UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING File No. 2014-CFPB-0002 In the matter of: PHH CORPORATION, PHH MORTGAGE CORPORATION, PHH HOME LOANS, LLC, ATRIUM INSURANCE CORPORATION, AND ATRIUM REINSURANCE CORPORATION.	**RESPONDENTS' COMPILATION OF MATERIAL IN SUPPORT OF THEIR APPEAL** Oral Argument: March 9, 2015

A HUD Letter – Letter dated August 6, 1997, from Nicolas P. Retsinas, Assistant Secretary for Housing-Federal Housing Commissioner, to Sandor Samuels, General Counsel of Countrywide Funding Corporation. (Attachment A to ECX 193)

B Milliman's Reinsurance Performance Metrics for Atrium Reinsurance Corporation (1st Quarter 2012) – Excerpts Relating to Genworth. (RCX 2004)

C Milliman's Reinsurance Performance Metrics for Atrium Reinsurance Corporation (1st Quarter 2013) – Excerpts Relating to UGI. (RCX 838)

D Minutes from the January 22, 1998 Meeting of the Board of Directors of MGIC Investment Corporation. (ECX 35 – Redacted in original)

E OTS Letter – Letter dated March 11, 1999, from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision. (RCX 822)

F OCC Interpretive Letter #743 – Letter dated October 17, 1996, from Julie L. Williams, Chief Counsel, Office of the Comptroller of the Currency, to Richard L. Gray, Vice President and General Counsel of United Guaranty. (RCX 821)

G HUD Statement of Policy 1996-3, Rental of Office Space, Lock-outs, and Retaliation, 61 Fed. Register 29264 (June 7, 1996).

H HUD Interpretive Rule – Real Estate Settlement Procedures Act (RESPA): Home Warranty Companies' Payments to Real Estate Brokers and Agents, 75 Fed. Register 36271 (June 25, 2010).

EXHIBIT A

U. S. Department of Housing and Urban Development
Washington, D. C. 20410-8000

August 6, 1997

Attachment A

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

Mr. Sandor Samuels
General Counsel
Countrywide Funding Corporation
155 N. Lake Avenue
Pasadena, California 91109

Dear Mr. Samuels:

Last year the Department of Housing and Urban Development (the Department) sought from you information on the captive reinsurance program of Amerin Guaranty Corporation (Amerin) with Countrywide Home Loans (Countrywide) and its affiliated reinsurer, Charter Reinsurance (Charter). You then requested that the Department clarify the applicability of Section 8 of the Real Estate Settlement Procedures Act (RESPA) to captive reinsurance programs. For the reasons set forth below, we have concluded that, so long as payments for reinsurance under captive reinsurance arrangements are solely "payment for goods or facilities actually furnished or for services actually performed," these arrangements are permissible under RESPA. See paragraph 8(c)(2) of RESPA, 12 U.S.C. § 2607(c)(2). The following details the facts concerning captive reinsurance programs as we understand them, relevant law, and how the Department will scrutinize these arrangements to determine whether any specific captive reinsurance program is permissible under RESPA.

I. BACKGROUND

A typical captive reinsurance arrangement involves a mortgage lender acting in concert with a fully licensed reinsurance affiliate of the mortgage lender and an unaffiliated primary mortgage insurer. The sole purpose of the reinsurance affiliate is to reinsure loans which the affiliated mortgage lender originates and which the unaffiliated, primary mortgage insurance company insures. The primary mortgage insurer and the reinsurer enter into a contract under which the primary insurer agrees to pay the reinsurer an agreed upon portion of the mortgage insurance premiums for loans originated by the lender and insured by the primary insurer. The lender, therefore, has a financial interest in having the primary insurer in the captive reinsurance program selected to provide the mortgage insurance.

ECX 0193

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PHH BOGANSKY CFPB 019544

CFPB-PHH-00112651

Premiums paid for the reinsurance may be net of an agreed upon "ceding commission," which represents the reinsurer's share of the costs of administering the book of insured business.

Under the contract between the primary insurer and the reinsurer, the reinsurer posts capital and reserves satisfying the laws of the state in which it is chartered and may also establish an additional security fund to ensure that, when a claim against the reinsurer is made, funds will exist to satisfy the claim. In exchange for a portion of mortgage insurance premiums (minus a ceding commission, if applicable) to be paid by the primary insurer, the reinsurer obligates itself to reimburse the primary insurer for an agreed portion of claims that may require payment under the contract. Under different reinsurance arrangements, the reinsurance obligations generally take one of two forms. The first is an "excess loss" arrangement, under which the primary insurer pays, and is solely responsible for, claims arising out of a given book of business up to a predetermined amount, after which the reinsurer is obligated to reimburse the primary insurer's claims up to another predetermined amount. Thereafter, the primary insurer is solely responsible for claims in excess of the reinsurer's tier of losses on a given book. A second type of contract is the "quota share" contract, under which the reinsurer would bear a portion of all insured losses.

Under captive arrangements of which the Department is aware, some degree of disclosure is provided to the consumer about the arrangement and some opportunity is accorded to the consumer to choose whether or not to have the loan insured through a captive reinsurance program.

II. <u>LEGAL ANALYSIS</u>

Subsection 8(a) of RESPA provides that "[n]o person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." 12 U.S.C. § 2607(a). "Thing of value" is further described in the Department's regulations as including "without limitation, monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies that may be paid at a future date, the opportunity to participate in a money-making program...." 24 C.F.R. § 3500.14(d). In addition, subsection 8(b) prohibits the giving or receipt of any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service "other than for services actually performed." 12 U.S.C. § 2607(b). These prohibitions against paying for referrals and against splitting fees are very broad and cover a variety of activities.

Subsection 8(c) of RESPA sets forth various exemptions from these prohibitions. It provides, in relevant part, that nothing in section 8 shall be construed as prohibiting "(2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed." 12 U.S.C. § 2607(c)(2).

The Department's view of captive reinsurance is that the arrangements are permissible under RESPA if the payments to the reinsurer: (1) are for reinsurance services "actually furnished or for services performed" and (2) are bona fide compensation that does not exceed the value of such services.

The rationale behind this two-step analysis is that in instances in which a lender selects the mortgage insurer, including under a captive reinsurance arrangement, the lender's actions would constitute a referral of loans to a mortgage insurer, by influencing the borrower's selection of his or her mortgage insurer. See 24 C.F.R. § 3500.14(f) (definition of "referral"). If the lender or its reinsurance affiliate is merely given a thing of value by the primary insurer in return for this referral, in monies or the opportunity to participate in a money-making program, then section 8 would be violated; the payment would be regarded as payment for the referral of business or a split of fees for settlement services. If, however, the lender's reinsurance affiliate actually performs reinsurance services and compensation from the primary insurer is bona fide and does not exceed the value of the reinsurance, then such payments would be permissible under subsection 8(c). Conversely, any captive reinsurance arrangement in which reinsurance services are not actually performed or in which the payments to the reinsurer are not bona fide and exceed the value of the reinsurance would violate section 8 as an impermissible referral fee.

A. Analysis of Specific Captive Reinsurance Arrangements

The Department will analyze captive reinsurance arrangements to determine if the arrangements comply with RESPA. Factors which may cause the Department to give particular scrutiny to an arrangement and cause it to apply the test set forth in Part II(B) of this analysis include, but are not limited to, the following:

1. The amount charged directly or indirectly to the consumer for mortgage insurance in a captive program is greater than the amount charged to the consumer for mortgage insurance not involving reinsurance for a similar risk.

2. The costs (premiums minus a ceding commission, if applicable) paid to the captive reinsurer are greater than the cost for comparable non-captive reinsurance available in the market.

3. The lender restricts its mortgage insurance business in whole or to a large extent to a primary mortgage insurer that has a reinsurance agreement with the lender's captive reinsurer.

4. Any major secondary market institution refuses to purchase mortgages insured under a particular captive reinsurance agreement or places special conditions on such purchases.

5. Any credit rating agency reduces the rating of the primary mortgage insurer in whole or in part because of agreements with captive reinsurers.

6. Any State regulatory body questions the adequacy of the reserves maintained by the primary mortgage insurer or the captive reinsurer.

7. The primary insurer's agreement to reinsure is conditioned on the affiliated lender's agreement to refer all of or a predetermined volume of its mortgage insurance business to the primary insurer, or the terms of the agreement (such as the percentage of the premium per loan reinsured that is paid to the reinsurer by the primary insurer) fluctuate depending on the volume of the primary insurance business referred by the lender to the primary insurer. The presence of either of these conditions makes it more likely that at least a portion of the compensation paid to the reinsurer is for the referral of mortgage insurance business.

8. Adequate consumer disclosure is not provided. The Department believes that consumers would be well served by a meaningful disclosure[1] and a meaningful choice[2] for consumers about having their loans included in a captive reinsurance program. A demonstrated willingness to provide such a disclosure may indicate that the arrangement is designed to provide real reinsurance.

The Department does not consider any of these eight factors to be determinative of whether an arrangement merits scrutiny by the Department, nor does it regard the absence of any of these factors to be determinative that further scrutiny is not merited. In addition, as noted in Part II(B), the Department may consider these eight factors in applying the test in Part II(B), to the extent applicable.

B. <u>Test for Whether a Captive Reinsurance Arrangement Violates RESPA</u>

Where the Department scrutinizes a captive reinsurance arrangement, it will apply a two-part test for determining whether the arrangement violates RESPA. The Department will first determine whether the reinsurance arrangement meets three requirements that establish that reinsurance is actually being provided in return for the compensation. If one or more of the requirements is not met, the inquiry will end, and the arrangement will be regarded as an impermissible captive reinsurance arrangement under RESPA. If all of the requirements are met, the Department will determine whether the compensation exceeds the value of the reinsurance. To facilitate its analysis, the Department may use information obtained from the lender, the primary insurer, the captive reinsurer, or other sources, including data on the rate, magnitude, and timing of default losses and mortgage insurance payments and any other

[1] A meaningful disclosure would reveal that the captive reinsurance arrangement exists, that the lender stands to gain financially under the arrangement, and that the consumer may choose not to have his or her insurance provided by an insurer in such an arrangement.

[2] A meaningful choice whether to participate would provide the consumer an easy, non-burdensome opportunity to opt out by, for example, indicating a preference one way or the other on a form.

information necessary to undertake the analysis and may exercise its subpoena authority pursuant to 24 C.F.R. part 3800 to obtain such information.

1. Determining that Reinsurance is Actually Being Provided in Return for the Compensation

To determine that a real service--reinsurance--is performed by the reinsurer for which it may legally be compensated, the following requirements must be satisfied:

a. There must be a legally binding contract for reinsurance with terms and conditions conforming to industry standards.

b. The reinsurer must post capital and reserves satisfying the laws of the state in which it is chartered and the reinsurance contract between the primary insurer and the reinsurer must provide for the establishment of adequate reserves to ensure that, when a claim against the reinsurer is made, funds will exist to satisfy the claim. Unless the reinsurer is adequately capitalized and adequate reserves (which may include letters of credit or guarantee arrangements) and funds are available to pay claims, real services are not being provided.

c. There must be a real transfer of risk. The reinsurance transaction cannot be a sham under which premium payments (minus a ceding commission, if applicable) are given to the reinsurer even though there is no reasonable expectation that the reinsurer will ever have to pay claims. This requirement for a real transfer of risk would clearly be satisfied by a quota share arrangement, under which the reinsurer is bound to participate pro rata in every claim. The requirement could also be met by excess loss arrangements, if the band of the reinsurer's potential exposure is such that a reasonable business justification would motivate a decision to reinsure that band. Unless there is a real transfer of risk, no real reinsurance services are actually being provided. In either case, the premiums paid (minus a ceding commission, if applicable) must be commensurate to the risk, as discussed in Part II(B)(2).

In evaluating these requirements, the Department may also consider the factors in Part II(A), to the extent relevant. If any of the requirements in this Part II(B)(1) is not met, the arrangement will be regarded as an impermissible reinsurance arrangement under RESPA. If any of the requirements is not met, the "service" being compensated would appear to be the lender's referral of business to the mortgage insurer, which RESPA prohibits.

2. Determining that the Compensation Paid for Reinsurance Does Not Exceed the Value of the Reinsurance

If the requirements in Part II(B)(1) for determining that reinsurance is actually being provided in return for the compensation are met, the Department will then determine whether the compensation paid for reinsurance does not exceed the value of the reinsurance. The Department will evaluate whether the compensation is commensurate with the risk and, where warranted, administrative costs. The Department's evaluation of this requirement may:

-- Compare, using relevant mathematical models, the risk borne by the captive reinsurer with the payments provided by the primary insurer.

-- Analyze the likelihood of losses occurring, the magnitude and volatility of possible losses, the amount of payments received, the timing of the payments and potential losses, current market discount rates, and other relevant factors.

-- Take into account the relative risk exposure of the primary lender and the captive reinsurer.

-- Consider the extent to which the lender or the firm controlling the captive reinsurer is shielded from potential losses by inadequate reserves and a corporate structure that segregates risks.

-- Examine other financial transactions between the lender, primary insurer, and captive reinsurer to determine whether they are related to the reinsurance agreement.

-- Examine whether the ceding commission is commensurate with the administrative costs assumed by the primary insurer.

In making this evaluation, the Department may also consider the factors in Part II(A), to the extent relevant. If the Department concludes that the compensation paid for the reinsurance exceeds the value of the reinsurance pursuant to the analysis in this Part II(B)(2), the arrangement will be regarded as an impermissible reinsurance arrangement under RESPA and the payments exceeding the value of the reinsurance will be considered a referral fee or unearned fee.

III. CONCLUSION

In setting forth this analysis, the Department notes the trend in the mortgage market toward increased diversification of risk. The Department welcomes such trends to the extent that such arrangements increase the availability of mortgage credit. Where RESPA would not preclude such arrangements, the Department would generally support them.

The Department believes the system of mortgage insurance and reinsurance is not necessarily comparable to other types of settlement services. Thus, the Department could analyze other settlement service programs differently, depending on the facts of the particular program.

I trust that this guidance will assist you to conduct your business in accordance with RESPA.

Sincerely,

Nicolas P. Retsinas

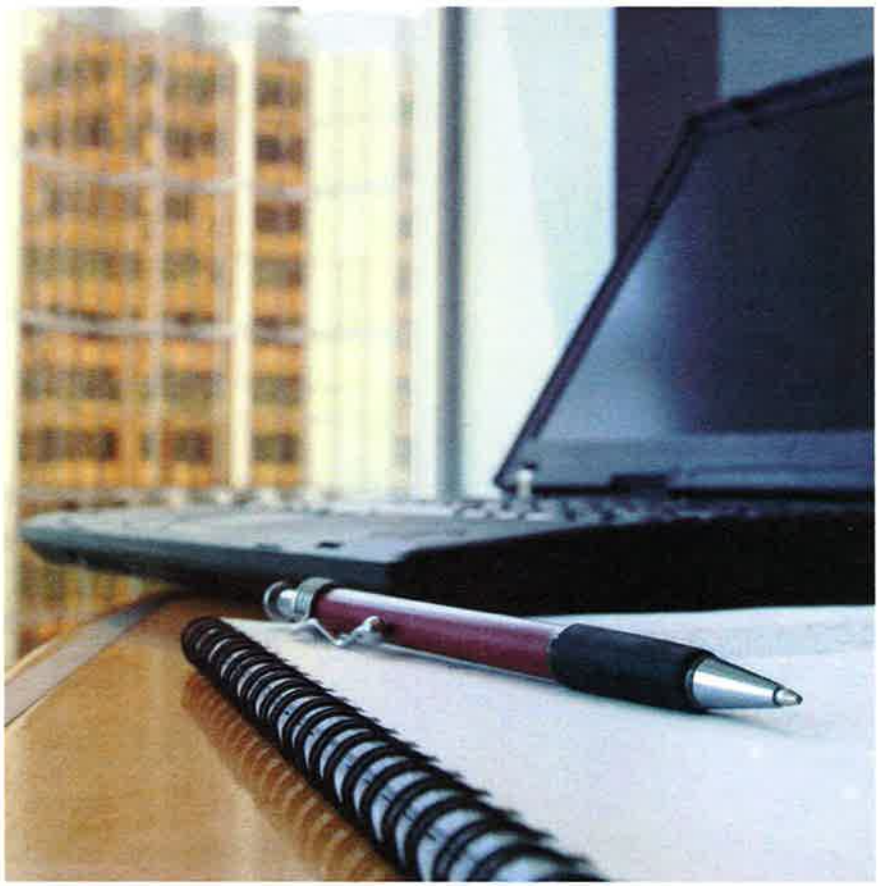
Nicolas P. Retsinas
Assistant Secretary for
Housing-Federal Housing
Commissioner

cc: Mr. Randolph C. Sailer II
Senior Vice President and General Counsel
Amerin Guaranty Corporation
200 East Randolph Drive, 49th Floor
Chicago, IL 60601-7125

