

MORTGAGE GUARANTY INSURANCE MODEL ACT

Table of Contents

Section 1.	Title
Section 2.	Definitions
Section 3.	Insurer's Authority to Transact Business
Section 4.	Mortgage Guaranty Insurance as Monoline
Section 5.	Risk Concentration
Section 6.	Capital and Surplus
Section 7.	Capital Standards
Section 8.	Reserves
Section 9.	Investment Restrictions
Section 10.	Reinsurance
Section 11.	Underwriting Standards
Section 12.	Quality Assurance
Section 13.	Conflict of Interest
Section 14.	Rebates, Commissions, Charges and Contractual Preferences
Section 15.	Policy Forms and Premium Rates Filed
Section 16.	Rescission
Section 17.	Records Retention
Section 18.	Mortgage Guaranty Insurance Standards Manual
Section 19.	Regulations

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:
- (1) An amortized note, bond or other instrument of indebtedness, except for reverse mortgage loans made pursuant to [insert citation of state law that authorizes reverse mortgages] of the real property law, evidencing a loan, not exceeding one hundred three percent (103%) 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 or junior lien or charge on real estate, with any percentage in excess of one hundred percent (100%) being used to finance the fees and closing costs on such indebtedness; provided:
 - (a) The real estate loan secured in this manner is one of a type that a creditor, which is supervised and regulated by a department of any state or territory of the United States of America 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;
 - (b) The improvement on the real estate is a:

- (i) Residential building designed for occupancy by not more than four families, a one-family residential condominium or unit in a planned unit development, or any other one-family residential unit as to which title may be conveyed freely; or
 - (ii) Mixed-use building with only one non-residential use and one one-family dwelling unit; or
 - (iii) Building or buildings designed for occupancy by five (5) or more families or designed to be occupied for industrial or commercial purposes.
 - (c) The lien on the real estate may be subject to and subordinate to other liens, leases, rights, restrictions, easements, covenants, conditions or regulations of use that do not impair the use of the real estate for its intended purpose.
- (2) An amortized note, bond or other instrument of indebtedness evidencing a loan secured by an ownership interest in, and a proprietary lease from, a corporation or partnership formed for the purpose of the cooperative ownership of real estate and which at the time the loan does not exceed one hundred three percent (103%) of the fair market value of the ownership interest and proprietary lease, if the loan is one of a type that meets the requirements of Section A(1)(a) In this Act, unless the context clearly requires otherwise, any reference to a mortgagor shall include an owner of such an ownership interest as described in this paragraph and any reference to a lien or mortgage shall include the security interest held by a lender in such an ownership interest.
- B. “Book year” refers to the year in which the mortgage originated.
 - C. “Book year group” consists of each of the last ten years and the aggregate of all book years prior to the most recent ten years.
 - D. “Bulk Mortgage Guaranty Insurance” means mortgage guaranty insurance that provides coverage under a single transaction on each mortgage loan included in a defined portfolio of loans that have already been originated.
 - E. “Capital Plan” means a comprehensive financial plan containing the elements specified in Section 7.
 - F. “Capital Reporting” means a Capital Plan, State Regulatory Mortgage Insurer Capital Standard Report, or other capital or reserve adequacy analysis requested by the Commissioner and submitted by a mortgage guaranty insurance company.
 - G. “Certificate” means a document issued by a mortgage guaranty insurance company to evidence that it has insured a particular authorized real estate security under a master policy and which describes the particular characteristics, terms and conditions of that insured authorized real estate security.
 - H. “Commissioner” means [insert the title of the principal insurance supervisory official] of this state, or the [insert the title of the principal insurance supervisory official]’s deputies or assistants, or any employee of the [insert name of the principal insurance regulatory agency] of this state acting in the [insert the title of the principal insurance supervisory official]’s name and by the [insert the title of the principal insurance supervisory official]’s delegated authority.

- I. “Contingency reserve” means an additional premium reserve established to protect policyholders against the effect of adverse economic cycles.
- J. “Corrective order” means an order issued by the Commissioner specifying insurer corrective actions which the Commissioner has determined to be required.
- K. “Domiciliary Commissioner” means the principal insurance supervisory official of the jurisdiction in which a mortgage guaranty insurance company is domiciled, or that principal insurance supervisory official’s deputies or assistants, or any employee of the regulatory agency of which that principal insurance supervisory official is the head acting in that principal insurance supervisory official’s name and by that principal insurance supervisory official’s delegated authority.
- L. “Effective guaranty” refers to the assumed backing of existing or future holders of securities by virtue of their issuer’s conservatorship or perceived access to credit from the U.S. Treasury, as opposed to the direct full faith and credit guarantee provided by the U.S. government.
- M. “Foreign insurer” means any insurance company which is licensed to do business in this state (cite statute) but not domiciled in this state.
- N. “Loss” refers to losses and loss adjustment expenses, excluding costs which have already been expensed.
- O. “Master policy” means a document issued by a mortgage guaranty insurance company to a creditor or mortgage-holding entity that establishes the terms and conditions of mortgage guaranty insurance coverage provided thereunder, including any endorsements thereto.
- P. “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 authorized real estate security; and
 - (2) 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.
- Q. “Mortgage Guaranty Insurance Loan Level Report” means a detailed loan level cash flow projection based on the guidance for such reports contained in the *Mortgage Guaranty Insurance Standards Manual*.
- R. “Mortgage Guaranty Insurance Standards Manual” means the current version of the *Mortgage Guaranty Insurance Standards Manual* developed and adopted by the National Association of Insurance Commissioners and as amended from time to time as set forth in Section 18 of this Act.
- S. “Mortgage Guaranty Quality Control Program” means an early detection warning system for potential underwriting compliance issues which could potentially impact solvency or operational risk within a mortgage guaranty insurance company.
- T. “NAIC” means the National Association of Insurance Commissioners.

- U. “Net risk in force” means risk in force after giving effect to reinsurance.
- V. “Pool Mortgage Guaranty Insurance” means mortgage guaranty insurance that provides coverage under a single transaction or a defined series of transactions on a defined portfolio of loans for losses up to an aggregate limit.
- W. “Right of rescission” represents a remedy available to a mortgage guaranty insurance company to void a certificate and restore parties to their original position, based on inaccurate information provided to, or information concealed from, the mortgage guaranty insurance company in the insurance application, resulting in an insured loan which does not meet acceptable risk tolerance requirements in accordance with the mortgage guaranty insurance company’s underwriting standards.
- X. “Risk in force” means the mortgage guaranty insurance coverage percentage applied to the unpaid principal balance.
- Y. “SRMICS Action Level Event” means the event of a mortgage guaranty insurer filing a State Regulatory Mortgage Insurer Capital Standard Report which indicates that the insurer’s total adjusted capital is greater than or equal to its 51% of its State Regulatory Mortgage Insurer Capital Standard but less than its State Regulatory Mortgage Insurer Capital Standard.
- Z. “SRMICS Mandatory Control Level Event” means the event of a mortgage guaranty insurer filing a State Regulatory Mortgage Insurer Capital Standard Report which indicates that the insurer’s total adjusted capital is 50% or less than its State Regulatory Mortgage Insurer Capital Standard
- AA. “State Regulatory Mortgage Insurer Capital Standard” means the economically countercyclical risk-based margin of safety developed to recognize risk and control elements unique to the mortgage guaranty insurance industry, the calculation of which is described in the *Mortgage Guaranty Insurance Standards Manual*.
- BB. “State Regulatory Mortgage Insurer Capital Standard Report” means the report required by Section 7 of this Act prepared in form and substance as required by the *Mortgage Guaranty Insurance Standards Manual*.
- CC. “Total adjusted capital” means the sum of a mortgage guaranty insurance company’s statutory capital, surplus and contingency reserves as determined in accordance with the statutory accounting applicable to the annual financial statements required to be filed under [cite appropriate statute] and such other items as the *Mortgage Guaranty Insurance Standards Manual* may provide.

