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March 27, 2023

Via Email to: rule-comments@sec.gov

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Prohibition against Conflicts of Interest in Certain Securitizations
Release No. 33-11151 (File No. S7-01-23)

Dear Ms. Countryman:

This comment letter is submitted by the U.S. private mortgage insurance industry companies[1] in response to the request of the Securities and Exchange Commission (the "Commission") for comments on proposed Rule 192 (the "Proposed Rule") pursuant to Section 27B ("Section 27B") of the Securities Act of 1933, as amended (the "Securities Act"), as set forth in Release No. 33-11151, dated January 25, 2023 (the "Release").[2] We are all U.S. insurance companies subject to regulation in our respective states of domicile and in each of the other jurisdictions in which we do business. We are also "approved insurers" for the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac" and, together with Fannie Mae, the "GSEs") under the Private Mortgage Insurer Eligibility Requirements ("PMIERs") promulgated at the direction of the Federal Housing Finance Agency ("FHFA").

Private mortgage insurance facilitates access to affordable and sustainable mortgage finance to borrowers, provides credit risk protection to lenders and mortgage investors, and promotes safety and soundness in the U.S. housing finance system. As of December 31, 2022, the private mortgage insurance industry insured approximately $1.512 trillion of U.S. mortgages, including $1.353 trillion of mortgages backed by Fannie Mae and Freddie Mac. As of such date, more than 5.7 million loans had active mortgage insurance coverage.[3]

We are submitting this comment letter because we are concerned about the potential impact that the Proposed Rule could have on mortgage insurance-linked note ("MILN") transactions that have been utilized by the private mortgage insurance industry since 2015 to procure reinsurance through the capital markets. Ambiguities within the Proposed Rule could be interpreted to prohibit or limit our ability to source capital markets-based reinsurance through MILNs, which we and our insurance regulators consider to be prudent for the risk management

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[1] The U.S. private mortgage insurance industry comprises the mortgage insurance company subsidiaries of Arch Capital Group Ltd., Enact Holdings Inc., Essent Group Ltd., MGIC Investment Corporation, NMI Holdings, Inc., and Radian Group Inc. (collectively, the "MIs"), all of whom are signatories to this letter.

[2] 88 Fed. Reg. 9678 (February 14, 2023).

[3] Aggregated data from MI and GSE 2022 10-K filings.

of the industry. Accordingly, we ask the Commission to clarify that MILNs are not synthetic asset-backed securities or conflicted transactions within the meaning of the Proposed Rule; we also ask the Commission to make clear that MILNs will not be viewed as a circumvention of the prohibitions in paragraph (a)(1) of the Proposed Rule.

I. Overview

Section 27B prohibits an underwriter, placement agent, initial purchaser, or sponsor (or any affiliate or subsidiary of any such entity) of an asset-backed security, including a synthetic asset-backed security ("ABS"), from engaging in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of such activity within one year of the first closing of the sale of the asset-backed security. The statute provides exceptions for risk-mitigating hedging activities, certain liquidity commitments and market-making.

The Release notes the statement by former Senator Carl Levin that the conflict of interest prohibition embodied by Section 27B "is intended to prevent firms that assemble, underwrite, place or sponsor these instruments from making proprietary bets against those same instruments." The Release goes on to state that "[t]he re-proposed rule targets transactions that effectively represent a bet against a securitization and focuses on the types of transactions that were the subject of regulatory and Congressional investigations and were among the most widely cited examples of ABS-related misconduct during the lead up to the financial crisis of 2007-2009" and "[b]y focusing on transactions that represent a 'bet' against the performance of an ABS, the re-proposed rule seeks to provide an explicit standard for determining which types of transactions would be prohibited."[4]

As described below, MILNs are a capital markets-based reinsurance product that are used by regulated insurance companies to obtain reinsurance coverage for a portion of their mortgage insurance risks. MILNs are not a "proprietary bet" by a mortgage insurer. To the contrary, the mortgage insurers retain significant portions of the risk exposure under the mortgage insurance policies and have an alignment of interest with the investors in the MILNs.

