2015 Spring National Meeting  
Phoenix, Arizona  

MORTGAGE GUARANTY INSURANCE (E) WORKING GROUP  
Monday, March 30, 2015  
2:00 – 4:00 p.m.  
Sheraton Phoenix Downtown—Valley of the Sun D/E—2nd Floor  

ROLL CALL  

Ted Nickel, Chair  Wisconsin  Margot Small  New York  
Kurt Regner  Arizona  Tony Riddick  North Carolina  
John Finston  California  Steve Johnson  Pennsylvania  
Robert Ballard  Florida  Doug Slape  Texas  

AGENDA  

1. Roll Call and Introductory Remarks—Commissioner Ted Nickel (WI)  

2. Consider Adoption of its March 10 Minutes—Commissioner Ted Nickel (WI)  Attachment A  

3. Discuss Revisions to the Mortgage Guaranty Insurance Model Act (#630)  
   —Commissioner Ted Nickel (WI)  Attachment B  

   —Commissioner Ted Nickel (WI)  Attachment C  

5. Discuss Any Other Matters Brought Before the Working Group—Commissioner Ted Nickel (WI)  

6. Adjournment  

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The Mortgage Guaranty Insurance (E) Working Group of the Financial Condition (E) Committee met via conference call March 10, 2015. The following Working Group members participated: Steve Junior, Chair (WI); Kurt Regner (AZ); John Finston and Monica Macaluso (CA); Robert Ballard and David Altmaier (FL); Susan Coble, Jackie Obusek and Tony Riddick (NC); Margot Small (NY); and Doug Slape (TX).

1. **Discussed Summary of Progress on the Mortgage Guaranty Capital Model**

Mr. Junior commented that the purpose of the meeting is to allow all interested parties to receive an update on the status of the mortgage guaranty capital model. He indicated that members of the Oliver Wyman Group will provide the presentation. He also stated that Wisconsin is conducting an inquiry within its authority under Wisconsin statute § 601.42 concerning the development and design of the mortgage guaranty capital model. Mr. Junior stated that other members of the Working Group have been participating in the capital model project under the NAIC Master Information Sharing and Confidentiality Agreement. He stated that, on Feb. 27, Wisconsin, along with several other states, established a set of questions regarding the capital model. Mr. Junior also indicated that it is the intention of the Working Group to hold a public meeting during each development phase of the capital model in order to facilitate public comment. Additionally, he indicated that the capital model will eventually be available for testing by any interested party prior to its adoption.

2. **Adopted its Nov. 18, 2014, Minutes**

Mr. Altmaier made a motion, seconded by Mr. Riddick, to adopt the Working Group’s Nov. 18, 2014, minutes (Attachment 1). The motion unanimously carried.

3. **Heard a Presentation from Oliver Wyman on the Mortgage Guaranty Capital Model**

Peter Reynolds (Oliver Wyman) summarized the mortgage guaranty capital model, including details on the loan-level model results, development approach and proposed grids, RBC results and the next steps (Attachment B). Mr. Slape questioned whether consideration was given to applying regional unemployment data to the capital model. Mr. Reynolds indicated that the national unemployment was applied to the capital model because a forecast of regional unemployment would be required, which could add regional dispersion to the capital model. Mr. Reynolds indicated that the capital model could be parameterized on regional unemployment with a forecast. Mr. Finston inquired about the data utilized within the cumulative claims ratio graph. Mr. Reynolds stated that the graph includes policies that were held as of year-end, regardless of what year the policy was issued. Tony Shore (Essent Guaranty) inquired about the validations performed on the data during development and the type of maintenance that will be required going forward. Mr. Reynolds stated that extensive documentation across all components as well as the code has been kept and each member of the consortium has reviewed the code and documentation. Further, he indicated that there would be additional validation as the capital model moves through the approval process. Mr. Reynolds commented that, regarding maintenance, Oliver Wyman’s views on performance tracking have been developed, which would trigger re-parameterization. Mr. Reynolds stated that the prepayment model is most likely to require updates, in the near future, as a result of interest rate changes. Mr. Reynolds also indicated that the capital model will likely be used by third parties, insurance companies, state insurance departments and the NAIC. Mr. Junior indicated that the NAIC has the necessary statistical analysis software, noting that the details to allow the NAIC and the states to run such data in a testing phase are being developed. Mr. Junior further stated that it would be necessary for the NAIC to run the capital model should it ultimately be adopted, just as the NAIC runs the RBC calculations for all other types of insurers for which RBC applies. Rob Ford (National Mortgage Insurance Corporation) inquired about whether the back-testing considered the level of capital that was in the industry during the stressed period. Mr. Reynolds stated that the back-testing considered capital levels during the stressed period. He stated that it was challenging, given the various structures and reinsurance.

Having no further business, the Mortgage Guaranty Insurance (E) Working Group adjourned.
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.

K. “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.

KL. “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.

LM. “Mortgage Guaranty Insurance Industry Loan Level Capital Standards” means mortgage detail loan level cash flow projection reporting adopted by the commissioner.

MN. “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.

NO. “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.

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

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

R. “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.

QS. “NOD” means notice of delinquency.

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

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

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

UW. “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.

VX. “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:
Mortgage Guaranty Insurance Model Act

(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
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;
Mortgage Guaranty Insurance Model Act

(4) Loan program or type qualification requirements;

(5) Minimum borrower repayment qualification requirements;

(6) Minimum property marketability qualifications.

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 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, unless otherwise provided by 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, unless otherwise provided by the commissioner.

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:
Mortgage Guaranty Insurance Model Act

(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).

ANNOTATIONS
MORTGAGE GUARANTY INSURANCE MODEL ACT

Section 5 Geographic Concentration

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:
Mortgage Guaranty Insurance Model Act

- 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.
MI INDUSTRY FEEDBACK – REVIEW COMMENTS

The attached listings summarize review of the MI Industry comments received on January 5, 2015, concerning the draft Mortgage Guaranty Insurance Standards Manual distributed at the NAIC 2014 Fall National Meeting. Wisconsin completed this review as directed by the MGIWG on its February 4, 2015 conference call.

Many of the MI Industry comments were found to provide useful clarifications to help fine-tune the manual draft. There were a number of cases in which the previous draft’s wording was retained or only partially edited. Based on Wisconsin’s review, the MI Industry’s comments were put into four distinct classifications:

- **Original Wording Retained due to Major Concerns**
  These items reflect the 2/4/15 MGIWG decision to maintain the Standards Manual in accordance with the objectives of its charter and to support the Model Act through the mandated underwriting and quality assurance standards and reference material.

- **MI Industry Wording Accepted for Clarification and Correction**
  These items reflect Standards Manual updates based on beneficial clarifications or general acceptance given no major changes in context.

- **Original Wording Retained due to Contextual Concerns**
  Items reflect retention of original presentation based on perceived consistencies with prior reference documentation.

- **Original Wording Retained for Other Perceived Benefit**
  Items reflect retention of original presentation based on perceived beneficial information, clearer presentation or minor wording changes with limited impact.

The current Version 2 of the Standards Manual reflects updates in accordance with the above.

**Other Section Updates**
Version 2 also reflects Wisconsin’s updates associated with Oliver Wyman methodology subsequent presentations, which represent a placeholder until the final Capital Model Project completion, and MI Industry recommended addition of Records Retention Requirements.
### Original Wording Retained due to Major Concerns

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Section Description</th>
<th>Industry Comments</th>
<th>Preliminary Review Comments</th>
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<tbody>
<tr>
<td>i.</td>
<td>Purpose &amp; Scope</td>
<td>Change Standards Manual to Whitepaper</td>
<td>Standards Manual serves to support the Model Act. Whitepaper is a marketing tool; not a user manual or technical document to provide support. Whitepaper by its nature is a one-time document; future reference use or value is unlikely.</td>
</tr>
<tr>
<td>ii.</td>
<td>Table of Contents (Title)</td>
<td></td>
<td>Background description of MI Industry, operating characteristics, risk environment was intended to be useful reference for both existing and potentially new MI regulators to support mandated standards.</td>
</tr>
<tr>
<td>i.</td>
<td>Purpose &amp; Scope</td>
<td>Drop additional mandated standards</td>
<td>Underwriting and QA Standards were intended to be mandated requirements under Model Act.</td>
</tr>
<tr>
<td>i.</td>
<td>Purpose &amp; Scope</td>
<td>Drop footnote that Standards Manual guidance is integral to Model Act</td>
<td>Deletion overrides basic MGIWG and Industry objective to document detail supporting mandated Model Act requirements in a more flexible manual format to facilitate update.</td>
</tr>
<tr>
<td>ii.</td>
<td>Table of Contents (Section VIII)</td>
<td>Move Other Mandated Requirements to Examiner’s Handbook</td>
<td>MGIWG intention is to document mandated standards for MI Industry. Movement to Examiner Handbook shifts emphasis on UW and QA requirements from the intended MI Company level to the regulatory exam level.</td>
</tr>
</tbody>
</table>

**VII.C** MI Industry Concerns  
**VII.D.2** Underwriting Standards  
**VIII.** Other Mandated Requirements

MGIWG intention is to document mandated standards for MI Industry. Movement to Examiner Handbook shifts emphasis on UW and QA requirements from the intended MI Company level to the regulatory exam level.

---

@ MGIWG Conference Call on 2/4/15 agreed to retain the Mortgage Guaranty Insurance Standards Manual as a consolidated document in accordance with charter objectives and the above Review Comments.
MI Industry Wording Accepted for Clarification and Correction:

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Section Description</th>
<th>Industry Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>I.B.1</td>
<td>Private Mortgage Ins</td>
<td>Change mortgage “lender” to “owner”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Change mortgage “guarantor” to “insurer”</td>
</tr>
<tr>
<td>I.B.2</td>
<td>Public Mortgage Ins</td>
<td>Change mortgage “lender” to “owner”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insignificant move of “in 2008” from beginning to end sentence</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insignificant change of “mortgages underlying insurance written” to “mortgages insured”</td>
</tr>
<tr>
<td>II.A</td>
<td>Pre-Great Depression</td>
<td>Limit comments to mortgage ‘insurance” industry versus mortgage industry at large</td>
</tr>
<tr>
<td>II.B</td>
<td>Post Great Depression</td>
<td>Change typo “guarantee” to guaranty</td>
</tr>
<tr>
<td>II.D.1</td>
<td>Loan Originator</td>
<td>Miscellaneous loan component and product type wording clarifications &amp; typos</td>
</tr>
<tr>
<td>II.D.2</td>
<td>Mortgage Gty Insurer</td>
<td>Miscellaneous wording clarifications related to MI insurance cancellation</td>
</tr>
<tr>
<td>II.D.3</td>
<td>Loan Securitizer</td>
<td>Drop potential for “individual” securitizer involvement</td>
</tr>
<tr>
<td>III/B</td>
<td>FHA</td>
<td>Delete FHA typical package benefits of relatively low down payment</td>
</tr>
<tr>
<td>III.E</td>
<td>Freddie Mac</td>
<td>Mortgage guarantee fee description clarification</td>
</tr>
<tr>
<td>III.F.2a</td>
<td>FHFA Eligibility Std</td>
<td>Modify PMIERs anticipated implementation date from 2014 to 2015 to reflect change subsequent to Standards Manual draft</td>
</tr>
<tr>
<td>IV.A.1</td>
<td>Primary Insurance</td>
<td>Change “policy” reference to “certificate”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Clarify coverage can be written on any type of “occupancy” versus “residential loan”</td>
</tr>
<tr>
<td>IV.A.1b</td>
<td>Bulk Basis</td>
<td>Miscellaneous bulk loan characteristics clarification</td>
</tr>
<tr>
<td>IV.A.2</td>
<td>Pool Insurance</td>
<td>Miscellaneous pool loan characteristics clarification</td>
</tr>
<tr>
<td>IV.B.1</td>
<td>Business Line Characteristics</td>
<td>Miscellaneous default option wording clarifications</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Change “policy” reference to “certificate”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Add potential for credit loss protection, insured party changes and undetected fraud</td>
</tr>
<tr>
<td>IV.C.1</td>
<td>Master Policy Concepts</td>
<td>Add “Subrogation” coverage</td>
</tr>
<tr>
<td>IV.C.2</td>
<td>Direct Underwriting</td>
<td>Consolidate other eligibility criteria from Automated to Direct UW sections</td>
</tr>
<tr>
<td>IV.C.4</td>
<td>Automated UW</td>
<td>Change “financial service provider” reference to “mortgage insurer”</td>
</tr>
<tr>
<td>IV.C.5</td>
<td>Borrower Credit History</td>
<td>Miscellaneous credit scoring wording clarification</td>
</tr>
<tr>
<td>IV.C.5</td>
<td>Debt to Income</td>
<td>Miscellaneous Debt to Income characteristics clarification</td>
</tr>
<tr>
<td>IV.C.5</td>
<td>Down Payment</td>
<td>Miscellaneous Down Payment characteristics clarification</td>
</tr>
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<td>IV.C.6</td>
<td>Property Valuation</td>
<td>Miscellaneous “value at risk” clarification</td>
</tr>
<tr>
<td>IV.D.1</td>
<td>Loan Integrity Objective</td>
<td>Insignificant change “loan origination” to “underwriting” process</td>
</tr>
<tr>
<td>IV.D.3c</td>
<td>Post Closing Review</td>
<td>Drop property insurance coverage review typically performed at claim settlement</td>
</tr>
<tr>
<td>IV.E.1</td>
<td>Loss Reserves</td>
<td>Add foreclosure vs. default clarification</td>
</tr>
<tr>
<td>IV.E.2</td>
<td></td>
<td>Modify loss factor descriptions to reflect potential for positive as well as negative trends</td>
</tr>
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MI Industry Wording Accepted for Clarification and Correction (continued):

