Mortgage Insurance Companies of America

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Federal Trade Commission
Office of the Secretary
Room H-135 (Annex T)
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: Mortgage Acts and Practices Rulemaking, Rule No. R911004

Dear Sir or Madam:

On behalf of the Mortgage Insurance Companies of America (MICA), I am writing with regard to the Federal Trade Commission (FTC) Advance Notice of Proposed Rulemaking (ANPR) on mortgage-lending acts and practices [74 FR 26118]. MICA is strongly committed to borrower protection and we thus support the intent of the FTC's ANPR. MICA urges quick action on a concrete proposal that contributes to the efforts to remedy the lapses in consumer protection that contributed to the current crisis.

MICA has written over the years repeatedly to all of the banking agencies urging regulatory improvements that protect borrowers by ensuring their long-term ability to repay a mortgage obligation, and we welcome the FTC's involvement in this effort. Working with the bank regulators and the Federal Housing Finance Agency (FHFA), the FTC can play a critical role in improving mortgage disclosure, lending and underwriting standards. However, these reforms must be uniformly imposed and apply to all market participants, not just to those directly subject to FTC rulemaking. Any variation among regulatory standards could quickly lead to a "race to the bottom" in mortgage lending, resulting in a costly repetition of all the failures that led to the current crisis for borrowers, communities, the financial system and even the U. S. economy as a whole.

Private mortgage insurance (MI) provides regulated, capitalized credit risk mitigation that protects lenders and the government-sponsored enterprises (GSEs) on mortgages with high loan-to-value (LTV) ratios. Credit risk mitigation means that MIs pay valid claims when a mortgage defaults, taking a first-loss position that ensures payment to lenders and other mortgage investors to reduce their risk of loss. Because MI is regulated by the states and well-capitalized, bank regulators have long provided loans backed by MI with a regulatory-

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capital charge lower than the risk-based requirement for loans without MI.[1] Reflecting the importance and value of MI, the charter requirements for Fannie Mae and Freddie Mac require that one of three forms of credit risk mitigation, specifically mentioning qualified insurance, be obtained when LTVs of loans purchased by the GSEs exceed eighty percent.[2]

MI is subject to counter-cyclical capital requirements that require segregation of contingency reserves equal to fifty percent of each premium dollar. This ensures that MIs can meet claims even under catastrophic scenarios – as MICA members are doing now. However, borrowers also receive significant protection when MI is used. Borrowers can be assured that an independent third party is convinced that they have a reasonable chance of staying in the home they are purchasing or refinancing if MI has approved the mortgage loan requested. MI is "skin in the game" – that is, private capital remaining at risk over the life of the mortgage regardless of which entity holds the mortgage at any point in time. This eliminates the disconnect between the incentives of the loan originator, who originates with intent to sell the mortgage to another party without ongoing risk, and those of the borrower, who remains obligated on the mortgage regardless of who owns it. The disconnect between these incentives sparked the current foreclosure crisis.

However, MI bridges this gap by remaining at risk in a first loss position. To protect its position the MI performs a second independent loan analysis at origination, resulting in independent loan underwriting that ensures disciplined origination and long-term borrower protection. Data MICA would be pleased to present to the FTC demonstrate that loans backed by private mortgage insurance are suffering significantly fewer foreclosures than alternative structures such as "piggyback" mortgages in which simultaneous second liens were used to avoid a second underwriting so as to put borrowers into mortgages that they could not afford. Borrowers who took out these alternative mortgages are also now facing serious obstacles to loan modification that do not occur when MI is provided on a first lien. Again, the mortgage insurer's incentive is aligned with the borrower to avoid foreclosure and prevent any unnecessary claims.

Key points in this comment letter include:

- Certain mortgage practices are so risky that they should be flatly prohibited. All mortgage underwriting must ensure

[1] See for example 12 CFR 3, appendix A.
[2] See 12 U.S.C. § 1717 and 12 U.S.C. § 1454 respectively for Fannie Mae and Freddie Mac.

the borrower's ability to repay over the long-term on fully-amortized, fully-indexed terms and conditions, including calculation of taxes, insurance, etc. The anticipated repayment of a loan instrument should never depend on home price appreciation or the borrower's ability to refinance within a few years.

