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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) "Revisions to the standardised approach for credit risk - consultative document" of December 2014 (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 Global Mortgage Insurance (MI) Division, and a U.S. Life Insurance Division that offers long term care insurance, life insurance and fixed annuities. Our Global MI Division primarily writes business in Australia, Canada and the United States with additional operations in Asia, Europe, and Latin America.

As a leading provider of MI globally, and therefore a specialist in residential real estate credit risk, we particularly appreciate the time and effort that the Committee has taken in defining, examining and making recommendations regarding that class of risk. Our comments below are arranged in response to the questions posed in the consultation and focus on the proper treatment of residential real estate risk and how it can be mitigated by banking institutions. To assist readability, some of the questions have been addressed in a different order, but the numbering has remained as in the Consultation.

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 fluid and cursive, with a long horizontal stroke extending to the right.

Scott D. Quesenberry

Q13. Do respondents propose any alternative/additional risk drivers for the Committee’s consideration in order to improve the risk sensitivity in this approach without unduly increasing complexity?

One of the Consultation’s major revisions to the standardized approach for credit risk would make the risk weighting for residential real estate loans more risk sensitive by assigning risk weights based on the loan-to-value ratio (LTV) of the exposure. Genworth has publicly advocated that banks’ capital for such lending needs to reflect accurately the credit risks that residential mortgages pose. (Genworth Mortgage Insurance Australia Limited 2014), (Genworth Financial, Inc. 2010). As a specialist in the credit risk of high LTV lending, we agree that the loss-given-default (LGD) and probability of default (PD) of an exposure are correlated with LTV. Accordingly, we urge the Committee to recognize the value of MI when setting risk weights.

MI is an “[i]ndemnity to credit providers for losses due to the failure of a borrower to repay a loan secured by a mortgage over property.” (International Association of Insurance Supervisors 2014, 158). MI is called different names in various jurisdictions, but as the Joint Forum has recognized, MI serves a similar risk-reducing function across jurisdictions:

MI is also called mortgage default insurance, mortgage credit insurance, mortgage guaranty insurance, mortgage indemnity insurance and lenders’ mortgage insurance. MI protects lenders against losses when loans default – ie when outstanding debt exceeds the foreclosure proceeds. The borrower pays the insurance premium, but the lender is the policy beneficiary, and the amount of loss coverage is usually capped as a proportion of lost loan principal. For example, if the insurer covers the lender down to 75% of the original purchase price, and the homeowner puts 5% down, the maximum claim amount is 20% of the purchase price or 21% of the loan amount. MI policies exclude losses caused by fire, earthquakes, floods, windstorms, and defective titles. Lenders normally require borrowers to purchase separate insurance against these other risks. (The Joint Forum 2013, 1).

In some markets, such as Australia and Canada, MI covers 100% of the credit loss in the event of a borrower default. In other markets, such as most European countries and India, only the first loss portion (after borrower equity) is covered. In a smaller set of markets, most notably in the United States and France, both types of coverage are available. In some jurisdictions, the product operates as an insurance product, and in others it operates as a guarantee product. While there are some legal differences across these different forms of MI, the economic effect is largely the same, and thus this response to the Consultation uses the phrase MI to include the various permutations of residential real estate credit risk solutions for creditworthy borrowers.

Mortgage Insurance Reduces Loss Given Default

MI has proven to reduce or eliminate LGD after a lender realizes the value of the collateral following a loss due to a credit event. A recent study examining actual loan level losses in a pool of 17 million U.S. residential mortgage loans originated from 1999 to 2013, with data provided by Freddie Mac, one of the U.S. Government Sponsored Enterprises (GSEs), demonstrates that MI consistently reduced losses to Freddie Mac even through the recent financial crisis. Goodman and Zhu of the Urban Institute, a nonprofit think tank, find that “[l]oans with higher LTVs and mortgage insurance have a significantly

lower loss severity than loans with lower LTVs and no mortgage insurance.” (Goodman and Zhu 2015, 15).