EXHIBIT B

Milliman

Milliman Mortgage Risk Analysis

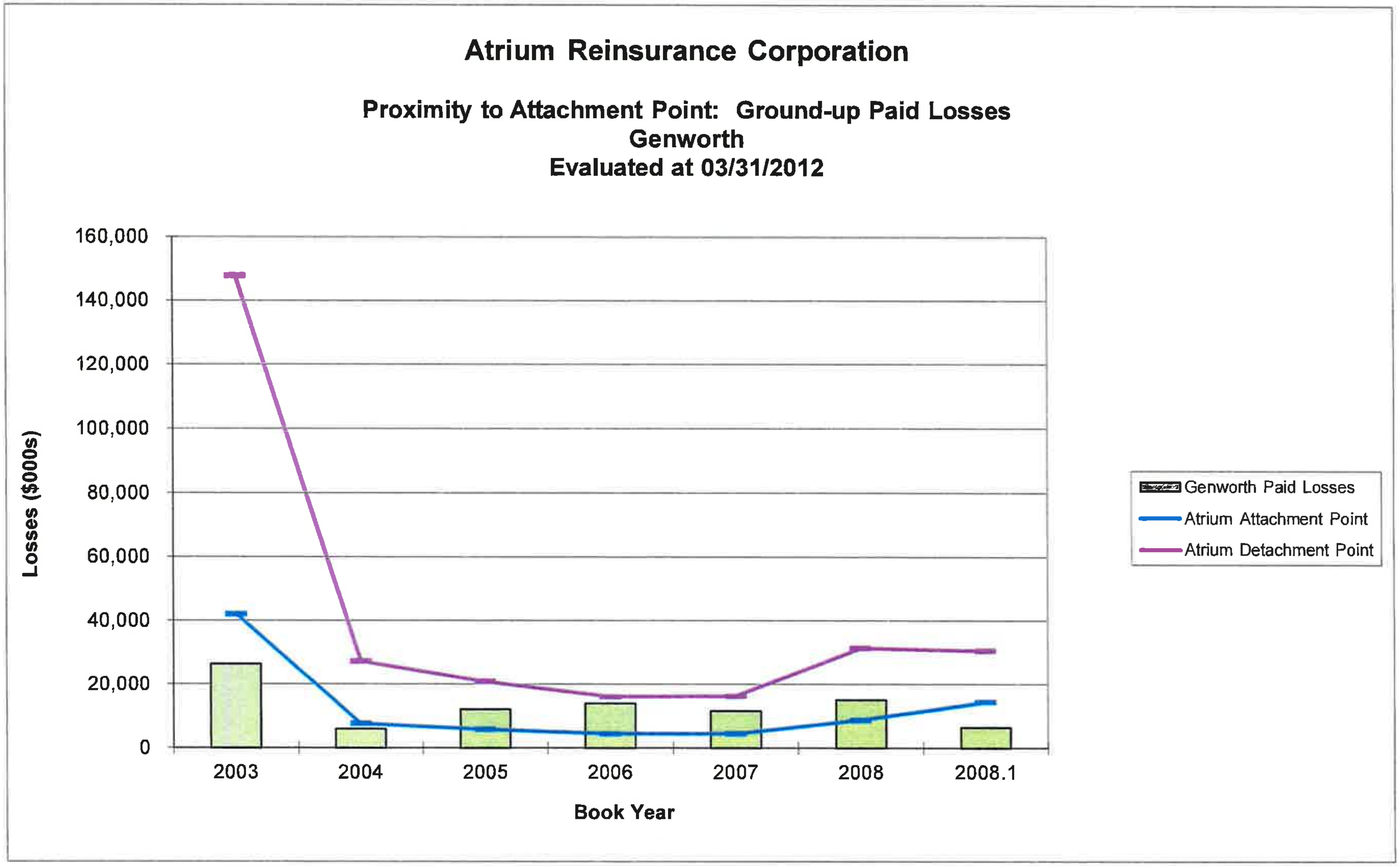


Reinsurance Performance Metrics for Atrium Reinsurance Corporation

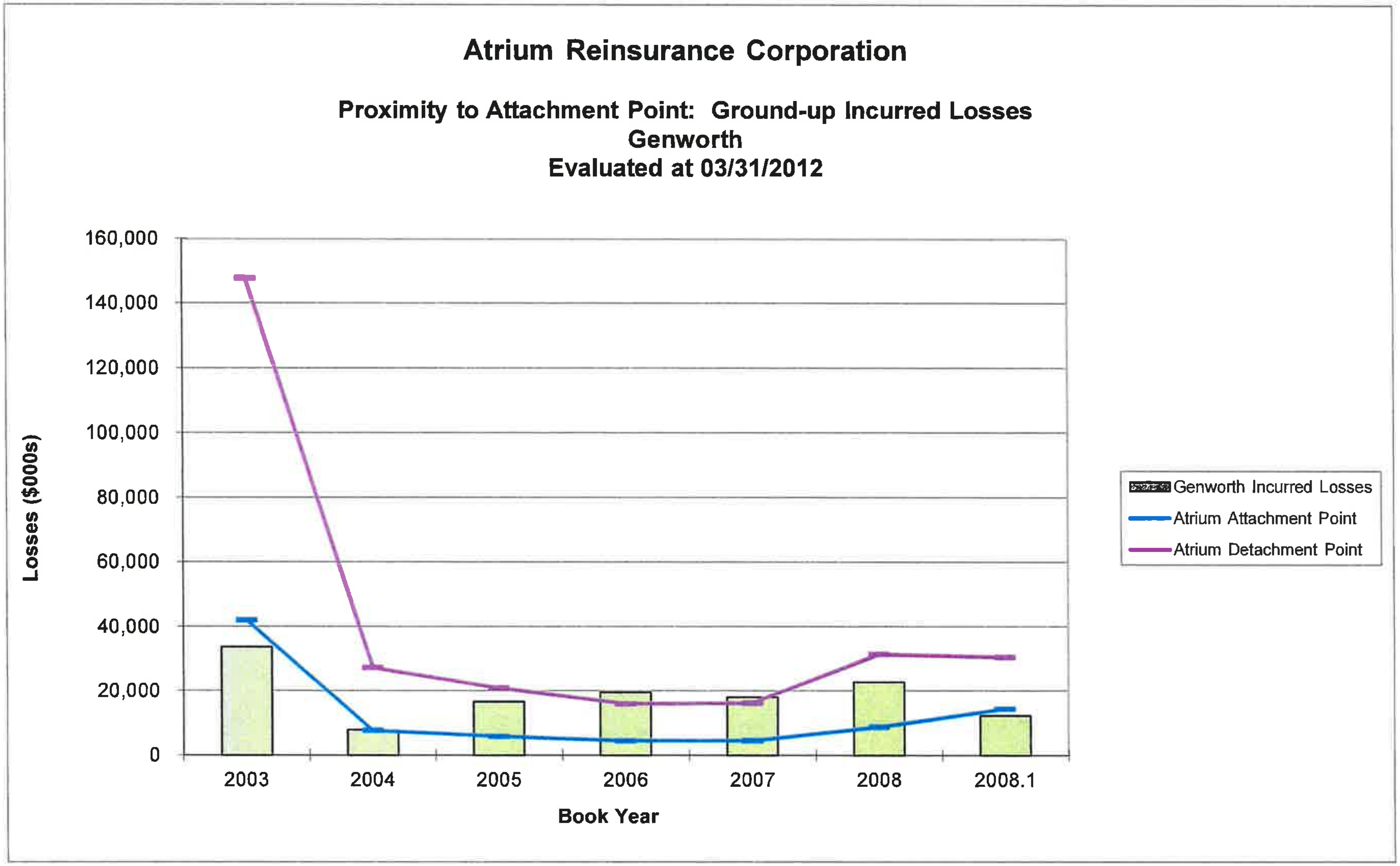
1st Quarter 2012

Michael C. Schmitz, FCAS, MAAA -- Principal and Consulting Actuary
Ken Bjurstrom -- Principal and Financial Consultant
Jean Cox -- Financial Consultant

RESPONDENTS' EXHIBIT 2004



Atrium Reinsurance Corporation
Proximity to Attachment Point: Ground-up Paid Losses
Genworth
Evaluated at 03/31/2012
Losses ($000s)
160,000
140,000
120,000
100,000
80,000
60,000
40,000
20,000
0
2003
2004
2005
2006
2007
2008
2008.1
Book Year
Genworth Paid Losses
Atrium Attachment Point
Atrium Detachment Point


Atrium Reinsurance Corporation
Proximity to Attachment Point: Ground-up Incurred Losses
Genworth
Evaluated at 03/31/2012
160,000
140,000
120,000
100,000
80,000
60,000
40,000
20,000
0
Losses ($000s)
2003
2004
2005
2006
2007
2008
2008.1
Book Year
Genworth Incurred Losses
Atrium Attachment Point
Atrium Detachment Point

Atrium Reinsurance Corporation
Genworth

Loss Ratios by Book Year

Evaluated as of 03/31/12

($000's)

Book Year	Projected Ultimate Paid Losses	Projected Ultimate Written Premium	Projected Ultimate Loss Ratio
2000	0	2	0.0%
2001	0	16,138	0.0%
2002	0	27,148	0.0%
2003	0	43,012	0.0%
2004	1,957	7,751	25.2%
2005	14,342	8,447	169.8%
2006	11,475	6,261	183.3%
2007	11,633	5,768	201.7%
2008	22,477	11,802	190.5%
2008.1	12,058	8,800	137.0%
Genworth Total	73,943	135,129	54.7%

Atrium Reinsurance Corporation
Genworth

Projected Ultimate Losses
($000's)

	A	B	C	D = A * B * C	E	F = D - E
Book Year	Original Risk	% of Risk Assumed	Selected Loss Rate in the Layer	Projected Ultimate Paid Losses in the Layer	Atrium Losses Paid as of 03/31/12	Projected Future Paid Losses
2003	1,055,413	100%	0.00%	0	0	0
2004	195,710	100%	1.00%	1,957	0	1,957
2005	149,642	100%	9.58%	14,342	6,191	8,151
2006	114,755	100%	10.00%	11,475	9,335	2,141
2007	116,329	100%	10.00%	11,633	6,967	4,666
2008	224,774	100%	10.00%	22,477	6,079	16,398
2008.1	322,474	100%	3.74%	12,058	0	12,058
Total	2,179,096			73,943	28,571	45,372

Note: The following books have completed their run-off, per the terms of the contract: Genworth's 2000 - 2002 books

14

Atrium Reinsurance Corporation
Genworth

Comparison of Projected Incremental Paid and Incurred Losses
($000's)

Evaluated as of 03/31/12

	A	B	C	D	E = C - D													
			Atrium Reinsured Layer			Projected Incremental Paid Losses in the Reinsured Layer												
Book Year	Gross Losses Paid by Genworth as of 03/31/12	Layer Attachment Point	Projected Ultimate Losses in Layer	Paid Losses in Layer as of 03/31/12	Projected Future Losses in Layer	2012 [1]	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
2000	0	0	0	0	0													
2001	0	0	0	0	0													
2002	0	0	0	0	0	0												
2003	26,431	42,217	0	0	0	0	0											
2004	5,995	7,828	1,957	0	1,957	0	683	1,274										
2005	12,176	5,986	14,342	6,191	8,151	2,159	3,746	2,246	0									
2006	13,925	4,590	11,475	9,335	2,141	2,141	0	0	0	0								
2007	11,620	4,653	11,633	6,967	4,666	3,030	1,636	0	0	0	0							
2008	15,070	8,991	22,477	6,079	16,398	3,833	7,445	5,120	0	0	0	0						
2008.1	6,513	14,511	12,058	0	12,058	0	503	5,023	3,368	2,111	976	76						
Total	91,730		73,943	28,571	45,372	11,164	14,014	13,662	3,368	2,111	976	76	0	0	0	0	0	0

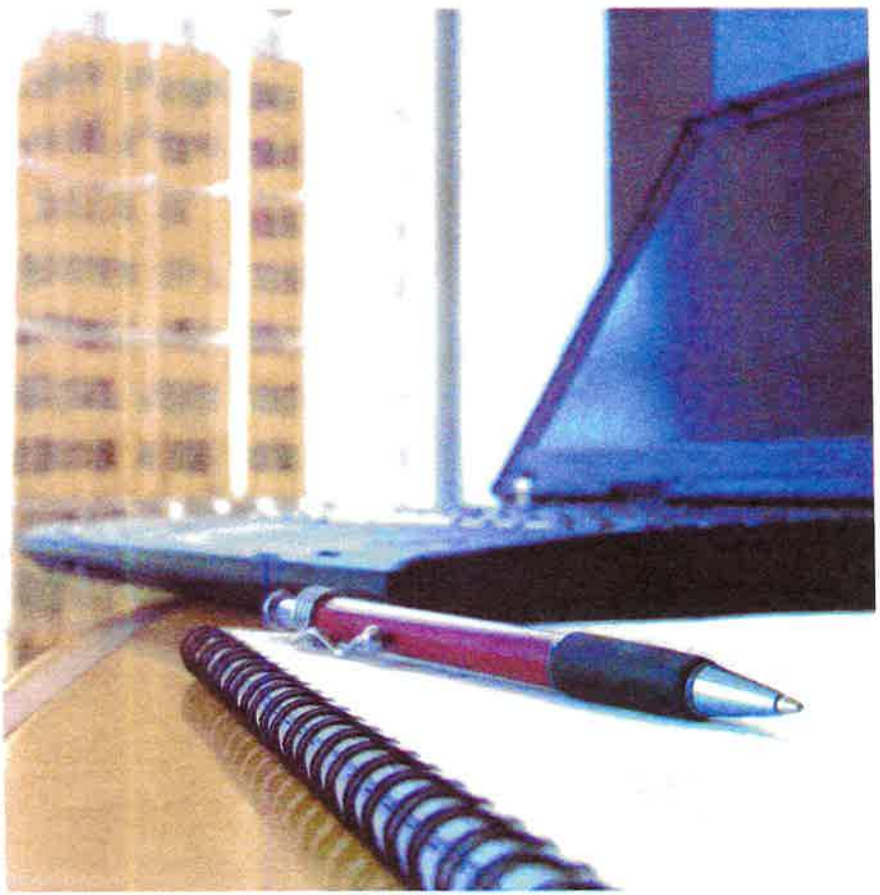
			Atrium Reinsured Layer			Projected Incremental Incurred Losses in the Reinsured Layer (Based on Primary Insurer's case reserves for known delinquencies, as well as an IBNR loss provision)												
Book Year	Gross Losses Incurred by Genworth as of 03/31/12	Layer Attachment Point	Projected Ultimate Losses in Layer	Incurred Losses in Layer as of 03/31/12	Projected Future Losses in Layer	2012 [1]	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
2000	0	0	0	0	0													
2001	0	0	0	0	0													
2002	0	0	0	0	0	0												
2003	33,682	42,217	0	0	0	0	0											
2004	7,785	7,828	1,957	0	1,957	1,397	560	0										
2005	16,606	5,986	14,342	10,620	3,722	2,826	895	0	0									
2006	19,463	4,590	11,475	11,475	0	0	0	0	0	0								
2007	17,976	4,653	11,633	11,633	0	0	0	0	0	0	0							
2008	22,677	8,991	22,477	13,686	8,792	6,251	2,541	0	0	0	0	0						
2008.1	12,280	14,511	12,058	0	12,058	2,443	4,295	3,068	1,841	411	0	0						
Total	130,469		73,943	47,414	26,528	12,917	8,291	3,068	1,841	411	0	0	0	0	0	0	0	0

[1] For remaining nine months of 2012

NOTES: (1) For book years 2005 and prior, projected paid and incurred losses are based on Milliman's expected emergence patterns, with both a 1/2 year acceleration and supplemental adjustments across all book years to reflect current market conditions.
(2) For the 2006 - 2008 books, Milliman applied an accelerated paid and incurred loss emergence pattern, with supplemental adjustments across all book years to reflect current market conditions.
(3) The incurred loss development in this exhibit is based on the Primary Insurer's underlying case reserves for known delinquencies, as well as an IBNR loss provision provided by the Primary Insurer.

