MORTGAGE GUARANTY INSURANCE MODEL ACT

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Section 1. Title

This Act may be cited as the Mortgage Guaranty Insurance Act.

Section 2. Definitions

The definitions set forth in this Act shall govern the construction of the terms used in this Act but shall not affect any other provisions of the code.

A. “Authorized real estate security,” for the purpose of this Act, means an amortized note, bond or other evidence of indebtedness, except for reverse mortgage loans made pursuant to [insert citation of state law that authorizes reverse mortgages] of the real property law, not exceeding one hundred three percent (103%) of the fair market value of the real estate, secured by a mortgage, deed of trust, or other instrument that constitutes, or is equivalent to, a first or junior lien or charge on real estate, with any percentage in excess of one hundred percent (100%) being used to finance the fees and closing costs on such indebtedness; provided:

(1) The real estate loan secured in this manner is one of a type that a creditor, which is supervised and regulated by a department of any state or territory of the United States of America or an agency of the federal government, is authorized to make, or would be authorized to make, disregarding any requirement applicable to such an institution that the amount of the loan not exceed a certain percentage of the value of the real estate;

(2) The improvement on the real estate is a:

(a) Residential building designed for occupancy by not more than four families, a one-family residential condominium or unit in a planned unit
development, or any other one-family residential unit as to which title may be conveyed freely; or
(b) Mixed-use building with only (i) one non-residential use and (ii) one one-family dwelling unit; or
(c) Building or buildings designed for occupancy by five (5) or more families or designed to be occupied for industrial or commercial purposes.

(3) The lien on the real estate may be subject to and subordinate to other liens, leases, rights, restrictions, easements, covenants, conditions or regulations of use that do not impair the use of the real estate for its intended purpose.

B. “Book year” refers to the year in which the mortgage originated.

C. “Book year group” consists of each of the last ten years and the aggregate of all book years prior to the most recent ten years.

D. “Bulk Mortgage Guaranty Insurance” means mortgage guaranty insurance that provides coverage under a single transaction on each mortgage loan included in a defined portfolio of loans that have already been originated.

E. “Certificate” means a document issued by a mortgage guaranty insurance company to evidence that it has insured a particular Authorized Real Estate Security under a master policy and which describes the particular characteristics, terms and conditions of that insured Authorized Real Estate Security.

F. “Commissioner” means [insert the title of the principal insurance supervisory official] of this state, or the [insert the title of the principal insurance supervisory official]’s deputies or assistants, or any employee of the [insert name of the principal insurance regulatory agency] of this state acting in the [insert the title of the principal insurance supervisory official]’s name and by the [insert the title of the principal insurance supervisory official]’s delegated authority.

G. “Contingency reserve” means an additional loss reserve, computed on the basis of premiums earned, established to protect policyholders against the effect of adverse economic cycles.

H. “Domiciliary commissioner” means the principal insurance supervisory official of the jurisdiction in which a mortgage guaranty insurance company is domiciled, or that principal insurance supervisory official’s deputies or assistants, or any employee of the regulatory agency of which that principal insurance supervisory official is the head acting in that principal insurance supervisory official’s name and by that principal insurance supervisory official’s delegated authority.

I. “Effective guaranty” refers to the assumed backing of existing or future holders of securities by virtue of their issuer’s conservatorship or perceived access to credit from the U.S. Treasury, as opposed to the direct full faith and credit guarantee provided by the U.S. government.

J. “Loss” refers to losses and loss adjustment expenses, excluding costs which have already been expensed.

JK. “Master policy” means a document issued by a mortgage guaranty insurance company to a creditor or mortgage-holding entity that establishes the terms and
conditions of mortgage guaranty insurance coverage provided thereunder, including any endorsements thereto.

K. “Mortgage guaranty insurance” is:

(1) Insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any Authorized Real Estate Security; and

(2) Insurance against financial loss by reason of nonpayment of rent or other sums agreed to be paid under the terms of a written lease for the possession, use or occupancy of real estate.


M. “Mortgage Guaranty Insurance Modified RBC Standards” means property and casualty risk based capital (RBC) methodology modified to recognize risk and control elements unique to the mortgage guaranty insurance industry.

N. “Mortgage Guaranty Insurance Standards Manual” for purposes of this Act, means the current version of the Mortgage Guaranty Insurance Standards Manual developed and adopted by the National Association of Insurance Commissioners and as amended from time to time as set in Section 17 of this Act.

O. “Mortgage Guaranty Quality Control Program” means an early detection warning system for potential solvency risk issues within a mortgage guaranty insurance company.

P. “NAIC” means the National Association of Insurance Commissioners.

Q. “Net risk in force” means risk in force after giving effect to reinsurance, which is reflective of the total amount the insurer stands to lose by paying out claims.

R. “NOD” means notice of delinquency.

S. “NOD certificate” refers to a certificate for which a NOD has been received and for which a loss reserve has been established.

T. “Non-NOD certificate” refers to a certificate for which no NOD has been received or for which no loss reserve has been established.

V. “Persistency” refers to the probability that an in force certificate will remain in force.

W. “Pool Mortgage Guaranty Insurance” means mortgage guaranty insurance that provides coverage under a single transaction or a defined series of transactions on a defined portfolio of loans for losses up to an aggregate limit.

X. “Right of Rescission” represents a remedy available to a mortgage guaranty insurance company to void a certificate and restore parties to their original position, based on inaccurate information provided to, or information concealed from, the mortgage guaranty insurance company in the insurance application, resulting in an
insured loan which does not meet acceptable risk tolerance requirements in accordance with the mortgage guaranty insurance company’s underwriting standards.

Y. Risk in force’ means the mortgage guaranty insurance coverage percentage applied to the unpaid principal balance.

WZ. “Time frame” refers to all calendar years subsequent to the as of date at which loss reserves are estimated. The next 5 years will be listed separately, and calendar years subsequent combined unless the domiciliary regulator requests a longer time frame.

Section 3. Insurer’s Authority to Transact Business

A mortgage guaranty insurance company may not transact the business of mortgage guaranty insurance until it has obtained a certificate of authority from the commissioner.

Section 4. Mortgage Guaranty Insurance as Monoline

A mortgage guaranty insurance company that anywhere transacts any class of insurance other than mortgage guaranty insurance is not eligible for the issuance of a certificate of authority to transact mortgage guaranty insurance in this state nor for the renewal thereof.

Section 5. Geographic Concentration

A. Single Risk Limit. A mortgage guaranty insurance company shall not expose itself to any loss on any one Authorized Real Estate Security risk in an amount exceeding ten percent (10%) of its surplus to policyholders. Any risk or portion of risk which has been reinsured shall be deducted in determining the limitation of risk.

B. State Concentration Limits. A mortgage guaranty insurance company with net risk in force in any one state or territory of the United States of America that exceeds fifteen percent (15%) of its total net risk in force shall be subject to the additional state concentration capital requirements provided by the Mortgage Guaranty Modified RBC Standards or the Mortgage Guaranty Insurance Industry Loan Level Capital Standards, as applicable.