<table>
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<tr>
<th>Ref #</th>
<th>Section Description</th>
<th>Industry Comments</th>
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<tbody>
<tr>
<td>IV.E.3</td>
<td>Unearned Premium</td>
<td>Change “policy” reference to “certificate” and “amortized” to “earned”</td>
</tr>
<tr>
<td>IV.F.2</td>
<td>Captive Reinsurance</td>
<td>Insignificant wording change insurers “have been” to “were” named defendants</td>
</tr>
<tr>
<td>IV.F.3</td>
<td>External Reinsurance</td>
<td>Expand external reinsurer status reasons</td>
</tr>
<tr>
<td>IV.G.1</td>
<td>Early Rescission</td>
<td>Reverse order of presentation / No content change</td>
</tr>
<tr>
<td>IV.G.2</td>
<td>Mandatory Rescission</td>
<td></td>
</tr>
<tr>
<td>IV.G.3</td>
<td>Misrepresentation</td>
<td>Clarify ‘intentional” misrepresentation as basis for rescission remedy</td>
</tr>
<tr>
<td>V.A.3</td>
<td>Divorce Factor</td>
<td>Modify “Divorce” Factor to “Income Reduction” including death &amp; divorce</td>
</tr>
<tr>
<td></td>
<td>Payment Shock</td>
<td>Consider Additional Default Factors</td>
</tr>
<tr>
<td></td>
<td>Strategic Default</td>
<td>(but recognize as not traditional factors)</td>
</tr>
<tr>
<td>V.B.2</td>
<td>Sub-Prime Background</td>
<td>Clarify loan expiration relates to “ARMs”</td>
</tr>
<tr>
<td></td>
<td>Insignificant wording change of “assuming” to “obtaining” mortgages</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Retain expansion of GSE authority factor; drop “to fill PMI void” as only reason</td>
<td></td>
</tr>
<tr>
<td>V.B.3</td>
<td>Subprime Crisis Causes</td>
<td>Add investor goal to “seek yield”</td>
</tr>
<tr>
<td>V.B.4</td>
<td>Housing Boom to Bust</td>
<td>Insignificant wording change from “fueled” to “helped fuel”</td>
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<tr>
<td></td>
<td>Drop disciplined new housing supply and restrained overbuilding factor</td>
<td></td>
</tr>
<tr>
<td>VIII.A6</td>
<td>Property Marketability</td>
<td>Clarify property title typically verified at time of claim settlement</td>
</tr>
<tr>
<td>VIII.B1</td>
<td>Segregation of Duties</td>
<td>Clarify segregation of duties does not apply to the highest senior management level responsible for ERM to address potential impacts</td>
</tr>
</tbody>
</table>

OTHER SECTION UPDATES:

VII.B.6 RBC Methodology  Updated methodology to reflect Oliver Wyman Presentation as of NAIC Summer Meeting
Adopted by MI Industry Section serves as a “placeholder” until Oliver Wyman Project completion

VII.C.3 Loan Level Methodology  Updated methodology to reflect Oliver Wyman Presentation as of NAIC Summer Meeting
Adopted by MI Industry Section serves as a “placeholder” until Oliver Wyman Project completion

VII.C. Records Retention Requirements  Added new MI Industry recommendation for Records Retention Requirements.
Standards Manual contains detail requirements which are cross-referenced to the overall requirements under the Model Act.
## Original Wording Retained due to Contextual Concerns

<table>
<thead>
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<th>Section Description</th>
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<tbody>
<tr>
<td>ii.</td>
<td>Table of Contents</td>
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<tr>
<td></td>
<td>Section VI.D.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VI.D.3</td>
<td>QA Standards</td>
<td>Change Heading from Quality Assurance to Quality Control</td>
<td>Retain consistency with Model Act Section 12 which is labeled “Quality Assurance”</td>
</tr>
<tr>
<td>VIII.B</td>
<td>QA Standards</td>
<td></td>
<td></td>
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<tr>
<td>IV.B.1</td>
<td>Business Line</td>
<td>Modify typical LTV percentages and average certificate life</td>
<td>Retain general consistency with SSAP #58 recognizing individual company variations may exist (Typical LTV 80-95%) (Average life – primary insurance = 7 years) (Average life – pool insurance = 8-12 years)</td>
</tr>
<tr>
<td></td>
<td>Characteristics</td>
<td></td>
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<tr>
<td>IV.D.3e</td>
<td>Reverification</td>
<td>Change sample “reverification” to “validation”</td>
<td>Retain Quality Control Best Practices identified in various regulatory guidance</td>
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<td></td>
<td>Procedures</td>
<td></td>
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<tr>
<td>IV.D.3f</td>
<td>File Documentation</td>
<td>Delete “application” early warning signs review</td>
<td>Retain Quality Control Best Practices identified in various regulatory guidance</td>
</tr>
<tr>
<td></td>
<td>Review</td>
<td></td>
<td></td>
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<tr>
<td>VI.B</td>
<td>MGIWG Concerns</td>
<td>Modify MGIWG concerns related to reform: Countercyclical environment Lack of formal UW Standards Lack of QA function RE investments outside ordinary conduct Rescission practices</td>
<td>Retain MGIWG Concerns consistency with original NAIC Concepts List</td>
</tr>
<tr>
<td>VIII.B.3</td>
<td>Board of Director</td>
<td>Modify BOD requirements to include Executive Management</td>
<td>Retain BOD oversight as distinct requirement apart from Management. Senior Management oversight requirements are previously covered under VIII.B.2</td>
</tr>
<tr>
<td></td>
<td>Oversight</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VIII.B.4QA Policy / Procedure Documentation</td>
<td>Drop Management and BOD Oversight responsibilities from QA Documentation</td>
<td>Retain QA Policy / Procedure Documentation for Senior Management and BOD Oversight responsibilities previously identified under VIII.B.2 and 3</td>
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</table>
## Original Wording Retained for Other Perceived Benefit

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<thead>
<tr>
<th>Ref #</th>
<th>Section Description</th>
<th>Industry Comments</th>
<th>Preliminary Review Comments</th>
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</thead>
<tbody>
<tr>
<td>I.B.2</td>
<td>Public Mortgage Ins</td>
<td>Delete mortgage insurance industry competes with governmental agencies and products designed to eliminate PMI.</td>
<td>Retain to reflect ongoing private versus public mortgage competitive relationships (with deletion of PMI elimination)</td>
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<tr>
<td>II.C</td>
<td>MGI Role &amp; Benefits</td>
<td>Delete “earlier” home ownership benefits Insignificant wording change “through” to “by the” restructuring</td>
<td>MI generally facilitates earlier home ownership through lower down payment</td>
</tr>
<tr>
<td>II.D.1</td>
<td>Loan Originator HARP</td>
<td>Delete refinancing limitations LTV&lt;80% which form the basis for HARP benefits LTV &gt; 80% is primary HARP requirement which addressed refinancing limitations</td>
<td></td>
</tr>
<tr>
<td>IV.A.1a</td>
<td>Flow Basis</td>
<td>Modify borrower / lender paid loan description No significant change</td>
<td></td>
</tr>
<tr>
<td>IV.C.5</td>
<td>Borrower Credit History</td>
<td>Delete “borrower willingness’ to pay evaluation Borrower willingness and ability to repay impact considered</td>
<td></td>
</tr>
<tr>
<td>IV.C.5</td>
<td>Debt to Income</td>
<td>Delete supporting reason for DTI analysis Retain reason for background review</td>
<td></td>
</tr>
<tr>
<td>IV.C.5</td>
<td>Down Payment</td>
<td>Delete supporting reason for Down Pay analysis Retain reason for background review</td>
<td></td>
</tr>
<tr>
<td>IV.C.7</td>
<td>Loan Documentation</td>
<td>Delete additional loan closing documentation Industry comments concur documents are typically included in loan file</td>
<td></td>
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<tr>
<td>IV.E.2</td>
<td>Loss Reserves</td>
<td>Deletion of claim “rate” component Claim rate description similar to comments</td>
<td></td>
</tr>
<tr>
<td>IV.E.3</td>
<td>Unearned Reserves</td>
<td>Delete “based on premium revenue recognition”Retain revenue recognition concept</td>
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<tr>
<td>IV.E.4</td>
<td>Contingency Reserves</td>
<td>Modify Contingency Reserve definition Description is based on SSAP 58</td>
<td></td>
</tr>
<tr>
<td>IV.G</td>
<td>Rescission Principles</td>
<td>Delete rescission description related to representation and warranty violations Add rescission practices “regularly protected” legitimate policyholders</td>
<td>Retain potential rescission violations Added material misrepresentation Legitimate use in all cases questioned based on subsequent settlement issues, but noted legitimate use for policyholder protection</td>
</tr>
<tr>
<td>V.B.1</td>
<td>Sub-Prime Crisis</td>
<td>Delete description of MBS default experience Retain MBS default impact on crisis (with minor wording change from MBS “caused” to “experienced” default)</td>
<td></td>
</tr>
<tr>
<td>V.B.3</td>
<td>Subprime Crisis Causes</td>
<td>Change “subprime” heading to “housing” crisis Topic discussed is specific to “sub-prime”</td>
<td></td>
</tr>
<tr>
<td>V.B.4</td>
<td>Housing Boom to Bust</td>
<td>Delete high ratio of home ownership factor Retain level of home ownership as factor</td>
<td></td>
</tr>
<tr>
<td>VI D.4</td>
<td>Concentration Limits</td>
<td>Delete geographic maximum limits Model Law incorporates 15% risk in-force limit with additional capital requirements</td>
<td></td>
</tr>
<tr>
<td>VIII.A.3</td>
<td>Minimum Doc Standards</td>
<td>Delete mortgage note and commitment certificate documentation Mortgage note and commitment represent basic loan documentation</td>
<td></td>
</tr>
<tr>
<td>VIII.B</td>
<td>QA Standards</td>
<td>Modify to include ERP related activity Appears to reopen ORSA replacement for QA which has been previously rejected</td>
<td></td>
</tr>
<tr>
<td>VIII.B1</td>
<td>Segregation of Duties</td>
<td>Delete QA Administration independence QA administration and testing responsibilities require independence</td>
<td></td>
</tr>
</tbody>
</table>
NAIC

MORTGAGE GUARANTY INSURANCE STANDARDS MANUAL

(Version 2)
MORTGAGE GUARANTY INSURANCE STANDARDS MANUAL

Purpose and Scope

The Mortgage Guaranty Insurance Standards Manual is designed to:

1) Provide a background history of the evolution of Mortgage Guaranty Insurance Industry including the public and private mortgage environment

2) Provide a background description of operating characteristics unique to the Mortgage Guaranty Insurance environment

3) Provide a background description of the Mortgage Guaranty Insurance risk environment

4) Provide a background history of the Mortgage Guaranty Insurance Working Group efforts, reasons and results contributing to the Mortgage Guaranty Insurance Model Act update

5) Provide an understanding of the NAIC Risk Based Capital framework and Mortgage Guaranty Insurance related modifications to support requirements referenced in the Mortgage Guaranty Insurance Model Act

6) Provide an understanding of the Mortgage Guaranty Insurance Loan Level Cash Flow Capital framework to support requirements referenced in the Mortgage Guaranty Insurance Model Act

7) Document additional supporting Mortgage Guaranty Insurance standards and requirements referenced but not detailed in the Mortgage Guaranty Insurance Model Act because of the potential for ongoing change triggered by economic conditions

8) Facilitate periodic update of related requirements without requiring adherence to the more formal NAIC Model Act update procedures

The background and guidance outlined in this manual are based on and integral to the requirements established under the Mortgage Guaranty Insurance Model Act (#630), which should be referenced when determining adopted mortgage guaranty insurance law.
# MORTGAGE GUARANTY INSURANCE STANDARDS MANUAL

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A. Mortgage Guaranty Insurance Definition
Mortgage guaranty insurance provides mortgage lenders with insurance against loss due to borrower non-payment and default of mortgage indebtedness.

B. Sources of Mortgage Guaranty Insurance
The primary sources of mortgage guaranty insurance include the following:

1. Private Mortgage Guaranty Insurance
Private mortgage guaranty insurance, referred to as PMI, is provided by commercial insurance companies, typically when the loan to value ratio is greater than 80% of the property’s appraisal value in recognition of the added risk. Private mortgage insurance is designed to indemnify the mortgage loan ownerorigination lender for the outstanding balance and accrued interest due on loan payments in default, as well as other real estate taxes and various maintenance costs until claim settlement. The cost of private mortgage guaranty insurance is typically added to the borrower’s loan mortgage payments. The lender may transfer title to the mortgage insurerguarantor, who uses the proceeds from resale to reduce claim costs, upon full claim settlement. Alternatively, the mortgage insurerguarantor has the option to pay the limit of coverage and forego the right to acquire title.

2. Public Mortgage Guaranty Insurance
Public mortgage guaranty insurance provides similar mortgage ownerlender insurance through a government agency. The private mortgage insurance industry competes with certain governmental agencies and products designed to eliminate the need to purchase private mortgage insurance.

The majority of public mortgage insurance is provided by governmental agencies that sponsor government backed mortgage insurance programs, primarily the Federal Housing Administration (FHA) and the Veteran’s Administration (VA). During the period 2011, 2012 and 2013, public mortgage guaranty insurance accounted for approximately 77%, 68% and 63% of the total low down payment residential mortgages subject to mortgage guaranty insurance.

The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) purchase residential mortgages as part of their government mandate to provide liquidity in the secondary mortgage market. These government sponsored entities (GSEs) have been the major purchaser of mortgages insured underlying insurance written by private insurers. GSE purchase of such low down payment mortgage loans requires credit enhancement, of which private mortgage insurance is key.

In 2008, the Federal Housing Finance Agency (FHFA) was appointed as the conservator of the GSEs with authority to control and direct their operations in 2008. As conservator, various GSE reforms are under review to reduce the government’s overall...
footprint in housing finance, including the recent development of increased “Private Mortgage Insurer Eligibility Requirements.”
II. PRIVATE MORTGAGE GUARANTY INSURANCE ENVIRONMENT

A. Pre “Great Depression” Programs
The original form of pre “great depression” era mortgage guaranty insurance was an outgrowth of the title insurance business. Coverage insured whole mortgages and guaranteed participation certificates representing a share in either a single mortgage or pool of mortgages originated by either the insuring entity itself or an affiliate.

