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August 1, 2011

Board of Governors of the Federal Reserve System
Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1411 / RIN 7100-AD70

Department of Housing and Urban Development
Regulations Division
Office of General Counsel
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
Docket FR 5504-P-01 / RIN 2501-AD53

Federal Deposit Insurance Corporation
Attn: Robert E. Feldman, Executive Secretary
Attention: Comments / RIN 3064-AD74
550 17th Street, NW
Washington, DC 20429

Federal Housing Finance Agency
Attn: Alfred M. Pollard, General Counsel
Attn: Comments / RIN 2590-AA43
1700 G Street, NW, Fourth Floor
Washington, DC 20552

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington, DC 20219
Docket No. OCC-2011-0002 / RIN 1557-AD40

Securities and Exchange Commission
Elizabeth M. Murphy, Secretary
100 F Street, NE
Washington, DC 20549-1090
File No. S7-14-11 / RIN 3235-AK96

Subject: Credit Risk Retention

Ladies and Gentlemen:

<u>Introduction and Summary</u>

Radian Group, Inc. appreciates the opportunity to respond to this joint request for comments on the Proposed Rule, Credit Risk Retention, 76 Fed. Reg. 24,089 (April 29, 2011), issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Securities and Exchange Commission, Department of Housing and Urban Development, and the Federal Housing Finance Agency (collectively referred to as "the Agencies") to implement Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1]

Radian Group, Inc. (NYSE: RDN), headquartered in Philadelphia, provides private mortgage insurance ("MI") and related risk mitigation products and services to mortgage lenders nationwide through its principal operating subsidiary, Radian Guaranty, Inc. ("Radian"). These services help promote and preserve homeownership opportunities for homebuyers with down payments of less than 20% of the purchase price of a home while protecting lenders and investors from default-related losses on residential first mortgages and facilitating the sale of low-down payment mortgages in the secondary market.

The Proposed Rule provides an exemption from the risk retention requirements provided in Section 941 for asset-backed securities that are collateralized solely by loans that meet the definition of a "Qualified Residential Mortgage" ("QRM") and establishes the terms and conditions under which a residential mortgage would qualify as a QRM.[2] As proposed, the loan-to-value ("LTV") for purchase mortgages that qualify as QRMs cannot exceed 80%, and the LTV must be calculated without considering the presence of MI.[3]

The Proposed Rule, however, requests comment on a broader definition of a QRM that includes a wider range of mortgages. Under this alternative approach, the proposed QRM standards could include loans that have a combined LTV ratio that does not exceed 90%, and private MI could be taken into account in determining whether the borrower met the applicable combined LTV requirement, but MI would not alter the 90% maximum combined LTV for a purchase transaction. The Agencies seek comment on this alternative, and in particular, whether MI would reduce the risk of default, and if so, whether the LTV ratio limits should be increased to account for this insurance.[4]

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 § 941, Pub. L. No. 111-203 (2010).

[2] Credit Risk Retention, 76 Fed. Reg. 24,117-24,129; 24,165-24,167 (April 29, 2011).

[3] *Id*. at 24,096.

[4] *Id.* at 24,129.

Radian appreciates the opportunity to provide comment on this alternative approach, as well as the overall approach taken by the Agencies in defining the QRM.[5] For the reasons discussed more fully below, Radian believes that the LTV ratio limits for loans that are included in the QRM and, therefore, exempted from the Dodd-Frank Act's risk retention requirements, should have parity with the Federal Housing Administration's ("FHA") LTV ratio limits (*i.e.*, up to 96.5%) but be no lower than 95%, as long as those loans are insured by private MI, which does, in fact, reduce the risk of default.

In this comment submission, we make ten specific comments.

1. The presence of private MI ensures that the private sector has "skin in the game," and thereby achieves the primary goal of the risk retention requirements.

2. Congress expressly required the Agencies to consider the use of private MI to the extent that it reduces the "risk of default," which means of necessity both *frequency* and *severity* of default.

3. Private MI protects both lenders and investors from the risk of default by reducing the frequency of borrower default and the severity of potential losses in the event of borrower default.

4. Congress clearly intended to include low down payment loans that are insured by private MI in the QRM exemption, and the present housing crisis will be unnecessarily prolonged by the exclusion of these loans from the QRM.

5. The Proposed Rule should specify how the use of "piggyback loans" will be detected and prohibited in the future.

6. The Proposed Rule would drive borrowers to loans insured by the FHA, further constraining the agency's resources and exposing taxpayers to additional losses.

7. The Agencies should maintain the proposed government-sponsored enterprise ("GSE") exemption from the risk retention requirements.

8. Radian supports the Mortgage Insurance Companies of America's ("MICA") proposed back-end debt-to-income ("DTI") ratio requirement.[6]

9. The private MI industry is well positioned to help expand affordable housing opportunities in a responsible manner.

10. Radian supports MICA's proposed financial eligibility requirements.[7]

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[5] Radian's comment letter provides comments made in response to Questions 79, 90, 106, 108, 110, 111, 112, 120, 121, 123, 143, 145, 147, 149, 150, 151, 162, 173.

[6] Mortgage Insurance Companies of America, *Comment Letter in Response to Credit Risk Retention Proposed Rule found at 76 Fed. Reg., 24,089 (April 29, 2011)*, 7 n.13 (Aug. 1, 2011).

[7] *Id.* at 24-26.

Radian is a member of MICA, the mortgage insurance industry trade association, and Radian endorses MICA's comment letter submitted in response to the Proposed Rule. Radian's comment letter is intended to complement and supplement the information provided in MICA's comment letter.

Background: Private Mortgage Insurance

For many families and individuals, the most common hurdle to home ownership is saving enough money for the down payment and closing costs. The traditional 20% cash payment is a hardship for many and an impossibility for others. Private MI has enabled those with less than 20% down to purchase a home, and for the past 50 years, private mortgage insurers like Radian have helped over 25 million first time and low- to moderate-income borrowers achieve the dream of home ownership while protecting lenders, investors, the GSEs, and taxpayers against the risk of loss from borrowers defaulting on their home loans. Privately-insured mortgages are the private sector alternative to mortgages insured by the FHA or guaranteed by the Department of Veterans Affairs.

