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

	REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1)	Insurance, Business & Financial Affairs Policy Committee	13 Y, 0 N	Reilly	Cooper
2)	Policy Council	17 Y, 0 N	Liepshutz	Ciccone
3)	General Government Policy Council			
4)				
5)				

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. According to the Office of Insurance Regulation (OIR), as of December 31, 2008, 18 companies 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. [1, 2] 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

[1] 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).

[2] 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[3] with a risk-to-capital limitation, or its technical equivalent,[4] 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.[5] 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,[6] 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 clams 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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[3] *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.

[4] *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.

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

[6] 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:

None.

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:

   None.

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.

An excerpt from a recent article appearing in the Insurance Networking News may help to illustrate the current dilemma facing the private mortgage insurance industry:

> Mortgage insurers are no longer an endangered species, but it will be more than a year before they return to profitability and healthy capital levels.
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> To nurse themselves back to health, the insurers are depending on a new crop of quality mortgages that will bring in premiums to offset losses on loans made during the bubble years. Trouble is, new business is hard to come by — at least business that meets the insurers' tightened underwriting standards. . . .
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> Mortgage insurers play an important role in the housing industry by enabling loans with low down payments to be sold to Fannie Mae and Freddie Mac. By law, the government-sponsored enterprises [GSEs] may not touch a mortgage if the borrower has equity of less than 20% unless it carries private insurance. And if lenders can't sell loans to the GSEs, they won't have funds to make new loans. . . .
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> But losses across the industry remain high, and given the fragility of employment and the housing market, many executives aren't forecasting a profit until some time (sic) next year.
>
> Michael Grasher, an equity research analyst at Piper Jaffray, said thin capital levels remain a huge problem for the insurers.
>
> "From a capital perspective, they are no better off than they were a year ago," he said. "The biggest issue facing these companies right now is risk-to-capital ratios."
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> The risk-to-capital ratio, a closely watched benchmark, measures how many times over an insurer's resources would be consumed if every loan it insures were to default. Sixteen states won't permit a mortgage insurer to write business if its ratio exceeds 25 to 1. (Three of those states, **North Carolina, Arizona and California, recently enacted laws that let the respective state's insurance regulator make exceptions.**) (Emphasis supplied)
>
> Risk-to-capital ratios have been creeping up, and at some companies they are approaching the 25-to-1 threshold. That's forced the companies to seek alternative ways to keep writing business.[7]

The three states mentioned in the excerpt took varying approaches to amending their statutes to authorize their insurance regulator to make exceptions to the risk-to-loss ratio. North Carolina amended its law to provide that a written request for waiver must be made at least 90 days before the insurer expects to exceed the ratio limit. Also, the request must address a list of factors that North Carolina's regulator must consider when making a determination whether the request is reasonable. The regulator is authorized to retain accountants, actuaries or other experts at the insurer's expense to assist in the review of the request, and a waiver cannot exceed two years duration or extend beyond July 2011.[8]

Arizona, rather than requiring an insurer to automatically stop transacting business whenever the minimum policy-holder position was exceeded, transformed the decision into a discretionary

[7] "Mortgage Insurers Find Themselves in a Volume Bind," *Insurance Networking News*, February 12, 2010, reprinted with permission from *American Banker*, available at: http://www.insurancenetworking.com/news/mortgage_insurance_underwriting_standards_housing_bubble-24211-1.html

[8] N.C.G.S.A. § 58-10-125; paragraph (j), subparts (1)-(12) of the section list the factors that must be addressed in the insurer's request and be considered by the regulator; paragraph (k) authorizes the retention of experts by the regulator; and, paragraph (l) limits the duration of the waiver to 2 years, not to extend beyond July 2011.

determination to be made by its regulator.[9] The Arizona Department of Insurance granted its first waiver under this provision in February 2010 and is expected to rule on similar requests in the near future.[10]

California authorized a waiver that must be requested at least 60 days prior to the time the insurer expects to exceed the required policyholder surplus; however, if the regulator fails to respond to the request within 60 days, the insurer may continue to write policies. The regulator can retain consultants or experts to evaluate the request at the expense of the insurer, and the insurer is responsible for the cost of hearings unless the insurer waives the right to hearings.[11]

At least two other states (Kansas and Idaho) are considering legislation that would provide exceptions to their risk to capital ratios of 25 to 1. As of March 11, 2010, the House and Senate in Kansas were about to begin conferencing on HB 2501.[12] As of the same date, the Idaho House considered HB 477 and rolled the bill to third-reading.[13]

Finally, on March 10, 2010, Oregon's governor signed HB 3654 which allows the state's insurance regulator to waive the state's risk to capital ratio upon a finding that the mortgage insurer's policyholders' position is reasonable in relation to the mortgage insurer's financial needs.[14]

IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES

[9] A.R.S. § 20-1550 G.; the underlined language was added to subpart G., which now reads: "G. If a mortgage guaranty insurer does not have the amount of minimum policyholder position required by this section, <u>the director may require that</u> it shall cease transacting new business until such time that its minimum policyholder position is in compliance with this section."

[10] "Mortgage Insurance Firm Gets Waiver to Bypass Capital Rules," *Phoenix Business Journal,* February 26, 2010, available at: http://www.bizjournals.com/phoenix/stories/2010/03/01/story5.html?s=industry&b=1267419600%5E2944401

[11] Ann.Cal.Ins.Code § 12640.05(g)(1)

[12] The bill broadly authorizes waiver by the insurance regulator "for such time and under such conditions as the commissioner may order, except that no such waiver shall exceed two years." The House and Senate appear to disagree about whether the commissioner should be required to notify specific, standing committee members when a waiver is granted to a company and also submit ongoing reports relating to that company and the actions being taken by the commissioner.

[13] The bill authorizes waiver by the regulator "if the insurer's policyholder surplus is reasonable in relationship to the insurer's aggregate insured risk and adequate to its financial needs." It also allows the regulator to retain experts at the company's expense to assist in the review of the waiver request.

[14] The bill requires the insurer to request waiver at least 60 days prior to the date the insurer expects to exceed the ratio limitation and lists factors that the regulator may consider in making a determination. The regulator may retain accountants, actuaries, or other experts. The waiver is limited to no more than two years, but may be extended for an additional two years after another review. The regulator must charge a fee designed to reimburse the regulator for all costs associated with reviewing the waiver request.