This mortgage industry collapsed in 1933 as a result of the placement of the majority of industry participants in rehabilitation, which was attributed to a combination of factors, including:

- Market competition among mortgage lenders directing business to companies that would make the largest loan
- Inaccurate property appraisals reflecting values necessary to obtain loan approval
- Loan packaging favoring larger institutions with less desirable mortgages packaged for sale to those of more limited means
- Substitution of less desirable mortgages in pools
- Mortgage guaranty sale of participations on vacant or foreclosed properties
- Mortgage lender and mortgage guaranty corporation affiliations creating conflicts of interest

B. Post “Great Depression” Programs
Max Karl, a Milwaukee-based attorney, subsequently studied the causes of the original mortgage guaranty insurance failure and reestablished the mortgage guaranty industry in the 1950’s. The Mortgage Guaranty Insurance Corporation was subsequently founded in 1956.

The new business model emphasized:

- Non-affiliation of the mortgage lender and mortgage guaranty insurer
- Monoline licensing requirements
- Investment restrictions on mortgage and mortgage backed securities
- Single family coverage
- Actuarial based premium charges
- Premium income allocation into loss, unearned and contingency reserves
- Commission, rebate and fee prohibitions for placement or purchase of PMI

C. Mortgage Guaranty Insurance Role and Benefits
Private mortgage guaranty insurance provides the following mortgage and borrower related benefits:

- Facilitation of earlier home ownership and equity buildup through low down payment mortgage support
• Borrower expense control through automatic mortgage guaranty insurance lender cancellation on the date when the principal mortgage balance is scheduled to reach 78% of the original property value per the Homeowners Protection Act of 1998

• Borrower financial assistance through private mortgage insurer and lender efforts to protect their housing investment through the restructuring of loan payments or terms and collection efforts to prevent foreclosure in many instances

• Mortgage lender expansion of lendable sources of funds through loan origination credit enhancement

D. Key Private Mortgage Participants
The key participants in the mortgage guaranty insurance environment consist of the following:

1. Loan Originator
The loan originator is the bank or other financial lending institution which creates a mortgage loan to finance ownership of property. The mortgage loan is used by borrowers to obtain funds to purchase real property. The loan is secured by a lien on the borrower’s property, which allows the lender to take possession and sell the secured property to pay off the loan in the event of borrower default. The mortgage loan involves two primary documents; the mortgage note, as evidenced by a promissory note to repay, and the security interest in the property, as evidenced by the mortgage document or deed of trust.

The primary financial components of a mortgage loan encompass the following:

• **Loan Term** – the number of years after which an amortizing loan will be fully repaid

• **Payment Amount and Frequency** – the amount paid per period and the frequency of payment installments

• **Principal** – the original amount of the loan which will typically decrease as repaid

• **Interest** – the charge to the borrower for obtaining mortgage loan funds

• **Amortization** – the calculation of regular periodic payments of principal and interest to repay the loan into installments

The primary mortgage loan product types in the marketplace include the following:

• **Conventional Loans** – Conventional loans are fixed rate loans with a variety of loan terms (30 years most common), whereby mortgage loan payments do not change throughout the loan term. Conventional loans offer the borrower a level of loan payment predictability, but provide no flexibility particularly for significant rate declines. The latter environment typically requires the borrower to refinance the loan to take advantage of declining rate scenarios.

• **Adjustable Rate Mortgages (ARMS)** – Adjustable rate mortgage loans provide for an initial term fixed payment after which rates are readjusted, which can result in
negative borrower payment impact in a significantly higher rate environment. Rates are typically based on an index reflecting current market conditions. ARMs can have caps, which establish and limit the amount by which the monthly payment or interest rate may change.

- **Interest Only Loans** – Interest only loans allow borrowers to pay only interest on the mortgage for a fixed period of time, after which the borrower has the option to refinance, pay off the higher loan balance or incur potentially significantly higher monthly payments. The interest only loan product is typically designed for strategic borrowers, who anticipate significant subsequent period income which would erase the debt.

- **Negative Amortization Loans** – Negative amortization loans consist of set payments at a level which fails to cover principal and interest due, resulting in an temporary increase versus decrease in total loan balance. Negative amortization loans are typically designed for borrowers who desire a relatively small initial payment with the intention of subsequently refinancing under a new loan at a later date that will build equity.

Various federal loan modification programs were also established as a result of the sub-prime mortgage crisis, including the following:

- **Home Affordable Modification Program (HAMP)** – The Home Affordable Modification Program is a federal program authorized under the Emergency Economic Stabilization Act of 2008. HAMP is part of the Making Home Affordable Program, which was created by the Financial Stability Act of 2009. The program is designed to assist homeowners who are in danger of foreclosure. The program was built around collaboration between lenders, investors, mortgage servicers, the government sponsored entities and the Federal Housing Finance Agency to create standard loan modification guidelines for lender consideration in conjunction with borrower evaluation for potential modification of loan terms. Under HAMP, lenders and / or mortgage servicers are required to make a calculated net present value determination as to whether entering into a loan modification versus foreclosure would be most beneficial. Loan modification must be pursued if the net present value of expected cash flow is greater under the modification scenario prior to any foreclosure proceedings, absent any considerations associated with fraud or contract prohibitions.

- **Home Affordable Refinance Program (HARP)** – The Home Affordable Refinance Program is a federal program setup by the Federal Housing Finance Agency in March 2009 to assist homeowner mortgage refinancing in instances where borrowers are prevented from taking advantage of lower interest rates through refinancing due to a decline in housing prices, often below the mortgage balance. Accordingly, refinancing became limited by traditional lender requirements for a loan to value ratio of 80% or less to qualify for refinancing without private mortgage insurance. Under HARP, the mortgage must be owned
or guaranteed by Freddie Mac or Fannie Mae on or before May 31, 2009 with a current LTV ratio greater than 80% and the homeowner must benefit in terms of either a lower monthly payment or movement to a more stable mortgage product.

2. **Mortgage Guaranty Insurer**
   The mortgage guaranty insurer is the private or public insurer who protects a lender against loss on all or a portion of the principal amount of the mortgage loan upon default and subsequent foreclosure. It is commonly used in loans with a loan to value ratio over 80%. The mortgage guaranty insurer issues a master policy to the bank or other financing institution which sets forth coverage terms and conditions under insurance certificates. The insurance certificate documents the particular characteristics and conditions of each individual loan covered under the master policy. The mortgage guaranty insurance policy premium is typically paid for by the borrower as a component of the monthly mortgage payment. Mortgage guaranty insurance, which is borrower-paid, must be cancelled by the lender when the loan balance is first scheduled to reach 78% of the original property value, irrespective of actual payments. It may also be cancelled if requested by the borrower when the loan has amortized down to below 80% LTV based on the actual or schedule payments. Lender-paid guaranty insurance typically provides coverage for the life of the loan can be dropped when the lender informs the borrower that the property has appreciated, the loan has been paid down or any combination of the above to reduce the loan to value to under 80%.

3. **Loan Securitizer**
   The loan securitizer is a business, or bank, or individual that originates or initiates an asset-backed security through grouping of loans originated in the primary mortgage market for sale as a collateralized mortgage obligation (CMO) or mortgage backed security (MBS) to investors in the secondary market. The secondary market functions as the market for sale of securities or bonds collateralized by the value of mortgage loans. This secondary market serves to provide a new source of capital for the market. Secondary investors typically include insurance companies, pension funds and hedge funds.
III. PUBLIC MORTGAGE GUARANTY INSURANCE ENVIRONMENT

A. Homeowners’ Loan Corporation Role (HOLC)
The origin of the existing housing finance structure in the United States dates back to the Great Depression era. The Homeowners’ Loan Corporation Act established the Homeowners’ Loan Corporation, which initiated operations in June 1933. The Homeowners’ Loan Corporation was founded to refinance home mortgages in default to prevent subsequent foreclosure. The HOLC sold bonds to lenders in exchange for home mortgages experiencing payment problems. The HOLC subsequently refinanced borrower loans typically resulting in loans with a longer term at a lower interest rate. The HOLC subsequently began curtailing lending activities in the mid 1930’s due to capital shortage and eventually ceased operations in 1951 associated with economic conditions and increasing borrower foreclosures.

B. Federal Housing Administration Role (FHA)
The Federal Housing Administration was established under the National Housing Act of 1934. The FHA insures mortgage loans originated by FHA approved banks and other private lending institutions. FHA loans typically offer a more affordable mortgage insurance package through a combination of relatively low minimum down payment requirements, an upfront mortgage insurance premium, and an annual mortgage insurance premium paid over the loan term. The FHA assumed a major role in establishing housing finance standards and conditions, insuring mortgages and providing stability to the mortgage market. The FHA subsequently became part of the Department of Housing and Urban Development in 1965 and is the largest mortgage insurer in the United States.

C. Federal National Mortgage Association Role (Fannie Mae)
The Federal National Mortgage Association was established in 1938 via amendments to the National Housing Act of 1934. Fannie Mae was established to provide local banks with federal money to finance home mortgages in an attempt to raise levels of home ownership and affordable housing availability. Fannie Mae developed a secondary mortgage market which provided the ability of banks and other loan originators to reinvest their assets and thereby issue increased mortgage loans through the purchase of Federal Housing Administration insured mortgages. Fannie Mae became a mixed ownership corporation in 1954 with the federal government holding preferred stock while private investors held the common stock. It was subsequently split into the currently known private corporation, Fannie Mae, and the government corporation, Ginnie Mae, in 1968. Fannie Mae was authorized to purchase private mortgages not insured by GSEs in 1970. In the same year, Congress established the Federal Home Loan Mortgage Corporation to enhance the secondary mortgage market by competing with Fannie Mae.

D. Government National Mortgage Association Role (Ginnie Mae)
The Government National Mortgage Association spin-off from Fannie Mae resulted in a government corporation within the U.S. Department of Housing and Urban Development. Ginnie Mae guarantees securities backed by mortgage loans on single-family and small multi-family structures insured by other government agencies, including the Federal Housing Administration, Department of Veterans Affairs and Office of Public and Indian Housing.
Private lending institutions approved by Ginnie Mae originate eligible loan pools, turn them into securities and issue Ginnie Mae mortgage backed securities, which are guaranteed as to the timely payment of principal and interest. Ginnie Mae is the only home loan agency explicitly backed by the full faith and credit of the U.S. Government.

E. Federal Home Loan Mortgage Corporation Role (Freddie Mac)
The Federal Home Loan Mortgage Corporation was established via the Emergency Home Finance Act in 1970 as a corporation owned by the Federal Home Loan Bank System to compete with Fannie Mae in the secondary market for private mortgages. Freddie Mac buys mortgages in the secondary market, pools them and sells mortgage backed securities to investors in the secondary market, which in turn increases the money supply available for mortgage lending. Investors of these mortgage backed securities, Mortgage sellers pay a guarantee fee in exchange for Freddie Mac’s assumption of the credit risk associated with principal and interest repayment, which benefits investors of these mortgage backed securities. Freddie Mac’s ties with the Federal Home Loan Bank System were severed in 1989 under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, resulting in the creation of an 18 member board of directors under the oversight of the U.S. Department of Housing and Urban Development.

F. Federal Housing Finance Agency (FHFA)

1. FHFA Role
The Federal Housing Finance Agency is an independent federal agency established by the Housing and Economic Recovery Act of 2008 to supervise the government sponsored enterprises (GSEs). The FHFA is the successor agency resulting from the merger of the Office of Federal Housing Enterprise Oversight, the Federal Housing Finance Board and the GSE mission office of the U.S. Department of Housing and Urban Development.

The FHFA was additionally appointed conservator of Fannie Mae and Freddie Mac as well as the regulator of the 12 Federal Home Loan Banks in September 2008.

2. FHFA Eligibility Standards *

a. Overview
The Federal Housing Finance Agency (FHFA), as current conservator of the Government Sponsored Enterprises (GSEs), has directed Fannie Mae (FNMA) and Freddie Mac (FHLMC) to revise, expand and align their risk management requirements for mortgage insurance counterparties. The GSEs are chartered by Congress to provide liquidity and stability in the secondary residential mortgage market. The GSEs require mortgage loans with an outstanding principal balance exceeding 80% of the property value to have an acceptable form of credit enhancement. Primary mortgage insurance typically provides the GSEs with loss protection on mortgage loans exceeding an 80% loan-to-value (LTV).

Each GSE has historically operated under its own set of mortgage insurance requirements, which a private mortgage guaranty insurer must comply with in order
to obtain “approved insurer” status. Fannie Mae and Freddie Mac have not updated
their MI eligibility requirements since 2003 and 2008, respectively.

Accordingly, the FHFA has issued new Private Mortgage Insurer Eligibility
Requirements (PMIERs), which establish a new risk-based framework with emphasis
on approved insurer maintenance of sufficient liquid asset levels for claims payment.
These PMIERs are potentially critical to the ongoing requirements and ability of the
private mortgage insurance industry to balance its responsibilities to maintain
sufficient solvency for claim payment as well provide reasonable consumer access to
mortgage credit. Accordingly, the PMIERs are currently in draft form and under
review with various state insurance regulators and private mortgage insurers with an
anticipated implementation date of December 31, in 2015.

