**STORAGE NAME:** h0353a.ccc.doc
**DATE:** March 22, 2001

**HOUSE OF REPRESENTATIVES**

**COUNCIL FOR COMPETITIVE COMMERCE**
**ANALYSIS**

**BILL #:** HB 353

**RELATING TO:** Mortgage Guaranty Insurance

**SPONSOR(S):** Representatives Kallinger and Brummer

**TIED BILL(S):** None

**ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:**

(1) INSURANCE YEAS 14 NAYS 0
(2) COUNCIL FOR COMPETITIVE COMMERCE YEAS 13 NAYS 0
(3)
(4)
(5)

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I. SUMMARY:

Mortgage guaranty insurance protects a lender, usually a bank or mortgage company, against loss of all or a portion of the principal amount of a mortgage loan upon the default of the homeowner.

Mortgage guaranty insurers would be permitted to exclude contingency reserves from total liabilities when demonstrating compliance with minimum surplus requirements. The flat minimum surplus however would be raised to $4 million from $1.5 million.

The sufficiency of capital and surplus for mortgage guaranty insurers would be determined based on outstanding *aggregate exposure* net of reinsurance, rather than *liability* net of reinsurance under their written policies.

Based on data available as of December 31, 2000, for the 18 companies writing mortgage guaranty insurance, the total required minimum surplus under current law was $719.9 million. By excluding contingency reserves from liabilities and raising the flat minimum surplus requirement, the total required minimum surplus would be $334.6 million, a $384.5 million reduction in required minimum surplus. However, the move to utilizing aggregate exposure as a capital and surplus sufficiency measure could operate to require additional capital or additional surplus above the required minimum to write the current amount of business. Insurers might have to lower their total exposure, raise additional capital, or keep an amount in surplus higher than would be required.

This bill takes effect July 1, 2001.

## II. SUBSTANTIVE ANALYSIS:

### A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

| | | | | |
|---|---|---|---|---|
| 1. | Less Government | Yes [] | No [] | N/A [x] |
| 2. | Lower Taxes | Yes [] | No [] | N/A [x] |
| 3. | Individual Freedom | Yes [] | No [] | N/A [x] |
| 4. | Personal Responsibility | Yes [] | No [] | N/A [x] |
| 5. | Family Empowerment | Yes [] | No [] | N/A [x] |

For any principle that received a “no” above, please explain:

### B. PRESENT SITUATION:

Mortgage guaranty insurance protects a lender, usually a bank or mortgage company, against loss of all or a portion of the principal amount of a mortgage loan upon the default of the homeowner. This type of insurance provides no protection other than against loss due to default, and is regulated by the Department of Insurance under Chapter 635, in addition to other applicable provisions of the Insurance Code (e.g., s. 624.408). According to the National Association of Insurance Commissioners (NAIC), most policies cover from 10 to 30 percent of the loan amount and are written on first mortgage loans that represent generally 80 to 95 percent of the value of the mortgaged property (NAIC publication: Mortgage Guaranty Insurance Accounting Principles Supplement).

Licensed agents market mortgage guaranty insurance directly to mortgage lenders (e.g., banks, mortgage companies, credit unions, and state and local housing authorities). Lenders obtain mortgage guaranty insurance in order to facilitate the sale of mortgage loans in the secondary markets (i.e., markets in which securities are sold after their original issue).

The nature of the insured risk for mortgage guaranty insurance is influenced by certain factors that in some respects distinguish this insurance from other types of insurance. For example, the exposure period for a particular risk is significantly longer for mortgage guaranty insurance. Further, coverage is renewable at the option of the insured and at the rate quoted when the policy was originally issued. In part because mortgage guaranty insurance is guaranteed renewable at a definite rate, insurers establish a so-called “contingency reserve.”

Minimum surplus requirements

As are other insurers, mortgage guaranty insurers must comply with statutorily-prescribed minimum surplus requirements. Minimum surplus must be equivalent to the greater of 10 percent of the insurer’s liabilities, or $1.5 million. No insurer is required to have more than $100 million in surplus. In determining the required minimum surplus, specified liabilities are charged against certain assets; a mortgage guaranty insurer’s contingency reserve is counted as a liability.
Under Florida law, a “contingency reserve” is a special premium reserve distinct from other premium reserves required by law. It is “established for the protection of policyholders against the effect of adverse economic cycles.” A contingency reserve must be established by each mortgage guaranty insurance company as a solvency requirement to protect policyholders against the effect

of adverse economic conditions. Each insurer must contribute an amount equal to 50 percent of earned premiums on each policy written into a contingency reserve and maintain the reserve over 10 years. The reserve may be reduced within this 10-year period only when losses in a calendar year exceed 35 percent of earned premiums.

