Mortgage Insurance Companies of America

Suzanne C. Hutchinson
Executive Vice President

December 8, 2009

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Numbers S7-17-08, S7-18-08, and S7-19-08

Dear Ms. Murphy:

The Mortgage Insurance Companies of America (MICA) is pleased to comment on the most recent proposal by the Securities and Exchange Commission (SEC) to revise the treatment of credit-rating agency (CRA) determinations in an array of SEC rules.[1] MICA strongly supports the SEC's recent rules to improve CRA methodology and prevent conflicts of interest, and we noted this in detail in our July 25, 2008 comment to the Commission on the SEC's proposal[2] and in our comment on the 2008 proposal relating to regulatory reliance on CRAs granted the status of nationally-recognized statistical rating organizations (NRSROs) by the Commission.[3]

MICA is appreciative of all the SEC's hard work in this area and of its renewed attention to ending undue regulatory reliance on credit rating agencies. Reform here will strike at the heart of failures in the "originate-to-distribute" model that has been widely cited as the cause of current market problems.[4] Action now will promote the commitments President Obama made at the most recent G-20 summit, which reiterated concern about CRA reliance[5] and the most recent statements from the International Organization of Securities Commissions on CRAs,[6] which commits global securities regulators to

[1] References to Ratings of Nationally Recognized Statistical Rating Organizations [NRSROs], 74 Fed. Reg. 52,374 (Oct. 9, 2009).
[2] Proposed Rules for NRSROs, 73 Fed. Reg. 36,212 (June 25, 2008).
[3] References to Ratings of NRSROs, 73 Fed. Reg. 40,088 (July 11, 2008).
[4] *See* President's Working Group on Financial Markets [PWG], *Policy Statement on Financial Market Developments* (Mar. 2008), *available at* http://www.ustreas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf; Basel Committee on Banking Supervision, The Joint Forum, *Credit Risk Transfer, Developments From 2005 to 2007*, Consultative Document (Apr. 2008), *available at* http://www.bis.org/publ/joint13.pdf.
[5] G-20 Leaders' Statement: The Pittsburgh Summit (Sept. 25, 2009), *available at* http://www.pittsburghsummit.gov/mediacenter/129639.htm.
[6] *See* International Organization of Securities Commissions [IOSCO], *Update on Credit Rating Agencies Oversight* (Mar. 2009), *available at* http://www.iosco.org/news/pdf/IOSCONEWS138.pdf; *see also* IOSCO, Technical Committee, *The Role of Credit Rating Agencies in Structured Finance Markets*, Final

1425 K Street, NW
Suite 210
Washington, DC 20005
(202) 682-2683
Fax (202) 842-9252

significant reductions of CRA determinations in capital and similar regulation. The Basel Committee on Bank Supervision is also committed to a new proposal later this year to eliminate CRA references in global bank-regulatory capital standards. As all of these statements make clear, SEC action on this proposal would thus not only improve investor and regulator practice, but also be critical to stabilizing global financial markets.

The more regulators and investors use their own judgment, instead of deferring to the CRAs, the better protected financial markets will become from models risk – an often-overlooked one that has been in some ways the most significant cause of the current credit-market collapse. In the notice of proposed rulemaking (NPR), the Commission rightly notes that its own reliance on CRA determinations has helped to create an "endorsement" that led to undue investor reliance on credit ratings. The sooner this official imprimatur is removed by the SEC and the more quickly other regulators follow suit, the better markets will become now and the more firmly they will be protected from future systemic risk.

Key points in our comment include:

- MICA strongly supports the NPR and urges that it be quickly finalized. We note that this NPR is not subject to any questions about the SEC's statutory authority because it addresses how ratings are used, not how they are derived. Congress is of course considering the role of CRAs in numerous financial-regulatory contexts,[7] but the SEC can and should act under current law to promote urgently-needed market reform.

- If SEC rules require investors to use their own judgment, not simple unquestioned reliance on the CRAs, no undue burden will be imposed. Instead, investors will turn to a

---

Report (May 2008), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf.

[7] Press Release, House Financial Services Committee, Kanjorski Circulates Discussion Draft of Accountability and Transparency in Credit Ratings Agencies Act (Sept. 25, 2009), *available at* http://www.house.gov/apps/list/press/financialsvcs_dem/presskanj_092509.shtml, Press Release, U.S. Senate Committee on Banking, Housing & Urban Affairs, Dodd, Banking Committee Democrats Unveil Comprehensive Financial Reform (Nov. 10, 2009), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Newsroom.PressReleases&ContentRecord_id=df7bf893-bb40-6970-cd5f-c75f56d0fb64&Region_id=&Issue_id=.

review of the degree to which risks are mitigated. Rather than turning to complex, black-box models, they will look to straight-forward risk determinants such as capital and the degree to which a guarantor can in fact honor its commitments. This will return the market to proven forms of risk mitigation in the credit- and operational-risk arenas, a major reform necessary to stabilize markets now and protect them going forward.