EXHIBIT C

Milliman

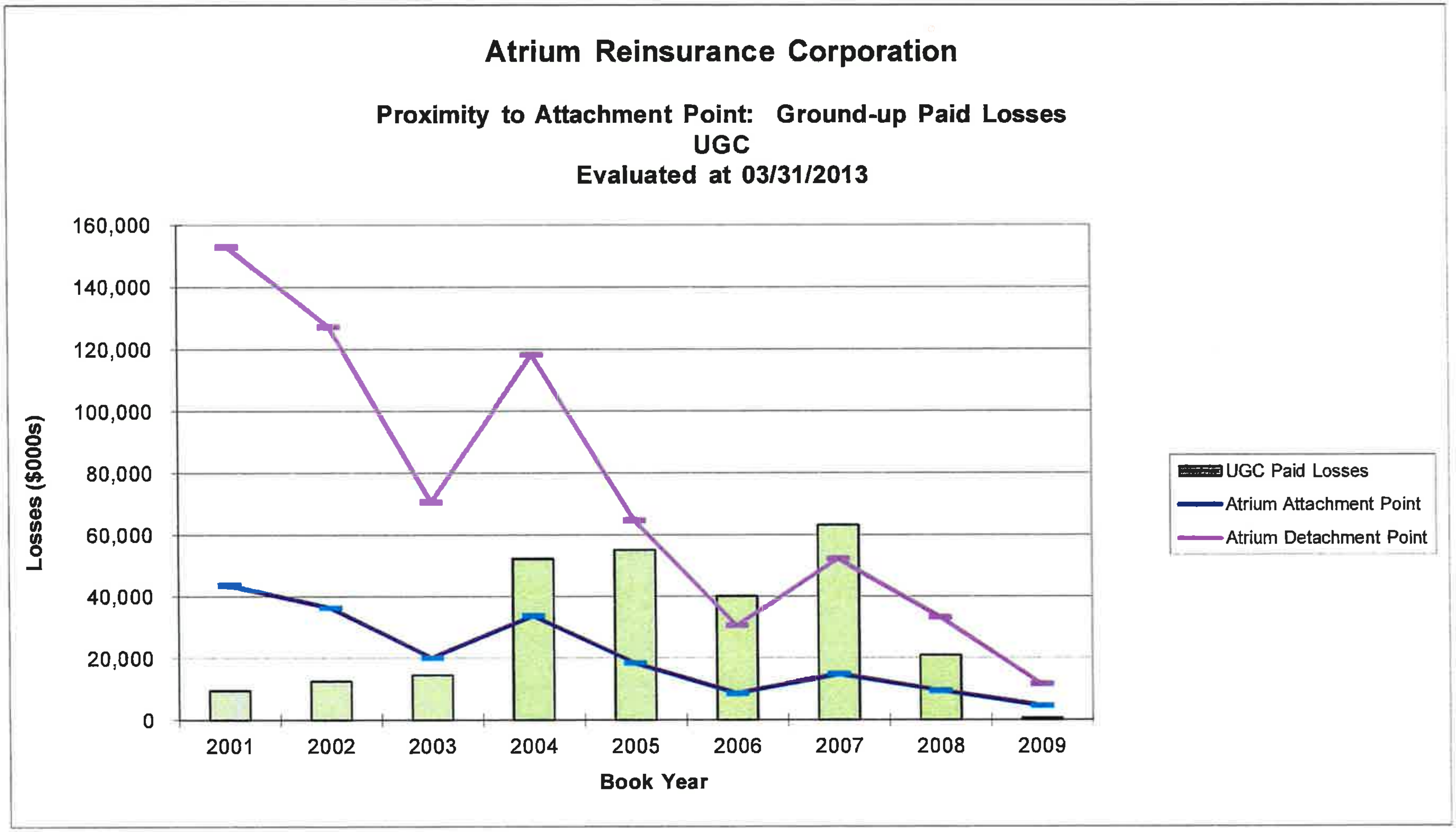


Reinsurance Performance Metrics for Atrium Reinsurance Corporation

1st Quarter 2013

Michael C. Schmitz, FCAS, MAAA -- Principal and Consulting Actuary
Ken Bjurstrom -- Principal and Financial Consultant
Jean Cox -- Financial Consultant
July 11, 2013

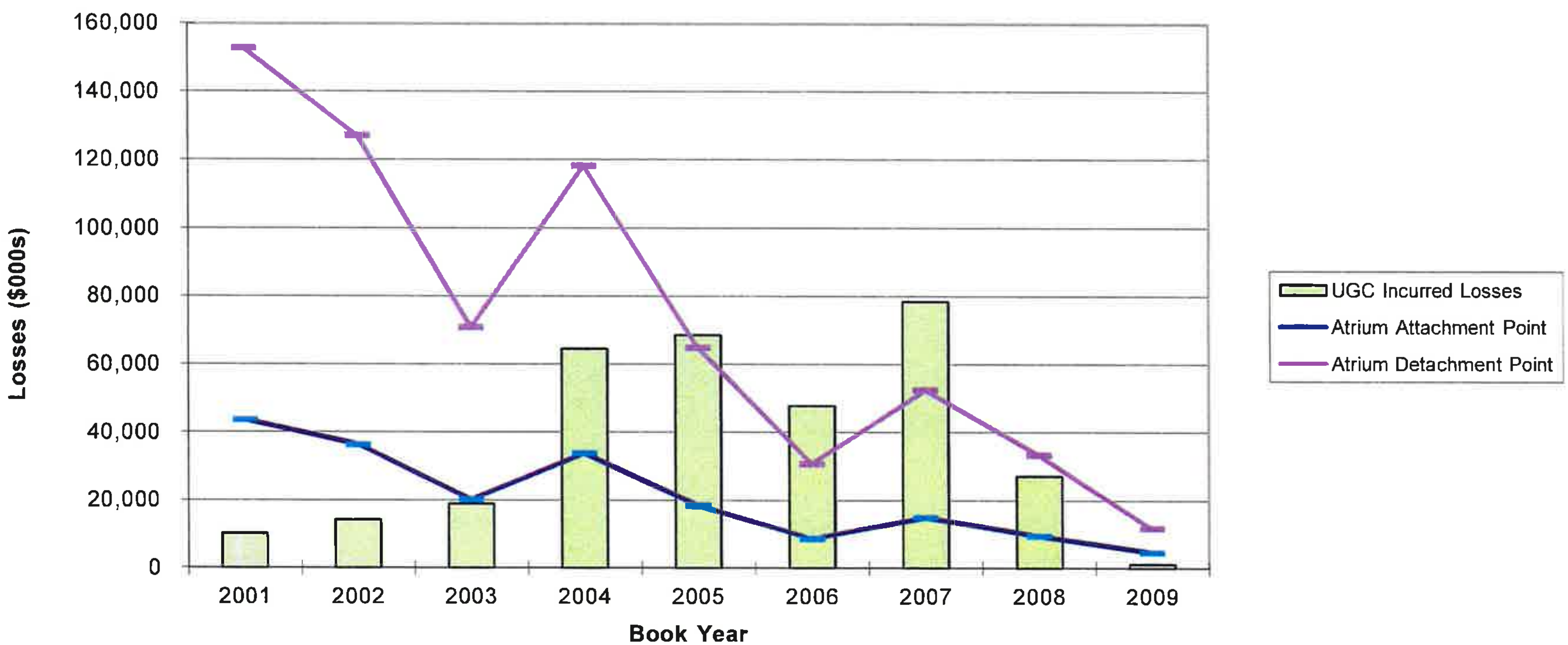
Respondents' Exhibit 0838



Atrium Reinsurance Corporation
Proximity to Attachment Point: Ground-up Paid Losses
UGC
Evaluated at 03/31/2013
Losses ($000s)
160,000
140,000
120,000
100,000
80,000
60,000
40,000
20,000
0
2001
2002
2003
2004
2005
2006
2007
2008
2009
Book Year
UGC Paid Losses
Atrium Attachment Point
Atrium Detachment Point

Atrium Reinsurance Corporation

Proximity to Attachment Point: Ground-up Incurred Losses
UGC
Evaluated at 03/31/2013



Atrium Reinsurance Corporation

Evaluated as of 03/31/13

UGC

Book Year	Projected Ultimate Paid Losses ($000's)	Projected Ultimate Written Premium ($000's)	Projected Ultimate Loss Ratios
2001	0	157,931 [1]	0.0%
2002	0	24,601	0.0%
2003	253	20,728	1.2%
2004	37,060	41,108	90.2%
2005	46,303	27,446	168.7%
2006	21,905	13,401	163.5%
2007	37,367	24,335	153.5%
2008	23,812	14,195	167.7%
2009	1,693	3,227	52.5%
Total	168,393	326,974	51.5%

[1] Also includes reinsurer written premium for book years 1994 - 2000.

19

Atrium Reinsurance Corporation
UGC

Projected Ultimate Losses
($000's)

	A	B	C	D = A * B * C	E	F = D - E
Book Year	Original Risk	% of Risk Assumed	Selected Loss Rate in the Layer	Projected Ultimate Paid Losses in the Layer	Atrium Losses Paid as of 03/31/13	Projected Future Paid Losses
2001	1,091,927	100%	0.00%	0	0	0
2002	908,386	100%	0.00%	0	0	0
2003	505,203	100%	0.05%	253	0	253
2004	844,877	100%	4.39%	37,060	18,405	18,655
2005	463,030	100%	10.00%	46,303	36,541	9,762
2006	219,053	100%	10.00%	21,905	21,905	0
2007	373,665	100%	10.00%	37,367	37,367	0
2008	238,123	100%	10.00%	23,812	11,465	12,347
2009	116,791	100%	1.45%	1,693	0	1,693
Total	4,761,054			168,393	125,683	42,710

Note: No additional delinquencies will be reported for UGC's 1994 - 2002 books.
However, Atrium will continue to have potential liability for any delinquencies that were reported as of each book's respective 10-year anniversary.

Atrium Reinsurance Corporation
UGC

Comparison of Projected Incremental Paid and Incurred Losses
($000's)

Evaluated as of 03/31/13

	A	B	C	D	E = C - D													
			Atrium Reinsured Layer			Projected Incremental Paid Losses in the Reinsured Layer												
Book Year	Gross Losses Paid by UGC as of 03/31/13	Layer Attachment Point	Projected Ultimate Losses in Layer	Paid Losses in Layer as of 03/31/13	Projected Future Losses in Layer	2013[1]	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
2001	9,463	43,677	0	0	0													
2002	12,478	36,335	0	0	0	0												
2003	14,571	20,208	253	0	253	0	253											
2004	52,200	33,795	37,060	18,405	18,655	5,885	9,134	3,636										
2005	55,062	18,521	46,303	36,541	9,762	6,536	3,226	0	0									
2006	40,118	8,762	21,905	21,905	0	0	0	0	0	0								
2007	63,129	14,947	37,367	37,367	0	0	0	0	0	0	0							
2008	20,990	9,525	23,812	11,465	12,347	3,292	7,245	1,810	0	0	0	0						
2009	685	4,672	1,693	0	1,693	0	0	0	475	764	353	92	9					
Total	268,697		168,393	125,683	42,710	15,713	19,858	5,446	475	764	353	92	9	0	0	0	0	0

			Atrium Reinsured Layer			Projected Incremental Incurred Losses in the Reinsured Layer (Based on Primary Insurer's case reserves for known delinquencies, as well as an IBNR loss provision)												
Book Year	Gross Losses Incurred by UGC as of 03/31/13	Layer Attachment Point	Projected Ultimate Losses in Layer	Incurred Losses in Layer as of 03/31/13	Projected Future Losses in Layer	2013[1]	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
2001	10,070	43,677	0	0	0													
2002	14,249	36,335	0	0	0	0												
2003	18,931	20,208	253	0	253	253	0											
2004	64,527	33,795	37,060	30,732	6,328	6,328	0	0										
2005	68,410	18,521	46,303	46,303	0	0	0	0	0									
2006	47,686	8,762	21,905	21,905	0	0	0	0	0	0								
2007	78,392	14,947	37,367	37,367	0	0	0	0	0	0	0							
2008	27,222	9,525	23,812	17,697	6,115	6,115	0	0	0	0	0	0						
2009	1,119	4,672	1,693	0	1,693	0	0	805	666	222	0	0	0					
Total	330,605		168,393	154,004	14,389	12,696	0	805	666	222	0	0	0	0	0	0	0	0

[1] For remaining nine months of 2013

Notes: (1) For book years 2005 and prior, projected paid and incurred losses are based on Milliman's expected emergence patterns, with both a 1/2 year acceleration and supplemental adjustments across all book years to reflect current market conditions.
(2) For the 2006 - 2009 books, Milliman applied an accelerated paid and incurred loss emergence pattern, with supplemental adjustments across all book years to reflect current market conditions.
(3) The incurred loss development in this exhibit is based on the Primary Insurer's underlying case reserves for known delinquencies, as well as an IBNR loss provision provided by the Primary Insurer.

EXHIBIT D

MINUTES OF THE MEETING OF THE BOARD OF DIRECTORS OF MGIC INVESTMENT CORPORATION

A regular meeting of the Board of Directors of MGIC Investment Corporation was held at approximately 8:00 a.m. on January 22, 1998 in the offices of the Corporation at 250 East Kilbourn Avenue, Milwaukee, Wisconsin.

Present and representing all of the members of the Board of Directors were James A. Abbott, Mary K. Bush, Karl E. Case, David S. Engelman, James D. Ericson, Daniel Gross, Kenneth M. Jastrow, II, William H. Lacy, Sheldon B. Lubar, William A. McIntosh, Leslie M. Muma, Peter J. Wallison and Edward J. Zore. Also present at this time were Curt S. Culver, President of Mortgage Guaranty Insurance Corporation ("MGIC") and an Executive Vice President of the Corporation; J. Michael Lauer, Executive Vice President and Chief Financial Officer of the Corporation; Lawrence J. Pierzchalski, Executive Vice President-Risk Management of MGIC; Gordon H. Steinbach, Executive Vice President-Credit Policy of MGIC; Jeffrey H. Lane, Senior Vice President, General Counsel and Secretary of the Corporation; James S. MacLeod, Senior Vice President-Field Operations of MGIC; Lou T. Zellner, Senior Vice President-Corporate Planning of MGIC; John D. Ludwick, Vice President-Human Resources of MGIC; and James A. McGinnis, Treasurer of the Corporation. Mr. Lacy acted as Chairman of the meeting and Mr. Lane acted as Secretary of the meeting.

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Mr. Culver presented his report on operations. Among other topics, he discussed the recent increase in mortgage insurance application volume in response to the decline in mortgage interest rates; and contract underwriting services, including the productivity of the underwriters, competitive pressures that have lead to increases in underwriter compensation, the revenues generated by this activity, new pilot pricing initiatives and the importance of contract underwriting services in preserving and strengthening relationships with lenders.

Privileged

Mr. Culver next discussed pool insurance to reduce guaranty fees on deliveries of loans to the GSEs ("GSE pool"). Mr. Culver covered pricing on 1998 GSE deliveries; pricing and terms of coverage being offered by MGIC's competitors, including that competitors were covering 80-10-10 loans, which MGIC excludes from coverage; MGIC's expectations for new GSE pool transactions in 1998; and the financial effect of writing GSE pool versus a captive mortgage reinsurance relationship. The Board then held a discussion of various matters relating to GSE pool.

Mr. Culver continued his report by discussing MGIC's captive mortgage reinsurance program. Among other subjects, Mr. Culver covered the number of active captive relationships and the terms of the related agreements, including the percentages of premium and risk ceded. He commented on MGIC's application market share and on the continuing consolidation among larger lenders and the potential effect on MGIC of several recent transactions. Mr. Culver also discussed the quality of MGIC's business, including the delinquency rate at December 31, 1997 as compared to the delinquency rates of those competitors of MGIC which were subsidiaries of publicly-traded companies, and a comparison of MGIC's recent writings with those of its competitors' on Freddie Mac deliveries segmented by FICO credit score. On both of these measures, MGIC continued to outperform its competitors. Mr. Culver concluded his report by briefing the Board on MGIC's pilot program to insure A- mortgages and the program of MGIC's affiliates to insure second mortgages, including home equity loans.

Mr. Lacy then held a discussion with the Board of various issues facing the mortgage insurance industry. These included increased penetration by the FHA into the low down payment segment of the market; increased authority granted by regulators to depository institutions to engage in insurance activities; and increased competition, through structured products and other means, among mortgage insurers, including the proposal by Bank One for a high quota share captive mortgage reinsurance arrangement to which two mortgage insurers had affirmatively responded. Mr. Lacy described the initiative by the Mortgage Insurance Companies of America ("MICA") to develop a policy statement, as requested by and directed to insurance regulators, which would define the terms on which risk sharing arrangements with lenders could be implemented consistent with sound insurance regulation. Representatives of three mortgage insurers, including MGIC, were meeting today on behalf of MICA with the Arizona Department of Insurance to discuss the policy statement; meetings had previously been held with insurance regulators in other states. Mr. Lacy distributed to the Board the materials prepared for the Arizona meeting and an article from the January 12, 1998 edition of BestWeek reporting on the MICA risk sharing initiative, both of which are attached to these minutes.

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Mr. Case said that because inclement weather had delayed his arrival at the Committee meeting, Mr. Engelman would report on the portion of the meeting occurring prior to Mr. Case's arrival. Mr. Engelman told the Board that the Committee had, among other topics, reviewed the GSE pool and captive mortgage reinsurance business; Redacted

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After the adoption of these resolutions, Messrs. Lacy, Lane and Ludwick left the meeting at approximately 11:35 a.m. and the Board continued to meet in executive session.

Jeffrey H. Lane, Secretary

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Captive Reinsurance

and

Other Risk Sharing Arrangements

ARIZONA DEPARTMENT OF INSURANCE

January 22, 1998

INTRODUCTION

There has recently been a proliferation of new risk-sharing arrangements by a mortgage insurer or an affiliate thereof with a lender or an affiliate thereof, pursuant to which the payments or rate of return are, directly or indirectly, a function of the performance of an underlying book of business insured by the mortgage insurer. These arrangements include, but are not limited to, captive mortgage reinsurance, "performance notes," and other arrangements characterized as debt securities or other, so-called "derivative" instruments.

All of these risk-sharing arrangements might offer potential benefits. However, if not properly controlled, they also present a threat to the overall strength and claims-paying ability of the private mortgage insurance industry. It is to address these risks that we are recommending that the Arizona Insurance Department adopt a regulation or other binding directive to impose appropriate conditions on all such arrangements irrespective of whether they are characterized as captive mortgage reinsurance or some form of security. Fundamentally, all of these arrangements involve the transfer of premium relative to risk, and should therefore be subject to the jurisdiction and supervision of the Department.

