May 2, 2024

The Honorable Jerome H. Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R–1813
RIN 7100–AG64

Mr. Michael J. Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th Street SW
Washington, DC 20219
Docket ID OCC–2023–0008

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064–AF29

Re: Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity, Docket ID OCC-2023-0008.

Dear Chair Powell, Chairman Gruenberg, and Acting Comptroller Hsu:

On behalf of its member companies, U.S. Mortgage Insurers (USMI) appreciates the opportunity to submit a comment letter to supplement our initial submission on January 16, 2024[1] in response to the Basel III Endgame proposed rule (Proposed Rule)[2] jointly issued last year by the Board of Governors of the Federal Reserve System (Federal Reserve), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively the Agencies).

USMI respectfully: (1) requests that the Agencies clarify their intention to recognize private mortgage insurance (MI) as a part of the prudent underwriting criteria that determines whether a loan is a "regulatory residential real estate exposure" in the Proposed Rule, including eliminating a mischaracterization about the private MI industry; and (2) urges the Agencies to provide loan-level capital credit for high loan-to-value (LTV) mortgages with private MI coverage. Private MI stands in the first loss position in the event of borrower default and has provided durable risk protection to banks, credit unions, independent mortgage banks (IMBs), Fannie Mae and Freddie Mac (the GSEs), and taxpayers since 1957. Accounting for the risk-mitigating benefits provided

[1] USMI's January 16, 2024 comment letter is available at https://www.regulations.gov/comment/OCC-2023-0008-0202.
[2] 88 Federal Register 64028 (September 18, 2023).

by private MI coverage when calculating loan-level capital requirements would align the Agencies with the Federal Housing Finance Agency's (FHFA) capital treatment of private MI in its Enterprise Regulatory Capital Framework (ERCF)[3] and the loan-level price adjustment (LLPA) framework used to determine loan-level charges assessed on mortgages sold to the GSEs.

The Agencies Should Clarify that Private MI is a Required Credit Factor in Determining a "Regulatory Residential Real Estate Exposure"

Following the Proposed Rule's comment deadline, statements made by representatives of the Agencies during two congressional hearings[4] and a March 11, 2024 interagency meeting with USMI and its member companies indicate that the Agencies intended any new regulation to require private MI as a relevant credit factor in the definition of a "regulatory residential real estate exposure," and thus a factor in determining a loan's LTV-based risk weight. Under the Proposed Rule, a "regulatory residential real estate exposure" is a first-lien residential mortgage exposure that meets several prudential criteria including, being "made in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the value of the property."[5] The current Interagency Guidelines for Real Estate Lending Standards (the Standards) stipulate that for a loan to be considered "prudently underwritten" it must meet Supervisory Loan-to-Value Limits and that private MI is a relevant credit factor.[6] For mortgage loans on owner-occupied, 1- to 4-family residential properties, no LTV limit is specified, however, the Standards state that, "for any such loan with a loan-to-value ratio that equals or exceeds 90 percent at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral."[7]

If this interpretation is consistent with the Agencies' intention, USMI commends the Agencies for recognizing the risk-mitigating benefits of private MI in the Proposed Rule as a required credit factor to consider in determining a "regulatory residential real estate exposure." This demonstrates the Agencies' acknowledgment of the strength and resiliency of the private MI industry and the many enhancements undertaken since the Great Financial Crisis.

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[3] 85 Federal Register 82150 (December 17, 2020).
[4] House Committee on Financial Services, "Importing Global Governance: Examining the Dangers of Ceding Authority Over American Financial Regulation" (March 21, 2024): in response to a question from Rep. Brad Sherman, Dr. Michael Gibson (Federal Reserve) stated "The proposal doesn't change the treatment of private mortgage insurance. It is recognized in a particular way in the current capital rules and that is not proposed to changes in the proposed rule."; House Committee on Financial Services, "Oversight of Prudential Regulators" (November 15, 2023): in response to a question from Rep. Brad Sherman, the Honorable Michael Barr (Federal Reserve) stated "Just to clarify, under the proposal our treatment of private mortgage insurance doesn't change, so it's the same approach now. Under our guidelines, private mortgage insurance can be a factor that contributes to a mortgage being considered prudently underwritten."
[5] 88 Federal Register 64186 (September 18, 2023).
[6] Interagency Guidelines for Real Estate Lending are available at 12 CFR Appendix C to Part 208.
[7] *Id.*

