Testimony of

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on behalf of the

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Regarding:

Housing Finance Reform: Powers and Structure of a Strong Regulator

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Introduction

Chairman Johnson, Ranking Member Crapo, and members of the Committee, thank you for the opportunity to testify today. My name is Kurt Regner, and I serve as the Assistant Director, Financial Affairs Division of the Arizona Department of Insurance. Arizona sits on the Mortgage Guaranty Insurance Working Group of the National Association of Insurance Commissioners (NAIC), and it is on behalf of the NAIC that I present this testimony today.

The NAIC is the United States' standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. Through the NAIC, we establish standards and best practices, conduct peer review, and coordinate our regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

State insurance regulators appreciate the opportunity to offer our expertise and perspective on federal efforts that impact our system of supervision. As the prudential regulators of insurance, we are in the business of protecting insurance policyholders and ensuring competitive insurance markets. As insurance markets evolve, state insurance regulators remain extensively engaged with all relevant stakeholders to promote an optimal regulatory framework and mortgage insurance is no exception. In that arena, we are very mindful of the need to carefully balance solvency standards with ensuring the availability of coverage in the market. We also appreciate the strong desire in Congress to address a number of issues arising from the mortgage transaction, but want to ensure that any legislation appropriately considers the existing regulatory regime that is designed to meet these important objectives.

Today, I will provide the committee with an overview of the private mortgage insurance (PMI) market, how participants are regulated by state insurance departments, and highlight actions underway at the NAIC and in the states. I will touch on related issues with respect to financial guaranty insurers, although this is not an area of my expertise. I will also offer impressions on how our regulation can fit in with the objectives of recent legislative proposals.

History of Private Mortgage Insurance

Any discussion of PMI should begin with an understanding of how the industry has evolved over time. The PMI industry dates back to the 1880s, when mortgage banks were first formed to finance loans to people securing land in the Midwest and West. Then as now, PMI promotes home ownership by facilitating the flow of credit from lenders and investors who might not otherwise have the capacity or desire to assume incremental credit risk. PMI enables those lenders to mitigate default risk when a borrower makes a smaller down payment, which inherently increases the risk of loss.

The PMI industry went bankrupt and disappeared for some time following the Great Depression and the housing collapse of the early 1930s, but reemerged in the late 1950s as alternatives to the federal government's Federal Housing Administration (FHA) and Veterans' Affairs (VA) mortgage insurance programs. State insurance regulators, understanding the lessons of the 1930s collapse, saw the need for stronger laws and regulations to ensure PMIs were equipped to handle economic shocks for all the tail risk (i.e. the least likely yet most severe risk) they carry. Since

then, the PMIs have faced and largely managed episodes of severe stress in the 1980s, early 1990s, and most recently with the housing crisis a few years ago.

Through the most recent financial crisis, the financial sector's collective assumptions about the housing market were proven wrong. As regulators, we recognized that regulatory requirements for mortgage insurers need to be enhanced to address the risks uncovered by the crisis. Today, the downturn's effects are clearly still being felt by PMI providers, although market and economic trends have generally stabilized in the last couple of years. The PMIs continue to suffer losses from the 2005-2007 books of business as some consumers continue to struggle with their mortgages. However, new defaults should keep trending downward assuming a continued housing and economic recovery; and newer, better priced, and higher credit quality business will continue to strengthen the PMIs. While the main players in the PMI space survived the crisis, they are recovering slowly as they try to improve their financial situations. We have been in the process of adjusting regulatory requirements to address the risks uncovered by the crisis. We have also been keenly focused on improving the competitive landscape for the mortgage insurance market by ensuring that opportunities exist for new market entrants and that our supervisory framework does not undermine the availability of coverage for new homeowners and the lenders that service them.

