Office of the
Comptroller of the Currency

MEMORANDUM

To: Public Comment File – Docket No. OCC–2023–0008

From: Carl Kaminski, Assistant Director, Bank Advisory, Chief Counsel's Office

Date: March 11, 2024

Subject: Meeting with representatives from U.S. Mortgage Insurers ("USMI") to discuss: Notice of Proposed Rulemaking: "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity"

Staffs of the Federal Deposit Insurance Corporation, Federal Reserve System, and Office of the Comptroller of the Currency (collectively, the "agencies") met with representatives from USMI regarding the agencies' Notice of Proposed Rulemaking on Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity (the "NPR"), which was published in the Federal Register on September 18, 2023 (88 FR 64028). The USMI representatives discussed their concerns with, and the impact of, the proposed treatment of mortgages and private mortgage insurance in the NPR as discussed in USMI's comment letter. USMI provided a slide presentation in connection with the meeting.

Attendees

OCC	Amrit Sekhon Margot Schwadron Andrew Tschirhart Benjamin Pegg Venus Fan Diana Wei Nadia Gerasimova JungSup Kim Kevin Korzeniewski Carl Kaminski
FDIC	Benedetto Bosco Iris Li Catherine Wood Ernest Barkett Richard Smith Andrew Carayiannis Kyle McCormick

	Merritt Pardini Keith Bergstresser Adam Casella Bob Charurat Huiyang Zhou David Riley Michael Maloney
Federal Reserve Board	Andrew Willis Jonah Kind Sarah Dunning Gillian Burgess Robin Oh David Imhoff Brian Chernoff Cecily Boggs David Alexander Isabel Echarte Ryan Rossner Christopher Appel Matthew McQueeney Abigail Roberts
USMI	Seth Appleton Brendan Kihn Christina Brown
Enact Mortgage Insurance Corp	Duane Duncan
Essent Guaranty, Inc.	Steven Sorge
Mortgage Guaranty Insurance Corporation	Geoff Cooper
National Mortgage Insurance Corporation	Bill Leatherberry Lesley Alli
Radian Guaranty, Inc.	Meghan Bartholomew

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Basel III Endgame Considerations

Credit for Private Mortgage Insurance (MI) & Serving Low Down Payment Borrowers

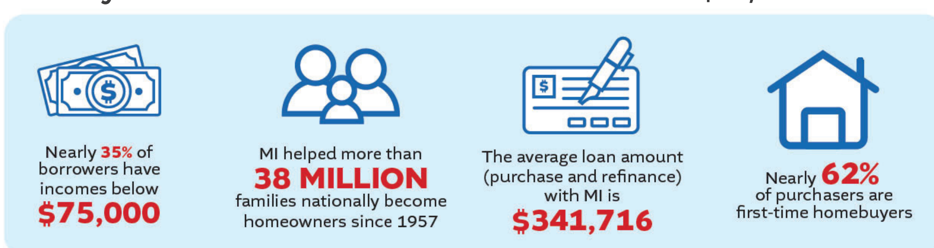
March 2024

Private MI Serves First-Time, Low- and Moderate-Income (LMI) & Minority Homebuyers

Amassing a large down payment is consistently cited as one of the biggest hurdles to homeownership, particularly for first-time borrowers in a high interest rate, low inventory market. It could take 35 years for a middle class family to save for a 20% down payment and closing costs.

Private MI helps bridge the gap and makes it possible for borrowers to qualify for affordable and sustainable mortgage financing with down payments as low as 3%. In 2022:

- Private MI helped **over 1 million homeowners** purchase a home or refinance an existing mortgage, including **nearly 130,000 Black households**
- **Nearly 62% percent** of purchase loans with private MI were for first-time homebuyers
- **Nearly 35%** were borrowers with **incomes below $75,000.**