According to the Department of Insurance, in the past five years, there has been only one instance in which the Department of Insurance has found a mortgage guaranty insurer out of compliance with minimum surplus requirements. In this instance, the company had listed approximately $1 billion in liabilities and $95 million in surplus, thus short of the minimum required surplus (i.e., 10 percent of liabilities) by approximately $5 million according to the Department of Insurance. The insurer had reported a contingency reserve of over $740 million. The Department of Insurance did not permit the company to exclude the contingency reserve from liabilities for purposes of determining the required minimum surplus. If the contingency reserve could have been excluded from total liabilities, the insurer's surplus would have been well in excess of the required minimum surplus requirements. Its total liabilities, excluding the contingency reserve, were $260 million; 10 percent of this amount would have been $26 million. Subsequently, this insurer has come back into compliance with the minimum surplus law.

Florida's approach in determining the amount of minimum surplus required of an insurer apparently is more formula-driven than that used in many states. The minimum surplus requirement in many states is based on a flat dollar amount rather than a percentage of liabilities, with the insurance regulator having more discretion to modify the minimum amount of surplus required.

The Florida Insurance Guaranty Association (which pays policyholder claims when companies become insolvent) does not cover mortgage guaranty insurance.

<u>Maximum outstanding liabilities</u>

Mortgage guaranty insurers are prohibited from having outstanding total liabilities under its aggregate mortgage guaranty insurance policies, net of reinsurance, exceeding 25 times its paid-in capital, surplus, and contingency reserve combined.

C. EFFECT OF PROPOSED CHANGES:

Mortgage guaranty insurers would be permitted to exclude contingency reserves from total liabilities when demonstrating compliance with minimum surplus requirements. Minimum surplus would be equivalent to the greater of 10 percent of the insurer's liabilities (less the contingency reserve amount), or $4 million ($2.5 million more than the minimum under current law). As under current law, the maximum required surplus would be $100 million.

Based on data available as of December 31, 2000 for the 18 companies writing mortgage guaranty insurance, the total required minimum surplus under current law was $719.9 million. By excluding contingency reserves from liabilities, the total required minimum surplus would be $334.6 million, a $384.5 million reduction in required minimum surplus. Examples of the effect the change has on two mortgage guaranty insurers are as follows:

| | Company A | Company B |
|---|---|---|
| Total liabilities | $1.613 billion | $60.7 million |
| Less: Contingency reserve | $1.238 billion | $36.6 million |
| Minimum surplus: Current law | $100 million | $6 million |
| Minimum surplus: Bill | $37.5 million | $4 million |
| Change in minimum surplus | ($62.5 million) | ($2 million) |

The sufficiency of capital and surplus for mortgage guaranty insurers would be based on outstanding *aggregate exposure* net of reinsurance, rather than *liability* net of reinsurance under their written policies. This change could operate to require additional surplus and capital to write the same amount of business as insurers might have to lower their total exposure, raise additional capital, or keep a larger amount in surplus. Mortgage guaranty insurers would be required to disclose their total aggregate exposure net of reinsurance in their audited financial report. Aggregate exposure likely will be reported in a footnote on the balance sheet. Finally, the Department of Insurance would be authorized to take administrative action against mortgage guaranty insurers not in compliance with these requirements.

D. SECTION-BY-SECTION ANALYSIS:

N/A

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

N/A

2. Expenditures:

N/A

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

N/A

2. Expenditures:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Mortgage guaranty insurers would benefit because they could decrease their liabilities by the amount of their contingency reserve for the purpose of calculating their minimum surplus requirements.

D. FISCAL COMMENTS:

N/A

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

N/A

B. REDUCTION OF REVENUE RAISING AUTHORITY:

N/A

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

N/A

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

N/A

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

| Prepared by: | Staff Director: |
| --- | --- |
| Warren A. “Drew” Crawford | Stephen T. Hogge |

AS REVISED BY THE COUNCIL FOR COMPETITIVE COMMERCE:

| Prepared by: | Staff Director: |
| --- | --- |
| Leonard Schulte | Hubert "Bo" Bohannon |