Section 6. Capital and Surplus

A. Initial and Minimum Capital and Surplus Requirements. A mortgage guaranty insurance company shall not transact the business of mortgage guaranty insurance unless, if a stock insurance company, it has paid-in capital of at least $10,000,000 and paid-in surplus of at least $15,000,000, or if a mutual insurance company, a minimum initial surplus of $25,000,000. A stock insurance company or a mutual insurance company shall at all times thereafter maintain a minimum policyholders’ surplus of at least $20,000,000.

B. Minimum Capital Requirements Applicability. A mortgage guaranty insurance company formed prior to passage of this Act may maintain the amount of capital and surplus or minimum policyholders’ surplus previously required by statute or administrative order for a period not to exceed twelve months following the effective date of the adoption of this Act.
C. **Minimum Capital Requirements Adjustments.** The commissioner may by order reduce the minimum amount of capital and surplus or minimum policyholders’ surplus required under Subsection 6A for an affiliated reinsurer that is a mortgage guaranty insurance company and that is or will be engaged solely in the assumption of risks from affiliated mortgage guaranty insurance companies, if in the commissioner’s opinion, the business plan and other relevant circumstances of the affiliated reinsurer justify the proposed reduction in requirements.

**Section 7. Capital Standards**

A. **Capital Adequacy Measurement and Restrictions.** All mortgage guaranty insurance companies shall maintain adequate capital requirements based on the following:

1. **Tier 1 Risk Based Capital RBC Model Requirements.** A mortgage guaranty insurance company shall maintain an RBC score above the company action level based on the Mortgage Guaranty Insurance Modified RBC Standards.

2. **Tier 2 Loan Level Capital Model Requirements.** A mortgage guaranty insurance company shall provide the commissioner with a detail loan level cash flow projection based on the uniform Mortgage Guaranty Insurance Industry Loan Level Capital Standards, upon the company’s RBC score falling below the company action level.

3. **Business Writing Authority Requirements.** A mortgage guaranty insurance company shall cease writing new business until such time as its RBC ratio is no longer below the company action level or it has obtained an appropriate written waiver from the commissioner.

4. **Dividend Restrictions.** A mortgage guaranty insurance company whose RBC is below the company action level may not pay dividends to its shareholders and an affiliate of the insurer may not accept such dividends unless the insurer reports the dividends to the domiciliary commissioner at least 30 days in advance of the intended payment and the domiciliary commissioner does not disapprove the dividends within that period. All dividend requests shall be required to include:

   a. Ordinary dividends as defined under the mortgage guaranty insurance company’s domiciliary law;
   b. Extraordinary dividends as defined under the mortgage guaranty insurance company’s domiciliary law; and
   c. Actuarially verified financial projections that disclose the adequacy of the mortgage guaranty insurance company’s capital and surplus subsequent to the dividend payment based upon scenarios acceptable to the domiciliary commissioner.

B. **Tier 1 Capital Requirements.** Mortgage guaranty insurance company capital requirements under the above Tier 1 Risk Based Capital Model shall incorporate modifications to base line RBC insurance industry methodology to recognize risk and control elements unique to the mortgage guaranty insurance industry, which are anticipated to include but not be limited to the following:
(1) **Investments Secured by Real Estate or Mortgages.** Any mortgage guaranty insurance company investment in notes or evidence of indebtedness secured by a mortgage or other lien upon real property, including residential mortgage-backed securities, not otherwise permitted under Section 9, shall be subject to additional capital requirements commensurate with the level of applicable risk associated with investment portfolio concentrations in the same industry as its primary business.

(2) **Subsidiary Controlled and Affiliated Investments.** Mortgage guaranty insurance company affiliated investments shall be subject to additional capital requirements to reflect the potential financial economic downturn impact on downstream affiliates engaged in the same business.

(3) **Geographic Concentration.** Any mortgage guaranty insurance company business writings exceeding the net risk in force concentration limits described under Section 5 shall be subject to additional capital requirements to recognize the level of geographic business concentration risk inherent in the company’s operations.

(4) **Underwriting Quality.** Mortgage guaranty capital requirements shall be subject to additional charges to reflect risk in force and related trend changes based on qualitative standards associated with:

(a) Loan to value;
(b) Debt to income;
(c) Borrower credit standing; and
(d) Reduced documentation loans.

(5) **Loss Reserving Considerations.** Mortgage guaranty insurance capital requirements shall be subject to credit adjustments to reflect loss sensitive business factors associated with:

(a) Contingent loss reserve provisions to protect against adverse economic loss conditions; and
(b) Premium deficiency reserve provisions to recognize differences between anticipated loss and future premium installments.

(6) **Off-Balance Sheet Risk.** Mortgage guaranty insurance company capital requirements shall be subject to additional charges to support non-controlled assets and contingent liabilities not exclusively under company controls, including material:

(a) Contingencies associated with pending or unpredictable litigation; and
(b) Affiliate related guarantees

(7) **Prospective Risk Economic Indicators.** Mortgage guaranty insurance company capital requirements shall be subject to additional charges to reflect forward-looking going concern economic projections of potential economic weakness based on:

(a) National and regional housing price index trends;
(b) Unemployment rate trends; and
(c) Public versus private mortgage market share trends.
(8) **Prospective Risk Company Indicators.** Mortgage guaranty insurance capital requirements shall be subject to additional charges to reflect forward-looking going concern company projections and trends of company operating weakness based on:

(a) Cash flow (indicator of capital buffer)
(b) Persistency (indicator of business retention level)
(c) Claim rate (indicator of claim frequency)
(d) Claim severity (indicator of claim size)
(e) Default notices (indicator of delinquency growth)
(f) Default inventory (indicator of delinquency age)
(g) Delinquent cures (indicator of delinquency resolution)
(h) Reserve development to surplus (indicator of reserve deficiency)

C. **Tier 2 Risk Capital Requirements.** Mortgage guaranty insurance company capital requirements under the Tier 2 Loan Level Capital Model shall provide a supporting risk-sensitive framework for forecasting mortgage guaranty insurance company solvency under various stress scenarios, as triggered by company action level or general collapse in housing prices or deterioration in economic conditions. This framework, which remains under development by the mortgage guaranty insurance industry, is anticipated to incorporate:

(1) Claims paying resource forecast based on analysis of existing sources and uses of funds, including:

(a) Surplus;
(b) Net premiums;
(c) Investment income;
(d) Losses and LAE; and
(e) Claims

(2) Credit loss forecast based on estimated probability of various outcomes including:

(a) Prepayment;
(b) Default; and
(c) Claim.

(3) Forward-looking assessment of capital solvency under stress over a ten year scenario.

D. **Uniform Standard of Reporting.** Each mortgage guaranty insurance company shall report its Tier 1 Risk Based Capital RBC Model Requirements and, if applicable, its Tier 2 Loan Level Capital Model Requirements to each jurisdiction for which it has a certificate of authority.

