<u>Insurance Europe response to joint forum consultation on Mortgage guarantee Insurance Europe</u>

Insurance Europe welcomes the work of the Joint Forum in assessing the interaction of mortgage insurers with mortgage originators and underwriters and its attempt to draw conclusions from the financial crisis of 2007/2008.

A difficulty with the exercise undertaken by the Joint Forum is the fact that, as is recognized in the consultation document, the concept of mortgage insurance encompasses very different insurance products, which are subject to a variety of regulatory requirements at national or regional (in the case of the EU) level. It is therefore important to avoid developing recommendations which would be an appropriate response to concerns related to some products or jurisdictions, but would be incompatible with what is in place and functioning well in other countries.

Specifically, Insurance Europe is somewhat concerned by the extent to which the Joint Forum's recommendations are based on the experience of US mortgage insurers during the financial crisis of 2007-8. Insurance Europe does not consider the lessons which the consultation draws from the difficulties of US mortgage guarantee insurers to be necessarily applicable across all markets and countries.

Insurance Europe is concerned that some of the proposed recommendations may not be readily applicable or compatible with the principles underlying the regulatory regimes in place at national or regional level. As an example, the proposed establishment of capital buffers is not necessarily compatible with the principles of risk based prudential regimes such as the forthcoming Solvency II framework in the EU, under which an insurer will incur capital charges based on a one year period Value at risk (VaR) calculation at a confidence level of 99.5%. Such a calculation will result in the mortgage insurers in the EU holding sufficient capital to counteract any potential losses as a result of downswings in the mortgage underwriting cycle.

Against this background, Insurance Europe urges the Joint Forum to further identify the extent to which the consultation's proposed policy recommendations are incorporated into existing or proposed regulatory frameworks and, more importantly, the extent to which they could be compatible with such frameworks. Insurance Europe would encourage the joint forum to assess the scope for greater coordination among sectoral regulators to monitor the extent to which underwriting standards in one sector are influencing business decisions in another.

There follow some comments on specific recommendations.

1. **Policymakers should consider requiring that mortgage originators and mortgage insurers align their interests.**

   Insurance Europe can welcome this recommendation based on the assumption that the common interest to which the recommendation refers is that of minimising the possibility of a mortgage holder defaulting on their obligation. In the first instance, it should be clear that the application of robust mortgage underwriting standards by originators can significantly reduce the potential for future problems for both underwriters and insurers'.

2. **Supervisors should ensure that mortgage insurers and mortgage originators maintain strong underwriting standards.**

   Insurance Europe can welcome the Joint Forum's finding that supervisors should ensure that mortgage originators maintain strong underwriting standards, as this would ensure that the available pool of insurable mortgages is of high quality. It is also important for supervisors to consider which sector has the capacity to exert a more significant influence on the mortgage underwriting cycle. In addition the relative influence of mortgage underwriters and mortgage insurers on the underwriting cycle may be different across markets and countries. Further study may be required to identify which business lines have the drive on the underwriting cycle within both national and regional markets.

3. **Supervisors should have the power to correct for deterioration in underwriting standards stemming from behavioural incentives influencing mortgage originators and mortgage insurers.**

4. **Supervisors should require mortgage insurers to build long-term capital buffers and reserves during the valleys of the underwriting cycle to cover claims and peaks.**

   Insurance Europe considers the establishment of capital buffers to be incompatible with the principles of risk based prudential regimes such as the forthcoming Solvency II directive in the European Union. In the EU, following the introduction of the proposed Solvency II directive, insurers will be subject to a risk-based capital regime, whereby insurers incur specific capital charges which are calculated based on the risks which insurers are underwriting.

   In addition the arguments forwarded by the consultation, in favour of requiring mortgage insurers to build capital buffers, are in our view somewhat incomplete. The policy recommendations would benefit from a quantitative study which could isolate the role of mortgage insurers in the mortgage underwriting cycle and also provide some insight into the correlation between the mortgage underwriting cycle and default by mortgage holders. This could also provide more robust evidence on the potential for capital buffers to mitigate the potential failure of a mortgage insurer due to the developments in the mortgage underwriting cycle.

5. **Supervisors should be aware of and mitigate cross-sectoral arbitrage which could arise from differences in accounting between insurer's technical reserves and banks loan loss provisions and from differences in the capital requirements for credit risk between banks and insurers.**

   Insurance Europe can agree with measures which reduce the potential for arbitrage between insurance and bank capital requirements providing that measures which target this source of risk do not interfere with the different regulatory principles applied in the banking and insurance sectors. As noted by the consultation, banks and insurers undertake risk management using different assumptions and any efforts to reduce cross sectoral arbitrage should in all cases respect the principles of the respective regulatory regimes.

6. **Supervisors should apply the FSB principles for sound residential mortgage underwriting practices to mortgage insurers noting that proper supervisory implementation necessitates both insurance and banking expertise.**

   The FSB principles for sound mortgage underwriting practices should be applied to insurers only in instances where they are both applicable and appropriate from a supervisory prospective. Regulatory frameworks such as the forthcoming Solvency II framework ensure that an insurer holds sufficient capital based on the risks that are being underwritten. Insurance Europe would caution against the suitability of applying principles which were originally designed to mitigate risks in the banking sector to insurance.

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