

**HOUSE OF REPRESENTATIVES STAFF ANALYSIS**

**BILL #:** HB 661

Minimum Surplus Requirements for Mortgage Guaranty Insurers

**SPONSOR(S):** Nelson

**TIED BILLS:**

**IDEN./SIM. BILLS:** SB 2084

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	<b>REFERENCE</b>	<b>ACTION</b>	<b>ANALYST</b>	<b>STAFF DIRECTOR</b>
1)	Insurance, Business & Financial Affairs Policy Committee		Reilly	Cooper
2)	Policy Council			
3)	General Government Policy Council			
4)				
5)				

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**SUMMARY ANALYSIS**

Mortgage guaranty insurance protects lenders, usually a bank or mortgage company, against loss of all or a portion of the principal amount of a mortgage loan if a homeowner defaults on a loan. Lenders generally require mortgage guaranty insurance when a borrower is unable to make a down payment of 20 percent of the home's value.

In Florida, mortgage guaranty insurers are required to maintain a minimum surplus of the greater of \$4 million or 10 percent of the insurer's liabilities, but not more than \$100 million. They must also have sufficient capital and surplus so that the outstanding aggregate exposure (net of reinsurance) does not exceed 25 times the insurer's paid-in-capital, surplus, and contingency reserve combined. In effect, mortgage guaranty insurers are required to set aside \$1 of capital for every \$25 of risk they insure, and are prohibited from writing new business when their risk-to-capital ratio reaches 25 to 1. The Office of Insurance Regulation (OIR) informs that as of December 31, 2008, 18 companies have reported premiums for mortgage insurance policies written in Florida. Two of these companies have risk-to-capital ratios that exceed 20 to 1.

House Bill 661 authorizes the Commissioner of Insurance Regulation, upon written request of a mortgage guaranty insurer, to temporarily permit the insurer to continue writing new business if its risk-to-capital ratio reaches 25 to 1. The request may be granted if the Commissioner finds that the insurer's financial position is reasonable in relation to its aggregate insured risk and financial needs, i.e., that the insurer's resources are adequate to satisfy policyholder claims to continue writing new business. The bill permits the OIR to take action against any mortgage guaranty insurer that does not obtain a temporary exception, but continues to write new business after its risk-to-capital ratio reaches 25 to 1.

The bill takes effect on July 1, 2010, and does not appear to have a financial impact on state or local governments.

## HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### **Mortgage Guaranty Insurance**

Mortgage guaranty insurance protects lenders, usually a bank or mortgage company, against loss of all or a portion of the principal amount of a mortgage loan if a homeowner defaults on a loan.<sup>1, 2</sup> Lenders generally require mortgage guaranty insurance when a borrower is unable to make a down payment of 20 percent of the home's value.

In Florida, mortgage guaranty insurance is defined in s. 635, 011, F.S., as a form of casualty insurance that insures lenders against:

(a) Financial loss by reason of nonpayment of principal, interest, and other sums agreed to be paid under the terms of any note, bond, or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate which contains a residential building or a building designed to be occupied for industrial or commercial purposes.

(b) Financial loss by reason of nonpayment of rent and other sums agreed to be paid under the terms of a written lease for the possession, use, or occupancy of real estate, provided such real estate is designed to be occupied for industrial or commercial purposes.

The Office of Insurance Regulation (OIR) informs that there are 79 companies with a mortgage guaranty line of business that are eligible to write these policies, As of December 31, 2008, 18 of these companies have reported premiums for mortgage insurance policies written in Florida.

##### **Regulatory Requirements for Mortgage Guaranty Insurers**

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<sup>1</sup> Mortgage guaranty insurance obtained from an insurance company in the private sector is referred to as private mortgage insurance. It is the private sector alternative to non-conventional, government-insured mortgages, which include mortgages insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs or the U.S. Department of Agriculture's Rural Housing Service. See Mortgage Insurance Companies of America, "2009-2010 Fact Book & Member Directory." Available at: <http://www.privatemi.com> (last accessed February 25, 2010).

<sup>2</sup> Unlike FHA-insured loans, private mortgage insurance does not insure the total balance of the loan. Typically, private mortgage insurance pays the lender 20% to 30% of the mortgage balance in case of default. To be considered for private mortgage insurance, a prospective homeowner must generally be able to make a down payment of at least 5% of the home's value. *Id.* at 5, 13.

Minimum surplus and capital requirements for mortgage guaranty insurers writing business in Florida are found in s. 635.042, F.S. The requisite minimum surplus is the greater of \$4 million or 10 percent of the insurer's liabilities other than the required contingency reserve, but not more than \$100 million. Insurers must also possess sufficient capital and surplus so that their outstanding aggregate exposure (net of reinsurance) does not exceed 25 times the insurer's paid-in-capital, surplus, and contingency reserve combined. In effect, insurers are required to set aside \$1 of capital for every \$25 of risk they insure, and are prohibited from writing new business when their risk-to-capital ratio reaches 25 to 1. Florida is among 16 states<sup>3</sup> with a risk-to-capital limitation, or its technical equivalent,<sup>4</sup> for mortgage guaranty insurers. Mortgage Insurance Companies of America, the trade association for the private mortgage insurance industry, informs that in each of these states mortgage guaranty insurers are prohibited from writing new business when their risk-to-capital ratio reaches 25 to 1.

