noted in carrying out the G-20 directive, "A sector-specific approach to supervision comes with the potential for increasing regulatory gaps, which causes supervisory challenges and presents opportunities for regulatory arbitrage."[12]

C. Insider CRM Should Not Be Accorded the Same Treatment as Third-Party Guarantees

As proposed, revised paragraph 195 in the Accord would include credit protection provided by "parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor." This is retained in the consultative paper only in connection with clarifying the role of ratings, but MICA urges the Committee carefully to reconsider its broad implications and eliminate this provision. When CRM is provided by parents or affiliates, significant risk remains in the banking organization even if nominally transferred through a CRM structure like a credit derivative. Indeed, risk may be even greater because parent or affiliate CRM is not capitalized or under-capitalized and, perhaps, provided without due consideration of all risk factors and objective-pricing considerations. This can lead to significant risk concentrations in banking organizations that pose not only credit and liquidity risk, but also significant reputational concerns that can contribute not only to prudential problems, but even to the types of systemic-risk situations all too frequent in the recent market crisis.

There are numerous examples of problematic affiliate-guarantee structures, including in the mortgage sector. For example, the Japanese mortgage market relied extensively on affiliated guarantee companies that, in retrospect, proved unable to exercise independent underwriting judgment or accumulate the capital needed to honor their counterparty claims without parental support.

V. Mortgage Risk-Based Capital Refinements

As noted, MICA strongly endorses the proposed focus on counter-cyclicality in the consultative paper.[13] We have frequently urged far more stringent and uniform stress testing in our prior comments to bank regulators and to the Committee that reflected the long term cyclical nature of house prices. MICA continues to believe that, had this been

[12] See *supra* note 2, at page 3.
[13] See *supra* note 1, paragraphs 239-262.

done with regard to mortgage risk, the recent crisis would have been averted or, at the least, considerably reduced in magnitude below a systemic-risk concern.

Because of the limited historical data available to many institutions (especially performance data under true stress) in many parts of the world, many observers and analysts of the IRB formula approach have missed an additional significant behavioral characteristic that alters the response rate of borrowers with high loan-to-value (HLTV) mortgages from those with low LTVs. The IRB formulas assume that the relationship between stress conditions and expected conditions can be estimated using a single equation, while employing a differentiating correlation factor to adjust the results for certain asset classes that demonstrate specific response rates to stress changes. In the case of residential mortgage loans, the single 15% correlation factor assumes that HLTV mortgage response rates will be similar to that of low LTV loans. MICA continues to believe that the current cyclical downturn in house price in the U.S. and elsewhere[14] is showing that HLTV mortgages perform differently from low LTV mortgages under stress conditions and that the single correlation factor of 15% as applied to residential mortgages is incorrect.

The key assumption for a single correlation factor is that the cure rates from serious delinquency status (over 90 days delinquent) will be the same for all delinquent loans. While it is possible that under normal circumstances cure rates may not vary significantly between LTV segments, US historical data suggest that in regional markets under stress, the cure rates on 90+ delinquent HLTV loans can change drastically compared to the cure rates of delinquent low LTV loans.

In our comment letter to the Basel Committee dated July 31,2003, we referred to a research study with the Federal Reserve Board (FRB) on the question of the appropriateness of the 15% correlation factor for residential mortgages. The results of the study were later published by FRB staff members.[15] Both the MICA work and the FRB study

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[14] With respect to the performance of residential mortgage loans outside of the United States we note an observation made by the Financial Services Authority in a memorandum on *Variable Scalar Approaches to Estimating Through the Cycle PDs*, dated February 19, 2009 and referenced in the Committee's consultative paper. In its memorandum the FSA states in paragraph 10 that "If one of a firm's drivers for segmenting a mortgage portfolio is LTV, such approaches tend to assume that the default rates in each LTV segment increase 6X in a downturn, whereas in practice we are seeing the high LTV segments increase by, say, 8X and the low LTV segments increase by 4X)."