Section 3. Insurer’s Authority to Transact Business

A company may not transact the business of mortgage guaranty insurance until it has obtained a certificate of authority from the Commissioner.

Section 4. Mortgage Guaranty Insurance as Monoline

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.

Section 5. Risk Concentration

A mortgage guaranty insurance company shall not expose itself to any loss on any one authorized real estate security risk in an amount exceeding ten percent (10%) of its surplus to policyholders. Any risk or portion of risk which has been reinsured shall be deducted in determining the limitation of risk.

Section 6. Capital and Surplus

- A. **Initial and Minimum Capital and Surplus Requirements.** 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 \$10,000,000 and paid-in surplus of at least \$15,000,000, or if a mutual insurance company, a minimum initial surplus of \$25,000,000. A stock insurance company or a mutual insurance company shall at all times thereafter maintain a minimum policyholders' surplus of at least \$20,000,000.
- B. **Minimum Capital Requirements Applicability.** A mortgage guaranty insurance company formed prior to passage of this Act may maintain the amount of capital and surplus or minimum policyholders' surplus previously required by statute or administrative order for a period not to exceed twelve months following the effective date of the adoption of this Act.
- C. **Minimum Capital Requirements Adjustments.** The Commissioner may by order reduce the minimum amount of capital and surplus or minimum policyholders' surplus required under Subsection 6A for an affiliated reinsurer that is a mortgage guaranty insurance company and that is or will be engaged solely in the assumption of risks from affiliated mortgage guaranty insurance companies, provided that the affiliated reinsurer is in run-off and, in the Commissioner's opinion, the business plan and other relevant circumstances of the affiliated reinsurer justify the proposed reduction in requirements.

Section 7. Capital Standards

- A. **Capital Adequacy Measurement and Restrictions.** A mortgage guaranty insurance company shall measure capital adequacy and comply with related restrictions based on the State Regulatory Mortgage Insurer Capital Standard.
 - (1) **State Regulatory Mortgage Insurer Capital Standard Report.** A mortgage guaranty insurance company shall prepare and submit a State Regulatory Mortgage Insurer Capital Standard Report in accordance with Section 7(B)(1).
 - (2) **Mortgage Guaranty Insurance Loan Level Report.** A mortgage guaranty insurance company shall prepare a detailed loan level cash flow projection based on the guidance for such reports contained in the *Mortgage Guaranty Insurance Standards Manual* as of each calendar-quarter-end within ninety (90) days following the end of such calendar quarter. A

mortgage guaranty insurance company shall provide the Commissioner with these projections upon failure to meet its State Regulatory Mortgage Insurer Capital Standard until such time as the mortgage guaranty insurance company exceeds State Regulatory Mortgage Insurer Capital Standard or otherwise, for the most recent calendar quarter-end projection available, within ten (10) days upon request of the Commissioner.

- (3) **Business Writing Authority Requirements.** A mortgage guaranty insurance company shall cease writing new business until such time as it is no longer below its SRMICS Mandatory Control Level and, if applicable, it is no longer in a financially hazardous condition as determined by the Commissioner by an order issued in accordance with [insert citation(s) of applicable state authority and due process statutes or regulations].
- (4) **Dividend Restrictions.**
 - (a) A mortgage guaranty insurance company whose total adjusted capital is below its State Regulatory Mortgage Insurer Capital Standard shall not pay dividends to its shareholders and an affiliate of the insurer shall not accept such dividends.
 - (b) A mortgage guaranty insurance company that has made releases or provisional releases from the contingency reserve pursuant to Section 8(C)(3) at any time in the preceding twelve calendar months shall not pay dividends to its shareholders and an affiliate of the insurer shall not accept such dividends unless the insurer reports the dividends to the Domiciliary Commissioner at least 30 days in advance of the intended payment and the Domiciliary Commissioner does not disapprove the dividends within that period. All dividend requests shall be required to include:
 - i. A computation of the amount of ordinary dividends as defined under the laws of the mortgage guaranty insurance company's state of domicile;
 - ii. A computation of the amount of extraordinary dividends as defined under the laws of the mortgage guaranty insurance company's state of domicile; and
 - iii. Financial projections that disclose the adequacy of the mortgage guaranty insurance company's capital subsequent to the dividend payment based upon scenarios acceptable to the Domiciliary Commissioner.

B. Capital Reporting.

- (1) **Annual Reporting.** All mortgage guaranty insurance companies shall, on or prior to each March 31 filing date, prepare and submit a State Regulatory Mortgage Insurer Capital Standard Report as of the end of the calendar year just ended in a form and containing such information as required by the *Mortgage Guaranty Insurance Standards Manual* to the:
 - (a) Company's Domiciliary Commissioner; and
 - (b) NAIC.

- (2) **SRMICS Action Level Event** means the filing of a State Regulatory Mortgage Insurer Capital Standard Report by a mortgage guaranty insurance company which indicates that the insurer's total adjusted capital is greater than or equal to its 51% of its State Regulatory Mortgage Insurer Capital Standard but less than its State Regulatory Mortgage Insurer Capital Standard. A SRMICS Action Level Event shall require:
- (a) Insurer preparation and submission of a Capital Plan or revised Capital Plan to the Domiciliary Commissioner in accordance with requirements in Section 7(B)(4);
 - (b) Domiciliary Commissioner examination or analysis as deemed necessary of the assets, liabilities and operations of the insurer including a review of its Capital Plan; and
 - (c) Domiciliary Commissioner issuance of an order, subsequent to the examination or analysis, specifying such corrective actions as the Domiciliary Commissioner shall determine are required, taking into account such factors as are deemed relevant with respect to the insurer based upon the examination or analysis of the assets, liabilities and operations of the insurer, including but not limited to, the most recent Mortgage Guaranty Insurance Loan Level Report and the Capital Plan.
 - (d) Domiciliary Commissioner actions, if deemed in the best interests of the policyholders and creditors of the insurer and of the public, as necessary to cause the insurer to be placed under regulatory control or withdraw or limit the insurer's certificate of authority under [insert reference to relevant insurance company rehabilitation and liquidation act]. In the event the Domiciliary Commissioner takes such actions, the SRMICS Action Level Event shall be deemed sufficient grounds for the Domiciliary Commissioner to take action under [insert same reference], and the Domiciliary Commissioner shall have the rights, powers and duties with respect to the insurer as are set forth in [insert same reference]. In the event the Domiciliary Commissioner takes actions under this paragraph pursuant to a revised Capital Plan, the insurer shall be entitled to such protections as are afforded to insurers under the provisions of Section [insert reference] related to summary proceedings.
- (3) **SRMICS Mandatory Control Level Event** means the filing of a State Regulatory Mortgage Insurer Capital Standard Report by the mortgage guaranty insurer, which indicates that the insurer's total adjusted capital is 50% or less than its State Regulatory Mortgage Insurer Capital Standard. A SRMICS Mandatory Control Level Event shall require:
- (a) Domiciliary Commissioner actions as are necessary to place the insurer under regulatory control under [insert reference to relevant insurance company rehabilitation and liquidation act], or allow the insurer to continue its run-off under supervision of the Domiciliary Commissioner in the case of an insurer which is writing no business and running off its existing business. In the event the Domiciliary Commissioner takes such actions, the SRMICS Mandatory Control Level Event shall be deemed sufficient grounds for the Domiciliary Commissioner to take action under [insert same reference], and the Domiciliary Commissioner shall have the rights, powers and duties with respect to the insurer as are set forth in [insert same reference]. In the event the Domiciliary Commissioner takes actions under this paragraph pursuant to a revised Capital Plan, the