In order to simplify the discussion of the general issues relating to risk-sharing arrangements, this presentation focuses on captive mortgage reinsurance. It must be reiterated, however, that any form of regulation which does not cover the entire gamut of potential risk-sharing arrangements will be ineffective. It would be a fundamental error to permit unregulated risk-sharing arrangements merely because they are structured so as to not take the form of traditional reinsurance risk transfer.

Mortgage Insurance Principles

- A fundamental tenet of all insurance is risk dispersion. This is particularly critical for PMI companies because significant losses are driven by catastrophic events that typically occur on a regional basis, not events that can be actuarially predicted.
- Mortgage guaranty insurers insure nationally dispersed books of business from both a geographic and lender base.
- Mortgage guaranty insurance is a long-cycle business that builds reserves during strong economic times as a shock absorber during economic downturns.

Industry Position . . .

- The mortgage insurance industry supports captive reinsurance structures that transfer risk under a proper regulatory framework that assures the financial strength of our industry to protect the ultimate policyholders.
- Such structures create an alliance between lender and insurer to control and manage risk better.

Lending Industry Trends . . .

- Mortgage lending has become commoditized and very efficient, forcing lenders to look for other opportunities to generate income. Captive reinsurance is one manner in which lenders may participate, on a limited basis, in the mortgage insurance business, subject to compliance with applicable state and federal law.

Mortgage Insurers, Lenders, Investors and Consumers . . .

- Over last 30 years, the mortgage industry and consumers have benefited from the spreading of risk through well-capitalized and supported mortgage insurance. The strong claims-paying ability of the industry gave investors the confidence to support the growth of the secondary market.
- Primary mortgage insurers are able to achieve broad and consistent geographic dispersion of risk by providing insurance to numerous lenders in all regions of the United States. Even the largest lender has only a 6% share of the origination market and thus cannot consistently match the broader diversification of risk by the average MI. In fact, only 14 lenders can claim as much as a 1% share of originations.

Risk Factors Associated With Captive Reinsurance

- Captive reinsurance structures raise some key issues for both the mortgage insurance companies and regulators. These include:
  - Segmentation
  - Compromised Risk Evaluation
  - Capital Adequacy

Segmentation

Captive reinsurance results in the segregation of premiums pledged to support losses on limited segments of a primary mortgage insurer's overall insured portfolio. Such segregation runs counter to the basis insurance principle that an insurer's liabilities should be supported by all of its assets. If mortgage insurers are permitted to reinsure more than 25% of their business in captive reinsurance structures, locking up those premiums, this degree of segmentation will be financially detrimental to the mortgage finance industry.

Compromised Risk Evaluation

Mortgage insurance is unique, in that the "creator" of the risk is the lender, who, as an affiliate of the captive, also has an interest in the insurance. This makes a true arms-length independent judgment of risk more difficult to obtain.

Capital Adequacy

Depending on the nature and level of risk assumed, captive reinsurers should be subject to risk-to-capital requirements which are more stringent than those applicable to primary mortgage insurers.

Inducements to Insure

The nature of the relationship between the mortgage insurer and the lender is such that, absent clear regulatory guidelines, reinsurance transactions will inevitably become more and more generous to the lender until, ultimately, they are no more than revenue-sharing arrangements, under which no risk is transferred.

Recommended Actions--Adopt a regulation or other binding directive, under which mortgage insurers licensed in Arizona would be prohibited from entering into captive reinsurance and other risk- and revenue-sharing arrangements unless the following conditions were satisfied:

- There must be a legitimate transfer of risk of loss from the primary insurer to the captive.
- Reinsurance premiums must be:
  - commensurate with the risk transferred, and
  - not materially greater than the cost of comparable coverage with an unrelated reinsurer
- The requirements of FASB 113 must be satisfied
- An independent actuary or reinsurance broker must provide an opinion to all parties and to the Commissioner of Insurance of the primary insurer's state of domicile concerning transfer of risk and reasonableness of premiums ceded
- Premiums and risk ceded to the captive must not exceed 25% of premiums (less a reasonable ceding commission) and risk relating to mortgage insurance business written by the primary insurer on loans originated by any affiliate (or group of affiliates) of the captive
- The captive's risk-to-capital ratios and reserves, including its contingency reserves, must:
  - satisfy the requirements of its state of domicile;
  - not be less than what is required by the NAIC Model Mortgage Guaranty Insurance Act;
  - be segregated and dedicated solely to the reinsurance obligations of the captive;
  - consist of cash, cash equivalents or marketable, nonaffiliated, investment-grade securities;
  - be adequate to pay projected claims
- Dividends and other payments by the captive must be restricted to ensure the availability of funds to pay claims
- Ceding commissions must be reasonable
- Some geographic risk dispersion requirements should be imposed (e.g.., no more than 20% of the reinsurer's book in any single SMSA)
- The captive must be monoline

MGIC [illegible] draft regulation for the Department's consideration

ECX 0035

Property/Casualty
Edition

BESTWEEK

Insurance News and Analysis
January 12, 1998 Release 2

Mortgage Insurers, Regulators Unite To Urge Curbs on New Bank Ventures

The eight companies that comprise the U.S. mortgage insurance industry and two key insurance commissioners agree that bank-owned reinsurance subsidiaries shouldn't be allowed to accept more than a 25% share of risk and premium income on private mortgage insurance policies.

The stance of the mortgage insurers and regulators is the most aggressive challenge yet to what they see as an especially risky example of banks' entry into the insurance business—made with the backing of Comptroller of the Currency Eugene Ludwig.

The Mortgage Insurance Association of America, the trade group of primary insurers, has called on all state insurance regulators to "act swiftly" to impose the 25% ceiling. The limitation would apply to quota-share and excess-of-loss arrangements between bank captive reinsurers and any primary mortgage insurer that is a partner.

MICA's position, outlined in a Dec. 4 letter to state regulators, is in line with the position of Vermont Insurance Commissioner Elizabeth Costle, whose state is the domicile for most national bank captive reinsurance subsidiaries.

Costle has said that based on solvency and capital-adequacy concerns, she wouldn't approve a captive reinsurance arrangement involving mortgage insurance in which a bank assumes more than 25% of the risk.

She took that position when Banc One Insurance Group, a subsidiary of Columbus, Ohio-based Bank One, approached the Vermont department last year about a license for its new captive mortgage reinsurer. (*BestWeek*, Oct. 27, 1997)

North Carolina Commissioner Jim Long, whose state is the domicile for three of the primary mortgage insurers, agrees

(continued on page 3)

Mortgage (cont'd)

by former Wisconsin Commissioner Josephine Musser, who at the time was president of the National Association of Insurance Commissioners. Long strongly urged all of his fellow commissioners to adopt the 25% limitation in their states.

"Treaties that exceed more than 25 percent begin to look less like reinsurance and more like primary mortgage guaranty insurance underwriting," said the letter.

Since national banks don't comply with the same safety and soundness requirements as primary mortgage insurers, the letter added, "this is a dangerous precedent to set."

Costle said in an interview last week that the issue and the letters were discussed as part of the agenda of a closed commissioners' session at the December NAIC meeting in Seattle.

"We would welcome Bank One, as we would anyone else who wants to form a captive reinsurer," she said of Vermont. "But we have established our standards."

The result of all the activity and letter-writing over the past two months has been to complicate Bank One's effort to get a captive license.

Bank One received approval last year from the Office of the Comptroller of the Currency to form a captive that could assume 50%, perhaps as much as 75%, of the risk in a quota-share deal with a primary mortgage insurer.

Six national banks have received the green light from the OCC to form mortgage reinsurance captives. But Bank One has been the most aggressive in pursuing a quota-share arrangement.

The Bank One plan drew criticism not only from MICA and others in the insurance industry, but more importantly from a key congressman, Rep. John Dingell, D-Mich., the ranking member of the House Banking Committee.

Glen Milesko, president of Banc One Insurance Group, said in an interview last week that his company has been talking to several states since Vermont turned him down. He expressed confidence that Bank One will get a captive license "very soon."

But Milesko is clearly angry about what he termed MICA's "lobbying" to keep Bank One from capturing a competitive share of the mortgage insurance market. "Every state we talk to, MICA comes in and tries to put pressure on the department not to give us a license," he said.

More pointedly, he said he viewed the Long-Musser letter of two months ago as evidence of "collusion" with MICA to frustrate Bank One's efforts.

"I don't know how he (Long) can comment on what we are planning to do when he has never even talked to us about it," said Milesko.

For instance, he said, Bank One is ready to capitalize its reinsurance captive to the tune of $8 million, far beyond the minimum required of incorporated primary mortgage insurers.

"That letter wasn't a responsible thing for a regulator to do," Milesko said. He said that he and others from Banc One Insurance Group are planning to meet with Long in North Carolina.

Long was away on business last week and couldn't be reached for comment.

The situation is all the more complicated because, according to various sources, some of the eight primary mortgage insurers would like to do business with Bank One. Although they signed the joint letter issued by MICA, which is their trade group, these smaller primary mortgage insurers see partnerships with national banks as a way to gain market share, even if it means ceding significant premium income and risk to a bank.

The Long-Musser letter addressed this issue directly. "In their eagerness to gain market share and short-term revenue increases," they wrote, some mortgage insurers "may be willing to give up half or more of their premium income to earn new business. We need to be vigilant to ensure that such partnerships do not result in instability in the mortgage guaranty insurance industry and in the mortgage financing system generally."

The eight companies that signed the Dec. 4 MICA letter were Amerin Guaranty Corp., Commonwealth Mortgage Assurance Co., GE Capital Mortgage Insurance Corp., Mortgage Guaranty Insurance Corp., PMI Mortgage

Insurance Co., Republic Mortgage Insurance Co., Triad Guaranty Insurance Corp. and United Guaranty Corp.

"The big companies in MICA are trying to use their clout to protect their turf," said Milesko. He did not mention names, but GE Capital and MGIC are thought to be the leading opponents of Bank One's quota-share plan.

"I can tell you that if we don't end up being able to do what we want to do," Milesko said, "we have gathered plenty of evidence to make the case that they (MICA) have wrongfully interfered with our business."

Ellen Schweppe, MICA's director of communications, said the trade group wants "a level playing field" in the marketplace. "That is what we have been trying to express to the insurance commissioners."

She said the Dec. 4 letter "represents the industry position as a whole. I can't speak for what the individual companies might do."

The eight companies wrote in their joint letter that they are "not opposed to bank entry into captive mortgage reinsurance per se." They added that "under the right conditions," captive arrangements "can have the same economic benefits as other reinsurance products."

The "prerequisites" that would need to exist to set the right conditions, MICA said, include the 25% limit, proper capitalization of the reinsurance subsidiary, adequate reserves to ensure payment of claims, and "appropriate dividending restrictions" that would preserve the safety and soundness of the mortgage guaranty industry.

In their Nov. 24 letter, Long and Musser went into greater detail about their concerns.

They listed five areas in which allowing more than a 25% share to a mortgage reinsurer owned by a bank lender would be "imprudent." They included:

• Capitalization. Captives can be incorporated with much less capital than primary insurers, and thus the captive may not be able to meet its reinsurance obligations "in a period of stress," the letter said. This, in turn, puts more pressure on the primary insurer to hold additional capital.

• Underwriting. "Lenders under pressure to increase origination volume, could be tempted to bring extra pressure to bear on mortgage guaranty insurance companies to approve loans for insurance," the letter argued.

• Diversification. Segmentation of the market by lenders "would segregate premiums shared with good lenders from being used to offset excess losses," said the letter. If 10 or more of the 25-largest lenders set up 50% quota-share deals with the four-largest mortgage guaranty insurers, the letter added, the current "stability of the primary insurance industry could be undermined seriously."

• Geographic Dispersion. Captives of lenders do business on a regional basis. This diminishes the benefits of geographic dispersion and thus undermines the "actuarial soundness" of the industry.

• Dividends. "Funds available from a poorly performing captive to pay benefits may be less than the premiums previously ceded plus investment income if the structure permits too liberal dividending policies or investment practices," the letter said.

"Whether you are a domicile for a mortgage guaranty insurance company or about to be approached as prospective domicile for a captive company, we are writing to ask you to follow Vermont's lead," Long and Musser said to their fellow regulators.

—Robert H. Gettlin

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EXHIBIT E

Date: March 11, 1999.

Summary Conclusion: A federal savings association may participate in the New England Mortgage Insurance Exchange ("Exchange"), a reciprocal mortgage guaranty reinsurer established under Vermont law. Participating lenders in the Exchange originate or purchase low down payment residential mortgages that are insured by a private mortgage insurance company. The Exchange then writes reinsurance coverage on those mortgages, allowing lenders to contribute risk from their loans into a pool and then take back a share of the risk from the pool.

Subject: Home Owners' Loan Act/Savings Association Powers.

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, DC 20552 • (202) 906-6251

P-99-4

Chief Counsel

March 11, 1999

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Re: Proposed Mortgage Guaranty Reinsurance Activities through Reciprocal Insurer

Dear [ ]:

This responds to your inquiry to the Office of Thrift Supervision ("OTS") regarding whether [ ], a federal savings association (the "Association"), may participate in the New England Mortgage Insurance Exchange (the "Exchange"), a reciprocal mortgage guaranty reinsurer. The Exchange provides private mortgage guaranty reinsurance coverage for loans originated or purchased by participating lenders and insured with a private mortgage insurance company.

In brief, we conclude that the activity is authorized because it is a power incident to the residential real property lending authority of federal savings associations in section 5(c)(1)(B) of the Home Owners' Loan Act ("HOLA").[1]

I. Background

The Association would like to participate in the Exchange, an association captive reciprocal mortgage guaranty reinsurer established under Vermont insurance law.[2] The authorized activities of the Exchange consist solely of writing private mortgage

[1] 12 U.S.C.A. § 1464(c)(1)(B) (West Supp. 1998).

[2] Captive insurers insure or reinsure only risks related to the business of their owner(s). "Association captives" are a type of captive insurer, all of whose participants or owners are also members of a sponsoring industry association or similar group, and which insures or reinsures only risks relating to its members. As a licensed reinsurer in the state of Vermont, the Exchange will be subject to ongoing supervision and regulation of the Vermont Commissioner of Banking, Insurance, Securities and Health Care Administration.

guaranty reinsurance coverage for loans originated or purchased by the participating lenders. As detailed in a supporting letter from the Exchange's legal counsel ("Counsel"),[3] the Exchange is not a separate legal entity, but is a web of contractual agreements among its members ("Participating Lenders"). Counsel represents that the current members of the Exchange consist of several national banks[4] and a large number of state-chartered commercial and savings banks. Counsel also represents that several federal savings associations, including the Association, have indicated that they wish to participate in the Exchange. Membership in the Exchange is limited to banks and other mortgage lenders that also participate in the Northern New England Insurance Trust ("NNEIT").[5] The Association is a member of NNEIT.

We are advised that, at inception, the Exchange funded three obligations. Under Vermont law, an association captive formed as a reciprocal must have free surplus of at least $1 million.[6] This level of surplus allows the Exchange to issue reinsurance obligations on a nonassessable basis, meaning there is no available recourse against the Participating Lenders for the Exchange's liabilities.[7] To satisfy this surplus requirement, Counsel represents that the Exchange has furnished a $1 million letter of credit in favor of the Vermont Commissioner of Banking, Insurance, Securities and Health Care Administration (the "Commissioner"), issued by a bank that is not participating in the Exchange.[8] The letter of credit was fully collateralized with cash, cash equivalents or other liquid assets acceptable to the Commissioner.

The Exchange also funded start-up expenses of $[ ] and a reinsurance trust with an initial deposit of $[ ]. The reinsurance trust was established to secure performance of the Exchange's reinsurance obligations to the private mortgage

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[3] Denise Deschenes, Law Offices of Primmer and Piper, PC, St. Johnsbury, Vermont, authored the supporting letter.

[4] The Office of the Comptroller of the Currency ("OCC") concluded last year that national banks may participate in the Exchange either directly or, with the OCC's approval, through their operating subsidiaries. See OCC Interpretive Letter No. 828 (Apr. 6, 1998).

[5] NNEIT is a pooled arrangement among bank and non-bank mortgage lenders in several states for the purchase of credit insurance at advantageous rates. Not all of the lenders participating in NNEIT will also participate in the Exchange.

[6] Vt. Stat. Ann. Tit. 8, § 6005(b) (1998). Free surplus is not defined within this section. However, the general Vermont insurance statute notes that such free surplus "shall be in the form of cash or marketable securities." Vt. Stat. Ann. Tit. 8, § 3304 (1998).

[7] Vt. Stat. Ann. Tit. 8, § 4853(a) (1998).

[8] The letter of credit was provided with the assistance of an insurance company.

insurance company (discussed below).[9] The start-up expenses and the initial contribution of $[ ] to the reinsurance trust were met with a loan from NNEIT. Because these funding requirements were met with the proceeds of this loan, no initial cash outlay or investment of funds is required to become a Participating Lender. The loan was funded by an insurance company and is evidenced by a [ ] surplus note.[10] The Exchange must make quarterly contributions into the trust of [ ] percent of new covered risk.[11] The Exchange is also required to contribute a specified percentage of its ceded premium[12] to the reinsurance trust beginning in the [ ] year of the program's operation, with the percentage contribution increasing over time to a rate of [ ]% of ceded premium in the [ ] years of operation. Once the trust achieves a level of funding equal to [ ]% of the aggregate risk in force, contributions of ceded premium to the trust in excess of that amount will be released to the Exchange and will be available for distribution to Participating Lenders. The initial $[ ] deposit to the trust was credited toward future required deposits.