Sources: GSE Aggregate Data & 2022 HMDA Data

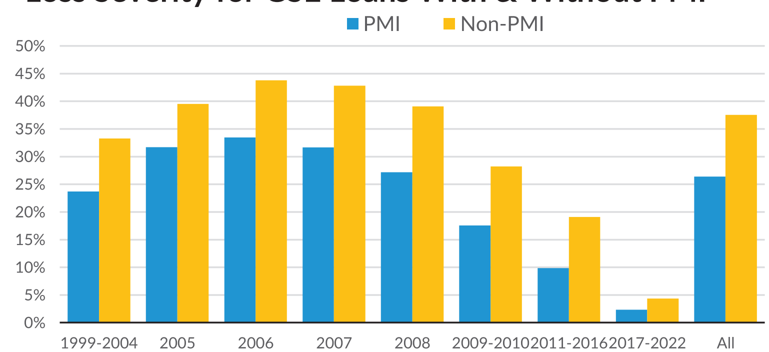
Private MI Provides Critical Risk Protection to Lenders, GSEs & Taxpayers

Private MIs deploy private capital that stands in the first-loss position throughout the economic cycle and nearly $1.6 trillion in mortgages currently benefit from private MI coverage, including approximately $200 billion in portfolio and PLS executions. Standard coverage insures up to 35% of the value of a loan and increases based on the LTV. This coverage reduces the effective LTV of a loan with private MI to well below 80%.

Analysis of GSE-backed mortgages for the 1994-2022 origination period found that the loss severity for mortgages without private MI was 11.2% higher than for mortgages with private MI coverage.

Original LTV	Losses Covered by Private MI (standard cover)	Private MI Net Impact on LTV	Effective LTV
90%	25.0%	-22.5%	67.5%
95%	30.0%	-28.5%	66.5%
97%	35.0%	-34.0%	63.1%

Loss Severity for GSE Loans With & Without PMI



Source: Urban Institute, “Mortgage Insurance Data At A Glance - 2023” (August 2023)

Bank capital rules should balance safety & soundness with consumer access to affordable mortgage products

- Bank capital rules should recognize the risk mitigating benefits of private MI and promote a level playing field between GSE and portfolio executions
- Risk weights for mortgages held in portfolio should be appropriately calibrated to:
  - Encourage banks to engage in low down payment lending, backed by private capital
  - Promote innovation in portfolio lending
  - Ensure that first-time, LMI, and minority borrowers using low down payment mortgages have options

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USMI Observations

1. **<u>The proposal will harm first-time, LMI & minority homebuyers.</u>** Given the excessively conservative treatment for low down payment mortgage loans, the capital requirements to support these loans would dramatically increase, negatively impacting many first-time, LMI, and minority borrowers who do not have access to intergenerational wealth to afford large down payments at closing. The proposal would increase costs to consumers and/or disincentivize low down payment balance sheet loans, reducing homebuyers' mortgage options. Furthermore, it would impede administrative, legislative, and industry initiatives to close the racial homeownership and wealth gaps.

2. **<u>The proposed capital treatment for mortgage loans is excessively conservative.</u>** Under the current standardized approach, a mortgage loan held by a bank with a LTV ratio that equals or exceeds 90% is given a risk weight of 50% if the loan is protected by private MI. However, the NPR would assign a mortgage loan held by a bank with $100 billion or more in assets with an LTV that exceeds 90% a risk weight of 70%, thereby eliminating the risk mitigating value of private MI. The NPR does not provide any data to justify the large increase in capital requirements for low down payment balance sheet mortgages.

3. **<u>The proposal fails to accurately value private MI.</u>** The agencies' proposal fails to recognize the private MI industry's historical performance, ignores the numerous enhancements undertaken since the Great Financial Crisis, and disregards the uniqueness of the U.S. housing finance system. The industry enhancements include: (1) robust financial, capital, operational, and quality control standards known as the Private Mortgage Insurer Eligibility Requirements (PMIERs); (2) updated Master Policy and revised Rescission Relief Principles; and (3) programmatic use of credit risk transfer (MI-CRT).

4. **<u>The proposal is inconsistent with FHFA's capital rule.</u>** The agencies take a divergent view of private MI compared to the FHFA's Enterprise Regulatory Capital Framework (ERCF). The FHFA's assessment of single-family mortgage credit risk recognizes the financial strength of private MI companies and provides for capital credit – and therefore reduced guarantee fees – for low down payment mortgages with private MI.