II. Description of Mortgage Insurance and Mortgage Insurance-Linked Notes

Private mortgage insurance protects lenders from a portion of the default-related losses on covered mortgage loans and plays a central role in providing credit risk mitigation to the GSEs and the U.S. housing market. Mortgage insurance is primarily geared toward high loan-to-value loans where borrowers make a down-payment that is less than 20% of the value of a home. Mortgage insurance helps facilitate secondary market sales of such mortgages, primarily to the GSEs, and provides lenders a means to diversify and mitigate their exposure to mortgage credit risk. Such credit protection allows lenders to increase their capacity for mortgage commitments and expand financing access to existing and prospective homeowners. In addition, the statutory charters of the GSEs require low down payment mortgages, which carry a higher risk of default,

[4] Release at 8.

to include credit enhancements such as mortgage insurance from a qualified insurer. [5] The current government conservatorship of the GSEs, and the formal keep-well agreements in place between each enterprise and the U.S. Treasury Department, means the government effectively guarantees these mortgages, but the inclusion of mortgage insurance benefits the GSEs – and therefore taxpayers – as private mortgage insurance stands to absorb potential losses before the GSEs and any taxpayer-provided support.[6]

Since 1957 the private mortgage insurance industry has served first-time, low- and moderate-income, and minority homebuyers to ensure access to affordable and sustainable mortgage credit. During that time, the industry has helped over 38 million families[7] enjoy the benefits of homeownership using low down payment mortgages. In fact, over 60% of purchasers with private mortgage insurance are first-time homebuyers and more than 40% of borrowers with private mortgage insurance have incomes below $75,000.[8] In 2022 alone, private mortgage insurers helped more than one million households purchase homes or refinance existing mortgages, and the industry supported nearly $402 billion in mortgage originations.[9]

After the financial crisis of 2008, the private mortgage insurance industry significantly improved its safety and soundness through enhanced capital, risk and operational standards to be more resilient and withstand severe economic stress. As strong and independent counterparties to the GSEs, the mortgage insurance industry provides an essential independent check on mortgage credit quality throughout the financial system, and reduces systemic risk in the housing and financial markets by deploying private capital to absorb mortgage credit losses.

MILNs were developed in 2015 based on structures employed by property and casualty catastrophe bonds to source reinsurance capacity through the capital markets. Reinsurance is essentially insurance for insurance companies. Most insurance companies, including mortgage insurers, purchase reinsurance from a combination of "traditional reinsurers" (i.e., in direct counterparty transactions with rated reinsurers) and through capital markets structures (such as insurance-linked securities) as a way to manage concentrated risk aggregations, provide protection against elevated losses, and to enhance their capital position. Reinsurance, including both traditional reinsurance and insurance-linked securities, is a critical component of the U.S. insurance regulatory landscape across all lines of business, including property and casualty, life and health and mortgage insurance. Reinsurance has been a necessary tool of insurance risk management for well over 100 years, and insurance-linked securities have been widely adopted by the insurance industry since the 1990s.

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[5] Fannie Mae credit enhancement requirements, 12 U.S.C. 1717(b)(2). Freddie Mac credit enhancement requirements, 12 U.S.C. 1454(a)(2).

[6] $1.353 trillion in GSE mortgages currently outstanding have protection from mortgage insurance and the mortgage insurance industry has covered nearly $60 billion in claims since the GSEs entered conservatorship in 2008. Aggregated data from MI and GSE 2022 10-K filings.

[7] Aggregated data from MIs, GSEs and Mortgage Insurance Companies of America.

[8] Aggregated data from MIs, GSEs and Home Mortgage Disclosure Act reporting.

[9] Aggregated data from MIs and GSEs.