The Participating Lenders in the Exchange originate or purchase low down payment residential mortgages[13] that are insured by [ ], a [ ] monoline private mortgage insurer (the "Company"). In turn, the Exchange writes private mortgage guaranty reinsurance coverage on those residential mortgages. Each Participating Lender must execute a Subscriber Agreement pursuant to which it agrees to remit mortgage insurance policy premiums to the Company and assume a pro rata share of the risk reinsured by the Exchange.[14] This arrangement allows Participating Lenders to contribute risk from the loans they have underwritten to a pool and then take back a share of the risk from that pool. If an institution does not contribute risk from its mortgages to the pool during a particular

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[9] In the event the Exchange's obligations under the Reinsurance Agreement are triggered, the Company has agreed to limit its claims against the Exchange to assets held in the reinsurance trust, plus offsets against future ceded premiums.

[10] A surplus note is a promissory note that may be repaid only out of the insurer's earned surplus and with the approval of the Vermont Commissioner.

[11] New covered risk is the added risk taken on by the Exchange during a quarter.

[12] The ceded premium is the premium income that the private mortgage insurance company cedes to the Exchange as compensation for taking on risk.

[13] For purposes of this letter, "low down payment mortgages" means those that have down payments of less than 20 percent of the property's value, or loan-to-value ("LTV") ratios of over 80 percent.

[14] Each Participating Lender must also appoint a common attorney-in-fact and agree to be bound by the Exchange's rules and regulations.

period, then it does not share in the premiums for that period.[15] New members to the Exchange contribute risk to the pool, take on their pro rata share of the risk of the Exchange, and are obligated to direct premium income toward the expenses of the Exchange to the same degree as other Participating Lenders. Like the original participants in the program, no initial cash outlay or investment of funds is required to become a Participating Lender.

Under an Excess Layer Primary Mortgage Guaranty Reinsurance Agreement ("Reinsurance Agreement") between the Exchange and the Company, the Company is responsible for the first layer of risk on the insured mortgages, up to a specified percentage ranging from [ ] percent to [ ] percent of an annual book.[16] Under the Reinsurance Agreement, the Exchange contractually assumes from the Company, and is obligated to the Company for, a second loss layer on each annual book. The Exchange's obligation on the second loss layer on an annual book is capped at [ ] percent of the total of the Company's first layer of risk on all product books included in the annual book.[17] The Exchange's reinsurance liability for an annual book terminates on December 31, [ ] years after the end of the calendar year of origination. In return for taking on this risk, the Exchange is compensated by payment of a fixed rate of [ ] percent of the mortgage insurance premiums paid to the Company by the Participating Lenders.[18] The Company continues to be directly liable, as the primary insurer, to the holders of the insured loans to pay the full amount of the mortgage insurance coverage.

Participating Lenders in the Exchange do not delegate credit underwriting analysis and decision making on any loan to the Company or any other party. The

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[15] For example, if an institution contributes risk from mortgages to the Exchange for two years, and then does not contribute risk during the third year, it will share in the premium allocation with respect to loans contributed to the pool during the first two years (for the ten year life of each of the annual books for such years), but not the premium allocation with respect to loans contributed to the pool during the third year.

[16] The range will vary depending upon the underlying loan type (fixed rate or variable rate) and LTV ratio (80 percent to 97 percent). Variable rate loans will have a higher first layer percentage than fixed rate loans and higher LTV loans will have a higher first layer percentage than lower LTV loans. The annual book is the total of all product books for a year. A product book is a grouping of loans originated or purchased during a year with similar characteristics for purposes of applying the applicable first layer percentage.

[17] For example, if $[ ] million of originations is insured for [ ]% of the principal balance, or $[ ] million, and the applicable percentage for the first layer of coverage is [ ]%, then the first loss layer maximum exposure for the Company is $[ ] and the second loss layer maximum exposure for the Exchange is $[ ].

[18] The borrower pays the mortgage insurance premium to the Participating Lender. In turn, the Participating Lender forwards the premium to the Company which pays the Exchange its [ ] percent share. The Exchange, after making appropriate deductions, including expenses, then returns the pro rata share of premiums back to the Participating Lender.

Company performs its own independent insurance underwriting evaluation of each loan, but it has approved delegated underwriting authority for certain of the lenders participating in the Exchange.[19]

Each Participating Lender in the Exchange provides the borrowers on loans it originates with a notice disclosing the reinsurance arrangement. This notice states that the lender will derive a financial benefit from the arrangement and that the borrower may choose to be excluded from the arrangement if desired.[20]

A Participating Lender may voluntarily withdraw from the Exchange at any time upon notice to a Subscribers' Advisory Committee ("Committee"). If a participant terminates membership at a time other than the end of a calendar year, that participant will share in the net income or loss of the Exchange for that partial year only at the discretion of the Committee. A participant terminating membership has no claim to the assets held in the reinsurance trust. The entire Exchange program may be terminated by a vote of three-fourths of the participants, subject to any limitations in the Reinsurance Agreement.

II. Discussion

The HOLA does not expressly authorize federal savings associations to participate in reciprocal mortgage guaranty reinsurance activities. However, OTS has long recognized that federal savings associations possess "incidental powers," i.e., powers that are incident to the express powers of federal savings associations, as set forth in the HOLA. OTS employs a four-factor analysis to determine the incidental powers of federal savings associations under the HOLA.[21] We will analyze the Association's proposed participation in the Exchange, a reciprocal mortgage guaranty reinsurance exchange, under each of these factors.

1. The Activity is Consistent with the Purpose and Function Congress Envisioned for Federal Savings Associations. In section 5(c)(1)(B) of the HOLA,

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[19] In other words, an institution with delegated underwriting authority from the Company has the ability to bind mortgage insurance coverage for a loan that it approves utilizing Company-approved underwriting criteria.

[20] Counsel's supporting letter recognizes the applicability of the Real Estate Settlement Procedures Act ("RESPA"). The Department of Housing and Urban Development ("HUD") issued an August 6, 1997 letter on captive mortgage reinsurance arrangements that will assist you in meeting your responsibility to comply with RESPA. You should contact HUD if you require further clarification.

[21] See, e.g., OTS Op. Chief Counsel (Jan. 10, 1995); OTS Op. Acting Chief Counsel (Oct. 17, 1994); OTS Op. Acting Chief Counsel (Mar. 25, 1994).

Congress granted explicit authority to savings associations to "invest in, sell or otherwise deal in ... [l]oans on the security of liens upon residential real property."[22] Participation in a reciprocal mortgage guaranty reinsurance program advances residential real property lending by enhancing the attractiveness of low down payment mortgages to lenders, investors and borrowers. Furthermore, the "statutory lending mission of federal savings associations is best served by giving each association the flexibility to structure debt repayment terms and to manage the risks of default in a way that fits with its own business strategy."[23] Thus, participation in the Exchange is consistent with the purpose and function Congress envisioned for federal savings associations.

2. The Activity is Similar to, or Facilitates the Conduct of, Expressly Authorized Activities for Federal Savings Associations. Participating in a reciprocal mortgage guaranty reinsurance program is similar to several activities that are expressly authorized for federal savings associations. Participation in a reciprocal mortgage guaranty program is similar to pricing and allocating risk on residential real property loans directly or through loan participations.[24] It is also a variation on a simple mortgage reinsurance program or mortgage loan performance guaranties.

First, participation in the Exchange will allow the Association and other members to partially take back risk on their own mortgage loans. The credit judgments and risks involved in taking back this risk are similar to those involved in residential real property lending. In both instances, an assessment must be made of the likelihood of default and the probability of loss upon liquidation of the pledged collateral based upon the credit history of the borrower, the size of the down payment made by the borrower and the value of the collateral. Thus, with respect to reinsuring the risks associated with loans they have already originated, Participating Lenders engage in credit underwriting analysis no different from that undertaken in conventional residential real property lending.

Unlike direct conventional residential mortgage lending, however, members of the Exchange take on risk that derives from loans underwritten by other Participating Lenders in the Exchange. Thus, institutions participating in the Exchange diversify risk by indirectly participating in lending activities in other geographic areas, including other states in the region. This is similar to a thrift diversifying its loan portfolio by

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[22] 12 U.S.C.A. § 1464(c)(1)(B) (West Supp. 1998).

[23] OTS Op. Chief Counsel (Jan. 10, 1995) at 6.

[24] This activity is authorized by HOLA section 5(c)(1)(B), 12 U.S.C.A. § 1464(c)(1)(B) (West Supp. 1998).

participating in one or more loan participations. Usually, a credit review of real estate loans is undertaken by the federal savings association extending the credit.[25] However, the loans pooled in the Exchange are reviewed by the originating Participating Lender, and as an additional review of the risk, the Company generally performs its own independent insurance underwriting evaluation. So long as Participating Lenders in the Exchange review the underwriting standards of the Company, and determine that these criteria are not less stringent than their own lending standards, it is not necessary for each participant to undertake a review of each loan reinsured by the Exchange.

Second, the activity is also similar to reinsurance and related activities that are authorized for federal savings associations. For example, in 1995, OTS concluded that the residential real property lending authority expressly granted to federal savings associations by HOLA section 5(c)(1)(B) includes the power to underwrite and reinsure credit insurance for loans made by the Association or its subsidiaries.[26] OTS noted that underwriting and reinsuring credit insurance is one way for a lender to set the terms of each loan, including the terms for repayment, and that no evidence suggests that Congress intended to prohibit associations from setting these terms.[27] The opinion concluded that flexibility in structuring debt repayment terms and managing the risks of default serves the statutory lending mission of federal savings associations."[28] This reasoning also fully applies to membership in the Exchange, which will assist the Association in managing the risk of default in two ways: by obtaining insurance for loans contributed to the pool and by diversifying its overall risk geographically by accepting risk from other Participating Lenders.

Participation in the Exchange is also similar to a federal savings association's issuance of mortgage loan performance guaranties on loans it originates, which is permissible under the authority of HOLA section 5(c)(1)(B).[29] Under the performance

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[25] Real estate lending standards are contained in 12 C.F.R. § 560.101 (1998).

[26] OTS Op. Chief Counsel (Jan. 10, 1995). The 1995 opinion also relied on the consumer lending authority set forth in HOLA section 5(c)(2)(D), 12 U.S.C.A. § 1464(c)(2)(D) (West Supp. 1998). For safety and soundness reasons, OTS indicated that the activity should be conducted in the association's operating subsidiary. OTS has also authorized federal savings association service corporations to underwrite and reinsure credit insurance. See, e.g., FHLBB No. 84-234 (May 14, 1984).

[27] OTS Op. Chief Counsel (Jan. 10, 1995) at 5.

[28] Id. See also OTS Op. Chief Counsel (Dec. 18, 1995) (a federal savings association may include a debt cancellation provision in a consumer loan contract) and OTS Op. Acting Chief Counsel (Sept. 15, 1993) (authority of federal savings associations to enter into debt cancellation contracts).

[29] OTS Op. Chief Counsel (Oct. 2, 1998).

guaranties, an association assumes a portion of the risk of default on low down payment mortgages it originates.[30]

Participating in a reciprocal mortgage guaranty reinsurance program also facilitates the conduct of residential real property lending, an expressly authorized activity. Mortgage insurance increases the attractiveness to lenders and secondary market participants of low down payment mortgages by carving out a first loss position in the lending transaction. This structure offers the option of reallocating risk between the lender and the insurer beyond what is available in a standard mortgage insurance contract without reinsurance.[31]

3. The Activity is Necessary To Enable Federal Savings Associations To Remain Competitive and Relevant in the Modern Economy. The ability of federal thrifts to participate in the Exchange is necessary to enable them to remain competitive and relevant. As noted above, the OCC has determined that national banks and their operating subsidiaries may participate in the Exchange.[32] The OCC concluded that the activities of the Exchange are part of the business of banking, and are, alternatively, an activity incidental to banking. Similarly, numerous state-chartered commercial banks and savings banks currently participate in the Exchange.

If federal savings associations are not allowed to pool their risks through a reciprocal mortgage guaranty reinsurance exchange, they may be placed at a

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[30] OTS has also approved reinsurance of private mortgage insurance by a saving association's service corporation. Under this reinsurance program, loans originated or purchased by the federal savings association, its mortgage lending subsidiaries, or its mortgage lending affiliates, are insured by a private mortgage insurer and then reinsured by the service corporation. In contrast, the Exchange involves a number of institutions pooling reinsurance risk from their mortgages and then taking back risk from loans underwritten by other lenders and from their own loans. OTS Op. Chief Counsel (Nov. 2, 1998). See also OTS Op. Business Transactions Division (Oct. 10, 1997) (service corporation providing reinsurance on private mortgage insurance for loans originated by a federal savings association or its mortgage lending subsidiaries).

[31] As noted previously, the OTS has permitted service corporations of federal savings associations to engage in reinsurance activities. The OTS also allows federal savings associations to engage in joint ventures. The vehicle for participating in the Exchange is similar to entering into a joint venture or joint user corporation to engage in permitted activities. Although the structure is not expressly authorized, these arrangements allow federal savings associations to join together with others to pool their resources to form a viable and potentially profitable entity and to do jointly what any one would be unable to do individually. See e.g., OTS Op. Chief Counsel (Dec. 22, 1995); OTS Op. Chief Counsel (Sept. 15, 1995). For example, it might be difficult for a small institution, like many of the Participating Lenders in the Exchange, to achieve individually the requisite economies of scale, and thus establish a viable mortgage guaranty reinsurance program by engaging in significant amounts of reinsurance activity.

[32] OCC Interpretive Letter No. 828 (Apr. 6, 1998).

competitive disadvantage in comparison to institutions that are able to take back, in return for compensation, some portion of the risk on their own loans. Through arrangements like the Exchange, institutions can achieve economies of scale and efficiencies that may not be possible individually. For example, smaller institutions may only find it feasible to participate in reinsurance activities if they can share risk on a pooled basis, as in the case of the Exchange.

4. The Activity Relates to the Financial Intermediary Role that All Federal Savings Associations Were Intended To Play. Federal savings associations play a role as financial intermediaries by facilitating transfers of funds. They do so by first receiving funds from depositors, investors and other creditors and then directing those funds to borrowers in need of credit. Participation in the Exchange relates to the financial intermediary role of federal savings associations. As discussed previously, it does so by facilitating the conduct of residential real estate lending by pooling and reallocating the risk from loans originated by Participating Lenders. By increasing the options available to participants in the real estate lending process, the Exchange may lead to expanded lending over the level achievable in an environment lacking the availability of reinsurance.

III. Conclusion

All four factors in the incidental powers analysis provide a basis for our conclusion that federal savings associations are authorized to participate in the Exchange. For the foregoing reasons, we conclude that the Association may participate in the Exchange as proposed. In participating in the Exchange, the Association should observe the guidance discussed in OTS Thrift Bulletin 72 pertaining to high loan-to-value home mortgage lending.[33] Finally, the Association's conduct of the proposed activity is subject to any safety and soundness or other conditions OTS's Northeast Region may deem appropriate.

In reaching the foregoing conclusions, we have relied on the factual information and representations contained in the materials submitted to us by you and by Counsel for the Exchange and made in subsequent telephone conversations with OTS staff. Any material change in facts or circumstances from those described herein could result in a

[33] OTS Thrift Bulletin 72, "High Loan-to-Value Home Mortgage Lending" (August 27, 1998) ("TB-72"). For example, for loans where the private mortgage insurance does not cover the portion of the loan that exceeds the supervisory LTV limits or where the risk is assumed through reinsurance, that portion not covered by private mortgage insurance (or a government guarantee) counts toward the percentage of capital investment limit. TB-72 at 4.

different conclusion. Furthermore, we wish to emphasize that these conclusions only apply to participation in the Exchange, and do not apply to, or authorize, participation in any other reinsurance program or arrangement. This office will review other proposed reinsurance programs or arrangements on a case-by-case basis.

If you have any questions regarding this matter, please feel free to contact Vern McKinley, Senior Attorney, at (202) 906-6241.

Very truly yours,

Carolyn J. Buck

Carolyn J. Buck
Chief Counsel

cc: Regional Directors
Regional Counsel
Denise J. Deschenes, Esq.,
Counsel for the Exchange

EXHIBIT F

Office of the Comptroller of the Currency

Interpretive Letter #743

Published in Interpretations and Actions October 1996

12 U.S.C. 24(7)
12 U.S.C. 371

October 17, 1996

Richard L. Gray, Esquire
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United Guaranty
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P.O. Box 20597
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Dear Mr. Gray:

This responds to your request of September 5, 1996, that the Office of the Comptroller of the Currency ("OCC") confirm that a national bank may establish an operating subsidiary ("Subsidiary") to reinsure a portion of the mortgage insurance on loans originated or purchased by the parent bank or one of its affiliates. Your request is on behalf of United Guaranty Residential Insurance Company ("United Guaranty"), a monoline mortgage guaranty insurer, which is a member company of American International Group ("AIG"). AIG is among the nation's largest underwriters of commercial and industrial coverages. Based on the information and representations provided, and for the reasons discussed below, we agree with your conclusion that the proposed activity would be permissible under the National Bank Act.