However, the Proposed Rule creates confusion regarding the Agencies' stance toward private MI due to the inclusion of a mischaracterization of the private MI industry's performance during and after the Great Financial Crisis.[8] In contrast to many large diversified financial institutions, no private MI company received federal or state bailout funds and the industry has never ceased writing new business, insuring mortgages, paying claims, or serving borrowers without the resources for large down payments. Since the Great Financial Crisis, the industry has paid nearly $60 billion in claims to lenders, investors, and the GSEs.[9] Thus, while USMI supports the Agencies' recognition of private MI within prudent underwriting standards, the Agencies should eliminate the conflicting negative commentary regarding the private MI industry that appears in the Proposed Rule.

Further, to provide certainty to market participants, the Agencies should make the recognition of private MI in the definition of "regulatory residential real estate exposure" explicit by clarifying the treatment of private MI in any re-proposal or final Basel III Endgame rule. Below is proposed commentary language for consideration:

> *The [proposed/final] rule would require a banking organization to use LTV ratios to assign a risk weight to a regulatory residential or regulatory commercial real estate exposure. Under the [proposed/final] rule, the LTV ratio would be calculated as the extension of credit divided by the value of the property. The proposed calculation of a loan's LTV ratio would generally be consistent with the real estate lending guidelines, including the requirement of private mortgage insurance or readily marketable collateral as an eligibility factor for determining whether a loan with a LTV ratio of 90 percent or above qualifies as a regulatory residential real estate exposure. Once a loan is determined to qualify as a regulatory residential real estate exposure, including by requiring credit enhancement with either private mortgage insurance or readily marketable collateral on a loan with a LTV ratio equal to or greater than 90 percent, the Agencies intend the [proposed] risk weights to be applied to the base LTV ratio without considering LTV ratio reductions that might otherwise be associated with private mortgage insurance coverage or readily marketable collateral.*

Should the Agencies decide to capture this commentary in regulatory text, proposed language for a re-proposal or final rule is included below:

> §___.101 Definitions
> […]
> *Regulatory residential real estate exposure* means a first-lien residential mortgage exposure that is not a defaulted real estate exposure, an ADC exposure, a pre-sold construction loan, a statutory multifamily mortgage, or an HVCRE exposure, and that meets the following criteria:
> (1) The exposure:
> i. Is secured by a property that is either owner-occupied or rented;

[8] 88 Federal Register 64047 (September 18, 2023).
[9] Private MI Company Statutory Filings.

ii. Is made in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the value of the property;
iii. Is subject to credit enhancement in the form of mortgage insurance or readily marketable collateral if the loan-to-value ratio equals or exceeds 90 percent at origination.
iv. During underwriting of the loan, the [BANKING ORGANIZATION] must have applied underwriting policies that took into account the ability of the borrower to repay in a timely manner based on clear and measurable underwriting standards that enable the [BANKING ORGANIZATION] to evaluate these credit factors; and
v. The property must be valued in accordance with §___.103

(2) When a [BANKING ORGANIZATION] holds the first-lien and junior-lien(s) residential mortgage exposure, and no other party holds an intervening lien, the [BANKING ORGANIZATION] must treat the exposures as a single regulatory real estate exposure.

The Agencies Should Provide Loan-level Capital Credit for High LTV Mortgages with Private MI Coverage

Notwithstanding the proposed language to clarify the intention of the Agencies, as a policy matter, we remain concerned that it is incongruent for the Agencies to include private MI as a part of the definition of prudent underwriting but not in the calculation for loan-level capital requirements.