How Private Mortgage Insurance Works

At its most basic level, mortgage insurance underwrites the risk of borrowers defaulting on their loans. The borrower pays the premiums, and the lender is the beneficiary of the policy. PMI premiums are paid either in monthly installments or a single premium payment at loan origination. Unlike FHA or VA loans, the amount of loss coverage is usually capped as a proportion of lost loan principal, usually between 20 to 30 percent of the loan balance.

Generally, mortgage insurers provide coverage in four basic forms: flow insurance, bulk insurance, pool insurance, and reinsurance.

- Flow insurance provides coverage on an individual loan basis and is purchased at the time a loan is originated. The lender selects the carrier, but the cost is paid by the borrower.

- Bulk insurance provides coverage on each loan in a larger group of loans that have already been originated. These loans may have flow insurance already, in which case the bulk provides a second layer of protection against losses.

- Pool insurance provides coverage of multiple mortgages, generally in connection with mortgage securitizations. Insurers provide coverage for losses up to an aggregate limit.

- Private mortgage reinsurance, in which the primary insurer passes a portion of the risk to a third party insurer, has generally been written by 'captive' reinsurers affiliated with lenders.

Supervision of Mortgage Insurers

PMIs are regulated by the states in which they do business, with the state of domicile providing primary regulatory oversight. Each domestic state conducts financial oversight of the companies operating in its jurisdiction. State laws and regulations that are specifically tailored for mortgage insurance control the risk PMIs can assume through a variety of limitations, including reserve requirements, capital requirements, investment and risk concentration restrictions, and restrictions on non-mortgage insurance related activities.

PMIs are required to file all policy forms and premium rates with state insurance departments, and must also file audited financial statements, prepared in accordance with statutory accounting principles (SAP) developed by insurance regulators.

The NAIC has a Mortgage Guaranty Model Act that has been adopted in substantial form by all the states primarily responsible for the regulation of mortgage guaranty insurers.[1] As I alluded to previously, the NAIC is in the process of making adjustments to this model and it is anticipated that these states will adopt the new version of the model.

Capital Requirements

PMIs are generally required to maintain risk-to-capital ratios not exceeding 25 to 1. Most state regulators are authorized to exercise discretion in administering this requirement.

State regulators are currently considering modifying the NAIC model to replace the 25 to 1 risk-to-capital ratio with a more refined capital requirement. This includes most notably, conformance with a risk-based capital formula to be developed for mortgage guaranty insurers. Regulators are also considering a separate loan level cash flow projection capital model requirement if the risk-based capital formula falls below the required threshold.

In addition to the capital ratio requirements, there are minimum capital requirements. Currently, PMIs cannot transact the business of mortgage guaranty insurance unless, if a stock insurance company, it has paid-in capital of at least $1 million and paid in surplus of at least $1 million, or if a mutual insurance company, a minimum initial surplus of $2 million. A stock company or a mutual company must maintain a minimum policyholders' surplus of at least $1.5 million. State regulators are currently considering modifying the NAIC model to increase the required paid in capital and paid in surplus to $10 million and $15 million, and at all times thereafter a minimum policyholders' surplus of at least $20 million.

As a practical matter, the minimum capital and surplus requirements are chiefly of importance in the technical details of organizing or reorganizing a PMI. Under the business plans of PMIs that are in business or in the process of being organized, a PMI writing business on a direct basis requires hundreds of millions or billions of dollars in capital and surplus.

[1] NAIC Model Act #630-1. Attached as Appendix A.

Reserve Requirements

As I mentioned earlier, PMIs have significant reserve requirements to protect against economic shocks, given the large amount of tail risk they carry. PMIs maintain up to four separate reserve components:

1. Unearned premium reserves: This reserve requirement reflects the amount of premium for the portion of the insurance coverage that has not yet expired.

2. Contingency reserves: This is a long-term, countercyclical regulatory capital requirement. PMIs contend with cyclical volumes of claims that generally stay within certain parameters but occasionally spike, with potentially significant consequences. This risk is kept in check by requiring PMIs to keep in reserve 50 percent of net earned premiums for 10 years in anticipation of larger defaults. These reserves are built over time and drawn down only when losses exceed statutory thresholds (typically 35 percent of premiums or more) or state regulators authorize special releases.

