AIG United Guaranty

United Guaranty Residential
Insurance Company of North Carolina
230 N. Elm Street/27401
P.O. Box 20327
Greensboro, NC 27420-0327
336.373.0232
800.334.0296
336.273.1785 Fax

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OFFICE OF EXECUTIVE SECRETARY

March 20, 2007

Office of the Comptroller of the Currency
250 E Street, S.W. Mail Stop 1-5
Washington, DC 20219
(Docket No. 06-09/ RIN 1557-AC91)

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington DC 20429
(RIN 3064-AC73)

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
(Docket No. R-1261)

Regulation Comments
Chief Counsel's Office, Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552, Attention: No. 2006-33
(RIN 1550-AB56)

Subject: Submission of comment on the Risk-Based Capital Standards: Advanced Capital Adequacy Framework, Notice of Proposed Rulemaking (NPR)

Dear Sir or Madam:

United Guaranty Residential Insurance Company of North Carolina (UGRIC-NC) is pleased to have the opportunity to comment on the Agencies joint Notice of Proposed Rulemaking "*Risk-Based Capital Standards: Advanced Capital Adequacy Framework, Notice of Proposed Rulemaking*" (NPR). We have limited our comments to three questions identified in the December 26, 2006 Federal Register, specifically, questions 4, 13, and 14.

UGRIC-NC strongly supports the concept of a more robust, risk-based approach to minimum regulatory capital for banks. However, we believe a judicious use of credit risk mitigants is warranted in order to satisfy the requirements of the proposed rule.

This would:

- Reduce the cost associated with implementation of the proposed rule.
- Allow all financial institutions, regardless of size, an outlet to reduce their risk exposure.
- Enable additional eligible guarantors to emerge in support of the banking industry.
- Increase the financial stability of the U.S. banking industry as intended by the rule.

Question 4: Risk weightings and additional eligible guarantors.

Although UGRIC-NC believes the weightings are acceptable *as stated*, we maintain that if an accepted risk mitigant is used to reduce the risk exposure of the underlying obligations, the weightings should be reduced. Also, additional eligible guarantors should be encouraged to participate in order to provide a larger pool to absorb periodic volatility associated with the U.S. banking industry. Such guarantors should be highly rated for financial strength by Nationally Recognized Statistical Rating Organizations (NRSRO). Finally, the value assigned to a guarantor's offerings should be commensurate with its overall rating, (for example, a lower-rated guarantor would not receive the same value as a higher-rated guarantor).

Question 13: Risk based capital treatment for HELOCs to include the adjusted LTV for utilization of the HELOC.

UGRIC-NC believes that there should be no LTV adjustment for utilization of HELOCs, because of the inability of lenders to control the use of a HELOC in circumstances other than default.

Question 14: Use of LTV and creditworthiness to determine risk weighting for junior based lien.

UGRIC-NC believes LTV ratios should be used for risk weighting for junior based liens. Borrower creditworthiness, to include debt ratios, income, career stability and payment history, is useful when estimating losses. Creditworthiness is not indicative of performance during periods of stress and should not be applied in lieu LTV ratios.

UGRIC-NC believes the mitigant-supported approach to capital treatment outlined in the NPR will substantially address all financial institutions' concerns related to (1) the cost of implementation, (2) the availability of external resources to help manage their required risk-based capital and (3) appropriate alignment of risk and capital.

Attached is our commentary, titled "Portfolio Credit Default Insurance," which provides additional insight into risk mitigants and their application to this NPR. We will also send, under separate cover, further supporting documentation, jointly written with Old Republic Insurance Corporation which also provides portfolio credit indemnity insurance.

Sincerely,

Alan D. Atkins
President

Attachment

PORTFOLIO CREDIT DEFAULT INSURANCE

A Strong Form of Credit Risk Mitigation
That Warrants Regulatory Recognition

In this paper, United Guaranty Residential Insurance Company of North Carolina (UGRIC-NC)[1] is presents an overview of portfolio credit default insurance, a form of credit risk mitigation with increasing market impact due to lender appetite for consumer lending products.
We think it is essential for bank and savings association regulators to understand this product and the regulatory framework in which it operates, so they can evaluate the manner in which it should be recognized in any future credit risk management and capital rules, as well as the current rewrite of the Basel Capital Accord.

Key characteristics of portfolio credit default insurance (PCDI):

- A proven form of credit risk mitigation (CRM) provided by regulated firms with the capital and ratings to ensure commitments are honored.

- A well-regulated form of CRM without the operational and legal risk identified by international regulators with credit derivatives and certain other forms of credit risk transfer.

- A demonstrated way for banks and savings associations to address credit risk not anticipated at loan origination.

Appropriate regulatory recognition includes:

- Clarification of the second-lien guidance to make clear that PCDI is an acceptable form of CRM for risk concentrations in addition to the private mortgage insurance (MI) and pool MI specifically mentioned in the guidance;[2]

- An indication in subsequent Basel II guidance to make clear that PCDI is an acceptable form of CRM that permits reduced risk-based capital; and

- Recognition of PCDI in the pending Basel IA rewrite to ensure that it is a recognized form of CRM.

In this paper, UGC is pleased to:

- Describe PCDI as a product;

- Detail the PCDI regulatory and ratings framework; and

- Describe specified appropriate regulatory recognition in light of these product and regulatory characteristics.

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[1] Also referred to as UGC, an acronym for United Guaranty Corporation.
[2] *Credit Risk Management Guidance for Home Equity Lending*, Office of the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation, and Office of Thrift Supervision, and National Credit Union Administration, May 16, 2005.