- MICA supports the liquidity-risk requirements that the SEC proposes to add to the risk requirements for investor and broker-dealer risk determinations. The failure to capture liquidity risk has been a critical investor and regulatory lapse, as was made all too clear in the failure of Lehman Brothers, Bear Stearns and other recent systemic-risk situations. The SEC's proposal will supplement pending supervisory liquidity standards[8] and, thus, reinforce ongoing efforts to stabilize financial markets.

- Finally, MICA urges the SEC to work with other regulators, most notably the federal bank regulators and the Federal Housing Finance Agency (FHFA), to coordinate its actions with those of other regulators. This is necessary not only to eliminate CRA reliance as quickly as possible from the banking rules (most notably capital requirements), but also to ensure that the SEC's action does not create opportunities for regulatory arbitrage between broker-dealers under the SEC's non-CRA regime and banks under one that still unduly depends on CRA determinations. In particular, we urge the SEC to work with the banking agencies to ensure that revisions to regulatory capital such as the final version of the Basel II "standardized" approach[9] do not include all the CRA-based triggers upon which regulators currently rely. Like the SEC's proposal, bank-capital rules should reference proven credit quality and claims-paying ability. Banks, like broker-dealers, can and should rely on their own credit-risk and related analytics, along with proven providers of risk mitigation. We also urge the SEC to work with the FHFA to coordinate similar changes in the capital rules now governing the housing government-sponsored enterprises (GSEs). Finalizing these rules is critical to ensuring sound GSEs succeed Fannie Mae and Freddie Mac

[8] Proposed Interagency Guidance—Funding and Liquidity Risk Management, 74 Fed. Reg. 32,035 (July 6, 2009).
[9] Risk-Based Capital Guidelines; Capital Adequacy Guidelines: Standardized Framework, 73 Fed. Reg. 43, 982 (July 29, 2008).

as they emerge from conservatorship and to prevent any future boom-bust cycles in the U.S. mortgage market.

I. Focus on Proven Forms of Risk Mitigation, Not CRA Determinations

MICA's members provide primary mortgage insurance (MI), backing mortgages held by private investors and the GSEs. Although MICA's members are state-regulated, well-capitalized firms, some have recently come under downgrades from the NRSROs on which various entities, including the GSEs, base decisions on capital or approved providers of credit-risk mitigation.

The NRSROs provide two ratings for MIs – one based on claims-paying capability and the other assessing the usual corporate-finance considerations that go into all issuer ratings. Confusion between the issuer and claims-paying rating has put undue stress on MICA's members, hampering their ability to raise new capital to do new business at a time when mortgage-market stability is critically dependent on proven forms of reliable mortgage credit-risk mitigation.

Importantly, we have sought to work with the NRSROs to improve the differentiation between issuer ratings and claims-paying ones. This is a critical differentiation – the issuer rating provides a CRA's judgment about the long-term prospects for corporate debt, while the claims-paying one is tied to the ability of a mortgage insurer to honor all its insurance commitments. While related, the capacities are inherently different because state regulation and industry practice require provisions – e.g., a contingency reserve comprised of half of new premium revenue – to handle claims under even catastrophic scenarios.

MICA's members strongly believe that investor and regulatory judgments based on review of claims-paying capacity – as evident by MI capitalization – justifies ongoing reliance on regulated MI as a form of credit-risk mitigation for purposes of setting factors such as eligible investments or regulatory capital. Indeed, we would note that one NRSRO (Standard & Poor's) noted in passing[10] that MICA members have AAA-rated capital even as it proceeded to downgrade firms based

[10] Standard & Poor's Ratings Direct, Research Update: Ratings Lowered on Three Mortgage Insurer Groups: Old Republic, PMI, and Radian (Aug. 26, 2008), *available at*
http://www.google.com/url?sa=t&source=web&ct=res&cd=1&ved=0CAcQFjAA&url=http%3A%2F%2Fwww.radian.biz%2Fpdf%2FS%26P_RadianGroupMI_8-26-08.pdf&ei=e879SoFizdicB8LUmcsD&usg=AFQjCNGIIy6iBO7dlS-NMpcxX5Ctux1-ow.

not on their capacity to pay claims, but rather on subjective judgments about the long-term prospects for the industry. This is an area of interest, of course, to corporate investors and other parties, but it is not one on which regulatory determinations should be based.