The overall objectives of the PMIERs are to:

- Mitigate future GSE losses
- Ensure approved insurers maintain sufficient financial strength to withstand a
  severe stress macroeconomic scenario
- Create a common set of approved insurer eligibility requirements

Key eligibility requirements under the proposed PMIERs to meet an approved insurer
status incorporate the following:

b. Business Requirements and Policy Underwriting

Business requirements and policy underwriting emphasize approved insurer
requirements to:

- Establish a documented risk diversification policy and employ risk
  management tools and techniques to avoid concentrated in-force risk exposure
- Pay or deny claims or rescind coverage within 180 days of claim perfection
  and rescind or deny any claim not perfected within 120 days from claim filing
- Maintain Fidelity Bond and Errors and Omissions business insurance no lower
  than $5 million with a deductible not to exceed $150,000
- Conduct a risk analysis to ensure that automated underwriting systems
  recommendations are aligned with the approved insurer’s independent credit
  risk guidelines

c. Quality Control

Quality Control guidelines require each approved insurer to:

- Maintain a proactive quality control program to facilitate approved insurer
  monitoring of compliance with its underwriting standards, ensure data
  accuracy and prevent approval of mortgages with defects
- Submit annually a copy of its formal Quality Control Program
- Comply with minimum review requirements encompassing independence,
  proper underwriting, loan selection, source of business, declined applications
  and formal documented operating procedures
- Complete a post-closing review of income, employment, property valuation
  and credit history
Monitor overall performance through completion of an operational performance scorecard which tracks performance using a prescribed set of indicators.

d. **Financial Requirements**

Financial requirements emphasize maintenance of adequate liquidity and claims paying ability under economic periods of stress based on approved insurer requirements to:

- Establish a Minimum Required Asset level equal to the greater of Total Risk Based Required Assets, based on factors involving vintage, loan to value ratio and credit score, or a floor limit of $400 million.
- Maintain Available Assets at a level which meets or exceeds the above Minimum Required Assets based on cash, bonds, stock at a discounted value, receivables, subsidiary dividends, and future premium income limited to 3 years based on pre-2009 crisis period policies subject to a discount.
- Obtain GSE approval to enter into any new capital support agreements, assumption of liabilities and affiliate or non-affiliate investments, if non-compliance with the above capital requirements exists.

e. **Failure to Meet Requirements**

Failure to meet the PMIERs requirements may result in approved insurer:

- Establishment of an action plan acceptable to the GSEs.
- Suspension or termination of its approved insurer status.

f. **Newly Appointed Insurer Requirements**

Newly appointed insurers are required to meet the following conditions to obtain approved insurer status:

- Demonstrate minimum initial capital funding of $500 million.
- Obtain agency ratings no later than 3 years following GSE status approval.
- Prohibit holding company or affiliate dividend payments for the first 3 years following GSE approval.

g. **Conclusion**

Although modifications based on the private mortgage industry and state regulator input are under review, the majority of the above draft FHFA eligibility standards are anticipated to become effective in the near future. Accordingly, they represent a relatively strong set of requirements, which individual private mortgage insurers will have to consider in developing their business plan to maintain status as a viable participant in the mortgage guaranty insurance industry.

*Key requirements will be updated as the PMIERs are finalized.*
G. Limited Federal Role in Regulation

U.S. insurance business has been primarily regulated at the state level through insurance laws enacted by state legislators and enforced by state regulators. This state regulation typically consists of:

- Financial oversight of solvency conditions to meet the mortgage guaranty insurer’s ability to satisfy policyholder claims
- Marketplace oversight of consumer protection issues related to pricing, advertising, policy terms and licensing

Proponents of the above state regulation cite the local nature of insurance business, mechanics for cooperation among states and better positioning to respond to consumer complaints.

The recent sub-prime mortgage crisis demonstrated that large insurers are often integrated into the broader financial systems. As part of the federal government response to the financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank Act) in 2010. This act established the Financial Stability Oversight Council responsibilities for monitoring emerging financial risks and designating global systemically important financial institutions (G-SIFIs) and domestic systemically important financial institutions (D-SIFIs). It also established the Federal Insurance Office (FIO) under the U.S. Department of Treasury with authority to monitor and consult on all aspects of the insurance industry, including identification of regulatory issues that could contribute to insurance industry crisis.
IV. OPERATING CHARACTERISTICS UNIQUE TO MORTGAGE GUARANTY INSURANCE

A. Private Mortgage Insurance Origination Types

Private mortgage insurance is typically categorized by origination type based on the following:

1. Primary Insurance

Primary insurance provides mortgage default protection on individual loans which covers unpaid principal, delinquent interest and expenses associated with the default and subsequent foreclosure or property sale. The insurer generally pays the coverage percentage of the claim amount specified in the insurance certificate with the option to pay 100% of the claim amount and acquire title to the property. Primary insurance is generally written on first lien mortgage loans secured by owner occupied single-family homes which includes one to four unit homes or condominiums. However, primary coverage can be written on any type of residential mortgage loan instrument approved by the mortgage insurer, including investor or non-owner occupied single family homes, vacation or second homes.

Primary insurance can be written under the following basis:

a. Flow Basis

Loans are insured on an individual loan-by-loan transaction basis. Premium rates typically vary depending on the perceived risk of a potential claim on the loan type based on consideration of the loan to value ratio, borrower credit score, payment plan, mortgage term and property type. The mortgage instrument may require the borrower to pay the mortgage which is referred to as “borrower paid”. Alternatively, the lender may be required to pay the premium, who in turn recovers the premium through an increase in the note rate, which is referred to as “lender paid”.

b. Bulk Basis

Coverage is provided on each mortgage loan included in a defined portfolio of loans insured under. Each loan in a portfolio of loans is individually insured in a single or bulk transaction. Bulk coverage typically insures the closed loans in an insured portfolio. Individual loans in the insured portfolio are generally insured to a specified levels of coverage. Loans insured on a bulk basis are typically part of a negotiated transaction, resulting in The premium in a bulk transaction is typically negotiated with the securitizer of the loan and is based on the mortgage insurer’s evaluation of the overall risk of the insured loans included in the transaction and often utilizes a composite rate applied to all such loans in the portfolio.

2. Pool Insurance

Pool insurance is generally used as an additional credit enhancement for secondary market mortgage transactions. A pool is a collection of mortgages with similar rates and terms which are often securitized by dividing the pool into bonds backed by the payments of principal and interest into the pool by borrowers homeowners. Pool insurance typically covers the excess of loss on a defaulted mortgage loan included in the pool, which is in
excess of the loan’s which exceeds the claim payment under the primary coverage, as well as the total loss on a defaulted mortgage which does not require primary coverage, if required, as well as the total loss on a defaulted mortgage which does not require primary coverage. Pool insurance may have a stated aggregate loss limit for a pool of loans or a deductible under which no loss is paid by the insurer until the deductible is exceeded.

B. Mortgage Guaranty Insurance Environment
Mortgage guaranty insurance overall is governed by the NAIC Statement of Statutory Accounting Principles No. 58.

1. Business Line Unique Characteristics  Mortgage guaranty insurance differs from other lines of insurance in a number of areas including the following:

- Mortgage guaranty insurance is typically provided on residential loans consisting of one to four family residences, including condominiums and townhouses
- Majority of polices cover 10%-30% of the loan amount and are written on first mortgages where the loan amount is a relatively high percentage (typically 80% to 95%) of the mortgaged property value
- Lenders obtain mortgage guaranty insurance to facilitate sales of mortgage loans in the secondary markets or to protect against credit losses on loans held in the portfolio
- Individual mortgage loans or pools of mortgage loans are separately underwritten and insured under lender-insurance certificates
- Exposure period is significantly longer than other property and casualty insurance products and can run for the mortgage term with an overall average certificate policy life of 7 years for primary insurance and 8-12 years for pool insurance
  Insured parties may change over time during the period coverage is in place
- Premium payment plans can typically include monthly, single or annual premium payment terms
- Premium written revenue is typically recognized based on premium plan as follows:
  - Monthly Premium Plan = Revenue is earned in respective months
  - Annual Premium Plan = Revenue is earned on a pro-rata basis over the applicable year
  - Single Premium Plan – Revenue is earned over the policy life
- Mortgage guaranty insurers do not have the option to cancel or non-renew a certificate policy, except for fraud or premium nonpayment, unlike other forms of insurance
- Mortgage insurance losses can be attributed to:
  - Underwriting errors in the evaluation of borrower willingness or financial ability to meet mortgage payment obligations
  - Interruptions in borrower earning power
  - Defaults arising from adverse local or regional economic conditions
  - Widespread defaults arising from severe U.S. economic downturns
  - Undetected mortgage fraud
• Mortgage guaranty insurer options under a default scenario include:
  o Payment of the percentage of **insured loss identified on the insurance certificate** lender’s cost covered under the policy
  o Property **acquisition by the insurer and payment of the lender’s entire loss purchase for the lender’s cost** with tender of merchantable title
  o Property sale with claim payment based on the actual lender loss up to the percentage of coverage identified in the insurance certificate. Lender arrangements for property sale with lender reimbursement for specified losses

• Mortgage guaranty insurers are required to maintain a contingency reserve liability to protect policyholders against loss in an amount equal to 50% of earned premium for ten years regardless of coverage period
• Contingency reserves may be subject to early release based on commissioner approval when actual incurred losses exceed 35% of the corresponding earned premium

2. **Monoline Considerations**
   Mortgage guaranty insurers are licensed on a monoline basis to require that they devote full attention to the unique business line characteristics highlighted above and their potential exposure to infrequent, but very significant swings and downturns in the economy impacting employment and housing prices.

3. **Conflict of Interest Considerations**
   Mortgage guaranty insurers are prohibited from engaging in potential conflicts of interest which may ensue based on underwriting mortgage guaranty insurance on:

   • Mortgages originated by a member’s holding company system
   • Mortgages originated by an affiliate of the holding company system
   • Mortgages originated by a lender to which credit is extended by the holding company system or its affiliates

C. **Underwriting Standards**

1. **Master Policy Concepts**
   A mortgage guaranty insurer’s master policy establishes the terms and conditions of insurance coverage under individual policy insurance certificates. The master policy includes various conditions for approving or denying coverage, notification of loans in default and claims settlement. Master policy contractual provisions have received increased scrutiny in accordance with the sub-prime mortgage crisis, resulting in the establishment of Government Sponsored Entity (GSE) revised requirements to ensure greater uniformity and consistency.

   Typical master policy coverage includes policy and procedure requirements related to:

   • Insurance application,
   • Commitment and Certificate issuance
• Coverage eligibility
• Cancellation and rescission
• Policy servicing
• Claim submission, settlement and reporting
• Subrogation

2. Direct Underwriting Role and Responsibilities

Underwriting refers to the process by which a financial service provider mortgage insurer assesses the eligibility of a customer to receive insurance coverage and the adequacy of property value collateral as a basis for loan approval or denial. The underwriting process involves measurement of the risk exposure and determination of the premium commensurate with the above risk exposure. The majority of risks that underwriting considers fall under the commonly referred to three C’s of underwriting:

• Credit – Borrower credit history
• Capacity – Borrower financial ability to repay
• Character – Borrower commitment to honor debts

Direct underwriting refers to the process by which the mortgage guaranty insurance company’s internal underwriting function directly reviews the loan documentation and approves or denies coverage. Direct mortgage guaranty insurer underwriting typically provides for the establishment of various internal underwriter authority levels based on underwriter experience and loan amount risk limits. The mortgage guaranty insurer’s underwriting process is controlled by detailed underwriting guidelines as it relates to the company’s:

• Underwriting philosophy
• Mortgage guaranty insurance application
• Loan type eligibility
• Borrower eligibility
• Property eligibility

In addition to the borrowers’s credit, capacity and character referenced above, mortgage guaranty insurance loan eligibility is generally assessed based on:

• Property Type & Purpose – which may include primary residences including 1-2 unit properties, condominiums, townhouses and second homes
• Loan to Value (LTV) – ratio of the total outstanding mortgage balance to the property value or sale price
• Loan Amortization Period – the maximum length of time that loan payments fully amortize the principal balance

3. Delegated Underwriting Role and Responsibilities

Delegated underwriting authority refers to the process by which a mortgage guaranty insurer authorizes the initial lender or another first party to underwrite loans on behalf of the mortgage insurer under a delegated underwriting program. A delegated underwriting
program establishes those specific requirements under which insurance coverage is
extended for a loan submitted to the mortgage guaranty insurer on its behalf via an
approved delegated underwriter, in accordance with the mortgage guaranty insurer’s eligibility criteria. The loan application is typically submitted to the mortgage guaranty insurer via some form of delegated underwriting transmittal.

Mortgage guaranty insurer approval of a delegated underwriter under its delegated underwriting program is typically based on an initial and ongoing review of the lender’s performance, underwriting practices, underwriter training and financial stability. The delegated underwriting program in effect requires the originating lender to adhere to similar private mortgage guaranty insurer credit guidelines and processes. Loan documents can typically be submitted via various mail, fax, courier or electronic methods. Overall, the mortgage guaranty insurer relies on the lender submission of accurate and valid information submitted, consistent with the delegated underwriting decision, subject to some form of post-origination quality review sampling to validate ongoing compliance.

4. Automated Underwriting Systems Role
Automated underwriting systems (AUS) refers to automated systems programs containing edits established to facilitate review of loans submitted for mortgage guaranty insurance to ensure that they are in compliance with the company’s internal underwriting guidelines and standards. Loans which the automated underwriting system detects as failing compliance with such underwriting guidelines are typically identified and forwarded to other more senior underwriters for further documentation and/or customer review to make a final underwriting approval or denial decision. Automated underwriting systems can consist of mortgage guaranty insurer internal automated systems or GSE agency underwriting systems such as Fannie Mae’s Desktop Underwriter or Freddie Mac’s Loan Prospector.

Private Mortgage Insurer Eligibility Requirements being proposed by the GSEs require that an approved insurer must utilize a risk review process to ensure that AUS recommendations are aligned with an approved insurer’s independent credit risk guidelines, if AUS recommendations are used for its own purpose or as part of a delegated underwriting program. Mortgage guaranty insurance loan eligibility is generally assessed based on:

- Property Type & Purpose — which may include primary residences including 1-2 unit properties, condominiums, townhouses and second homes
- Loan to Value (LTV) — ratio of the total outstanding mortgage balance to the property value or sale price
- Loan Amortization Period — the maximum length of time that loan payments fully amortize the principal balances

5. Borrower Credit Worthiness Evaluation
Borrower eligibility for mortgage guaranty insurance typically involves review and evaluation of the following underwriting components:
• **Credit History**
Underwriting review of the borrower’s credit history is completed to evaluate borrower willingness and ability to manage debt and repay the loan. Credit history reports, which are provided by several major reporting agencies, typically will evaluate payment delinquency history and other adverse credit issues associated with bankruptcy, foreclosure, judgments, and charge-offs.

