Mortgage Insurance Companies of America

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July 1, 2010

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street. N.W.
Washington, D.C. 20429
Attention: Comments

RIN# 3064-AD53

Dear Mr. Feldman:

The Mortgage Insurance Companies of America (MICA) is pleased to comment on the notice of proposed rulemaking (NPR) from the Federal Deposit Insurance Corporation (FDIC) regarding a safe harbor from claim following conservatorship or receivership for assets related to securitizations by insured depository institutions [75 FR 27471]. MICA strongly endorses the FDIC's goal of encouraging sound lending and incentive alignment for asset-backed securities (ABS), especially with regard to residential mortgages. MICA represents the interests of the U.S. private mortgage insurance (MI) industry and thus has long advocated for significant improvements in residential-mortgage finance. Indeed, we began to alert U.S. banking agencies as early as 2002 to the need to prevent practices that have now, sadly, put millions of borrowers in foreclosure and created a global financial crisis. We can provide the FDIC with copies of any of our communications to this effect in the years leading up to the current crisis, and MICA believes they bear strong witness to the MI industry's commitment to sustainable mortgage finance with capital at risk in securitization.

However, the U.S. mortgage system is now profoundly fragile in large part because reforms were not implemented in time. Thus, while MICA supports the FDIC's goals and aspects of the NPR, we urge caution with regard to several aspects of the proposal and recommend that the FDIC carefully coordinate its final rule with ongoing legislative and regulatory initiatives in the ABS arena. We also fear that the proposed end of the transitional safe harbor – September 30, 2010 – is too rapid and, if implemented, could lead to significant credit-availability problems. Thus, great care should be taken with the implementation of the revised safe-harbor framework, with the new ABS regulatory framework implemented only after credit-market recovery is demonstrated, macroeconomic conditions have improved and the overall condition of the U.S. banking system stabilized.

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As a broad preamble to MICA's comment, we would like first to update the FDIC on the condition of the U.S. private mortgage insurance industry. Current data reinforce the points we discuss and support the recommended treatment of MI in the FDIC's framework for residential mortgage-backed securities (RMBS). MI insurance-in-force at April 30, 2010 was $829 billion, or 8.6 percent of U.S. single family first liens then outstanding.[1] Giving effect to the strong risk to capital requirements imposed by state insurance regulators, the industry has capacity to insure an additional $261 billion in insurance in force in each of 2010, 2011, and 2012. This translates to approximately 1.3 million additional mortgages in each of those years – an important contribution to housing recovery, especially for low- and moderate-income first-time home buyers who may lack large downpayments but still have ample capacity to enjoy sustainable home ownership. These first-time home-buyers are crucial to the reduction in excess housing inventory which is essential to a full recovery in the housing market.

The first loss position of private mortgage insurance makes it a valuable offset to mortgage credit risk. This benefit extends to lenders that hold loans in portfolio, investors in securitizations collateralized by loans with MI, and, in the case of Fannie Mae and Freddie Mac, to taxpayers who are otherwise exposed to GSE losses. Over the course of the current mortgage crisis, the MI industry estimates that it will pay between $30 billion to $40 billion in claims in front of the taxpayer to Fannie Mae and Freddie Mac. Indeed, since the current mortgage crisis began, Fannie Mae and Freddie Mac have received from MIs $14.5 billion in claim payments and receivables, equivalent to 10% of the amount U.S. taxpayers have had to spend to date on these GSEs during their conservatorship. If MI is also recognized as a form of risk retention, it would perform the same function for the FDIC – standing in front of the Deposit Insurance Fund (DIF) to protect it and, as a result, taxpayers and the banking system.

Importantly, the MI industry has ample regulatory capital, with MIs distinguished among all sources of private capital in U.S. residential-mortgage finance due to recent capital inflows to the industry based on investor confidence in the business model and its regulatory construct. An additional $7.4 billion in capital has been raised by existing MIs and investors have provided a further $475 million for a new entrant to the industry since the mortgage crisis began.