E. **Retention of Consultants.** In the event that Tier 2 Loan Level Capital Model Requirements become effective with respect to any mortgage guaranty insurance company, the domiciliary commissioner may retain consultants, including accountants, attorneys, investment bankers, actuaries and other experts to assist in the assessment of the mortgage guaranty insurance company's financial condition, exposure to claims loss and credit, liquidity, or other risks, along with related remediation plans and reported information submitted by the mortgage guaranty company.
insurance company. All costs associated with the work of consultants retained for such assessment shall be borne by the mortgage guaranty insurance company that is the subject of the assessment.

F. **Protection of Integrity of Capital Standards.** A mortgage guaranty insurance company’s aggregate net risk in force, net of reinsurance, shall not exceed twenty-five (25) times its capital, surplus and contingency reserve. In the event that any mortgage guaranty insurance company’s aggregate net risk in force exceeds twenty-five (25) times its capital, surplus and contingency reserve, it shall cease transacting new mortgage guaranty insurance business until such time as its total net risk in force no longer exceeds twenty-five (25) times its capital, surplus and contingency reserve, unless it obtains a written waiver from the commissioner.

**Drafting Note:** While the risk-to-capital standard itself is insufficient to account for differences in risk among numerous varieties of mortgage loans offered in the United States, the purpose of Section 7F is to allow for a reasonable period of time in which insurance regulators and the public at large can test and establish confidence in the new Tier 1 Risk Based Capital Model Requirements and Tier 2 Loan Level Capital Model Requirements. It is further intended to prevent future changes to, and developments in, the capital standards resulting in weaker standards than established in the previous version of this Mortgage Guaranty Insurance Model Act.

**Section 8. Reserves**

A. **Unearned Premium Reserves.** A mortgage guaranty insurance company shall compute and maintain an unearned premium reserve as set forth by regulation adopted by the commissioner.

B. **Loss Reserve.** A mortgage guaranty insurance company shall compute and maintain adequate case basis and other loss reserves that accurately reflect loss frequency and loss severity and shall include components for claims reported and for claims incurred but not reported, including estimated losses on:

1. Insured loans that have resulted in the conveyance of property that remains unsold;
2. Insured loans in the process of foreclosure;
3. Insured loans in default for four (4) months or for any lesser period that is defined as default for such purposes in the master policy provisions; and
4. Insured leases in default for four (4) months or for any lesser period that is defined as default for such purposes in the master policy provisions.

C. **Contingency Reserve.** Each mortgage guaranty insurance company shall establish a contingency reserve subject to the following provisions:

1. The mortgage guaranty insurance company shall make an annual contribution to the contingency reserve which in the aggregate shall be equal to fifty percent (50%) of the net earned premiums reported in the annual statement.
2. A mortgage guaranty insurance company’s contributions to the contingency reserve made during each calendar year shall be maintained for a period of
120 months, to provide for reserve buildup. That portion of the contingency reserve established and maintained for more than 120 months shall be released and shall no longer constitute part of the contingency reserve.

(3) Withdrawals may be made from the contingency reserve in any year in which incurred losses and loss adjustment expenses exceed 35% of the net earned premium, with the prior written approval of the domiciliary commissioner, subject to:

(a) Contingency reserves aged less than 120 months may only be released if the mortgage guaranty insurance company falls below the amount that is the product of 1.2 times its Tier 1 Risk Based Capital RBC Model Requirements due to adverse loss experience. The amount that may be released will be no more than the amount required to maintain an amount of capital, surplus, and contingency reserves at the level of the amount that is the product of 1.2 times its Tier 1 Risk Based Capital RBC Model Requirements; and

(b) Amounts obtained through early releases from the contingency reserve shall not be available for the payment of dividends.

(4) Provisional withdrawals may be made from the contingency reserve on a quarterly basis in an amount not to exceed 75% of the withdrawal calculated in accordance with Section 8C(3), as adjusted for the quarterly nature of the withdrawal, with the prior written approval of the domiciliary commissioner.

(5) The mortgage guaranty insurance company’s domiciliary commissioner may consider loss developments and trends in reviewing a request for withdrawal pursuant to this Section 8C. If any portion of the contingency reserve for which withdrawal is requested is maintained by a reinsurer or in a segregated account or trust of a reinsurer, the domiciliary commissioner may also consider the financial condition of the reinsurer.

D. Premium Deficiency Reserve. A mortgage guaranty insurance company shall compute and maintain a premium deficiency reserve to the extent required and in accordance with NAIC’s statements of statutory accounting principles applicable to mortgage insurers (currently SSAP No.58), as amended, restated or modified, but without giving effect to any related permitted practices (“NAIC Accounting Principles”).

(1) Reserve Computations. Premium deficiency reserve computations shall be based on the following, notwithstanding any NAIC Accounting Principle to the contrary:

(a) Reasonable estimates based on documented assumptions;

(b) Loss and premium estimates net of reinsurance; and

(c) Premium, loss and expense discounting using a methodology not objected to by the domiciliary commissioner.

(2) Actuarial Report Disclosures. The following components of a premium deficiency reserve shall be disclosed in the annual actuarial report:
(a) Premium deficiency reserve methodology for each book year group and in the aggregate;
(b) Projected cash flows for at least a ten year future period for each book year group and in the aggregate; and
(c) Additional disclosures with respect to other segments of the mortgage guaranty insurance company’s books, which may be required by the domiciliary commissioner.

(3) **Financial Statement Disclosures.** A mortgage guaranty insurance company shall include the following disclosures and related reporting considerations in the statutory financial statements:

(a) Description of its methodology for analyzing and computing the premium deficiency reserve in the notes to the annual financial statement;
(b) Premium deficiency reserve calculations, including the amount of the projected deficit, for any book year where estimated future losses and expenses exceed estimated anticipated premiums;
(c) Premium deficiency reserve recognition by recording an additional liability for the deficiency, with a corresponding charge to operations, when the anticipated losses, loss adjustment expenses, commissions, other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve and the estimated future premiums on existing policies;
(d) Commissions and other acquisition costs need not be considered in the premium deficiency analysis to the extent they have been previously expensed;
(e) Insurance contracts shall be grouped by book year group for purposes of determining if a premium deficiency exists, unless sub-groupings within each book year group are requested by the domiciliary commissioner, with recognition of a corresponding liability for each grouping where a premium deficiency is indicated;
(f) Deficiencies shall not be offset by anticipated profits in other book year groups or subgroups; and
(g) Premium deficiency reserve disclosure along with a statement of anticipated investment income utilization as a factor in the premium deficiency calculation, including the rate of return used in the calculation, as applicable, if a premium deficiency reserve is established.

E. **Miscellaneous.**

(1) Whenever the laws of any other jurisdiction in which a mortgage guaranty insurance company subject to the requirement of this Act is also licensed to transact mortgage guaranty insurance require a larger unearned premium reserve or contingency reserve in the aggregate than that set forth herein, the establishment of the larger unearned premium reserve or contingency reserve in the aggregate shall be deemed to be in compliance with this Act.

