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

Prepared for: CAS Annual Meeting 2008

Prepared by: Jonathan M. Guy, FCAS, MAAA
Vice President—Lead Actuary
Triad Guaranty Insurance Corporation

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

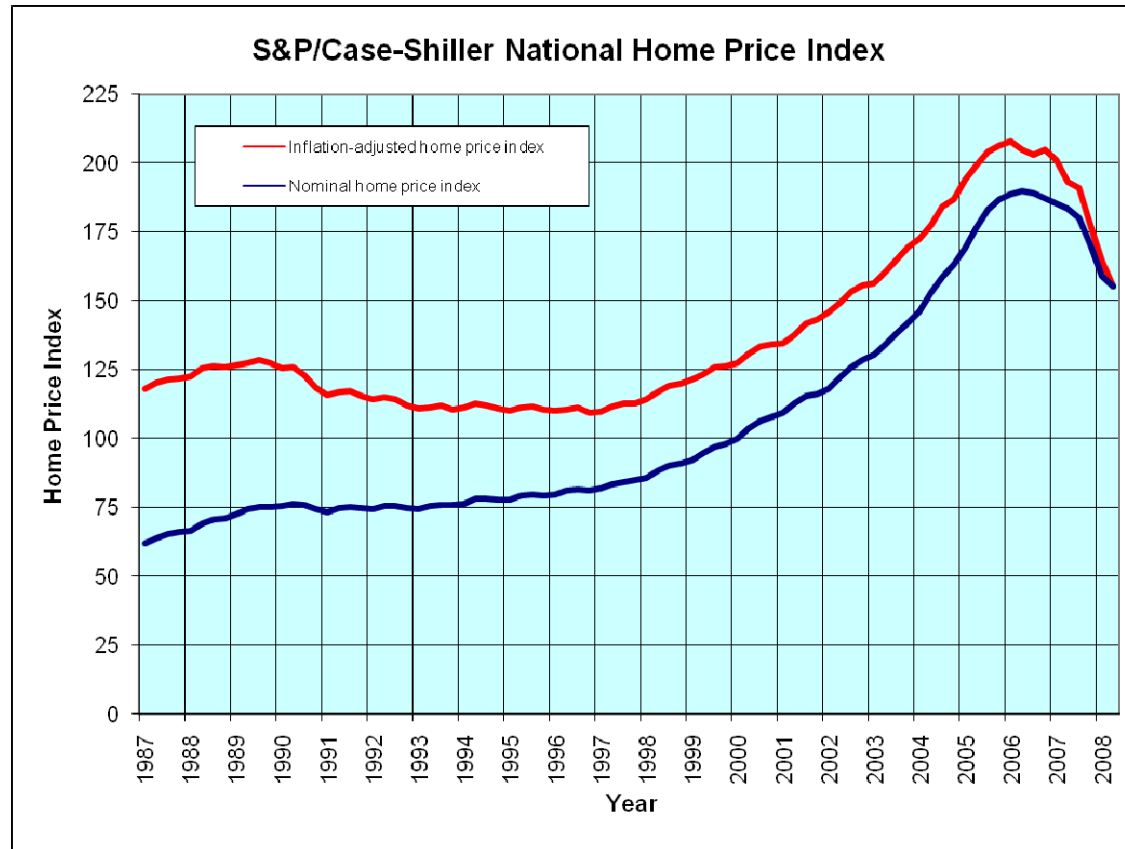
A quick look back (How did we get here?)

- 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% |

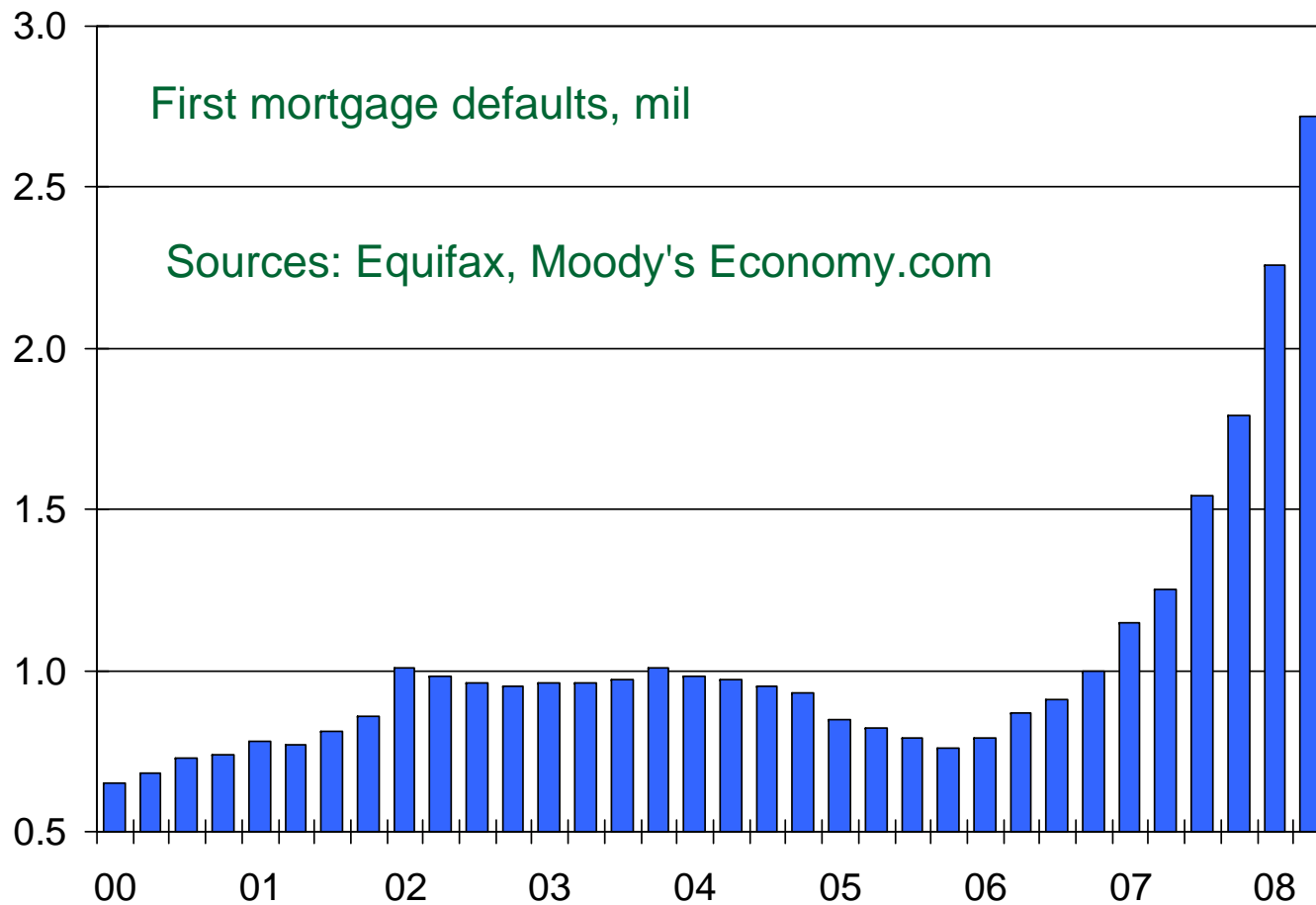
Source: S & P Cash-Shiller Home Price Index