MIs have also played an active role in preventing otherwise-avoidable foreclosures, thus advancing the FDIC's goals of sustainable

1 MICA, *Monthly Statistical Report*, April 30, 2010, *available at*: http://www.privatemi.com/news/statistics/detail.cfv?id=163. Fannie Mae, *Economics and Mortgage Market Analysis: Housing Forecast: May 2010*, *available at: h*ttp://www.fanniemae.com/media/pdf/economics/2010/Housing_Forecast_051210.pdf.

mortgage lending and appropriate loan modification. Over 199,000 trials have been started by MIs under the HAMP,[2] with 34,945 completed through the first quarter of 2010. Further, the industry has participated in 53,901 approvals under the HARP,[3] with 41,155 closed refinances during this same time period. These efforts combined with other MI-related loan workouts resulted in 374,304 completed workouts from 2008 through the first quarter of 2010 by the MI industry, covering $73.8 billion in mortgage loans.

Specific comments discussed in more detail below include:

- MICA supports the proposed recognition of the value of loan-level credit risk mitigation, which the NPR notes is among the eligibility criteria for a safe harbor. In our comment on the advance notice of proposed rulemaking [75 FR 934], MICA urged the FDIC to limit eligibility only to loan-level protection provided by regulated, capitalized providers. We again recommend this to ensure that capital is indeed at risk based on clear analysis of loan-level risk (i.e., independent underwriting criteria).

- Because private MI is capital at risk in mortgage securitization at the loan level, MICA urges the FDIC to permit it in lieu of risk retention for loans with CLTVs above 80 percent that meet other terms for prudently underwritten loans. The U.S. private MI industry is, as detailed in this letter, amply capitalized to take on this role – indeed, MI is now a significant form of private capital in the United States ready and willing to support new mortgage lending and securitization. Failure to recognize MI as a form of risk retention will adversely affect mortgage-market recovery and promote undue reliance on government securitization channels.

- Reflecting Congressional action, the FDIC should provide its safe harbor to residential mortgages that meet defined qualification standards that ensure borrower protection and prudential underwriting. Congress is currently finalizing the "Dodd-Frank Act," which includes a clear exemption for qualified mortgages in its Section 941 provisions related to asset-securitization reform. The FDIC will play a major role in finalizing these standards for all securitizers and should conform its rules for insured depositories to them. Doing so will promote mortgage-market recovery, simplify compliance with the FDIC's rules (especially for smaller

[2] Department of the Treasury, *Making Home Affordable Summary of Guidelines*, March 4, 2009.
[3] Ibid.

insured depository institutions) and promote a prudent private securitization market that will avoid undue reliance on government or government-sponsored enterprise (GSE) securitization that puts taxpayers at risk.

- MICA supports the proposed new disclosure and servicing-related requirements for the safe harbor regarding RMBS. We strongly support the goal of preventing otherwise-avoidable foreclosures and believe the proposed requirements will advance this important objective. However, we urge the FDIC to go farther and mandate appropriate reporting on second liens to ensure servicers have the information required to comply with the proposed loan-servicing standards related to residential mortgages where multiple liens exist on a single property.
- MICA respects the FDIC's unique interest in protecting the deposit insurance fund (DIF). We thus agree that the FDIC may need to consider unique concerns under its authority provided by the Federal Deposit Insurance Act.[4] However, the goals expressed in the NPR of "better aligning the incentives in securitization to support sustainable lending and structured finance transactions"[5] are also shared by Congress and other regulators. Thus, the FDIC should coordinate its final rule with other initiatives to promote a consistent ABS regulatory framework across all classes of originators and securitizers. Failure to do so will promote the "shadow" banking system and, in the long run, undermine the FDIC's laudable objectives. Indeed, freestanding action could jeopardize the FDIC's goals of stabilizing the financial system, as asset securitization will flee to the "shadow" banking system, limiting the ability of banks to meet community credit needs and promoting high-risk lending and securitization.

I. MICA Supports Recognition of Mortgage Insurance as a Condition for the Safe Harbor, But Recommends Caution Regarding Other Guarantors

Private mortgage insurance is in a first-loss position (after borrower equity) on high loan-to-value (LTV) mortgages. MICA is pleased to see the Safe Harbor Proposal's reflection of this in its endorsement of MI as an acceptable form of loan-level credit risk mitigation. MI is a regulated, counter-cyclical source of loan level protection provided for a mortgage loan based on independent, objective underwriting criteria. It is for this reason that the recent

[4] Pub. L. No. 81-797 (1950).
[5] 75 FR 27474.

report from the Joint Forum of global banking, securities and insurance regulators endorsed mortgage insurance as an important element of a reformed mortgage origination and securitization framework.[6]