insurer shall be entitled to the protections which are afforded to insurers under the provisions of Section [insert reference] pertaining to summary proceedings.

- (b) Notwithstanding any of the foregoing, the Domiciliary Commissioner may forego actions for up to one year after the occurrence of the SRMICS Mandatory Control Level Event if there is a reasonable expectation that the SRMICS Mandatory Control Level Event may be eliminated within a period determined to be reasonable by the Domiciliary Commissioner.

(4) **Capital Plan Submission and Review Requirements.**

- (a) A failure to meet the State Regulatory Mortgage Insurer Capital Standard shall require the mortgage guaranty insurer to prepare and submit a Capital Plan to the Domiciliary Commissioner which shall:
 - i. Identify the conditions which contribute to its SRMICS Action Level Event;
 - ii. Contain proposals of corrective actions which the insurer intends to take and would be expected to result in the elimination of the SRMICS Action Level Event;
 - iii. Provide the results of the most recent Mortgage Guaranty Insurance Loan Level Report prepared in accordance with the *Mortgage Guaranty Insurance Standards Manual*;
 - iv. Provide projections of the insurer's financial results utilizing the most recent Mortgage Guaranty Insurance Loan Level Report, adjusted to give effect to the proposed corrective actions;
 - v. Identify the key assumptions impacting the insurer's projections and the sensitivity of the projections to the assumptions; and
 - vi. Identify the quality of and problems associated with the insurer's business, including but not limited to its assets, anticipated business growth and associated surplus strain, extraordinary exposure to risk, mix of business and use of reinsurance, if any.
- (b) The Capital Plan shall be submitted to the Domiciliary Commissioner within forty-five (45) days after the occurrence of the SRMICS Action Level Event.
- (b) The Domiciliary Commissioner shall notify the insurer whether the Capital Plan shall be implemented or is, in the judgment of the Domiciliary Commissioner, unsatisfactory within sixty (60) days after the submission by a mortgage guaranty insurance company.
- (c) The Domiciliary Commissioner's notification of an unsatisfactory Capital Plan shall set forth the reasons for the determination and may set forth proposed revisions which will render the Capital Plan satisfactory.
- (d) The insurer shall prepare a revised Capital Plan upon notification from the Domiciliary Commissioner, which may incorporate by reference any revisions proposed by the Domiciliary Commissioner and shall submit the revised Capital Plan to the Domiciliary Commissioner within forty-five (45) days after the notification.
- (e) Material changes to the capital position of the mortgage guaranty insurance company shall require the filing of a revised Capital Plan at the end of each quarter, following a SRMICS Action Level Event.

C. Foreign Insurer Requirements.

- (1) Any foreign insurer shall upon the written request of the Commissioner submit its State Regulatory Mortgage Insurer Capital Standard Report as of the end of the calendar year just ended within the later of:
 - (a) The date a State Regulatory Mortgage Insurer Capital Standard Report would be required to be filed by a domestic insurer under this Act; or
 - (b) Fifteen (15) days after the request is received by the foreign insurer.
- (2) Any foreign insurer shall, upon the written request of the Commissioner, promptly submit a copy of any Capital Plan that is filed with the insurance Commissioner of any other state.
- (3) The Commissioner may require a foreign insurer to file a Capital Plan within forty-five (45) days after the Commissioner's request upon the occurrence of a SRMICS Action Level Event or SRMICS Mandatory Control Level Event with respect to any foreign insurer as determined under the laws applicable to mortgage guaranty insurance in the state of domicile of the insurer (or if no such laws are in force in that state, under the provisions of this Act), if the Commissioner of the state of domicile of the foreign insurer fails to require the foreign insurer to file a Capital Plan in the manner specified under that state's laws. Failure of the foreign insurer to file a Capital Plan with the Commissioner shall be grounds to order the insurer to cease and desist from writing new insurance business in this state.
- (4) The Commissioner may make application to the [cite appropriate state court] permitted under the [cite rehabilitation and liquidation statute] with respect to the liquidation of property of foreign insurers found in this state and the occurrence of the SRMICS Mandatory Control Level Event shall be considered adequate grounds for the application, in the event of a SRMICS Mandatory Controls Level Event with respect to the foreign insurer if no domiciliary receiver has been appointed with respect to the foreign insurer under the rehabilitation and liquidation statute applicable in the state of domicile of the foreign insurer.

D. Retention of Consultants. If a mortgage guaranty insurer files a State Regulatory Mortgage Insurer Capital Standard Report or a Mortgage Guaranty Insurance Loan Level Report that indicates total adjusted capital of 125% or less of the mortgage guaranty insurer's State Regulatory Mortgage Insurer Capital Standard, or if an examination or investigation of a mortgage guaranty insurer has indicated material deficiencies in underwriting procedures or the Mortgage Guaranty Quality Control Program, the Domiciliary Commissioner may retain consultants, including accountants, attorneys, investment bankers, actuaries and other experts to assist in the assessment of the mortgage guaranty insurance company's financial condition, exposure to claims loss and credit, liquidity, or other risks, along with related remediation plans and reported information submitted by the mortgage guaranty insurance company. All costs associated with the work of consultants retained for such assessment shall be borne by the mortgage guaranty insurance company that is the subject of the assessment.

E. Confidentiality. Capital Reporting shall be subject to the following confidentiality provisions:

- (1) All Capital Reporting (to the extent the information therein is not required to be set forth in a publicly available annual statement schedule) and Capital Plans that are in the possession or control of respective departments of insurance (including the results or report of any examination or analysis of a mortgage guaranty insurance company performed pursuant hereto and any corrective order issued by the Commissioner pursuant to examination or analysis) with respect to any insurer shall be confidential by law and privileged, not subject to [insert open records, freedom of information, sunshine or other appropriate provisions], and not subject to subpoena or discovery and not admissible in evidence in any private civil action.
- (2) The Commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the Commissioner's official duties.
- (3) Neither the Commissioner nor any person who received documents, materials or information while acting under the authority of the Commissioner shall be permitted or required to testify in any private civil action concerning any confidential documents, materials or information related to a mortgage guaranty insurance company's Capital Reporting.