Private mortgage insurers stand first in line to pay a loss if a borrower defaults. When a homeowner defaults on a home loan insured by a private mortgage insurer, the insurer must pay a specified percentage of the loan value – historically, 20-30% (including costs) of the loan value – to the owner of the loan. Private MI generally covers costs associated with defaulted loans (interest charges during the delinquent period and during foreclosure, legal fees, ordinary course home maintenance and repair costs, real estate brokers' fees, and closing costs) and any losses resulting from reselling the property for less than its original sales price.

MI companies have honored their obligations during the housing downturn. Over the past three years, private mortgage insurers have blunted the loss of taxpayer dollars by absorbing approximately $24 billion in foreclosure losses and are projected to pay approximately $40 billion in total to cover losses in the current housing downturn. Radian has paid approximately $4 billion in foreclosure losses thus far. Most importantly, the industry has the resources to pay claims on existing loans while continuing to insure new loans. This is because of the stringent, countercyclical capital and reserve requirements imposed on them by their state enabling statutes and insurance regulators.

Private MI not only enables those with limited savings to achieve home ownership, but it also plays a critical role in providing systemic liquidity to the housing finance markets by facilitating the sale of mortgages in the secondary market and contributing to the GSEs' ability to fulfill their roles. Indeed, existing federal law recognizes the value that private MI provides to the housing finance system by requiring that Fannie Mae and Freddie Mac obtain credit enhancement such as mortgage insurance for the higher LTV mortgages they purchase.[8]

[8] 12 U.S.C. § 1717(b)(2)(C); 12 U.S.C. § 1454(a)(2)(C).

Loans Insured by Private MI Should Be Included in the QRM Exemption From Dodd-Frank Risk Retention Requirements

1. The presence of private MI ensures that the private sector has "skin in the game," and thereby achieves the primary goal of the risk retention requirements.

(Questions 69 and 90)

The housing market's recent collapse occurred, in large part, because certain participants were allowed to pass on to investors risky loans that were imprudently underwritten without having to retain any credit risk on those loans. As a result, the Dodd-Frank Act required securitizers to have "skin in the game," operating under the premise that private capital at risk will drive underwriting discipline to prevent another housing crisis. We agree. However, the private capital does not have to come solely from the lender or the investor. Private MI should be considered a permissible form of risk retention.

MI is "skin in the game." With private capital at risk in a first loss position after the borrower's equity, private mortgage insurers have a natural alignment with borrowers' and investors' interests, ensuring underwriting discipline. MI companies hold this risk throughout the loan term or until the LTV goes below 78%, and thus, it is true risk retention. When a borrower defaults, mortgage insurers use their private capital to pay out claims to lenders and investors to mitigate their losses. The GSEs have been the largest beneficiaries of these claim payments. From the start of the current housing market collapse to date, private MIs have paid almost $24 billion in claims to Fannie Mae and Freddie Mac, thereby reducing U.S. taxpayer liability by over 14%.

Mortgage insurers are required to maintain substantial capital reserves to absorb losses. In fact, half of each premium dollar earned goes into the contingency reserve and generally cannot be touched by the mortgage insurer for a 10-year period to ensure that adequate capital is available to cover losses that occur during downturns. This reserving structure positions private MI companies as effective risk retainers. MI companies have been able to draw on their reserves to pay for their obligations without reliance on bailouts from the federal government. In fact, the MI industry's reserve model serves as a disciplined countercyclical example in considering reforms to the capital structures of the insured depositories and their regulated holding companies.

The history of the private MI industry proves that private mortgage insurers have paid their claims through good and bad economic cycles. For example, in the early 1980s, the mortgage market had to cope with double-digit interest rates and inflation in a period of severe recession and, therefore, introduced many experimental adjustable-rate mortgages. As economic conditions deteriorated—particularly in energy-oriented regions of the country—defaults began to rise, resulting in numerous foreclosures. The MI industry paid more than $6 billion in claims to its policyholders during the 1980s. In the early 1990s, the MI industry paid more than $8 billion in claims primarily in California and the Northeast. Policyholders included the GSEs, commercial banks, savings institutions, institutional mortgage investors, mortgage bankers, the Federal Deposit Insurance Corporation, and the Federal Savings and Loan Insurance Corporation.

As noted above, MI companies have also paid their claims during the current housing downturn, blunting the loss of taxpayer dollars by absorbing approximately $24 billion in foreclosure losses. Bank regulators are only now seeking to institute this countercyclical reserving structure for insured depositories and their holding companies.

Indeed, the MI industry's model is founded on the premise of "skin in the game." As a result, private MI protects borrowers, lenders, investors, and taxpayers by ensuring that home financing is both affordable for the borrower at closing and sustainable over the life of the mortgage. For decades, private mortgage insurers have served as risk retainers, thereby meeting the purpose of the risk retention requirements. Therefore, private mortgage insurers should be considered eligible risk retainers, in addition to the GSEs, for the purpose of the credit risk retention requirements in Section 941.

2. Congress expressly required the Agencies to consider the use of private MI to the extent that it reduces the "risk of default," which means of necessity both *frequency* and *severity* of default.