The Safe Harbor proposal also suggests that other forms of external loan-level guarantees would be acceptable in addition to MI. However, MICA urges that the FDIC clarify that guarantees or any other form of external credit support only be supplied by providers that are regulated, well capitalized, and that can demonstrate a proven capacity to satisfy their obligations and ensure prudent loan origination. Further, permissible external credit support should only be offered by a bona fide third-party unrelated to the originator or securitizer. Guarantees offered by affiliated parties (which is possible if cosigners or similar forms of loan-level credit enhancement are protected as proposed) undermine the value of true external credit support and should be prohibited under the Safe Harbor.[7]

It is our understanding that the loan-level guarantee eligibility criterion for the safe harbor would not permit use of derivatives, including credit default swaps (CDS). We urge clarification of this in the final rule to ensure that specific CDS structured for eligibility are not crafted and used in ways that expose the DIF to risk. CDS should not be considered as an acceptable form of guarantee for purposes of the Safe Harbor. CDS have been a source of profound systemic risk in the current crisis, with the regulatory framework required to correct this problem still only in proposed form in the U.S. and most other national regimes. The Joint Forum paper cited above rightly details an array of supervisory and capital problems in the CDS sector. For these reasons, a prudent and cautious attitude regarding CDS is appropriate.

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[6] The Joint Forum, *Review of the Differentiated Nature and Scope of Financial Regulation Key Issues and Recommendations*, January 2010, at p. 17. "*Other factors important to an effective underwriting program:* The following are not substitutes for sound underwriting practices but should be taken into consideration when determining the soundness of an underwriting program. Mortgage insurance provides additional financing flexibility for lenders and consumers, and supervisors should consider how to use such coverage effectively in conjunction with LTV requirements to meet housing goals and needs in their respective markets. Supervisors should explore both public and private options (including creditworthiness and reserve requirements), and should take steps to require adequate mortgage insurance in instances of high LTV lending (*e. g.,* greater than 80 percent LTV)."

[7] For example, the Japanese mortgage market relied extensively on affiliated guarantee companies that, in retrospect, proved unable to exercise independent underwriting judgment or accumulate the capital needed to honor their counterparty claims without parental support.

II. MI Should be an Alternative to Risk Retention

Recent analysis of mandatory risk retention requirements by the IMF[8] and academics[9] has raised serious concerns as to how risk-retention requirements could be implemented without either shutting down the securitization market or allowing for arbitrage of accounting and regulatory-capital requirements by securitization sponsors to undermine the goals of risk retention. Importantly, the IMF work has urged that "the decision for regulatory retention requires more in-depth analysis than simply assigning a 5 percent formula."[10]

We would note in this regard that the recent ABS proposal from the Securities and Exchange Commission (SEC) [75 FR 23328] would, like the FDIC NPR, seek to bar risk hedging, but it would allow issuers to trade in CDS indices and related structures to offset risk retention. As MICA shall make clear in its comments to the SEC, this would in fact increase ABS risk not reduce it, as a new set of incentives to trade in securitization-related risk positions would result.

MICA thus respectfully recommends that the concept of a mandatory risk retention requirement imposed on either loan originators or securitizers requires a great deal of additional analysis before it is implemented and that alternatives to mandatory risk retention such as meaningful underwriting standards and proven credit risk mitigation (see below) should be adopted in the Safe Harbor proposal.

However, if the FDIC adopts a form of risk retention, then the proposal should encompass viable alternatives to ensure the existence of *bona fide* capital at risk. Alternatives such as the exemption for qualified residential mortgages that is included in the "Dodd-Frank Act" are consistent with the policy objective of "skin in the game" that underlies risk retention. This is also the view that has been advanced by the President's Working Group on Financial Markets and statements from the G-20.[11]

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[8] IMF Survey, September 21, 2009, *Chapter 2 Restarting Securitization Markets: Policy Proposals and Pitfalls*.

[9] Fender, Ingo, and Mitchell, 2009, "Incentives and Tranche Retention in Securitization: A Screening Model" (unpublished; Bank for International Settlements) *available at* http://www.bis.org/bcbs/events/cbrworkshop09/fendermitchell.pdf. *See also* Kiff, John, and Kisser, forthcoming, "Optimal Retention Policy and Capital Requirements," IMF Working Paper, as cited in *Ibid*., p. 25.

[10] IMF Survey, *op. cit.*, p. 30.