[15] In 2003 MICA provided data to Federal Reserve researchers examining models of mortgage portfolio performance developed to estimate stress loss levels and ensuing

estimated stress case losses by various segments and then calculated the corresponding correlation factor necessary to factor expected losses in line with such stress losses. The analysis showed that the implied correlation factor increased as the stress level increased and at increasing rates. As noted at the time, the study strongly suggested that a higher correlation factor was justified with analysis of MICA high LTV data for a geographically concentrated portfolio justifying a correlation factor ranging from 25% to 45%. The MICA diversified portfolio analysis resulted in correlation coefficients of 20% to 25% while the FRB diversified portfolio resulted in coefficients of 15% to 20%. The difference in the two sets of results was that the FRB paper assumed that cure rate levels under expected normal conditions were unchanged under stress level conditions. The MICA approach incorporated regionally observed sharply lower stress cure rates for high LTV loans in both their stress frequencies and stress LGD calculations. These observations were taken primarily from the mid 1980s and early 1990s recessions that had a very severe effect on parts of the housing markets of the US.

Analysis of sampled data from MICA-member firms beginning in 2002 demonstrates that the degree of net equity position on loans at time of default has a strong impact on observed cure rates. In the first table below we organize the cure rates by net equity position at time of default. Loans with larger degrees of net equity had substantially higher cure rates than those loans that low or negative equity positions.

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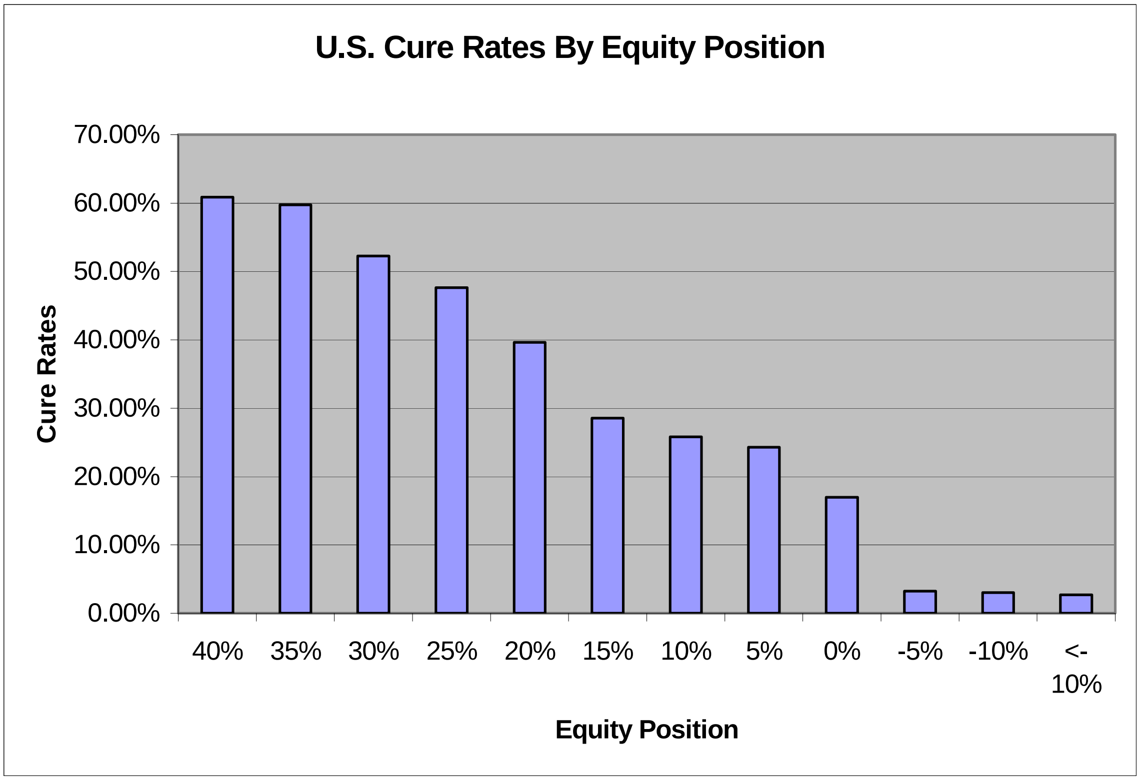
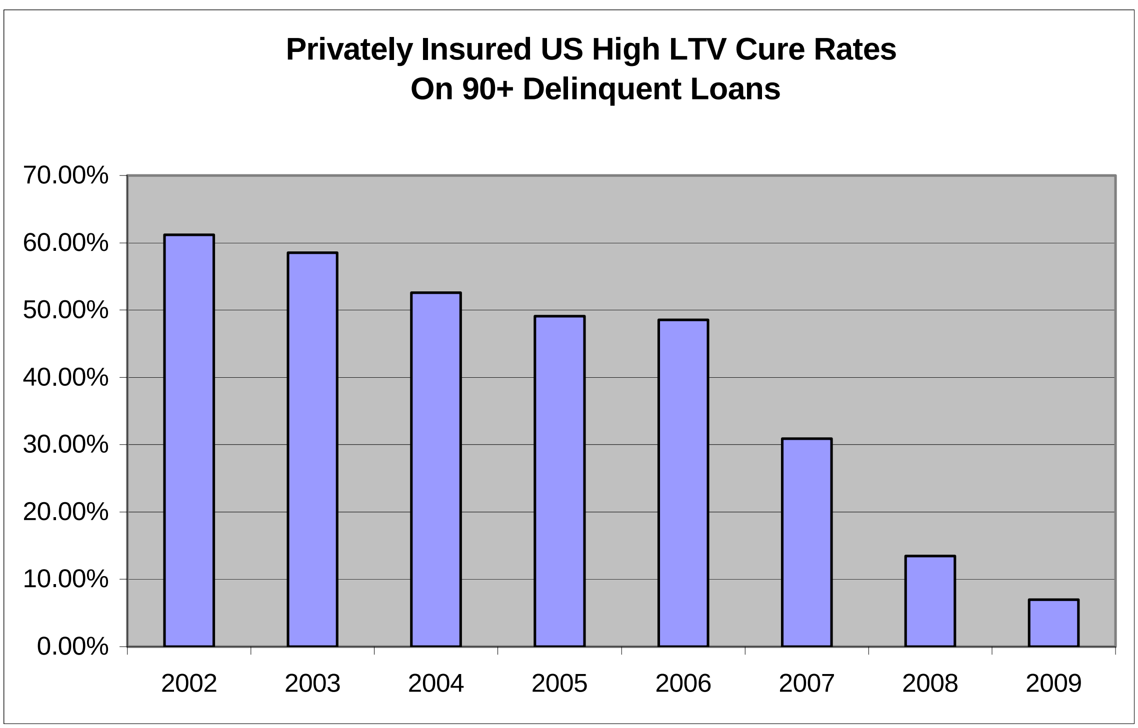
capital requirements. As part of that effort, the MICA group combined information on over 240,000 actual recovery values on defaulted loans between 1990 and 2002. Paul S. Calem and James R. Follain, *The Asset Correlation Parameter in Basel II for Mortgages on Single Family Residences*, Board of Governors of the Federal Reserve System, October 15, 2003.