In a typical MILN structure, investors purchase securities issued by a special purpose insurer, which is a legally-constituted, licensed reinsurance company that simultaneously enters into a reinsurance agreement or other risk transfer contract with the mortgage insurance company. MILN structures mitigate adverse selection risk by reinsuring all or virtually all of the ceding insurer's mortgage insurance policies originated during a specified coverage period which satisfy the eligibility criteria set forth in the MILN offering circular and the reinsurance agreement. Exhibit A hereto shows a representative example of an MILN structure.

MILNs have significant benefits over traditional reinsurance, a fact which has been recognized by the industry and regulators, including that the reinsurance obligation in an MILN is fully collateralized. MILNs also offer a broader, more diversified capital base, often with more efficient pricing and significantly greater capacity than the reinsurance market alone. MILNs were designed to satisfy state insurance regulatory and PMIERs requirements, and have been structured in close cooperation with our insurance regulators and the GSEs. For these reasons, MILNs have been recognized by state insurance regulators and by the GSEs as an effective risk and capital management tool for private mortgage insurers. From 2015 through 2022, the private mortgage insurance industry issued over 50 MILNs, transferring over $20.8 billion of risk exposure on more than $2.176 trillion of notional mortgages to capital market investors.

III. Comments Regarding the Proposed Rule

1. Mortgage Insurance Linked Notes Are Not Synthetic Asset-Backed Securities.

The Proposed Rule does not define the term "synthetic asset-backed securities" and the Release does not provide specific guidance regarding whether any particular products are synthetic ABS. Rather, the Commission states its belief that its previous descriptions of the term are well understood by market participants and adequately address key issues raised by commenters on the prior version of the Proposed Rule, and that market participants have been able to readily distinguish synthetic ABS from other types of transactions.[10] The Release does, however, seek comment on whether the Commission should define the term and asks whether there are "particular products (1) where additional clarity is necessary as to whether such products are 'synthetic ABS' or (2) that the rule should expressly state are not 'synthetic ABS'."[11] MILNs are not synthetic ABS, as we understand the term. However, for the reasons discussed below, the Commission should clarify, or expressly state, that MILNs are not synthetic ABS.

In the 2004 Regulation AB Adopting Release,[12] which the Release refers to as a source of guidance, the Commission described synthetic ABS as follows:

> Synthetic securitizations *are designed* to create exposure to an asset that is not transferred to or otherwise part of the asset pool. These synthetic transactions are generally effectuated through the use of derivatives such as a credit default swap

[10] Release at 14.

[11] Release, Request for Comment 4.

[12] Release No. 33-8518 (Dec. 22, 2004) (the "Regulation AB Adopting Release").

> or total return swap. The assets that are to constitute the actual "pool" under which the return on the ABS is primarily based are only referenced through the credit derivative…. (emphasis added)
>
> Payments on the securities in a synthetic securitization can primarily or entirely comprise or include payments based on the value of a reference asset which is unrelated to the value of or payments on any actual assets in the pool. Payment is therefore by reference to an asset not in the pool instead of primarily from the performance of a discrete pool of financial assets that by their terms convert into cash and are transferred to a separate issuing entity.

While MILNs have indirect exposure to individual mortgage loans, MILNs are not *designed* to create exposure to mortgage loans for securitization, but rather provide reinsurance on insurance policies written in the ordinary course of a U.S. regulated insurance business. Moreover, there are significant differences between an MILN investor's exposure to the mortgage insurance policies via the reinsurance agreement and the underlying insured mortgage loan, in particular because of the coverage and termination terms of the insurance policy.[13]

MILNs are *designed* to provide reinsurance to a ceding insurance company for a discrete pool of mortgage insurance policies, which are not self-liquidating financial assets. We believe that implicit (although not express) in the Commission's discussions of synthetic securitizations is that the referenced asset needs to be a self-liquidating financial asset, as is required for a non-synthetic ABS. The Commission should make this explicit in the final rule or the accompanying commentary. As MILNs are a transfer of mortgage insurance risk via the capital markets and do not reference self-liquidating financial assets,[14] the Commission should clarify that MILNs are not synthetic ABS under the Proposed Rule, notwithstanding the indirect exposure to mortgage loans.[15]