- F. **Protection of Integrity of Capital Standards.** The State Regulatory Mortgage Insurer Capital Standard calculation shall incorporate monitoring of the company's aggregate net risk in force to ensure it shall not exceed twenty-five (25) times its capital, surplus and contingency reserve. In the event that any mortgage guaranty insurance company's aggregate net risk in force exceeds twenty-five (25) times its capital, surplus and contingency reserve, it shall be deemed a SRMICS Action Level Event and subject to the requirements under Section 7 (B)(2).

Drafting Note: While the risk-to-capital standard itself is insufficient to account for differences in risk among numerous varieties of mortgage loans offered in the United States, the purpose of Section 7F is to allow for a reasonable period of time in which insurance regulators and the public at large can test and establish confidence in the new State Regulatory Mortgage Insurer Capital Standard. It is further intended to prevent future changes to, and developments in, the capital standards resulting in weaker standards than established in the previous version of this Mortgage Guaranty Insurance Model Act.

Section 8. Reserves

- A. **Unearned Premium Reserves.** A mortgage guaranty insurance company shall compute and maintain an unearned premium reserve as provided in the accounting practices and procedures prescribed or permitted by the applicable accounting practices and procedures manual of the National Association of Insurance Commissioners.
- B. **Loss Reserve.** A mortgage guaranty insurance company shall compute and maintain adequate case basis and other loss reserves as provided in the accounting practices and procedures prescribed or permitted by the applicable accounting practices and procedures manual of the National Association of Insurance Commissioners. Loss reserves shall 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 master 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 the master policy provisions.

C. **Contingency Reserve.** Each mortgage guaranty insurance company shall establish a contingency reserve subject to the following provisions:

- (1) The mortgage guaranty insurance company shall make an annual contribution to the contingency reserve which in the aggregate shall be equal to fifty percent (50%) of the net earned premiums reported in the annual statement.
- (2) Except as provided in Section 8(C)(3) of this Act, a mortgage guaranty insurance company's contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months, to provide for reserve buildup. The portion of the contingency reserve established and maintained for more than 120 months shall be released and shall no longer constitute part of the contingency reserve.
- (3) Withdrawals may be made from the contingency reserve on a first-in, first-out basis, with the prior written approval of the Domiciliary Commissioner, based on the amount by which:
 - (a) Incurred losses and loss adjustment expenses exceed 35% of the net earned premium in any year; or
 - (b) Aggregate contingency reserves exceed the dollar equivalent of its State Regulatory Mortgage Insurer Capital Standard, only to the extent of such excess.
- (4) Provisional withdrawals may be made from the contingency reserve on a quarterly basis in an amount not to exceed 75% of the withdrawal calculated in accordance with Section 8(C)(3), as adjusted for the quarterly nature of the withdrawal, with prior written approval of the Domiciliary Commissioner.
- (5) The mortgage guaranty insurance company's Domiciliary Commissioner may consider loss developments and trends in reviewing a request for withdrawal pursuant to this Section 8(C). If any portion of the contingency reserve for which withdrawal is requested is maintained by a reinsurer or in a segregated account or trust of a reinsurer, the Domiciliary Commissioner may also consider the financial condition of the reinsurer.

D. **Premium Deficiency Reserve.** A mortgage guaranty insurance company shall compute and maintain a premium deficiency reserve to the extent required and in accordance with NAIC's statements of statutory accounting principles applicable to mortgage insurers (currently SSAP No.58), as amended, restated or modified, but

without giving effect to any related permitted practices (“NAIC Accounting Principles”).

- (1) **Reserve Computations.** Premium deficiency reserve computations shall be based on the following, notwithstanding any NAIC accounting principles to the contrary:
 - (a) Reasonable estimates based on documented assumptions;
 - (b) Loss and premium estimates net of reinsurance;
 - (c) Premium, loss and expense discounting using a methodology not objected to by the Domiciliary Commissioner;
 - (d) Commissions and other acquisition costs need not be considered in the premium deficiency analysis to the extent they have been previously expensed;
 - (e) Insurance contracts shall be grouped by book year group for purposes of determining if a premium deficiency exists for actuarial reporting, unless sub-groupings within each book year group are requested by the Domiciliary Commissioner; and
 - (f) Deficiencies shall be offset by anticipated profits in other book year groups or subgroups with recognition of a corresponding liability for the net aggregate amount for which a premium deficiency is indicated.

- (2) **Actuarial Report Disclosures.** The following components of a premium deficiency reserve shall be disclosed in the annual actuarial report:
 - (a) Premium deficiency reserve methodology for each book year group and in the aggregate;
 - (b) Projected cash flows for at least a ten year future period for each book year group and in the aggregate; and
 - (c) Additional disclosures with respect to other segments of the mortgage guaranty insurance company’s risk in force, which may be required by the Domiciliary Commissioner.

- (3) **Financial Statement Disclosures.** A mortgage guaranty insurance company shall include the following disclosures and related reporting considerations in its statutory financial statements:
 - (a) Description of its methodology for analyzing and computing the premium deficiency reserve in the notes to the annual financial statement;
 - (b) Premium deficiency reserve calculations, including the amount of the projected deficit, for any book year where estimated future losses and expenses exceed estimated anticipated premiums;
 - (c) Premium deficiency reserve recognition by recording an additional liability for the deficiency, with a corresponding charge to operations, when the anticipated losses, loss adjustment expenses, commissions, other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve and the estimated future premiums on existing policies; and
 - (d) Premium deficiency reserve disclosure along with a statement of anticipated investment income utilization as a factor in the premium deficiency calculation, including the rate of return used in the calculation, as applicable, if a premium deficiency reserve is established.

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 9. Investment Restrictions

- A. **Investments Secured by Real Estate or Mortgages.** A mortgage guaranty insurance company shall not invest in notes or other evidence of indebtedness secured by a 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 contract of sale are acquired in the course of 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. This section shall not apply to investments backed by the full faith and credit of the United States of America or, with the approval of the Domiciliary Commissioner, to investments with the effective guaranty of the United States of America.
- B. **Deposit Accounts.** A mortgage guaranty insurance company, its holding company or any affiliate thereof is prohibited from entering into or maintaining any form of deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit for which there is no apparent or reasonably explicable business purpose.

Section 10. Reinsurance

- A. **Minimum Risk Retention Requirement.** A mortgage guaranty insurance company shall retain at least fifteen percent (15%) of its risk in force on either a first loss or quota share basis, if any portion of the risk in force is ceded to one or more reinsurers, unless a lesser retention is approved in writing by the Domiciliary Commissioner.
- B. **Prohibition of Captive Reinsurance.** A mortgage guaranty insurance company shall not enter into captive reinsurance arrangements which involve the direct or indirect ceding of any portion of its insurance risks or obligations to a reinsurer owned or controlled by an insured; 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 owned or controlled by an insured or an insured's officer, director or employee or any member of their immediate family that has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing.