The authors show that Freddie Mac’s loss severities for loans with LTVs exceeding 80 on which MI was written were lower in the actually observed pool than the loss severities for loans with LTVs between 80 and 60 originated in all years, and remarkably, were lower than the sub-60 LTV pool except for loans originated between 2011 and 2013.

The relationship between loss severities and LTV categories is particularly interesting. Severities for loans with LTVs over 80 are much lower than for loans with LTVs between 60 and 80. In fact, the severities for the over-80-LTV loans are even lower than severities for the 60-or-under-LTV loans. The reason is simple. Loans with LTVs over 80 are required to have mortgage insurance, which covers the first loss; this coverage is usually deep enough that Freddie is not exposed unless the market value of the home drops far more than 20 percent. For example, standard practice is to bring down an 85 LTV mortgage to 73 LTV, a 90 or 95 LTV mortgage to 65 LTV, and a 97 LTV mortgage to 63 LTV. These results would indicate that mortgage insurance is more effective at protecting the GSEs against losses than is commonly assumed. (Goodman and Zhu 2015, 7).

The data table follows. In the United States, the GSEs require mortgage insurance or other credit enhancement in order to buy any loan with an LTV exceeding 80. The entire pool of loans with LTVs exceeding 80 in this sample was covered by private mortgage insurance.

Severity at Liquidation by Origination Year, FICO, and LTV (percent)

Year	FICO	≤ 60	60–80	> 80	Total
1999–2004	≤ 700	20.4	31.0	14.9	22.3
	700–750	17.1	29.3	17.8	24.3
	> 750	19.0	29.8	20.8	26.3
	Total	19.3	30.4	15.9	23.2
2005	≤ 700	28.8	40.6	25.2	35.8
	700–750	26.6	39.4	26.8	36.2
	> 750	26.2	39.0	27.9	36.2
	Total	27.7	39.9	26.0	36.0
2006	≤ 700	35.2	45.3	27.0	39.7
	700–750	32.3	43.6	30.1	40.7
	> 750	30.6	42.2	29.1	39.6
	Total	33.5	44.1	28.0	40.0
2007	≤ 700	38.8	46.1	28.6	38.7
	700–750	33.6	43.4	29.3	38.9
	> 750	31.7	41.2	27.8	37.3
	Total	35.9	44.2	28.7	38.5
2008	≤ 700	31.9	43.6	27.5	36.5
	700–750	27.2	40.1	25.3	34.1
	> 750	23.1	37.5	23.3	31.9
	Total	28.6	40.9	25.8	34.6
2009–10	≤ 700	21.9	34.4	16.1	30.2
	700–750	20.5	30.7	13.6	26.3
	> 750	18.5	28.4	13.8	24.5
	Total	20.5	30.7	14.1	26.5
2011–13	≤ 700	0.0	23.7	6.5	17.0
	700–750	10.4	26.1	8.1	15.5
	> 750	0.0	22.1	9.2	15.6
	Total	8.2	23.8	8.3	15.9%
Total		29.2	39.9	23.1	33.9

Source: (Goodman and Zhu 2015, 7).

The LGD for loans with LTVs exceeding 80 on which MI was written was actually less than for loans with LTVs of 60 or less for loans originated in every assessed time period except 2011 to 2013, and over the course of the entire 1999 to 2013 time period experienced a 6.1 percent lower LGD on average. Notably, the effectiveness of MI was demonstrated not only across the 60-80 LTV band for all origination years, but also across each FICO category within the 60-80 LTV band.

Mortgage Insurance Reduces Probability of Default

The evidence from the recent economic cycle in the U.S. also demonstrates that MI is correlated with a decrease in PD. Two major studies of the effects of MI were conducted following the recent financial crisis, and each study controlled for other possible variables that indicate a risk of default, such as credit scores of the borrower.