5. **<u>The proposal will negatively impact the housing finance system.</u>** By reducing consumers' mortgage options, the proposed rule would cause homebuyers to rely more heavily on mortgage products and programs that are either indirectly or directly backed by the federal government. Changes to bank capital rules should not simultaneously decrease borrowers' options and shift mortgage credit risk from the private sector to U.S. taxpayers.

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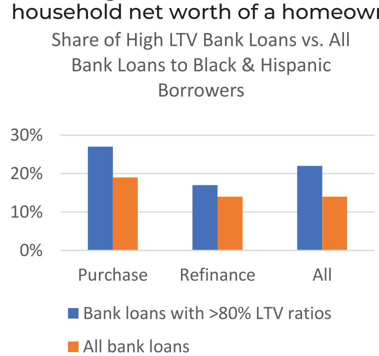
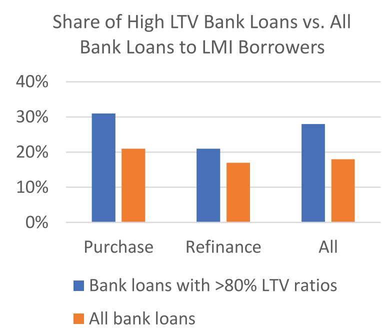
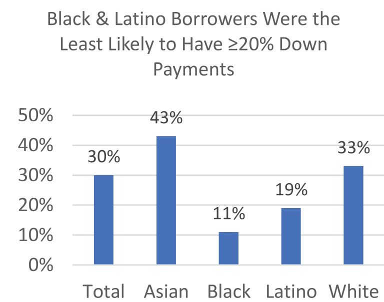
The Proposal Will Harm First-Time, LMI & Minority Homebuyers

First-time, LMI, and borrowers of color overwhelmingly utilize high LTV mortgages because they are less likely to have access to intergenerational wealth to afford large down payments. Access to low down payment mortgage products is critical for these households to become homeowners and begin to build long-term wealth, as Federal Reserve data shows that the median household net worth of a homeowner is nearly 40x that of a renter.







Share of borrowers who put down 20% or more in 2022
Source: Urban Institute analysis of 2022 HMDA data for owner-occupied, 1-to-4 unit purchase loans only

Source: Urban Institute analysis of 2020-2021 HMDA & Black Knight data on mortgages in bank portfolios

The proposal would significantly increase capital requirements on high LTV portfolio mortgages and increase costs to borrowers and/or disincentivize large commercial banks from offering low down payment mortgage options. Creditworthy homebuyers should have access to multiple mortgage options and capital rules should not arbitrarily divide the market and reduce access to loan products.

USMI supports policies and initiatives that increase access to affordable and sustainable homeownership, especially for historically underserved communities, and the proposal represents a misalignment with industry and policymaker goals to address the racial homeownership and wealth gaps.

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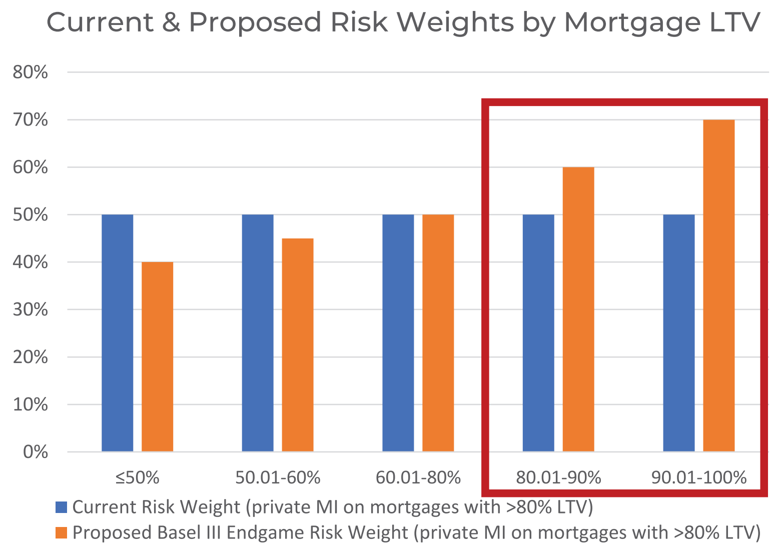
The Proposed Capital Treatment for Mortgage Loans is Excessively Conservative

USMI supports bank capital requirements that are risk-based, analytically justified based on historical analysis, and completely transparent to market participants.