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[13] For example, (i) mortgage insurance typically terminates at a 78-80% loan-to-value ratio, meaning that the way that mortgage insurance reduces/terminates is distinct from the amortization of the underlying mortgage loan, (ii) in paying claims, the insurance company can exercise certain mitigation options, including paying a percentage of principal and interest, acquiring the underlying property or approving the sale of the property, and (iii) mortgage insurance coverage is also subject to policy exclusions, such as rescission for a fraudulent insurance application, failure to obtain title to the property or physical damage to a property, such as caused by a natural disaster.

[14] The Commission has not defined the term "self-liquidating" but it used the term in the Regulation AB Adopting Release to describe an asset that "converts into cash payments within a finite period of time." Insurance policies and reinsurance contracts are principally contingent liability contracts (i.e., a promise to pay) and do not convert to cash within a finite time period.

[15] We also believe that the rights and obligations of an insurer under insurance policies that are ceded via a reinsurance agreement do not constitute an "asset" or "financial asset" within the meaning of the proposed definitions of synthetic ABS in the Release, Request for Comment 4. Instead, insurance is a promise to pay upon the occurrence of a fortuitous event (i.e., an event over which the insurer and insured have no control) and is a contingent obligation of the insurer. We note that expanding the definition of synthetic ABS to include any asset or financial asset, instead of a self-liquidating financial asset, could have unintended negative implications for other forms of insurance-linked securities that are prominent in the insurance industry.

2. Mortgage Insurance and Reinsurance are the Domain of Insurance Regulators.

Mortgage insurance is a traditional insurance product regulated under applicable state insurance law and is subject to oversight by state insurance departments and by the GSEs through the PMIERs. Historically, the Commission has differentiated between traditional insurance products of U.S. regulated insurers and derivatives. For instance, in its 2012 definition of a swap,[16] the Commission and the CFTC created a non-exclusive safe harbor for traditional insurance products (the so-called "Product Test") issued by U.S. domiciled insurance companies (the so-called "Provider Test"), *including the reinsurance of such products*. Such enumerated products include: (i) surety bond; (ii) fidelity bond; (iii) life insurance; (iv) health insurance; (v) long-term care insurance; (vi) title insurance; (vii) property and casualty insurance; (viii) annuity; (ix) disability insurance; (x) *insurance against default on individual residential mortgages (commonly known as private mortgage insurance, as distinguished from financial guaranty of mortgage pools)*; and (xi) reinsurance of any of the foregoing products. The insurance and reinsurance linked to an MILN transaction satisfies both the Product Test and the Provider Test.

In establishing the insurance safe harbor from the definition of a swap, we believe the Commission and the CFTC rightly concluded that the regulation of traditional insurance products, such as mortgage insurance, and the reinsurance of such products, was principally the domain of state and federal insurance regulators. Similarly, the business of insurance was excluded from many sections of Dodd-Frank to avoid interfering with the regulation of insurance under state law.

The Commission's description of synthetic ABS in the Release states that "synthetic transactions are generally effectuated through the use of derivatives such as a CDS or a total return swap, or an ABS structure that replicates the terms of such a swap."[17] The Commission should clarify that a reinsurance agreement of a traditional insurance product is not covered by the foregoing description. We appreciate the Commission's concern of opening too wide of a door by granting exceptions for certain synthetic structures. However, a clarification for MILNs could be narrowly tailored to not have general applicability to other capital markets structures that are intended to be covered by Section 27B. We propose the Commission clarify that synthetic ABS do not include any security issued by a special purpose entity in a transaction in which performance of the security depends primarily on the performance of a reinsurance agreement for which the special purpose entity acts as reinsurer and that does not constitute a "swap" under Section 1a of the Commodity Exchange Act of 1974, as amended,[18] including the non-exclusive insurance safe harbor set forth the Commission's Rule 3a69-1.[19]

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[16] Release No. 33-9338.

