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Mortgage Insurance Companies of America

Suzanne C. Hutchinson
Executive Vice President

July 12, 2000

Manager
Dissemination Branch
Records Management and Information Policy
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

Re: Joint Notice of Proposed Rulemaking: Risk-Based Capital Standards; Recourse and Direct Credit Substitutes

Dear Sir or Madam:

The Mortgage Insurance Companies of America (MICA) would like to bring to your attention several material errors of fact in one of the letters filed in response to the request for comment on the proposed changes to the recourse capital rules. We recognize that the comment period on that regulation has closed, but believe it important to bring these mistakes to your attention to ensure that the agencies craft a final rule with the best possible information in hand. We have no objection to having this additional comment made part of the public record should this be required.

Specifically, we would like to note some significant misstatements in the comment letter filed by the Federal Home Loan Bank of Chicago. MICA disagrees with the Bank's view of ratings and several other policy issues in the letter, but leaves it to the agencies to decide these questions. However, the FHLB-Chicago included a factually incorrect description of the capital required to provide mortgage insurance, as well as an incorrect description of the business itself. The mortgage-backed securities market will be heavily affected by the final recourse rules, and an accurate understanding of the role of credit

727 15th St., N.W.
12th Floor
Washington, D.C. 20005
(202) 393-5566
Fax (202) 393-5557

enhancement in it is thus essential for your further deliberations.

In its letter, the FHLB-Chicago argued in favor of lower capital ratios for mortgage risk by pointing to the private mortgage insurance (MI) industry. The letter suggested that MI companies are granted high ratings but have low capital ratios. For example, the letter stated that MI companies "effectively hold 0.80% of capital coverage of the mortgage loan if one applies a 4% capital requirement against the 20% first loss, direct credit substitute position they typically hold." It goes on to conclude that "these capital standards...result in AA or better ratings for the MIs…"

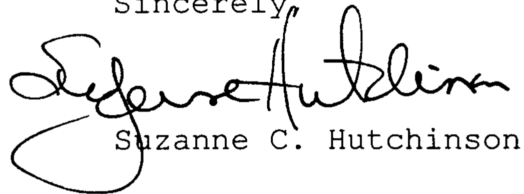
First, no mortgage insurance company holds a mere four percent in capital. While this is the regulatory minimum, all MI companies must operate with at least an AA rating to meet market requirements. In 1999, the MI industry's ratio of capital to net risk-in-force was 7.4%. Net risk-in-force includes both primary insurance and reinsurance commitments and deducts ceded insurance risk that companies outside of the industry have assumed. This capital-to-risk measure does not reflect availability of capital from outside sources such as support agreements from parent companies. MIs must meet not only a leverage ratio, but also very stringent stress tests established by the ratings agencies to receive their high ratings. It is precisely because of their high capital and robust financial condition that MI companies receive their high ratings, and we believe the toughness of these tests validates the ratings approach proposed in the recourse capital regulation.

The Chicago letter also describes mortgage insurance as equivalent to a direct credit substitute. We strongly disagree with this characterization of our industry. MI companies are required by state law to be monoline -- that is, they may provide no other form of insurance. Mortgage insurance is provided on an actuarial basis governed by state rules, not priced to fit opportunistic market demands as is the case with letters of credit and other direct credit substitutes.

In fact, the Basle Committee has drawn an important distinction between guarantees and insurance and forms of direct credit substitutes. In its January, 2000 consultative paper, the Basle committee outlined the criteria for guarantees that would make credits backed by them eligible for capital based on the rating of the guarantor, not the underlying collateral. These conditions include an historical record of meeting claims, high capital, meaningful regulation, and market liquidity. Mortgage insurance meets all these criteria, which direct credit substitutes do not.

In short, mortgage insurance is a very different product than a direct credit substitute -- and it is capitalized, regulated and rated accordingly. As the banking agencies proceed to final recourse capital requirements, we urge that these differences be clearly understood and that any capital benefits provided for risk mitigation through rated counterparties be provided only for the bona fide risk transfers accomplished through mortgage insurance and similar highly-rated guarantors.

Sincerely,



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