   This requirement is also in place to prevent excessive dividends or otherwise dissipating reserves that might be needed to pay claims in a highly adverse loss scenario.

3. Loss reserves: This is a short-term regulatory reserve requirement. Sometimes called "case basis loss reserves," these must equal expected losses on delinquent loans of which the insurer is aware.

4. Premium deficiency reserves: This reserve is established when anticipated losses plus related expenses exceed expected future revenue. It is intended to cover potential losses from all business in force, since mortgage insurers can be responsible for future losses.

Contingency reserves are intended to be built up over good times in stable markets, so that when the housing market slumps and PMI is most needed, the providers will be well-positioned to pay out claims.

State regulators are currently considering modifying the NAIC model to increase the risk sensitivity of the contingency reserves previously mentioned.

Coverage, Investment and Geographic Restrictions

Coverage provided by mortgage guaranty insurers ceded is limited to 25 percent of the entire indebtedness to the insured.

Insurance regulators also place limits on the ability of a PMI to invest in any particular security, and while they can invest in stocks, bonds, notes, and other instruments, they may generally not invest in real estate.

PMIs are not allowed to insure loans that are individually in excess of 10 percent of the company's aggregate policyholders' surplus and contingency reserves. Also, PMIs are prohibited from having more than 20 percent of total insurance in force in any one "Standard Metropolitan Statistical Area," as defined by the United States Department of Commerce.

These concentration limitations are intended to protect against sector and regional housing slumps – it enables PMIs to use premiums collected in more stable regions to offset losses incurred in distressed markets. It is worth noting here that the broad geographic scope of the housing crisis illustrates the unique challenge for PMIs. Geographic spreading of the risk is an effective tool, for example, for property insurance where natural disasters and economic events are not necessarily correlated. However, the 2008 crisis illustrated that lending risk can be correlated at the extremes, so there are unique challenge that PMIs and regulators must manage to address the unique characteristics of this product.

Non-Mortgage Activities

PMIs are "monolines" and generally may not engage in activities other than mortgage related insurance because of the unique type of insurance risks involved. Unlike insurance designed to protect against loss of life or property, the risks faced by PMIs are directly correlated with the housing market and economic conditions. Although monolines are subject to unique risks, they are not exposed to the multitude of risks that a multi-line writer is exposed to protecting the mono-line writer from risks that they do not underwrite. However, PMIs may be affiliated with a variety of other types of businesses that do write other types of insurance or engage in other types of financial services.

Recent Trends in the PMI Market

Next, let me to turn to discussing the state of the PMI market. The financial crisis found PMIs exposed on the front lines – after all, they were the ones directly underwriting the risk of borrowers defaulting on their loans. Since PMIs provided coverage on high loan-to-value mortgages with very thin equity slices, they were vulnerable to potential losses in the event of rising delinquencies and defaults.[2]

The PMI industry recorded its best year in terms of new insurance volume in 2007, with total new insurance written exceeding $300 billion for the first time.[3] A short two years later, new insurance written had declined to $81 billion as the market for mortgage insurance shrunk, following the collapse of the housing market and the subprime crisis. As home prices plummeted, the wave of mortgage defaults and home foreclosures weakened mortgage insurers' capital position as a result of substantial losses. Having to set aside substantial capital to cover future claims severely constrained mortgage insurers' ability to write new business. The very challenging market conditions that the mortgage insurance industry experienced since the eruption of the crises are reflected in the sharp rise of the industry's loss and combined ratios. The industry's loss ratio (losses over net premiums earned) jumped from 41 percent in 2006 to a record high 218 percent in 2008.[4]

As of year-end 2012 there were a total 34 active mono-line writers of mortgage guaranty products within 9 insurance groups. Of these 9 insurance groups, 7 groups accounted for 95.7 percent of gross mortgage guaranty premiums.