The current proposal lacks the necessary analytical information and clear rationale to justify the significantly higher capital requirements and the departure from the current treatment of mortgages held on bank balance sheets.



The proposed capital levels exceed what would be needed to protect banks from a repeat of the Great Financial Crisis and downplay or ignore important system-wide post-crisis reforms, including statutory (Dodd-Frank Act) and regulatory (CFPB's Ability-To-Repay/Qualified Mortgage Rule) mortgage underwriting standards and prohibitions on risky loan products and features. Applying the proposed capital requirements to the post-Dodd-Frank Act mortgage underwriting ecosystem fails to recognize those reforms and results in excessively high capital charges for mortgage loans.

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The Proposal Fails to Accurately Value Private MI & Would Eliminate Capital Credit for Private MI on High LTV Mortgages

Current Bank Capital Framework

50%
Risk Weight

Under the existing bank capital framework, single-family owner-occupied mortgages held in portfolio by banks are given a 50% risk weight so long as they are “prudently underwritten mortgages” with LTVs below 90% after considering private MI.

Proposed Basel III Endgame Framework

No Credit for Private MI

The expanded risk weight approach is expected to be the binding computation for the majority of banks with assets of at least $100 billion. This approach uses LTV ratios to set the risk weight of mortgages held in portfolio, but *without* considering private MI. The presence of MI will not reduce the capital charge, and a down payment of 20% or more will be required for a risk weight of 50%.

The current capital framework that gives credit for private MI would continue to apply to banks with assets below $100 billion.

The Proposal Does Not Recognize Post-Crisis Enhancements to the Private MI Industry

Private MIs are structured as monoline insurers that are exclusively dedicated to absorbing single-family mortgage credit risk. The business model is built to serve borrowers, lenders, the GSEs, and taxpayers in all economic/market cycles and private MIs are not subject to bank run type events.

Since 1957, the private MI industry has never stopped writing new business, insuring loans, or paying valid claims, and did not receive a single dollar of federal bailout funds.

Private MIs are highly-rated counterparties and in January 2024 S&P Global Ratings upgraded the long-term insurer financial strength and issuer credit ratings for all USMI member companies, an indication of the industry's capital adequacy, strong underwriting, and performance.

Private MIs are strong sources of "permanent capital" and sophisticated long-term managers of credit risk. Unfortunately, the proposal does not recognize the unique cycle-tested features of the private MI business model and the numerous post-crisis enhancements to the industry, including:

- **PMIERs**: private MIs are subject to a robust set of capital , financial, operational, and quality standards that are set by the GSEs with significant input from the FHFA. The industry collectively holds more than $11.4 billion in excess of the capital requirements, for a sufficiency ratio of 172%.
- **Master Policy**: private MIs' contract for claims paying guidelines and procedures underwent significant changes in 2014 to improve coverage and streamline the payment of claims to ensure that private MI results in reliable and predictable payments to lenders and the GSEs. A USMI-developed common Master Policy became effective on March 1, 2020.
- **Rescission Relief Principles**: first published in 2013 and updated in 2017 to align with the GSE representations and warranty framework. Includes automatic relief after 36 timely payments and early relief after 12 timely payments with a full file review.
- **MI-CRT**: since 2015, the programmatic use of CRT deals has transformed the industry's risk management model from "Buy-and-Hold" to "Aggregate-Manage-Distribute." Since 2015, the industry has transferred more than $75.2 billion in risk on $3.6 trillion of insurance-in-force to the global reinsurance and capital markets.