Promontory Financial Group, a leading strategy, risk management and regulatory compliance consulting firm, conducted the first study on behalf of Genworth, and examined over 5 million loans originated from 2003 to 2007, including those with MI and those that used second lien “piggyback” loans without MI. Its conclusion was as follows:

Overall, our analysis is supporting of the assertion that the historical performance of first lien MI-insured loans has been associated with lower rates of extreme delinquency or default, when compared to noninsured first lien loans accompanied by a piggyback second lien, and when controlling for various risk factors. For instance, results from estimating a survival model indicate that, considering all regions, the percent surviving to 72 months for insured loans is 12.4 points higher than that for non-insured loans with a piggyback, controlling for the average effect of all covariates in the model. (Promontory, 2011, iii).

Milliman, a leading actuarial firm, conducted the second study with a sample size of 4.4 million loans. Using actuarial techniques, the Milliman study reached the same conclusion as Promontory:

The study demonstrates that loans with mortgage insurance defaulted at a lower rate than loans not insured by private mortgage insurers, all else equal. The study was performed on loans originated between 2002 and 2007 and the results of the study were statistically significant. (Milliman 2012, 21).

These studies demonstrate that even in a high LTV market, during one of the worst downturns in the housing markets in U.S. history, the loans with MI performed better than comparable loans without MI. Thus, evidence from the U.S. supports giving credit for MI when determining the LTV of a mortgage loan and therefore supports reducing the risk weight for the credit risk of loans on which MI has been written.

International Policy Makers and Market Participants Recognize that Mortgage Insurance Reduces Lenders’ Risks

The existing international standardized approach generally assigns a flat risk weight to residential mortgages unless they become past-due, and does not recognize with granularity the credit risk that increases as the LTV of an exposure increases; thus, the current standardized approach does not consider the credit risk mitigation provided by MI. In contrast, as described below, international policy

makers and many individual Basel Committee member jurisdictions have recognized the risk-reducing effect of MI in various contexts.

The Financial Stability Board (FSB) has recognized that MI is “a form of credit support for mortgage loans, and a way to provide additional financing flexibility for lenders and borrowers.” (Financial Stability Board 2012, 7) (FSB Underwriting Principles). The Joint Forum recognized that MI reduces the credit risk of high LTV loans by recommending that national regulators take steps to require adequate MI for loans with LTVs exceeding 80 percent:

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 (eg greater than 80 percent LTV). (The Joint Forum 2010, 17).

MI or a similar form of credit protection for residential real estate lending is used in a majority of the Basel Committee member jurisdictions. Appendix 1 lists the program names that Genworth is aware of in these jurisdictions.

Private mortgage insurers have acted as countercyclical capital sources for banks and other creditors and that have helped creditworthy borrowers get into homes sooner.¹ MI has existed as a government program in the U.S. since 1934, and private MI has been offered continuously in the U.S. market since 1957. Private MI allows the GSEs to support low down payment mortgages, reducing disincentives that would otherwise exist for lenders to make loans to low down payment borrowers. By law, the GSEs may not purchase a mortgage with an LTV exceeding 80 unless the lender provides one of several types of credit enhancements, including private MI. As noted previously, the product served its economic role in the U.S. during the global financial crisis by significantly reducing the losses of lenders. The product also protected U.S. taxpayers by reducing the amount of government assistance that needed to be provided to systemically important financial institutions and the GSEs. Since the onset of the housing crisis in the U.S., private mortgage insurers have covered over 44 billion USD in claims. Three U.S. mortgage insurers did exit the business, but they all continue paying claims under their prudentially supervised resolution regimes. The remaining U.S. mortgage insurers are stronger than they were during the crisis, having raised approximately 10 billion USD in new capital since the outset of the crisis. (Gupta 2015). Three new regulated U.S. mortgage insurers entered the business since 2008. (Gupta 2015).

Other senior policymakers in Basel Committee member countries have created MI programs more recently as part of their national housing policies. For example, in 2012, the Government of India created the “Credit Risk Guarantee Fund Scheme For Low Income Housing,” and in 2013, the Reserve

¹ In these respects, MI plays a similar economic role for one of the largest banking asset classes to the “Capital Insurance” proposed at the 2008 Reserve Bank of Kansas City symposium on “Maintaining Stability in a Changing Financial System,” held at Jackson Hole, Wyoming. (Kashyap, Rajan and Stein 2008).