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[2] Center for Insurance Policy Research. "Financing Home ownership: Origins and Evolution of Mortgage Securitization – Public Policy, Financial Innovations, and Crises." August, 2012. http://www.naic.org/cipr.

[3] Mortgage Insurance Companies of America (MICA). . "2012-2013 Fact Book & Member Directory."

[4] Mortgage Insurance Companies of America (MICA). . "2012-2013 Fact Book & Member Directory."

Gross premiums written for mono-line mortgage guarantors have fluctuated over the past five-years from low of $4.9 billion in 2012 to a high of $7.4 billion in 2008. Gross paid losses peaked in 2010 at $12.9 billion (77.4 percent of which was reported within the six largest guarantors) compared to $2.8 billion for 2007. Contingency reserves were nearly exhausted over the past five years, totaling $221.4 million at year-end 2012 compared to $13.4 billion in 2007.

It is also worth noting that today, most residential mortgages insured by PMIs are sold to Fannie Mae and Freddie Mac, the Government Sponsored Enterprises (GSEs). They have a statutory requirement to obtain credit enhancement on single-family residential mortgages purchased with loan-to-value ratios of over 80 percent. PMI is the major credit enhancement they use.[5] A recent study on the role of PMI explained that in addition to the regulatory structure, PMIs are preferable to other credit enhancements because of lender diversification, delayed losses, and acquaintance with the risks.[6] However, in the event the GSEs are wound down, it is unclear how PMI providers will be affected.

Although market and economic trends appear to have generally stabilized in the last couple of years, this trend has not yet helped mortgage insurers to materially improve their financial situation. Many mortgage insurers have been able to obtain additional capital, but the losses were material enough that it's expected to take additional time to fully recover.

Mortgage Guaranty Insurers* - As of December 31, *($ in Millions)*

	2012	2011	2010	2009	2008
Policyholders' Surplus	$3,223	$3,813	$7,852	$6,527	$5,606
Contingency Reserves	$201	$605	$613	$2,793	$7,135
Gross Premiums Written	$4,841	$5,201	$5,591	$6,248	$7,421
Net Premiums Written	$3,914	$4,205	$4,235	$4,544	$5,370
Net Income (Loss)	($1,740)	($4,986)	($2,460)	($2,908)	($4,954)
Cash From Operations	($2,078)	($5,597)	($3,511)	($900)	$575

* Includes only pure mortgage guaranty writers (only writing MG)

State Regulators' Ongoing Efforts to Make Adjustments to MI Regulations

State insurance regulators are actively studying what changes are deemed necessary to the solvency regulation of mortgage guaranty insurers. The NAIC's Mortgage Guaranty Insurance (E) Working Group was formed by the Financial Condition (E) Committee in late 2012. This Working Group is assessing what changes should be made to the Model Act, and each of the previously mentioned potential changes have been developed by this NAIC group.

[5] GAO Report: "FHA Mortgage Insurance: Applicability of Industry Requirements is Limited, but Certain Features could Enhance Oversight." September, 2013.

[6] Promontory Financial Group, LLC, *The Role of Private Mortgage Insurance in the U.S. Housing Finance* System. January, 2011.

In February 2013, the Working Group released a list of potential regulatory changes in which it identified the issues with mortgage guaranty insurance as it exists now. The primary problems are threefold:

1. The overconcentration of mortgage originations in only a few banks has increased the pressure on mortgage insurers to accept everything given to them by any single bank or risk losing all the business from that bank.

2. The cyclical nature of mortgage insurance means that periods of high profitability are followed by periods of varying duration of catastrophic loss.

3. The lack of incentives to continue adhering to strict underwriting standards during booming periods when there is no threat of discontinued business.