The Proposal is Inconsistent with FHFA’s Capital Rule

The FHFA’s capital framework for the GSEs – the ERCF – explicitly provides capital credit for low down payment mortgages that are protected by private MI via its “credit enhancement multipliers” (Table 8 of the final rule, 85 Fed. Reg. 82150 (December 17, 2020)). The NPR, however, takes a divergent view of private MI and does not give capital credit for loans with private MI. USMI member analysis of 2023 GSE purchase mortgages shows that the proposal would require 70% more risk-based capital than under the ERCF.

TABLE 8 TO PARAGRAPH (e)(2)(iii)(E): CREDIT ENHANCEMENT MULTIPLIERS FOR PERFORMING LOANS AND NON-MODIFIED RPLS SUBJECT TO CANCELABLE MORTGAGE INSURANCE

			Loan Age											
	OLTV	Coverage Percent	<= 5	>5, <= 12	>12, <= 24	>24, <= 36	>36, <= 48	>48, <= 60	> 60, <= 72	> 72, <= 84	> 84, <= 96	>96, <=108	>108, <=120	>120
15/20 Year Amortizing Loan with Guide-level Coverage	>80%, <=85%	6%	0.997	0.998	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
	>85%, <=90%	12%	0.963	0.971	0.988	0.999	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
	>90%, <=95%	25%	0.826	0.853	0.912	0.973	0.996	1.000	1.000	1.000	1.000	1.000	1.000	1.000
	>95%, <=97%	35%	0.732	0.765	0.848	0.936	0.986	0.998	1.000	1.000	1.000	1.000	1.000	1.000
	>97%	35%	0.630	0.673	0.762	0.865	0.945	0.980	0.996	1.000	1.000	1.000	1.000	1.000
30 Year Amortizing Loan with Guide-level Coverage	>80%, <=85%	12%	0.867	0.884	0.928	0.962	0.994	0.999	1.000	1.000	1.000	1.000	1.000	1.000
	>85%, <=90%	25%	0.551	0.584	0.627	0.679	0.785	0.893	0.950	0.986	0.998	1.000	1.000	1.000
	>90%, <=95%	30%	0.412	0.440	0.456	0.484	0.547	0.654	0.743	0.845	0.932	0.969	0.992	1.000
	>95%, <=97%	35%	0.322	0.351	0.369	0.391	0.449	0.535	0.631	0.746	0.873	0.925	0.965	1.000
	>97%	35%	0.272	0.295	0.314	0.353	0.410	0.462	0.515	0.607	0.756	0.826	0.887	1.000
15/20 Year Amortizing Loan with Charter-level Coverage	>80%, <=85%	6%	0.997	0.998	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
	>85%, <=90%	12%	0.963	0.971	0.988	0.999	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
	>90%, <=95%	16%	0.887	0.904	0.943	0.983	0.997	1.000	1.000	1.000	1.000	1.000	1.000	1.000
	>95%, <=97%	18%	0.854	0.874	0.918	0.966	0.992	0.999	1.000	1.000	1.000	1.000	1.000	1.000
	>97%	20%	0.788	0.810	0.859	0.922	0.969	0.989	0.998	1.000	1.000	1.000	1.000	1.000
30 Year Amortizing Loan with Charter-level Coverage	>80%, <=85%	6%	0.934	0.943	0.964	0.981	0.997	0.999	1.000	1.000	1.000	1.000	1.000	1.000
	>85%, <=90%	12%	0.780	0.795	0.819	0.845	0.896	0.948	0.976	0.993	0.999	1.000	1.000	1.000
	>90%, <=95%	16%	0.679	0.690	0.703	0.719	0.755	0.813	0.861	0.916	0.963	0.983	0.995	1.000
	>95%, <=97%	18%	0.642	0.652	0.662	0.676	0.708	0.756	0.806	0.866	0.933	0.960	0.981	1.000
	>97%	20%	0.597	0.607	0.617	0.629	0.658	0.686	0.715	0.765	0.845	0.882	0.914	1.000

“MI coverage absorbs first losses and reduces the total loss exposure of the [GSEs] because the approved insurance providers bear much of these losses in the event of default. Absent MI, the [GSEs] would assume a far greater proportion of the losses associated with defaults on these loans. For borrowers making a down payment smaller than 20 percent of the home’s value, the costs of the required credit enhancement, such as MI, contribute to the overall cost of their loan. As such, any analysis of guarantee fees without consideration of MI or other credit enhancement costs is incomplete—both from the perspective of the borrower and from the perspective of the [GSEs].”

FHFA Director Sandra Thompson (May 23, 2023)

Private MI Should Receive Credit In U.S. Bank Capital Rules

In light of the strength and resiliency of today's MI industry, the federal framework for bank capital requirements should recognize the value of private MI in providing robust credit risk protection. There are multiple ways to provide for the recognition of private MI and an important consideration in determining which of these options is most appropriate is operational ease. If the agencies are intent upon a six LTV-based tier approach, USMI recommends careful consideration of the ERCF.

Two ways to amend the NPR to incorporate capital credit for private MI are:

1) <u>Retain the current Standardized Approach</u>: The private MI-adjusted LTV ratio would be used for determining the applicable risk weight. This would create stability by preserving the current treatment of private MI for determining loan-level capital requirements, promote a level playing field between mortgage executions, and align with the FHFA's ERCF.

2) <u>Tiered risk-weight approach (MI reduces exposure)</u>: Banks may recognize a guarantee by netting the coverage amount from the exposure amount; the risk weight applied to that exposure amount would be based on the loan's LTV and not an MI-adjusted LTV. This would be consistent not only with the ERCF but also how banks apply credit for private MI in their internal models, as well as align with the Basel III agreement's approach to calculating guarantees.

Loan Examples Across Approaches

Thin Coverage		Expanded Risk-Based Approach		
	Standardized Approach	**NPR:** No Credit for MI	**Option 1:** MI Reduces LTV	**Option 2:** MI Reduces Exposure
Loan Amount	$ 290,000	$ 290,000	$ 290,000	$ 290,000
Initial LTV	97.0%	97.0%	97.0%	97.0%
MI %	**8.0%**	**8.0%**	**8.0%**	**8.0%**
Exposure %	89.2%	89.2%	89.2%	89.2%
Adjusted Exposure	$ 258,796	$ 258,796	$ 258,796	$ 258,796
LTV for Determining RWA	89.2%	97.0%	89.2%	97.0%
Risk-Weighting	50%	70%	60%	70%
Risk-Based Capital	$ 11,600	$ 16,240	$ 13,920	$ 14,493
Effective RBC %	**4.0%**	**5.6%**	**4.8%**	**5.0%**

Deeper Coverage		Expanded Risk-Based Approach		
	Standardized Approach	**NPR:** No Credit for MI	**Option 1:** MI Reduces LTV	**Option 2:** MI Reduces Exposure
Loan Amount	$ 290,000	$ 290,000	$ 290,000	$ 290,000
Initial LTV	97.0%	97.0%	97.0%	97.0%
MI %	**35.0%**	**35.0%**	**35.0%**	**35.0%**
Exposure %	63.1%	63.1%	63.1%	63.1%
Adjusted Exposure	$ 182,845	$ 182,845	$ 182,845	$ 182,845
LTV for Determining RWA	63.1%	97.0%	63.1%	97.0%
Risk-Weighting	50%	70%	50%	70%
Risk-Based Capital	$ 11,600	$ 16,240	$ 11,600	$ 10,239
Effective RBC %	**4.0%**	**5.6%**	**4.0%**	**3.5%**

Breakeven of MI Options		Expanded Risk-Based Approach		
	Standardized Approach	**NPR:** No Credit for MI	**Option 1:** MI Reduces LTV	**Option 2:** MI Reduces Exposure
Loan Amount	$ 290,000	$ 290,000	$ 290,000	$ 290,000
Initial LTV	97.0%	97.0%	97.0%	97.0%
MI %	**8.0%**	**8.0%**	**8.0%**	**11.6%**
Exposure %	89.2%	89.2%	89.2%	85.7%
Adjusted Exposure	$ 258,796	$ 258,796	$ 258,796	$ 248,571
LTV for Determining RWA	89.2%	97.0%	89.2%	97.0%
Risk-Weighting	50%	70%	60%	70%
Risk-Based Capital	$ 11,600	$ 16,240	$ 13,920	$ 13,920
Effective RBC %	**4.0%**	**5.6%**	**4.8%**	**4.8%**