(Question 111(a))

In defining the QRM exemption, Section 941 of the Dodd-Frank Act requires the Agencies to take into consideration "underwriting product features that historical loan performance data indicate result in a lower risk of default, such as mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risk of default."[9] After reviewing data on private MI, the Agencies have maintained that, while private MI protects lenders and purchasers of securities from losses when borrowers default, they have not identified studies or historical loan performance data adequately demonstrating that mortgages with such credit enhancements are less likely to default than other mortgages.[10]

However, the Agencies have narrowly and incorrectly interpreted the "risk of default" to only refer to the frequency of default when the risk of default actually encompasses both the *frequency* of default and the *severity* of default. That is, the risk of default not only refers to the *incidence* of default, but also the consequence of the incidence of default, which is the severity of the loss to lenders, investors, and taxpayers that results from borrower default. Radian believes that the measure of effectiveness for any form of insurance is its ability to protect against or reduce the insured party's risk, and particularly their risk of loss. It is clearly far more relevant to evaluate MI based on its primary purpose, which is to reduce the severity of losses to mortgage lenders and investors from defaults on their insured loans. A useful analogy is to fire insurance, which is not designed to reduce the incidence (i.e. "frequency") of fires; rather it protects homeowners against the losses, (i.e. "severity") attributable to fires' occurrence. In addition, these losses are further reduced by mitigation efforts in which private MI companies have engaged to cure troubled loans and prevent borrowers who initially default from actually losing their homes.

[9] Dodd-Frank Act § 941.

[10] Credit Risk Retention, 76 Fed. Reg. at 24,119.

Consistently throughout the Dodd-Frank Act, the concept of systemic risk is measured not only in terms of frequency, but also in terms of the severity of impact on financial markets. Therefore, a narrow interpretation of risk that only takes into account the frequency of default in the QRM context is inconsistent with the Dodd-Frank Act's larger efforts to minimize the impact of market stress and institution failure.

For example, Title I of the Dodd-Frank Act creates the Financial Stability Oversight Council ("FSOC") that is charged with evaluating and monitoring systemic risks posed by large, interconnected companies.[11] In identifying systemic risks, FSOC may determine that the "nature, scope, size, scale, concentration, interconnectedness, or mix of the activities" of a nonbank financial institution poses a threat to the stability of U.S. financial markets."[12] In making this determination, FSOC shall consider, among other factors, the amount and nature of the company's financial assets, the extent of the company's leverage, and the amount and type of the company's liabilities.[13] As a consequence of this determination, the company would be subject to the supervision of the Board of Governors of the Federal Reserve ("Federal Reserve") and increased prudential standards.[14] FSOC's framework for evaluating risk is based predominantly on the *severity* of potential loss. That is, the "risk" in this context focuses on the severity of potential harm to market stability.

Similarly, the Dodd-Frank Act also aims to ensure that large bank holding companies, which pose a risk to financial stability should they falter or fail, ultimately remain under the supervision of the Federal Reserve and subject to stringent prudential standards.[15] Only bank holding companies that have total consolidated assets equal to or greater than $50 billion would be subject to this type of oversight.[16] Again, the focus here is on severity of a potential failure.[17]

There exists additional evidence that the Dodd-Frank Act's focus on reducing risk is to mitigate loss. The Federal Reserve, FSOC, Commodity Futures Trading Commission, and the Securities and Exchange Commission have the authority to prescribe risk management standards governing designated payment, clearing, and settlement activities.[18] The objectives of promulgating these risk management standards include the reduction of systemic risk and the support of broader market stability.[19] In order to meet these objectives, the risk management standards may address margin and collateral requirements, as well as capital and financial resource requirements for designated financial market utilities.[20] In other words, the risk management standards seek to address the ability of parties in certain transactions to cover their losses in the event that counterparties default.

[11] Dodd-Frank Act § 111.

[12] *Id.* § 113.

[13] *Id.*

[14] *Id.* § 115.

[15] *Id.* § 117.

[16] *Id.*

[17] *Id.* (noting that even if a bank holding company that meets the asset threshold closes its bank and ceases to be a bank holding company, the entity will be treated as a nonbank financial institution subject to supervision under § 113 in order to assure continuity and mitigate risk).

[18] *Id.* § 804.

[19] *Id.*

[20] *Id.*

Other areas of law outside of the Dodd-Frank Act also underscore the point that severity is often taken into account when evaluating risk. The consideration of risk in the context of the Federal Flood Insurance Program ("FFIP") is instructive – risk is measured by the severity of loss in addition to frequency. FFIP provides severe repetitive loss insurance.[21] Severe repetitive loss insurance aims to reduce the risk associated with certain areas that are prone to floods. This type of insurance is only available for those households that have received "four or more separate claims payments under flood insurance coverage, with the amount of each such claim exceeding $5,000 and with the cumulative amount of such claims payments exceeding $20,000; or for which at least two separate claims payments have been made under such coverage, with the cumulative amount of such claims exceeding the value of the property."[22] Risk in this context is not only measured by the frequency of flood claims made, but also by the severity of loss resulting from the flood. Indeed, insurance is not designed to prevent the frequency of harm, but instead, to mitigate the severity of that harm.

3. Private MI protects both lenders and investors from the risk of default by reducing the frequency of borrower default and the severity of potential losses in the event of borrower default.

(Question 111(a))

The Agencies' narrow and incorrect interpretation of Congress's mandate to consider the impact of MI on the risk of default to solely mean the frequency of default ignores the important role that MI has played and continues to play in managing market risk. It is also counter-productive to encouraging the return of the private market and diminishes the role that private capital should play in the future of housing finance.

A. Severity

As discussed previously, private mortgage insurers stand first in line to pay a loss if a borrower defaults. When a homeowner defaults on a home loan insured by a private mortgage insurer, the insurer must pay a claim to the owner of the loan. The MI claim coupled with the down payment has historically covered 20-30% of the loan amount, depending on the amount of borrower down payment. *See* Figure 1. This claim payment, along with the proceeds from the sale of the house, significantly reduces the severity of the economic loss that occurs when a borrower defaults on a loan.

When loans with private MI are included in securitized pools, the claims payments flow through to the benefit of the investors to reduce their losses. Private mortgage insurers have paid out almost $24 billion in foreclosures losses in the past three years – losses that would have otherwise been borne by lenders, investors, the GSEs, and taxpayers.

Importantly, a 5% down payment with private MI has historically provided <u>more</u> protection to lenders and investors from the risk of default than would a 20% down payment. This is because private MI coupled with the borrower's down payment typically covers 20-30%

[21] 42 U.S.C. § 4102a.