BACKGROUND

A. Mortgage Guaranty Insurance Generally

Mortgage guaranty insurance, also known as private mortgage insurance, protects an investor holding a mortgage loan against default by the mortgagor. Banks and mortgage lenders generally require that borrowers obtain mortgage guaranty insurance from third-party mortgage guaranty insurers on low down payment loans.<**NOTE:**For purposes of this letter, "low down payment loans" are those loans with down payments of less than 20 percent of the property's value, or loans with loan-to-value ratios in excess of 80 percent.>

Mortgage guaranty insurance has played a vital role in helping low and moderate-income families become homeowners by allowing families to buy homes with less cash. Mortgage guaranty insurance also has expanded the secondary market for low down payment mortgages and the funding available for these loans. Government sponsored enterprises ("GSE's") such as the Federal National Mortgage

Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and most other purchasers in the secondary market, typically will not consider purchasing low down payment conventional loans unless the loans have mortgage guaranty insurance. Secondary market purchases of low down payment loans with mortgage guaranty insurance helped fuel the expansion in home construction and sales during the 1970s and 1980s, aiding many first-time and other home buyers. *See* Mortgage Insurance Companies of America 1995-1996 Fact Book.

B. The Proposed Reinsurance Activities

1. The Reinsurance Relationship Generally

Under the proposal, the Subsidiary would reinsure <**NOTE:**Reinsurance is a process whereby an original insurer reduces its risk by passing part or all of it on to another insurance company. The original insurer may retain only a portion of the risk and reinsure the balance with a second company that then assumes that portion of the risk. *See* 13A John Alan Appleman & Jean Appleman, Insurance Law and Practice 7681 (1976).> a portion of the mortgage guaranty risk exposure written by primary mortgage guaranty insurers, including United Guaranty, on loans originated or purchased by the parent national bank or its affiliates. The Subsidiary would thus be assuming a portion of the credit risk that the national bank or its affiliate originally would have accepted had it originated or purchased the loan without mortgage guaranty insurance in the first instance. In return, the primary mortgage guaranty insurer would pay the Subsidiary a reinsurance premium equal to a percentage of the primary insurer's own premium.

2. Standard Terms of United Guaranty's Reinsurance Agreement

United Guaranty expects that national banks generally will choose an arrangement referred to as [ ]. However, the structure and terms of the reinsurance arrangement, like the terms of the direct insurance relationship, may differ according to the business plans and objectives of the parties.<**NOTE:** For example, the reinsurance arrangement may be based on [ ] instead of a [ ]. Similarly, the terms of the [ ] arrangement may be varied to suit a national bank's business objectives. For example, there may be modifications to the provisions establishing the point at which the reinsurer becomes liable for its portion of any claim payments, the initial capitalization requirement, or the premium paid.> Under United Guaranty's [ ] agreement, the Subsidiary generally would agree to reimburse United Guaranty for direct paid losses in a given [ ] in an amount equal to or greater than [ ], but not greater than [ ]. United Guaranty would retain liability for all losses up to [ ] and all losses above [ ]. In return, United Guaranty would pay to the Subsidiary a reinsurance premium of [ ] that United Guaranty collects on the reinsured loans.

3. Capitalization and Reserve Requirements

The capitalization of the Subsidiary would be subject to both initial and ongoing requirements, which may vary depending on its size and expected book of business, and other factors. The Subsidiary will maintain a statutory contingency reserve as required under state insurance regulations. This reserve is not a separate reserve or liability, but a "reservation of capital" that restricts dividend payments. United Guaranty represents that in most states, the contingency reserve is accumulated by retaining 50 percent of earned premiums each year.<**NOTE:** The Subsidiary will invest its assets only in investment-grade debt securities that are permissible investments for national banks as required by law.> The Subsidiary may make withdrawals from the contingency reserves to the extent that losses exceed 35 percent of earned premium in any year. Additional capital requirements would be imposed under United Guaranty's standard reinsurance agreement.

Also, the OCC requires that national banks hold capital commensurate with the level and nature of all the risks of their business, including the operation of operating subsidiaries. If the OCC determines that a bank's capital levels do not adequately protect the bank from any risks of the reinsurance business of its

Subsidiary the OCC may use its authority under 12 C.F.R. Part 3 to require the bank to maintain additional capital.<**NOTE:**Section 3.10 specifically authorizes the OCC to require higher capital ratios for an individual bank in view of its circumstances. For example, higher capital ratios may be required for "a bank with significant exposure due to the risks from concentrations of credit, certain risks arising from nontraditional activities, or management's overall inability to monitor and control financial and operating risks presented by concentrations of credit and nontraditional activities." 12 C.F.R. 3.10(d).> Such a requirement could be imposed at the time a subsidiary is established, or thereafter, based upon the bank's capital levels and the OCC's supervisory experience with the subsidiary.

United Guaranty represents that under standard insurance accounting practices and the applicable reinsurance agreement, the reinsurer is required to establish the following types of reserves: an unearned premium ("UEP") reserve, a loss reserve, and an incurred but not reported ("IBNR") loss reserve. The UEP reserve represents the unearned portion of premiums assumed. The loss reserve represents estimated future loss payments for loans that are delinquent but for which an insurance claim has not yet been perfected and paid. The IBNR loss reserve is a liability for future estimated losses and loss adjustment expenses for loans which are delinquent, but not yet reported as such to United Guaranty.

4. Consumer Provisions

Banks generally purchase mortgage insurance directly from an insurer and charge the borrower for the cost of the insurance. Those charges for mortgage insurance are included in the monthly payments and annual percentage rates disclosed by banks to customers who are shopping for a low down payment mortgage. Mortgage insurance fees thus will be a component of the costs customers consider when comparing competitive loan products.

In connection with United Guaranty's reinsurance agreement with a Subsidiary, United Guaranty will recommend that the national bank, and any of its affiliates that may originate loans to be included in the Subsidiary's reinsurance program, disclose to borrowers prior to the loan closing that the Subsidiary may be providing reinsurance and may receive a portion of the mortgage insurance premium. These disclosures will also assure borrowers that the existence of the reinsurance agreement does not change the premium paid for mortgage insurance. Borrowers will also be provided the option of having their loan excluded from the reinsurance agreement.

5. Safety and Soundness Considerations

United Guaranty's proposal includes safeguards to limit the national bank's mortgage guaranty reinsurance risk. The national bank would establish a state-chartered reinsurer as an operating subsidiary. The Subsidiary would be a monoline company (that is, its business will be restricted to the reinsurance of mortgage guaranty insurance) and would reinsure third party mortgage guaranty insurance only on loans originated or purchased by the national bank or one of its affiliates. The Subsidiary would not reinsure mortgage guaranty risks on other mortgage loans, and it would not underwrite mortgage guaranty insurance as a primary insurer, an activity which the law of its chartering state may prohibit.

The national bank's own credit standards and credit underwriting experience will provide a valuable safeguard against excessive risk since the Subsidiary will only accept home mortgage loan credit risks consistent with the bank's underwriting standards. United Guaranty has represented that under the proposed arrangement, in order for loans originated or purchased by the bank or its affiliates to receive mortgage insurance, these loans must meet the bank's credit standards.

The Subsidiary's risk exposure also will be limited because the Subsidiary will reinsure only a specified loss layer of United Guaranty's mortgage guaranty risk exposure. This means that under many loss scenarios, the Subsidiary will not be required to make any payment under the reinsurance agreement with United Guaranty.

The Subsidiary will also be subject to various forms of regulation and oversight by regulatory authorities. <**NOTE:** The national bank also must possess the appropriate level of insurance experience to charter and operate a mortgage guaranty reinsurer effectively, or must contract with a management company to handle these functions, as required by state insurance regulations.> As a state-chartered reinsurer, the Subsidiary will be subject to regulation by the state insurance authority of the state of its domicile and applicable state law requirements including licensing, capital and reserve requirements. Because the Subsidiary will be receiving premiums and reinsuring mortgage insurance provided by United Guaranty, the Subsidiary may also be subject to inquiries from time to time by the insurance department of North Carolina, United Guaranty's state of domicile, or insurance departments of other states in which United Guaranty conducts business. In addition, United Guaranty provides insurance to institutions who sell their loans to Fannie Mae and Freddie Mac, and both GSE's reserve the right to examine United Guaranty's reinsurance arrangements.

In return for accepting the limited credit risk associated with the proposed reinsurance arrangement, the Subsidiary will receive reinsurance premiums, as well as investment income from its cash flow, providing a potentially important source of revenue for the bank and its Subsidiary. United Guaranty represents that it has entered into similar reinsurance arrangements with nonbank mortgage lenders. The proposed reinsurance activities therefore may enable national banks to compete more effectively with nonbank mortgage lenders.

ANALYSIS

A. Statutory Framework

The National Bank Act provides that national banks shall have the power:

> [t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes . . . .

12 U.S.C. 24(Seventh).

The Supreme Court has held that this powers clause is a broad grant of the power to engage in the business of banking, including, but not limited to, the five specifically recited powers and the business of banking as a whole. *See NationsBank of North Carolina, N.A. v. Variable Life Annuity Co.*, 115 S.Ct. 810 (1995) ("*VALIC*"). Many activities that are not included in the enumerated powers are also part of the business of banking. Judicial cases reflect three general principles used to determine whether an activity is within the scope of the "business of banking": (1) is the activity functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks. *See, e.g., Merchants' Bank v. State Bank*, 77 U.S. 604 (1871); *M & M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978); *American Insurance Association v. Clarke*, 865 F.2d 278, 282 (2d Cir. 1988). Further, as the Supreme Court established in the *VALIC* decision, national banks are also authorized to engage in an activity if that activity is incidental to the performance of the five specified powers in 12 U.S.C. 24(Seventh) *or* incidental to the performance of an activity that is part of the business of banking.

B. "Business of Banking" Analysis

1. Functionally Equivalent to or a Logical Outgrowth of Recognized Banking Functions

A national bank's reinsurance, through its Subsidiary, of mortgage loans made or purchased by the bank or its affiliates, is functionally equivalent to, or a logical outgrowth of, the bank's business of underwriting mortgage loans. National banks are expressly authorized to make loans under 12 U.S.C. 24(Seventh) and to underwrite mortgages under 12 U.S.C. 371. The proposed reinsurance arrangements are comparable to the extension of low down payment mortgage loans without mortgage insurance, but with higher interest rates to cover the risk of nonpayment. Through the reinsurance vehicle, the bank is engaged in credit judgments and assumes credit risks indistinguishable from those involved in making these mortgage loans without mortgage reinsurance. With both arrangements, the bank's decision to accept those credit risks are determined by the bank's underwriting standards, which are derived from the bank's lending experience and expertise. Moreover, the risks assumed by the bank are credit risks rather than actuarial risks. Unlike many traditional forms of insurance, which relate to casualties, death, disability, etc., the Subsidiary's reinsurance would relate to the ability of the mortgage borrower to pay the underlying mortgage obligation. Thus, when reinsuring a mortgage guaranty insurance risk, the Subsidiary would assume credit rather than actuarial risk.

The Subsidiary's proposed reinsurance activities also are functionally equivalent to a partial repurchase of a national bank's own loans, a traditional banking activity. It is well established that banks may originate, purchase and sell mortgage and other loans. *See* 12 U.S.C. 371(a); OCC Letter No. 418, *reprinted in* Fed. Banking L. Rep. (CCH) [1988-89 Transfer Binder] 85,642, at 78,011 (Feb. 17, 1988) (referring to origination, making, purchase and sale of real estate loans as "centrally traditional banking activities"); OCC, *Mortgage Banking: Comptroller's Handbook* 1-3, 9-10 (March) 1996). Under the proposed reinsurance arrangements, the Subsidiary will accept from a mortgage guaranty insurer part of the credit risk from loans originated and/or purchased by the national bank or its affiliates. Both the proposed mortgage reinsurance and the purchase of participations in the parent bank's loans thus would involve credit decisions based on the same underwriting criteria and comparable credit risks. Both involve the receipt of income for assuming those credit risks and the assumption of losses when the borrower defaults for any reason. The proposed reinsurance activities thus are functionally equivalent to established bank lending activities.

The process of reinsuring mortgage insurance in the manner proposed by United Guaranty is "functionally interchangeable" with the process of lending and is essentially a new way of conducting an aspect of the very old business of banking. *See M&M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1377, 1382 - 1383 (9th Cir. 1977). In the *M&M Leasing Corp.* decision, the court affirmed the opinion of the Comptroller, holding that personal property leasing was a permissible activity for national banks. The court concluded that leasing, when the transaction constitutes a loan secured by leased property, is essentially the lending of money on personal security, an express power under the National Bank Act. *Id.* at 1382. In its analysis, the court discussed how financial leasing is similar to lending on personal security, serves the same purpose as lending, and is "functionally interchangeable" with lending. The court stressed that this "functional interchangeability" was the touchstone of its decision. *Id.* at 1383. Similarly, in *American Insurance Association v. Clarke*, 865 F.2d 278 (D.C. Cir. 1988), the court also considered whether a new activity was "functionally equivalent" to a recognized banking power. There, the court affirmed the Comptroller's opinion that the use of standby credits to insure municipal bonds was functionally equivalent to the issuance of a standby letter of credit, a device long recognized as within the business of banking. United Guaranty's proposal that the Subsidiary reinsure the parent bank's and the parent bank's affiliates' mortgage loans is clearly consistent with this line of analysis and represents an alternative way for a national bank to extend mortgage loans.

United Guaranty's proposal is also consistent with other bank activities related to banks' lending powers. Under 12 C.F.R. 7.1013 a national bank may offer debt cancellation contracts for the death or disability of a borrower.<**NOTE:** *See also* Interpretive Letter No. 277, December 21, 1983, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,441 (permitting national banks to underwrite credit life insurance); Interpretive Ruling 7.1016 (permitting national banks to issue and honor independent undertakings).> A bank's credit position, as reinsurer of mortgage loans through its Subsidiary, would resemble the position assumed by lenders in issuing debt cancellation contracts. In both of these activities, the initial credit decision also provides the basis for assuming the additional role involving the loan. Moreover, in both cases the risk assumed is closely related to the risk of default that is inherent in banks' lending functions.<**NOTE:**Debt cancellation contracts provide for the cancellation of specified loan amounts upon the occurrence of a specific event (*e.g.*, the borrower's death), whereas private mortgage insurance covers mortgage loan defaults for any reason where there is insufficient mortgage loan collateral. Thus, the risks assumed when a bank reinsures mortgage loans is more analogous to a bank's lending than the risks assumed when a bank issues debt cancellation contracts.>

The fact that the Subsidiary's reinsurance activities would include reinsuring mortgage insurance on certain loans that are not originated or purchased by the parent bank, *i.e.*, mortgage loans that are originated or purchased by the parent bank's affiliates, does not affect the permissibility of United Guaranty's proposal. Under United Guaranty's proposed reinsurance arrangement, a portion of the risk of default associated with a loan of a mortgage lending affiliate would simply be transferred to the Subsidiary. According to United Guaranty, in order for a bank's loans and the bank's affiliates' loans to receive mortgage insurance, the bank and the bank's affiliates' must utilize and meet the same underwriting standards. As a result, the Subsidiary will be reinsuring essentially homogenous mortgage loans subject to the credit guidelines of the same banking company. The fact that the banking company may choose for business reasons to originate some portion of these mortgage loans from the bank's affiliates, or to purchase some portion of these mortgage loans, should not limit the bank's authority to engage in the proposed reinsurance activity through the Subsidiary.

2. Respond to Customer Needs or Otherwise Benefit the Bank or Its Customers

United Guaranty's proposal potentially benefits national banks and their customers. Banks and their mortgage lending affiliates usually require a down payment of at least 20 percent of the appraised value of a home. However, banks and their mortgage lending affiliates will accept smaller down payments if repayment of a mortgage is backed by mortgage insurance. Thus, customers benefit from mortgage insurance because it enables them to make small down payments on the purchases of their homes. They have the option of paying the higher monthly costs associated with low down payments, or paying a larger down payment. Banks' involvement in mortgage insurance reinsurance should not diminish customers' ability to obtain optional mortgage insurance, and may even increase competition and promote the availability of mortgage insurance at competitive rates.<**NOTE:** At this point, it is difficult to measure or predict with certainty the competitive effects of banks' participation in mortgage insurance reinsurance. >

Additionally, United Guaranty represents that its proposed reinsurance program for banks would particularly benefit affordable housing borrowers. United Guaranty participates in several affordable housing loan <**NOTE:** United Guaranty represents that a loan it classifies as an affordable housing loan typically has the following characteristics: the borrower's income level is at or below 115 percent of the area median income, or the property is located in a specified geographic area; and the loan has a loan-to-value ratio of between 95 and 97 percent.>

risk sharing agreements with certain mortgage lenders. United Guaranty represents that these risk sharing agreements have the same basic characteristics as reinsurance programs, although the risk sharing agreements are not reinsurance programs. In both types of arrangements, the mortgage lenders accept a limited amount of risk with respect to the ultimate performance of the insured loans. When a lender enters into a risk sharing arrangement in connection with its affordable housing loan program, United Guaranty is willing to provide more flexibility on underwriting standards than United Guaranty gives to other lenders who are not "at risk" with United Guaranty on these loans. This unity of interests between the insurer and the lender allows United Guaranty to permit the lenders to make a greater number of affordable housing loans, and to obtain mortgage guaranty insurance for those loans. United Guaranty expects that this experience will be replicated in the proposed reinsurance program for national banks.