In addition to the previously mentioned potential changes to the NAIC model and a new Risk Based Capital formula specific to Mortgage Insurance, the following additional potential changes are being considered:

- The need for new reporting requirements that break out mortgage insurers' exposures to different levels of risk and are used as partial input into the minimum capital requirements.
- The need to prohibit captive reinsurance agreements between mortgage insurers and originating banks.
- The need to refer potential accounting issues to the NAIC's Statutory Accounting Principles (E) Working Group for further consideration as a longer term project than what the Working Group is focused on currently.

The Working Group's next steps are to expose a concept draft of a new model for public comment and debate.

Financial Guaranty Insurance

I understand that you are also interested in bond insurers (also known as "Financial Guarantors"). Since Arizona is not a domestic regulator for a financial guarantor, I have limited expertise in the area and encourage the committee to discuss the regulation of these insurers with a state that regulates one of the remaining financial guarantors. Nevertheless, as an experienced insurance regulator, I do have some thoughts on the state of the industry. Bond insurers are distinct from other property casualty insurers. Their business is based almost exclusively on selling their credit rating to other parties. This niche industry developed in the early 1970's and initially focused on wrapping AAA ratings around lower rated municipal obligations for a small fee. Bond insurance benefitted municipalities by both increasing the market for their bonds and lowering their net costs. In the 1990's, bond insurers expanded their business into structured products like Asset Backed Securities, Credit Default Swaps, and Collateralized Debt Obligations. These more complicated investment vehicles, some of which were tied to subprime-backed mortgages, exposed bond-insurers to greater risk, which became painfully evident during the financial crisis.

Since the crisis, the structured bond insurance market has basically dried up. The bond industry struggled to remain relevant following the 2008 economic crisis and ensuing housing crash. The industry declined to only two affiliated active writers, who are only writing coverage on traditional municipal business, and are rated AA- by Standard and Poor's.

Gross written premiums for mono-line financial guarantors have steadily fallen over the past five-year period, from $4.4 billion in 2007 to $1.2 billion at year-end 2011. Gross paid losses peaked in 2009 at $10.8 billion (mostly due to the four large insurers), compared to $110.6 million for 2007, with reported losses of $3.4 billion at year-end 2011. Contingency reserves totaled $6.1 billion at year-end 2011 compared to $8.7 billion for 2007, before the financial crisis started.

On a positive note, this has opened the door for new participants, as newly established insurers and surviving players compete to meet the continued demand for bond insurance for municipal obligations. There have been two recent entrants who have written $8 million in traditional municipal business as of mid-year 2013 – one is rated AA- and the other is rated AA by Standard and Poor's. The 2008 crisis dramatically illustrated the risk inherent to many of the structured products linked to the mortgage market that financial guarantors were seeking to insure.

Current Legislative Proposals

State regulators working through the NAIC recognize the important role that PMI continues to play in the housing market and the role that recent legislative proposals contemplate the PMIs and the financial guarantors playing in that market. While, at this time, the NAIC has not taken a position on any of these legislative proposals including S. 1217, the bi-partisan Housing Reform bill introduced by Senators Corker and Warner, we certainly appreciate the need for and the efforts by Congress to address the issues that arose during the financial crisis with the housing finance system and the GSEs. We recognize that there are many who would like a more prominent role for the private market in housing finance markets and less reliance on the GSEs, and insurance regulators remain committed to helping Congress shape such proposals.

However, any effective proposal needs to take into account the existing regulatory regime and the lessons state insurance regulators learned during the crisis. In this regard, we caution against solutions that solely or substantially rely on the use of private mortgage insurers and financial guarantors as the lubricant for the housing market engine. Private mortgage insurers appropriately insure individual loans and, to date, there has been little experience with their insuring securities. Indeed, there may be regulatory concerns with expansion into this business as they could in some cases take on risks in the same loan or type of loan as both a guarantor of the securities and the insurer of the individual loan. Conversely, financial guarantors have substantial experience in the area but failed to live up to expectations during financial crisis and, given our experience to date, insurance regulators remain skeptical of their capability of insuring anything other than municipal debt – particularly if the underlying financial instrument they seek to insure is not appropriately capitalized and secure. Reliance on these entities should not be considered the "magic bullet" that will fix the housing finance market. Moreover, throughout this process, neither PMI nor financial guaranty insurance should be seen as a substitute for due diligence or sound underwriting by mortgage servicers or bond issuers.