[22] *Id.*

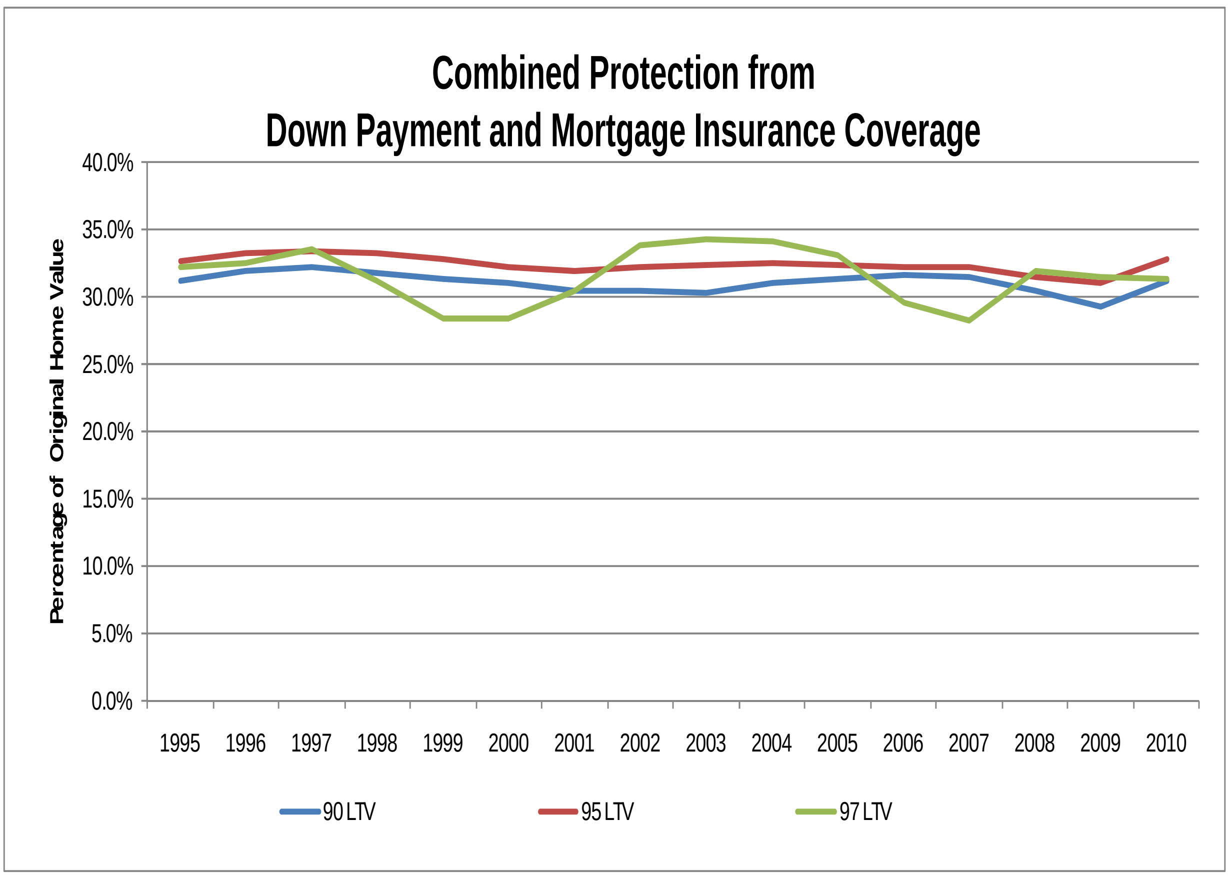
of the loan amount – meaning lenders and investors are at risk for only 65-70% of the loan amount instead of 80% for a loan with 20% down and no private MI. *See* Figure 2.

Recognizing the value of MI, Acting Comptroller of the Currency John Walsh stated:

> Private mortgage insurers with adequate financial resources might provide investor protection against losses, and applying conservative loan-by-loan underwriting criteria for mortgages would foster securitization of high-quality assets. Both outcomes are consistent with the objectives of the statute…[23]

Also, including loans insured by MI in the QRM definition would be consistent with the GSEs' historical practices of purchasing low down payment loans that are insured by MI. By purchasing low down payment loans insured by MI, the GSEs have historically provided broader credit availability than allowed by the proposed QRM rules while reducing overall credit risk exposure.