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

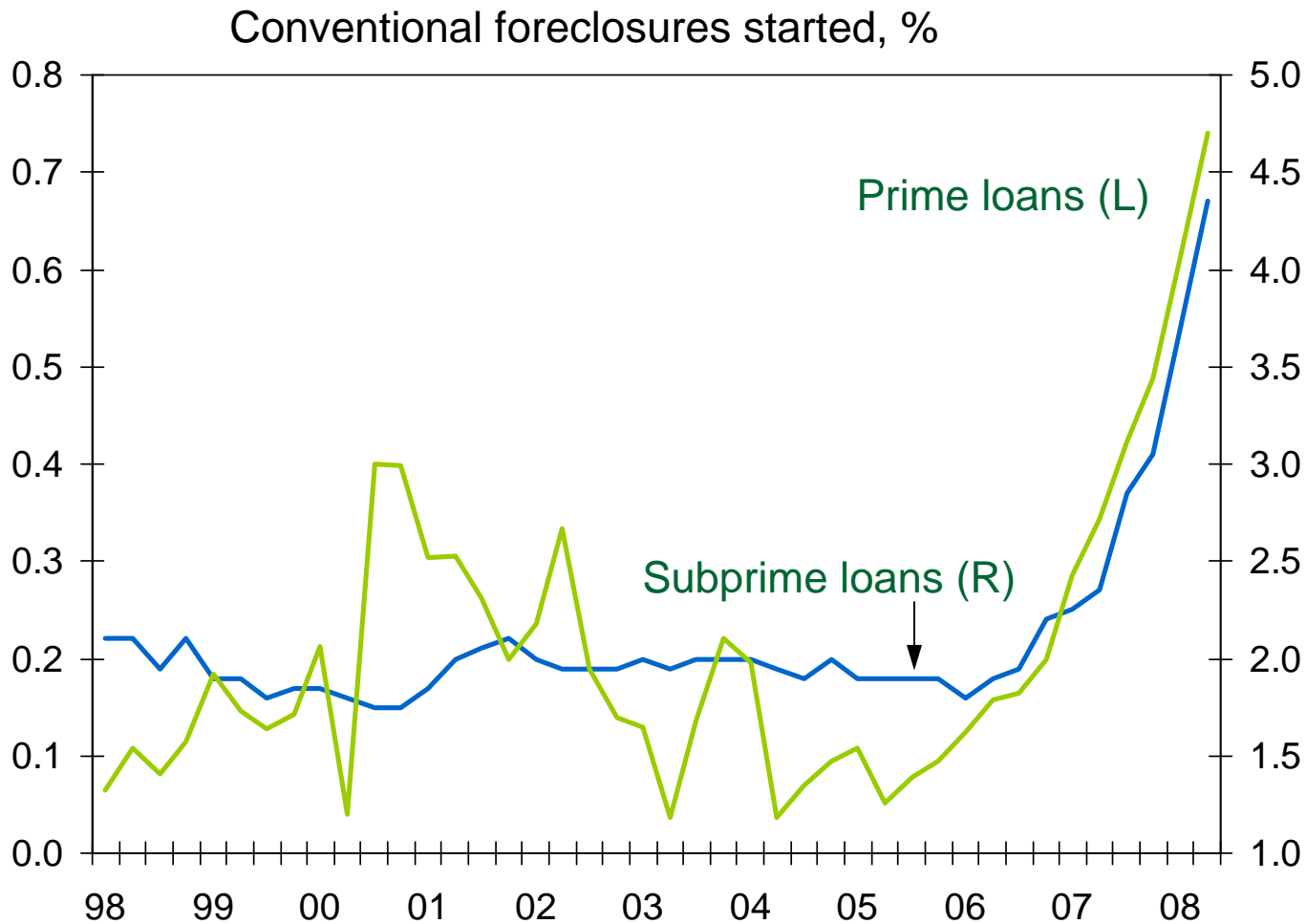
Mortgage defaults are soaring



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

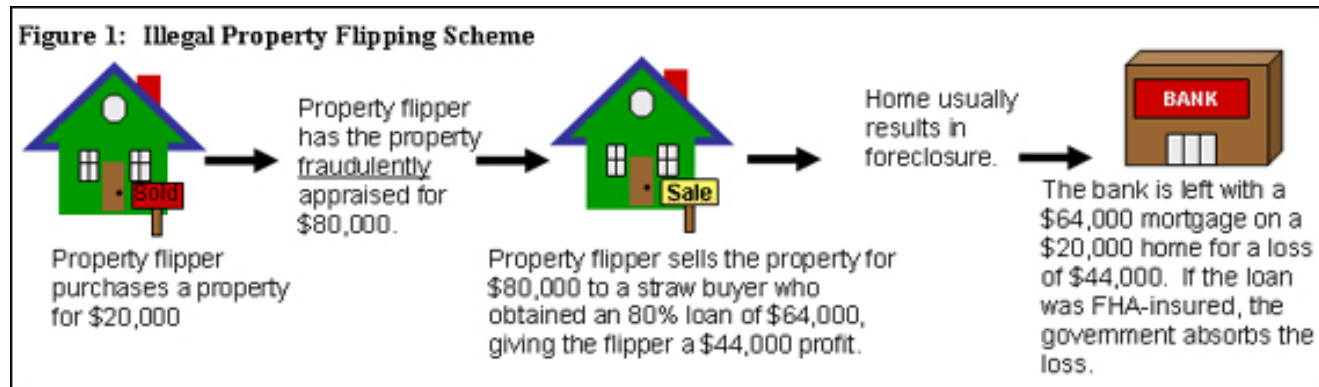
