



**Mortgage  
Insurance  
Companies  
of America**

Suzanne C. Hutchinson  
Executive Vice President



LETTER OF COMMENT NO. 35

June 18, 2007

Financial Accounting Standards Board  
c/o Technical Director - File Reference No.  
1530-100  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116  
Via email to [director@fasb.org](mailto:director@fasb.org)

**Re: Financial Guaranty Insurance Project**

Ladies and Gentlemen:

Mortgage Insurance Companies of America ("MICA") the national trade association of the private mortgage insurance industry, respectfully offers these comments in response to the recent exposure draft issued by the FASB titled *Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60* (the "Exposure Draft").

Mortgage guaranty insurance provided by MICA members helps loan originators and investors make funds available to home buyers with as little as 3-to-5 percent down - and even less for qualified borrowers - by protecting these institutions from a major portion of the financial risk of default. While we believe the Board has appropriately excluded mortgage guaranty from the scope of the Exposure Draft, our observations and perspectives are relevant to the Board's deliberations, as there are several concepts introduced in the Exposure Draft that could be applied to future guidance related to mortgage guaranty. In this letter, we will highlight several key differences between mortgage guaranty and financial guaranty as they relate to the issues the Board has identified in the Exposure Draft, and so reinforce our support

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for the Board's determination that mortgage guaranty is sufficiently different from financial guaranty so as to warrant a separate accounting model. However, as providers of insurance related to a debtor's ability to repay debt, we also believe that we can provide potentially useful insight related to the conclusions the Board has reached regarding financial guaranty insurance.

Overall, we believe it is appropriate for the Board to provide guidance related to the accounting for loss reserves due to discrepancies in the application of Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprises*, ("SFAS 60") in the financial guarantee industry, whereas in regards to mortgage guaranty, it should be noted that the issuers in the industry have consistent accounting practices in key areas such as revenue recognition, deferred acquisition costs, loss reserves, etc. We believe that in instances where all entities in an industry consistently follow the same set of accounting practices developed through thoughtful interpretation of the relevant existing accounting guidance, additional guidance that would radically change the practices is generally not appropriate.

This letter has been organized to address issues in the sequential order they were included in the Exposure Draft. We have only responded to those issues which we feel require a specific response from MICA.

#### General Issue

As it relates to the Board's question regarding the new format of the FASB documents, we feel that the new format in the Exposure Draft enhances the understandability of the statement. In particular, the use of bold text is very helpful when users first begin to familiarize themselves to the standard. The inclusion of examples in the text helps to

reinforce the statement's point before moving on to a different section of guidance.

Issue 1: Definition of a Financial Guaranty Contract

Financial guaranty is a contract issued by an insurance enterprise that provides protection to the holder of a financial obligation from a financial loss in the event of a default. It obligates the insurer to pay a claim upon the occurrence of a default and does not provide the ability to negotiate the claim amount prior to payment. In contrast, a mortgage guaranty contract provides protection of a mortgage holder for a specified amount (generally less than 35% of the obligation), chosen at contract inception, in the event of a default by the mortgagee. Generally, mortgage guaranty is only used on mortgages with a loan to value ratio exceeding 80%.

Additionally, a significant difference relates to the length of the contract. Generally, a financial guaranty contract is in effect for the full term of the insured financial obligation, while a mortgage guaranty contract is in effect for a much shorter term (recently averaging only three to five years) covering only the higher risk periods of the financial obligation. The predominant length of an issued mortgage guaranty contract is one month with automatic renewals at the option of the insured. The number of renewals varies significantly based on such external factors as: payment history; home price appreciation; and interest levels. Home price appreciation (or depreciation) and interest levels are highly volatile external factors that cannot be estimated with any reasonableness.

It is very common for the mortgage guaranty contract to be cancelled when the loan to value ("LTV") ratio on the mortgage falls below 80%. In fact, the Homeowners Protection Act of 1998 assures that the borrower can cancel coverage when their LTV ratio falls

below this threshold and coverage is automatically cancelled when the mortgage loan has been amortized to an LTV of 78%. In addition to this property risk is the credit risk of the individual borrowers. After the initial underwriting, the insurers and the insureds have little or no information on the financial capacity of the borrowers to repay the obligation other than the actual payment itself. This is dramatically different than the financial guarantee insurer's ability to monitor the insured's financial strength and payment capacity.

