
Mortgage Insurance Market Developments and Outlook: Where are we Now?

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Where are we now?

- A quick look back
- Current Outlook of Mortgage Market
 - Home Prices/Sales
 - Foreclosures/Defaults
- Impact on Mortgage Insurers
 - Counterparty Risk for GSE's
 - Rating Agencies
 - Captive Reinsurers
 - International

A Quick Look Back

A quick look back (How did we get here?)

- Community Reinvestment Act (1977)
- Gramm-Leach-Bliley Act (1999)
- Commodity Futures Modernization Act (2000)
- Federal Funds rate cuts (2000-2001)
- Housing Market Boom and Bust

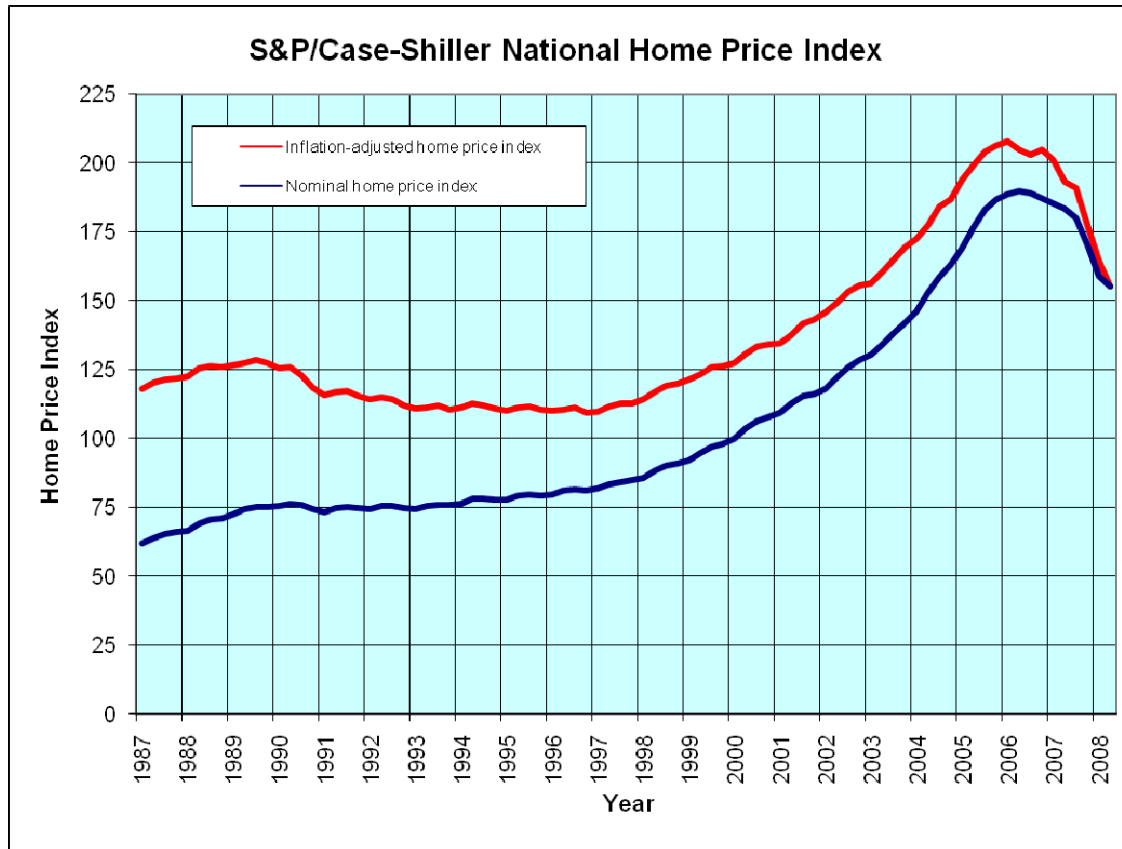
A quick look back (How did we get here?)

- Speculation
- High-Risk loans and lending practices
- Securitization practices
- Inaccurate credit ratings

Current Outlook of Mortgage Market

Current Outlook of Mortgage Market

- How much have home prices dropped?



There may still
be about 10%
more to go

Source: Economy.com

Home Price declines from peak to Aug-08 (top 20 metro areas in the U.S.)

SPCS HPI	Peak	% change from peak
Phoenix	Jun-06	-36.3%
Los Angeles	Sep-06	-30.9%
San Diego	Nov-05	-32.8%
San Francisco	May-06	-30.7%
Denver	Aug-06	-5.4%
Washington	May-06	-22.4%
Miami	Dec-06	-34.7%
Tampa	Jul-06	-26.8%
Atlanta	Jul-07	-8.5%
Chicago	Sep-06	-11.3%
Boston	Sep-05	-10.8%
Detroit	Dec-05	-27.2%
Minneapolis	Sep-06	-17.1%
Charlotte	Aug-07	-2.8%
Las Vegas	Sep-06	-35.9%
New York	Jun-06	-10.7%
Cleveland	Jul-06	-10.5%
Portland	Jul-07	-7.8%
Dallas	Jun-07	-2.8%
Seattle	Jul-07	-8.9%
Composite-20	Jul-06	-20.3%