Credit history is traditionally evaluated based on credit scores obtained from various independent consumer reporting agencies. A credit score is a single number calculated from the major credit report agency data that seeks to quantify provides an underwriting guide as to the borrower’s credit worthiness. The most widely used universal credit scoring system is the FICO Credit Score created by the Fair Isaac Corporation in the 1990’s. The major components of the FICO Credit Score include:

- Payment history
- Amounts owed as percentage of all available credit
- Length of credit history
- New credit recently opened
- Types of credit used

• **Income Sources**
Underwriting review of income sources is completed to identify the borrower’s future ability to maintain mortgage repayment schedules. Qualifying income review will typically encompass evaluation of employment stability, base salary, commissions, self-employment, co-borrower income sources, investment income including interest and dividends, pensions, and rental income.

• **Debt to Income (DTI)**
Underwriting review of debt to income ratios is completed to evaluate the reasonable ability of the borrower to comfortably afford applicable mortgage premium payments. Debt to Income is the ratio of a borrower’s monthly debt payments to monthly qualifying income, which is an indicator of a borrower’s capacity to repay a mortgage. Evaluation of borrower debt to income is typically based on review of estimated monthly housing obligations and expenses to total monthly disposable income. A higher debt to income ratio is indicative of increased use of credit with a smaller margin to withstand future income fluctuations, borrower dependence on rising property values and income to manage debt.

• **Down Payment**
Underwriting review of the borrower’s down payment is completed to evaluate the borrower’s commitment to add equity to the property being mortgaged through various liquidity sources including savings, gifts, asset sale or other financing. A borrower’s down payment reflects the ability to save as well as
invest in the property. The greater the down payment, the less likely a loss will be realized by a mortgage insurer.

6. Property Value Evaluation
Underwriting review of property value is completed to evaluate its market value to support the reasonable eligibility for mortgage insurance and reasonably confirm the value at risk. Property valuation typically includes review of:

- Comparable values with other similar property types
- Property condition
- Housing design and characteristics
- Housing trends

Property valuation is generally obtained via an independent appraisal report along with photos of the subject property.

7. Loan Documentation
Minimum mortgage guaranty insurance underwriting documentation requirements generally include the following, as discussed in detail above:

- Lenders loan application
- MI application
- Credit history reports
- Credit score
- Verification of income sources and assets
- Appraisal report

Additional loan documentation at loan closing, which mortgage insurers do not typically use, typically includes:

- Mortgage – lien on the property as security
- Promissory Note - to pay off the loan
- Settlement Statement- accounting of all fees and charges
- Warranty Deed – detail property description
- Title Search - certification of ownership
- Other – various regulatory compliance notifications

D. Quality Control Standards

1. Loan Origination Integrity Objectives
The overall purpose of an internal quality program is to:

- Monitor and evaluate the:
  - Integrity of a mortgage guaranty insurer’s loan underwriting process in terms of adherence to company underwriting guidelines
  - Accuracy of data and documentation relied on
Prevention of approval of mortgages bearing deficiencies associated with fraud, inaccurate data or insufficient loan documentation

- Provide ongoing organizational feedback concerning the effectiveness of the loan origination process and identification of weaknesses requiring corrective action

2. Organizational Considerations

A mortgage guaranty insurer’s quality control program should be structured, staffed and customized to ensure reasonable coverage based on specific organizational considerations related to:

- Organizational size
- Geographic areas of operation
- Mortgage origination volume and types
- Loan origination sources
- Staff experience

3. Quality Control Best Practices

a. Separation of Responsibilities

Assignment of responsibilities for a mortgage guaranty insurance company’s quality control program should ensure it is independent from the mortgage origination, underwriting and processing functions it is monitoring. Reporting lines of authority should provide the ability to independently evaluate and critique internal operating practices without fear of reprisal.

b. Quality Control Program Documentation

A mortgage guaranty insurance company’s quality program should be formally documented to ensure understanding and establish measurement criteria as it relates to:

- Purpose
- Responsibilities
- Management and board of director oversight
- Review scope
- Sample selection
- Documentation and communication of findings
- Corrective action
- Administration policies and procedures

c. Post Closing Reviews

A quality control program should provide for sample review of mortgages to monitor internal direct underwriter compliance with loan approval guidelines and standards. Quality control reviews are completed most often on a post-closing basis. Quality control program loan sampling should ensure mortgage loan sampling is reasonably representative of the mortgage insurance company’s business production process as it relates to:
• Branch office originations
• Underwriting staff originations
• Loan product / type originations
• Third party originations

The quality control review process should encompass validation and/or verification of the following:

• Data entry accuracy into applicable underwriting systems
• Income documentation
• Employment documentation
• Property appraisal and valuation
  Mortgage property insurance coverage


\[d. \ \text{Loan Sampling / Selection}\]
Loan selection should consider the benefits of the following sampling practices.

• **Random Sampling** – provides for the opportunity for sample selection based on an equal chance of every mortgage being selected. Random sampling removes the potential for bias in comparison to a sampling process based on every nth mortgage. Random sampling can typically be based on random number generation utilizing random number tables or a computer generated program. Mortgage guaranty insurers with larger loan production volumes may typically consider use of a more sophisticated statistically based sampling methodology to ensure a reasonable confidence level within a margin of error.

• **Targeted Sampling** – provides for discretionary sample selection for specific populations which may be deemed to be associated with higher risk concerns. Targeted sampling may be appropriate to consider as it relates to review of:
  - Delinquent loans
  - New origination offices
  - New underwriters
  - Suspected fraud
  - Declined applications
  - High volume loan originators
  - Loan origination patterns of non-compliance

\[e. \ \text{Re-verification Procedures}\]
Quality Control programs typically should include sample re-verification of key documentation relied on in the original underwriting decision, including:

• **Employment and Other Income** – based on review of applicable pay stubs, salary vouchers, W-2 forms, tax returns and financial statements
• **Self-Employment Income** – based on tax returns and financial statements
• **Other Sources of Funds** – based on depository account and investment statements
• **Credit History** – based on independent credit reports
• **Property Valuation / Marketability** – based on independent appraisal reports

**f. File Documentation Review Procedures**
Quality Control program review of file documentation should emphasize:

- Verification of the existence and accuracy of mortgage file documents
- Conformance to underwriting requirements and guidelines
- Evaluation of underwriting decisions in accordance with the file documents
- Comparison of original documents with re-verifications

The overall objective is to review loan production for “Early Warning Detection” signs of potential inconsistencies associated with the following:

- **Application** – unsigned, undated or contradictory changes
- **Credit Report** – incomplete payment histories or derogatory information
- **Employment Records** – inconsistencies with employment record or alterations
- **Appraisal Report** – ordered by parties other than lender or lack of reasonable housing comparables in the marketplace
- **Loan Closing Documents** – mortgage term differences from underwriting, unusual settlement statement items or alterations
- **Underwriting Decision** – loan approval unsupported by file documentation

**g. Loan Review Results Reporting**
A Quality Control Program should provide for formal and timely management reporting and review of ongoing quality control procedures. Reporting should be based on reasonableness in relation to the company’s size and loan production operations. Quality Control report distribution should encompass applicable internal risk management committee, board audit or other oversight committee and operating area management. Accordingly, Quality Control reporting should consider:

- Loan sample selection
- Mortgage file review findings and recommendations to responsible operating areas and senior management
- Management responses
- Corrective action recommendations and status

**E. Reserving Principles**

1. **Typical Reserving Practices**
   Loss reserving refers to the overall process of estimating reasonable liability accruals for unpaid loss and loss adjustment expenses for business lines of insurance for which a meaningful definition of expense can be assigned.
Historically, initial mortgage guaranty insurance reserving considerations were characterized as:

- Lacking statistical independence
- Underwritten to a very low loss ratio
- Focused on location and mortgage type versus the insured

Mortgage guaranty insurance reserving practices encompass the following unique characteristics.

2. Loss Reserves
Mortgage guaranty insurance unpaid loss and loss adjustment expense is recognized in accordance with SSAP 55. The claimable event in mortgage guaranty is the foreclosure by the insured. The default of a borrower arising from the credit risk associated with the mortgage loan is considered the incident that gives rise to a claim and is the point at which a mortgage insurer books a reserve. Loss reserves are typically established by estimating the claim rate or number of delinquent inventory loans which are likely to result in claim payment and an estimate of the severity or claim amount. The process for estimating the reserve liability includes projections for losses that have been reported as well as those that have been incurred but not reported. Estimates are based on historical data, trends, economic factors and other statistical information including paid claims, reported losses and insurance in force. Mortgage guaranty insurance reserves are not typically recognized for estimates for future claims on insured loans that are not currently in default.

Mortgage loss reserve estimation is judgmental and can be impacted by a variety of factors, including:

- Rising unemployment trends resulting in reduction of impacting personal borrower income
- Declining housing market values resulting in negative impacting borrower equity
- Deteriorating economic conditions at a national or local level
- Ongoing claim rescission and settlement practices
- Risk characteristics associated with a particular class of loans

3. Unearned Premium Reserves
Unearned premium reserves are computed based on premium revenue recognition. Monthly policy premiums are earned as coverage is provided. Premiums written on a single and annual premium basis are initially deferred as unearned premium and earned over the policy term typically on a monthly pro rata basis. Premiums written on policies covering more than one year are earned amortized over the policy life in accordance with the expiration of risk. CertificatePolicy cancellation results in immediate recognition of earned premium for all non-refundable premiums, while refundable premium is returned to the lender.
4. Contingency Reserves

Mortgage guaranty insurers maintain contingency reserves to protect policyholders from loss during periods of extreme adverse economic conditions in accordance with SSAP No. 58. Contingency reserves are increased annually in an amount equal to 50% of the earned premium from mortgage guaranty insurance contracts. Contingency reserves are required to be maintained for a period of ten years. Contingency reserves may be released in any year in which actual incurred losses exceed 35% of the corresponding net earned premiums with domiciliary commissioner approval.

Mortgage guaranty insurers are allowed to deduct the annual addition to contingency reserves from gross income only if special non-interest bearing US Mortgage Guaranty Tax and Loss Bonds are purchased in an amount equal to the tax benefit from the deduction. Annual deductions not utilized for tax purposes during the current period may be carried forward for a period of eight years, similar to the carryforward of a net operating loss.

5. Premium Deficiency Reserves

Premium deficiency reserves are required to be recognized under SSAP No. 58 when anticipated losses, loss adjustment expenses, commissions and other maintenance costs exceed the recorded unearned premium reserve, contingency reserve and the estimated future renewal premium on existing policies. Premium deficiency reserves are recognized by recording an additional liability for the deficiency with a corresponding charge to operations.

F. Reinsurance Principles

Reinsurance refers to the contractual arrangement under which an insurer, the ceding company, transfers some or all of the risk related to a policy or group of policies to another insurer, known as the assuming reinsurer. The ceding and assuming companies enter into a reinsurance agreement which details the conditions upon which the reinsurer would pay a share of the claims incurred by the ceding company. Reinsurance enables an insurance company to expand its capacity, stabilize underwriting results, finance expanding volume, secure protection against catastrophic losses and spread larger risks across other institutions. The essential element of a reinsurance contract is the transfer of risk, which requires evidence of reinsurer assumption of significant insurance risk under the reinsurance portions of the underlying agreement and reasonable understanding that the reinsurer may realize significant loss from the transaction.

The two basic types of reinsurance are treaty and facultative. Treaty reinsurance is written to cover a particular class of policies issued by the reinsured. Facultative reinsurance is issued on an individual policy based on analysis of the terms and provisions of the underlying policy.

Reinsurance coverage is typically allocated on either a proportional or non-proportional basis. Proportional reinsurance provides coverage for only a portion or percentage of the loss or risk typically based on the percentage of premiums paid. Proportional reinsurance arrangements may be issued under a quota share basis, whereby a fixed percentage of each
policy is reinsured, or a surplus basis, whereby the balance of risk exceeding a ceding company’s retention limit is reinsured.

In contrast, non-proportional reinsurance provides coverage based on a set amount of loss typically exceeding a base or deductible amount. The primary forms of non-proportional reinsurance include excess of loss and stop loss. Excess of loss reinsurance provides for coverage when total claims paid in a given period exceed a stated amount established based on an excess per risk, occurrence or aggregate risk basis. Stop loss reinsurance provides coverage when a company specified threshold amount of total annual losses, typically expressed as a percent of premium, has been reached.

1. **Affiliate Reinsurance**
   Mortgage guaranty insurers have in the past typically reinsured loans in excess of 25% of the risk in force with affiliated companies, to satisfy certain statutory reinsurance requirements applicable to the company, which require a mortgage guaranty reinsurer to limit its retention under a single policy of insurance to no more than 25% of debt of the mortgage borrower. Affiliate reinsurance has increasingly been viewed as an additional element of administrative overhead, which results in the spreading of the financial condition among affiliated related companies versus presenting a consolidated financial picture.

2. **Captive Reinsurance**
   Captive reinsurance programs refer to mortgage guaranty insurer business cessions to reinsurers that are affiliated with mortgage lending institutions. Under a captive reinsurance arrangement, a portion of the mortgage guaranty insurance risk written by a primary mortgage insurer that pertains to loans originated or serviced by a particular mortgage lender is transferred to a reinsurance company that is owned or controlled by the loan originator or servicing institution, which is referred to as a captive reinsurer. The lender establishes a captive reinsurer and undertakes reinsurance assumption of insurance risk through its captive to participate in the profits that can be potentially realized from providing mortgage guaranty insurance on mortgage loans that are originated or serviced by the lender.

   The typical captive reinsurance arrangement is between the mortgage guaranty insurer and a captive insurance subsidiary. Mortgage guaranty insurer business subject to a captive reinsurance cession consists of business that is derived from the mortgage guaranty insurance company’s guaranty of mortgages originated or serviced by the respective lending institution. Risk is transferred from the mortgage guaranty insurer to the captive reinsurer.

   The use of captive reinsurance arrangements in the mortgage guaranty insurance industry expanded significantly in the mid 1990’s and became a standard business practice in the mortgage lending industry prior to the sub-prime mortgage crisis. However, post crisis various mortgage lenders and insurers were have been recently named as defendants in class action lawsuits alleging causes of action related to captive mortgage arrangements, including that the lenders’ captive reinsurers received excessive premium in relation to the risk assumed by those captives. This litigation alleges violations of the anti-referral
fee provisions of the Real Estate Settlement Procedures Act (RESPA). The above litigation has resulted in various settlements with the Consumer Financial Protection Bureau, including fines and agreements not to enter into such future captive arrangements.