- C. **Restriction on Affiliated Reinsurance.** A mortgage guaranty insurance company shall not enter into any new reinsurance arrangements with any affiliate after the effective date of this Act, unless it has obtained prior written approval by its Domiciliary Commissioner. Cessions or assumptions of premium under any reinsurance arrangements with any affiliate in force on the effective date of this Act must cease within one year from the effective date of this Act, unless the mortgage guaranty insurance company has obtained prior written approval by its Domiciliary Commissioner.
- D. **Subterfuge in Reinsurance Prohibited.** A mortgage guaranty insurer may, by written contract, reinsure any insurance that it transacts, except that no mortgage guaranty insurer may enter into reinsurance arrangements designed to circumvent the compensation control provisions of Section 14 or the contingency reserve requirement of Section 8C. The unearned premium reserve required by Section 8A, the loss reserve required by Section 8B, and the contingency reserve required by Section 8C shall be established and maintained by the original insurer or by the assuming reinsurer so that the aggregate reserves shall be equal to or greater than the reserves required by Sections 8A, 8B, and 8C. A reinsurer that is not a mortgage guaranty insurance company is not required to establish a contingency reserve provided the obligations reinsured that are not supported by a reserve maintained by the reinsurer will not be entitled to reinsurance credit unless the obligations are supported by collateral complying with the requirements of [insert provisions defining acceptable collateral for non-admitted reinsurers] and the cession shall be accounted for as a retroactive reinsurance agreement as provided in the accounting practices and procedures prescribed or permitted by the applicable accounting practices and procedures manual of the National Association of Insurance Commissioners.
- E. **Advance Approval of Reinsurance Required.** All reinsurance arrangements shall comply with the following requirements:
- (1) The following information must be filed with the ceding mortgage guaranty insurer's Domiciliary Commissioner at least 30 days prior to the intended date of entry into the reinsurance agreement or any amendment thereto:
 - (a) The reinsurance agreement and any segregated account or trust arrangements or letter of credit applicable to the reinsurance agreement or any amendments thereto;
 - (b) Any service or ancillary agreements related to the proposed reinsurance relationship;
 - (c) The financial statements and other financial due diligence information secured by the ceding mortgage guaranty insurer;
 - (d) Evidence that there is transfer of risk under the reinsurance arrangement; and
 - (e) If the reinsurance is assumed by an insurer which insures or reinsures other lines of insurance in addition to mortgage guaranty insurance, evidence from the reinsurer that its aggregate concentration of mortgage guaranty risk from all sources does not exceed 15% of the assuming reinsurer's gross written premium in the prior calendar year and that its

aggregate maximum loss exposure to mortgage guaranty insurance risk does not exceed 30% of its capital and surplus as of the end of the immediately preceding calendar year.

- (2) Each reinsurance agreement established with a mortgage guaranty insurance company shall provide that:
 - (a) The Domiciliary Commissioner shall approve any amendments to the reinsurance agreement before becoming effective.
 - (b) The ceding mortgage guaranty insurance company shall have the right to terminate the ceding of additional insurance under the reinsurance agreement if so ordered by the Domiciliary Commissioner.
 - (c) Each reinsurance agreement established with a mortgage guaranty insurance company that includes the use of a segregated account or trust may not limit liability for losses to the assets held in any one or more segregated accounts or trusts.
 - (d) The Domiciliary Commissioner has the right to request from the assuming reinsurer information concerning its financial condition and, when applicable, such requests shall be in accord with the terms of 15 U.S.C. § 8222, and as such federal law may be amended or superseded.
 - (e) The assuming reinsurer shall notify the Domiciliary Commissioner of any material change in its financial condition and, when applicable, such duty of notification shall be in accord with the terms of 15 U.S.C. § 8222, and as such federal law may be amended or superseded.
- (3) The Domiciliary Commissioner of the ceding mortgage guaranty insurer may disapprove any reinsurance agreement at any time upon discovering that the filing requirements of Section 10(D)(1) were altogether disregarded; otherwise, the Domiciliary Commissioner may disapprove a reinsurance agreement filed pursuant to Section 10(D)(1) in any of the following circumstances:
 - (a) The financial due diligence conducted by the ceding mortgage guaranty insurer was inadequate, as evidenced by failure to adequately review timely audited financial statements or otherwise;
 - (b) Reasonable transfer of risk has not been demonstrated or there is reasonable cause to understand the reinsurance arrangement as being entered to improve the appearance, but not the reality, of the ceding mortgage guaranty insurer's financial solvency;
 - (c) If the reinsurance is assumed by an insurer which insures or reinsures other lines of insurance in addition to mortgage guaranty insurance, the aggregate concentration of mortgage guaranty risk from all sources exceeds the levels referenced in Section 10(E)(1)(e).
 - (d) The reinsurance agreement does not contain the provisions required by Section 10(E)(2);
 - (e) The reinsurance agreement would violate the law of the ceding mortgage guaranty insurer's state of domicile or would be contrary to the interests of insureds, creditors, or the public.

Section 11. Underwriting Standards

- A. **Underwriting Review and Approval Required.** All certificates of mortgage guaranty insurance, excluding policies of reinsurance, shall be written based on a

reasonable and thorough examination and assessment of evidence that prudent underwriting standards have been met by the originator of the mortgage. Delegated underwriting decisions shall be reviewed based on a reasonable method of sampling of post-closing loan documentation to ensure compliance with the mortgage guaranty insurance company's underwriting standards. Quality control reviews for Bulk Mortgage Guaranty Insurance and Pool Mortgage Guaranty Insurance shall be based on a reasonable method of sampling of post-closing loan documentation to ensure compliance with the representations and warranties of the creditors or creditors originating the loans and with the mortgage guaranty insurance company's underwriting standards

- B. **Minimum Underwriting Guidelines.** Mortgage guaranty insurance companies shall establish formal underwriting guidelines which set forth the basis for concluding that prudent underwriting standards have been met.
- C. **Underwriting Guideline Review and Approval.** A mortgage guaranty insurance company's underwriting guidelines shall be:
- (1) Reviewed and approved by executive management;
 - (2) Reviewed with either the board of directors or a board committee designated to provide oversight of underwriting policy and ratification of material changes under a written resolution of the board of directors setting forth the scope of review for such oversight and ratification; and
 - (3) Communicated across the organization to promote consistent business practices with respect to underwriting.
- D. **Maintenance of Minimum Underwriting Standards and Documentation Generally.** Underwriting standards, including but not limited to review and approval procedures, minimum underwriting guidelines, and the collection and retention of underwriting documentation shall be in compliance with the *Mortgage Guaranty Insurance Standards Manual*.
- E. **Notification of Changes in Underwriting Guidelines.** A mortgage guaranty insurance company shall provide notice to the Commissioner of changes to its underwriting guidelines as follows:
- (1) On or before March 1 of each year, a mortgage guaranty insurance company shall file with the Commissioner an annual summary of material changes in underwriting guidelines implemented during the course of the immediately preceding year along with references to supporting hardcopy or website documentation.
 - (2) The annual summary of material underwriting guideline changes should include any change associated with loan to value ratios, debt to income ratios, borrower credit standing or maximum loan amount which has resulted in a material impact on net premium written of +/- 5% from prior year to date.
- F. **Nondiscrimination.** In extending or issuing mortgage guaranty insurance, a mortgage guaranty insurance company may not discriminate on the basis of the applicant's sex, marital status, race, color, creed, national origin, disability, or age or solely on the basis of the geographic location of the property to be insured unless the

discrimination related to geographic location is for a business purpose that is not a mere pretext for unfair discrimination; or the refusal, cancellation, or limitation of the insurance is required by law or regulatory mandate.