In addition, United Guaranty represents that some national banks may hold pools of affordable housing loans that do not qualify for traditional mortgage insurance and therefore cannot readily be sold into the secondary market. Through the type of mortgage insurance reinsurance arrangement proposed by United Guaranty, banks may be able to secure mortgage insurance for these pools of loans and sell them into the secondary market. Sales of these pools of loans into the secondary market could further expand the availability of affordable housing loans. To the extent that the proposed reinsurance program encourages greater flexibility in underwriting mortgage insurance on affordable housing loans, the program offers the possibility of an important public benefit by potentially increasing the availability of affordable housing loans.

United Guaranty's proposal also benefits banks by providing flexibility in structuring the banks' activities to obtain new sources of credit-related income. Mortgage guaranty insurers assume some of the credit risks on a bank's low down payment loans that would otherwise be borne by the bank. Through the proposed reinsurance activities, a bank may acquire additional mortgage credit business that can be managed as part of the bank's overall mortgage credit risk management program. This additional business provides the bank an alternative vehicle for achieving risk objectives. One alternative approach by which a bank could expand its mortgage credit-related business would be to buy interests in loans originated by unrelated lenders. However, this approach has the drawback that the initial underwriting of the mortgage-related risk would not have been done by the bank's own (or an affiliate's) personnel, using the bank's underwriting standards. Thus, the bank would need to review the underwriting standards and credit information for the loans, or obtain appropriate credit enhancements and guarantees, since they would not have the same familiarity with the borrowers as with its own (or its affiliate's) loans. Mortgage insurance reinsurance may provide national banks a means to manage their mortgage-related risk exposure that could be preferable due to cost or safety and soundness considerations.

3. Risks Similar in Nature to Those Already Assumed by National Banks

As discussed, the risks a national bank confronts in reinsuring mortgage insurance in the manner proposed by United Guaranty are essentially the same type as the risks associated with the permissible activities of underwriting mortgage loans. Through the proposed reinsurance activities, the Subsidiary would assume additional risks transferred by the bank to a mortgage guaranty insurer. However, these Subsidiary risks are similar to risks that would be incurred by the bank or its mortgage lending affiliates on a loan with a high loan-to-value ratio not covered by mortgage insurance or through purchases of participations in the bank's loans. Under the reinsurance agreement, this credit-like risk is simply transferred from the bank or its mortgage lending affiliates to the mortgage guaranty insurer, and then to the Subsidiary. <**NOTE:** The credit-like risk transferred to the Subsidiary is also similar to the risk assumed by a bank in repurchasing an interest in a loan that the bank has previously sold, or in retaining an interest in a pool of loans that the bank has securitized.> The Subsidiary receives compensation for the risk of default through its share of premiums paid under the reinsurance contract. Moreover, because the underwriting standards for mortgage insurance are the same as those for the mortgage loans themselves, the Subsidiary's likelihood of liability on a claim is no different than that of the bank (or the bank's mortgage lending affiliate) upon default if the loan were not covered by mortgage insurance.

C. Incidental To the Business of Banking Analysis

Even if United Guaranty's proposal were not viewed as part of the business of banking, the proposal clearly is incidental to the business of banking. In *VALIC*, the Supreme Court expressly held that the "business of banking" is not limited to the enumerated powers in 12 U.S.C. 24(Seventh), but encompasses more broadly activities that are part of the business of banking. *VALIC* at 814, n.2. The *VALIC* decision further established that banks may engage in activities that are incidental to the enumerated powers as well as the broader "business of banking."

Prior to *VALIC*, the standard that was often considered in determining whether an activity was incidental to banking was the one advanced by the First Circuit Court of Appeals in *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972) ("*Arnold Tours*"). The *Arnold Tours* standard defined an incidental power as one that is "convenient or useful in connection with the performance of one of the bank's established activities pursuant to its *express* powers under the National Bank Act." *Arnold Tours* at 432 (emphasis added). Even prior to *VALIC*, the *Arnold Tours* formula represented the narrow interpretation of the "incidental powers" provision of the National Bank Act. OCC Interpretive Letter 494 (December 20, 1989). The *VALIC* decision, however, has established that the *Arnold Tours* formula provides that an incidental power includes one that is convenient and useful to the "business of banking," as well as a power incidental to the express powers specifically enumerated in 12 U.S.C. 24(Seventh).

The activity United Guaranty proposes is incidental to the business of banking under the *Arnold Tours* standard. Reinsuring mortgage insurance in the manner proposed by United Guaranty is incidental to a national bank's express power to make loans under 12 U.S.C. 24(Seventh). <**NOTE:** National banks are also expressly authorized to make real estate loans under 12 U.S.C. 371.> The proposed activity is "convenient" and "useful" to a national bank's power to make loans because it will enable a national bank to structure mortgage loans in a more flexible way. *Arnold Tours*.<**NOTE** *See also Franklin National Bank of Franklin Square v. New York*, 347 U.S. 373 (1954) (power to advertise bank services); and *Auten v. United States Nat'l Bank*, 174 U.S. 125 (1899) (power to borrow money). In these cases the courts' holdings relied on whether the activity was "useful."> Specifically, the proposed activity will provide national banks an alternative structure for making loans that could otherwise be made with a higher rate of interest to cover the increased risk of nonpayment associated with a low down payment.<**NOTE:** This same rationale also supports a Subsidiary's reinsurance of loans purchased by the parent bank or the bank's affiliate, since the bank or the affiliate could otherwise have originated the purchased loan with a higher rate of interest to cover the increased risk of nonpayment associated with a low down payment.>

The proposed activities also provide national banks an alternative to participating in loans to expand their credit activities. This flexibility is convenient and useful to banks in determining how to structure their mortgage lending activities in the most efficient and profitable manner and in offering a competitive array of mortgage lending products to their customers. The proposed activities also are incidental to lending activities because they enable banks to use existing credit staff and credit expertise to generate additional revenues through activities that supplement the banks' lending efforts. The activities also enable banks to better manage their credit portfolios.

CONCLUSION

Based upon the foregoing facts and analysis, we agree with your conclusion that reinsuring a portion of the mortgage insurance on loans originated or purchased by the Subsidiary's parent bank or the bank's mortgage lending affiliates, in the manner described herein, is permissible under the National Bank Act. <**NOTE:** A specific proposal by a national bank to establish a Subsidiary to reinsure mortgage insurance requires an application and would be subject to the OCC's review under 12 C.F.R. § 5.34. The OCC's review would include an assessment of whether any supervisory concerns or legal issues in addition to those discussed herein are presented in each case. Also, of course, activities of individual banks and their subsidiaries are subject to other applicable laws and regulations..>

Sincerely,

/s/
Julie L. Williams
Chief Counsel

EXHIBIT G

ownership interest and unrelated to referrals of business.

HUD Analysis. A review of the factors reflects an arrangement involving a *bona fide* provider of settlement services. In this example, the real estate brokerage company is not the sole source of referrals to the title agency. However, the title agency continues its exclusive agency arrangement with the title insurance company owner. While this last factor initially may raise a question as to why other title insurance companies are not used for title insurance policies, upon review there appears to be nothing impermissible about these referrals of title business from the title agency to the title insurance company.

This example involves the purchase of stock in an existing full service provider. In such a situation, HUD would carefully examine the investment made by the real estate brokerage company. In this example, the real estate brokerage company pays a fair value contribution for its ownership share and receives a return on its investment that is not based on referrals of business. Since the real estate brokerage provides the CBA disclosure, does not require the use of the title agency and the only return to the brokerage is based on the profits of the agency and not reflective of referrals made, the arrangement meets the CBA exemption requirements. HUD would consider this a *bona fide* controlled business arrangement.

5. A mortgage banker sets up a limited liability mortgage brokerage company. The mortgage banker sells shares in divisions of the limited liability company to real estate brokers and real estate agents. For $500 each, the real estate brokers and agents may purchase separate "divisions" within the limited liability mortgage brokerage company to which they refer customers for loans. In later years ownership may vary by the amount of referrals made by a real estate broker or agent in the previous year. Under this structure, the ownership distributions are based on the business each real estate broker or real estate agent refers to his/her division and not on the basis of their capital contribution to the entity as a whole. The limited liability mortgage brokerage company provides all the substantial services of a mortgage broker. It does not contract out any processing to its mortgage banker owner. It sends loan packages to its mortgage banker owner as well as other lenders.

HUD analysis. Although HUD would consider the mortgage brokerage company to be a *bona fide* provider of mortgage brokerage services, this example illustrates an arrangement that fails to meet the third condition of the CBA exception. 12 U.S.C. 2607(c)(4)(C). Here, the capitalization, ownership and payment structure with ownership in separate "divisions" is a method in which ownership returns or ownership shares vary based on referrals made and not on the amount contributed to the capitalization of the company. In cases where the percent of ownership interest or the amount of payment varies by the amount of business the real estate agent or broker refers, such payments are not *bona fide* returns on ownership interest, but instead, are an indirect method of paying a kickback based on the amount of business referred. 24 CFR 3500.15(b)(3).

Authority: 12 U.S.C. 2617; 42 U.S.C. 3535(d).

Dated: May 31, 1996.

Nicolas P. Retsinas,

Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. 96-14331 Filed 6-6-96; 8:45 am]

BILLING CODE 4210-27-P

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24 CFR Part 3500

[Docket No. FR-3638-N-05]

Office of the Assistant Secretary for Housing-Federal Housing Commissioner; Real Estate Settlement Procedures Act (RESPA); Statement of Policy 1996-3, Rental of Office Space, Lock-outs, and Retaliation

AGENCY: Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

ACTION: Statement of Policy 1996-3, Rental of Office Space, Lock-outs, and Retaliation.

SUMMARY: This statement sets forth the Department's interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) and its implementing regulations with regard to the rental of office space, lock-outs and retaliation. It is published to give guidance and to inform interested members of the public of the Department's position on enforcement of this section of the law.

FOR FURTHER INFORMATION CONTACT: David R. Williamson, Director of the Office of Consumer and Regulatory Affairs, Room 5241, telephone: (202) 708-4560. For legal enforcement questions, Peter Race, Assistant General Counsel for Program Compliance, or Rebecca J. Holtz, Attorney, Room 9253, telephone: (202) 708-4184. (The telephone numbers are not toll-free.) For hearing- and speech-impaired persons, this number may be accessed via TTY (text telephone) by calling the Federal Information Relay Service at 1-800-877-8339. The address for the above-listed persons is: Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410.

SUPPLEMENTARY INFORMATION:

General Background

Section 8 (a) of the Real Estate Settlement Procedures Act (RESPA) prohibits any person from giving or accepting any fee, kickback, or thing of value for the referral of settlement service business involving a federally related mortgage loan. 12 U.S.C. 2607(a). Congress specifically stated it intended to eliminate kickbacks and referral fees that tend to increase unnecessarily the costs of settlement services. 12 U.S.C. 2601(b)(2).

Since July 1993, the Department has been seeking comments and advice concerning the final rule of November 2, 1992, implementing Section 8 of RESPA. On July 21, 1994, the Department published a new proposed rule on certain Section 8 issues. Simultaneously with the issuance of this Statement of Policy, HUD is publishing a final rule in that rulemaking. As part of that rulemaking process, the Department received comments concerning the application of Section 8 of RESPA to the rental of office space, lock-outs and retaliation in connection with real estate brokerage office practices. In addition, the Department's enforcement officials have received numerous complaints dealing with these same issues.

Rental of Office Space

In the last few years, the Department has received numerous complaints alleging that certain settlement service providers, particularly lenders, are leasing desks or office space in real estate brokerage offices at higher than market rate in exchange for referrals of business. In HUD's rulemaking docket, number R-94-1725 (FR-3638), many commenters argued that HUD should scrutinize this rental practice. The concern expressed is that real estate brokers charge, and settlement service providers pay, high rent payments for the desk or office space to disguise kickbacks to the real estate broker for the referral of business to the settlement service provider. In this Statement of Policy, the Department sets forth how it distinguishes legitimate payments for rentals from payments that are for the referral of business in violation of Section 8.

Lock-outs

The Department also received comments and complaints alleging that settlement service providers were being excluded from, or locked-out of, places of business where they might find potential customers. The most common occurrence cited was where a real estate brokerage company had leased space to a particular provider of services, and had prevented any other provider from entering its office space.

As part of the July 21, 1994, rulemaking, a Nebraska lender commented:

> We are experiencing a rapid growth of lender lock-out relationships wherein real estate companies lease office space within their sales offices to a particular mortgage company. A part of the agreement is that other lenders are not allowed in the sales offices to solicit business. This clearly prevents free competition in financing to the home buyer.
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> * * * * *
>
> * * * [I]t is very clear that the [real estate] office managers are exerting a lot of control to keep all other lenders out. This would not be done without proper incentive ($$$) * * *.

Several other commenters alleged that real estate office space arrangements with particular lenders, coupled with limiting or denying rival lenders access to customers, were being used in their communities to eliminate competition. These commenters called for special RESPA rules to ban these practices.

Retaliation

The Department also has received complaints concerning retaliation practices used to influence consumer referrals. In one complaint, financial service representatives in a real estate broker's office were given specific quotas of referrals of home buyers to an affiliated lender and were threatened with the loss of their jobs if they did not meet the quotas.

Commenters on the proposed rules also alleged that some employers were engaging in practices of retaliation or discrimination against employees and agents who did not refer business to affiliated entities. Reprisals could range from loss of benefits, such as fewer sales leads, higher desk fees, less desirable work space, and ultimately, loss of job. Some commenters requested that the Department issue guidelines or other regulatory provisions to restrict such retaliatory activities.

The Coalition to Retain Independent Services in Settlement (CRISIS) called for a rule prohibiting retaliation against employees and agents who refer business to non-affiliated entities as most consistent with the language of the RESPA statute. CRISIS suggested strong language to prohibit negative actions against employees and agents who refer business to non-affiliated entities, including prohibitions against more subtle actions, such as loss of work space or increases in desk fees.

Statement of Policy—1996-3

To give guidance to interested members of the public on the application of RESPA and its implementing regulations to these issues, the Secretary, pursuant to Section 19(a) of RESPA and 24 CFR 3500.4(a)(1)(ii),[1] hereby issues the following Statement of Policy.

Rental of Office Space

Section 8 of RESPA prohibits a person from giving or from accepting any fee, kickback or thing of value pursuant to an agreement that business incident to a settlement service involving a federally related mortgage loan shall be referred to any person. 12 U.S.C. § 2607(a). An example of a thing of value is a rental payment that is higher than that ordinarily paid for the facilities. The statute, however, permits payments for goods or facilities actually furnished or for services actually performed. 12 U.S.C. § 2607(c)(2). Thus, when faced with a complaint that a settlement service provider is paying a high rent for referrals of settlement service business, HUD analyzes whether the rental payment is bona fide or is really a disguised referral fee.

HUD's regulations implement the statutory provisions at 24 CFR 3500.14 and give greater guidance to this analysis. Section 3500.14(g)(2) of the regulations provides that the Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. It states: "If the payment bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided * * *. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services." *Id.*

Thus, under existing regulations, when faced with a complaint that a person is renting space from a person who is referring business to that person, HUD examines the facts to determine whether the rental payment bears a reasonable relationship to the market value of the rental space provided or is a disguised referral fee. The market value of the rental space may include an appropriate proportion of the cost for office services actually provided to the tenant, such as secretarial services, utilities, telephone and other office equipment. In some situations, a market price rental payment from the highest bidding settlement service provider could reflect payments for referrals of business to that settlement service provider from the person whose space is being rented. Thus, to distinguish between rental payments that may include a payment for referrals of settlement service business and a payment for the facility actually provided, HUD interprets the existing regulations to require a "general market value" standard as the basis for the analysis, rather than a market rate among settlement service providers.

In a rental situation, the general market value is the rent that a non-settlement service provider would pay for the same amount of space and services in the same or a comparable building. A general market value standard allows payments for facilities and services actually furnished, but does not take into account any value for the referrals that might be reflected in the rental payment. A general market standard is not only consistent with the existing regulations, it furthers the statute's purpose. Congress specifically stated that it intended to protect consumers from unnecessarily high settlement charges caused by abusive practices. 12 U.S.C. § 2601. Some settlement service providers might be willing to pay a higher rent than the general market value to reflect the value of referrals of settlement service business. The cost of an above-general-market-rate rental payment could likely be passed on to the consumer in higher settlement costs. If referrals of settlement service business are taking place in a given rental situation, and the rental payment is above the general market value, then it becomes difficult to distinguish any increase in rental payment over the general market from a referral fee payment.

HUD, therefore, interprets Section 8 of RESPA and its implementing regulations to allow payments for the rental of desk space or office space. However, if a settlement service provider rents space from a person who is referring settlement service business to the provider, then HUD will examine whether the rental payments are reasonably related to the general market value of the facilities and services actually furnished. If the rental payments exceed the general market value of the space provided, then HUD will consider the excess amount to be for the referral of business in violation of Section 8(a).

[1] All citations in this Statement of Policy refer to recently streamlined regulations published on March 26, 1996 (61 FR 13232), in the Federal Register (to be codified at 24 CFR part 3500).

As an additional consideration, HUD will examine whether the rent is calculated, in whole or in part, on a multiple of the number or value of the referrals made. If the rental payment is conditioned on the number or value of the referrals made, then HUD will consider the rental payment to be for the referral of business in violation of Section 8(a).