(2) Unearned premium reserves and contingency reserves shall be computed and maintained on risks insured after the effective date of this Act as required by Subsections A and C. Unearned premium reserves and contingency reserves on risks insured before the effective date of this Act may be computed and maintained as required previously.
Section 9. Investment Restrictions

A. **Investments Secured by Real Estate or Mortgages.** A mortgage guaranty insurance company shall not invest in notes or other evidence of indebtedness secured by a mortgage or other lien upon real property. This section shall not apply to obligations secured by real property, or contracts for the sale of real property, which obligations or contract of sale are acquired in the course of good faith settlement of claims under policies of insurance issued by the mortgage guaranty insurance company, or in the good faith disposition of real property, so acquired. This section shall not apply to investments backed by the full faith and credit of the United States of America or, with the approval of the domiciliary commissioner, to investments with the effective guaranty of the United States of America.

B. **Deposit Accounts.** A mortgage guaranty insurance company, its holding company or any affiliate thereof is prohibited from entering into or maintaining any form of deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit for which there is no apparent or reasonably explicable business purpose.

Section 10. Reinsurance

A. **Minimum Risk Retention Requirement.** A mortgage guaranty insurance company shall retain at least twenty-five percent (25%) of its risk in force on either a first loss or quota share basis, if any portion of the risk in force is ceded to one or more reinsurers, unless a lesser retention is approved in writing by the domiciliary commissioner.

B. **Prohibition of Captive Reinsurance.** A mortgage guaranty insurance company shall not enter into captive reinsurance arrangements which involve the direct or indirect ceding of any portion of its insurance risks or obligations to a reinsurer owned or controlled by an insured; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity owned or controlled by an insured or an insured’s officer, director or employee or any member of their immediate family has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing.

C. **Restriction on Affiliated Reinsurance.** A mortgage guaranty insurance company shall not enter into any new reinsurance arrangements with any affiliate after the effective date of this Act, unless it has obtained prior written approval by its domiciliary commissioner.

D. **External Reinsurance Requirements.** External reinsurance relationships shall comply with minimum financial quality standards including the following:

1. The reinsurance agreement and any segregated account or trust arrangements or letter of credit applicable to the reinsurance agreement or any amendments thereto shall be submitted to the domiciliary commissioner for approval.

2. Cumulative reserves established by the mortgage guaranty insurance company and the reinsurer shall not be less than 100% of the reserves
required by this Act, except that a reinsurer that is not a mortgage guaranty insurance company is not required to establish a contingency reserve.

(3) Each reinsurance agreement established with a mortgage guaranty insurance company shall provide that:

(a) The domiciliary commissioner shall approve any amendments to the reinsurance agreement before becoming effective.
(b) The ceding mortgage guaranty insurance company shall have the right to terminate the ceding of additional insurance under the reinsurance agreement if so ordered by the domiciliary commissioner.
(c) The domiciliary commissioner has the right to request from the assuming reinsurer information concerning its financial condition.
(d) The assuming reinsurer shall notify the domiciliary commissioner of any material change in its financial condition.

(4) Each reinsurance agreement established with a mortgage guaranty insurance company that includes the use of a segregated account or trust may not limit liability for losses to the assets held in any one or more segregated accounts or trusts.

(5) As a condition for a mortgage guaranty insurance company to receive credit for purposes of meeting its Mortgage Guaranty Insurance Modified RBC Standards and Mortgage Guaranty Insurance Industry Loan Level Capital Standards under Section 7, each reinsurance agreement between a mortgage guaranty insurance company and a reinsurer domiciled in a jurisdiction outside of the United States of America shall require the reinsurer to collateralize 100% of its liabilities attributable to the reinsurance agreement with either a segregated account, segregated trust, one or more letters of credit, or some combination thereof.

Section 11. Underwriting Standards

A. Underwriting Review and Approval Required. All certificates of mortgage guaranty insurance, excluding policies of reinsurance, shall be written based on a reasonable and thorough examination and assessment of evidence that prudent underwriting standards have been met by the originator of the mortgage by:

(1) Mortgage guaranty insurance company review and approval before inception of coverage for loans that are directly underwritten by the mortgage guaranty insurance company; or

(2) Mortgage guaranty insurance company review and validation of delegated underwriting decisions based on a reasonable method of sampling of post-closing loan documentation to ensure compliance with the mortgage guaranty insurance company’s underwriting standards within 180 days following the latest inception date of coverage and receipt of documents for the selected loans; or

(3) Mortgage guaranty insurance company review and approval before inception of coverage of minimum documentation requirements specified by the mortgage guaranty insurance company’s underwriting standards for approval of coverage, together with the mortgage guaranty insurance company’s post
loan closing review and validation on a sampling basis completed within 180 days following the latest inception date of coverage and receipt of documents for the selected loans to ensure compliance with the mortgage guaranty insurance company’s underwriting standards when less than the fully documented loan file is submitted with the insurance application; or

(4) Mortgage guaranty insurance company quality control reviews for Bulk Mortgage Guaranty Insurance and Pool Mortgage Guaranty Insurance based on a reasonable method of sampling of post-closing loan documentation to ensure compliance with the representations and warranties of the creditors or creditors originating the loans and with the mortgage guaranty insurance company’s underwriting standards within 180 days following the inception of coverage.

B. Minimum Underwriting Guidelines. Mortgage guaranty insurance companies shall establish formal underwriting guidelines which set forth the basis for concluding that prudent underwriting standards have been met. Such underwriting guidelines shall, at a minimum, include an assessment of mortgage loan credit quality based on the following factors:

(1) Mortgage loan type and characteristics;

(2) Borrower’s creditworthiness and loan repayment ability, which must, at a minimum, include obtaining and maintaining documents verifying a borrower’s income; and

(3) Property’s marketability qualifications, which must, at a minimum, include receipt and maintenance of supporting property valuation documentation.

C. Underwriting Guideline Review and Approval. A mortgage guaranty insurance company’s underwriting guidelines shall be:

(1) Reviewed and approved by executive management; and

(2) Reviewed with either the board of directors or a board committee designated to provide oversight of underwriting policy and ratification of material changes under a written resolution of the board of directors setting forth the scope of review for such oversight and ratification; and

(3) Communicated across the organization to promote consistent business practices with respect to underwriting.

D. Underwriting Documentation and Approval Guidelines. Mortgage guaranty underwriting guidelines shall incorporate documentation and approval requirements in key control areas to support the underwriting evaluation, which shall include but not be limited to the following:

(1) Lender loan submission requirements;

(2) Loan documentation and underwriting compliance evaluation responsibilities;

(3) Minimum mortgage documentation standards;
E. **Underwriting Documentation and Approval Considerations.** Mortgage guaranty insurance company establishment of the documentation and approval requirements outlined in Section 11D shall include the considerations detailed in the corresponding Mortgage Guaranty Insurance Standards Manual Section, based on the appropriateness in relation to the size and status of the mortgage guaranty insurance company’s organization and its residential and commercial mortgage loan environment.