Even Prime Loans are being affected



Source: MBA

Mortgage Fraud

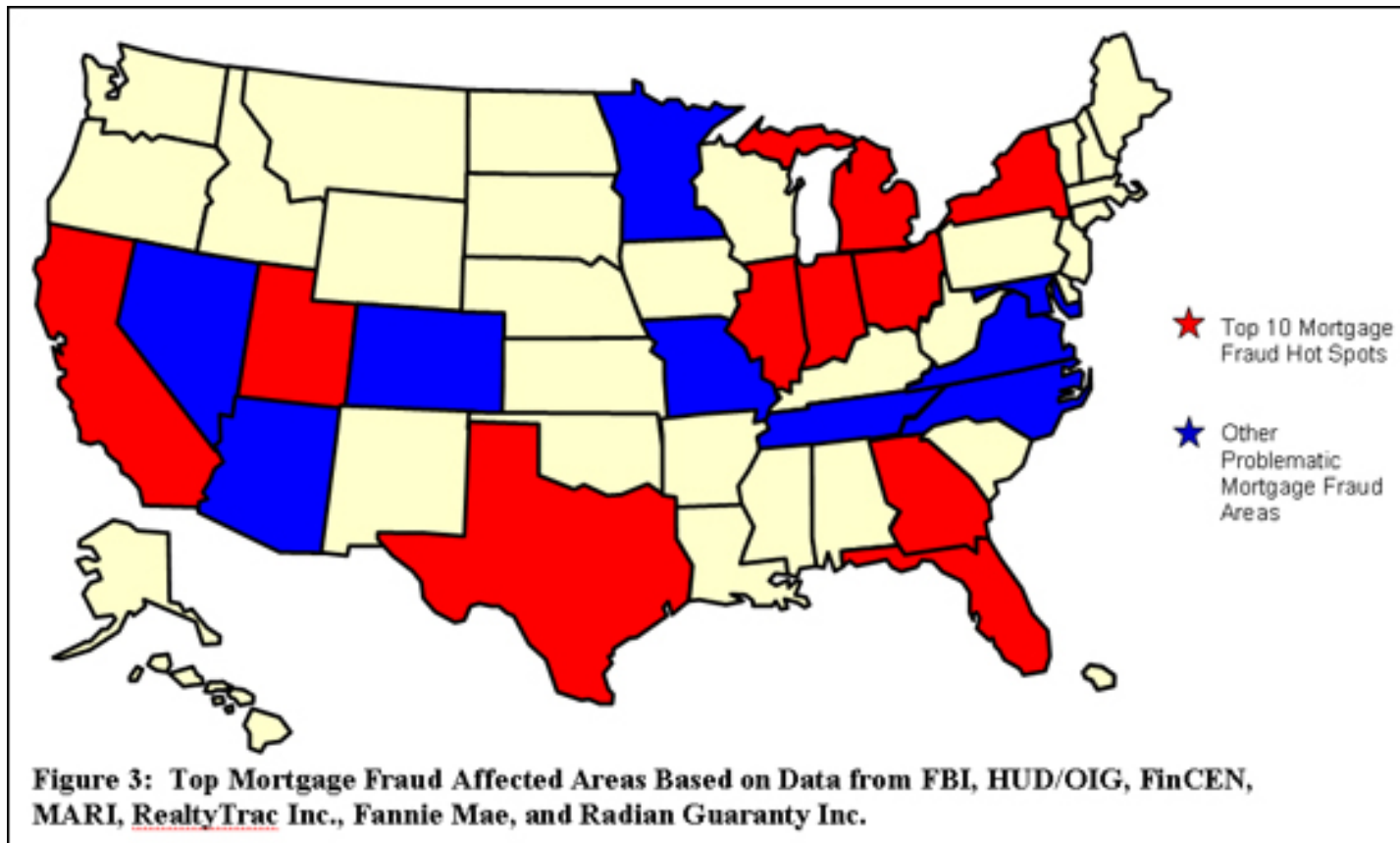
- Borrower Fraud
 - ❑ Fraud for property/housing
 - ❑ Fraud for profit (see figure 1)
- Lender Fraud
 - ❑ Deceptive or Predatory Lending