[11] The President's Working Group on Financial Markets, *Policy Statement on Financial Market Developments*, March 13, 2008, *available at* http://www.ustreas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf. G-20, *Declaration on Further Steps to Strengthen the Financial System*, September 4-5, 2009, *available at* http://www.g20.org/Documents/FM__CBG_Declaration_-_Final.pdf.

Thus, if the FDIC proceeds with mandatory risk retention, as proposed, it should also provide for alternatives that ensure long-term capital at risk. As detailed above, mortgage insurance meets this goal. Given the critical importance of promoting mortgage-market recovery without undue reliance solely on government-securitization channels, the FDIC should provide that qualified mortgages (see below) must include MI at the time of origination if their loan-to-value ratios (combined to reflect all mortgages collateralized by the same property) exceed a specified level.[12] Given the role private MI has demonstrated in dramatic reductions in taxpayer risk related to the GSEs (discussed above), it is clear that, even in the current, severely adverse market conditions now evident in U.S. mortgage finance, that MI is in fact real capital at risk that advances prudent mortgage securitization and investor protection.

III. A Qualified-Mortgage Exemption from Risk Retention is Essential to Ensure Prudent Lending and Credit Availability

MICA believes that a qualified mortgage standard should be established and mortgages meeting this standard should be exempt from any credit risk-retention requirements, including those imposed by the FDIC. As noted, Congress is currently finalizing a new law that will in fact mandate this for loans that collateralize RMBS. These standards can and should be stringent to ensure appropriate borrower protection and incentive alignment, with the FDIC given a clear role in promoting its goals in this inter-agency process. MICA thus urges the FDIC to defer action on its safe harbor until the shape of the broad risk-retention standards for RMBS are clear and, then, to conform its criteria to these eligibility criteria.

By including qualified mortgages within an FDIC safe harbor, the securitization of these mortgages is both simplified and made capital efficient. As a result, lenders will have a regulatory incentive to adopt the highest lending standards, and home-ready borrowers will have access to safe, affordable mortgages. Absent the creation of a qualified mortgage exemption, even the lowest-risk mortgage loans would become scarce and expensive, chilling the housing-market recovery.

Qualified mortgages should include underwriting and product features such as: documentation and verification of a borrower's financial resources, standards regarding a borrower's ability to repay

[12] As recent severe declines in home values have left many borrowers with negative equity (owing more than the property is currently worth), MICA recommends that the FDIC give serious consideration to requiring MI on all loans with combined LTV ratios of seventy-five (75) percent or more.

the loan (based on a borrower's income and the ratio of income to housing and other debt obligations), factors that mitigate the potential for "payment shock," and a requirement for mortgage insurance at the time of origination.

The requirement for mortgage insurance is an important feature of a qualified mortgage. Private MIs are required by regulation to place their own capital at risk on every loan they insure – mortgage insurers have "skin in the game" on every loan they insure, and thus a clear economic incentive to ensure that their loans are prudently underwritten. But, because MIs do not insure a lender against 100 percent of losses (typically MI insures against the first 20 - 25 percent of losses), lenders are still accountable for careful underwriting standards, and have a clear financial incentive to ensure that their loans comply with those standards. Moreover, reliance on private capital to facilitate low down payment loans, and to mitigate against the risk of foreclosure, means less exposure of taxpayer dollars that accompanies growing reliance on FHA insured loans.

A study of over 20 million mortgage loans made between 2002 and 2008 found that mortgages with the characteristics noted above for qualified mortgages performed almost three times better than loans that had one or more risk characteristics (as measured by foreclosure or 90-day delinquency rates). Qualified mortgages performed better regardless of when the loan was originated, and regardless of where the home was located. The data confirms that qualified mortgages are significantly lower risk than loans that are not prudently underwritten.[13]

Qualified mortgages as defined above are low risk assets, the securitization of which promotes a strong, stable housing market. Risk retention is designed to ensure that parties cannot avoid accountability for risky assets by moving them off balance sheet via securitization. By extending the safe harbor to qualified mortgages as defined pursuant to the Dodd-Frank Act, the FDIC will be distinguishing soundly underwritten loans from unsound ones and rewarding the securitization of sound mortgages.