3. **External Reinsurance**
   External reinsurance with non-affiliates within the mortgage guaranty insurance industry has historically been limited by the number of reinsurers with capacity and expertise active participants in this specific line of business.

   External reinsurance placement has recently been reviewed and used by various mortgage guaranty insurers to free up additional sources of capital to meet increasing capital requirements imposed as a result of the experience under the sub-prime mortgage crisis and economic downturn. External reinsurance arrangements typically require reinsurer ratings of “A” or better and collateralization involving clean irrevocable letter of credit or trust agreement options.

G. **Rescission Principles**
Mortgage guaranty insurers have the contractual right to rescind coverage if the financial institution that originated the mortgage loan violated its representations and warranties or misrepresented material information. Rescission typically arises as a result of overstatement of borrower income and ability to repay the loan or overvaluation of the property being mortgaged. The legitimate use of rescission protects those policyholders that do not violate such representations or warranties or misrepresent material information.

Rescission was a major factor in the mortgage guaranty insurance industry’s loss mitigation efforts during the mortgage sub-prime crisis and economic downturn. Historically, mortgage guaranty insurer practices resulted in the rescission review and decision not to pay in conjunction with claims payment at the back-end. Accordingly, subsequent GSE master policy requirements have advocated the implementation of rescission relief principles, which emphasize the following more definitive transparent practices:

1. **Mandatory Rescission Relief**
   Mortgage insurer definitive requirements to provide rescission relief after 36 timely payments from the borrower’s own funds.

2. **Early Rescission Relief**
   Mortgage insurer optional provisions to provide early rescission relief before mandatory requirements based on independent re-verification of repayment from the borrower’s own funds after 12 monthly payments.

3. **Material Misrepresentations or Fraud Impacts**
   Mortgage insurer retention of rescission remedies associated with intentional misstatements, misrepresentations, omissions and data inaccuracies in connection with the loan origination or closing based on:
   - Materiality to mortgage insurer acceptance of the risk
• Credible evidence

Mortgage Guaranty Insurance Model Law amendments have implemented similar rescission relief concepts based on materiality, credible evidence and compliance with the insurer’s overall internal payment history and loan status eligibility guidelines, in an effort to avoid references to potential ongoing regulatory environment changes in specific eligibility criteria over time.
V. MORTGAGE GUARANTY INSURANCE RISK ENVIRONMENT

A. Traditional Mortgage Loan Default Factors
Traditionally, mortgage loan default has been attributed to the following major factors:

1. **Unemployment**
   Unemployment rate increases translate to potential borrower/homeowner reduction of personal family income, which in turn drives reduction in consumer spendable income levels and potential increases in mortgage delinquency, defaults and eventual foreclosure.

2. **Medical Expense**
   Significant increases in medical expenses associated with personal and/or family health care similarly result in unanticipated reduction of family income, which translates into mortgage payment delinquency.

3. **Income Reduction**
   Death or divorce can result in significant loss of combined family income and disruptions in the stability of established life patterns, which translates into reduction of personal income available and the ability to meet mortgage loan payments based on combined family income.

Additional factors emerging in recent years include:
- Strategic default related to a borrower decision to cease making payments due to significant reduction or elimination of equity in property due to declining prices
- Payment shock resulting from a significant increase in monthly mortgage payments due to an interest rate reset or the end of an interest only period combined with the lack of refinancing opportunities

B. Mortgage Loan Sub-Prime Crisis and Risk Factors

1. **Sub-Prime Crisis Overview**
   The sub-prime mortgage crisis in the U.S. refers to the series of events and economic conditions that led to a financial crisis and subsequent recession beginning in 2008. The subprime mortgage environment is a term generally used by lenders to designate mortgage borrowers who are characterized by weak credit histories and reduced repayment capacity. The crisis was characterized by a rise in sub-prime mortgage delinquencies and foreclosures along with a resulting decline in related mortgage-backed securities. These mortgage-backed securities, which initially offered attractive rates of return due to higher mortgage interest rates, experienced significant defaults related to the lower credit quality associated with sub-prime mortgages. U.S. outstanding mortgage delinquencies and foreclosures are estimated to have approximated 14% by 2009. Some ten states accounted for approximately 74% of foreclosure filing activity.

2. **Sub-Prime Crisis Background / Timeline**
   The subprime crisis was initially triggered by the bursting of the United States housing bubble which peaked during 2005-06. Prior to this period, loan incentives encompassing relatively easy credit terms and long-term rising house pricing trends, resulted in
borrowers obtaining mortgages often exceeding their financial means in anticipation of the ability to easily refinance. The ability to refinance became more difficult as interest rates rose while housing prices dropped during 2006-07. The ensuing expiration of initial loan terms on adjustable rate products and decline in home prices resulted in increases in loan defaults and foreclosures. This ongoing foreclosure activity became a key factor in the more global economic crisis associated with the overall depletion of consumer wealth and the financial strength of banking institutions.

The increase in mortgage-backed securities during the housing and credit boom resulted in increasing financial institution and investor investment in the U.S. housing market. However, as housing prices declined, major financial institutions experienced significant losses associated with heavy investment in such mortgage-back securities. These resulting losses impacted the ability of financial institutions to lend, leading to an overall downturn in economic activity.

Losses in the stock market and ongoing housing value declines continued to result in a downturn in consumer spending, which represents a key component of economic prosperity. The risks to the economy created by this housing market downturn and subsequent financial market crisis led to central bank decisions to cut interest rates and government implementation of various economic bail-out and stimulus packages. These stimulus packages included one-time tax cuts for households and businesses, expansion of GSE mortgage lending authority to fill the void due to the decline in private mortgage insurance and encouragement of borrowers and lenders to negotiate changes to minimize foreclosures.

3. Sub-Prime Crisis Causes
The subprime crisis was attributed to a number of pervasive conditions in the housing and credit markets, including:

- Homeowner inability to make mortgage payments due to borrower overextension, weak lending practices and resetting of previously attractive adjustable rate mortgages
- Overbuilding during the mortgage boom period flooding the housing market
- Erosion of the sense of responsibility in the lending process resulting in risky mortgage products involving limited documentation requirements to obtain loan approval
- Financial mortgage-backed security investments which potentially concealed the risk of mortgage default and reflected misleading agency ratings related to the sub-prime mortgages backing such investments
- Reluctance of government regulation to intervene in the mortgage market under the presumption that financial institutions and borrowers can effectively manage and control the marketplace
- Persistently low interest rates which led fixed income investors worldwide to seek yield, which created demand for complex mortgage-backed securities such as Collateralized Debt Obligations (CDO’s), of which many investors had little understanding
4. Housing Market Boom versus Bust Cycle

The period from the mid 1990’s to early 2006 is often referred to as the “boom” period. The housing market and economic environment conditions during this period were generally characterized by:

- Disciplined new housing supply and restrained overbuilding
- Solid housing demand versus supply
- Falling mortgage rates
- Rising household income
- Falling unemployment
- Affordable housing prices

The price of the typical house is estimated to have increased approximately 124% at the peak housing “bubble” in 2006 according to the Economist.com. This housing bubble was characterized by:

- High rates of household debt
- High rates of home ownership
- Rising housing prices
- Low interest rates
- Generally easy credit conditions
- Increased consumer borrowing and spending
- Speculation that housing prices would continue to rise resulting in a good investment

The above economic environment resulted in a building boom leading to a surplus of unsold homes and a peak in housing prices. Sub-prime lending helped fuel this increase in home ownership which drove prices higher. Borrowers who had planned to refinance mortgages after several years of appreciation were confronted with higher monthly payments leading to an increase in payment defaults by 2008, often referred to as the “bust” period. Foreclosures and the supply of homes for sale increased as a result of the default rate. Housing prices significantly declined, resulting in negative equity associated with loan values falling below mortgage balances. In addition, many negative equity households were also impacted by a weakening job market encompassing job layoffs and/or job loss.

The increase in mortgage defaults also reduced the value of mortgage-backed securities, which impacted the financial banking system resulting in increased losses, tighter lending standards and restrictions, an overall decline in bank capital and the write-down of investments under mark to market accounting rules. Overall, economic expansion collapsed under this crisis in housing, which is an integral and essential component of the economic and business cycle.

5. Lending / Borrowing Practice Deterioration
Lending standards deteriorated during the period prior to the mortgage crisis and economic downturn. Mortgage loan qualification guidelines became progressively weaker, characterized by:

- Stated income reliance and acceptance as a replacement for proof of income via statement evidence requirements
- Bank account verification acceptance as a replacement for proof of employment requirements
- “Alt-A” or prime loans bearing solid credit scores, but possessing other credit or data limitation issues or “No doc” loans displaying high loan to value, excessive debt to income or low credit scores
- Lender reliance on automated loan approval systems authorizing loans without appropriate underwriting review and documentation verification prior to loan approval

6. Securitization Practices Impact

Traditional mortgage lending involved loan origination to the borrower/homeowner with retention of the credit risk associated with loan payment default. Current mortgage lending typically involves loan securitization. Securitization is the process by which loans are bundled to create a form of bond security which can be sold to investors. Securitization allows the lending bank to retain capital to make additional loans. The Government Sponsored Enterprises or GSEs pool conforming mortgages, sell the bonds to investors and guarantee those bonds against default on the underlying mortgages.

The securitization process undermined responsible lending and shifted incentives, resulting in an increased focus on lending bank processing of mortgage loans for sale and distribution of related credit risk to investors through such mortgage-backed securities and other collateralized debt obligations, often at the expense of properly ensuring credit quality. Securitization accelerated, tripling during the period from the mid 1990’s, often involving pooling of higher risk sub-prime loans. Investors found comfort in the fact that securitized mortgage product risks could be more easily matched and hedged with other investments that would proportionately rise or fall in value. Loan funding originated increasingly from non-bank institutions including investment banks, hedge funds and finance companies, forming a “shadow banking” system which was subject to limited regulatory oversight and public disclosure.

7. Mortgage Rating Agency Impact

Credit rating agencies came under increased scrutiny for assigning investment grade ratings to such mortgage-backed securities based on riskier sub-prime mortgage loans. High credit ratings were justified based on risk reduction practices involving credit default insurance and equity investor willingness to bear the initial loss. Investors relied on these ratings which became a key contributor to the financial meltdown.

Rating agencies subsequently lowered credit ratings on mortgage-backed securities during the subprime crisis period, forcing the financial institutions to lower the value of their investment portfolios and acquire additional capital to maintain solvency ratios. The adjustment of the value of marketable securities to market value was required under
accounting standards designed to assist investors in understanding the value of invested assets at a point in time versus historical purchase price.
VI. MORTGAGE GUARANTY INSURANCE WORKING GROUP
ROLE and HISTORY

A. Working Group Charge
The Mortgage Guaranty Insurance Working Group (MGIWG) was formed by the National Association of Insurance Commissioners (NAIC) in 2012.

The MGIWG overall charge was twofold:

1. Solvency Improvement
   The MGIWG’s primary objective was to determine and make recommendations regarding changes deemed necessary to improve the solvency regulation of mortgage guaranty insurers.

2. Mortgage Guaranty Model Act Enhancement
   The MGIWG’s secondary objective was to recommend related changes and enhancements to the Mortgage Guaranty Insurance Model Act to support the above solvency regulation environment.

B. Working Group Major Concerns Promoting Reform
Major MGIWG issues promoting the reform of the Mortgage Guaranty Insurance Model Act were primarily a direct outgrowth of the sub-prime mortgage crisis and included the following concerns:

- Mortgage origination activity concentration in a limited number of large banks placed undue pressure on mortgage guaranty insurers to accept loan origination offerings with limited review of credit quality in lieu of the potential consequences of reduced business volume.

- Mortgage guaranty insurance characteristically is a countercyclical environment, whereby relatively long periods of profitability are interrupted by periods of varying duration of catastrophic loss resulting in solvency weaknesses, as exemplified by the recent mortgage loan sub-prime crisis environment.

- Lack of formal minimum underwriting standards resulted in increased loan default, delinquency and foreclosure rates associated with the acceptance of sub-prime credit loans and reduced documentation loans under existing underwriting practices.

- Lack of formal quality assurance functions resulted in limited internal compliance monitoring to complement underwriting guidelines.

- Risk to capital methodology for measuring the minimum amount of capital relative to risk in force necessary for the mortgage insurer to continue writing new business did not serve the mortgage industry exceptionally well during the mortgage sub-prime
crisis with solvency issue recognition generally occurring prior to the capital ratio reaching the 25:1 maximum ratio.

- Securitization through complex repackaging of subprime mortgages into investments, further contributed to the financial crisis, associated with increased default risk from the standpoint of reduction in alignment of loan originator and mortgage guarantor insurer interests and incentives to ensure borrower repayment credit quality.

- Contingency reserve historic allocations are not driven by economic indicators of potential mortgage crisis and economic downturn resulting in relatively easy depletion when losses exceed 35% of corresponding earned premiums.

- Lack of geographical concentration limits to address historical trends, which demonstrated that local market conditions can and do impact regional delinquency and foreclosure experience, resulted in high loss concentration in selective regions.

- Existing reinsurance practices resulted in resource concentration in affiliates, which led to unnecessary overhead expenses, and captive reinsurers, which led to regulatory sanctions associated with questionable risk transfer.

- Mortgage guaranty insurer investments in mortgages and real estate were not directly related to the ordinary conduct of mortgage business.

- Rescission practices resulted in evaluation of the ability to deny coverage historically on the back-end, based on analysis of loan origination documents in conjunction with normal claims processing, versus more upfront transparent recognition at the time commitment coverage was issued.

C. Mortgage Guaranty Insurance Industry Considerations

Private Mortgage Guaranty Insurance Industry Group initial considerations with respect to Mortgage Guaranty Insurance regulation generally encompassed the following industry recommendations:

- Mortgage originator and insurer alignment of interests recognizing that the MI credit risk is shared.