The NAIC is concerned with proposals for a new federal regulator with the authority to develop, adopt, and publish standards for the approval of insurers that provide first loss coverage for individual loans (such as the PMIs) or provide coverage for eligible bonds. While insurance regulators recognize that any new federal entity charged with establishing and maintaining the requirements surrounding a government guarantee has a strong interest in ensuring that taxpayers are not left with the bill, appropriate deference should be given to existing state insurance regulatory requirements such as capital and reserving requirements that are designed with the dual purpose of protecting policyholders and ensuring competitive insurance markets. The incentive is simply too great for a regulator charged with maintaining the viability of a government guarantee to overshoot this regulatory objective and put in place standards, particularly solvency standards such as capital requirements, that are more stringent than necessary. This would ultimately threaten the availability of coverage and undermine the objective of a private market solution to support a vibrant housing market for the future.

We would propose that any new federal entity defer to the state regulators' supervision of the companies within their purview, which are designed to protect policyholders and ensure availability of coverage. Instead, the focus should be on establishing standards for any unregulated entities that may participate in the housing finance framework and create standards relating to the establishment and administration of any new government guarantee. If there are issues of common concern that arise, federal regulators should work hand in hand with the insurance regulators to address them, as is done today with the Federal Housing Finance Administration, the Federal Reserve, and the other federal financial regulatory agencies.

Conclusion

As the GAO recently affirmed, U.S. insurance regulators have a strong track record of effective supervision of insurers, even in the face of the worst financial crisis since the Great Depression.[7] The NAIC and state regulators are committed to working alongside Congress and federal banking regulators to help ensure open, competitive, and stable housing and mortgage insurance markets that promote investment in home ownership while protecting both lenders and borrowers.

The NAIC looks forward to contributing meaningful input as insurers, lenders, borrowers, policyholders, and the federal government work together to develop a new framework for housing regulatory structure in the U.S. Together, we will meet any new challenges posed by a dynamic housing market. We remain committed to effective regulation of the PMI and financial guaranty industries, and to making changes to our regulatory structure where necessary. We continue to believe that well-regulated markets make for competitive markets and well-protected policyholders.

Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions.

[7] GAO Report 13-583: "Insurance Markets: Impacts of and Regulatory Response to the 2007-2009 Financial Crisis." June 2013.

APPENDIX A

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, not exceeding ninety-five percent (95%) 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 lien or charge on real estate; provided:

(1) The real estate loan secured in this manner is one of a type that a bank, savings and loan association, or an insurance company, which is supervised and regulated by a department of this state 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 building or buildings designed for occupancy as specified by Subsections A(1) and A(2) of this section; and

(3) The lien on the real estate may be subject to and subordinate to the following:

(a) The lien of any public bond, assessment or tax, when no installment, call or payment of or under the bond, assessment or tax is delinquent; and

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(b) Outstanding mineral, oil, water or timber rights, rights-of-way, easements or rights-of-way of support, sewer rights, building restrictions or other restrictions or covenants, conditions or regulations of use, or outstanding leases upon the real property under which rents or profits are reserved to the owner thereof.

B. "Contingency reserve" means an additional premium reserve established to protect policyholders against the effect of adverse economic cycles.

C. "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 note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, provided the improvement on the real estate is a residential building or a condominium unit or buildings designed for occupancy by not more than four families;

(2) Insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, providing the improvement on the real estate is a building or buildings designed for occupancy by five (5) or more families or designed to be occupied for industrial or commercial purposes; and

(3) 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, provided the improvement on the real estate is a building or buildings designed to be occupied for industrial or commercial purposes.