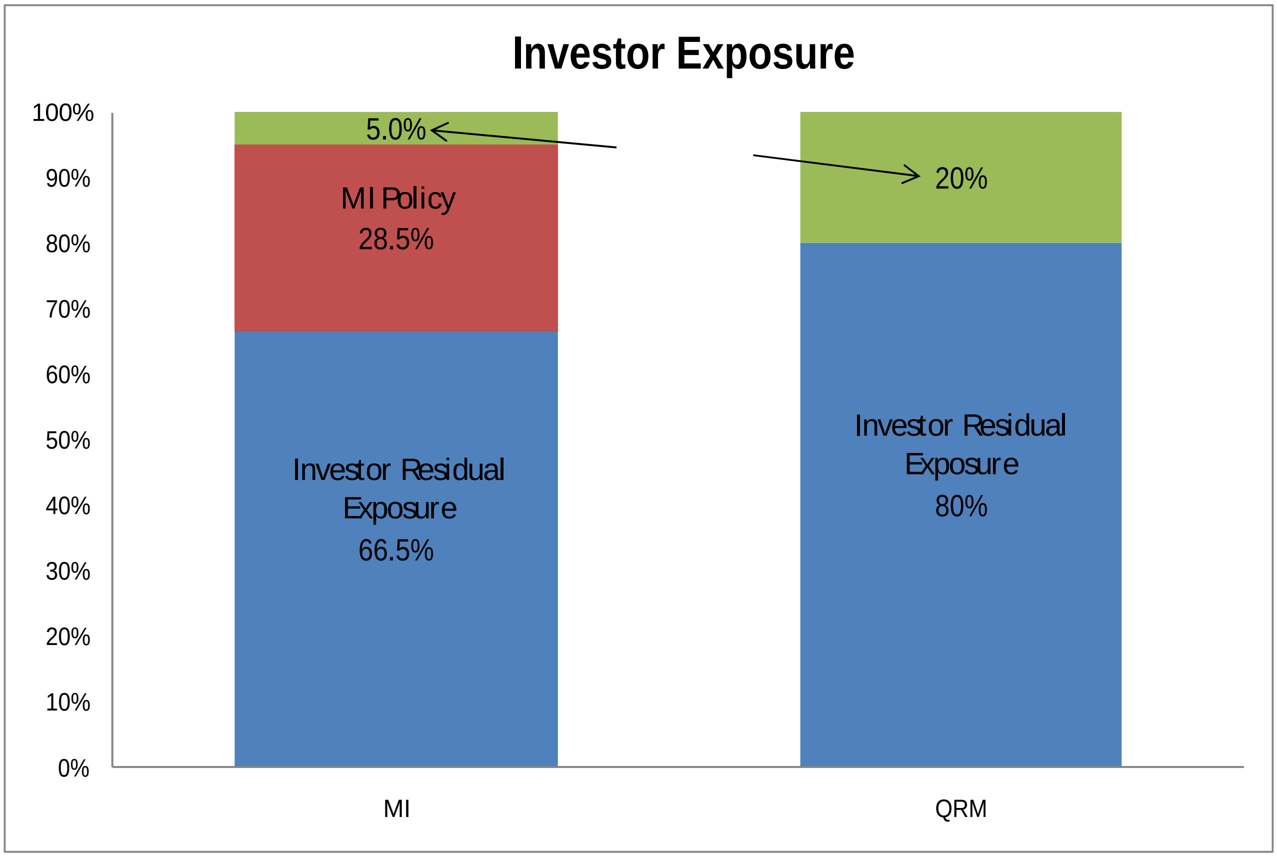
Figure 1



Source: MICA, 13M Loans

[23] Statement of John Walsh, Acting Comptroller of the Currency, to the Federal Deposit Insurance Corporation Board of Directors Regarding the Proposed Rulemaking on Credit Risk Retention Requirements, 2 (March 29, 2011) found at http://www.occ.treas.gov/news-issuances/speeches/2011/pub-speech-2011-34.pdf.

Figure 2



B. Frequency

i. Private mortgage insurers provide a second set of criteria to the underwriting process.

After a lender's review of a borrower's loan application, MI companies have historically scrutinized that loan application according to their own independent set of underwriting criteria. This dual underwriting process has acted as an additional check in the origination process, serving to ensure that loans are prudently underwritten.

Radian acknowledges that during the period leading up to the housing boom, the MI industry did not always carry out its second set of criteria function for each loan, in large part because of the MI industry's increased reliance on the then current GSE automated-underwriting ("AU") systems. Over time, changes were made to these AU systems to approve higher risk borrowers in order to allow the GSEs to compete with the private label market. These changes were made without visibility to the components of the models and how they migrated over time from a true credit underwriting system to one that met the GSEs' perceived market and production objectives.

At present, MI companies continue to rely in part on a delegated underwriting model. However, the industry has put a number of reforms and quality controls in place to strengthen its loan review process to facilitate even greater underwriting discipline. Specifically, Radian has instituted an automated eligibility engine that screens loans for compliance with Radian's eligibility criteria prior to making the commitment to insure. This supplants the company's reliance on originators to adhere to existing eligibility guidelines. By screening prior to commitment, Radian identifies lender errors in their origination process and eliminates the need for lenders to ask Radian for loan-level accommodations of these errors once a commitment has been granted. In addition to removing operational risk from the delegated origination process, Radian has instituted credit policies that result in lender termination for higher than expected early default experience and for failing to deliver a representative mix of business. Finally, in order to prevent favorable market conditions from masking underlying origination risk, Radian revamped its quality control process to sample even well-performing loans to see if they should have been made.

ii. Private mortgage insurers reduce the incidence of borrower default.

According to an analysis conducted by Genworth Financial relying on loan level performance information contained in the CoreLogic servicing database to compare the performance of insured versus uninsured loans, delinquent loans insured by private MI cure 54% more frequently than delinquent loans that are not insured by private MI.[24] This is understandable because private mortgage insurers' interests are aligned with those of borrowers. Because private mortgage insurers only pay out claims when a borrower goes into foreclosure, private mortgage insurers have an incentive to work with borrowers to cure troubled loans to prevent foreclosures. In fact, the industry has undertaken a number of efforts over the past few years to help keep troubled borrowers in their homes, including support in modifying loans, providing third-party credit counseling to borrowers, and participating in various foreclosure mitigation programs. Radian's Fast Advance program is an example of the mortgage insurer making a partial payment prior to claim in order to assist the borrowers to get and stay current. We have also put in place our own expediters and additional personnel in servicing shops in order to assist with loan modifications.

4. Congress clearly intended to include low down payment loans that are insured by private MI in the QRM exemption, and the present housing crisis will be unnecessarily prolonged by the exclusion of these loans from the QRM.

(Questions 111(b), 111(c), 108, 120, 121, 143, 145, 147, 149, and 150)

The sponsors of the QRM provision – Sens. Mary Landrieu (D-LA), Kay Hagan (D-NC), and Johnny Isakson (R-GA) – have repeatedly stated that their intent was for low down payment loans insured by private MI to be included in the QRM exemption. During Senate floor consideration of the QRM exemption provision, Sen. Isakson said that the QRM was intended to

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[24] Genworth Financial (relying on CoreLogic data), *Performance of Insured vs. Piggyback Mortgage Loans* (Aug. 2010). The CoreLogic (NYSE: CLGX) servicing database encompasses more than 80% of the first-lien mortgages in the U.S. Further information regarding CoreLogic is available at www.corelogic.com.

ensure that, among other things, "there is equity of 20 percent in every loan made, either through the downpayment being 20 percent or through whatever downpayment is made, having mortgage guarantee insurance on the amount above 80, and up to the downpayment, which is the way things used to work."[25] He added that the purpose of requiring mortgage insurance for loans with less than 20% down was to ensure that the lender is protected because "if there is a default, that insurance is paid immediately, which ensures you that you are making a better quality loan."[26]