Bank of India assigned a zero risk weight to the guaranteed portion.² In addition, the Reserve Bank of India also licensed India Mortgage Guarantee Corporation Private Limited (IMGC), the first mortgage guarantee company there in 2012. IMGC is a public private partnership in the form of a joint venture between the Government of India's National Housing Bank, the World Bank Group's International Finance Corporation and the Asia Development Bank along with a Genworth subsidiary as investor and technical partner. In 2013, the United Kingdom launched the "Help to Buy" mortgage guarantee scheme. In Australia, the Government commissioned a Financial System Inquiry, which included MI in its recommendations on how to bridge the capital requirement differential between Standard and Internal Ratings Based lenders. (Financial System Inquiry 2014, 66). So as far as Genworth is aware, the most recent program to come into operation in a Committee member jurisdiction is in 2015 in Italy.

Mortgage Insurance Can be Used as an Effective Macroprudential Tool

The risk weights of the standardized approach are by their nature microprudential tools. Nevertheless, as pointed out by many and most recently by Jaime Caruana, General Manager of the Bank of International Settlements, macroprudential considerations have become an essential part of the regulatory toolkit. (Caruana 2015).

In Canada and Hong Kong, where MI is mandatory to support low down payment mortgages, governmental authorities have used their powers to change MI rules to tighten or loosen credit provided to homebuyers. (Krznar and Morsink 2014, 16), (Carney, Housing in Canada 2011), (Poloz 2015), (Wong, et al. 2011), (International Monetary Fund 2014). For instance, in Canada, MI has been used to dampen the lending cycle:

"We find that the Canadian authorities have used their exceptional power to set mortgage insurance rules to dampen the housing boom. Specifically, the reductions in maximum LTV ratios for first-time buyers and refinancing in 2010, 2011, and 2012 have curbed mortgage credit growth and moderated the surge in house price." (Krznar and Morsink 2014, 16)

Senior Canadian policymakers have publicly supported the important role that being able to modify the MI framework plays in stabilizing their financial system. For instance, then-Bank of Canada Governor Carney noted, "Since 2008, the federal government has taken a series of prudent and timely measures to tighten mortgage insurance requirements in order to support the long-term stability of the Canadian housing market." (Carney, Housing in Canada 2011) See also (Poloz 2015). Canadian supervisors have publicly declared a desire to see its system accommodated in future Committee standard making. (Rudin 2015)

A similar dynamic also occurred in Hong Kong Special Administrative Region (SAR), where the Hong Kong Monetary Authority has used its ability to control the MI rules as a macroprudential tool. (Wong, et al. 2011), (International Monetary Fund 2014).

² As discussed more fully in answer to Q24. below, many of these government programs around the world may have a sovereign risk weight, but they also have policy conditions that do not appear to meet the standards for guarantees to count as a Credit Risk Mitigant (CRM) under the Consultation.

Providing a credit for MI in the standardized approach would ease the use of MI as a macroprudential tool in these jurisdictions, as well as jurisdictions where MI is not mandatory by incentivizing the use of MI to support high LTV lending.

National Supervisors Can Ensure that Mortgage Insurance Provides Effective Risk Reduction

As highlighted above, MI and related programs, whether public or private, exist in a wide number of Basel Committee member jurisdictions. As the example from the U.S. shows, MI programs enjoy broad support as promoting homeownership for responsible borrowers with a smaller down payment. And, MI is not just a legacy concept, as the examples from India, United Kingdom and Italy demonstrate; national policymakers continue to create new MI programs.

The Financial Stability Board affirmed the risk-reducing role of MI when setting forth principles for sound mortgage underwriting practices, with Principle 5 “Prudent Use of Mortgage Insurance.” The FSB’s other principles — including appropriate LTV and reasonable debt service coverage — have clearly been incorporated in the Consultation’s revised risk weighting. Genworth recommends that Principle 5 also be incorporated in the standardized approach to credit risk.