[17] Release at 14.

[18] 7 U.S.C. 1a(47).

[19] 17 CFR § 240.3a69-1

3. Mortgage Insurance-Linked Notes Should Not Be Considered Conflicted Transactions

In much the same way that a policyholder buys an insurance policy to cover a particular risk in the event of a loss, an insurer buys reinsurance to protect itself against losses under the original insurance policy. As in any reinsurance arrangement, the mortgage insurer in an MILN has an insurable interest in the underlying policy claims and remains directly responsible for its insurance policy and related regulatory obligations, notwithstanding the reinsurance. MILNs are structured as indemnity excess of loss reinsurance, meaning that the insurer is only entitled to recover its actual loss on a follow-the-fortunes basis above a pre-defined attachment point, similar to a deductible in an insurance policy. Moreover, the insurer in an MILN transaction retains significant risk exposure below and above the coverage layers ceded to the capital markets. At no time is the insurer permitted to recover more than its actual loss under the reinsured policies.[20]

The requirement to maintain an insurable interest differentiates MILNs from credit default swaps and related structures described by the Commission as problematic in the Release. Because of the significant retained risk exposure and the insurable interest, the mortgage insurer maintains a strong alignment of interest with MILN investors to underwrite insurance on high quality loans and mitigate losses through a robust claims process. In addition, given that the mortgage insurer remains bound by the underlying insurance policy to pay the policyholder upon a valid claim, the insurer remains subject to the same regulatory and PMIERs requirements notwithstanding the MILN. At no time does the mortgage insurer benefit from the adverse performance of a mortgage insurance pool. Instead, the MILN is a prudent risk management tool that helps to mitigate aggregate losses from more extreme actuarial scenarios affecting the insurer's policies. In much the same way that one would not characterize the purchase of insurance as a conflicted transaction, we do not believe that reinsurance-based note structures with an insurable interest and significant risk retention should be viewed as a conflicted transaction as defined in the Proposed Rule. The Commission should clarify that such reinsurance structures do not constitute conflicted transactions.

4. Anti-Circumvention

The Proposed Rule provides that if a securitization participant engages in a transaction that circumvents the prohibition in paragraph (a)(1) of the Proposed Rule, the transaction will be deemed to violate paragraph (a)(1) of the Proposed Rule. We ask the Commission to make clear that MILNs will not be viewed as a circumvention of the prohibitions in paragraph (a)(1) of the Proposed Rule.

[20] The indemnity excess of loss reinsurance protection provided under an MILN transaction is often identical to the coverage provided by a panel of traditional reinsurers. Mortgage insurers often execute both an MILN and a traditional excess of loss reinsurance agreement on the same group of mortgage loans in order to secure the reinsurance capacity needed.

Thank you for the opportunity to comment on the Proposed Rule. If it would be helpful to discuss our specific comments or general views on this issue, please contact Seth Appleton (sappleton@usmi.org), Kirk Willison (kwillison@archmi.com), Matthew Stern (mstern@willkie.com) and Adam True (atrue@willkie.com).

Sincerely,

Arch Mortgage Insurance Company

Enact Mortgage Insurance Corporation

Essent Guaranty, Inc.