The private MI industry is stronger and better prepared for downturns due to significant enhancements to its capital structure through the GSEs' updated Private Mortgage Insurer Eligibility Requirements (PMIERs), new recission relief principles, and a more precise and certain Master Policy. Further, the industry now uses a combination of capital markets-based and traditional reinsurance executions to reduce volatility and exposure to mortgage credit risk within the mortgage finance system. Since 2015, the programmatic use of credit risk transfer (CRT) has transferred more than $75.2 billion in risk to the global reinsurance and capital markets via 56 mortgage insurance-linked notes (ILN) deals and 55 quota share reinsurance (QSR) and excess of loss (XOL) transactions.[10]

Considering these important enhancements and performance during times of global stress, USMI contends that private MI should receive the same or *more*, not less, recognition and credit in any updated bank capital framework than it received in the Agencies' 2013 final rule.[11] Importantly, consideration of private MI in the loan-level capital calculation would incentivize large financial institutions to make mortgage loans to first-time, low- to moderate-income (LMI), and minority homebuyers who often purchase homes with low down payment mortgages. A diversity of mortgage loan options for these borrowers ensures that they receive the same access to mortgage credit as borrowers that bring larger down payments to closing.

[10] Private MI CRT Transaction Data, as of 12/31/2023.
[11] 78 Federal Register 62018 (October 11, 2013).

While the aforementioned proposed clarification would provide regulatory certainty to covered banks for securing credit risk protection on low down payment mortgages held in portfolio, we also believe that the Agencies should consider additional changes to recognize private MI in the calculation of loan-level bank capital requirements that would be consistent with the proposed expanded risk-based approach. The current approach for providing risk-based capital credit for MI set forth in the Standards is consistent with the Standardized Approach, which recognizes only two risk weights for 1-to 4-family single-family residential mortgages: (1) 50%; and (2) 100%. The proposed expanded risk-based approach introduces six risk weights and, as such, it is appropriate to provide credit for MI in a more granular manner consistent with the proposed approach.

USMI encourages the Agencies to consider loan-level capital relief for private MI, provided that the coverage is written by an insurer meeting the capital and operational standards to be an "approved insurer" in compliance with PMIERs or by a subsidiary of a holding company that includes a flagship MI entity that is an "approved insurer" in compliance with PMIERs. Two potential options for providing loan-level capital credit for private MI are: (1) to allow banks to consider the risk protection provided by private MI when calculating the LTV for purposes of determining loan-level risk based capital, as was recommended in USMI's previous comment letter; or (2) implement a capital framework that allows private MI to reduce the exposure on a mortgage loan.

Under the second approach, banks would be permitted to recognize a guarantee by netting the coverage amount from the exposure amount and applying the risk weight associated with the loan's base LTV, and not a private MI-adjusted LTV. This approach would be consistent with how banks apply credit for private MI in their internal models and the Basel III agreement's approach to considering and calculating guarantees. It would also align with FHFA's ERCF that was finalized and revised following robust analysis of single-family mortgage credit risk and feedback from industry and consumer advocate stakeholders.

The FHFA is an independent agency established by the *Housing and Economic Recovery Act of 2008* and is responsible for the supervision, regulation, and housing mission oversight of the GSEs and Federal Home Loan Bank System. As such, the FHFA oversees approximately $8.4 trillion in funding for the U.S. mortgage markets and has considerable expertise in housing finance and mortgage credit risk. Following a review of the GSEs' LLPA grids last year, FHFA reduced fees on high LTV loans because of the risk protection provided by private MI on those loans. FHFA Director Sandra Thompson explained the updated pricing policy during an April 18, 2024 Senate Banking Committee hearing by stating:

> "We continue to have risk-based pricing, [but] what happened in the discussion was, when you have a loan-to-value ratio that is 80% or higher, you have to purchase credit enhancement, usually in the form of mortgage insurance… [low down payment borrowers]

were overcharged because we were not capturing the mortgage insurance that they have to pay, it's mandatory."[12]