In fact, an amendment offered by Senator Bob Corker (R-TN) that would have required a 5% down payment as part of the QRM was defeated, in large part because it was viewed as being too restrictive. Then Senate Banking Committee Chairman Christopher Dodd (D-CT) said that the Corker amendment would have serious consequences for first-time and minority home buyers.[27]

Subsequent to the enactment of the Dodd-Frank Act, Sens. Landrieu, Hagan, and Isakson have written to the Agencies several times regarding their intent. For example, in a November 8, 2010 letter to the Agencies, these Senators stated:

> In addition, for loans with lower down payments that have combined loan-to-value ratios greater than 80 percent, the protections provided by mortgage insurance results in lower losses for lenders and investors and fewer foreclosures for borrowers than similar loans that lack insurance. The mortgage insurance provision ensures that the qualified residential mortgage exemption can serve those consumers that cannot afford a 20 percent down payment while putting substantial private capital at risk to drive underwriting discipline.[28]

Despite the clear intent of the QRM exemption's sponsors, the Agencies have proposed only exempting loans with a 20% down payment from the Dodd-Frank Act risk retention requirements. Not only was a down payment requirement intentionally excluded from the statute, but loans with a 20% down payment currently do not require private MI. As noted above, the sponsors expressly contemplated the inclusion of low down payment loans that are insured by private MI in the QRM.

Further, a 20% down payment would unnecessarily place homeownership out of reach for many. In 2010, 86% of first-time borrowers who used a mortgage made down payments of less than 20%. Even with a 10% down payment requirement, 70% of first-time borrowers who used a mortgage would have been excluded from the housing market.[29] An overly-burdensome and restrictive 20% down payment requirement is unnecessary when private MI makes it possible for qualified borrowers with less than 20% down but who still have adequate income and credit to enjoy long-term, sustainable homeownership through an insured mortgage, while

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[25] 156 CONG. REC. S3576 (daily ed. May 12, 2010) (statement of Sen. Isakson).

[26] *Id.*

[27] Amendment No. 3955; 156 CONG. REC. S3518 (daily ed. May 11, 2010) (statement of then Senate Banking Committee Chairman Christopher Dodd (D-CT)).

[28] Letter from Sens. Landrieu, Hagan, and Isakson to Secretary Donovan, Chairman Bair, Chairman Bernanke, Chairman Schapiro, and Messrs. DeMarco and Walsh (Nov. 8, 2010).

[29] National Association of Realtors, *Profile of Home Buyers and Sellers 2010,* 71 (2010).

protecting lenders, investors, and taxpayers from the risk of borrower default. Federal housing policy should encourage prudent low down payment lending for borrowers who have a proven capacity to meet their mortgage obligations as long as those loans are properly underwritten, made to qualified borrowers, and lenders are required to obtain private MI on those loans. Enabling first-time, low- and moderate-income borrowers who put down less than 20% to purchase homes is essential to reducing the excess inventory of available homes and facilitating a housing market recovery.

Indeed, loans with LTVs of greater than 80% LTV and up to 96.5% LTV should be included as a QRM as long as they are insured by MI. First, FHA insures loans with only 3.5% down, and FHA is exempted from the proposed risk retention requirements. The Agencies should provide parity between FHA and privately-insured loans. Without such parity, all loans made with less than a 20% down payment would have to be insured by FHA to be exempt, which would provide the FHA with virtually the entire market, further constraining the Agency's limited resources and exposing taxpayers to additional risk.

Second, as noted previously, a loan with a 5% down payment and private MI provides more protection to lenders and investors from the risk of default than would a 20% down payment. *See* Figure 2.

Further, the MI industry has been successfully insuring loans with 5% down since the 1980s. It was not until the introduction of exotic risk-layering products coupled with the added risk-taking embedded in the AU systems that the performance of these loans began to suffer. In the past two years, however, Radian has insured prudently underwritten loans with borrower down payments between 3% and 10%, and this book of business is one of the best performing books of business the company has ever had. Indeed, the risks that are associated with a lower down payment can be offset by the borrower's credit and capacity.

5. The Proposed Rule should specify how the use of "piggyback loans" will be detected and prohibited in the future.

The Proposed Rule prohibits the use of a junior lien or "piggyback loan" in conjunction with a QRM to purchase a home. However, the Agencies have not specified how the use of piggyback loans will be detected and prohibited in the future.

Piggyback loans allow borrowers who have less than 20% down to obtain a mortgage without private MI. With a piggyback loan, two loans are made at the time of the home purchase – the first for 80% of the purchase price of the home, and the second for 10%, 15%, or even 20% of the purchase price. The first mortgage enables the borrower to meet the GSEs' LTV requirements for sale in the secondary market, while the simultaneous second lien enables the borrower to receive a larger loan with a smaller down payment. Piggyback loans are also referred to as "hidden" second mortgage loans because they allow borrowers to present the illusion of having a 20% down payment, when, in fact, they do not.

During the 2000s, piggyback loans became a popular home financing mechanism as many borrowers sought to avoid paying private MI premiums. In addition to avoiding private MI premiums, piggyback loans initially offered borrowers a tax advantage because the interest on the second lien was tax-deductible. Private MI premiums did not become deductible until 2007.

Unfortunately, however, piggyback loans played a substantial role in causing the recent housing crisis because they significantly increase the risk of borrower default. The analysis conducted by Genworth Financial also shows that insured loans perform 32% better than piggyback loans.[30] This is because loans insured by private MI are better underwritten since they have to meet private MI companies' independent set of underwriting criteria. Loans insured by private MI also have deeper coverage, protecting borrowers, lenders, investors, and taxpayers in the event of borrower default.