- Mortgage servicing practices related to foreclosures should be improved to enhance borrower protection. Appropriate practices include verification of the claim, adequate time for the borrower to remedy a deficiency, and immediate contact with the borrower explaining the consequences of delinquency and the available options to satisfy or modify the loan.

- Clear, up-front disclosures are vital to consumer protection and considerable improvement in current advertising, offering, and closing disclosures is required to enhance borrower protection.

Based on these views, MICA supports new FTC rules – not case-by-case enforcement actions -- prohibiting unfair and deceptive acts and practices (UDAP) in the mortgage sector. Enforcement proceedings are often complex, fact driven cases against smaller firms which can be difficult to transform into generalized market best practices. MICA believes the best way to protect consumers is prospectively through the adoption of a clear set of rules necessary to ensure broad market adoption of best practices. FTC resources are most effectively deployed prosecuting rule violations, not going case by case to ascertain if variable practices meet vague UDAP criteria. Further, borrowers are far better protected when originators – the vast majority of which seek to comply with all applicable requirements – know the rules up front.

As noted, we urge the FTC to work carefully with all relevant agencies to ensure uniform mortgage-origination standards. The HOEPA rules [73 FR 44521] promulgated by the Federal Reserve Board are an improvement in this area, but they are not sufficient to ensure long-term borrower protection. MICA also recommends that the FTC work with the Federal Housing Finance Agency to ensure that the GSEs only purchase mortgages that comply with all applicable regulatory safeguards.

Mortgage-Market Context

Extensive experience in mortgage underwriting by MICA members has shown that the two main drivers of mortgage performance are the total equity position of the borrower relative to the home (the amount of all liens relative to the value of the home or the combined LTV) and the borrower's credit history and ability to manage debt. There are, however, other layers of risk that dramatically affect loan performance. These include loan documentation and income/asset validation, loan purpose (primary residence, investor property, second home), loan terms and structure, and the borrower's income and debt ratios.

Given the impact of these risk layers to the repayment of the loan and the compounding effect that they have when taken together, MICA believes that the FTC should recognize the importance of risk layering in its rulemaking by placing limits on risk layering to protect vulnerable consumers and reduce mortgage market volatility.

MICA understands that the mortgage market will continue to innovate and evolve, and believes that an effective mortgage regulator should have the flexibility to monitor emerging market trends for products that could unduly harm consumers. The recent surge in foreclosure rates tied to certain mortgage structures and layered risk products suggests that there may be a need to determine an unacceptable rate of foreclosures which would trigger a review of the mortgage structure or risk layer involved.

Specific Comments

Throughout the ANPR, the FTC rightly seeks views on whether any actions it might take would be disproportionately disruptive to the firms it governs if not otherwise applicable to banks, savings associations and credit unions. Below, MICA provides our views on the general policy issues raised in the ANPR to promote rapid FTC action on specific proposals. We urge the FTC to stipulate best practice in its rules and move them quickly to finalization regardless of the limited scope of its regulatory purview. This would at least ensure robust consumer protection for a segment of the mortgage market, one perhaps most vulnerable to abuse because of the lack of coverage by other federal regulators. At the same time, the FTC should, as noted above, work closely with the bank regulators and Federal Housing Finance Agency to ensure that its standards are applied broadly throughout the mortgage market. Even if the bank regulators fail to act or differ with the FTC on details, action by the GSE regulator would ensure that all loans sold into the secondary market through firms now

backed by billions in taxpayer dollars ensure long-term borrower protection.