Drafting Note: States and jurisdictions should consult their constitution or comparable governance documents and applicable civil rights legislation to determine if broader protections against unacceptable forms of discrimination should be included in Section 11F.

Section 12. Quality Assurance

- A. **Minimum Quality Assurance Standards.** A mortgage guaranty insurance company shall establish a formal internal Mortgage Guaranty Quality Control Program, which provides an early detection warning system as it relates to potential underwriting compliance issues which could potentially impact solvency or operational risk. This Mortgage Guaranty Quality Control Program shall provide for the documentation, monitoring, evaluation and reporting on the integrity of the ongoing loan origination process based on indicators of potential underwriting strategy and control inadequacies or non-compliance. The Mortgage Guaranty Quality Control Program shall be in compliance with the *Mortgage Guaranty Insurance Standards Manual*.
- B. **Regulator Access.** The Commissioner shall be provided access to an insurer's Mortgage Guaranty Quality Control Program for review at any reasonable time upon request and during any financial regulatory examination. Nothing herein shall be construed to limit a regulator's right to access any and all of the records of an insurer in an examination or as otherwise necessary to meet regulatory responsibilities.

Section 13. 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, engage in activities proscribed in Sections 13 and 14.

Section 14. Rebates, Commissions, Charges and Contractual Preferences

- A. **No Inducements.** 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, lessor, lessee 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. No Compensation for Placement.** In connection with the placement of any mortgage guaranty insurance, a mortgage guaranty insurance company shall not cause or permit the conveyance of anything of value, including but not limited to any commission, fee, premium adjustment, remuneration or other form of compensation of any kind whatsoever 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, except for the value of the insurance itself or claim payments thereon as provided by contract or settlement.
- C. No Rebates.** A mortgage guaranty insurance company shall not make a rebate of any portion of the premium charge. A mortgage guaranty insurance company shall not 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. No Undue Contractual Preferences.**
- (1) Any contract, letter agreement, or other arrangement used to modify or clarify any terms, conditions, or interpretations of a master policy or certificate shall be documented in writing.
 - (2) Any contractual or letter agreements used to modify or clarify general business practices and administrative, underwriting, claim submission or other information exchange processes shall not contain provisions which override or significantly undermine the intent of key provisions of the Mortgage Guaranty Insurance Model Act, including mortgage insurer discretion, rights and responsibilities related to:
 - (a) Underwriting standards
 - (b) Quality assurance
 - (c) Rescission
- E. Sanctions.** 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, rebate, or makes any unlawful conveyance of value under this section 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.
- F. Educational Efforts and Promotional Materials Permitted.** A mortgage guaranty insurance company may engage in any educational effort with borrowers, members of the general public, and officers, directors, employees, contractors and agents of insured lenders that may reasonably be expected to reduce its risk of loss or promote its operational efficiency and may distribute promotional materials of minor value.

Section 15. Policy Forms and Premium Rates Filed

- A. **Policy Form Filing.** All policy forms and endorsements shall be filed with and be subject to the approval of the Commissioner, unless otherwise provided by the Commissioner.
- B. **Policy Form Amendment Filing.** Any contract, letter agreement, or other arrangements used to modify or endorse terms of the company's master policy or any certificate shall be filed as an endorsement and be subject to the disapproval of the Commissioner.
- C. **Policy Rate Filing.** Each mortgage guaranty insurance company shall file with the Commissioner the rate to be charged and the premium including all modifications of rates and premiums to be paid by the policyholder, unless otherwise provided by the Commissioner.
- D. **Timely Response to Requests for Explanation.** Upon written request of a party liable for payment of premium under a master policy or certificate, a mortgage guaranty insurance company shall, within 30 days following receipt of the request, provide a written explanation of how the amount of premium for which the requesting party is liable was computed. A mortgage guaranty insurance company need not respond to requests that are made with a frequency that a reasonable person would construe to be harassment.
- E. **Limited Right to Acquire Title.** Each master policy and certificate issued by a mortgage guaranty insurance company shall provide that the mortgage guaranty insurance company, in lieu of payment of its limit of coverage, may elect to pay the entire indebtedness to the insured and acquire title to the authorized real estate security.
- F. **Conditional Limitation on Deficiency Liability.** Each master policy and each applicable certificate issued by a mortgage guaranty insurance company shall provide that the borrower upon any single-family dwelling or a mixed-use building described in Section 2A(1)(b), which is owner-occupied at the time of loan origination and for at least 50% of the days within the twelve (12) consecutive months prior to borrower default, shall not be liable for any deficiency arising from a foreclosure sale.

Drafting Note: Open rating states may delete a portion or all of Subsections 15A and 15B and insert their own rating law. States should consult their individual market conduct regulations to determine if adjustment of contractual filing approval requirements should be included in Section 15C. States that wish to allow pursuit of deficiency judgements against those who have lost their principal residence to foreclosure could either delete Section 15F or limit the exemption from deficiency judgements on personal residences to defaults occasioned by certain specified causes such as unemployment, illness, and divorce.

Section 16. Rescission

The right of rescission shall be governed by the following:

- A. **Rescission Rights and Responsibilities.** All mortgage guaranty insurance company master policies shall include a detailed description of provisions governing rescissions and cancellations, which specify the insurer's and insured's rights,

obligations and eligibility terms under which those actions may occur to ensure transparency.

B. Rescission Relief Provisions. Mortgage guaranty insurance company rescission relief practices shall be in accordance with the following:

- (1) A mortgage guaranty insurance master policy may provide for mandatory rescission relief based on evidence of compliance with payment history and loan status eligibility requirements.
- (2) A mortgage guaranty insurance master policy may offer an earlier rescission relief option based on evidence of compliance with underwriting and payment history eligibility requirements.
- (3) A mortgage guaranty insurance company shall retain the right of rescission in instances in which a creditor or the officers, directors, employees, contractors, and agents of a creditor engage in misstatements, misrepresentations, omissions, data inaccuracies or active efforts to deceive through submission of forged or fictitious information in connection with loan origination or closing for a period of at least 10 years, based on:
 - (a) Credible evidence of the existence of the above conditions; and
 - (b) Credible evidence of the materiality of the above conditions to the mortgage guaranty insurance company's acceptance of risk.

C. Re-pricing Provisions. A mortgage guaranty insurance company shall have the option to re-price the insurance premium for coverage upon a loan, when prudent, in lieu of rescinding coverage based on the following:

- (1) Rescission relief has not been granted based on Subsection 16B;
- (2) The loan would have been eligible for coverage with alternative pricing under the underwriting standards in effect at origination; and
- (3) Misstatements, misrepresentations, omissions or inaccuracies by the creditor or the officers, directors, employees, contractors, and agents of a creditor are not considered material based on reasonable verification of appraisal value and borrower income by the mortgage guaranty insurance company.

Section 17. Records Retention

A. Record Files. A licensed mortgage guaranty insurance company shall maintain its records in a manner which allows the Commissioner to readily ascertain the insurer's compliance with state insurance laws and rules during an examination including, but not limited to, records regarding the insurer's management, operations, policy issuance and servicing, marketing, underwriting, rating and claims practices.