Additionally, borrowers who obtained piggyback loans are unable to take advantage of the foreclosure mitigation efforts that private MI companies have put in place to prevent borrowers who default on their loans from losing their homes. As noted previously, delinquent loans insured by private MI cure 54% more frequently than delinquent loans that are not insured by private MI because, with private capital at risk whenever a borrower defaults, private mortgage insurers have an incentive to work with borrowers to cure troubled loans to prevent foreclosures. The private MI industry participates in numerous efforts to keep troubled borrowers in their homes.

It is also important to note that the presence of second mortgages have stymied government and private sector loss mitigation efforts. Specifically, the presence of second mortgages has hindered opportunities to complete short sales or modify first mortgage loans.

The Agencies should specify in the Proposed Rule how hidden piggyback loans will be detected and prohibited in the future or whether the issuer will have to retroactively bear the consequences of the QRM definition being violated because the borrower obtained a piggyback loan instead of providing a 20% down payment.

6. The Proposed Rule would drive borrowers to loans insured by FHA, further constraining the agency's resources and exposing taxpayers to additional losses.

Under the Dodd-Frank Act, loans that are insured by government guarantee programs, like FHA, are automatically exempted from the Act's risk retention requirements because FHA is deemed a risk retainer. Yet, the Agencies have not exempted loans insured by private MI from the Act's risk retention requirements despite the fact that private MI is the private sector alternative to FHA that expands homeownership *without* exposing taxpayers to risk.

Failure to include loans with private MI in the QRM definition, while at the same time exempting FHA loans, which includes loans with down payments as low as 3.5%, from the Act's risk retention requirements, would have the perverse effect of driving all low down payment borrowers to FHA loans. Doing so would further constrain FHA's stressed capital reserves and further increase taxpayer exposure to additional losses. Doing so would also deprive consumers

[30] Genworth Financial (relying on CoreLogic data), *Performance of Insured vs. Piggyback Mortgage Loans* (Aug. 2010).

of the option to obtain private MI, when a private MI premium may be more cost-effective for the borrower than an FHA premium.

Additionally, failing to exempt privately-insured loans from the Act's risk retention requirements while exempting FHA loans would undermine the ability of private capital to return to the housing market by placing private MI, which places private capital at risk, at a disadvantage relative to government loan guarantee programs, which put taxpayer dollars at risk. There is no reason that FHA should insure loans – putting taxpayer dollars at risk – that private mortgage insurers can and will insure by putting private capital at risk. This would be exactly the opposite result of what Congress intended. Recognizing that utilizing private capital promotes incentive alignment and market discipline while reducing government and taxpayer exposure to risk, the Agencies should implement housing policy that continues the role of the private sector and reduces the role of government. Further, while we support the GSE exemption discussed below, because the GSE exemption would only continue as long as the GSEs operate under the control of the Federal Housing Finance Agency ("FHFA") and with capital support from the government, we believe a separate exemption for private MI is necessary to ensure long-term competition with the FHA.

7. The Agencies should maintain the proposed GSE exemption from the risk retention requirements.

(Question 79)

The Proposed Rule provides that the guaranty provided by a GSE while operating under the conservatorship or receivership of FHFA with capital support from the federal government will satisfy the risk retention requirements with respect to the mortgage-backed securities issued by the GSEs. This is because the Agencies have determined that the GSEs actually retain 100% of the credit risk as opposed to the 0% risk retention that would be possible for loans that meet the QRM definition. This exception would only continue as long as the GSEs operate under the control of FHFA and with capital support of the government.[31]

We support the proposed GSE exemption from the risk retention requirements. Under the proposal, FHA loans are exempted from the Act's risk retention requirements. Without a similar exemption for GSE-backed loans, almost all low down payment loans would go to FHA, which is already resource-constrained. Unlike FHA loans, which are government-insured, low down payment loans purchased by the GSEs are privately-insured, thereby promoting affordable homeownership while placing private capital in a first loss position after the borrower's equity.

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[31] Credit Risk Retention, 76 Fed. Reg. 24,514.

8. Radian supports MICA's proposed back-end debt-to-income ("DTI") ratio requirement.

(Questions 123 and 160)

Radian concurs with the proposed back-end DTI ratio as described in MICA's comment letter submitted in response to the Proposed Rule, which has been included below for the convenience of the Agencies:

> The Agencies' Proposal includes a front-end DTI (the ratio of monthly mortgage payments to monthly gross income) and a back-end DTI (the ratio of total monthly scheduled debt to monthly gross income). MICA recommends that the QRM not include a front-end DTI requirement. Should the Agencies determine that a front-end DTI is appropriate, however, MICA recommends that it be set at a level that corresponds to a 45% back-end DTI. As a general rule, front-end DTIs are typically six percentage points less than comparable back-end DTIs.[32]

9. The private MI industry is well positioned to help expand affordable housing opportunities in a responsible manner.

Over the past three years, private mortgage insurers have blunted the loss of taxpayer dollars by absorbing approximately $24 billion in foreclosure losses and are projected to pay approximately $40 billion in total to cover losses in the current housing downturn.

Not only is the industry withstanding the current, unprecedented nationwide downturn in housing, since the crisis began, the MI industry has attracted over $8 billion in new capital throughout the mortgage crisis, including $600 million that a new entrant to the industry has received.

Moreover, the industry has the resources to pay claims on existing loans and insure new loans because of the rigorous, countercyclical capital and reserve requirements imposed by state insurance commissioners, which have served as the backbone of the industry's financial strength. Mortgage insurers are required to keep three types of reserves, the most important of which is the contingency reserve. Half of each premium dollar earned goes into the contingency reserve and generally cannot be touched by the mortgage insurer for a 10-year period. This structure ensures that significant capital reserves are accumulated during good times and then drawn upon to absorb losses during downturns.

The other two reserves that mortgage insurers must maintain are case-basis loss reserves and unearned premium reserves. Case-basis loss reserves are established for losses on individual policies when the insurer is notified of defaults and when foreclosures occur, and premiums received for the term of a policy are placed in unearned premium reserves. Each state establishes the method by which premiums are earned to match premiums with loss and exposure.

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[32] MICA Comment Letter at 7 n13.