- Mortgage originator and insurer maintenance of strong underwriting standards, favoring conversion of underwriting standards into risk capital modelling approaches.

- Mortgage guarantor awareness and correction of underwriting standards deterioration stemming from behavioral incentives influencing mortgage originators and insurers.

- Mortgage guaranty insurer establishment of countercyclical capital buffers and reserves during the underwriting cycle valleys to provide for claims during peak downturns.
Mortgage insurer implementation of sound mortgage underwriting practices as it relates to developing, monitoring and enforcing standards for the verification and documentation of borrower related information, sustainable debt to income limits, LTV ratios and appraisal evaluation of property marketability.

Mortgage Guaranty Industry Group overall comments regarding subsequent Mortgage Guaranty Insurance Model Act revisions have emphasized the following considerations:

- Establishment of a proper regulatory balance between the need to:
  - Effectively manage overlapping FHFA/GSE and NAIC authorities
  - Define the proper location of detailed requirements within the NAIC Model Act, Standards Manuals, FHFA/GSE Eligibility Standards and MI Master Policies

- Implementation of an improved capital and reserving framework encompassing:
  - Risk based capital requirement assessment
  - Claims paying sufficiency evaluation
  - Capital enforcement through early warning triggers with regulatory actions

- Employment of RBC-like measures that permit prudent risk taking based on capital strength without restricting the MI ability to insure sound, profitable business

- Incorporation of sound principles for the conduct of underwriting, quality assurance and contractual business practices to strengthen risk management

- Supervisory examination guides and standards manuals consideration for detailed business practice expectations to allow for more timely revision and incorporation of potential changes in business practices

D. Mortgage Guaranty Insurance Model Act Summary Reforms

Accordingly, the Mortgage Guaranty Insurance Model Act amendments have emphasized incorporation of the following major provisions to address the above Mortgage Guaranty Insurance Working Group and MI Industry Working Group considerations:

1. Capital Standards

The current Mortgage Guaranty Insurance Model Act seeks to ensure the advantages of a risk-based capital methodology 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 RBC methodology, through incorporation of many similarities with existing property and casualty insurance industry methodology and supplemented by modifications to recognize risk and control elements unique to the mortgage guaranty insurance industry.
2. Underwriting Standards
The revised Mortgage Guaranty Insurance Model Act and supporting Standards Manual establish 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.

3. Quality Assurance Standards
The revised Model Act establishes a Quality Assurance standard to complement the underwriting guidelines through the 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:

- Senior management oversight
- Board of director oversight
- Loan policy and procedure documentation
- Underwriting risk tolerance levels and exposures
- Lender underwriting performance
- Mortgage guaranty insurer underwriter performance
- Problem loan trends
- Underwriting system change oversight
- Pricing and performance oversight
- Internal audit validation

4. Concentration Limits
Mortgage Guaranty Insurance Model Act revisions have been designed to minimize the risk and strengthen control over geographic business mix by establishing additional capital requirements based on:

- Maximum net risk in force state concentration limits
- Additional capital requirements where limits are exceeded to strengthen enforcement and encourage diversification
5. **Investment Limitations**
Mortgage Guaranty Insurance Model Act investment limitations 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 investment restrictions, as well as additional capital requirements, for 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 which are not guaranteed by the full faith and credit of the United States.

6. **Reinsurance**
Mortgage Guaranty Insurance Model Act provisions emphasize greater reinsurance flexibility options through:

- Discouragement of affiliate reinsurance arrangements, thereby permitting mortgage guaranty insurers to achieve improved administrative efficiencies
- Financial quality standards compliance for external reinsurance programs
- Prohibition of captive reinsurance arrangements which have been the subject of legal actions

7. **Rescission**
Mortgage Guaranty Insurance Model Act amendments have emphasized provisions for greater rescission relief, which are anticipated to be generally consistent with ongoing GSE regulatory requirements under review and/or reasonable practices aligned with those requirements, including:

- Master policy definitions of both insurer and insured rescission rights and responsibilities to provide for greater transparency
- Rescission relief provisions based on MI underwriting validation, timely payment history and suspected material misrepresentation considerations
VII. MORTGAGE GUARANTY INSURANCE CAPITAL REQUIREMENTS

A. Two Tiered System Concepts

Model Act capital adequacy measurement and restrictions establish risk-based capital requirements based on the following two levels:

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.

B. Tier 1 – NAIC Risk Based Capital (RBC) System

1. Overview
   The NAIC Risk-Based Capital (RBC) system was established to provide a capital adequacy standard which is:
   - Risk related
   - Provides a safety net for insurers
   - Provides uniformity among state regulators
   - Provides regulatory authority for timely action

2. Purpose
   The RBC methodology establishes a minimum capital requirement appropriate for an insurance company to support operations based on its risk profile.

3. Applicability
   Specific RBC formulas exist for each of the primary insurance types including:
   - Property & Casualty
   - Life
   - Health

   Mortgage guaranty insurance companies have historically been exempted from the RBC requirement due to their unique operating environment, as previously discussed under Section IV. The objective of the Mortgage Guaranty Insurance Model Act update is to modify existing RBC methodology to adapt it to the mortgage insurance industry.

4. Methodology
   Existing RBC methodology encompasses the following components:
a. **Risk-Based Capital Formula**
The Risk-Based Capital Formula establishes a hypothetical minimum capital level which is compared to the company’s actual capital level. The RBC is calculated by applying a set of actuarial based risk factors to various asset, premium, and reserve balances. Higher risk factors reflect greater underlying risks.

b. **Risk Based Capital Model Law**
The Risk-Based Capital Model Law grants state insurance regulators authority to take specific actions triggered based on the level of capital impairment, which is defined as the ratio of Total Adjusted Capital to the Authorized Control Level.

c. **Company and Regulatory Action Levels**
Current RBC action levels applicable to all companies, except mortgage, include:

- No Action based on Adjusted Capital of 200% or more of the Authorized Control Level
- Company Action Level (150-200%) – requires a company plan containing proposals to correct financial problems and project financial condition
- Regulatory Action Level (100-150%) – requires company filing of an action plan as well as a state insurance department examination
- Authorized Control Level (70-100%) – allows regulator control of the insurer in addition to all other previously discussed remedies
- Mandatory Control Level (less 70%) – requires regulator control of the insurer

d. **Major Components**
Major property and casualty RBC components include the following:

- Asset Risk – Affiliates
- Asset Risk – Fixed Income Investments
- Asset Risk – Equity
- Asset Risk - Receivables
- Underwriting Risk – Reserves
- Underwriting Risk – Net Premium Written

5. **Mortgage Guaranty Insurance RBC Modification Considerations**
The Mortgage Guaranty Insurance Working Group review of capital requirements under the above Tier 1 Risk Based Capital Model (in-process of development) identified the following potential modifications to base line RBC insurance industry methodology to recognize risk and control elements unique to the mortgage guaranty insurance industry:

a. **Investments Secured by Real Estate or Mortgages**
Mortgage guaranty insurance company additional capital requirements for investments secured by a mortgage or other lien upon real property, not secured by the full faith and credit of the United States, commensurate with the level of applicable risk associated with investment portfolio concentrations in the same industry as its primary business.
b. **Subsidiary Controlled and Affiliated Investments**

Mortgage guaranty insurance company affiliated investment additional capital requirements to reflect the potential financial economic downturn impact on downstream affiliates engaged in the same business.

c. **Geographic Concentration**

Mortgage guaranty insurance company additional capital requirements for business writings exceeding the specified risk in force concentration limits to recognize the level of geographic business concentration risk inherent in the company’s operations.

d. **Credit / Underwriting Quality**

Mortgage guaranty capital requirement additional charges to reflect risk in force and related trend changes based on qualitative underwriting standards associated with loan to value, debt to income, borrower credit standing and reduced documentation loans.

e. **Loss Reserving Considerations**

Mortgage guaranty insurance capital requirement credit adjustments to reflect loss sensitive business factors associated with contingent loss reserve provisions, to protect against adverse economic loss conditions, and premium deficiency reserve provisions, to recognize differences between anticipated loss and future premium installments.

f. **Prospective Risk Economic Indicators**

Mortgage guaranty insurance company capital requirement additional charges to reflect forward-looking going concern economic projections of potential economic weakness based on:

- National and regional housing price index trends
- Unemployment rate trends
- Interest rate trends

g. **Prospective Risk Company Indicators**

Mortgage guaranty insurance capital requirement additional charges / credits to reflect forward-looking going concern company projections and trends of company operating weakness based on:

- Cash flow (indicator of capital buffer)
- Persistency (indicator of business retention level)
- Claim rate (indicator of claim frequency)
- Claim severity (indicator of claim size)
- Default notices (indicator of delinquency growth)
- Default inventory (indicator of delinquency age)
- Delinquent cures (indicator of delinquency resolution)
- Reserve development to surplus (indicator of reserve deficiency)
- Future premium (indicator of existing income stream to offset loss)
6. Modified RBC Methodology Adopted by Mortgage Industry *

a. Overview
The mortgage guaranty insurance industry engaged external consultants to introduce improvements over current Risk to Capital and Minimum Policyholders Position capital requirements methodology through the development of a loan level cash flow model based on the risk sensitivity factors and capital solvency projection forecast discussed further under Section VII-C.

b. Purpose
The overall objective of the mortgage guaranty insurance industry capital model project was to develop a related mortgage guaranty insurance modified Risk Based Capital (RBC) framework, based on the risk sensitivity factors inherent in the loan level cash flow model, which would be reviewed and accepted by the applicable insurance regulatory agencies.

c. Methodology Description *
The high level modified RBC methodology adopted by the mortgage guaranty insurance industry is anticipated to encompass the following framework based on preliminary specifications.

- **Required Capital Calculation** = Required Assets less Statutory Reserves

- **Required Assets** = Required Assets on Performing Risk In Force + Required Assets on Delinquent Risk In Force

- **Required Assets on Performing Risk In Force** = Analysis of performing loan tables for claim incidence, seasoning, risk multipliers, loss severity and premiums under a stress scenario using loan level model to assign factors applied to risk-in-force, encompassing:

  Loss Estimation based on:

  - **Countercyclical Stress Analysis** = market assignment based on loan origination date and regional market category classification under various stressed home price scenarios, based on projected declines in housing price index trends (A=10%, B=17.5%, C=25%, D=35%)

  - **Claim Incidence Rate Analysis** = analysis of projected claim incidence at loan origination based on LTV and credit score within market category classification, based on the above stress level of expected market downturn

  - **Claim Risk Multiplier Analysis** = adjustment for additional risk factors to reflect stress associated with various loan and market level risk attributes related to lower terms, amortization type, incomplete loan...
Claim Seasoning Factor Analysis = adjustment of claim incidence to reflect the diminished risk of loss over time as loans age

Loss Severity Factor Analysis = adjustment of claim incidence to reflect conversion of a claim into loss based on the severity as a multiple of the claims amount within applicable market category classifications

Regional Dispersion Multiplier = loss adjustment to account for HPI dispersion difference between MSA and Census levels

Premium Estimation based on:

Premium = premium calculation based on insurance in force multiplied by insurance contract rate

Premium Renewal Multiplier Analysis = premium factor assignment utilizing a multiple of annual premium to reflect renewal expectations based on LTV and credit score within applicable market category classification

Premium Seasoning Factor Analysis = premium renewal adjustment associated with the increase in loan age

Capital Estimation based on:

Net Loss = calculation of net loss on performing assets based on Loss Estimation less Premium Estimation

Investment Income Multiplier = adjustment of capital requirements to reflect interest income earned on capital during the forecast period

Required Assets on Non-Performing Risk In Force = Analysis of non-performing loan tables for claim incidence and loss severity using loan level model to assign factors applied to risk-in-force, encompassing:

Delinquent Loan Claim Incidence Analysis = analysis of projected claim incidence based on missed payment and pending claim factors within market category assignment based on stress level of expected market downturn

Loss Severity Factor Analysis = adjustment of claim incidence to reflect conversion of a claim into loss based on the severity as a
multiple of the claims amount within applicable market category classifications

- Countercyclical Stress Analysis = establishment of stressed home price scenarios under various market category classifications based on projected declines in housing price index trends

- Claim Incidence Analysis = Analysis of projected claim incidence centered on:
  - Performing loan analysis based on LTV and credit score at origination
  - Non-Performing loan analysis based on market category assignment, missed payments and pending claims

- Seasoning Factor Analysis = Performing loan accounting for diminished risk of loss over time as policies age
- Loss Severity Analysis = Exposure severity analysis based on market category classification assignment and LTV coverage

- Premium Multiple Analysis = Performing loan premium factor assignment utilizing a multiple of annual premium based on market category assignment, LTV and credit score factors

* Note: The above represents preliminary Modified Mortgage Guaranty RBC Methodology adopted by the industry, which is under development by MI Industry and Oliver Wyman Consulting Project, and will be finalized upon completion.
C. Tier 2 – Loan Level Capital Model Concepts

1. Overview
The mortgage guaranty insurance industry engaged external consultants to introduce improvements over the current Risk to Capital and Minimum Policyholders Position capital requirements methodology to address weakness noted during the recent mortgage sub-prime crisis. The core design principles of this mortgage industry capital model project emphasize:

- Increased risk and premium sensitivity incorporating the impact of macroeconomic factors
- Forward looking capital assessment at multiple points in the future
- Comprehensive modelling incorporating both asset and liability stress scenarios
- Adaptability to accommodate new product features
- Transparency and credibility with key regulatory stakeholders and compatibility with other regulatory and supervisory frameworks

2. Purpose
The overall objective of the mortgage industry capital model project was to develop a risk sensitive framework for estimating the sufficiency of mortgage guaranty insurer capital to withstand losses under a stress scenario.