F. **Notification of Changes in Underwriting Guidelines.** A mortgage guaranty insurance company shall provide notice to the commissioner of changes to its underwriting guidelines as follows:

1. On or before March 1 of each year, a mortgage guaranty insurance company shall file the underwriting guidelines in place as of the immediately preceding year-end with the commissioner, together with a summary of material changes since the previous annual report; and

2. Any change associated with loan to value ratios, debt to income ratios, borrower credit standing or maximum loan amount shall be filed with the commissioner within thirty (30) days following the publication of the change.

G. **Nondiscrimination.** In extending or issuing mortgage guaranty insurance, a mortgage guaranty insurance company may not discriminate on the basis of the applicant’s sex, marital status, race, color, creed, national origin, disability, or age or solely on the basis of the geographic location of the property to be insured unless the discrimination related to geographic location is for a business purpose that is not a mere pretext for unfair discrimination; or the refusal, cancellation, or limitation of the insurance is required by law or regulatory mandate.

**Drafting Note:** States and jurisdictions should consult their constitution or comparable governance documents and applicable civil rights legislation to determine if broader protections against unacceptable forms of discrimination should be included in Section 10G.

**Section 12. Quality Assurance**

A mortgage guaranty insurance company shall establish a formal internal Mortgage Guaranty Quality Control Program, which provides an early detection warning system as it relates to potential solvency risk issues. This Mortgage Guaranty Quality Control Program shall provide for the documentation, monitoring, evaluation and reporting on the integrity of the ongoing loan origination process based on indicators of potential underwriting strategy and control inadequacies or non-compliance. A Mortgage Guaranty Quality Control Program shall address the following provisions, as well as related considerations discussed in the corresponding Mortgage Guaranty Insurance Standards Manual section, based on appropriateness in relation to the size and status of the company’s organization:
A. **Segregation of Duties.** Administration of the quality control program shall be delegated to designated risk management, quality control or internal audit personnel, who are technically trained and independent from activities related to loan origination, pricing, underwriting and operations.

B. **Senior Management Oversight.** Quality control personnel shall provide periodic quality control reports to an enterprise risk management committee or other equivalent senior management level oversight body.

C. **Board of Director Oversight.** Quality control personnel shall provide periodic quality control reports to the board of directors or a designated committee of directors established to facilitate board of director oversight.

D. **Policy and Procedures Documentation.** Mortgage Guaranty Quality Control Program policies and procedures shall be formally established and documented to define scope, roles and responsibilities.

E. **Underwriting Risk Review.** Quality control review shall include an examination of underwriting risk including categorization of the insurer’s exposure and compliance with risk tolerance levels.

F. **Lender Performance Reviews.** Quality control monitoring provisions shall include an assessment of lender performance expectations.

G. **Underwriting Performance Reviews.** Quality control monitoring provisions shall assess compliance with underwriting guidelines.

H. **Problem Loan Trend Reviews.** Quality control monitoring provisions shall assess prospective risks associated with timely loan payment including delinquency, default inventory, foreclosure and persistency trends.

I. **Underwriting System Change Oversight.** Underwriting system program changes shall be monitored to ensure the integrity of underwriting and pricing programs, which impact automated underwriting system decision making.

J. **Pricing and Performance Oversight.** Pricing controls shall be monitored to ensure that business segment pricing supports applicable performance goals.

K. **Internal Audit Validation.** Periodic internal audits shall be conducted to validate compliance with the Mortgage Guaranty Quality Control Program.

L. **Regulator Access.** The commissioner shall be provided access to an insurer’s Mortgage Guaranty Quality Control Program for review at any reasonable time upon request and during any financial regulatory examination. Nothing herein shall be construed to limit a regulator’s right to access any and all of the records of an insurer in an examination or as otherwise necessary to meet regulatory responsibilities.

Section 13. **Conflict of Interest**

A. If a member of a holding company system, a mortgage guaranty insurance company licensed to transact business in this state shall not, as a condition of its certificate of authority, knowingly underwrite mortgage guaranty insurance on mortgages originated by the holding company system or an affiliate or on mortgages originated...
by any mortgage lender to which credit is extended, directly or indirectly, by the holding company system or an affiliate.

B. A mortgage guaranty insurance company, the holding company system of which it is a part, or any affiliate shall not, as a condition of the mortgage guaranty insurance company’s certificate of authority, engage in activities proscribed in Sections 13 and 14.

Section 14. Rebates, Commissions and Charges

A. No Inducements. A mortgage guaranty insurance company shall not pay or cause to be paid either directly or indirectly, to any owner, purchaser, lessor, lessee, mortgagee or prospective mortgagee of the real property that secures the authorized real estate security or that is the fee of an insured lease, or any interest therein, or to any person who is acting as an agent, representative, attorney or employee of such owner, purchaser, lessor, lessee or mortgagee, any commission, or any part of its premium charges or any other consideration as an inducement for or as compensation on any mortgage guaranty insurance business.

B. No Compensation for Placement. In connection with the placement of any mortgage guaranty insurance, a mortgage guaranty insurance company shall not cause or permit the conveyance of anything of value, including but not limited to any commission, fee, premium adjustment, remuneration or other form of compensation of any kind whatsoever to be paid to, or received by an insured lender or lessor; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity in which an insured or an officer, director or employee or any member of their immediate family has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing, except for the value of the insurance itself or claim payments thereon as provided by contract or settlement.

C. No Rebates. A mortgage guaranty insurance company shall not make a rebate of any portion of the premium charge. A mortgage guaranty insurance company shall not quote any rate or premium charge to a person that is different than that currently available to others for the same type of coverage. The amount by which a premium charge is less than that called for by the current schedule of premium charges is an unlawful rebate.

D. Sanctions. The commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company, or in his or her discretion, issue a cease and desist order to a mortgage guaranty insurance company that pays a commission, rebate, or makes any unlawful conveyance of value under this section in willful violation of the provisions of this Act. In the event of the issuance of a cease and desist order, the commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company that does not comply with the terms thereof.

E. Educational Efforts and Promotional Materials Permitted. A mortgage guaranty insurance company may engage in any educational effort with borrowers, members of the general public, and officers, directors, employees, contractors and agents of insured lenders that may reasonably be expected to reduce its risk of loss or
promote its operational efficiency and may distribute promotional materials of minor value.

Section 15. Policy Forms and Premium Rates Filed

A. Policy Form Filing. Unless otherwise provided by the commissioner, all policy forms and endorsements shall be filed with and be subject to the approval of the commissioner.

B. Policy Rate Filing. Unless otherwise provided by the commissioner, each mortgage guaranty insurance company shall file with the commissioner the rate to be charged and the premium including all modifications of rates and premiums to be paid by the policyholder.

C. Timely Response to Requests for Explanation. Upon written request of a party liable for payment of premium under a master policy or certificate, a mortgage guaranty insurance company shall, within 30 days following receipt of the request, provide a written explanation of how the amount of premium for which the requesting party is liable was computed. A mortgage guaranty insurance company need not respond to requests that are made with a frequency that a reasonable person would construe to be harassment.