This includes Principle 5.3, which states: “Jurisdictions should ensure that all mortgage insurers be subject to appropriate prudential and regulatory oversight and, where used, represent an effective transfer of risks from lenders to insurers.” (Financial Stability Board 2012, 7) Consistent with the role of member jurisdictions to oversee MI under the FSB principles, the Committee could expressly allow national supervisors to use their discretion to provide a reduction for risk weights for loans with prudentially regulated MI.³

Genworth Recommendation for Q13.: In proposed Annex 1, paragraph 38, the Committee should recognize prudentially regulated MI as a reduction to the risk weight for residential real estate exposures. Alternatively, the Committee could allow national discretion to recognize prudentially regulated MI as a reduction to the risk weights.

Q24. What are respondents’ views on the proposed corporate guarantor eligibility criteria?

As stated above, Genworth believes that MI should be directly recognized in the residential real estate risk weights, as is often how Basel Committee member jurisdictions treat the product in their standardized approaches to credit risk today. MI could also be treated as eligible credit protection provided by a “prudentially regulated financial institution” under Annex 1, paragraph 130 of the Consultation as MI is partially or wholly treated in a smaller set of countries. However, the Consultation should clarify that all “prudentially regulated financial institutions” will receive bank-like risk weighting under paragraph 19, in order to give effect to paragraph 130’s clear recognition of the benefits of credit protection provided by “prudentially regulated financial institutions.”

³ Australia, Canada and New Zealand currently use this formulation in their standardized approach credit risk weights. (Australian Prudential Regulation Authority 2013, APS 112, Attachment D, 28-31), (Government of Canada 1991, §416), (Reserve Bank of New Zealand July 2014, 47-48).

Insurers as “Financial Institutions”

Footnote 79 of the Consultation defines a “prudentially regulated financial institution” as a legal entity supervised by a regulator that imposes prudential requirements consistent with international norms or a legal entity (parent company or subsidiary) included in a consolidated group where any substantial legal entity in the consolidated group is supervised by a regulator that imposes prudential requirements consistent with international norms. These include, but are not limited to, prudentially regulated insurance companies.

We appreciate that insurers are included as potential providers of eligible credit protection under proposed paragraph 130. However, proposed paragraph 133 would substitute the risk weight of the protected portion of the exposure for the risk weight of the provider of credit protection, and other parts of the Consultation, if not clarified, would effectively treat exposures to regulated insurance companies as corporate exposures, reversing any beneficial risk-weighting for eligible credit protection provided by insurers.

Proposed paragraph 13 would assign a variable risk weight to a bank based on the common equity Tier 1 ratio and net non-performing asset ratio of the bank, as calculated and reported under Basel capital standards. Paragraph 19 provides that “other financial institutions” will be treated like banks for risk weighting, provided these firms are subject to prudential standards and a level of supervision equivalent to those applied to banks (including capital and liquidity requirements) and the risk drivers used to ascertain the applicable risk weights (or the information to calculate them) are publicly disclosed. However, paragraph 19 only uses the phrase “financial institutions,” and does not repeat the term “prudentially regulated financial institution” as defined in footnote 79 to include prudentially regulated insurance companies. Paragraph 20 provides that insurance companies that are not eligible for bank-like treatment under paragraph 19 should be assigned risk weights as corporate exposures.

Generally, insurers are subject to prudential standards and a level of supervision *similar* to those applied to banks. But owing to differences in business models, risk profiles and licensing regimes when compared to those applicable to banks, insurers are subject to somewhat different prudential standards. In particular, insurers are not often required publicly to disclose common equity Tier 1 capital ratios or net non-performing asset ratios as calculated under Basel capital standards, but rather look at similar publicly disclosed financial metrics. As a result, paragraph 20 would effectively remove the “financial institutions” treatment for insurance companies that the definition of “prudentially regulated financial institution” in footnote 79 seems to allow.

Paragraph 19 should be revised to provide that any “prudentially regulated financial institution” as defined in footnote 79 will receive bank-like risk weights under a scale similar to paragraph 13, but using inputs more readily ascertainable for regulated insurance companies. Creating a rule that fails to recognize insurance companies as providers of eligible credit protection with potentially significantly lower risk weights could reintroduce variability across the banks’ risk weight capital and deny the banking system meaningful access to other prudentially regulated counterparties with potentially complementary needs.