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

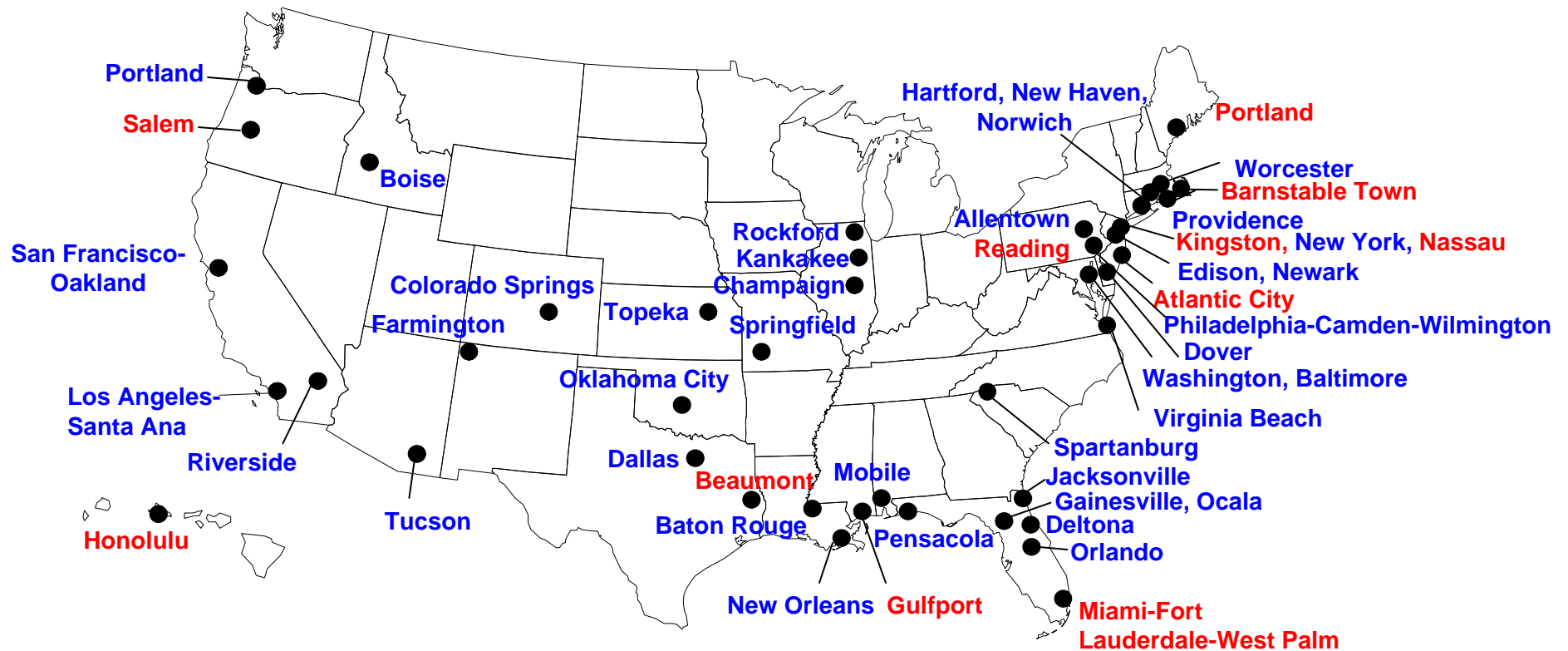
| All homes | Sales Volume | | Median Price | | | %Chg | Foreclosure Sales (% of existing home sales) |
|----------------|--------------|--------|--------------|-----------|-----------|---------|---|
| | Sep-07 | Sep-08 | %Chg | Sep-07 | Sep-08 | | |
| Los Angeles | 4,361 | 6,274 | 43.90% | \$525,000 | \$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?



