



VIA Electronic Submission

June 24, 2016

Mr. William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Dear Mr. Coen:

Genworth Financial, Inc. (Genworth) appreciates the opportunity to comment on the Basel Committee on Banking Supervision (Committee) "Reducing variation in credit risk-weighted assets - constraints on the use of internal model approaches" of March 2016 (Consultation). Genworth is a U.S.-based Fortune™ 500 insurance holding company with assets in excess of 105 billion USD at the end of FY 2015.

We are dedicated to helping meet the homeownership and long-term care needs of our customers. We facilitate homeownership in the United States and internationally by providing mortgage insurance (MI) products that allow people to purchase homes with low down payments while protecting lenders against the risk of default. Genworth primarily writes MI in Australia, Canada, and the United States with additional operations in other countries. Through our homeownership education and assistance programs, we help people keep their homes when they experience financial difficulties. We also offer long-term care insurance products to meet consumer needs for long-term care in the United States.

As a leading provider of MI globally, and therefore a specialist in residential real estate credit risk, 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 contact us via Scott Quesenberry at scott.quesenberry@genworth.com or +1.919.846.4374.

Sincerely,


Scott D. Quesenberry

Executive Summary

Genworth appreciates the opportunity to comment on the Consultation. For the final framework, we would urge the Committee to:

- Recognize the value of Mortgage Insurance (MI) when setting risk weights and allow jurisdictions the national discretion to lower the Loss Given Default (LGD) floor to 5% when the bank uses MI to offset the risk.
- Ensure that some of the improvements to the definition of Residential Real Estate exposures consulted for the Standard Approach (SA), if adopted, are incorporated into the Internal Ratings Based (IRB) approaches.
 - Maintain comparable risk sensitivity between the IRB and SA approaches.
 - Retain the use of cumulative loan-to-value (LTV) and increased risk weighting for junior liens.
 - Clarify that the cumulative LTV should include junior liens originated by other lenders simultaneously with the senior lien.

I. Mortgage Insurance Should Reduce Residential Real Estate 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 carries 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.

Since MI explicitly and purposefully transfers high LTV residential real estate credit risk, it is priced and paid for in an actuarially sound manner under prudential supervision. This is in contrast to loans that were made without combining the LTVs, thus possibly obscuring the real credit risk, such as junior liens.

Recommendation: Mortgage Insurance Reduces Loss Given Default

The Institute of International Finance, in its response to the Consultation, recommends that the mortgage LGD floor of 10% apply where MI is not held and a 5% LGD floor for those assets that have LMI. (Institute of International Finance 2016). Genworth supports this recommendation and believes it is justified both by the historical experience and by additional through-the-cycle capital that regulated MI companies hold in the system.

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

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

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).

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).

The ability to cover claims and allow lenders to originate through the economic cycle - even at its worse - is a design feature of MI as a prudently regulated product offered by specialized insurers rather than just purely capital markets driven products. The systemic advantages of this arrangement though the cycle were recently noted in the context of possible GSE reform:

Transaction-based capital, in which capital markets investors invest on a transaction-by-transaction basis, provides relatively cheap capital in good economic times but would become more costly in tougher economic times, given how fickle and nimble the capital markets tend to be. Institution-based capital, in which companies [including MI companies] put up their institutional capital against a series of investments, presents the reverse trade-off, with an execution that is more expensive in steady economic times but stable through times of stress, as they rely on well-regulated counterparties that will price through the cycle and build capital accordingly. (Parrott, et al. 2016).

This through-the-cycle benefit was explicitly recognized in the most recent IMF Article 4 staff report for Canada as having played an important counter cyclical role in during the economic stress. (International Monetary Fund 2016).

As noted above, the U.S. has used public and private MI since the mid-twentieth century. Likewise, Canada's CMHC originated in 1946, with the first private MI starting in 1963. Australia has used Lenders Mortgage Insurance since 1965 and has had an entirely private system since 1997. But, MI programs do not just predate the Basel Standards. Since the start of the Basel III reforms, other senior policymakers in Basel Committee member countries have created MI programs 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 Bank of India assigned a zero risk weight to the guaranteed portion. 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 Reserve Bank 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 discussion on how to bridge the capital requirement

differential between Standard and Internal Ratings Based lenders. (Financial System Inquiry 2014, 66). Even more recently, an Italian program began operation in 2015.

Mortgage Insurance Can Be Used As An Effective Macroprudential Tool

Risk weights of the SA are by their nature microprudential tools. Nevertheless, as pointed out by many and 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). Macroprudential tools have been the subject of intense study as part of the response to the financial crisis, and a full review of the literature is beyond the scope of this response. Nevertheless, while questions remain around the proper balance of macro and micro prudential effects, the proper timing with the economic cycle, the utility of specific tools and the ability to properly target tools at either types or localization of risks, MI has played a positive role in several jurisdictions as one way for policy makers to transmit limits on LTV and serviceability standards via underwriting requirements or time-varying capital by increasing the cost of MI. For example, 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. (International Monetary Fund 2016), (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).

As the ongoing study of macroprudential tools makes clear, not all tools are appropriate for all situations. In those situations where MI can serve a positive role as a tool for transmission of policy, providing a credit for MI in the Basel Framework would ease the use of macroprudential tools in these jurisdictions, as well as in jurisdictions where MI is not mandatory by incentivizing the use of MI to support high LTV lending for creditworthy borrowers.

II. Residential Real Estate Improvements In The Standard Formula Should Also Be Incorporated In To The IRB Approach

One of the Standard Approach Consultation's (SA Consultation) major revisions to the SA 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). Genworth thus agreed with the proposal to increase capital risk weights as the LTV ratio increases for residential real estate that meet the operational requirements. (Genworth Financial, Inc. 2016). Recognizing the Committee's notation in the Consultation that consideration of overall floors with the SA is ongoing, Genworth urges the Committee to consider further modifications of the IRB Approach that could anchor the IRB modelling variability to the new SA.

One layered residential real estate risk that Genworth was pleased to see the Committee address in the revisions in the SA Consultation was the requirement that the lender base the LTV calculation on the cumulative LTV rather than just loans in isolation. We continue to urge the Committee to keep the cumulative amount as part of LTV calculation in the final SA and make corresponding (or conforming) changes in the IRB approach.

Genworth also appreciated the recognition with a higher risk weight multiplier in the SA Consultation that loans with junior liens have performed differently than loans underwritten (and insured) at nominally higher LTV ratios. As discussed above, published analysis of our data, MI industry data, and Government Sponsored Enterprise data from the United States through the last economic cycle all support this higher risk weighting for the loan amount of the junior liens. We urge the Committee to retain a higher risk weighting in the revisions to the SA and make conforming changes in the IRB approach.

While the SA Consultation included both senior and junior lien loans when originated by the same lender in the LTV calculation, Genworth continues to advocate the clear inclusion into the LTV calculation for the senior liens any junior liens originated by any other lender (including shadow banking lenders) at the same time would more accurately reflect the risk. This would limit the available arbitrage by creating a different capital requirement for the senior lien only if the same lender originates the junior lien. Requiring such a calculation would also potentially limit the leakage from any macroprudential limitations on LTVs. A similar effective requirement should be made in the calculation of required capital under the IRB approach.

Appendix 1

Basel Committee On Banking Supervision Members With Mortgage Insurance Or Equivalent

Committee Member	Mortgage Insurance Or Equivalent Program Or Providers
Australia	Lenders Mortgage Insurance
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	Used by 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]
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
South Africa	Collateral Replacement Indemnity
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).

Appendix 2

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