The table immediately below provides a comparison of risk weights for regulatory residential real estate exposures based on the treatment of private MI under the ERCF, current bank capital framework, Proposed Rule, and Basel III agreement.[13]

Risk-Weighted Assets by LTV Ratio for Regulatory Residential Real Estate Exposures That Are Not Dependent on the Cash Flows of the Real Estate						
	50% LTV	60% LTV	80% LTV	90% LTV	100% LTV	>100% LTV
ERCF – no MI (illustrative for >80%)	4.1%	11.7%	26.2%	49.4%	72.7%	121.5%
ERCF – with MI	4.1%	11.7%	26.2%	41.4%	55.0%	94.3%
Standardized Approach – no MI	50.0%	50.0%	50.0%	100.0%	100.0%	100.0%
Standardized Approach – with MI	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%
2023 NPR	40.0%	45.0%	50.0%	60.0%	70.0%	90.0%
2023 NPR with MI-Adjusted LTV	40.0%	45.0%	50.0%	50.0%	50.0%	50.0%
2023 NPR with MI-Adjusted Exposure	40.0%	45.0%	50.0%	47.1%	48.2%	54.0%
Basel III – no MI	20.0%	30.0%	30.0%	40.0%	50.0%	70.0%
Basel III with MI-Adjusted LTV	20.0%	25.0%	30.0%	30.0%	30.0%	30.0%
Basel III with MI-Adjusted Exposure	20.0%	25.0%	30.0%	31.4%	34.4%	42.0%

Owner-occupied mortgages with standard private MI coverage

The tables below illustrate how the two proposals to recognize private MI would operate with various levels of private MI coverage. These loan examples demonstrate how a re-proposal or final rule could appropriately balance robust risk-based bank capital requirements with commensurate capital relief for the credit risk protection provided by private MI.

Thin MI Coverage		**Expanded Risk-Based Approach**		
	Standardized Approach	**2023 NPR**	**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 Risk Weight	89.2%	97.0%	89.2%	97.0%
Risk Weight	50.0%	70.0%	60.0%	70.0%
Risk-Based Capital	$11,600	$16,240	$13,920	$14,493
Effective Risk-Based Capital %	**4.0%**	**5.6%**	**4.8%**	**5.0%**

[12] Senate Committee on Banking, Housing, and Urban Affairs "Oversight of Federal Housing Regulators" (April 18, 2024).

[13] Based on a loan-level analysis of all owner-occupied loans delivered to the GSEs in 2023 with first payment due dates between January 1, 2023 and December 31, 2023.

Standard MI Coverage		Expanded Risk-Based Approach		
	Standardized Approach	**2023 NPR**	**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 Risk Weight	63.1%	97.0%	63.1	97.0%
Risk Weight	50.0%	70.0%	50.0%	70.0%
Risk-Based Capital	$11,600	$16,240	$11,600	$10,239
Effective Risk-Based Capital %	**4.0%**	**5.6%**	**4.0%**	**3.5%**

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Accordingly, USMI requests that the Agencies, at a minimum, clarify that private MI is a required credit factor to consider in determining whether a loan is prudently underwritten and thus a "regulatory residential real estate exposure" and strike the mischaracterization of the industry's performance during and after the Great Financial Crisis. Furthermore, we ask the Agencies to consider loan-level capital relief for high LTV mortgages covered by private MI. Doing so will ensure that first-time, LMI, and minority homebuyers without the resources to make large down payments can access affordable and sustainable mortgage credit options from large commercial banks.

USMI and its member companies appreciate the opportunity to provide this additional feedback and recommendations on the Agencies' proposed capital requirements for large banking organizations and we look forward to continued engagement to promote regulations that appropriately balance access to affordable mortgage credit with safety and soundness in the U.S. housing finance system. Please feel free to reach out to me directly at sappleton@usmi.org or 202-280-1820 if you have any questions or should you need any further information.

Sincerely,

Seth D. Appleton
President, USMI