1. Prohibited Products

In questions 6 through 10, the FTC seeks views on whether individual mortgage origination practices should be limited, banned or otherwise regulated. MICA urges the FTC to stipulate that certain mortgage products are so problematic that they should be flatly prohibited for a borrower's primary residence. Loan structures that may be appropriate for investment or vacation homes are simply unsuitable for primary residences, the loss of which in foreclosure exacts untold harm to borrowers, communities and the nation as a whole. The destructive impact of certain mortgage practices on consumers and market conditions is now evident. Although the Federal Reserve's HOEPA rule restricted some practices, and we urge the FTC to enforce these restrictions by incorporating them into its own rules as contemplated by question 9, the Board's rule continues to allow them for certain market segments. We believe that certain mortgage practices are so risky that they should be flatly prohibited for all borrowers.

MICA particularly believes that the FTC should focus on the non-traditional mortgage products addressed in question 7. Prohibited products should include no- and low-documentation loans, negative amortization loans and piggybacks (which, as noted above, are loans originated with simultaneous first and second liens to evade requirements applicable to banks and GSEs for third-party credit enhancement like private mortgage insurance). In addition, second liens that result in a combined LTV over ninety percent and refinancings of first liens with an LTV above ninety percent should be barred. The planned repayment of loan instruments should never depend on home price appreciation or the ability of borrowers to refinance within a few years, but each of these products in fact cannot be underwritten with any prospect of repayment without assuming continued price appreciation for the house that collateralizes the mortgage. This of course puts the borrower at immediate risk of foreclosure if house prices stagnate or fall at a time when the borrower has few, if any, resources with which to continue to meet their mortgage obligations under stressed conditions such as loss of employment.

In response to question 6 on restricting origination practices for all types of mortgages, MICA recommends that all mortgage underwriting must ensure a long-term ability to repay on fully-amortized, fully-indexed terms and conditions, including the

calculation of taxes and insurance. The Federal Reserve's HOEPA rule has done this, but only to a limited extent. MICA does not believe that any borrower should take out a loan that cannot be repaid under any and all of its terms, especially since the more complex a mortgage, the less likely a consumer is to understand his or her risk as these terms and conditions change over time. In response to question 9, therefore, we recommend that the FTC go further than the Board's rule and fully realize the goal of ensuring a borrower's long-term ability to repay. This prohibition should also include loan modifications and repayment plans, as asked by question 20(d).

2. Servicer Responsibilities

The foreclosure crisis has also shown a need for reform in the mortgage servicing sector. The servicer serves as the direct contact to the borrower concerning the status of the mortgage payment and the obligations remaining under the mortgage. The borrower, the mortgage holder and the MI rely on the servicer to provide the borrower with accurate and timely information. The FTC rightly focuses on servicer obligations and seeks comment on them in questions 16 through 22.

Regarding question 20, MICA believes that mortgage servicing practices related to foreclosures should be improved to enhance borrower protection. Servicers should have to first verify loan information and investigate disputes, as suggested by question 20(a). As asked in question 20(b), the borrower should also be given adequate time to remedy a deficiency. Additionally, servicers should be required to make immediate contact with the borrower to explain the delinquency and options to eliminate or modify the loan.

3. Disclosures

In response to questions 7, 8, and 17, MICA reiterates its support for improved disclosure practices. With respect to all loan originations under question 8, we believe that simple disclosures must be included to give consumers an accurate and thorough understanding of the mortgage instrument. True consumer understanding of the loan product and its terms is key to the success of every mortgage. Borrowers must be made aware of the critical loan terms including loan payments, payment duration, and amortization. Regarding the non-traditional products of question 7, MICA urges that adjustable-rate mortgage (ARM) loans should clearly and simply disclose the index, margin, periodic and life caps, including examples of the largest and smallest payments required. Loan disclosures also should spell out the worst-case scenario for borrowers by detailing all the consequences of

nonpayment including the calculation of late fees and applicable timelines to foreclosure, as asked by question 17.

We hope that our comments are found to be useful and MICA stands ready to provide the Commission with further information if desired.

Sincerely,

Suzanne C. Hutchinson