In its RESPA enforcement work, HUD has also encountered "bogus" rental arrangements that are really agreements for the payment of referral fees. For example, one case involved a title insurance company that paid a "rental fee" to a real estate broker for the "per use rental" of a conference room for closings. The title insurance company paid a $100 fee for each transaction. This "rental fee" was greater than the general market value for the use of the space. In addition, the facts revealed that the room was rarely actually used for closings. In this case, HUD examined whether a "facility" was actually furnished at a general market rate. HUD concluded that this was a sham rental arrangement; the "rent" was really a disguised referral fee in violation of Section 8(a).

Lock-outs

A lock-out situation arises where a settlement service provider prevents other providers from marketing their services within a setting under that provider's control. A situation involving a rental of desk or office space to a particular settlement service provider could lead to other, competing, settlement service providers being "locked-out" from access to the referrers of business or from reaching the consumer. The existence of a lock-out situation could, therefore, give rise to a question of whether a rental payment is *bona fide*. A lock out situation without other factors, however, does not give rise to a RESPA violation.

The RESPA statute does not provide HUD with authority to regulate access to the offices of settlement service providers or to require a company to assist another company in its marketing activity. This interpretation of RESPA does not bear on whether State consumer, antitrust or other laws apply to lock-out situations. Of course, Section 8 still applies to any payments made to a referrer of business by a settlement service provider who is not "locked out" of the referrer's office and receives referrals of settlement service business from that office.

Retaliation

Section 8 of RESPA expressly prohibits giving positive incentives, "things of value," for the referral of settlement service business. 12 U.S.C. 2607(a). The Act is silent as to disincentives. If HUD were to find that Section 8 also prohibited disincentives for failure to make referrals, HUD would find itself being called upon to resolve numerous employment disputes under RESPA. HUD does not believe that Congress intended that RESPA reach these matters. Retaliatory actions against employees are more appropriately governed by State labor, contract, and other laws. However, the Department will continue to examine for possible violations of Section 8 whether payments or other positive incentives are given employees or agents to make referrals to other settlement service providers.

New RESPA regulations are being issued simultaneously with this Statement of Policy. With regard to this area, the public should note the new exemptions for payments to employees in 24 CFR 3500.14.

Authority: 12 U.S.C. 2617; 42 U.S.C. 3535(d).

Dated: May 31, 1996.

Nicolas P. Retsinas,

Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. 96–14332 Filed 6–6–96; 8:45 am]

BILLING CODE 4210–27–P

EXHIBIT H

Dated: June 16, 2010.

Deborah S. Merkle,

Chairman.

[FR Doc. 2010–15317 Filed 6–24–10; 8:45 am]

BILLING CODE P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 3500

[Docket No. FR–5425–IA–01]

Real Estate Settlement Procedures Act (RESPA): Home Warranty Companies' Payments to Real Estate Brokers and Agents

AGENCY: Office of General Counsel, HUD.

ACTION: Interpretive rule.

SUMMARY: Under section 8 of RESPA and HUD's implementing RESPA regulations, services performed by real estate brokers and agents as additional settlement services in a real estate transaction are compensable if the services are actual, necessary and distinct from the primary services provided by the real estate broker or agent, the services are not nominal, and the payment is not a duplicative charge. A referral is not a compensable service for which a broker or agent may receive compensation. This rule interprets section 8 of RESPA and HUD's regulations as they apply to the compensation provided by home warranty companies to real estate brokers and agents. Although interpretive rules are exempt from public comment under the Administrative Procedure Act, HUD nevertheless welcomes public comment on this interpretation.

DATES: *Effective date:* June 25, 2010. *Comment Due Date:* July 26, 2010.

ADDRESSES: Interested persons are invited to submit comments regarding this interpretive rule to the Regulations Division, Office of General Counsel, 451 7th Street, SW., Room 10276, Department of Housing and Urban Development, Washington, DC 20410–0500. Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. *Submission of Comments by Mail.* Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW., Room 10276, Washington, DC 20410–0500.

2. *Electronic Submission of Comments.* Interested persons may submit comments electronically through the Federal eRulemaking Portal at *www.regulations.gov.* HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the *www.regulations.gov* Web site can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule

No Facsimile Comments. Facsimile (FAX) comments are not acceptable.

Public Inspection of Public Comments. All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an advance appointment to review the public comments must be scheduled by calling the Regulations Division at 202–708–3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800–877–8339. Copies of all comments submitted are available for inspection and downloading at *http://www.regulations.gov.*

FOR FURTHER INFORMATION CONTACT: For legal questions, contact Paul S. Ceja, Assistant General Counsel for RESPA/SAFE, telephone number 202–708–3137; or Peter S. Race, Assistant General Counsel for Compliance, telephone number 202–708–2350; Department of Housing and Urban Development, 451 7th Street, SW., Room 9262, Washington, DC 20410. For other questions, contact Barton Shapiro, Director, or Mary Jo Sullivan, Deputy Director, Office of RESPA and Interstate Land Sales, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW., Room 9158, Washington, DC 20410; telephone number 202–708–0502. These telephone numbers are not toll-free. Persons with hearing or speech impairments may access this number via TTY by calling the toll-free Federal Information Relay Service at 1–800–877–8339.

SUPPLEMENTARY INFORMATION:

I. Background

A homeowner's warranty is covered as a "settlement service" under HUD's RESPA regulations at 24 CFR 3500.2. Accordingly, the framework for compensation of real estate brokers and agents for services performed on behalf of home warranty companies (HWCs) is established in RESPA and HUD's regulations, as discussed in an unofficial staff interpretation letter dated February 21, 2008, issued by the Office of General Counsel. In brief, services performed by real estate brokers and agents on behalf of HWCs are compensable as additional settlement services if the services are actual, necessary and distinct from the primary services provided by the real estate broker or agent. (*See* 24 CFR 3500.14(g)(3).) The real estate broker or agent may accept a portion of the charge for the homeowner warranty only if the broker or agent provides services that are not nominal and for which there is not a duplicative charge. (*See* 24 CFR 3500.14(c).)

HUD has received inquiries regarding the application of this framework to the compensation provided by HWCs to real estate brokers and agents for the selling of home warranties in connection with the sale or purchase of a home. In particular, interested parties have inquired about the legality of the HWCs providing compensation to real estate brokers and agents on a per transaction basis and about the scope of services provided on behalf of the HWC for which real estate brokers and agents can be compensated by the HWC.

II. This Interpretive Rule

This interpretive rule clarifies the legality under section 8 of RESPA and HUD's implementing regulations of the compensation provided by HWCs to real estate brokers and agents, and it is provided in accordance with Secretary of HUD's delegation of authority to the General Counsel to interpret the authority of the Secretary. (*See* 74 FR 62801, at 62802.)

A. Unlawful Compensation for Referrals

RESPA does not prohibit a real estate broker or agent from referring business to an HWC. Rather, RESPA prohibits a real estate broker or agent from receiving a fee for such a referral, as a referral is not a compensable service. (*See* 24 CFR 3500.14(b).) HUD's regulations, at 24 CFR 3500.14(f), defines referral, in relevant part, as follows:

A referral includes any oral or written action directed to a person which has the effect of *affirmatively influencing the selection by any person of a provider of a settlement service* or business incident to or part of a settlement service when such person will pay for such settlement service or business incident thereto or pay a charge attributable in whole or in part to such settlement service or business. (Emphasis added.)

To evaluate whether a payment from an HWC is an unlawful kickback for a referral, HUD may look in the first instance to whether, among other things:

- The compensation for the HWC services provided by the real estate broker or agent is contingent on an arrangement that prohibits the real estate broker or agent from performing services for other HWC companies; *e.g.* if a real estate broker or agent is compensated for performing HWC services for only one company, this is evidence that the compensation may be contingent on such an arrangements; and
- Payments to real estate brokers or agents by the HWC are based on, or adjusted in future agreements according to, the number of transactions referred.

If it is subsequently determined, however, that the payment at issue is for only compensable services,[1] the existence of such arrangements and agreements would not be an indicator of an unlawful referral arrangement, and would be permissible. (*See* discussion in Sections C and D below.)

B. Marketing by a Real Estate Broker or Agent Directed to Particular Homebuyers or Sellers

In some circumstances, marketing services performed on behalf of an HWC are not compensable services. In particular, a real estate broker or agent is in a unique position to refer settlement service business and through marketing can affirmatively influence a homebuyer's or seller's selection of an HWC. As a real estate broker and agent hold positions of influence in the real estate transaction, a homebuyer or seller is more likely to accept the broker's or agent's promotion or recommendation of a settlement service provider. Therefore, marketing performed by a real estate broker or agent on behalf of an HWC to sell a homeowner warranty to particular homebuyers or sellers is a "referral" to a settlement service provider.

Accordingly, in a transaction involving a federally related mortgage loan, an HWC's compensation of a real estate broker or agent for marketing services that are directed to particular homebuyers or sellers would be a payment that violates section 8 of RESPA as an illegal kickback for a referral of settlement service business. For example, a real estate broker or agent actively promoting an HWC and its products to sellers or prospective homebuyers by providing HWC verbal "sales pitches" about the benefits of a particular HWC product or by distributing the HWC's promotional material at the broker's or agent's office or at an open house is considered to be a referral. Thus, compensating the real estate broker or agent for such promotion would result in a violation of section 8 of RESPA.

Nothing precludes a real estate broker or agent from performing services to aid the seller or buyer, or to increase the possibility that the real estate transaction will occur and thereby benefit the broker or agent. However, the broker or agent may not be compensated by the HWC for marketing services directed to particular homebuyers or sellers.

C. Bona Fide Compensation for Services Performed

Section 8(c) of RESPA and HUD's regulations allow payment of bona fide compensation for services actually performed. (*See* 24 CFR 3500.14(g)(1)(iv).) HUD's regulations also allow persons in a position to refer settlement service business to receive payments for providing additional compensable services as part of a transaction. (*See* 24 CFR 3500.14(g)(3).) Services performed by real estate brokers and agents on behalf of HWCs would be compensable as additional settlement services only if the services are actual, necessary and distinct from the primary services provided by the real estate broker or agent. Further, the real estate broker or agent may accept, and an HWC may pay to the broker or agent, a portion of the charge for the homeowner warranty only for services that are not nominal and for which there is not a duplicative charge. (*See* 24 CFR 3500.14(c).) HUD looks at the actual services provided to determine in a particular case whether compensable services have been performed by the real estate broker or agent.[2]

A determination that compensable services have been performed by the real estate broker or agent will be based on a review of the particular facts of each case. Evidence in support of such a determination may include:

- Services—other than referrals—to be performed are specified in a contract between the HWC and the real estate broker or agent, and the real estate broker or agent has documented the services provided to the HWC;
- The services actually performed are not duplicative of those typically provided by a real estate broker or agent;
- The real estate broker or agent is by contract the legal agent of the HWC, and the HWC assumes responsibility for any representations made by the broker or agent about the warranty product; and
- The real estate broker or agent has fully disclosed to the consumer the compensable services that will be provided and the compensation arrangement with the HWC, and has made clear that the consumer may purchase a home warranty from other vendors or may choose not to purchase any home warranty.

HUD will review evidence on a case-by-case basis to determine whether compensation provided was a kickback for a referral or a legal payment for the compensable services. If it is factually determined that only actual compensable services have been performed by a real estate broker or agent in a transaction, it follows that transaction-based compensation of that broker or agent that is reasonable would not be an indicator of an unlawful referral arrangement and would be permissible.

Reasonableness of Compensation

As the final step in assessing the legality of the compensation for these services, HUD will also assess whether the value of the payment by the HWC is reasonably related to the value of the services actually performed by the real estate broker or agent. In the context of loan origination, for example, HUD has stated that the mere taking of an application is not sufficient work to justify a fee under RESPA. In its Statement of Policy 1999–1, entitled "Regarding Lender Payments to Mortgage Brokers" (64 FR 10080, March 1, 1999), HUD stated:

Although RESPA is not a rate-making statute, HUD is authorized to ensure that payments from lenders to mortgage brokers are reasonably related to the value of the goods or facilities actually furnished or services actually performed, and are not

[1] Compensable services are services that are actual, necessary and distinct from the primary services provided by the real estate broker or agent, that are not nominal, and for which duplicative fees are not charged.

[2] For example, conducting actual inspections of the items to be covered by the warranty to identify pre-existing conditions that could affect home warranty coverage, recording serial numbers of the items to be covered, documenting the condition of the covered items by taking pictures and reporting to the HWC regarding inspections may be compensable services.

compensation for the referrals of business, splits of fees or unearned fees.

In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with that amount normally charged for similar services, goods or facilities * * *. If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. (*See* 24 CFR 3500.14(g)(2).) Moreover, HUD also believes that the market price used to determine whether a particular payment meets the reasonableness test may not include a referral fee or unearned fee, because such fees are prohibited by RESPA. Congress was clear that for payments to be legal under Section 8, they must bear a reasonable relationship to the value received by the person or company making the payment. (S. Rep. 93–866, at 6551.) 64 FR 10086.

D. Conclusion

Accordingly, HUD interprets section 8 of RESPA and HUD's regulations as these authorities apply to the compensation provided by home warranty companies to real estate brokers and agents as follows:

(1) A payment by an HWC for marketing services performed by real estate brokers or agents on behalf of the HWC that are directed to particular homebuyers or sellers is an illegal kickback for a referral under section 8;

(2) Depending upon the facts of a particular case, an HWC may compensate a real estate broker or agent for services when those services are actual, necessary and distinct from the primary services provided by the real estate broker or agent, and when those additional services are not nominal and are not services for which there is a duplicative charge; and

(3) The amount of compensation from the HWC that is permitted under section 8 for such additional services must be reasonably related to the value of those services and not include compensation for referrals of business.

F. Solicitation of Comment

This interpretive rule represents HUD's interpretation of its existing regulations and is exempt from the notice and comment requirements of the Administrative Procedure Act. (*See* 5 USC 553(b)(3)(A)). Nevertheless, HUD is interested in receiving feedback from the public on this interpretation, specifically with respect to clarity and scope.

Dated: June 18, 2010.

Helen R. Kanovsky,

General Counsel.

[FR Doc. 2010–15355 Filed 6–24–10; 8:45 am]

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DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Parts 1, 3, 8, 13, 19, 23, 25, 26, 27, 51, 67, 81, 84, 89, 96, 101, 104, 105, 110, 114, 116, 118, 120, 126, 127, 128, 135, 140, 141, 144, 148, 149, 150, 151, 153, 154, 155, 156, 157, 158, 159, 160, 164, 165, 167, 169, 174, 179, 181, and 183

[Docket No. USCG–2010–0351]

RIN 1625–ZA25

Navigation and Navigable Waters; Technical, Organizational, and Conforming Amendments

AGENCY: Coast Guard, DHS.

ACTION: Final rule.

SUMMARY: This rule makes non-substantive changes throughout Title 33 of the Code of Federal Regulations. The purpose of this rule is to make conforming amendments and technical corrections to Coast Guard navigation and navigable waters regulations. This rule will have no substantive effect on the regulated public. These changes are provided to coincide with the annual recodification of Title 33 on July 1.

DATES: This final rule is effective June 25, 2010.

ADDRESSES: Comments and material received from the public, as well as documents mentioned in this preamble as being available in the docket, are part of docket USCG–2010–0351 and are available for inspection or copying at the Docket Management Facility (M–30), U.S. Department of Transportation, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue, SE., Washington, DC 20590, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. You may also find this docket on the Internet by going to *http://www.regulations.gov*, inserting USCG–2010–0351 in the "Keyword" box, and then clicking "Search."

FOR FURTHER INFORMATION CONTACT: If you have questions on this rule, call or e-mail Diane LaCumsky, Coast Guard; telephone 202–372–1025, e-mail *Diane.M.LaCumsky@uscg.mil*. If you have questions on viewing the docket, call Renee V. Wright, Program Manager, Docket Operations, telephone 202–366–9826.

SUPPLEMENTARY INFORMATION:

Table of Contents for Preamble

I. Regulatory History

We did not publish a notice of proposed rulemaking (NPRM) for this rule. Under 5 U.S.C. 553(b)(3)(A), the Coast Guard finds this rule is exempt from notice and comment rulemaking requirements because these changes involve rules of agency organization, procedure, or practice. In addition, the Coast Guard finds notice and comment procedure are unnecessary under 5 U.S.C. 553 (b)(3)(B) as this rule consists only of corrections and editorial, organizational, and conforming amendments and these changes will have no substantive effect on the public. This rulemaking also implements the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, by revising the Penalty Adjustment Table published in 33 CFR 27.3. This revision reflects statutorily prescribed adjustments of civil monetary penalties (CMP) for 2010. These statutes do not allow for discretion in implementation, rendering prior notice and comment unnecessary and contrary to the public interest.

Under 5 U.S.C. 553(d)(3), the Coast Guard finds that, for the same reasons, good cause exists for making this rule effective upon publication in the **Federal Register.**

II. Background

Each year the printed edition of Title 33 of the Code of Federal Regulations is recodified on July 1. This rule, which becomes effective June 25, 2010, makes technical and editorial corrections throughout Title 33 in time to be reflected in the recodification. This rule does not create any substantive requirements.

III. Discussion of Rule

This rule amends 33 CFR Part 1 by adding a new paragraph to clarify the Coast Guard's District Commanders' authority to redelegate signature of