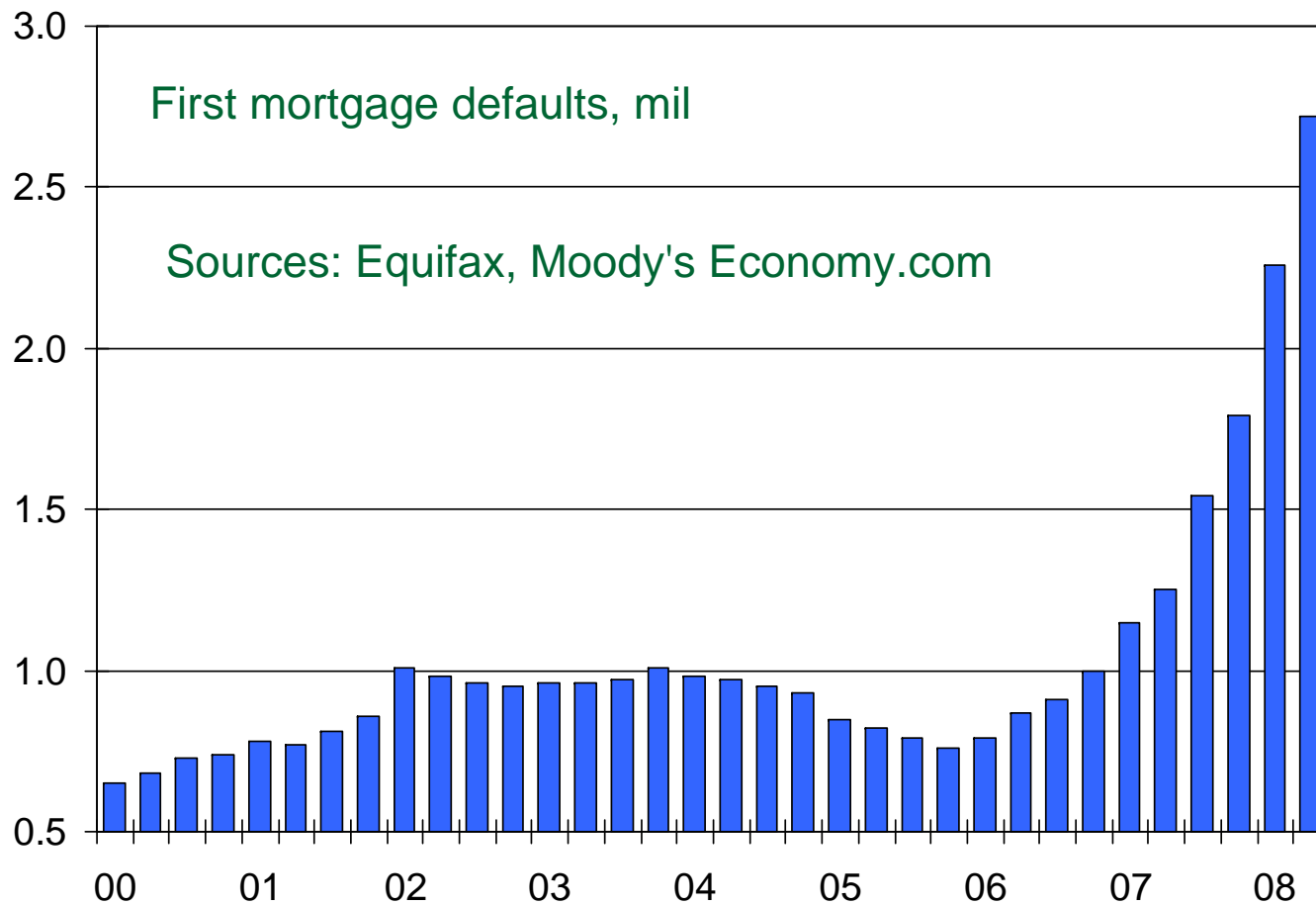
Source: S & P Cash-Shiller Home Price Index

As of 10/31/08, nearly 10 million homes are “upside down”, with the highest percentages in:

- Nevada (48%)
- Michigan (39%)
- Florida (29%)
- Arizona (29%)
- California (27%)
- Georgia (23%)

Source: Inman News

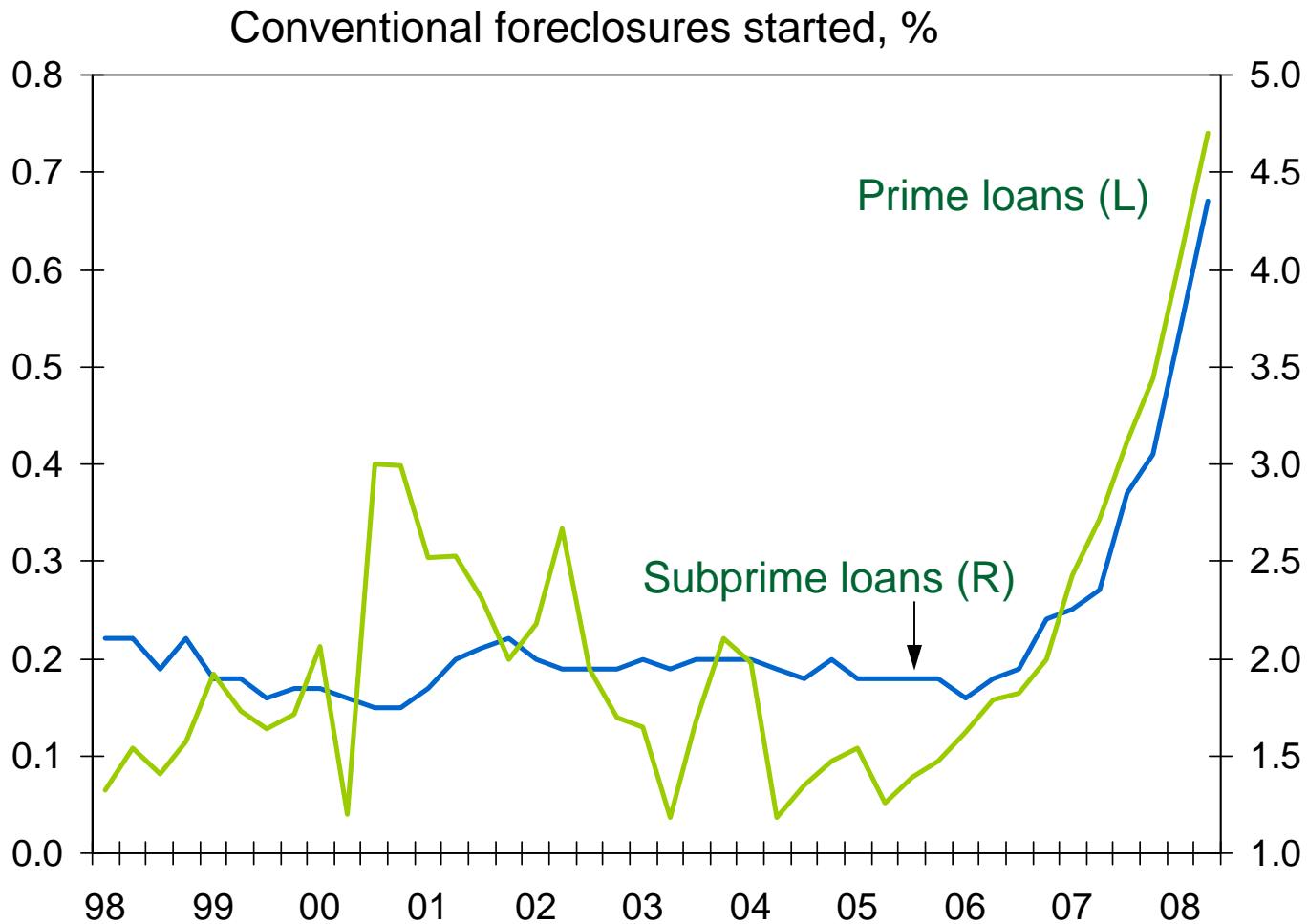
Mortgage defaults are soaring



Where are foreclosures and defaults coming from?

- Primarily from loans generated in 2006 & 2007 and parts of 2005
 - Types of loans
 - Subprime
 - Pay Option ARM's
 - Alt A (Low or No Documentation)
 - 100% LTV loans
 - California, Florida, Arizona, and Nevada
- Loans generated prior to 2005 in general have not deteriorated substantially

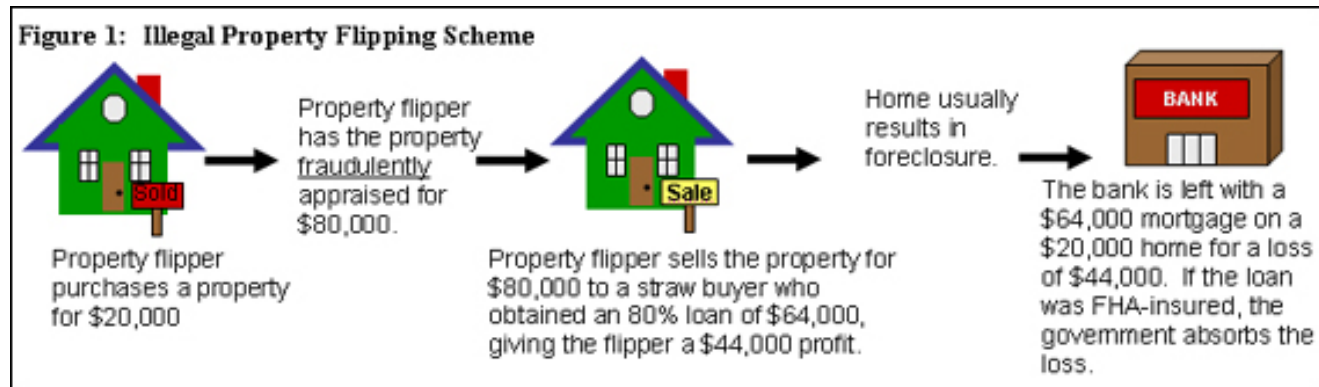
Even Prime Loans are being affected



Source: MBA

Mortgage Fraud

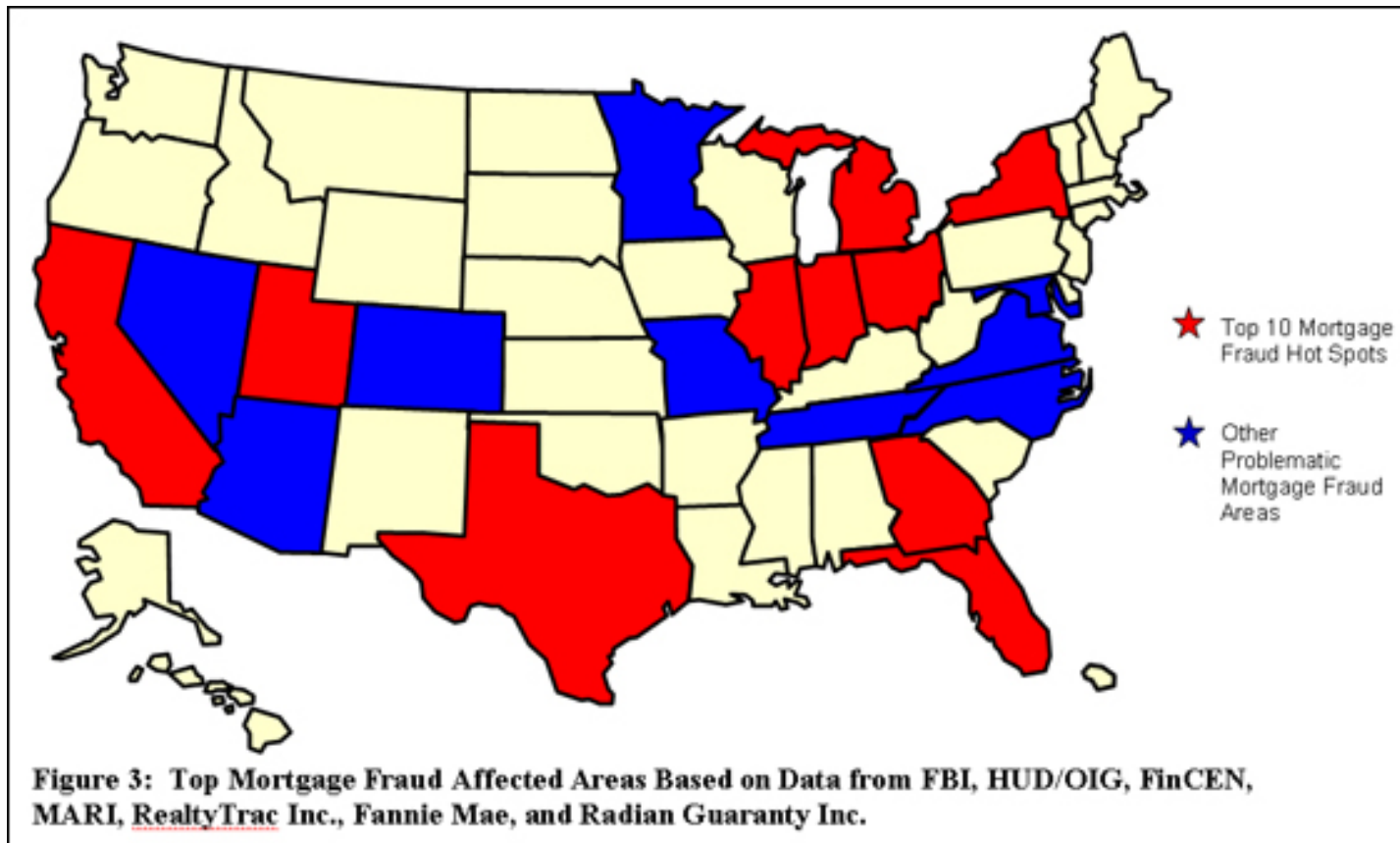
- Borrower Fraud
 - Fraud for property/housing
 - Fraud for profit (see figure 1)
- Lender Fraud
 - Deceptive or Predatory Lending



Source: Federal Bureau of Investigation

Mortgage Fraud

■ Top Mortgage Fraud States



Mortgage Fraud

- Emerging Schemes
 - Foreclosure Fraud
 - Deed Transfers and up-front fees
 - HELOC Fraud
 - Focus on property equity
 - Sometimes coincide with check fraud

Impact of foreclosures and defaults

- 303 major U.S. lending operations have failed since late 2006 (ml-implode.com)
- Default Inventory & Reserves keeps growing
- Foreclosures clogging up the pipeline
- Claims handling & mitigation is overwhelming
- Sales of Foreclosed Homes
 - Has helped home sales to pick up recently
 - However, drives home prices down further, creating new defaults
 - Need to stop the downward spiral

Foreclosures are impacting the sales

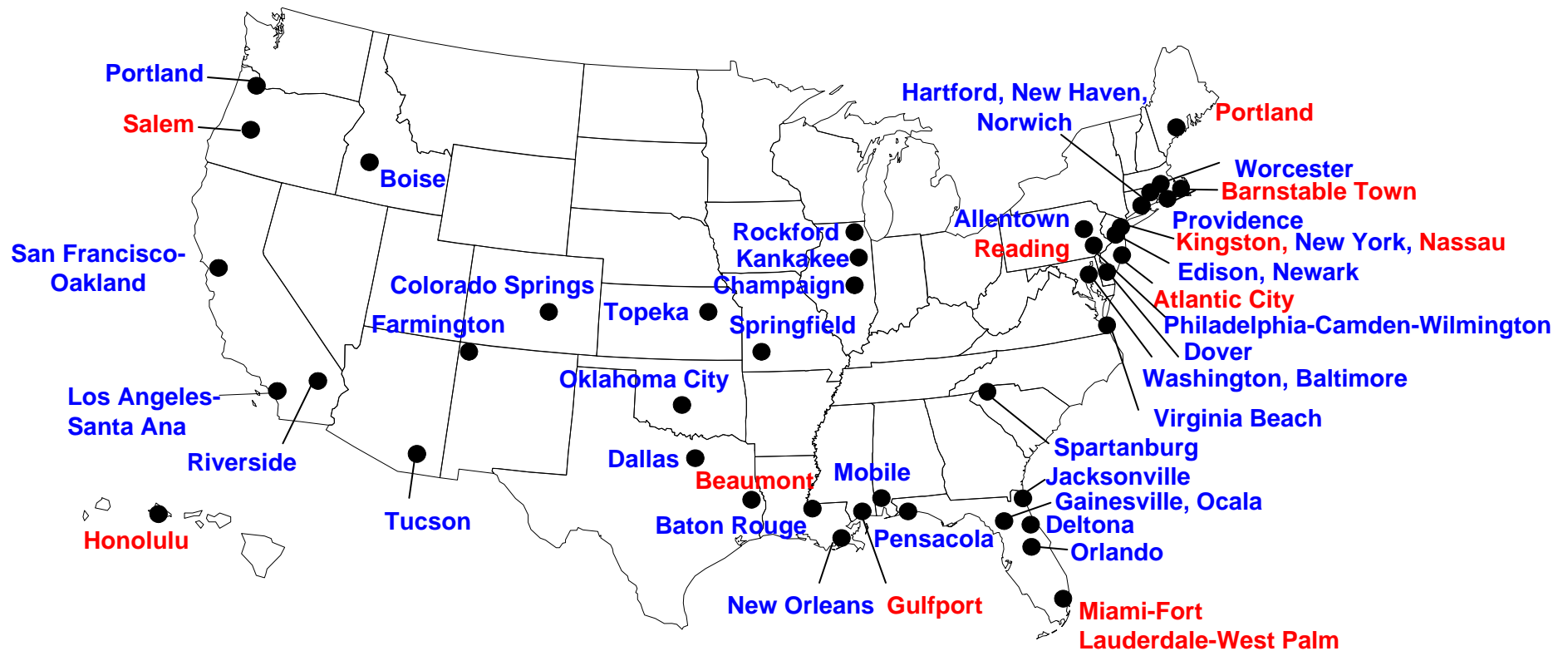
All homes	Sales Volume		Median Price			Foreclosure Sales (% of existing home sales)	
	Sep-07	Sep-08	%Chg	Sep-07	Sep-08		%Chg
Los Angeles	4,361	6,274	43.90%	\$525,000	\$360,000	-31.40%	39.1%
Orange	1,643	2,667	62.30%	\$570,000	\$425,000	-25.40%	36.8%
Riverside	2,208	4,551	106.10%	\$375,500	\$237,500	-36.80%	68.9%
San Bernardino	1,509	2,831	87.60%	\$325,000	\$205,000	-36.90%	63.1%
San Diego	2,152	3,366	56.40%	\$470,000	\$328,000	-30.20%	47.3%
Ventura	582	808	38.80%	\$545,500	\$385,000	-29.40%	44.0%
SoCal	12,455	20,497	64.60%	\$462,000	\$308,500	-33.20%	50.0%

Source: DQ News

Actions to address current foreclosures

- Lenders/GSE's enacting loan modifications or foreclosure prevention programs
 - Lowering interest rate
 - Extending term
 - Reducing amount of debt (last resort)
- Federal Government will likely have to come forward with a comprehensive foreclosure mitigation plan

Which Markets are High Risk vs. Elevated Risk?



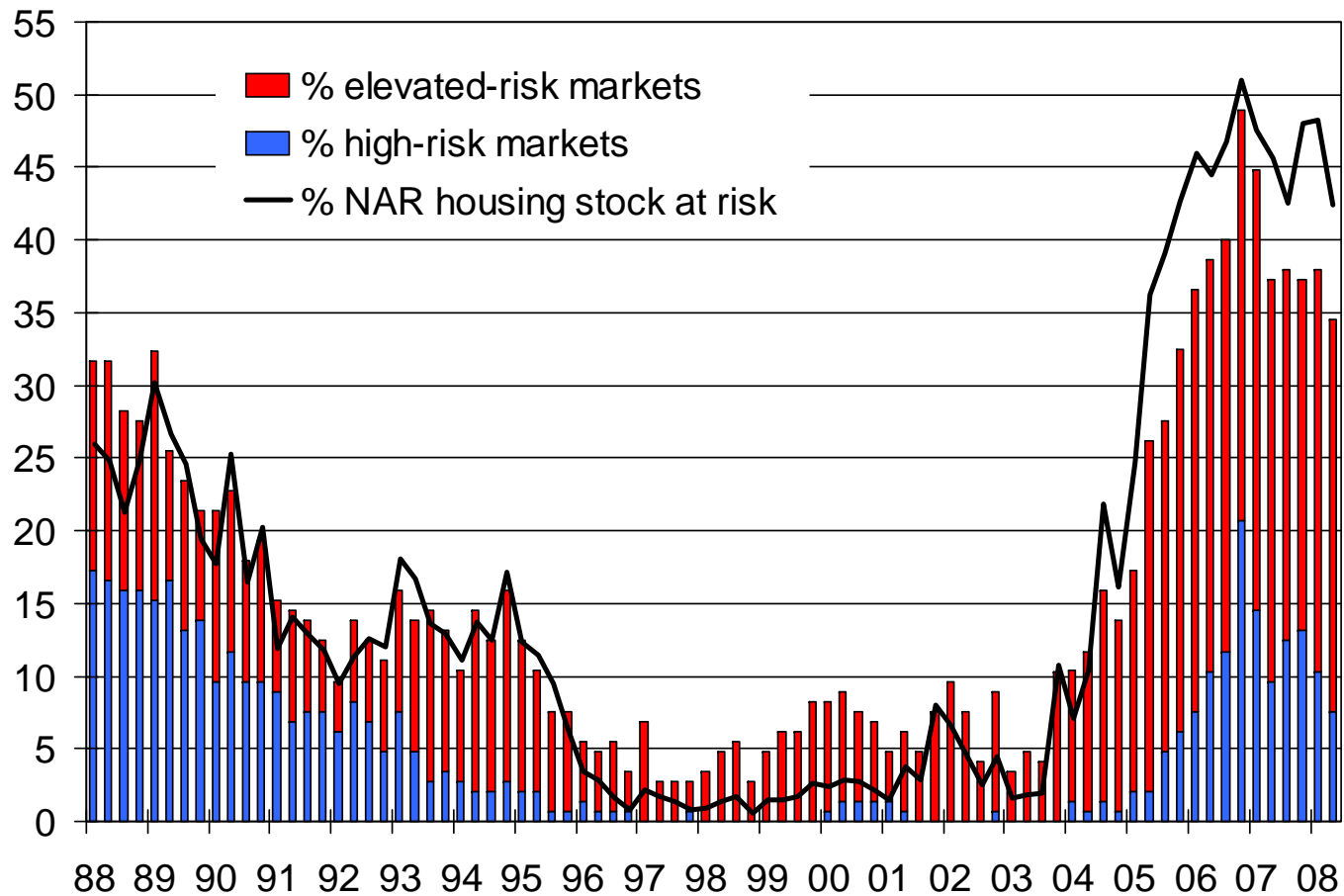
High-risk markets = Probability of decline 50% or greater

Elevated-risk markets = Probability less but twice historical average

Based on the NAR median house price, 2008Q2

Sources: Moody's Economy.com, National Association of Realtors

At Risk Markets are Declining

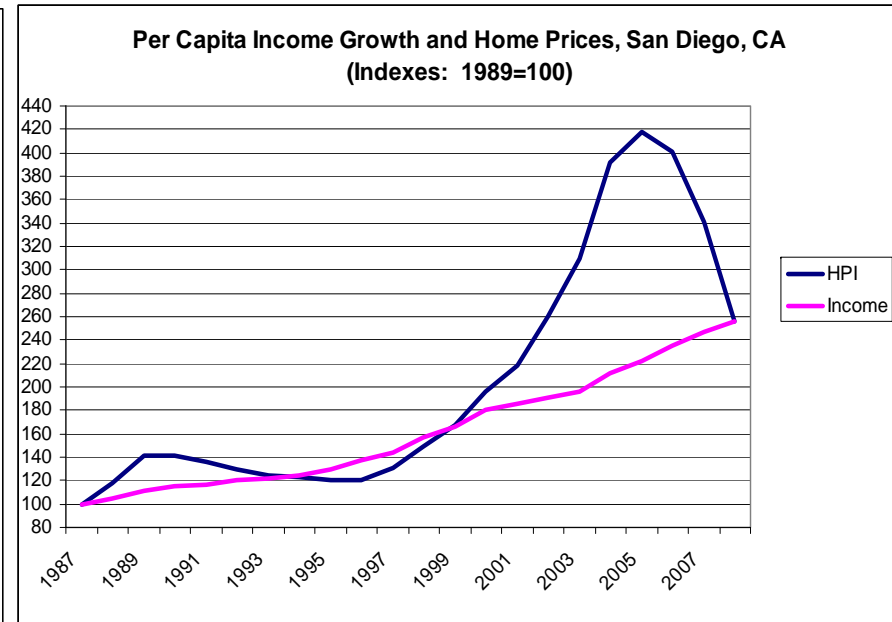
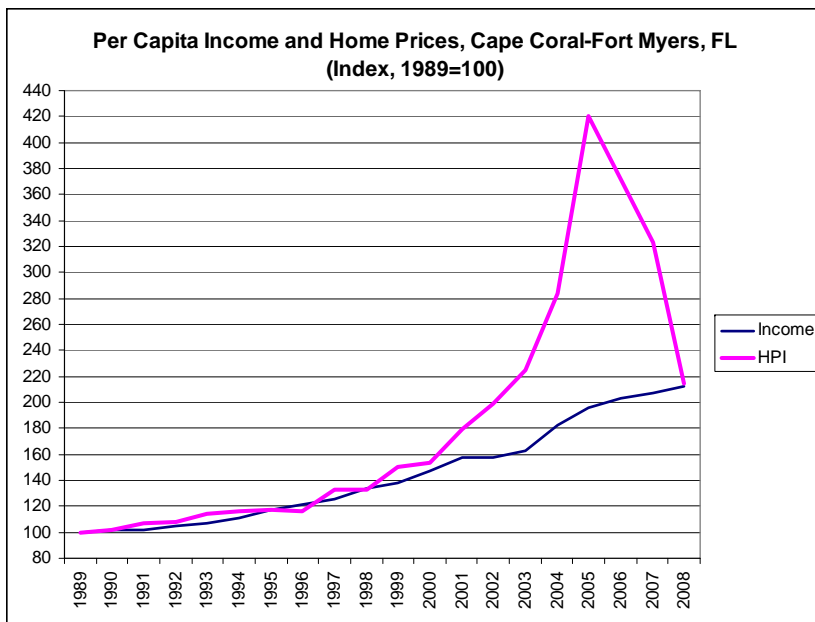


Source: Moody's Economy.com

Home Prices vs. Income

Cape Coral/Fort Myers, FL and San Diego, CA

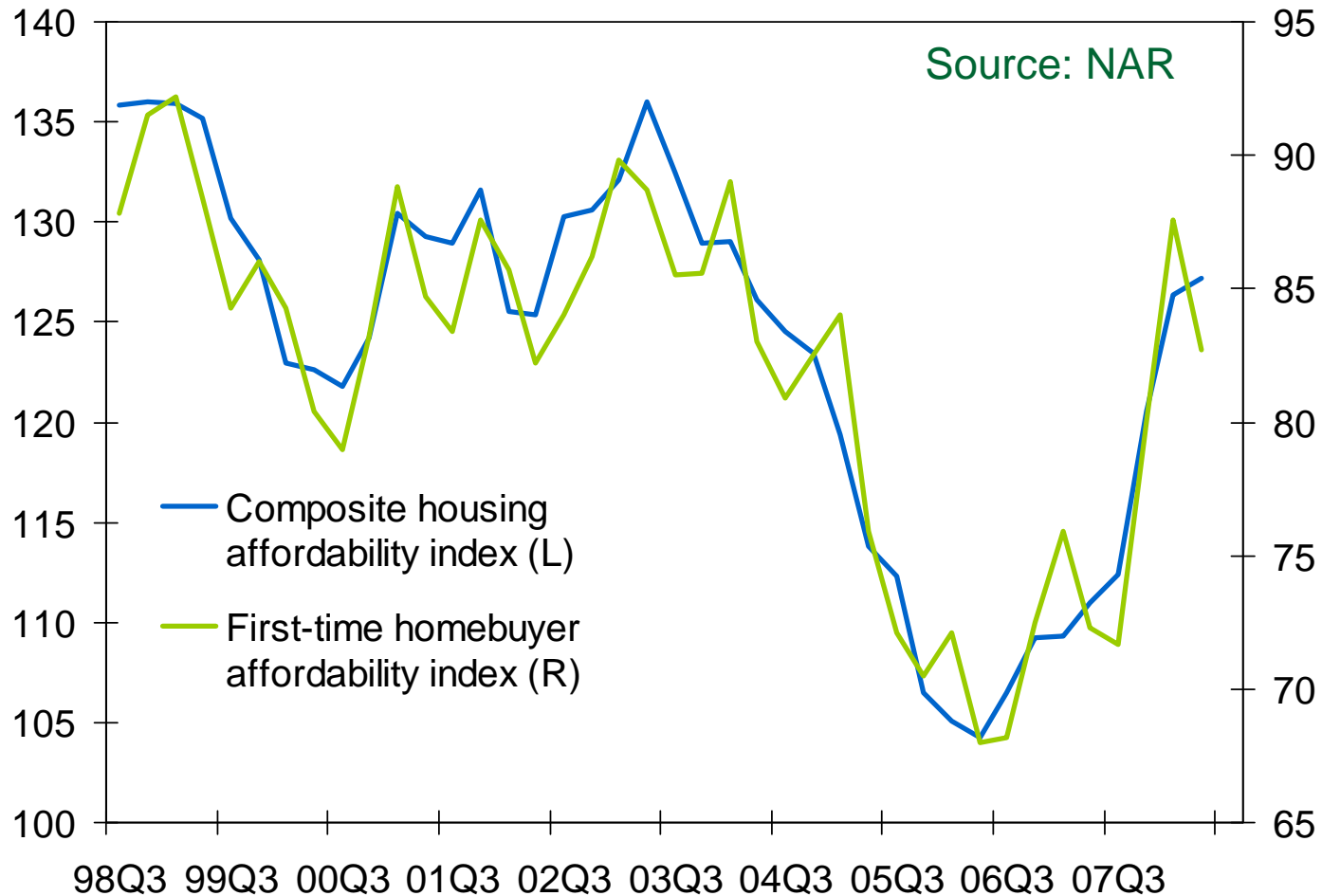
- Overbuilt when things were going well
- Some of the first markets to start going bad
- Have gotten back to equilibrium—Will likely overcorrect



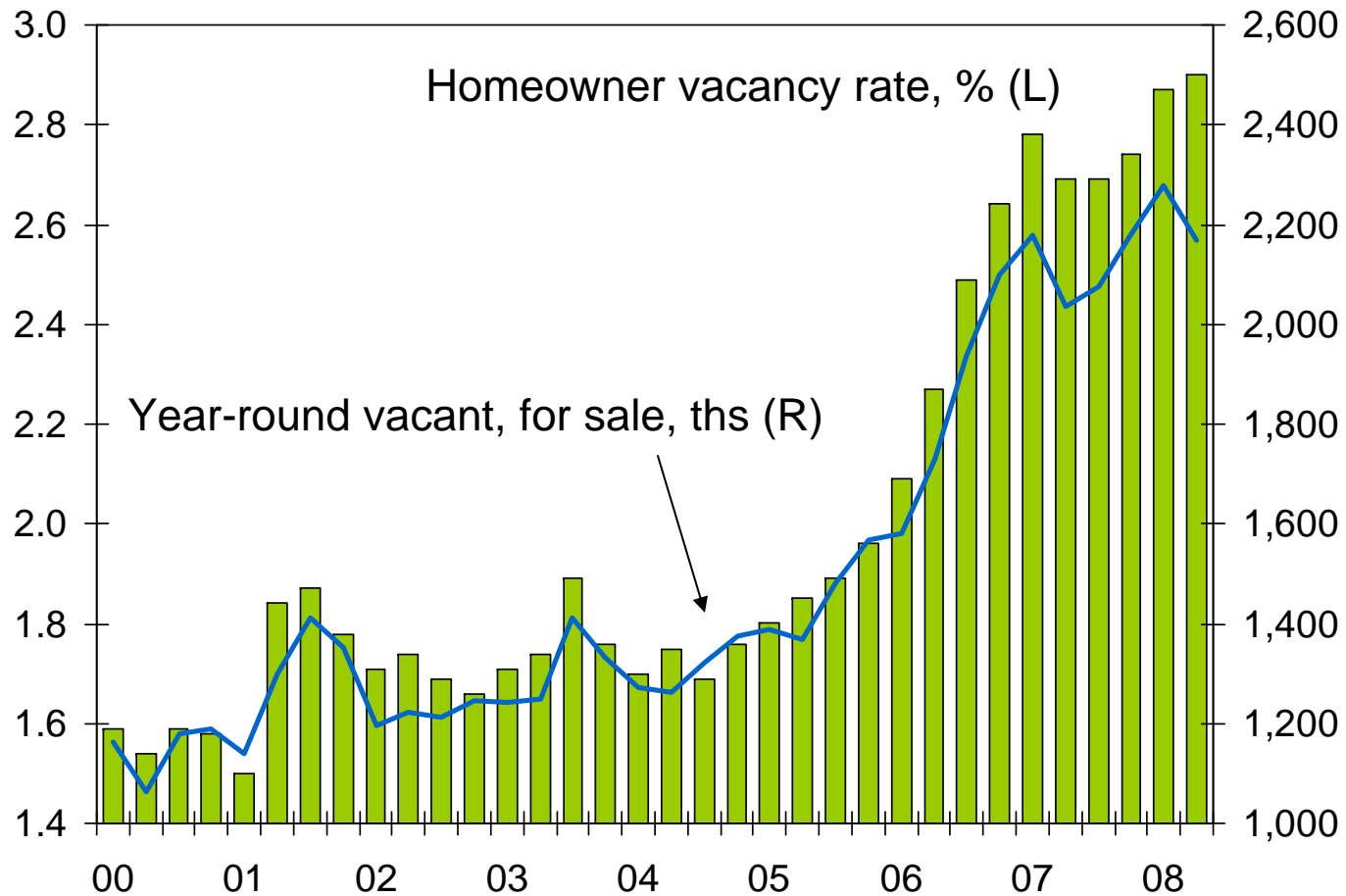
Source: National Association of Realtors; S&P Case-Shiller

Houses are returning to affordability

% of median-priced home that median-income family can afford



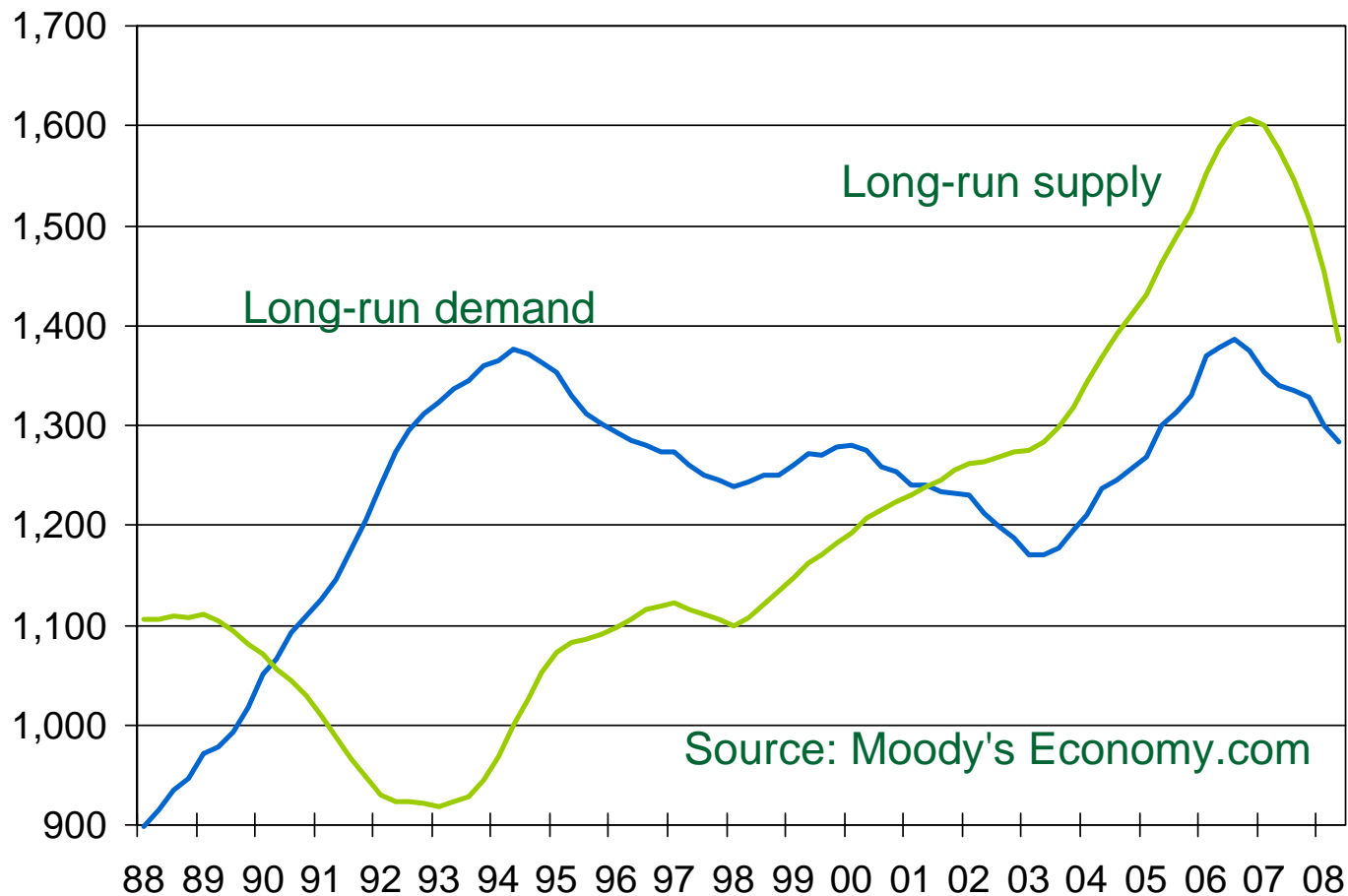
Inventories may be stabilizing



Source: National Association of Realtors

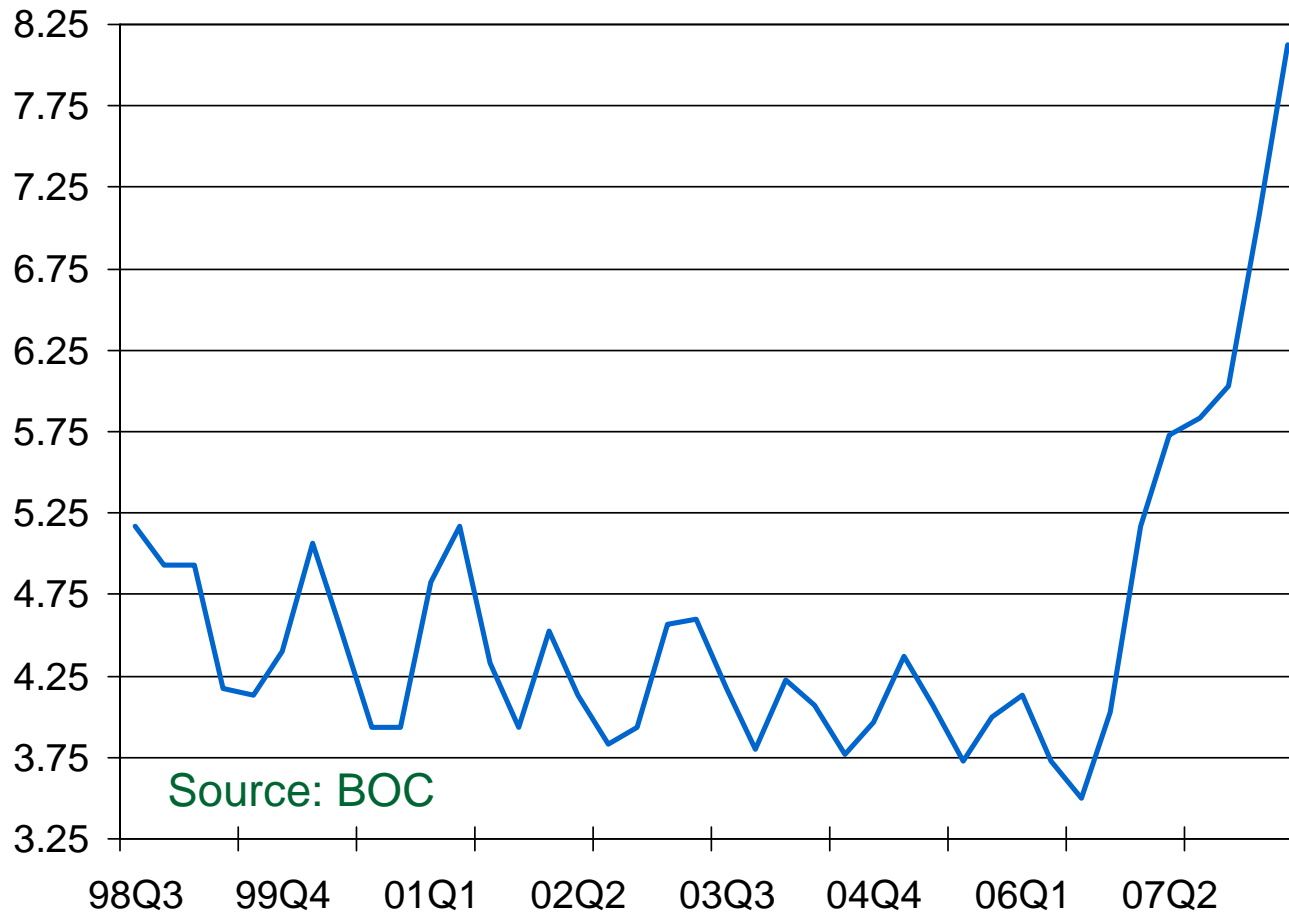
Supply-Demand Balance is Improving

Single-family total units, SAAR, ths



Median months on market

Median number of months for sale since completion



Impact on Mortgage Insurers

How are MI's being affected?

- Volume down
 - Prices have increased
 - Underwriting standards have been tightened
 - Mortgage volume down
 - FHA volume up
- Exit of some product lines

How are MI's being affected?

- Higher Risk to Capital levels
 - Could force more MI's into runoff
- Higher persistency → greater premiums but much greater losses
 - “Bad” loans have no place to go
- International retraction
 - PMI Australia, Triad Canada, and MGIC Canada
- Premium Deficiency Reserves
- Seasonality
 - Defaults typically surge in the 4th quarter

Protection for MI's against high losses

- Captive Excess of Loss Reinsurance contracts
- Aggregate Excess of Loss contracts
- Quota Share reinsurance contracts
- Bulk Deals with deductibles and/or stop losses
- Rescissions
- Denials
- Loss mitigation techniques

Captive Reinsurance

- Captive Reinsurers
 - ❑ Available on “Flow” insurance
 - ❑ Excess of loss reinsurance agreements
 - ❑ Ceded premiums placed into trust balances
 - ❑ “Deep-ceded” captives and others
 - ❑ PY 2006 & 2007
 - ❑ Capital calls for lenders to maintain adequate level of capital in trust balance
 - ❑ Possibility of uncollectible reinsurance for some lenders that have already failed

Bulk Deals--Deductibles & Stop Losses

- Bulk Deals with Structures
 - Many deals have deductibles and/or stop losses
 - Possible that all 2006 and 2007 deals with stop losses will breach their stop loss
 - “Bulk” has many more risk layers compared to “Flow”
 - Highly concentrated in CA, FL, AZ, and NV
 - Lots of low and no documentation business
 - Lots of Investor Properties and Cash-Out Refinances

Rescissions/Denials

- Rescissions
 - Fraud
 - Material Misrepresentation
 - Program Violations
- Denials
 - Claim not filed properly

Loss Mitigation techniques

- Traditional techniques are not working as well
 - Many depend on equity
- Proactive strategies in working with default servicers
 - Personal contacts
 - Education
 - Imminent defaults
 - Creative solutions to reduce current defaults and keep other loans from going into default

MI's, GSE's, and Rating Agencies

- MI rating affects credit risk of loans to GSE's (Fannie and Freddie)
- MI's repeatedly downgraded by Rating Agencies since February 2008
- Type I insurer vs Type II insurer
 - Remediation plans
- Captive cede limits to 25%
- Limiting new entrants

What's next?