It is generally agreed that deterioration in lending standards was a key factor in initiating the housing crisis. As house prices rose, underwriting and credit guidelines became increasingly lax. Reliance on stated income and assets rather than validating a borrower's financial resources, extending credit based on future home price appreciation and without regard for a borrower's ability to pay, qualifying borrowers based on low "teaser rates" that would adjust to unaffordable levels, and allowing "piggyback" loans to substitute for

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[13] *Historical Performance of Qualified vs. Non-Qualified Mortgage Loans*, February 2010, *available at* http://www.restorethedream.com/assets/documents/QM%20vs%20Non-QM%20Loan%20Analysis.pdf.

capitalized, regulated mortgage insurance on lower down payment loans were all features of this high-risk process. The creation of qualified mortgages would help assure that the underwriting mistakes of the past crisis are not repeated in the future.

MICA also urges that no "piggyback" second mortgages should be allowed to qualify as mortgages afforded a safe harbor by the FDIC. Piggyback mortgages (those with simultaneous second liens) were a major factor in the run-up to the current crisis, with many originated to evade requirements in the charters of Fannie Mae and Freddie Mac[14] that limit the maximum loan amount that the GSEs may purchase and require MI or another form of credit enhancement for mortgages with LTVs above eighty percent. In effect, MI functions like the margin requirements used in the equity-securities context to prevent excessive leverage. Instead, "80/10/10s", "85/15/5s", and "80/20s" (denoting the percentage amount of the first and second mortgages and borrower down payment respectively) proliferated because applicable bank capital rules did not recognize the true risk inherent in the retention or securitization of second liens.

MICA repeatedly urged bank regulators to recognize the true risk of piggyback mortgages as the crisis worsened, noting the risk they posed to borrowers, Fannie Mae and Freddie Mac, and banking organizations.[15] The agencies finally took action on home equity loans and lines of credit in 2005[16], but the guidance at that time was implemented inconsistently. As the FDIC knows all too well, these loans are a serious financial-market risk and an impediment to mortgage-loan modifications that prevent otherwise-avoidable foreclosures. Moreover, a recent study prepared by Genworth Financial, based on performance data compiled by First American Corelogic, demonstrated that the performance of 80 LTV first liens originated with a simultaneous second lien was on average nearly 60% worse than insured loans of comparable CLTV, FICO score and origination year.[17] Piggyback loans are both dangerous to the borrower and the lender and unnecessary. Thus, MICA recommends that underwriting standards adopted for purposes of the Safe Harbor

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[14] *See* 12 U.S.C. § 1717 and 12 U.S.C. § 1454 respectively for Fannie Mae and Freddie Mac.

[15] *See for example*, MICA's letter of December 3, 2002 to U.S. bank regulators regarding the appropriate treatment of structured mortgages under the recourse rule focusing on the higher risks associated with structured second liens and the need for adequate capital requirements.

[16] *Credit Risk Management Guidance for Home Equity Lending* (May 24, 2005), Financial Institution Letter (FIL-45-2005) (FDIC), OCC Bulletin 2005-22 (OCC), SR letter 05-11 (FRB), CEO Letter 222 (OTS), *available at* http://www.fdic.gov/news/news/press/2005/pr4405a.html.

[17] *Insured Versus Piggyback Loan Analysis, available at http://www.restorethedream.com/assets/documents/Insured-vs-Piggyback-Loan-Analysis.pdf.*

prohibit any residential mortgage transaction involving a piggyback second lien.

Further, MICA recommends mandatory credit risk mitigation on all loans with CLTVS above 80% that is provided by well capitalized and regulated credit enhancers. The underwriting standards for high CLTV loans should reflect the risk management value of the credit enhancement used as a partial replacement for the cash down payment by the borrower provided the credit enhancer is MI or another form of regulated and well capitalized credit enhancement, or insurance from the Federal Housing Administration (FHA) or a similar government agency. As recognized in the Safe Harbor Proposal, these loan-level forms of credit risk mitigation place capital at risk and provide a second underwriting and other controls that protect the FDIC, along with borrowers.

Indeed, failure to recognize the role of credit enhancement would threaten the mortgage market recovery. Overly restrictive down payment requirements resulting from the failure to recognize well capitalized credit enhancement would undermine the fragile market recovery as first-time, low- and moderate-income home buyers seeking to take advantage of lower home prices would see their purchase opportunity at best delayed if not foregone as a consequence of unnecessarily high minimum down payment requirements. When private or federal capital, relying on its own prudent underwriting criteria, is put at risk on these mortgages, it ensures appropriate borrower, investor and FDIC protection.

