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VIA Electronic Submission

March 27, 2015

Dr. Stefan Ingves
Chairman
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Dear Chairman Ingves:

Genworth Financial, Inc. (Genworth) appreciates the opportunity to comment on the Basel Committee on Banking Supervision (Committee) "Capital Floors: The design of a framework based on standardised approaches: Consultative Document" of December 2014 (Floors Consultation). Genworth is a U.S. based Fortune™ 500 insurance holding company with assets in excess of 110 billion USD at the end of FY 2014. Genworth is primarily concentrated on two core businesses: a U.S. Life Insurance Division that offers long term care insurance, life insurance and fixed annuities; and a Global Mortgage Insurance (MI) Division. Our Global MI Division primarily writes business in Australia, Canada and the United States with additional operations in Asia, Europe, and Latin America. Genworth is only commenting on the first question for the Floors Consultation.

Q1. Assuming the respective floors were calibrated to achieve the same level of required capital, what are your views on the relative merits of a risk category-based floors and an aggregate RWA-based floor? What are your views on a floor based on exposure class?

Genworth views floors based on exposure class to be optimal. For the Committee's stated purposes, certain classes of exposures, such as high Loan-To-Value (LTV) residential real estate risk, it may better to require comparability within the exposure class if there are distinctions made in the standard formula.

As noted in the Floors Consultation, the Committee has identified meaningful discrepancies in the risk weights between standard and AIRB banks in its member jurisdictions. Since the thematic review was conducted, other studies have found similar discrepancies, documented the attendant market distortions and made recommendations.

The final report of Australia's Financial System Inquiry is a noteworthy example.¹ Among many other issues, the FSI's final report compared the current average AIRB lenders' residential mortgage risk weight and standardised lenders' residential mortgage risk weight to be 18% and 39% respectively.

¹ Financial System Inquiry. *Final Report*. Sydney, NSW: The Australian Government the Treasury, 2014. Accessible at http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf

Genworth notes that the standardised lenders' average of 39% includes explicit capital credit for MI usage whilst the AIRB lenders' percentage does not. The report found that there is clear inconsistency with risk-weighted asset levels that are evidenced within the Australian residential mortgage market. This excessive variation has created an uneven playing field between AIRB and standardised lenders impacting on competition with differing levels of capital required for essentially the same risk. The FSI's final report recommendations for resolving this discrepancy included a range of between 25% and 30% RWA for the AIRB lenders to be more appropriate. The policy solution recommended by the Financial System Inquiry also called upon the Australian regulator primarily responsible for implementing the recommendations on balancing standardised and AIRB capital, the Australian Prudential Regulation Authority, to recognize the value of MI and give capital credit for using it.

Given the differences in the proposed and existing standardised formulas with the AIRB formula, simply creating a floor across the residential real estate asset class will not resolve the capital advantage for AIRB lenders noted by the Committee and the Financial System Inquiry. While AIRB lenders can segment their loans in considerable detail, the segmentation for probability of default (PD) does not require segmentation based on LTV. When considering that a 95% LTV stand-alone loan without MI for an outstanding quality risk with a PD set at 0.05% and a 20% loss given default (LGD) would only require 2.9% risk weight (RW) credit capital – compared with a 1.00% PD segmented risk that would require 26.6% (almost 10 times the credit risk capital) – this benefit can be considerable. These figures are based on a review of Australian AIRB lenders' Pillar 3 disclosures.²

This incentive to hold lower capital, coupled with lower expected loss for AIRB lenders, is further exacerbated by being able to underwrite high quality loans but at high LTVs where the larger AIRB lenders can also charge a premium or a higher interest rate due to the borrower's lack of a deposit. Charging a premium or higher interest rate in Australia is typically done in lieu of mortgage insurance. This has also led to AIRB lenders increasingly "cherry-picking" better risk borrowers without using MI, with those lenders essentially retaining risk and thus reducing the overall system capital held. There is less bank capital because the AIRB formula, as applied in Australia, Genworth does not believe recognizes the availability of MI to offset the LGD. Therefore, the bank ends up holding the same level of capital – still far less than standardised banks – for the risk. What is then missing is the capital being held against that same risk by the MI insurer. This inconsistency is detrimental to the financial system as it results in less system capital available to absorb an unexpected crisis, indirect subsidisation for bigger banks and a concentration risk with deterioration in the average mortgage risk across the industry. Therefore, Genworth recommends the Committee consider not just credit risk as having a separate floor, but more specifically greater than 80% LTV loans³ being treated as a separate asset class and

² Genworth Mortgage Insurance Australia Limited. "Genworth Response to Interim Report of the Financial System Inquiry." Sydney, NSW, 2014. Accessable at <http://fsi.gov.au/files/2014/09/Genworth.pdf>

³ Genworth recognizes that significant work has been undertaken by the Committee to update some of the definitional issues regarding LTV and residential real estate risk. Genworth has and is commenting separately on those work streams. For the purposes of this consultation, Genworth generically refers to residential real estate loans originated in general conformance to the Financial Stability Board's "Principles for Sound Residential Mortgage Underwriting Practices." For specialty types of loans, the LTV threshold could be lower.



having a separate floor. By having this calibration, the incentive of increasing exposure to low capital, high LTV loans can be minimized and at the very least monitored for global comparability.

As a leading supplier of credit risk protection for residential real estate, we have significant amounts of data across lenders, loan characteristics, borrower characteristics, and geographies through economic cycles. If there are any questions or additional data we could supply the Committee to assist in its deliberations, please do not hesitate to contact us via Scott Quesenberry at scott.quesenberry@genworth.com or +1.919.846.4374.

Sincerely,

A handwritten signature in black ink that reads "Scott D. Quesenberry". The signature is written in a cursive style with a long, sweeping underline.

Scott D. Quesenberry