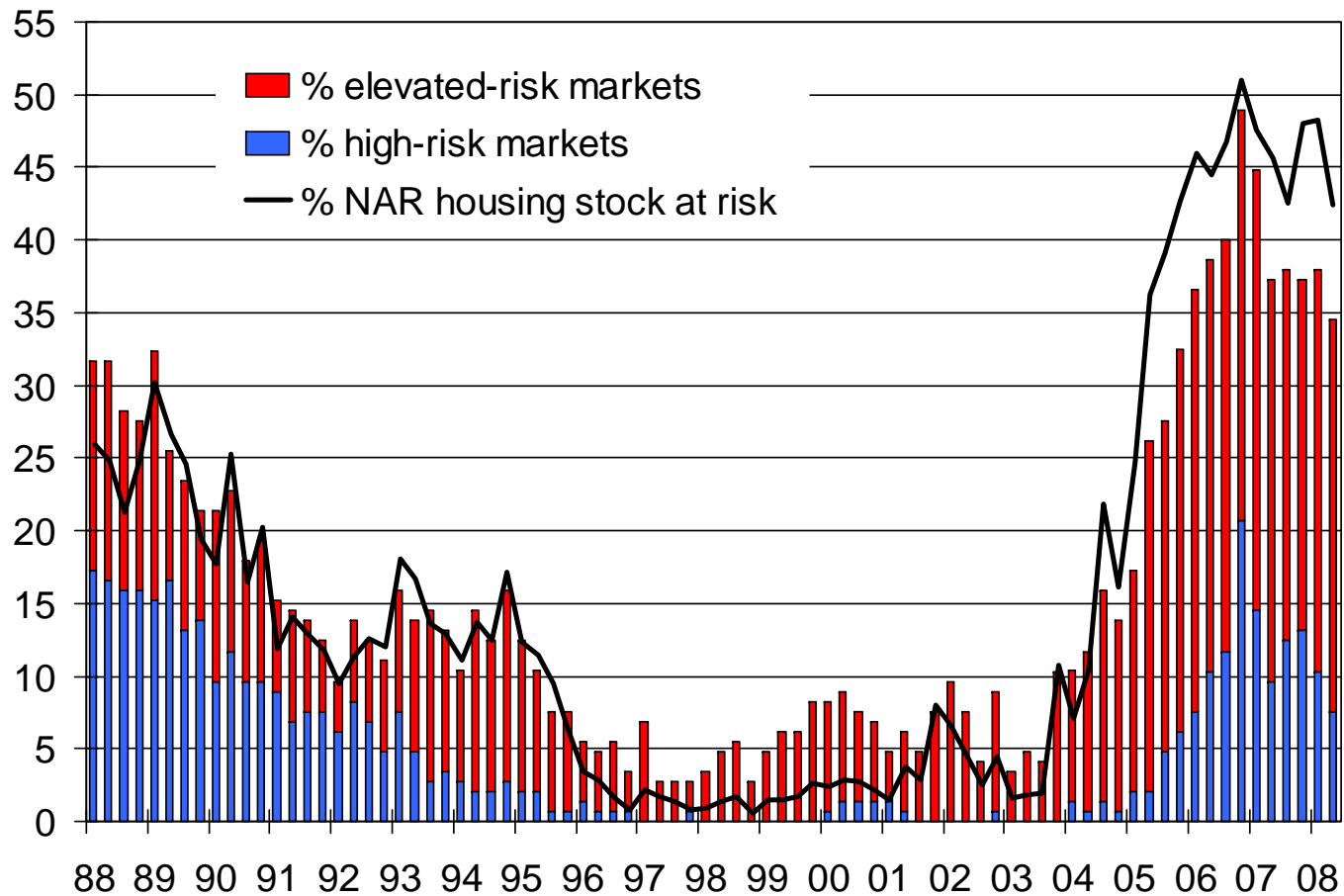
High-risk markets = Probability of decline 50% or greater

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

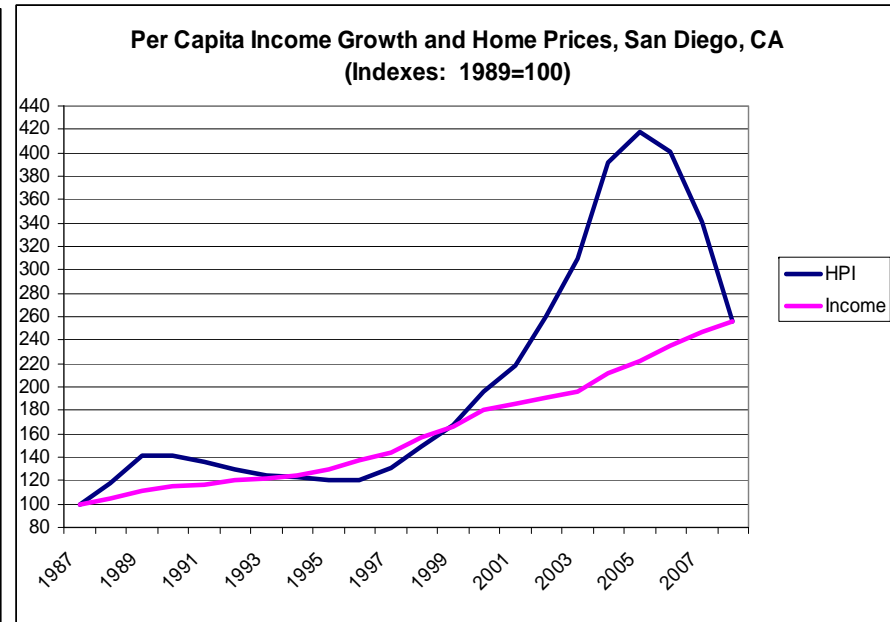
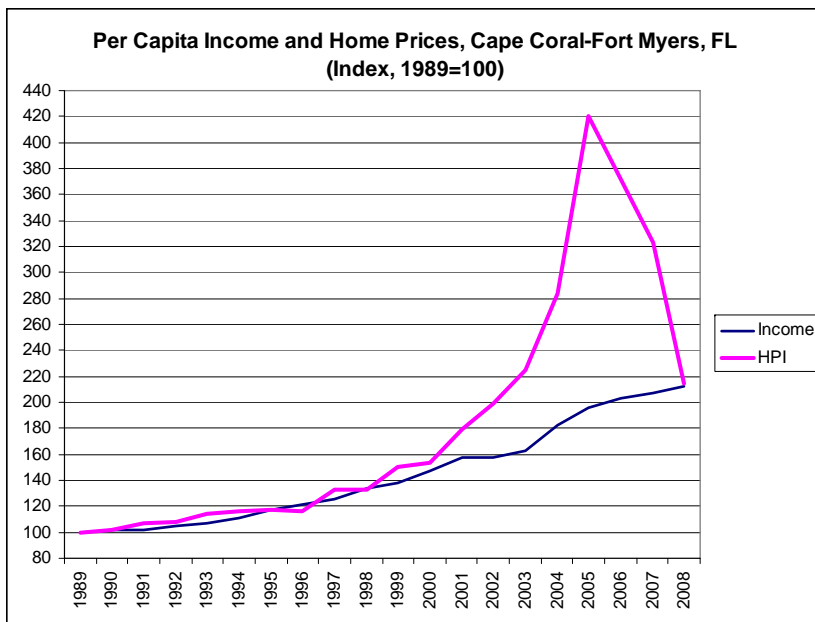