3. Methodology Adopted by Mortgage Industry
The high level structure of the mortgage industry loan level capital model is anticipated to encompass the following components based on preliminary specifications:

a. Claim Payment Resource Forecast
The claims payment resource forecast component analyzes and estimates available claims paying resources based on projected sources and uses of capital, including:

- **Starting Surplus and Reserve Balances**, including:
  - Surplus as Regards Policyholders
  - Unassigned Surplus Funds
  - Net Loss, Unearned Premium and Contingency Reserves

- **Credit Risk on Assets** – available assets credit risk utilizing asset risk capital multipliers based on NAIC RBC requirements for P&C asset capital

- **Premiums** – premiums estimated on a cash basis assuming a runoff portfolio

- **Investment Income** – based on:
  - Asset balances projected forward as a function of loss, income and expense cash flows
  - Asset maturity forecast to decrease under projected portfolio runoff
  - Assets assumed to be reinvested given evolving maturity and rates
**Expenses** – utilizing:
- Loss adjustment expense estimates based on MI industry historical ratios
- Non-loss expense estimates based on recent expense history

### b. Macroeconomic Scenario
The macroeconomic path consists of the key drivers or variables which are used to forecast a stress scenario.

- **Key variables include:**
  - Home Price Index (HPI),
  - Unemployment rates
  - Interest rates
- **Home Price Index** is the primary macroeconomic driver of default frequency, loss and prepayment rates
- **Key components of HPI include:**
  - Trend Granularity – models HPI based on regional versus high-level national or very detail MSA level
  - Trend Approach – normalizes the HPI trend based on the Per Capita Income (PCI) or average income
  - PCI Forecast – projects PCI forward based on Moody’s S4 scenario
  - Trough Granularity – forecasts the low point by applying the largest national trough experience to each region
  - Trough Approach – sets the trough or how far prices can go below trends based on national level data
  - Path to Trough – forecasts average peak to trough direction based on 10 year projection encompassing 3 year decline, 4 year static and 3 year increase
  - Mark to Market Dispersion – establishes a dispersion multiplier based on regional mark to market multiplier to reflect a less granular home price path
  - Minimum Threshold – caps home price decline from actual to trough after 3 years at 0%
- **Other macroeconomic variables generally replicate the approach used by the FHFA**

### bc. Credit Loss Forecast
The credit loss forecasting component estimates the probability of various loan outcomes over the projection horizon of 10 years based on the following components:

- **Base Projection** – based on:
  - Loan balance amortized over 10 years
  - Key risk factors evolve with the above macroeconomic scenario including:
  - Loan origination characteristics related to credit score, product type and loan documentation completeness
Ongoing loan characteristics related to loan to value, delinquency and default history

- Macroeconomic factors related to housing price index and unemployment rates

**Hazard Forecast – Probability of Prepayment**

- Based on:
  - Basic prepayment categories include:
    - Fixed rate loans
    - Hybrid loans
    - Variable rate loans
  - Key Origination Variables include:
    - Credit score
    - Product type
    - Loan documentation completeness
    - Loan purpose
    - Property use
    - Number of borrowers
  - Key Ongoing Loan Factors include:
    - Current LTV
    - Loan age
    - Current or previous delinquency or default
  - Key Macroeconomic Factors include:
    - Change in HPI
    - Refinance interest rate incentives

**Probability of prepayment**

**Hazard Forecast - Probability of Default**

- Basic Default Categories include:
  - Unseasoned loans (less 12 months age)
  - Seasoned performing loans
  - Seasoned delinquent loans
  - Key Origination Variables include:
    - Credit score
    - Product type
    - Loan documentation completeness
    - Loan purpose
    - Property use
    - Number of borrowers
  - Key Ongoing Loan Variables include:
    - Current LTV
    - Current or previous delinquency or default
  - Key Macroeconomic Factors
    - Change in HPI
    - Change in unemployment rate

- Hazard Forecast - Probability of Remaining in-Force

- Loss Forecast Given Default – based on:
- Probability of paid claim
- Probability of cure
- Probability of cancellation

- **Key Origination Variables include:**
  - MI coverage level
  - Non-standard products

- **Key Ongoing Loan Variables include:**
  - Current LTV
  - Loan age at default
  - Time elapsed since default

- **Key Macroeconomic Factors include:**
  - Change in HPI
  - Change in unemployment rate

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**Projection of Capital Solvency Forecast**

The capital solvency projection involves an assessment of:

- Solvency measured based on available resources and projected cash flow
- Capital resource sufficiency to survive given stress scenarios

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**Note: The above preliminary Loan Level Cash Flow Model is under development by the Mortgage Guaranty Insurance Industry and Oliver Wyman Consulting Project and will be finalized upon completion.**
VIII. OTHER MORTGAGE GUARANTY INSURANCE MANDATED REQUIREMENTS

A. Underwriting Standards - Documentation and Approval Considerations
Overall Mortgage guaranty insurance company underwriting standards are documented in the Mortgage Guaranty Insurance Model Act under Section 11. The following considerations constitute additional requirements mandated by the Mortgage Guaranty Insurance Act.

Mortgage guaranty insurer establishment of the underwriting documentation and approval requirements outlined in the Mortgage Guaranty Insurance Model Act (Section 11 E) shall include the following additional considerations based on the appropriateness in relation to the size and status of the mortgage guaranty insurer’s organization and loan environment:

1. Lender Loan Submission Requirements
Loan submission shall include identification of requirements for loan application processing under scenarios involving both:

   a. Loan document submission by loan originators to the mortgage guaranty insurer; and
   b. Electronic submission of summary loan data without documents.

2. Loan Documentation and Underwriting Compliance Evaluation Responsibilities
Loan documentation and underwriting evaluation responsibilities shall include but not be limited to the following:

   a. Lender responsibilities for loan data entry accuracy and providing loan documentation supporting the loan file information submitted electronically;
   b. Mortgage guaranty insurer’s responsibilities for verifying loan data entry accuracy and compliance with loan submission procedures;
   c. Automated underwriting systems reliance for verification of loan underwriting decisions and compliance with loan document and electronic submission procedures;
   d. Lender obligations to provide underlying loan documents based on subsequent mortgage guaranty insurer request; and
   e. Mortgage guaranty insurer and insured’s rescission rights and responsibilities to demonstrate transparency in accordance with Section 16.

3. Minimum Mortgage Documentation Standards
Mortgage documentation standards shall include but not be limited to:

   a. Loan application;
   b. Mortgage insurance application;
   c. Credit history reports and sources;
   d. Borrower income verification and sources;
   e. Borrower employment verification;
   f. Property appraisal reports;
   g. Mortgage note evidence of indebtedness; and
   h. Commitment certificate.
4. **Loan Program or Type Qualification Requirements**
   Loan program qualification requirements shall include but not be limited to:
   
   a. Loan purpose;
   b. Property type;
   c. Maximum loan to value;
   d. Maximum loan terms;
   e. Maximum loan amount;
   f. Minimum credit score under any credible scoring system; and
   g. Maximum debt to income ratio.

5. **Minimum Borrower Repayment Qualification Requirements**
   Borrower repayment requirements shall include but not be limited to:
   
   a. Borrower’s credit history;
   b. Borrower’s sources of funds;
   c. Borrower’s credit score under any credible scoring system;
   d. Borrower’s debt to income ratio; and
   e. Borrower’s down payment.

6. **Minimum Property Marketability Qualifications**
   Property marketability requirements to support the reasonableness of the mortgaged property’s valuation shall take into account:
   
   a. Marketability, as demonstrated by property appraisals for comparable properties or other equivalent comparisons; and
   b. Valid property title, as demonstrated by title insurance or other equivalent legal opinion or state coverage programs **at time of claim settlement.**
B. Quality Assurance Standards
Overall Mortgage guaranty insurance company quality assurance standards are documented in the Mortgage Guaranty Insurance Model Act under Section 12. A quality control program provides the organization with feedback, which can be used by management to establish or modify company loan origination policies and procedures. The following considerations constitute additional requirements mandated by the Mortgage Guaranty Insurance Model Act.

All mortgage guaranty insurers shall establish a Mortgage Guaranty Quality Control Program in accordance with Model Act (Section 12), which addresses the following additional considerations, as adjusted to the size and status of the insurer’s organization and mortgage guaranty environment.

1. Segregation of Duties
Persons who administer the quality control program shall be prohibited from engaging in activities related to loan origination, pricing, underwriting and operations, which create a potential conflict of interest and impact reviewer independence. This requirement does not apply to the highest level of senior management responsible for enterprise risk management.

2. Senior Management Oversight
Management shall appoint an appropriate internal senior management level committee to provide internal oversight as it relates to ongoing review of Quality Control Program compliance, exception findings, recommendations and corrective action.

3. Board of Director Oversight
The board of directors shall designate the board’s audit or other appropriate committee responsibilities for providing external oversight as it relates to ongoing review of Quality Control Program compliance, exception findings, recommendations and corrective action.

4. Policy and Procedures Documentation
Mortgage Guaranty Quality Control Program policies and procedures shall be formally established and documented, and shall include but not be limited to:

   a. Organizational responsibilities;
   b. Program objectives and purpose;
   c. Management underwriting performance objectives and targets;
   d. Scope of quality control review;
   e. Sampling methodology representative of loan origination environment;
   f. Frequency of reviews;
   g. Management and board of director oversight roles;
   h. Reporting levels and scope; and
   i. Corrective action requirements.
5. **Underwriting Risk Reviews**
Quality control review shall include an examination of underwriting risk including categorization of the insurer’s exposure and compliance with risk tolerance levels associated with:

a. Mortgage type;
b. Loan to value;
c. Credit score;
d. Debt to income;
e. Geographic region; and
f. Restricted market targets.

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

a. Lender underwriting volumes and trends; and
b. Lender exception volume, recommendations and solutions.

7. **Underwriting Performance Reviews**
Quality control monitoring provisions shall assess underwriting guidelines compliance based on:

a. Loan documentation compliance review;
b. Selective verification of original loan data relied on including borrower income and employment status;
c. Loan approvals outside of mortgage guaranty insurer authority limits;
d. Mortgage guaranty insurer underwriter exception volumes; and
e. Declined loan compliance.

8. **Problem Loan Trend Reviews**
Quality control monitoring provisions shall assess prospective risks related to potential future loss impact trends associated with:

a. Delinquency;
b. Foreclosure;
c. Default Inventory; and
d. Persistency.

9. **Underwriting System Change Oversight**
Quality Control procedures shall include a review of system and program change controls for compliance with user testing and signoff over key changes which impact automated underwriting system decision making.

10. **Pricing and Performance Oversight**
Quality Control shall monitor loss trends by business segment for reasonable alignment with related premium schedules to ensure pricing adequacy.
11. **Internal Audit Validation**
   Internal audit shall periodically review overall compliance with the Mortgage Guaranty Quality Control Program requirements, if it is not directly responsible for such program execution.

12. **Regulator Access**
   The regulator of the state of domicile shall review the insurer’s Mortgage Guaranty Quality Control Program for indicators of critical risk exposure and reliance in conjunction with cyclical examinations.
C. Records Retention Standards

Overall Mortgage Guaranty Insurance company record retention requirements are set forth in Section 17 of the Mortgage Guaranty Insurance Model Act. The following record retention related considerations constitute additional requirements mandated under the Mortgage Guaranty Insurance Model Act.

1. Records Retention Requirements

a. Policy Records

Policy record retention requirements shall include the following:

- Application and accompanying records for each Certificate, which clearly identify the producer involved in the transaction;
- Declaration pages, Master Policy and Certificates evidencing coverage, any endorsements or riders associated with a Master Policy and any written or electronic correspondence to or from the insured pertaining to the coverage;
- Guidelines, manuals or other information necessary for the reconstruction of the rating, underwriting policy servicing and claims handling of the Certificate (Maintenance of an on-site copy of a market conduct examination of each of the above shall satisfy this requirement); and
- Declined underwriting files or expired Certificates for the current year plus the three (3) preceding calendar years which includes the related:
  - Application
  - Documentation substantiating the decision to decline Certificate issuance
  - Documentation substantiating the decision not to add additional or reinstate coverage when requested
  - Termination, rescission or application denial notifications required by law

b. Claims Records

Claim files shall be maintained which clearly document the inception, handling and disposition of each claim to permit reconstruction of pertinent events and dates, including the following:

- Files containing the notice of claim, claim forms, proof of loss, other forms of claim submission and claim acknowledgment;
- Documents submitted in support of a claim and any documentation demands;
- Claim investigation documentation;
- Correspondence to and from the insureds or their representatives or agents relating to the handling, payment or denial of the claim;
- Documented or recorded telephone communications related to the handling of claim payment or denial;
- Copies of claim checks or drafts;
- Subrogation and salvage documentation;
- Other documentation created or maintained in a paper or electronic format necessary to support claim handling activity; and
- Claim manuals or other information necessary for reviewing the claim.
2. **Retention Period**

The above policy and claim records shall comply with the retention periods of the Mortgage Guaranty Insurance Model Act, unless applicable law establishes a different retention period.

3. **Record Format**

Record retention format shall conform with the following detailed guidelines:

   a. **Template Requirements**

   Documents produced or sent an insured by use of a template and an electronic mail list shall be considered to be sufficiently reproduced if the insurer can provide proof of document mailing and a copy of the template.

   b. **Signature Requirements**

   Documents requiring the signature of the insured shall be maintained in any format listed in the Model Act provided evidence of the signature is preserved in that format.

   c. **Archive Requirements**

   Maintenance of records in a computer-based format shall be archived so as to preclude the alteration of the record after initial transfer to a computer format. Records created electronically or in a computer-based format may be maintained in their original format.

   d. **Examination Requirements**

   All records shall be available and as legitimate as the original hard copy or another medium for examination review in whatever reasonable form, interval, time or manner designated by the commissioner.

   e. **Reproduction Requirements**

   Photographs, images, microfilms, microfiche, or other image processing reproductions of records shall be equivalent to the originals and may be certified as the same in actions or proceedings before the commissioner unless inconsistent with (insert citation to administrative proceedings law), as applicable.

   f. **Retention Procedure Requirements**

   Records shall be maintained according to written procedures developed and adhered to by the insurer and made available to the commissioner upon request during an examination.

4. **Records Maintenance**

Insurer records maintenance shall comply with the applicable Model Act location accessibility and related third-party contractual requirements.
DC. Modified Risk Based Capital Standards

*Modified Risk Based Capital Standards are dependent on completion of the Mortgage Guaranty Insurance Industry and Oliver Wyman consulting project.*