Beyond the reserves requirements, state regulators have detailed and comprehensive regulations designed to protect policyholders. State insurance regulations address, among other things, the licensing of companies to transact business, policy forms, claims handling, financial statements, periodic reporting, permissible investments, adherence to financial standards, and premium rates. The premium rates and policy forms are generally subject to regulation in every state and are intended to protect policyholders against the effects of excessive, inadequate or unfairly discriminatory rates and to encourage competition.

Today, the private MI industry is well positioned to help expand affordable housing opportunities in a responsible manner by putting private capital at risk. The industry has capacity to take on at least an additional $261 billion in insurance in force over the next three years. This translates to approximately 1.3 million additional mortgages in each of those years, especially for low- and moderate-income first-time home buyers. Private MI is just the type of private sector solution that Congress and the Agencies should be relying upon as they seek to reinvigorate the private market and reduce the role of government.

10. Radian supports MICA's proposed financial eligibility requirements.

(Questions 112 and 151)

Radian concurs with the eligibility requirements as described in MICA's comment letter submitted in response to the Proposed Rule, which has been included below for the convenience of the Agencies:

> Including MI within the final risk retention rule as proposed by MICA requires MI to be a durable source of risk mitigation expertise and risk retention capacity. For this reason, MICA suggests recognition of "qualified MI." Qualified MI is defined as insurance covering the first loss exposure on a residential mortgage loan which meets the following criteria:
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> - The MI company should be in good standing with its state domiciliary regulator. Within the context of a multi-state regulatory system, the domiciliary regulator asserts the most supervisory authority, receives the most financial and operating information, undertakes periodic financial/operational assessments and makes judgments on qualitative aspects not easily reduced to a "requirement." The domiciliary regulator is the linchpin of the state insurance regulatory system. Any business written outside the domiciliary jurisdiction requires a license, which allows regulators in those jurisdictions to impose additional prudential and market conduct requirements. Further description of the regulatory regime applicable to MI companies (including capital and reserves) is available in Appendix 2 to this response.
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> - Adequate MI coverage must be obtained. At a minimum, 20% coverage must be obtained to cover the basic costs of a mortgage foreclosure (*i.e.*, accrual of unpaid interest, foreclosure fees,

property maintenance, real estate disposition fees and legal fees). Customary coverage (also known as standard coverage)[33] provides coverage for normal foreclosure costs in addition to covering modest home price decline. Although not specified in the legislative history of Dodd-Frank, Congress likely was assuming standard coverage in its references to MI. "Deep coverage," or a greater level of insurance protection than that provided by standard coverage but less than the 100% protection provided by the FHA, also might be considered within the context of an expanded QRM definition for investor protection purposes. Deep coverage likely would cover substantially all the loss in most foreclosures, including those experienced in the ongoing housing market downturn.[34]

- It is important to note that deeper MI coverage levels that bring the initial LTV below 60% will not undermine the incentive of the lender to originate loans that comply with the MI underwriting requirements at the time of origination. Failure by a lender to meet these requirements allows for rescission of the loan when a request for a claim payment is made to the MI. Similarly, unlike FHA insured loans, MI insured loans with deep coverage continue to put the lender at risk for losses on individual loans which exceed the coverage amount.

- The insured loan must have been underwritten according to the MI company's specified underwriting guidelines.

  MICA's suggested combination of MI company regulatory compliance, minimum coverage levels and adherence to rigorous credit underwriting discipline ensures a higher standard than that available simply from specifying financial requirements for MI companies. MICA's suggestions assure robust incentive alignment with originators, securitizers and investors as well.[35]

Radian adds that the MI industry's strong state regulatory structure is the primary reason why the industry has been able to survive the recent housing crisis. We support the continuation of this effective state regulatory structure going forward. We also note that most states employ

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[33] 35% for 97% LTV loans (bringing the initial exposure down to 63%), 30% for 95% LTV loans (exposure down to 66.5%), 25% for 90% LTV loans (exposure down to 67.5%), and 12% for 85% LTV loans (exposure down to 74.8%).

[34] *See* Appendix 7, Milliman Client Report, *Mortgage Cohort Credit Loss Analysis as of September 2010* (April 1, 2011) prepared for Mortgage Insurance Companies of America. This analysis analyzed the loan level pricing fees imposed by the GSEs on borrowers which are supplemental to the MI insurance coverage on the subject loans. The study reviewed the performance of loans originated from 1998 through 2010. Part of this analysis determined the projected loss severity for loans subject to varying levels of deeper MI coverage with simulated average present value loss rates net of mortgage insurance varying from 0.88%, for loans with the current standard MI coverage, to 0.06% where deeper MI coverage is sufficient to bring the initial LTV down to 35%, which indicates a significantly reduced risk of loss beyond current coverage levels to what may be considered essentially negligible loss rates.

[35] MICA Comment Letter at 24-26.

similar regulatory structures for the MI industry because most states have adopted the National Association of Insurance Commissioner's model regulatory structure.

Conclusion

Radian commends the Agencies for their efforts toward developing a strong credit risk retention scheme. Radian recognizes that this rule can be both complex and controversial. However, this scheme, if appropriately designed and implemented, will ultimately make progress toward establishing a safe, sound, and robust housing market and preventing another housing crisis.

To ensure the return of a healthy housing market while effectively managing market risks, loans with up to 96.5% LTV insured by private MI should be included in the QRM exemption. Exempting privately-insured loans from the Dodd-Frank Act's risk retention requirements would enable qualified first-time, low- and moderate-income borrowers the opportunity to own a home while protecting lenders, investors, and taxpayers from the risk of default.

It is important to note that while some Agencies have asserted that the QRM should represent only a small portion of the market going forward, the size of the housing market has already adjusted downward significantly since 2007 such that only qualified borrowers are able to obtain loans at present. The final "Qualified Mortgage" rule, when issued, will ensure that this continues. Therefore, it is not unreasonable to expect that loans that meet QRM criteria may represent a sizeable portion of the housing market in the future.

Sincerely,

Teresa Bryce Bazemore
President