Finally, while Genworth strongly believes that prudentially regulated insurers should be recognized as “financial institutions” under paragraph 19, we note that the risk weight table in paragraph 22 for corporate exposures insufficiently rewards companies with very low levels of leverage and should

include more granularity beyond the current “Leverage 1x-3x” category for extremely low leverage counterparties.

Clarification of Residential Real Estate’s Eligibility to be Mitigated by Eligible Credit Protection

The framework could also benefit from a clarification of the meanings of proposed paragraphs 65 and 68. Paragraph 65 of the Consultation states that CRMs “must not be double counted” and that “no additional supervisory recognition of CRM for regulatory capital purposes will be granted on claims for which the risk weight already reflects that CRM.” Paragraph 68 states that:

In the case where a bank has multiple CRM techniques covering a single exposure (eg a bank has both collateral and a guarantee partially covering an exposure), the bank must subdivide the exposure into portions covered by each type of CRM technique (eg portion covered by collateral, portion covered by guarantee) and the risk-weighted assets of each portion must be calculated separately.

As we understand it, these paragraphs do not change the policies of the existing Standardized Approach, which has long since used language nearly identical to proposed Paragraphs 65 and 68.⁴

Nevertheless, these paragraphs could benefit from clarification. Consistent with its use in the Standardized Approach and Table 2 of the Consultation, CRM should be defined to include guarantees and credit derivatives, financial collateral, and on-balance netting of deposits and loans. CRM should *not* include a lowering of risk weights below 100% based on the type of exposure, independent of guarantees and credit derivatives, financial collateral, and on-balance netting of deposits and loans. For example, the 50% risk weight that would be applied to an eligible real estate loan with an LTV of 70 to a borrower with a DSC above 35% under paragraph 38 the Consultation should not disqualify such exposure from credit risk mitigation through the use of a guarantee, because the 50% risk weight is not based on CRM. Any interpretation to the contrary would disincentivize the use of CRM and increase systemic risk.

The Basel Standardized Approach Should Ensure Uniformity in the Eligibility of Credit Risk Mitigants, Whether the Protection Provider is a Public or Private Entity.

Paragraph 126 of the Consultation sets forth a number of required product features for a guarantee to serve as a credit risk mitigant, including an unambiguous requirement that the guarantee be

⁴ See Basel Committee on Banking Supervision, *International Convergence of Capital Measurement and Capital Standards, A Revised Framework*, at ¶¶ 114, 206 (June 2006), available at <http://www.bis.org/publ/bcbs128.htm> (“The effects of CRM will not be double counted. Therefore, no additional supervisory recognition of CRM for regulatory capital purposes will be granted on claims for which an issue-specific rating is used that already reflects that CRM In the case where a bank has multiple CRM techniques covering a single exposure (e.g. a bank has both collateral and guarantee partially covering an exposure), the bank will be required to subdivide the exposure into portions covered by each type of CRM technique (e.g. portion covered by collateral, portion covered by guarantee) and the risk-weighted assets of each portion must be calculated separately. When credit protection provided by a single protection provider has differing maturities, they must be subdivided into separate protection as well.”).

“unconditional.” This paragraph, too, is nearly identical to language in the existing Standardized Approach.⁵

In practice, however, several Basel member jurisdictions allow government mortgage insurance programs (and not private mortgage insurance) to have features disallowed by the definition of a “guarantee” and still qualify as a “guarantee” under the Standardized Approach. One example comes from the Joint Forum’s review of MI in the Netherlands. While banks apply a zero risk weight to loans covered by the national mortgage guarantee (NHG), the terms of the NHG guarantee are conditional:

WEW [Home-ownership Guarantee Fund] will only pay out the full claim if the loan complies with all of the conditions that apply to an NHG guaranteed mortgage. In case of operational errors by the lender, possibly at the origination of the loan, the WEW may pay out less than the claim or reject it completely. (The Joint Forum 2013, 27).