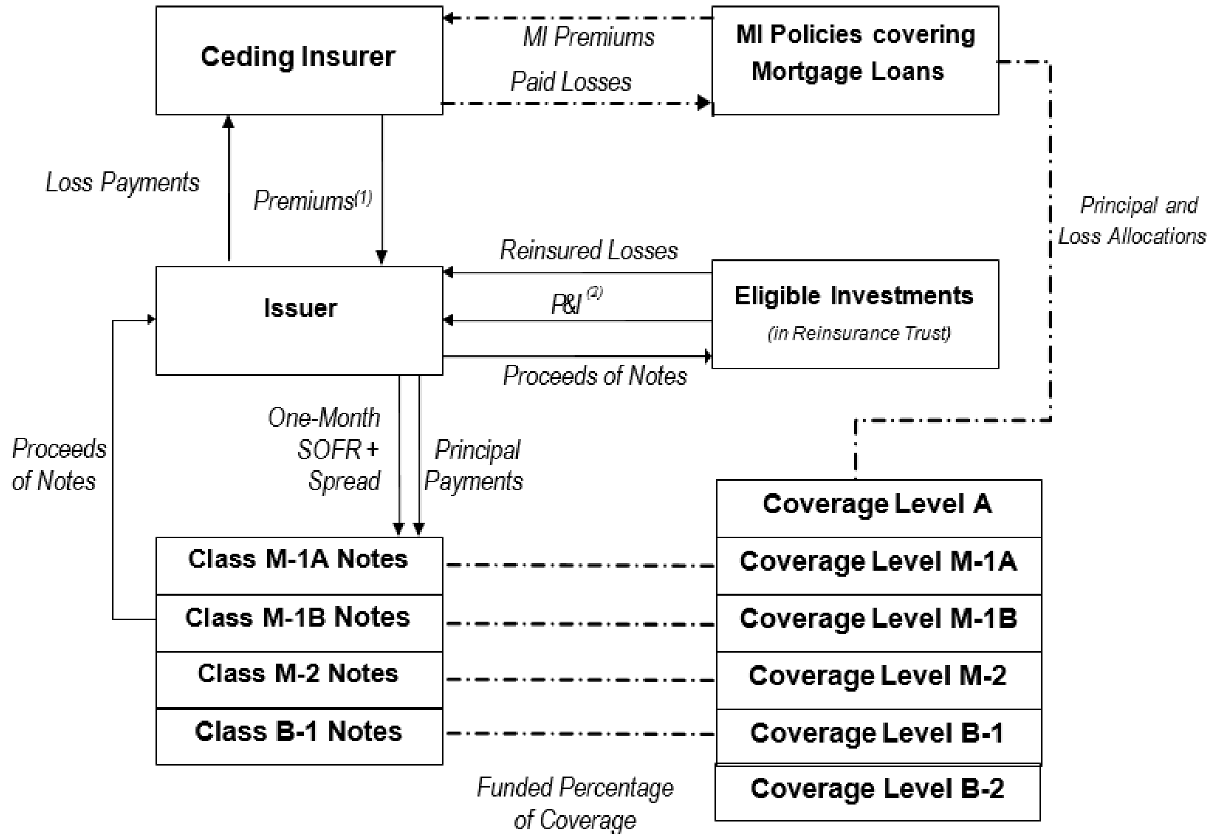
Mortgage Guaranty Insurance Corporation

National Mortgage Insurance Corporation

Radian Guaranty Inc.

Exhibit A

1. MILNs are a mechanism through which U.S. domiciled mortgage insurers purchase excess of loss reinsurance for a defined pool of mortgage insurance policies from a registered special purpose insurer. A diagram of a representative structure is shown below, pursuant to which the mortgage insurer has purchased coverage for Coverage Levels B-1, M-2 and M-1, and retained the risk within Coverage Levels B-2 and A.



(1) Premiums consisting of Coverage Premiums, Initial Expense Premium and Supplemental Premiums.

(2) Principal Payments and Investment Income.