Source: Moody's Economy.com

Home Prices vs. Income

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

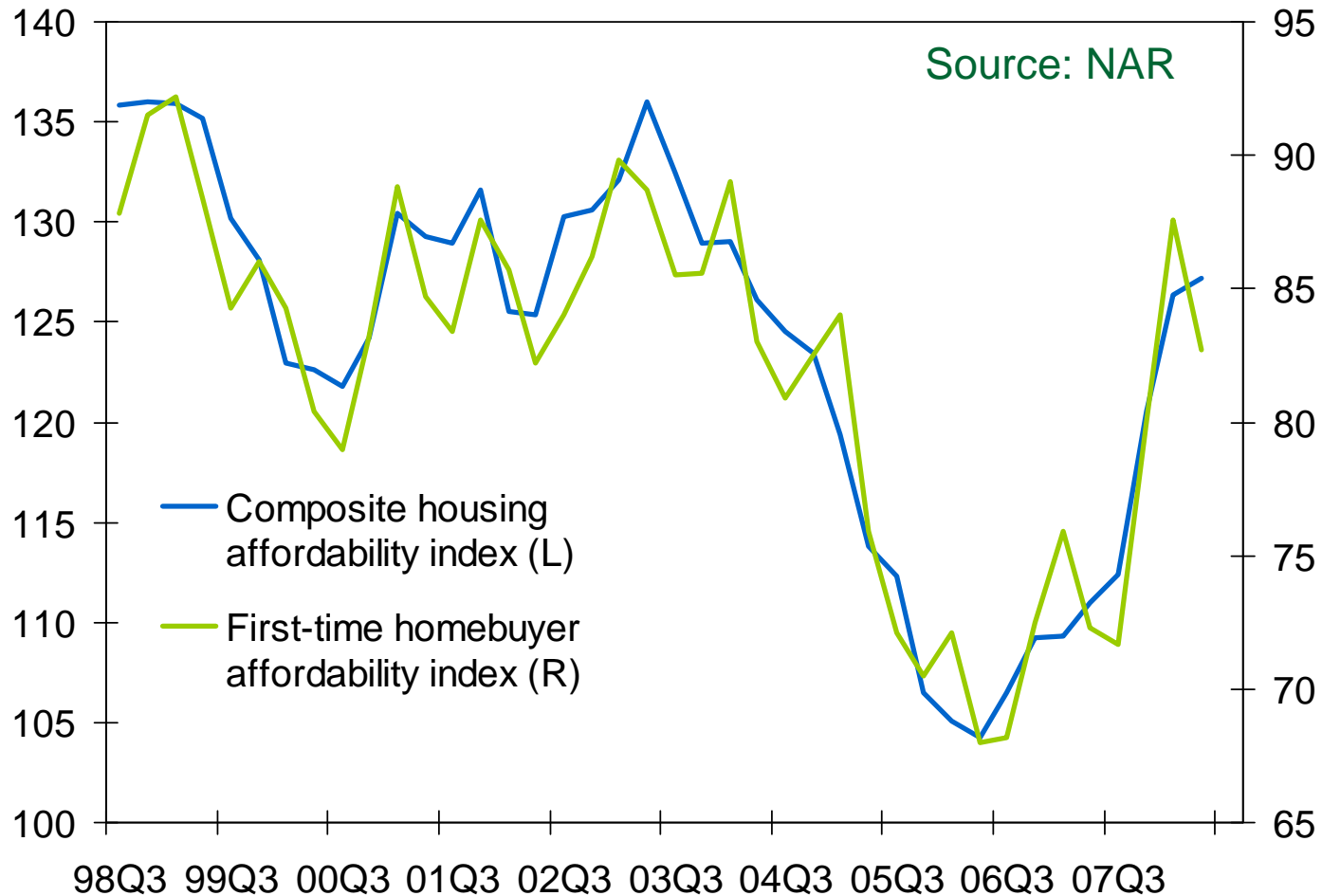
- Overbuilt when things were going well
- Some of the first markets to start going bad
- Have gotten back to equilibrium—Will likely overcorrect