Section 3. Capital and Surplus

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 $1,000,000 and paid-in surplus of at least $1,000,000, or if a mutual insurance company, a minimum initial surplus of $2,000,000. A stock company or a mutual company shall at all times thereafter maintain a minimum policyholders' surplus of at least $1,500,000.

Section 4. Insurer's Authority to Transact Business

No mortgage guaranty insurance company may issue policies until it has obtained from the commissioner of insurance a certificate setting forth that fact and authorizing it to issue policies.

Section 5. Geographic Concentration

A. A mortgage guaranty insurance company shall not insure loans secured by a single risk in excess of ten percent (10%) of the company's aggregate capital, surplus and contingency reserve.

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B. No mortgage guaranty insurance company shall have more than twenty percent (20%) of its total insurance in force in any one Standard Metropolitan Statistical Area (SMSA), as defined by the United States Department of Commerce.

C. The provisions of this section shall not apply to a mortgage guaranty insurance company until it has possessed a certificate of authority in this state for three (3) years.

Section 6. Advertising

No mortgage guaranty insurance company or an agent or representative of a mortgage guaranty insurance company shall prepare or distribute or assist in preparing or distributing any brochure, pamphlet, report or any form of advertising to the effect that the real estate investments of any financial institution are "insured investments," unless the brochure, pamphlet, report or advertising clearly states that the loans are insured by mortgage guaranty insurance companies possessing a certificate of authority to transact mortgage guaranty insurance in this state or are insured by an agency of the federal government, as the case may be.

Section 7. Investment Limitation

A mortgage guaranty insurance company shall not invest in notes or other evidences of indebtedness secured by 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 contracts of sale are acquired in the course of the 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.

Section 8. Coverage Limitation

A mortgage guaranty insurance company shall limit its coverage net of reinsurance ceded to a reinsurer in which the company has no interest to a maximum of twenty-five percent (25%) of the entire indebtedness to the insured or in lieu thereof, a mortgage guaranty insurance company may elect to pay the entire indebtedness to the insured and acquire title to the authorized real estate security.

Section 9. Mortgage Guaranty Insurance as Monoline

A. 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.

B. A mortgage guaranty insurance company that anywhere transacts the classes of insurance defined in Section 2A(2) or 2A(3) is not eligible for a certificate of authority to transact in this state the class of mortgage guaranty insurance defined in Section 2A(1). However, a mortgage guarantee insurance company that transacts a class of insurance defined in Section 2A may write up to five percent (5%) of its insurance in force on residential property designed for occupancy by five (5) or more families.

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Section 10. Underwriting Discrimination

A. Nothing in this chapter shall be construed as limiting the right of a mortgage guaranty insurance company to impose reasonable requirements upon the lender with regard to the terms of a note or bond or other evidence of indebtedness secured by a mortgage or deed of trust, such as requiring a stipulated down payment by the borrower.

B. No mortgage guaranty insurance company may discriminate in the issuance or extension of mortgage guaranty insurance on the basis of the applicant's sex, marital status, race, color, creed or national origin.

C. No policy of mortgage guaranty insurance, excluding policies of reinsurance, shall be written unless and until the insurer has conducted a reasonable and thorough examination of the evidence supporting credit worthiness of the borrower and the appraisal report reflecting market evaluation of the property and has determined that prudent underwriting standards have been met.

Section 11. Policy Forms and Premium Rates Filed

A. All policy forms and endorsements shall be filed with and be subject to the approval of the commissioner. With respect to owner-occupied, single-family dwellings, the mortgage guaranty insurance policy shall provide that the borrower shall not be liable to the insurance company for any deficiency arising from a foreclosure sale.

B. In addition, each mortgage guaranty insurance company shall file with the department the rate to be charged and the premium including all modifications of rates and premiums to be paid by the policyholder.