IV. MICA Supports Proposed Disclosure and Servicing Requirements

MICA supports the FDIC's broad goal of enhanced ABS transparency, which reduces information asymmetry, enhances market-pricing efficiency and promotes informed investor decision-making. The FDIC will also be able to ensure that any ABS provided a safe harbor is in fact prudent if the underlying loan-level disclosures are sufficient, transparent and objective, permitting both it and other bank supervisors to validate bank underwriting and securitization practice without burdensome examinations that may divert needed supervisory resources.

MICA believes that accurate and complete disclosure of risk factors in mortgage underwriting is necessary to prevent the return of aggregators which create a demand for imprudently underwritten primary loans. These aggregators use weak disclosure requirements to place within their pools of mortgages very high risk products that do not reflect the risk attributable to other mortgages within the pool. The ability of investors or their agents to conduct a thorough analysis of mortgage pools down to the loan level and track their performance back to the various agents involved in the origination process is just as important at the securitization stage as preventing the return of dangerous mortgages practices in the primary mortgage underwriting process. MICA suggests that arguments against full and comprehensive disclosure which hinge on excessive reporting cost burdens should be discounted by the regulators when compared with how costly asymmetric information about mortgage pools has been to investors and how the resulting uncertainty virtually shut down the private securitization market when investors realized that they did not know the true nature of the mortgages comprising their MBS investments.

Below, we note our views on the proposed disclosure and servicing requirements for RMBS germane to private mortgage insurance and suggest several additional requirements to promote the FDIC's goals of ensuring prudent, sustainable mortgage-securitization practice.

A. Proposed Disclosure Requirements

The FDIC has proposed that loan-level data be disclosed, noting an array of criteria (maturity, interest rate, etc.). MICA supports this disclosure due to the FDIC's correct view that loan-level data are critical to effective investor due diligence. Much of the FDIC's loan-level data requirements are echoed and expanded upon in the SEC's proposed revisions to Rule AB, which would expressly mandate a series of new disclosures regarding private mortgage insurance. MICA generally supports the SEC proposal and welcomes the FDIC's intention to rely upon it. However, should this change in the final rule, then MICA urges the FDIC to ensure that its disclosure requirements ensure that investors are apprised of the existence of mortgage insurance in RMBS structures, as the value of proven credit risk mitigation is, of course, a critical concern.

MICA also supports the proposed requirement that sponsors certify compliance with current regulatory standards governing mortgages in RMBS and with any subsequent rules in this regard. We recognize that this could prove burdensome, but believe that banking agencies in the past and going forward will only promulgate standards that balance burden with the need for borrower and investor protection. Were bank RMBS sponsors to issue securitizations with underlying assets that did not comply with standards governing their own origination, a dangerous opportunity for regulatory arbitrage would ensue that could quickly lead to another bout of high-risk securitization. MICA also supports the proposed requirement that sponsors disclose a third party due diligence report on compliance with applicable regulatory standards and the representations and warranties made with respect to the financial assets. This will promote investor understanding and reduce the sponsor's burden associated with loan-level compliance review.

The NPR would also require servicers to disclose their own or affiliate ownership interests in any whole loans secured by the same property securing other loans in the RMBS pool. MICA supports this proposal, which would significantly contribute to RMBS-market transparency and help to resolve allegations that servicer conflicts of interest are inhibiting loan modification for loans with second liens. However, we urge additional requirements related to these loans, detailed below.

B. Proposed Servicing Requirements

Under the NPR, servicing and other agreements would have to provide servicers with full authority, subject to contractual oversight by any master servicer or oversight advisor, to mitigate losses on financial assets consistent with maximizing the net present value of the financial asset. MICA supports this proposal, but urges the FDIC to exercise care to ensure that net present value calculations protect borrowers. To date, servicers have sometimes determined that loans backed by primary mortgage insurance should be placed into foreclosure due to the expected claims payment from the MI. Often, however, a loan modification in which the MI company participates provides both greater borrower protection and higher net present value. All such calculations should take full consideration of all possible payment options, not just press for speedy foreclosure. Clarification of this requirement would be desirable in the final rule to ensure full consideration of all loan-modification options. Additionally, MICA asks the FDIC to recognize that servicers must respect contractual MI and other third-party policy rights to conduct borrower workouts. As noted in the data provided at the start of this letter, private MIs are full and willing partners in foreclosure prevention, providing an array of different structures to support both borrower and investor interests.