The chart below shows the sampled data by year of termination.



High LTV borrowers, because of low initial downpayments are more likely to have lower net equity cushions at the time of default, and therefore have generally lower cure rates under stress conditions.

Small down payment borrowers are extremely vulnerable to changes in the value of their homes. As their equity cushion disappears with falling house prices they are more likely to default. Under the stress of falling home prices, should net equity go negative on average, the cure rates fall significantly below where they were during periods of stable or rising home prices. Analysis of sampled MICA member data shows that between the 2002 to 2006 period well over half (nearly 54% on average) of all insured high LTV 90 days+ loan delinquencies cured within twelve months. However, during the recent housing market downturn from 2007 to 2009 the comparable cure rate was significantly reduced by 87% to a less than 7% average. At such levels the data once again support the need of a correlation factor in the range of 20% to 25% for high LTV loans. As MICA's analysis is completed we will share it with U.S. regulators.

Conclusion

The Mortgage Insurance Companies of America is pleased to provide the foregoing comments to the Basel Committee. We have provided our views on both the broad policy goals of the proposal and specific mortgage-risk related components of the Accord designed to ensure that appropriate, stringent risk weights are assigned by regulators to reflect real risk over the life of an obligation and take fully into account the value of third-party capital when provided in a robust, proven form of credit risk mitigation like private mortgage insurance. We would be pleased to provide any additional information on these comments the Committee may find of value and to make available the data on which our technical comments are based.

Sincerely,

Suzanne C. Hutchinson