D. Limited Right to Acquire Title. Each master policy and certificate issued by a mortgage guaranty insurance company shall provide that the mortgage guaranty insurance company, in lieu of payment of its limit of coverage, may elect to pay the entire indebtedness to the insured and acquire title to the Authorized Real Estate Security.

E. Conditional Limitation on Deficiency Liability. Each master policy and each applicable certificate issued by a mortgage guaranty insurance company shall provide that the borrower upon any single-family dwelling or a mixed-use building described in Section 2A(2)(b), which is owner-occupied at the time of loan origination and for at least 50% of the days within the twelve (12) consecutive months prior to borrower default, shall not be liable for any deficiency arising from a foreclosure sale.

NOTE: Open rating states may delete a portion or all of Subsections 15A and 15B and insert their own rating law. States that wish to allow pursuit of deficiency judgements against those who have lost their principal residence to foreclosure could either delete Section 15E or limit the exemption from deficiency judgements on personal residences to defaults occasioned by certain specified causes such as unemployment, illness, and divorce.

Section 16. Rescission

The right of rescission shall be governed by the following:

A. Rescission Rights and Responsibilities. All mortgage guaranty insurance company master policies shall include a detailed description of provisions governing rescissions and cancellations, which specify the insurer’s and insured’s rights, obligations and eligibility terms under which those actions may occur to ensure transparency.

B. Rescission Relief Provisions. Mortgage guaranty insurance company rescission relief practices shall be in accordance with the following principles:
(1) A mortgage guaranty insurance company shall offer mandatory rescission relief based on evidence of compliance with payment history and loan status eligibility requirements.

(2) A mortgage guaranty insurance company may exercise an earlier rescission relief option based on evidence of compliance with underwriting and payment history eligibility requirements.

(3) A mortgage guaranty insurance company shall retain the right of rescission in instances in which a creditor or the officers, directors, employees, contractors, and agents of a creditor engage in misstatements, misrepresentations, omissions, data inaccuracies or active efforts to deceive through submission of forged or fictitious information in connection with loan origination or closing for a period of 10 years, based on:

(a) Credible evidence of the existence of the above conditions; and
(b) Credible evidence of the materiality of the above conditions to the mortgage guaranty insurance company’s acceptance of risk.

C. **Re-pricing Provisions.** A mortgage guaranty insurance company shall have the option to re-price the insurance premium for coverage upon a loan, when prudent, in lieu of rescinding coverage based on the following:

(1) Rescission relief has not been granted based on Subsection 16B;

(2) The loan would have been eligible for coverage with alternative pricing under the underwriting standards in effect at origination; and

(3) Misstatements, misrepresentations, omissions or inaccuracies by the creditor or the officers, directors, employees, contractors, and agents of a creditor are not considered material based on reasonable verification of appraisal value and borrower income by the mortgage guaranty insurance company.

**Section 17 Records Retention**

A. **Record Files.** A licensed mortgage guaranty insurance company shall maintain its records in a manner which allows the commissioner to readily ascertain the insurer’s compliance with state insurance laws and rules during an examination including, but not limited to, records regarding the insurer’s management, operations, policy issuance and servicing, marketing, underwriting, rating and claims practices. Recordkeeping requirements shall conform to the mandated standards detailed in the corresponding Records Retention Requirements section of the Mortgage Guaranty Insurance Standards Manual, as it relates to:

(1) Policy records to clearly document the application, underwriting, issuance and servicing of each policy and Certificate

(2) Claim records to clearly document the inception, handling and disposition of each claim

B. **Retention Period.** Policy and claim records shall be retained for the period during
which the Certificate or claim is active plus five (5) years, unless otherwise specified herein or in the Mortgage Guaranty Insurance Standards Manual.

C. **Record Format.** Any record required to be maintained by a mortgage insurer may be created and stored in the form of paper, photograph, magnetic, mechanical or electronic medium, subject to conformance with the format related requirements detailed in the corresponding Records Retention Requirements section of the Mortgage Guaranty Insurance Standards Manual.

D. **Record Maintenance.** Record maintenance under this regulation shall comply with the following requirements:

1. Insurer maintenance responsibilities shall provide for record storage in a location that will allow the records to be reasonably produced for examination within the time period required.

2. Third-Party maintenance related responsibilities shall be set forth in a written agreement, a copy of which shall be maintained by the insurer and available for purposes of examination.

**Section 178. Mortgage Guaranty Insurance Standards Manual**

The NAIC shall develop and adopt a *Mortgage Guaranty Insurance Standards Manual*, as amended from time to time, which shall include such other information as the National Association of Insurance Commissioners shall deem appropriate. A change in the *Mortgage Guaranty Insurance Standards Manual* shall be effective on January 1 following the calendar year in which the change has been adopted by the National Association of Insurance Commissioners if such change is adopted on or before September 1st. A change in the *Mortgage Guaranty Insurance Standards Manual* shall be effective on the second January 1 following the calendar year in which the change has been adopted by the National Association of Insurance Commissioners if such change is adopted after September 1st.

The background, guidance and standards in this manual are based on and integral to the requirements established under the Mortgage Guaranty Insurance Model Act (#630). Mandated standards included under Underwriting, Quality Assurance, and Records Retention should be referenced when determining adopted mortgage guaranty insurance law.

**Section 189. Regulations**

The commissioner shall have the authority to promulgate rules and regulations deemed necessary to effectively implement the requirements of this Act.

*Chronological Summary of Actions (all references are to the Proceedings of the NAIC).*

Annotation 1: This section addresses the mortgage guaranty insurance industry risks associated with geographical business mix concentrations.

An economic boom in the 2000’s created a “housing bubble” characterized by a rise in housing prices and falling mortgage rates, which peaked in 2005-06, serving as a major trigger to the U.S. subprime mortgage crisis. The crisis was ignited by a rise in subprime mortgage delinquencies and foreclosures. Securitization through complex repackaging of subprime mortgages into investments further contributed to the financial crisis and subsequent recession beginning in 2008.

Following the housing market peak, housing prices experienced a significant fall, declining some 30% nationwide and more than 45% in selected markets, including Nevada, Arizona, Florida and California where the total past due averaged 9%-11%, as of December 2008. Economic studies have pointed to a strong, positive relationship between the rate of housing price deterioration in urban areas and the subsequent rate of mortgage delinquency and foreclosure. The fall in housing prices and decline in loan to value ratios limited the ability of borrowers to avoid loan delinquency by exercising prepayment, home sales or refinancing options. The financial crisis also contributed to a growth in unemployment rates and loss of retirement savings, impacting borrower ability to meet loan payments.

