

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 74-254
September 19, 1974

REGULATION Y

To All Banks, Bank Holding Companies, and Others
Concerned in the Eleventh Federal Reserve District:

The Board of Governors of the Federal Reserve System has announced its decision not to adopt the underwriting of mortgage guarantee insurance as a permissible activity for bank holding companies at this time.

The Board's decision follows an oral presentation held on this matter in January, 1974, at which proponents and opponents expressed views.

A copy of the Board's order is attached.

Yours very truly,

P. E. Coldwell,

President

Attachment

FEDERAL RESERVE SYSTEM

[12 CFR Part 225]

[Reg. Y]

BANK HOLDING COMPANIES

Nonbanking Activities of Bank Holding Companies

By notice of proposed rulemaking published in the Federal Register on May 23, 1973 (38 F.R. 13572), the Board of Governors proposed, in connection with applications filed pursuant to § 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1848(c)(8)) and § 225.4(b)(2) of the Board's Regulation Y (12 CFR 225.4(b)(2)), to add to the list of activities that it has determined to be closely related to banking or managing or controlling banks (§ 225.4(a) of Regulation Y) the following: "Engaging in the underwriting of real estate mortgage guaranty insurance." An oral presentation considering possible rulemaking with respect to the proposal was held on January 24 and 25, 1974, after notice thereof was published in the Federal Register on October 26, 1973 (38 F.R. 29650), and revised with respect to the date of the oral presentation on November 28, 1973 (38 F.R. 32823).

The Board has considered all comments received prior to the oral presentation, the record of the oral presentation, and all comments submitted in connection with, and subsequent to, the oral presentation that were received by the Board through July 31, 1974. After considering

all relevant aspects of the proposal to add the underwriting of real estate mortgage guaranty insurance to the list of closely related activities, the Board has determined not to adopt this activity at the present time.

Mortgage guaranty insurance is essentially a limited guarantee of a mortgage loan.^{1/} The underwriting processes of the mortgage insurer are similar to the mortgage extension processes of banks since both involve analysis of the credit worthiness of the borrower and appraisal of the real estate that is pledged as collateral. The underwriting of mortgage guaranty insurance is principally a credit determination, similar to those made by banks in their regular course of business. Because guaranteeing mortgages involves activities that banks frequently perform and requires skills that banks clearly possess, the Board concludes that this activity is closely related to banking.

Opponents of this proposal cite the possibilities of conflicts of interest, structural tying of services, and diversion of capital from the banking industry as adverse effects which could result from bank holding company performance of this activity. In its notice of proposed rulemaking, the Board proposed restrictions and requirements upon bank holding company performance of this activity:

(1) the proposed subsidiary may not underwrite mortgage guaranty insurance on mortgages originated by the holding company system;

^{1/} Mortgage guaranty insurance typically covers the top 20 or 25 per cent of a mortgage loan. In the event of default by the borrower, the lender acquires title to the property and then submits a claim to the insurer. The insurer then has a choice of two options: (1) take title to the property and pay the lender the unpaid principal and interest; or (2) pay the lender the 20 or 25 per cent insured portion of the loan, with the lender retaining title to the property.

(2) the proposed subsidiary must become an insurer qualified by the Federal Home Loan Mortgage Corporation; (3) the bank holding company system may not make demand deposits in, or reduce correspondent service charges for, any financial institution as an indirect means of compensating that financial institution for utilizing the holding company's proposed underwriting subsidiary; (4) the name of the proposed subsidiary may not resemble that of the the holding company or any subsidiary bank; and (5) the proposal that, with respect to any proposed mortgage guaranty subsidiary, in no event may the resources of any banking subsidiary of the holding company be used to support such company if it encounters financial difficulties. The Board finds that the possible adverse effects could be maintained at an acceptable level by adoption of these proposed restrictions and requirements.

Proponents have contended that bank holding company performance of this activity could be expected to result in some significant benefits to the public. For example, it is stated that the private mortgage insurance industry is presently characterized by a high level of concentration, and bank holding company entry into the industry would bring increased competition. It is further contended that bank holding companies will bring new capital into the industry, increase the underwriting capacity of the industry, and increase the supply of mortgage guaranty insurance.

The Board notes that the present private mortgage insurance industry is a relatively young industry which is still developing ^{2/} and which has a limited, and as yet untested, operating history. In addition, the Board believes that these are times when it would be desirable for bank holding companies generally to slow their present rate of expansion and to direct their energies principally toward strong and efficient operations within their existing modes, rather than toward expansion into new activities. This is particularly true with regard to expansion into a new area such as private mortgage insurance involving uncertainties which are sufficient in the Board's view to outweigh at the present time the public benefits that might be expected to result from this proposal. Accordingly, the Board has concluded that it would not be appropriate, at this time, to adopt the underwriting of mortgage guaranty insurance as permissible for bank holding companies.

By order of the Board of Governors, ^{3/} effective September 9, 1974.

(Signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

[SEAL]

^{2/} The oldest company in the industry was founded in 1956, the next oldest companies were founded in 1961.

^{3/} Voting for this action: Chairman Burns and Governors Brimmer, Bucher and Holland. Voting against: Governors Sheehan and Wallich. Absent and not voting: Vice Chairman Mitchell. Board action was taken while Governor Brimmer was a Board member.