C. Every mortgage guaranty insurance company shall adopt, print and make available a schedule of premium charges for mortgage guaranty insurance policies. Premium charges made in conformity with the provisions of this Act shall not be deemed to be interest or other charges under any other provision of law limiting interest or other charges in connection with mortgage loans. The schedule shall show the entire amount of premium charge for each type of mortgage guaranty insurance policy issued by the insurance company.

NOTE: Open rating states may delete a portion or all of this provision and insert their own rating law.

Section 12. Outstanding Total Liability

A mortgage guaranty insurance company shall not at any time have outstanding a total liability, net of reinsurance, under its aggregate mortgage guaranty insurance policies exceeding twenty-five (25) times its capital, surplus and contingency reserve. In the event that any mortgage guaranty insurance company has outstanding total liability exceeding twenty-five (25) times its capital, surplus and contingency reserve, it shall cease transacting new mortgage guaranty business until such time as its total liability no longer exceeds twenty-five (25) times its capital, surplus and contingency reserve. Total outstanding liability shall be calculated on a consolidated basis for all mortgage guarantee insurance companies that are part of a holding company system.

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Section 13. Rebates, Commissions and Charges

A. 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 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. In connection with the placement of any mortgage guaranty insurance, a mortgage guaranty insurance company shall not cause or permit any commission, fee, remuneration or other compensation to be paid to, or received by an insured lender or lessor; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity in which an insured or an officer, director or employee or any member of their immediate family has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing.

C. No mortgage guaranty insurance company shall make a rebate of any portion of the premium charge shown by the schedule required by Section 11C. No mortgage guaranty insurance company shall 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. 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 or makes an unlawful rebate 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.

Section 14. Compensating Balances Prohibited

Except for commercial checking accounts and normal deposits in support of an active bank line of credit, a mortgage guaranty insurance company, holding company or any affiliate thereof is prohibited from maintaining funds on deposit with the lender for which the mortgage guaranty insurance company has insured loans. Any deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit in excess of amounts insured by an agency of the federal government shall be presumed to be an account in violation of this section. Furthermore, a mortgage guaranty insurance company shall not use compensating balances, special deposit accounts or engage in any practice that unduly delays its receipt of monies due or that involves the use of its financial resources for the benefit of any owner, mortgagee of the real property or any interest therein or any person who is acting as agent, representative, attorney or employee of the owner, purchaser or mortgagee as a means of circumventing any part of this section.

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Section 15. 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, pay any commissions, remuneration, rebates or engage in activities proscribed in Sections 13 and 14.

Section 16. 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 of insurance.

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 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 policy provisions.

C. Contingency Reserve

Each mortgage guaranty insurance company shall establish a contingency reserve out of net premium remaining (gross premiums less premiums returned to policyholders net of reinsurance) after establishment of the unearned premium reserve. The mortgage guaranty insurance company shall contribute to the contingency reserve an amount equal to fifty percent (50%) of the remaining unearned premiums. Contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months, except that withdrawals may be made by the company in any year in which the actual incurred losses exceed thirty-five percent (35%) of the corresponding earned premiums, and no releases shall be made without prior approval by the commissioner of insurance of the insurance company's state of domicile.

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If the coverage provided in this Act exceeds the limitations set forth herein, the commissioner of insurance shall establish a rate formula factor that will produce a contingency reserve adequate for the added risk assumed. The face amount of an insured mortgage shall be computed before any reduction by the mortgage guaranty insurance company's election to limit its coverage to a portion of the entire indebtedness.

D. Reinsurance

Whenever a mortgage guaranty insurance company obtains reinsurance from an insurance company that is properly licensed to provide reinsurance or from an appropriate governmental agency, the mortgage guaranty insurer and the reinsurer shall establish and maintain the reserves required in this Act in appropriate proportions in relation to the risk retained by the original insurer and ceded to the assuming reinsurer so that the total reserves established shall not be less than the reserves required by this Act.

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 17. 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).

1976 Proc. II 15, 17, 647, 686, 747-753 (adopted).
1979 Proc. I 44, 47-48, 49, 719, 968-969 (corrected).

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