The New York Federal Reserve analysis of the top states with respect to mortgages 90 days or more delinquent at the end of 2011 indicated the following delinquent percentages and potential causes:

- Florida (18.02%) – Florida faced the third worst housing market crash with homes losing 48% of their value since the market peak. 44% of Florida mortgage loans were underwater. The state’s unemployment rate of 9% represented the sixth highest in the nation.
- Nevada (13.57%) – Nevada’s unemployment rate of 12%, represented the highest in the nation. The state held the most underwater mortgages at 61% of all mortgaged properties in Nevada. Housing prices were down 59% from their pre-crash peak.
- Arizona (7.63%) – Arizona experienced a higher than average unemployment rate of 8.6%. Home prices plummeted 48% since 2007. The state had the second highest percentage of mortgages underwater at 48%.
- California (7.57%) – California’s high unemployment rate of 11% combined with a poor housing market drop of 42% from its peak and a 30% underwater mortgage rate served as contributing factors to the market crisis. The state ranked seventh with one in twelve mortgage holders in serious delinquency.

National mortgage loan delinquent rate trend analysis indicates that current mortgage delinquency rates in the above states have experienced improvements. Nevertheless, these historical trends demonstrate that local market conditions and differences in state laws with respect to the judicial foreclosure process, can and do impact regional delinquency and foreclosure experience. Accordingly, the Mortgage Guaranty Insurance Model Act was designed to minimize the risk and strengthen control over geographic business mix by establishing:

1. Concentration limits by state
2. Additional capital requirements where limits are exceeded to strengthen enforcement
Section 7  Capital Standards

Annotation 2: This section addresses the mortgage guaranty insurance industry risks and controls associated with capital standards.

The previous Mortgage Guaranty Insurance Model Act reflected the mortgage guaranty insurance industry historic requirements for a mortgage insurer to maintain a minimum amount of statutory capital relative to risk in force in order for the mortgage insurer to continue to write new business. The most common formulation of this risk to capital methodology allowed for a maximum permitted risk to capital ratio of 25 to 1. The risk to capital ratio did not serve the mortgage industry exceptionally well during the recent mortgage sub-prime crisis, as the identification of potential solvency problems associated with the sub-prime crisis and economic downturn were generally recognized prior to the risk to capital ratio reaching the above 25 to 1 maximum.

The Property and Casualty Insurance Industry has historically utilized a Risk-Based Capital (RBC) methodology to provide a capital adequacy standard. However, mortgage and financial guaranty insurance companies have historically been exempted from this RBC requirement, based on the unique differences in operations. The RBC methodology is generally viewed as a standard which provides:

- Uniformity among state regulatory agencies as a basis for establishing hypothetical minimum capital level requirements compared to the company's actual capital level
- RBC calculation based on risk relationships by applying a set of actuarial risk factors to various asset, premium and reserve balances
- State of domicile regulatory authority to enforce timely action based on company, regulatory and mandatory action levels driven by the severity of solvency issues

Accordingly, the current Mortgage Guaranty Insurance Model Act seeks to ensure these advantages through emphasis on the development of a two-tier capital adequacy measurement standard encompassing:

**Tier 1 Risk Based Capital (RBC) Model** - Establishment of a base line capital standard ratio commonly recognized in the industry based on the RBC methodology, through incorporation of many similarities with the existing property and casualty insurance industry methodology and supplemented by modifications to recognize risk and control elements unique to the mortgage guaranty insurance industry.

**Tier 2 Loan Level Capital Model** - Establishment of a uniform detail loan level cash flow projection to further supplement the above RBC methodology, in instances where the RBC scoring results reflect the equivalent of a “company action level”, and support company requirements to submit a detailed action plan to address potential solvency issues.

Development of the above models is under ongoing planning with anticipated utilization of external consulting services to maximize the benefits of current mortgage guaranty insurance industry projects to develop the framework for the loan level capital model and utilize such project research to facilitate development of unique mortgage guaranty risk components and rating factors under the modified RBC model.
Section 8  Contingency Reserves

Annotation 3:

This section addresses the mortgage guaranty insurance industry risks and controls associated with the Contingency Reserve practices.

Contingency reserves have historically served to provide an additional form of premium reserves to protect policyholders against the effect of adverse economic cycles. These reserves have been established based on an automatic provision calculation of 50% of premium written. Current reserve provisions are required to be maintained for a period of 10 years (120 months), unless early release is approved by the commissioner of insurance of the insurer’s state of domicile.

Significant loss experience during the recent sub-prime mortgage crisis has noted that:

- Contingency reserve historic allocations under the current automatic formula calculation are not driven by economic indicators of potential mortgage crisis and economic downturn, as recently experienced
- Contingency reserve protection provisions can easily be exhausted and depleted under provisions which allow for the early withdrawal when losses exceed 35% of corresponding earned premiums during such periods of economic downturn

Accordingly, the Mortgage Guaranty Insurance Model Act emphasizes the contingency reserve provisions through:

1. Contingency reserve retention period to build-up reserve positions for periods of cyclical downturn in the mortgage industry
2. Contingency reserve release restrictions

The Reserves section includes premium deficiency reserve requirements that impact both actuarial opinion and financial statement reporting.

Section 9  Restrictions on Investments Secured by Real Estate or Mortgages

Annotation 4: This section addresses the mortgage guaranty insurance industry relationships and risks associated with the secondary mortgage market.

The secondary mortgage market represents a market for the sale of securities or bonds collateralized by the value of mortgage loans. Mortgage lenders or other specialized investment firms typically group together loans originated in the primary mortgage market for sale as collateralized mortgage obligations or mortgage backed securities for sale to investors, including insurance companies.

Principal parties involved in the secondary mortgage market include:

1. Government National Mortgage Association (GNMA) – a wholly-owned government corporation, whose mortgage backed securities are guaranteed by the full faith and credit of the United States government
(2) Freddie National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC), federally chartered government-sponsored but privately owned entities, which are not backed by the full faith and credit of the United States government, although often considered as effective beneficiaries of this guarantee as a result of government rescue from insolvency during the recent mortgage crisis.

The Secondary Mortgage Market Enhancement Act of 1984 (SMMEA) amended the Securities Exchange Act of 1934 to provide additional capital sources through improvement in the marketability of mortgage backed securities. The SMMEA effectively allowed:

1. Federally chartered and regulated financial institutions to invest in mortgage-backed securities guaranteed by FNMA and FHLMC, although not backed by the full faith and credit of the U.S.
2. Override of state investment laws to enable state chartered and regulated institutions to invest in such mortgage-backed securities.

SMMEA initially resulted in exceptional residential mortgage market growth and expansion, triggered by the theory that default risk on an individual loan basis was generally deemed to be minimized under the loan aggregation process.

The above growth in the secondary mortgage market was, however, also considered a contributing factor to the recent housing market crisis beginning in 2007. On the downside, mortgage securitization increased default risk from the standpoint of reduction in alignment of mortgage loan originator and mortgage guaranty insurer interests and incentives to ensure borrower repayment credit quality. As a result, mortgage loan defaults, delinquencies and foreclosures increased associated with potential rating agency assignment of inflated credit ratings, lending standard deterioration and subprime borrowing.