II. Liquidity-Risk Requirements

MICA also supports the additional liquidity-risk provisions in the NPR, which are a critical supplement to an independent, non-CRA dependent focus on investor and prudential risk. Off-balance sheet risk-transfer structures – e.g., letters of credit, guarantees – conducted without adequate capitalization by institutions lacking stress-tested claims-paying ability has contributed to the ongoing market crisis, as evidenced now by the previously-cited efforts by the Basel Committee and U.S. banking agencies to ensure appropriate liquidity-risk management going forward.

The SEC's proposal is also a critical element in the necessary revamp of liquidity-risk management and analysis. As the NPR would require, investors and broker-dealers should assess not only the long-term potential for a counterparty to honor its commitments, but also its capacity to do so under stress conditions. When a regulated institution faces a sharp increase in capital because of CRA failings, asset fire sales along the lines of those recently observed in financial markets ensue. These can create serious liquidity problems that lead to failures of otherwise-sound institutions. Adverse macroeconomic impact also results because institutions are suddenly unable to support customer demand for credit or to provide counterparty services essential to an orderly market. Capital recognition should result from proven, capitalized claims-paying ability, not CRA determinations.

Thus, MICA strongly endorses the proposed changes to broker-dealer net capital rules, including the new focus on liquidity risk.

III. Other Regulators

As noted, Congress has pushed the SEC to work with other regulators to reduce all regulatory reliance on credit ratings agencies. The first step in doing so is, of course, finalizing the NPR to set the template for how one agency reforms its practice. Once the SEC has set its course, however, it should quickly act on Congress' instructions and coordinate with other agencies to ensure comparable, quick efforts to reduce CRA reliance in eligibility, capital and similar rules.

In this regard, we note the degree to which the bank regulators rely on CRA determinations in the Basel II standardized NPR cited above. This proposal will shortly be reissued in conjunction with a broader rewrite to U.S. bank regulatory capital, and it is vital that CRA reliance is omitted to the greatest extent possible from these new regulations. MICA suggests that the SEC continue to work with the agencies to ensure they are fully apprised of all of the analytical work underlying this NPR, as well as of recent SEC enforcement actions evidencing serious methodological problems at the CRAs.[11]

We also urge the SEC to undertake comparable outreach with the FHFA. Currently, a wide array of requirements applicable to Fannie Mae, Freddie Mac and the Federal Home Loan Banks is CRA-based. These include the eligibility requirements Fannie Mae and Freddie Mac use to select providers of credit-risk mitigation[12] and the risk-based capital rules applicable to the housing GSEs.[13] As large, sophisticated institutions, all of the housing GSEs should be more than capable of making independent analytical judgments about credit and liquidity risk.

It is vital that the banking agencies and FHFA quickly follow the SEC's lead to ensure that the market-stability benefits of the SEC's NPR are more widely established and, thus, better implemented and longer lasting. However, any divergence in practice among the regulators – especially with regard to regulatory capital – could result in regulatory arbitrage – that is, entities selecting charters or housing risk in different types of on- or off-balance sheet obligations to take advantage of more generous risk-related capital based on erroneous CRA ratings reflected in one or another agency's requirements.

Conclusion

MICA would like again to thank the SEC for its leadership in the area of CRA reform and urges quick action to finalize the NPR. We then hope the SEC will quickly coordinate with the bank regulators and FHFA to win comparable changes in the capital and related rules of all of these agencies so that financial markets can more quickly be brought back to the stability only possible when credit-, liquidity- and

---

[11] SEC, Office of Compliance Inspections and Examinations, Division of Trading and Markets, Office of Economic Analysis, *The Role of Credit Rating Agencies in Structured Finance Markets*, Final Report (May 2008), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf.

[12] *See* Fannie Mae MI Approval Requirements, https://www.efanniemae.com/is/mis/miapprovalreqs.jsp.

[13] OFHEO Risk-Based Capital Regulation, 12 C.F.R. § 1750 (2009), and FHFB Capital Requirements for Home Loan Banks, 12 C.F.R. § 932 (2009).

operational-risk judgments are based on proven risk mitigation, not untested, conflicted CRA determinations.

Sincerely,

Suzanne C. Hutchinson

[1] SEC, Office of Compliance Inspections and Examinations, Division of Trading and Markets, Office of Economic Analysis, *The Role of Credit Rating Agencies in Structured Finance Markets*, Final Report (May 2008), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf.
[2] *See* Fannie Mae MI Approval Requirements, https://www.efanniemae.com/is/mis/miapprovalreqs.jsp.
[3] OFHEO Risk-Based Capital Regulation, 12 C.F.R. § 1750 (2009), and FHFB Capital Requirements for Home Loan Banks, 12 C.F.R. § 932 (2009).