We believe that for the reasons noted above and many others, mortgage guaranty does not fit the definition FASB intended for financial guaranty.

#### Issue 2: Scope of Guidance

We believe the scope of the statement should include all financial guaranty contracts regardless of whether or not they are issued by an insurance company. Under paragraph 5b, mortgage guaranty is specifically excluded from the scope of this statement. However, 5b also states that mortgage guaranty insurance is "similar to" financial guarantee insurance. We believe that in fact, mortgage guaranty is very different from financial guarantee for the many reasons stated in this letter, specifically, the definition of the insurance contract, the effective length of time of insurance coverage, the accounting of unearned premium reserve, the uncertainty of premium receivable, terminations, events insured, and the lack of ability to establish surveillance lists.

#### Issues 4 and 5: Recognition of Unearned Premium Revenue (Liability)

While the recognition of an unearned premium liability would be consistent with current practice in regards to prepaid premiums, we believe that the requirement to recognize a premium receivable asset for

installment premiums would materially overstate asset and liability balances for both mortgage guarantors and financial guarantors, particularly as it relates to residential mortgage-backed securities ("RMBS").

As noted above, while most mortgages will include a term of many years (typically thirty), the average life of a mortgage is significantly shorter due to borrowers either refinancing or selling one home and prepaying the existing mortgage and purchasing a different home and taking out a new mortgage. Should the guidance in the Exposure Draft be adopted, financial guarantors would be required to record assets and liabilities related to premiums that would be due from the RMBS by using the contractual lives of the underlying mortgages. However, in reality, the vast majority of the premium receivable asset would later be written off as the underlying mortgages are prepaid. Furthermore, overstating the unearned premium liability would provide an inaccurate indication of future premium earnings. For mortgage guarantors, this issue would be exacerbated as the entire volume of our business is mortgages. We believe that this practice, especially as applied to mortgage guarantors, risks significantly overstating the assets and future expected premium earnings of the reporting entity.

We believe that the users of our financial statements have a sufficient understanding of the variety of mortgage guaranty contracts, from premiums due monthly to single premiums that apply to the life of the mortgage. We have identified no evidence that users have had any difficulty understanding the predictability of earned premiums in the mortgage guaranty industry. Furthermore, assembling and processing this information would represent a significant new burden to the issuers.

#### Issue 6: Accretion of Unearned Premium Revenue (Liability)

We believe the accretion of the discount rate on the premium receivable through investment income would lessen the relevance of investment income within the financial statements. Additionally, the usefulness of related ratios for users of the financial statements would be diminished. These ratios are key metrics by which insurance company performance is measured.

#### Issue 7: Changes in Contractual Premiums

Within the mortgage guaranty industry, changes in contractual premiums happen frequently. These changes are related to the terms of the underlying mortgage contract and partial prepayments. Mortgage products have a wide variety of payment structures that can lead to significant differences in the timing and amount of contractual payments. Some examples of products that inherently have these features include adjustable rate mortgage ("ARM") with balloon payments and option ARMs that allow significant flexibility in how much principle and interest is paid by the borrower. Any proposed requirement should address this frequent issue.

#### Issues 8-11: Premium Revenue Recognition

We agree with the Board's desire to recognize premium as a function of reduced exposure. However, in our view the proposed requirement that an insurance enterprise recognize a premium as revenue over the period of the contract in proportion to the insured contractual payments highlights an additional reason why the proposed statement should not be applied to mortgage guaranty. We do not believe that relying on the various contractual premium patterns associated with the many different types of mortgage contracts are indicative of when our exposure is reduced. We believe that basing the recognition of premium solely on the

contractual payments ignores another significant measure of exposure for mortgage guaranty, which is the passage of time. The passage of time concept is particularly important for mortgage guaranty as the homeowner is able to establish a pattern of consistent monthly mortgage payments. As a large volume of mortgage guaranty is provided to first time home buyers, this consistent payment pattern strongly correlates with reduced credit risk and thus a reduced potential for a claim. Additionally, the proposed requirement does not allow a mortgage insurer to take into account other factors that determine if a mortgage guarantee contract will result in a claim, namely property values. Long-term home price appreciation in conjunction with the reduced credit risk decreases the risk of default over the course of the loan.