Accordingly, Mortgage Guaranty Insurance Model Act investment limitations are proposed to reduce potential mortgage guaranty insurer risks associated with portfolio concentrations in securities reflective of investment in the same industry risk as the mortgage guarantor’s primary business. This encompasses securities which represent an ownership interest in or are secured directly or indirectly by a pool of mortgages or cash flows generated by a pool of mortgages.

Section 10 Reinsurance

Annotation 5: This section addresses the mortgage guaranty insurance industry risks associated with reinsurance.

Mortgage guaranty reinsurance has generally been limited to affiliate ceding in lieu of limited external reinsurance alternatives, which typically creates unnecessary overhead expenses with limited benefits.

Affiliate reinsurance has generally been executed under requirements that a mortgage guaranty insurer cannot retain more than 25% of the total risk exposure related to the indebtedness of the insured.

Accordingly, the Mortgage Guaranty Insurance Model Act provisions emphasize greater reinsurance flexibility options through:
• Removal of the mortgage guaranty insurer maximum 25% risk retention limits
• Discouragement of affiliate reinsurance arrangements by the above adjustment of reinsurance requirements, thereby permitting mortgage guaranty insurers to achieve improved administrative efficiencies
• Financial quality standards compliance where external reinsurance programs are employed
• Prohibition of captive reinsurance arrangements

Section 11 Underwriting Standards

Annotation 6: This section addresses mortgage guaranty insurer underwriting and related environmental causes and risks associated with the recent mortgage loan sub-prime mortgage loan crisis.

Legacy private mortgage insurers have suffered significant losses from exposure to the recent downturn of the U.S. housing market, which contributed to the national recession. Housing price declines in recent years have created negative equity on a large scale, with homeowner debt exceeding property values.

Key factors driving mortgage performance have included mortgage type, age, inadequate borrower credit score, loan to value, and debt to equity relationships and delinquency status. Pending delinquencies, default inventory aging and eventual foreclosures have become major factors to achieving financial recovery.

Regulatory actions based on the level of losses associated with the above factors have resulted in ongoing emphasis on capital adequacy requirements, which has in turn restricted or prevented companies from writing new mortgage guaranty insurance business.

Policy rescissions have avoided some large insurer losses, while at the same time demonstrating the susceptibility to misrepresentation or potential fraud.

The concentration of mortgage loan originations in limited banks has placed competitive pressures on mortgage guaranty insurers to accept loans of lower credit quality or face the consequences of reduced business volume. Captive reinsurance agreements have resulted in regulatory concerns for originating banks to command considerations from mortgage insurers. These industry-wide competitive pressures have resulted in increased loan default, delinquency and foreclosure rates associated with the acceptance of sub-prime credit loans and reduced documentation and even “no documentation” loans.

The previous Mortgage Guaranty Insurance Model Act’s requirements for measuring capital adequacy in terms of 25 times company capital, surplus and contingency reserves were typically exceeded in the course of the housing price decline and have not proven effective in monitoring risk. The above results suggest that more risk sensitive measures to ensure future solvency are desirable along with an increased proactive monitoring role, particularly in areas where guidance is limited or silent.
Accordingly, the Mortgage Guaranty Insurance Model Act establishes formal minimum standards for underwriting guidelines, which serve to establish a supervisory framework to ensure that lenders are obtaining adequate documentation, undertaking effective verification of financial information including income, maintaining reasonable debt service coverage and loan to value ratios, and making reasonable inquiry to resolve problems without significant market disruption.

Section 12 Quality Assurance

Annotation 7: This section is intended to complement the underwriting guidelines discussed under section 12 through the proposed establishment of mortgage guaranty insurer independent internal quality assurance guidelines, which provide a prospective “early warning system” to monitor and identify potential risk, control and compliance weaknesses associated with:

(1) Senior management oversight
(2) Board of director oversight
(3) Loan policy and procedure documentation
(4) Underwriting risk tolerance levels and exposures
(5) Lender underwriting performance
(6) Mortgage guaranty insurer underwriter performance
(7) Problem loan trends
(8) Underwriting system change oversight
(9) Pricing and performance oversight
(10) Internal audit validation

Section 16 Rescission

Annotation 8: This section addresses the mortgage guaranty insurance industry’s rescission rights and responsibilities.

A mortgage guaranty insurer’s exercise of rescission rights essentially consists of the unwinding of an insurance contract as if the contract was never entered into. Premiums are typically returned by the insurer and no claims are paid. Rescission typically results based on the mortgage guaranty insurer’s determination that coverage provided under a policy was essentially not in force due to:

- Misrepresentation
- Failure to follow underwriting guidelines
- Failure to meet certain obligations at the time the policy was written

Rescissions have historically occurred on a loan by loan basis on the back-end, based on review of loan origination documents in conjunction with the normal processing of claims submitted, to evaluate the ability to deny coverage or, at the very least, reduce the claim amount.

Loans entering the rescission process typically resulted from loans originated during the 2005-2007 period coinciding with the housing market peak and the rise in subprime mortgages. Rescission volume increased dramatically, based on increasing MI company evidence of misrepresentation, fraud, loans not meeting bulk commitments and loan overstatement of value.
The exercise of coverage rescissions has materially mitigated paid losses during the subprime mortgage crisis. Business insured by mortgage guaranty insurers over the last 6 years has been significantly impacted by rescission activity based on significant findings resulting from the claims and underwriting review process associated with:

- Lower quality insured business previously written such as low documentation loans
- Improper underwriting standards
- Delegated lender underwriting

Rescission has often resulted in extensive subsequent settlement proceedings and legal delays to establish eventual rescission rights and responsibilities. Policy rescission volume has also impacted the GSE’s due to typical efforts to seek restitution through the qualified servicer. The GSE’s and mortgage guaranty insurance industry are in the process of working to address mutually agreed upon standard master policy provisions which will clarify these rescission rights and responsibilities.

Accordingly, the Mortgage Guaranty Insurance Model Act amendments have emphasized the following provisions, which provide greater rescission relief and are anticipated to be generally consistent with ongoing GSE regulatory requirements under review and / or reasonable practices aligned with those requirements:

1) Master policy definitions of both insurer and insured rescission rights and responsibilities
2) Rescission relief provisions based on MI underwriting validation, timely payment history and suspected material misrepresentation considerations

All mortgage guaranty insurance companies are required by law to follow the Unfair Insurance Practices Act in each state in which they are licensed. The Unfair Insurance Practices Act specifies certain business practices that constitute unfair claim settlement or compromise practices.

**Section 17 Standards Manual**

**Annotation 9:**

This section is reserved for NAIC potential subsequent development of a Mortgage Guaranty Insurance Standards Manual, which would supplement and support the Mortgage Guaranty Insurance Model Act.

The primary purpose of such a standards manual would be to provide for a potentially less formal process for periodic updates in expected accounting and business practices than reopening the Mortgage Guaranty Insurance Model Act, which is expected to serve as a long-term framework for the regulation of mortgage guaranty insurance.