Similar examples exist in the United Kingdom, India, and other Basel member countries.

These policies exacerbate the incentives for banks and governments to generate more sovereign risk at the expense of private capital, thereby undermining market discipline, increasing risks for taxpayers, and creating potential subsidies. These incentives are already embedded in the Standardized Approach based on the zero risk weight some member countries have applied to sovereign entities, regardless of the credit rating of such sovereign entities, which has had serious negative implications in the global economy. As Hervé Hannoun, the Deputy General Manager for the Bank of International Settlements, has noted:

The global sovereign debt crisis has exposed fault lines in the regulatory treatment of sovereign risk. However, the deficiency is not in the Basel standards but in the way the global standards have been applied in some countries and especially in the European Union. (Hannoun 2011).

We understand that the Committee intends to consider the risk weighting of sovereign entities as part of a broader and holistic review of sovereign risks. However, the Committee should also address the implicit preference for sovereign guarantees that member jurisdictions have created by deviating from the definition of an eligible guarantee.

While we believe MI should be recognized directly in the calculation of LTV, if MI is only recognized as a guarantee, then the identity of the CRM provider should only affect the risk weight, not the allowable product features, of the CRM.

⁵ See *id.* at ¶ 189. (“A guarantee (counter-guarantee) or credit derivative must represent a direct claim on the protection provider and must be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible. Other than non-payment by a protection purchaser of money due in respect of the credit protection contract it must be irrevocable; there must be no clause in the contract that would allow the protection provider unilaterally to cancel the credit cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure. It must also be unconditional; there should be no clause in the protection contract outside the direct control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due.”).

Genworth Recommendations for Q24.:

- 1) Clarify that “prudentially regulated financial institutions,” including regulated insurance companies, will be treated as “financial institution” counterparties under paragraph 19 consistent with footnote 79.
- 2) To improve transparency and consistency, provide a lookup table in paragraph 19 under the equivalent prudential standards that apply to insurers. This table should be calibrated to any revisions to the Internal Ratings-Based formula and the PDs and LGDs could be based on the extensive work that prudential regulators have already conducted. See, for example, (European Insurance and Occupational Pensions Authority 2104, 182).
- 3) If insurers are to be considered corporate counterparties, then more granularity should be included beyond the current “Leverage 1x-3x” category for extremely low leverage counterparties.
- 4) Clarify that under paragraphs 65 and 68, an exposure with a risk weight below 100% based on the type of exposure—but not based on CRM methods such as guarantees and credit derivatives, financial collateral, and on-balance netting of deposits and loans—is eligible for reductions using CRM methods.
- 5) In defining required product features for CRMs (including guarantees under proposed paragraph 126), the Committee should ensure a consistency of treatment of public and private providers of CRM to mitigate the arbitrage towards greater taxpayer risk already embedded in the counterparty risk weights for sovereigns.

Q12. Do respondents have views on whether the use of a fixed threshold for the DSC ratio is an appropriate way for differentiating risks and ensuring comparability across jurisdictions? If not, what reasonably simple alternatives or modifications would respondents propose while maintaining consistent outcomes?

One underwriting factor that Genworth and other insurers consider fundamental is the capacity of the borrower to repay the mortgage. (Gupta 2015). However, as noted in the Consultation, many jurisdictional differences go into that determination. Instead of having the DSC or any other debt servicing ratio as part of the capital standards, this issue could be better addressed by keeping it a prudential requirement for loan and insurance underwriting as envisioned by the FSB and as implemented by many of the FSB and Committee members as a separate underwriting prudential rule. See, for example Canada’s B21 Guideline. (Office of the Superintendent of Financial Institutions 2014).

Genworth Recommendation for Q12.: Keep “ability to pay” in the form of a DSC or DTI as a prudential underwriting standard instead of including DSC or DTI in the calculation of residential mortgage risk weights.

Q19. What are respondents’ views on the alternative treatments currently envisaged for past-due loans?