It is widely recognized that the first two years after a loan is originated is a period of relatively low claims for mortgage insurers, with claims increasing substantially for several subsequent years and then declining. There is no direct correlation of exposure to the contractual payment pattern on the underlying mortgage. An additional complication arises from the ability of a mortgage insurer to capture and incorporate the significant number of variations of earnings patterns that would result from recognizing premium revenue as proposed in the statement. The costs associated with building system resources to capture and update these patterns on an individual policy basis would be prohibitive and not result in any discernibly better information for the users of the financial statements.

Mortgage guaranty provides for a predetermined coverage over the life of the mortgage loan, typically 15-30 years. Premium is collected based upon the terms of the certificate of insurance and is renewable at the option of the lender. Mortgage loans almost

always are paid off before the final maturity of the mortgage due to sale of the property by the owner, refinance, amortization of the loan below a specified loan-to-value ratio or claim. A concept that would result in recognition of premium over the contract period (term of the mortgage) does not represent the period over which insurance protection is provided.

Issue 15: Expected Cash Flows / Surveillance List

The concept of a surveillance list is one generally not utilized in mortgage guaranty. At any given time, mortgage insurers typically have tens of thousands of reported delinquencies compared to the less than 100 detailed on the surveillance list in Appendix A of the proposed statement. Additionally, specific financial information such as current employment or FICO scores necessary to model expected cash outflows and the probability of default for individual borrowers, while available during the underwriting process, is generally less obtainable after the policy is issued. That said, we support establishing any reserve as a result of a specific credit event. This is consistent with mortgage guaranty, where we establish a reserve based on receiving a notice of default.

Issue 17: Effective Date

The Exposure Draft states that the Board expects to issue the final statement in the third quarter of 2007. The Board concluded that the provisions of this statement should be effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Based on the accounting and disclosure requirements of this statement, we believe an enterprise would be required to make substantial business process changes and to implement significant systematic modifications to be able to adopt the provisions of this statement as of January 1, 2008. Given the

period of time between when this statement will be issued in its final form and December 31, 2007, there would not be sufficient time for an enterprise to respond and make all the required process and systematic changes necessary to comply with the provisions of this statement. We would envision that an insurance enterprise would have to review and implement extensive modifications to key business processes and the related information technology systems in connection with recognizing premium revenue and establishing liabilities for future claim obligations. Therefore, we believe it would be appropriate for the Board to extend the required adoption date of this standard for an additional year for financial statements issued for fiscal years beginning after December 15, 2008.

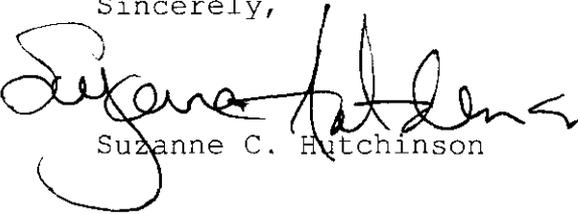
#### Issue 18: Retrospective Application

The Exposure Draft states that the proposed statement would require that an insurance enterprise recognize the cumulative effect of initially applying this statement as an adjustment to the opening balance of retained earnings for that fiscal year in which this statement is initially applied. Retrospective application of this statement is not permitted.

We agree with the proposed prospective accounting treatment in connection with adopting the provisions of the statement contained within the Exposure Draft. Given the nature and extent of the accounting and financial reporting changes contained within this proposed standard, we do not believe that retrospective application would be completely achievable. Therefore, we believe that it would not be appropriate to restate prior-period balances upon adopting the provisions of this proposed statement.

We hope that the Board will find these comments useful as it continues to deliberate this important subject. We would be happy to make ourselves available to further discuss these responses.

Sincerely,

A handwritten signature in black ink, appearing to read "Suzanne C. Hutchinson". The signature is fluid and cursive, with a large initial "S" and a long, sweeping underline.

Suzanne C. Hutchinson