Recordkeeping requirements shall conform to the mandated standards detailed in the corresponding Records Retention Requirements section of the *Mortgage Guaranty Insurance Standards Manual*, as it relates to:

- (1) Policy records to clearly document the application, underwriting, issuance and servicing of each policy and certificate; and

- (2) Claim records to clearly document the inception, handling and disposition
- B. **Retention Period.** Policy and claim records shall be retained for the period during which the certificate or claim is active plus five (5) years, unless otherwise specified herein or in the Mortgage Guaranty Insurance Standards Manual.
- C. **Record Format.** Any record required to be maintained by a mortgage insurer may be created and stored in the form of paper, photograph, magnetic, mechanical or electronic medium, subject to conformance with the format related requirements detailed in the corresponding Records Retention Requirements section of the *Mortgage Guaranty Insurance Standards Manual*.
- D. **Record Maintenance.** Record maintenance under this regulation shall comply with the following requirements:
- (1) Insurer maintenance responsibilities shall provide for record storage in a location that will allow the records to be reasonably produced for examination within the time period required.
- (2) Third-Party maintenance related responsibilities shall be set forth in a written agreement, a copy of which shall be maintained by the insurer and available for purposes of examination.

Section 18. Mortgage Guaranty Insurance Standards Manual

The *Mortgage Guaranty Insurance Standards Manual* refers to the current version of the Mortgage Guaranty Insurance Standards Manual, which is integral to the requirements established under the *Mortgage Guaranty Insurance Model Act (#630)*, as adopted and amended from time to time by the National Association of Insurance Commissioners. A change in the *Mortgage Guaranty Insurance Standards Manual* shall be effective on January 1 following the calendar year in which the change has been adopted by the NAIC if such change is adopted on or before September 1st. A change in the *Mortgage Guaranty Insurance Standards Manual* shall be effective on the second January 1 following the calendar year in which the change has been adopted by the NAIC if such change is adopted after September 1st.

Section 19. 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).

ANNOTATIONS

MORTGAGE GUARANTY INSURANCE MODEL ACT

Section 7. Capital Standards

Annotation 1: This section addresses the mortgage guaranty insurance industry risks and controls associated with capital standards.

The previous Mortgage Guaranty Insurance Model Act reflected the mortgage guaranty insurance industry historic requirements for a mortgage insurer to maintain a minimum amount of statutory capital relative to risk in force in order for the mortgage insurer to continue to write new business. The most common formulation of this risk to capital methodology allowed for a maximum permitted risk to capital ratio of 25 to 1. The risk to capital ratio did not serve the mortgage industry exceptionally well during the recent mortgage sub-prime crisis, as the identification of potential solvency problems associated with the sub-prime crisis and economic downturn were generally recognized prior to the risk to capital ratio reaching the above 25 to 1 maximum.

Accordingly, the current Mortgage Guaranty Insurance Model Act has developed a new capital standard to be known as the State Regulatory Mortgage Insurer Capital Standard. This new standard offers the following advantages, among others:

- More granular risk assessment
- Economically countercyclical, which recognizes the role of mortgage insurers in the U.S. housing finance system
- Attempts to achieve reasonable projection of book year ultimate net losses
- Allows reasonable premium credits
- Transparency in assumptions
- Forecastable by the mortgage guaranty insurers

The current Mortgage Guaranty Insurance Model Act also requires to timely prepare and maintain detailed loan level cash flow projection based on the guidance for such reports contained in the *Mortgage Guaranty Insurance Standards Manual*. This keeps all mortgage guaranty insurers in a state of readiness to provide such company-specific information during a significant downturn in the economy or if the individual insurer experiences adverse financial results.

Development of the above standards utilized external consulting services to maximize the benefits of current mortgage guaranty insurance industry projects to develop the framework for the loan level capital model and utilize such project research to facilitate development of unique mortgage guaranty risk components and rating factors.

Section 8. Contingency Reserves

Annotation 2: This section addresses the mortgage guaranty insurance industry risks and controls associated with the Contingency Reserve practices.

Contingency reserves have historically served to provide an additional form of premium reserves to protect policyholders against the effect of adverse economic cycles. These reserves have been established based on an automatic provision calculation of 50% of premium written. Current reserve provisions are required to be maintained for a period of 10 years (120 months), unless early release is approved by the commissioner of insurance of the insurer's state of domicile.

Significant loss experience during the recent sub-prime mortgage crisis has noted that:

- Contingency reserve historic allocations under the current automatic formula calculation are not driven by economic indicators of potential mortgage crisis and economic downturn, as recently experienced
- Contingency reserve protection provisions can easily be exhausted and depleted under provisions which allow for the early withdrawal when losses exceed 35% of corresponding earned premiums during such periods of economic downturn

Accordingly, the Mortgage Guaranty Insurance Model Act emphasizes the contingency reserve provisions through:

1. Contingency reserve retention period to build-up reserve positions for periods of cyclical downturn in the mortgage industry
2. Contingency reserve release restrictions

The Reserves section includes premium deficiency reserve requirements that impact both actuarial opinion and financial statement reporting.

Section 9. Restrictions on Investments Secured by Real Estate or Mortgages

Annotation 3: This section addresses the mortgage guaranty insurance industry relationships and risks associated with the secondary mortgage market.

The secondary mortgage market represents a market for the sale of securities or bonds collateralized by the value of mortgage loans. Mortgage lenders or other specialized investment firms typically group together loans originated in the primary mortgage market for sale as collateralized mortgage obligations or mortgage backed securities for sale to investors, including insurance companies.

Principal parties involved in the secondary mortgage market include:

- (1) Government National Mortgage Association (GNMA) – a wholly-owned government corporation, whose mortgage backed securities are guaranteed by the full faith and credit of the United States government
- (2) Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC), federally chartered government-sponsored but privately owned entities, which are not backed by the full faith and credit of the United States government, although often considered as effective beneficiaries of this guarantee as a result of government rescue from insolvency during the recent mortgage crisis

The Secondary Mortgage Market Enhancement Act of 1984 (SMMEA) amended the Securities Exchange Act of 1934 to provide additional capital sources through improvement in the marketability of mortgage backed securities. The SMMEA effectively allowed:

- (1) Federally chartered and regulated financial institutions to invest in mortgage-backed securities guaranteed by FNMA and FHLMC, although not backed by the full faith and credit of the U.S.

- (2) Override of state investment laws to enable state chartered and regulated institutions to invest in such mortgage-backed securities

SMMEA initially resulted in exceptional residential mortgage market growth and expansion, triggered by the theory that default risk on an individual loan basis was generally deemed to be minimized under the loan aggregation process.

The above growth in the secondary mortgage market was, however, also considered a contributing factor to the recent housing market crisis beginning in 2007. On the downside, mortgage securitization increased default risk from the standpoint of reduction in alignment of mortgage loan originator and mortgage guaranty insurer interests and incentives to ensure borrower repayment credit quality. As a result, mortgage loan defaults, delinquencies and foreclosures increased associated with potential rating agency assignment of inflated credit ratings, lending standard deterioration and subprime borrowing.