Mortgage guaranty insurers also are required to establish and maintain a contingency reserve pursuant to s. 635.041, F.S. This reserve, which is in addition to other premium reserves required by law, requires insurers to set aside 50 percent of every premium dollar earned and to maintain contributions made to the reserve during each calendar year for 10 years. Upon approval by the mortgage guaranty insurer's state of domicile and 30 days' notice to the OIR, the contingency reserve will be made available to a mortgage guaranty insurer at an earlier time for loss payments only when the insurer's incurred losses in a calendar year exceed 35 percent of earned premiums.

As of the end of 2008, the OIR reports that no mortgage guaranty insurer had reached the maximum allowable risk-to-capital ratio.<sup>5</sup> However, two mortgage guaranty insurers writing business in Florida had risk-to-capital ratios in excess of 20 to 1. These companies had risk-to-capital ratios of 23.6 to 1 (over \$51 million in Florida direct written premiums in 2008) and 21.1 to 1 (nearly \$84 million in Florida direct written premiums in 2008), respectively. Additionally, one mortgage guaranty insurer is not writing new business,<sup>6</sup> but is continuing to service existing policies.

## Effect of Bill

House Bill 661 authorizes the Commissioner of Insurance Regulation, upon written request of a mortgage guaranty insurer, to temporarily permit the insurer to continue writing new policies in the event the insurer's risk-to-capital ratio reaches 25 to 1. Such request may be granted if the Commissioner finds that the insurer's financial position is reasonable in relation to its aggregate insured risk and financial needs, i.e., that the Commissioner finds that the insurer's resources are adequate to satisfy policyholder claims to continue writing new business.

The bill also permits the OIR to take action against any mortgage guaranty insurer that does not obtain a temporary exception, but continues to write new business when its risk-to-capital ratio is at the maximum allowable level.

## B. SECTION DIRECTORY:

**Section 1.** Amends s. 635.042, F.S., Minimum surplus requirements for mortgage guaranty insurers.

**Section 2.** Provides an effective date of July 1, 2010.

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<sup>3</sup> See Mortgage Insurance Companies of America (MICA), "Florida Risk-to-Capital Ratio Requirements" (August 2009). A copy of the white paper is on file with the Insurance, Business & Financial Affairs Policy Committee.

<sup>4</sup> *Id.* at 1 and correspondence between representatives of MICA (Meredith Woodrum Snowden) and staff of the Insurance, Business & Financial Affairs Policy Committee. In addition to Florida, MICA informs that mortgage guaranty insurers in Arizona, California, Idaho, Illinois, Iowa, Kansas, Kentucky, Missouri, New Jersey, New York, North Carolina, Ohio, Oregon, Texas, and Wisconsin are subject to risk-to-capital requirements, or its technical equivalent. Several of these states, e.g., Arizona, California, and Wisconsin, make reference in statute or rule to terms such as "minimum policyholder position" or "minimum policy surplus." For practical purposes, MICA reports these are the equivalent of a maximum allowable risk-to-capital ratio of 25 to 1.

<sup>5</sup> Risk-to-capital ratios for 2009 will not be available until June 1, 2010, when insurers are required to file audited financial statements.

<sup>6</sup> OIR reports that this insurer had \$9,063 in Florida direct written premiums in 2008.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

#### 1. Revenues:

None.

#### 2. Expenditures:

None.

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

#### 1. Revenues:

None.

#### 2. Expenditures:

None.

### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

To the extent that mortgage guaranty insurers with a strong financial position are allowed to temporarily continue to write new business when their risk-to-capital ratio reaches 25 to 1, the bill may increase the availability of mortgage guaranty insurance in Florida and the willingness of lenders to make mortgages available to individuals unable to make a down payment of 20% of a home's value.

### D. FISCAL COMMENTS:

## III. COMMENTS

### A. CONSTITUTIONAL ISSUES:

#### 1. Applicability of Municipality/County Mandates Provision:

This bill does not require counties or municipalities to spend funds or take an action requiring the expenditure of funds. The bill does not reduce the percentage of a state tax shared with counties or municipalities. The bill does not reduce the authority that municipalities have to raise revenue.

#### 2. Other:

### B. RULE-MAKING AUTHORITY:

None.

### C. DRAFTING ISSUES OR OTHER COMMENTS:

The bill allows the Commissioner of Insurance Regulation to issue a "temporary" exception to the maximum allowable risk-to-capital ratio for a mortgage guaranty insurer upon finding that the insurer's financial position is "reasonable" in relation to the insurer's aggregate insured risk and financial needs. The bill does not specify when the request for an exception is to be made (when the insurer begins to write business in Florida, when it is on the verge of reaching the maximum allowable risk-to-capital ratio, etc.), and does not provide a durational limit or risk-to-capital limit for the temporary exception.

The bill also does not define what a reasonable financial position would be to allow a mortgage guaranty insurer to continue to write new business.

#### **IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES**