

MEMORANDUM FOR THE RECORD

Event: Jeffrey H. Lane, executive vice president and general counsel,
Mortgage Guaranty Insurance Company

Type of Event: Group phone interview

Date of Event: September 23, 2010

Team Leader: Tom Krebs

Location: FCIC Office at 1717 Pennsylvania Ave., N.W., Washington, D.C.

Participants – Non-Commission:

- Jeffrey H. Lane

Participants –Commission:

- Tom Krebs
- Vic Cunicelli
- Tom Borgers
- Troy Burrus
- George Wahl
- Jon Armstrong

MFR Prepared By: Jon Armstrong

Date of MFR: October 1, 2010

Date Reviewed: December 3, 2010

Note: This is a summary of the interview and the dialogue is paraphrased. It is not a transcript and should not be quoted as such.

Overview of Private Mortgage Insurance (PMI) Process

A lender is able to make a claim on a delinquent mortgage once the home goes into foreclosure. MGIC's main lenders were the GSEs and Wall Street investment banks. The GSEs comprised two-thirds of the MGIC's business.

Most of the claims that MGIC received were not made by the economic insurer or lender, but rather the party that serviced the loan for them. These servicers typically filled out a form 30-60 days after the foreclosure. MGIC then investigated the merits of the claim to determine if it was valid. If it was determined that the claim is valid, MGIC paid the claim.

The PMI typically insured between 10% to 30% of the mortgage amount. The coverage percentage received varied based on the LTV percentage of the loan. For example a loan that had a LTV of 95% would typically receive coverage on 30% of the mortgage; a loan that had a 90% LTV loan would receive 25% coverage. For the GSEs, the coverage percentage was intended to reduce their exposure to under 80%. Under the GSE's charter they could not purchase a loan with a LTV of greater than 80% unless that loan was made with a credit enhancement such as private mortgage insurance.

The claim amount was composed of the principle of the mortgage at the time of foreclosure, the unpaid interest, and various foreclosure expenses.

MGIC had the option of either paying the claim amount or paying the total cost of the home and taking the title.

Delegated Underwriting

At one point in time MGIC served as a review underwriter. This practice began to change between 2002 and 2003 as they competed for market share. Instead of doing underwriting upfront they relied on the automated underwriting systems of the lenders. MGIC took on the view that "if it is good for them, it is good for us." One of the primary reasons MGIC relied on the automated underwriting systems of the lenders was because lenders wanted to know within two to three minutes whether MGIC would insure their loans. This demand for quick turnaround made it impossible for MGIC to conduct an investigation into every loan.

After the financial crisis MGIC no longer relied on automatic underwriting to insure loans.

Business Channels Flow vs. Bulk

The *Flow Channel* insured loans on a one by one basis. A lot of these loans ended up with the GSEs or in a small lenders portfolio.

The *Bulk Channel* also insured loans on an individual loan basis as opposed insuring an entire pool of loans. When each loan defaulted, MGIC would pay the claim amount on that particular loan. These loans mainly ended up as private label securitizations.

MGIC's bulk customers included: Lehman, Countrywide, Novastar, Ameriquest, Credit Suisse, Deutsche Bank, Bear Stearns, Merrill Lynch, and Residential Funding Corp. (GMAC)

MGIC performed due diligence only on the bulk channel. They typically did due diligence reviews in-house and on occasion would enlist the help of a third-party due diligence company such as Clayton Holdings. MGIC would receive a tape from the lender that listed various data point

elements. They would then send a team of people out to the lender's site to perform the due diligence. They typically reviewed a sample of between 5% to 10% of the loans. MGIC representatives were not certain whether the sample was random or adverse. Also, the loans that they performed due diligence on, in most cases, would have already been subject to due diligence performed by Wall Street firms. MGIC would not perform due diligence on the same sample of loans as the Wall Street firms.

MGIC performed verification due diligence as opposed to validation. They did not actually verify whether the information within the loan file was correct. Their due diligence consisted of matching the data points on the loan tape to the information in the borrower's loan file. MGIC did not perform compliance due diligence. If the lender could not foreclose because it was found that the loan was predatory and did not comply with state or federal regulation, they did not insure that loan.

Eligibility Criteria

There were typically between two to eight eligibility criteria that had to be met in order for MGIC to insure a loan. They would look at factors such as the debt-to-income ratio (DTI), FICO score, and whether the property was a one-to-four family residence.

Investigation Process

After an insurance claim was filed, MGIC would launch an investigation to verify whether the information in the loan file was accurate. To do this, MGIC would speak with the borrower to determine what information they exchanged with the lender. MGIC also looked into whether the appraisal of the house was accurate. If MGIC's investigation found sufficient evidence to rescind a loan, they would notify the lender of their findings and give the lender an opportunity to rebut.

2009 Rescission

From the beginning of January 2009 to August 2009, MGIC rescinded approximately 20,000 loans in their flow channel and 10,000 loans in their bulk channel. Twenty-five percent of the bulk and flow claims were rescinded.

The aggregate amount of the claims that were rescinded during the 2009 time period would have been over \$2 billion. This number represents the amount they would have paid but for the rescissions.

In 2006 and 2007, the total face amount for mortgage insurance on the flow side was between \$50 and \$70 billion per year.

Dropping Lenders

In 2007, MGIC began increasing their prices. This was one of the principle ways that MGIC avoided doing business with lenders. Another technique that they used to avoid doing business was to reduce the percentage of the pool that they were willing to cover.

Litigation

MGIC currently has litigation pending with Countrywide. The Countrywide case was filed in California state court. There is also a parallel arbitration currently taking place with the American Arbitration Association Tribunal.

Put Backs

Lenders would put the loan back on the borrower under the provision in the contract in cases involving fraud.

Rating Agencies

MGIC never met with the rating agencies to discuss issues they were seeing in regards to the deterioration of the mortgages they insured.

Staffing up

The rise in fraud on the flow side prior to the crisis was less than 2% and now it's around 20%. Between 2007 and early 2008, MGIC began to increase their staff in the claims and fraud investigation area. Prior to 2007, they had 40 people working in these areas. After an increase in claims, they hired 200 new employees including outsourced employees from India.