MICA also supports the proposed requirement that servicers have the authority to modify assets to address reasonably foreseeable default, and to take other actions necessary to maximize the value and minimize losses on the securitized financial assets, applying industry best practices for asset management and servicing. These best practices appropriately reflect the value of MI in foreclosure-prevention and loan-modification, but clarity in the final rule would again be desirable in this respect.

Finally, MICA agrees that the documents should require the servicer to act for the benefit of all investors, and not for the benefit of any particular class of investors. The servicer must commence action to mitigate losses no later than ninety (90) days after an asset first becomes delinquent unless all delinquencies on such asset have been cured. A servicer must maintain sufficient records of its actions to permit appropriate review.

C. Additional Standards Addressing Second Liens

Home equity loans and lines of credit have combined with piggybacks to become significant obstacles to ongoing mortgage-loan modification efforts and restoring investor confidence in the integrity of bank balance sheets. All second liens are problematic because, by definition, they increase borrower indebtedness and, thus, reduce home equity.[18] The Joint Forum paper referenced above pointed to equity extraction as a major mortgage-risk factor.[19] MICA recommends that the FDIC include in its Safe Harbor disclosure requirements an express mandate for insured depository institutions to notify the FDIC in quarterly reports of all second liens and lines of credit taken out on all first liens, whether or not the first lien remains in the bank's portfolio. This will permit the FDIC and other parties to monitor these risks on a loan-by-loan basis and determine when an insured depository institution is taking undue risk related to second liens that must be addressed through supervisory action.

V. MICA Urges The FDIC To Coordinate With Other Pending ABS-Reform Initiatives

Finally, as noted, MICA respects the FDIC's unique interests, but continues to urge it to defer action on its safe-harbor rule until Congress has concluded its deliberations and other regulatory actions in this arena are better understood. To be sure, the FDIC is coordinating with the SEC, but the SEC's pending NPR will likely be significantly revised after Congress concludes action on ABS reform and related disclosure and registration initiatives. Further, the pending legislation requires the FDIC to work not only with the SEC, but also with the Federal Reserve Board, Office of the Comptroller of the Currency (as it shall be reconstituted)and the Federal Housing Finance Agency to establish a qualifed-mortgage standard that will then provide an exemption to risk-retention requirements. Unless or until the FDIC has reviewed this standard and found it insufficient for purposes of its safe harbor, the FDIC should work in concert with other regulators, not on its own.

[18]As the housing crisis has developed, more studies have shown the close correlation between the availability of second lien financing and mortgage defaults. *See e.g.,* LaCour-Little *et al*., *Follow the Money: A Close Look at Recent Southern California Foreclosures***,** (May 23, 2009), *available at* http://www.areuea.org/conferences/papers/download.phtml?id=2133.

[19] Joint Forum, *op. cit.* pp. 16-17. "Equity extraction limitations contribute to housing market stability, deter irresponsible financial behavior that puts homes at risk, and promote savings through equity build. (ff. While it might be argued that supervisors are not responsible for protecting borrowers from themselves or promoting such savings, to ignore this important aspect would be irresponsible from a public policy standpoint). They effectively limit the fallout associated with unfettered "monetization" of the equity gained during periods of rapid home price appreciation, especially since that appreciation may not prove sustainable."

All of these new rules will determine the degree to which the FDIC's standards need to be unique for insured depositories or – as appropriate – coordinated with the other banking agencies and the SEC to prevent the flight of asset securitization from insured depositories to the "shadow" banking system. The legislation is likely to, for example, give regulators broad authority to exempt not only qualified mortgages, as discussed above, but also asset securitizers for government agencies like the FHA. Regulators will also have the authority to provide a full or partial exemption for mortgages sold to the GSEs. Should the FDIC take a unique stand on these mortgage-securitization channels, mortgage-securitization flows could be significantly disrupted in ways that would increase borrower risk, potentially reduce credit availability and market recovery and increase taxpayer risk related to the conservatorships at Fannie Mae and Freddie Mac. Conversely, if the FDIC works with other agencies to craft appropriate securitization rules that rightly reflect the ability of mortgage insurance to absorb credit risk and protect borrowers, market recovery will be significantly facilitated.

Sincerely,

Suzanne C. Hutchinson