2. The MILNs relate to risks under mortgage insurance policies issued in the United States. A mortgage insurance policy ("MI Policy") is nearly always obtained for mortgage loans in the United States with a down payment of less than 20% in order to comply with eligibility for purchases by Fannie Mae and Freddie Mac. Lenders that purchase a MI Policy from an insurance company (the "Ceding Insurer") select a specific coverage level for each insured loan. Defaulted mortgage loans that are not cured will eventually turn into claims against the Ceding Insurer when certain conditions are met. Title to the property

must be transferred to the insured or a third party in an approved sale before the insured can submit a claim. Upon review and determination that a claim is valid, a Ceding Insurer generally has the following three settlement options under the MI Policies:

- *Percentage option*—determined by multiplying the claim amount by the applicable coverage percentage, with the customer retaining title to the property. The claim amount is defined in the MI Policy as consisting of the unpaid loan principal, plus past due interest, subject to a defined maximum, and certain expenses associated with the default and foreclosure;

- *Third-party sale option*—The Ceding Insurer can elect to pay the amount of the claim required to make the insured whole, commonly referred to as the "actual loss amount" (not to exceed the Ceding Insurer's maximum liability as outlined under the percentage option), following an approved sale of the underlying mortgaged property; or

- *Acquisition option*—The Ceding Insurer can elect to pay the full claim amount and acquire title to the property.

Mortgage insurance coverage is also subject to policy exclusions, such as rescission for a fraudulent insurance application, failure to obtain title to the property or physical damage to a property, such as caused by a natural disaster.

In many cases, once the loan-to-value ratio of a mortgage loan reaches 78-80%, the MI Policy is required to terminate and coverage will cease, notwithstanding that the mortgage loan remains outstanding.

3. In an MILN transaction, a licensed special purpose insurer (the "Issuer") will be established which will provide a form of reinsurance known as excess of loss insurance to the Ceding Insurer. The reinsurance will indemnify the Ceding Insurer in respect of its actual losses on a fixed pool of MI Policies that exceed a certain threshold (or "attachment point") specified in the reinsurance contract, up to a limit as specified in the contract. For example, the excess of loss reinsurance contract could indemnify the Ceding Insurer for $100 million in respect of losses to the Ceding Insurer in excess of $150 million. The excess of loss reinsurance will contain "layers" of coverage so that, to continue this example, the first layer of coverage is $50 million excess of $150 million, a second layer of $25 million excess of $200 million and a third layer of $25 million excess of $225 million. The special purpose insurer is independent of, and not an affiliate of, the Ceding Insurer.

4. MILN structures mitigate adverse selection risk by reinsuring all or virtually all of the ceding insurer's mortgage insurance policies originated during a specified coverage period which satisfy the eligibility criteria set forth in the MILN offering circular and the reinsurance agreement.

5. The Issuer will raise capital through the issuance of MILNs to large sophisticated institutional investors. ILNs are issued under an exemption from registration provided by Rule 144A and Regulation S of the Securities Act. The Issuer uses the proceeds from the

MILN issuance to provide collateral to the Ceding Insurer for its reinsurance obligations through a regulatory compliant credit-for-reinsurance collateral account. The proceeds will be deposited into such collateral account for the sole benefit of the Ceding Insurer and will be invested in specified eligible investments, such as US Treasury Money Market Funds.

6. The Ceding Insurer is required to pay a risk premium to the Issuer for the reinsurance coverage, which is typically based on a floating index plus a fixed spread. The premiums will be used to provide funds for the payment of interest on the MILNs.

7. If there are losses suffered by the Ceding Insurer that are covered by the reinsurance provided by the Issuer, then investors will bear such losses through an ultimate write-down of the MILNs.

8. The limit of reinsurance provided by the Issuer will reduce over time in line with the reduction in "insurance risk in force" under the MI Policies. Consequently, as the outstanding principal amounts under mortgage loans are reduced by payments from the borrowers or as a result of a loan refinancing, the insurance risk in force reduces at the related covered percentage. The insurance risk in force is also reduced by the feature of an automatic policy termination when the loan to value percentage drops to 78% or below, as required under the Homeowners Protection Act of 1998 and other GSE requirements.