When residential real estate loans become past due, the PD increases. The standardized approach’s credit risk weights should recognize that PD risk increases as the length of delinquency increases. Since the standardized approach does not directly recognize PD, a simple lookup table should be created that increases the risk weight of a residential real estate exposure as the time-past-due increases at certain

intervals. To allow for some realistic risk sensitivity, the risk weight increase could be expressed as a multiple of the LTV bucket to recognize the role of the collateral. For instance, credit events normally will not lead to a loss on a residential real estate loan with an LTV lower than 40 once the collateral is realized. To the extent that any eventual loss is offset by MI, wholly or partially, any requirement for additional provisioning should also be offset by the MI in recognition of its first loss position after the borrower's equity.

Genworth Recommendation for Q19.: Create a provision look up table based on the length past due and allow for offsets due to MI coverage.

Q2. Do respondents believe the net NPA ratio is an effective measure for distinguishing a bank exposure's credit risk? What alternative asset quality measure, if any, should be considered by the Committee?

See the answer to Q24. above for Genworth's recommendation that prudently regulated financial institutions like insurers be analyzed under paragraph 19 with a separate lookup table rather than under the bank-centric requirements of proposed paragraph 13.

Consistent with the answer to Q19. immediately above, a bank should be allowed to reduce its provisioning by recognizing offsets due to the MI coverage. As shown above in the answer to Q13. above, MI will reduce the eventual LGD, particularly for high LTV residential real estate loans. Therefore, the calculation of the net NPA ratio, and specifically the definition of "non-performing loans and leases" set forth in proposed paragraph 15.d.1, should be modified to only include the uncovered portion of a loan that is 90 days past due.

Also, given many banks and other financial institutions in some Committee member jurisdictions have much lower levels of non-performing assets than in the current table in proposed paragraph 13, additional granularity at lower NPA ranges should be considered during the calibration phase.

Genworth Recommendations for Q2.:

- 1) Revise the definition of "non-performing loans and leases" loans in proposed paragraph 15.d.1 to recognize MI and credit risk mitigants against that loan exposure amount.
- 2) Include more NPA bands for banks and other financial institutions with net NPAs ratios below 1%.

Appendix 1

Basel Committee on Banking Supervision Members with Mortgage Insurance or Equivalent

Committee Member	Mortgage Insurance or Equivalent Program or Providers
Argentina	
Australia	Lenders Mortgage Insurance
Belgium	
Brazil	
Canada	Canada Mortgage and Housing Corporation (CMHC) Private Mortgage Insurance
China	Mortgage Loan Guarantees by Guarantee Company like Beijing Housing Guaranty / Shanghai Housing Guaranty Co (抵押贷款担保)
European Union	See Individual Member States
France	La garantie de prêt immobilier de Crédit Logement
Germany	Required of Building Societies
Hong Kong SAR	Mortgage Insurance by HKMC (按揭保險計劃) Private Mortgage Insurance
India	Credit Risk Guarantee Fund Scheme For Low Income Housing Mortgage Guarantee Companies
Indonesia	Credit Insurance by Askrindo (Asuransi Kredit)
Italy	Fondo di garanzia per la prima casa (Fondo prima casa) Credito Fondiario
Japan	Bank-Owned "Credit Guarantee" Companies Japan Housing Finance Agency
Korea	Mortgage Credit Insurance (for <70LTV) [모기지 신용 보험] Mortgage Insurance (for 71~85LTV) [모기지 보험]
Luxembourg	
Mexico	Sociedad Hipotecaria Federal (SHF) Private Mortgage Insurance
Netherlands	de Nationale Hypotheek Garantie
Russia	The Agency for Housing Mortgage Lending
Saudi Arabia	Real Estate Finance Law
Singapore	
South Africa	

Spain	
Sweden	
Switzerland	
Turkey	
United Kingdom	“Help to Buy” mortgage guarantee Private Mortgage Insurance
United States	Federal Housing Authority (FHA) mortgage insurance Veteran Affairs (VA) guaranty Department of Agriculture (USDA) guaranty Private Mortgage Insurance

Sources: (Genworth research), (The Joint Forum 2013), (Blood 2009).

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