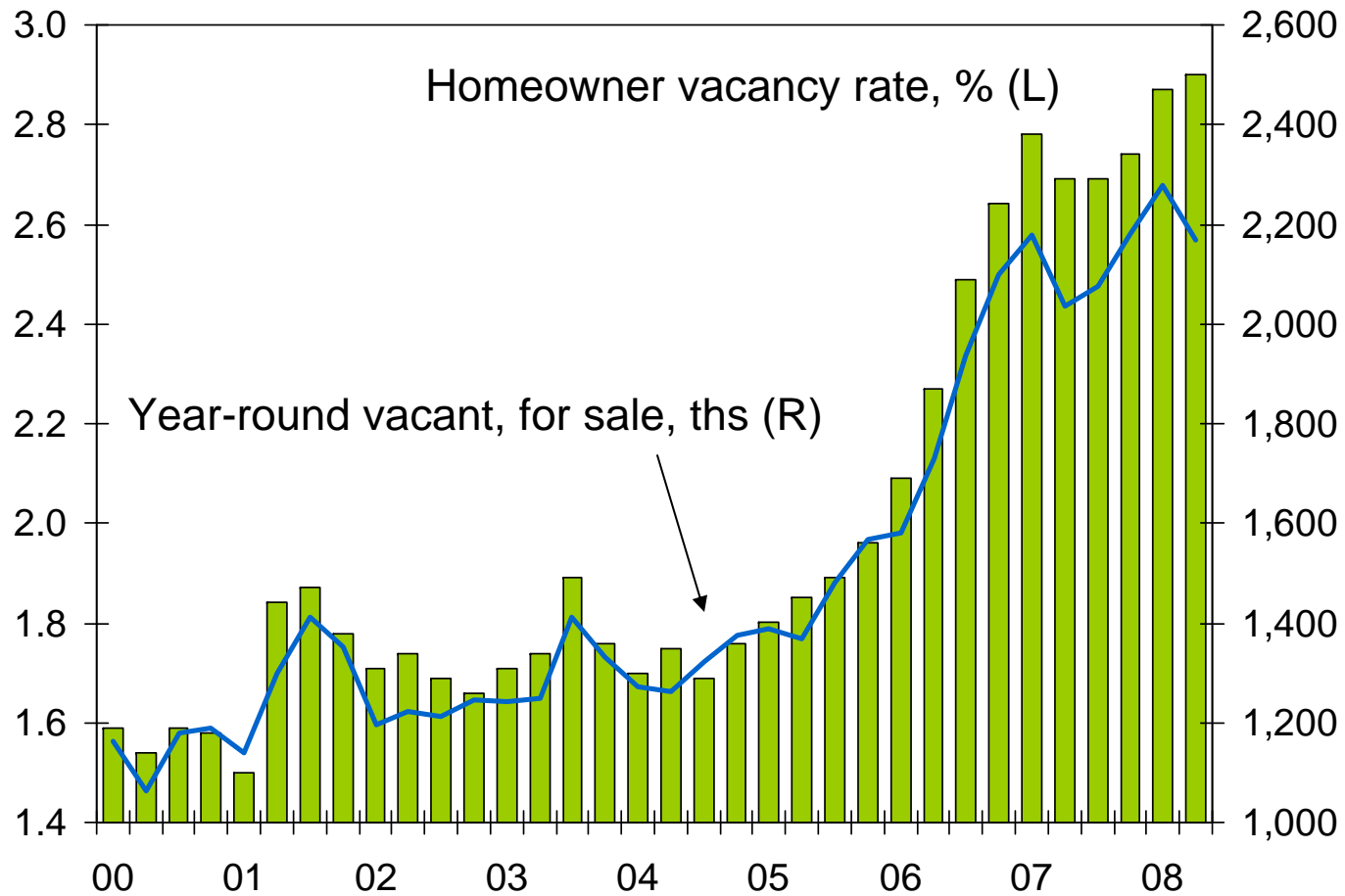
Source: National Association of Realtors; S&P Case-Shiller