What Housing Finance Stakeholders Are Saying About the Proposal & Private MI

"The Proposed Rule's requirement for mortgages that carry [private] MI are not appropriately aligned with credit risk because the risk weight is not required under the Basel III standards, the credit risk is already mitigated through the PMI, and the risk weight is not consistent with the approach of the [FHFA] […] Given that the Basel III framework does not require such high regulatory capital and that the purpose of [private] MI is to mitigate credit risk, which was carefully analyzed and acknowledged by FHFA, it does not appear that the Agencies' Proposed Rule is based on a sound credit risk analysis."

- National Fair Housing Alliance

"Rejecting PMI as a credit risk mitigant without exception would limit banking organizations' ability to engage in residential real estate lending, reducing the availability of credit generally…"

- Capital One, PNC, Truist & U.S. Bank

"Compounding the shortcomings of the proposed higher capital levels is the rule's failure to give proper credit for the role of private mortgage insurance (PMI) or reinsurance, which enables affordable and sustainable mortgage credit for borrowers without large down payments and has undergone a vital transformation since the global financial crisis"

- National Housing Conference

"Such a significant increase in capital standards will lead to reduced credit availability for all types of lending and undermine economic growth. If these standards are adopted, they will have a devastating impact on our efforts to increase Black homeownership and disadvantage all first-time, and in particular, first-generation homebuyers who do not have the benefit of multi-generational wealth or higher than average incomes."

- National Urban League, National Association for the Advancement of Colored People, National Housing Conference, Mortgage Bankers Association, & National Association of REALTORS

"In short, the level of capital that banks would be required by the NPR to hold against mortgage loans held in portfolio is excessive, at all LTV levels, and is likely to discourage bank mortgage lending. The NPR's impact on lending to LMI borrowers and communities and to borrowers of color is particularly perverse…"

- Urban Institute

What Federal Policymakers Are Saying About the Proposal & Private MI

"The proposal is particularly punitive to high [LTV] mortgages, which is especially problematic for [LMI] and minority borrowers who disproportionately rely on high LTV mortgages due to the generational racial wealth gap… By removing [private] MI from the equation, the proposal could create fewer options for low down payment borrowers, disincentivizing lenders to provide high LTV mortgage or buy the loans at a later date."

- House Democrat Letter Led by Reps. Beatty (D-OH), Meeks (D-NY), Vargas (D-CA), and Horsford (D-NV)

"Moreover, the proposed rule removes the ability of banks to use private [MI] to reduce risk weights for low down payment mortgages. This change fails to recognize important enhancements to the MI industry, including strong capital requirements, updated terms of coverage, and rescission relief principles. It also stands in contrast to the [FHFA's] Enterprise Regulatory Capital Framework that gives capital relief to the [GSEs] for MI."

- House Republican Letter Led by Rep. Fitzgerald (R-WI)

"When it comes to providing mortgages for [LMI] households, this proposal represents a departure from the original 2017 Basel agreement in favor of arbitrary capital increases and a disregard for banks' ability to offset risk through existing tools like private mortgage insurance, all without providing analytic justification to support these changes. The impact of these requirements for [LMI] households will be significant."

- Senate Republican Letter Led by Sen. Scott (R-SC)

"We believe that the Agencies proposed risk weights for residential mortgages are excessive and likely to further discourage bank mortgage lending, particularly to high [LTV] borrowers who are disproportionately first-time homebuyers, LMI borrowers, and borrowers of color…Concerningly, the Agencies have also proposed to give no credit for [PMI] designed to offset risks for higher LTV loans by absorbing default-related credit losses ahead of lenders and other parties. Providing capital credit for [MI] and other forms of private credit enhancement within appropriate parameters, and in the context of a robust risk-based capital framework, is a proven way to mitigate risks to regulated entities while preserving and enhancing access to affordable homeownership."

- House Financial Services Committee Democrat Letter Led by Rep. Cleaver (D-MO)