We are prepared to answer any questions this paper raises and provide additional information as needed.

Portfolio Credit Default Insurance Basics

Although most mortgage insurance is placed on a loan-by-loan basis at the time of origination, several companies have insurance affiliates that provide insurance coverage on a portfolio basis, ensuring that lenders can manage credit risks on (1) loans they may not have originated and (2) loans that have exhibited certain risk characteristics over time. PCDI has been successfully distributed for more than 35 years, during which time it has proven that it can safely be applied to loans other than traditional mortgages. For example, portfolios containing home equity, boat, automobile and student loans can all benefit from risk mitigation provided by PCDI. While the market is not as developed as other insurance markets, PCDI is a well-established product. We estimate PCDI in force today at approximately $50 billion. However, the overall market for this product is obviously much larger, potentially including almost every facet of consumer lending.

PCDI is a proven risk mitigant that does not present many of the dangers of other forms of portfolio insurance (such as dynamic hedging) or credit derivatives. Unlike PCDI, these other forms of insurance or CRM can actually subject firms to greater risk. It is for this reason that the International Joint Forum has completed a detailed consultative effort on credit risk transfer (CRT) with an array of new internal risk-management and supervisory standards designed to limit counterparty credit, operational, and liquidity risk in the credit derivatives arena.[3]

How PCDI Works

PCDI premiums, which are usually paid from the net interest margin of the insured portfolio, are typically expressed as a rate in basis points charged against the outstanding balance of the loan. PCDI covers 100% of the principal and unpaid accumulated interest upon borrower default.

For example, consider the default of a $50,000 mortgage in a portfolio covered by PCDI. At the time of default, the mortgage balance is $45,000. In addition, there is $1,800 of unpaid accumulated interest. Therefore, the PCDI provider would pay the lender $46,800 in return for the recovery rights. Recovery rights are those associated with the value of the foreclosed property securing the loan.

Cumulative payments on the overall portfolio are, however, subject to a stop loss limit. The stop loss is expressed as either a percentage of the original aggregate principal balances for closed-end loans or the original aggregate lines of credit extended for the portfolio. The portfolio can be structured as a collection of previously originated loans (or lines of credit) or on a flow basis (by loans or lines meeting mutually agreed-upon underwriting criteria insured during a twelve month period).

The stop loss would apply on an aggregate basis for each policy year that the loans (or lines) are insured. The stop-loss percentage is set according to the requirements of the portfolio holder and is often determined by the ratings agencies. Generally, the stop loss is set at 10%. So, for example, a

[3] *Credit Risk Transfer*, Basel Committee on Bank Supervision, Joint Forum, March 2005.

$100 million portfolio with a 10% stop loss would cover a cumulative liability of $10 million in any one policy year.

When PCDI providers contract with lenders, they develop a policy tailored to fit state regulations that clearly establishes the settlement process. The usual claims process requires that the insured party notify the provider of the default. Claims are paid within 60 days of receipt of all appropriate documentation.

Importantly, PCDI providers do not require foreclosure on the underlying loans as a prerequisite for collection. This ensures that lenders are able to mitigate their loss without undertaking costly and often time-consuming foreclosure and recovery proceedings.

Events triggering PCDI agreements result in an obligation that is clearly defined in courts of law. Accordingly, the amount of protection is firmly defined when the insurance policy is initiated; full rights are transferred with the underlying asset and without any subsequent contractual negotiations. Also, the amounts paid under PCDI are not subject to after-the-fact negotiation, except in cases where fraudulent activity may have occurred.

PCDI Regulatory Framework

PCDI is a product offered by state-regulated insurers. Despite the fact that PCDI has not been heavily marketed, the insurance has nonetheless, over the past 35 years, played an integral role in reducing risk to lenders and the overall banking system.

Parent Companies

PCDI providers generally operate as subsidiaries or affiliates of mortgage insurers (MIs). Because of their important role as a backstop, MIs must be the soundest of financial companies. For starters, they carry the highest capital of any type of insurance firm – all are AA-rated or better – and are rated by credit ratings agencies using rigorous stress tests covering the claims paying ability of the insurer over a ten-year period. This stress test is significantly longer than the one-year holding period used in the Basel internal ratings standard, and it is unique to the MI industry.

MIs are subject to strict state insurance regulation and must be extremely well-capitalized to protect policyholders against the type of catastrophic loss that can occur during a depressed economic period. Strong parent companies are required to maintain three separate reserves to ensure adequate resources to pay claims.

PCDI Providers

PCDI providers are regulated and licensed at the state level, usually as property and casualty firms, and sometimes as mortgage guarantors and/or credit insurers. PCDI products are not tailored to individual lenders, and as a result, all PCDI agreements are thoroughly reviewed and approved by state regulators.

Providers are independently rated. This rating is generally derived from their strong capital position and experience/business expertise, as well as the explicit support from their parent company. This support generally includes a capital support agreement and stop loss reinsurance. UGRIC-NC, for example, is currently rated AA by both Moody's and Standard & Poor's.

In addition, PCDI providers establish loan-loss reserve levels that are carefully developed and reviewed by licensed actuaries. This is done by taking into account the asset type, length of the claim cycle and other well-established actuarial methods. Reserves are then reviewed periodically by both internal and independent actuaries to ensure safety and soundness. Reinsurance is also purchased to cover various unforeseen events that might be outside methodology or assumptions.