Houses are returning to affordability

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



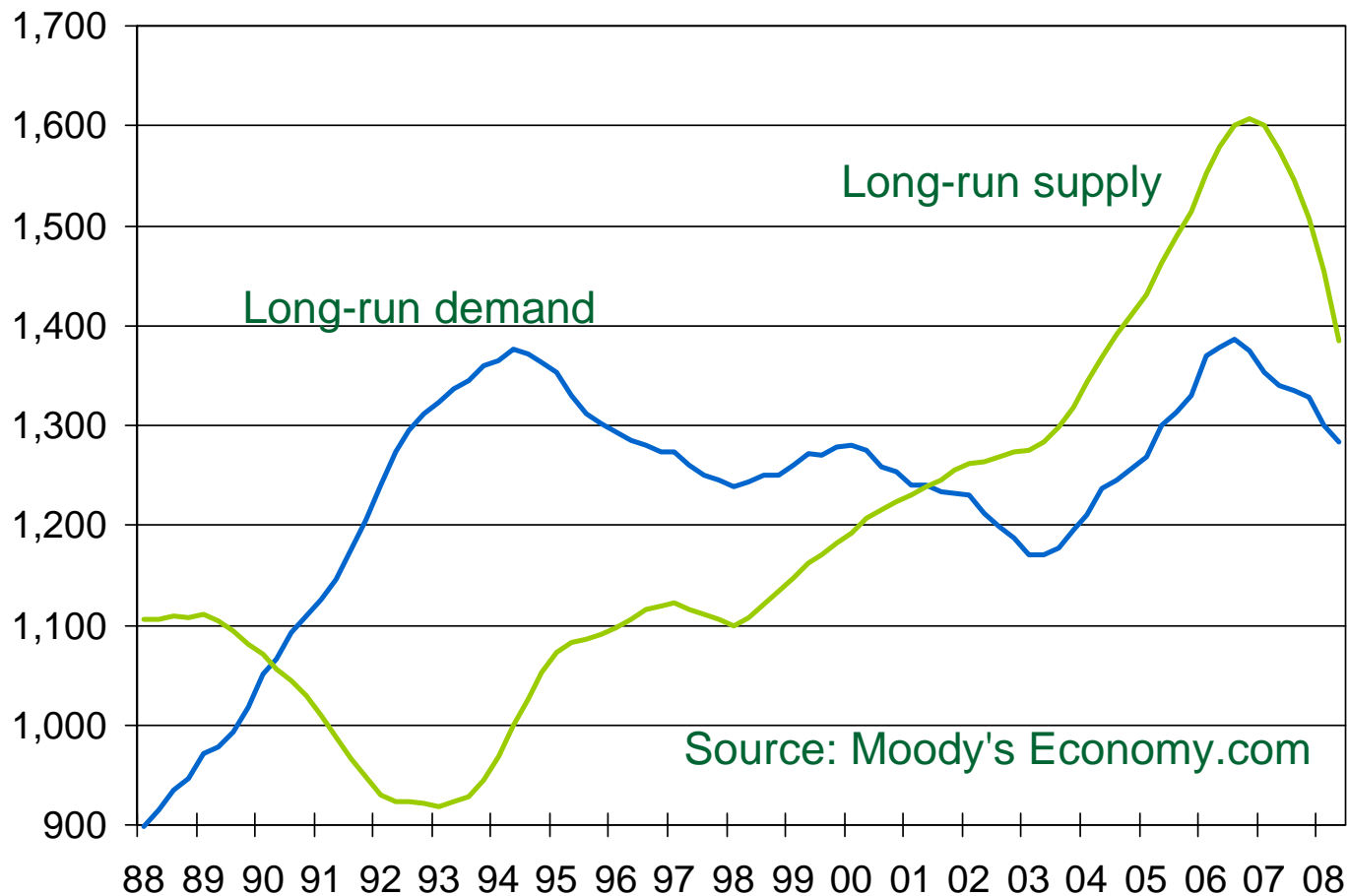
Inventories may be stabilizing



Source: National Association of Realtors

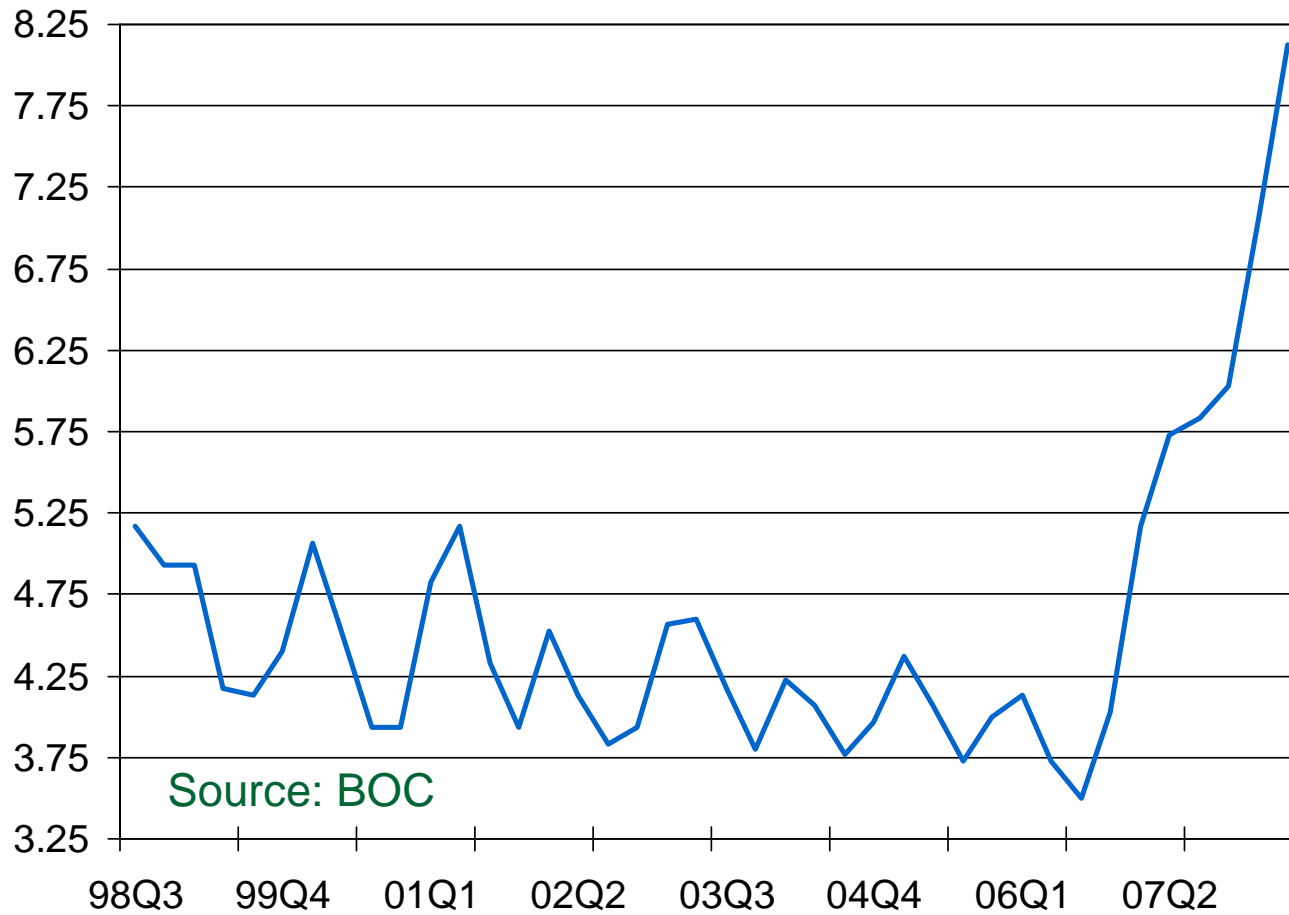
Supply-Demand Balance is Improving

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?