Accordingly, in the Mortgage Guaranty Insurance Model Act, investment limitations are proposed to reduce potential mortgage guaranty insurer risks associated with portfolio concentrations in securities reflective of investment in the same industry risk as the mortgage guarantor's primary business. This encompasses securities which represent an ownership interest in or are secured directly or indirectly by a pool of mortgages or cash flows generated by a pool of mortgages. Exceptions are made for securities that are backed by the full faith and credit of the United States and securities that the mortgage guaranty insurer's state regulator determines are effectively guaranteed by the United States Treasury.

Section 10. Reinsurance

Annotation 4: This section addresses the mortgage guaranty insurance industry risks associated with reinsurance.

Mortgage guaranty reinsurance has generally been limited to affiliate ceding in lieu of limited external reinsurance alternatives, which typically creates unnecessary overhead expenses with limited benefits.

Affiliate reinsurance has generally been executed under requirements that a mortgage guaranty insurer cannot retain more than 25% of the total risk exposure related to the indebtedness of the insured.

Accordingly, the Mortgage Guaranty Insurance Model Act provisions emphasize greater reinsurance flexibility options through:

- Removal of the mortgage guaranty insurer maximum 25% risk retention limits
- Discouragement of affiliate reinsurance arrangements by the above adjustment of reinsurance requirements, thereby permitting mortgage guaranty insurers to achieve improved administrative efficiencies
- Prohibition of captive reinsurance arrangements
- Regulatory review of all reinsurance arrangements

Section 11. Underwriting Standards

Annotation 5: This section addresses mortgage guaranty insurer underwriting, and related environmental causes and risks associated with the recent mortgage loan sub-prime mortgage loan crisis.

Legacy private mortgage insurers have suffered significant losses from exposure to the recent downturn of the U.S. housing market, which contributed to the national recession. Housing price declines in recent years have created negative equity on a large scale, with homeowner debt exceeding property values.

Key factors driving mortgage performance have included mortgage type, age, inadequate borrower credit score, loan to value, and debt to equity relationships and delinquency status. Pending delinquencies, default inventory aging and eventual foreclosures have become major factors to achieving financial recovery.

Regulatory actions based on the level of losses associated with the above factors have resulted in ongoing emphasis on capital adequacy requirements, which has in turn restricted or prevented companies from writing new mortgage guaranty insurance business.

Policy rescissions have avoided some large insurer losses, while at the same time demonstrating the susceptibility to misrepresentation or potential fraud.

The concentration of mortgage loan originations in fewer and fewer financial institutions as the banking industry has consolidated has placed competitive pressures on mortgage guaranty insurers to accept loans of lower credit quality or face the consequences of reduced business volume. Captive reinsurance agreements have resulted in regulatory concerns for originating banks to command considerations from mortgage insurers. These industry-wide competitive pressures have resulted in increased loan default, delinquency and foreclosure rates associated with the acceptance of sub-prime credit loans and reduced documentation and even “no documentation” loans.

The previous Mortgage Guaranty Insurance Model Act’s requirements for measuring capital adequacy in terms of 25 times company capital, surplus and contingency reserves were typically exceeded in the course of the housing price decline and have not proven effective in monitoring risk. The above results suggest that more risk sensitive measures to ensure future solvency are desirable along with an increased proactive monitoring role, particularly in areas where guidance is limited or silent.

Accordingly, the Mortgage Guaranty Insurance Model Act establishes formal minimum standards for underwriting guidelines, which serve to establish a supervisory framework to ensure that lenders are obtaining adequate documentation, undertaking effective verification of financial information including income, maintaining reasonable debt service coverage and loan to value ratios, and making reasonable inquiry to resolve problems without significant market disruption.

Section 12. Quality Assurance

Annotation 6: This section is intended to complement the underwriting guidelines discussed under section 12 through the proposed establishment of mortgage guaranty insurer independent internal quality assurance guidelines, which provide a prospective “early warning system” to monitor and identify potential risk, control and compliance weaknesses associated with:

- (1) Senior management oversight
- (2) Board of director oversight
- (3) Loan policy and procedure documentation
- (4) Underwriting risk tolerance levels and exposures
- (5) Lender underwriting performance
- (6) Mortgage guaranty insurer underwriter performance
- (7) Problem loan trends
- (8) Underwriting system change oversight
- (9) Pricing and performance oversight
- (10) Internal audit validation

Section 16. Rescission

Annotation 9: This section addresses the mortgage guaranty insurance industry’s rescission rights and responsibilities.

A mortgage guaranty insurer’s exercise of rescission rights essentially consists of the unwinding of an insurance contract as if the contract was never entered into. Premiums are typically returned by the insurer and no claims are paid. Rescission typically results based on the mortgage guaranty insurer’s determination that coverage provided under a policy was essentially not in force due to:

- Misrepresentation
- Failure to follow underwriting guidelines
- Failure to meet certain obligations at the time the policy was written

Rescissions have historically occurred on a loan by loan basis on the back end, based on review of loan origination documents in conjunction with the normal processing of claims submitted, to evaluate the ability to deny coverage or, at the very least, reduce the claim amount.

Loans entering the rescission process typically resulted from loans originated during the 2005-2007 period coinciding with the housing market peak and the rise in subprime mortgages. Rescission volume increased dramatically, based on increasing MI company evidence of misrepresentation, fraud, loans not meeting bulk commitments and loan overstatement of value.

The exercise of coverage rescissions has materially mitigated paid losses during the subprime mortgage crisis. Business insured by mortgage guaranty insurers over the last 6 years has been significantly impacted by rescission activity based on significant findings resulting from the claims and underwriting review process associated with:

- Lower quality insured business previously written such as low documentation loans
- Improper underwriting standards

- Delegated lender underwriting

Rescission has often resulted in extensive subsequent settlement proceedings and legal delays to establish eventual rescission rights and responsibilities. Policy rescission volume has also impacted the GSE's due to typical efforts to seek restitution through the qualified servicer. The GSE's and mortgage guaranty insurance industry are in the process of working to address mutually agreed upon standard master policy provisions which will clarify these rescission rights and responsibilities.

Accordingly, the Mortgage Guaranty Insurance Model Act amendments have emphasized the following provisions, which provide greater rescission relief and are anticipated to be generally consistent with ongoing GSE regulatory requirements under review and / or reasonable practices aligned with those requirements:

- 1) Master policy definitions of both insurer and insured rescission rights and responsibilities
- 2) Rescission relief provisions based on MI underwriting validation, timely payment history and suspected material misrepresentation considerations

All mortgage guaranty insurance companies are required by law to follow the Unfair Insurance Practices Act in each state in which they are licensed. The Unfair Insurance Practices Act specifies certain business practices that constitute unfair claim settlement or compromise practices.

Section 18. Standards Manual

Annotation 10: The NAIC shall develop and adopt a *Mortgage Guaranty Insurance Standards Manual*, as amended from time to time, which shall include such other information as the National Association of Insurance Commissioners shall deem appropriate, which shall supplement and support the Mortgage Guaranty Insurance Model Act. The background, guidance and standards in this manual are based on and integral to the requirements established under the Mortgage Guaranty Insurance Model Act (#630). The primary purpose of such a standards manual would be to provide for timely updates to the detailed technical standards specific to this specialized type of insurance.