What's the right amount of MI coverage for your portfolio?

MGIC

If your portfolio is home to residential mortgages with LTVs greater than 80%, you may be vulnerable when it comes to credit risk, higher capital requirements and higher loss reserve allowances.

Mortgage insurance can help.

Different levels of MI coverage can meet different needs, depending on your portfolio and your goals. Check out these examples of standard, medium and light MI coverage, then contact your MGIC representative to discuss how our Portfolio Playbook™ products can help match your coverage goals with your portfolio holdings.

PORTFOLIO PLAYBOOK™

Standard Coverage

How MI helps you reduce credit losses

The core value of mortgage insurance is protection against losses due to borrower default. Market conditions can have a dramatic impact on losses. We base standard coverage levels on what's typically required for secondary market transactions. This level of coverage reduces your institution's exposure to significantly below 80% LTV, and in many cases completely insulates you from any credit losses.

MI at any level can have additional benefits, including making it easier to comply with certain requirements, as illustrated by the following light and medium coverage examples.

Medium Coverage

Choosing a level below standard MI coverage improves borrower affordability for high-LTV loans, enhancing your competitive position while still providing substantial loss protection.

How MI helps you reduce your reserving requirements and minimize earnings volatility under CECL

CECL stands for "Current Expected Credit Loss." It's the new accounting standard introduced by the Financial Accounting Standards Board.

Current accounting standards use an "incurred loss" methodology that delays recognition until it is probable that a loss has been incurred. CECL introduces a new approach, where you'll have to recognize expected losses immediately and update these reserves as your forecasted, expected losses change. The result is an immediate impact to net income and increased earnings volatility.

You can use credit enhancement to reduce the impact of CECL, unless it's a freestanding contract, meaning that the contract is detachable from the loan itself. Examples of freestanding contracts include Credit Default Swaps (CDS) or pool insurance, as they are not structurally attached to the loan. Primary mortgage insurance, which by its very nature is attached to the loan, is a recognized method of reducing your loss allowance under CECL.

Light Coverage

Lighter MI coverage can help you manage capital affordably while providing a smaller measure of loss protection. It can also help banks with single-family, residential mortgage lending portfolios meet certain regulatory requirements, like Basel III.

How MI helps you optimize capital utilization and meet regulatory requirements

Banks subject to safety and soundness regulation under Basel III* can substantially reduce the amount of capital they're required to hold in reserve when a loan is insured with MI. Under Basel III, the minimum regulatory capital ratio is 8%. A simplified approach to meeting this ratio is to retain capital against each asset in an amount equal to 8% of each asset's balance. However, because some assets are riskier than others – for example, a commercial loan is riskier than a first-lien, prime-quality home mortgage – regulators use risk-weighting coefficients to determine minimum capital requirements for different asset classes.

How the math works

A mortgage loan with a 90% LTV or greater is risk-weighted 100%, meaning it has a regulatory capital requirement of 8% (see table below). However, if a bank purchases primary, loan-level MI to reduce its exposure to less than 90%, the risk-weighting coefficient is 50% and the regulatory capital requirement is reduced to 4%.

Risk Weight Category	Effective Capital Charge (rw% x 8%)
0%	No Capital Charge
20%	1.6%
50%	4.0%
100%	8.0%

*Basel III is a global regulatory framework on bank capital adequacy, stress testing and market liquidity risk.

Half the capital means twice the lending capacity. If a bank has $25 million to invest in its high-LTV residential loan portfolio, it could originate $625 million in loans with MI, versus $312.5 million without MI.

Half the capital means a lower cost of funds. Assuming a bank will want to earn a return of 15% on invested capital, it will theoretically have a higher cost of funds, with 8% invested capital versus 4%, given the low cost of other sources that banks routinely use to fund loans (i.e., consumer deposits, short-term advances, etc.).

It's easier to comply with supervisory LTV limits. First-lien residential mortgage loans with 90% LTVs or greater exceed supervisory LTV limits, unless they have acceptable credit enhancement. Regulations prohibit a bank from having an aggregate balance of loans exceeding supervisory LTV limits that is greater than total capital. MI removes high-LTV mortgage loans from this so-called "high-risk bucket" by bringing them into compliance with supervisory LTV limits.

Choosing the right amount of MI: Compare the numbers

Example 1: Stable Market

This example demonstrates what can happen in a relatively stable market environment. On a loan without MI, you can easily experience a loss severity of 40% compared to the unpaid principal balance (UPB) of the defaulted loan. Adding in 25% MI coverage results in a loss severity of around 11.5%, saving you more than $53,000 on what once was a $190,000 loan. Making the small incremental movement from 25% to 30% MI coverage cuts your loss in half.

We can work with you to tailor coverage that meets your needs. While you can purchase coverage at the standard GSE levels, that may not be the best choice for your unique portfolio lending needs.

	Without MI	Standard 30% MI	Medium 25% MI	Light 6% MI
Original Value	$200,000	$200,000	$200,000	$200,000
Original LTV	95%	95%	95%	95%
Original Loan Amount	$190,000	$190,000	$190,000	$190,000
UPB	$186,654	$186,654	$186,654	$186,654
Other Claimable Expenses*	$27,998	$27,998	$27,998	$27,998
Claimable Amount/ Lender Exposure	$214,652	$214,652	$214,652	$214,652
MGIC Claim Payment	n/a	($64,396)	($53,663)	($12,879)
REO Expense	$20,532	$20,532	$20,532	$20,532
Sale Proceeds	($160,000)	($160,000)	($160,000)	($160,000)
Lender Net Loss	$75,184	$10,788	$21,521	$62,305

*Claimable expenses include delinquent interest, accrued-but-unpaid property taxes, attorney fees, hazard insurance premiums, property maintenance costs and other routine default servicing expenses.

Example 2: Distressed Market

Moving from a single loan in a stable market to a portfolio of loans in a distressed market, the case for MI and the importance of the right coverage becomes even clearer. In Example 2, going without MI means you could expect a loss of 8.5% on a $95 million mortgage portfolio. By adding MI, even at 25% coverage, the loss drops to 4.5%. Choosing the proper coverage level can have a significant impact on your bottom line in the event market conditions deteriorate.

	Without MI	Standard 30% MI	Medium 25% MI	Light 6% MI
Loan Count	500	500	500	500
$ Volume	$95,000,000	$95,000,000	$95,000,000	$95,000,000
Incidence %	14%	14%	14%	14%
UPB at Claim	$13,065,780	$13,065,780	$13,065,780	$13,065,780
Claimable Amount/ Lender Exposure	$15,025,647	$15,025,647	$15,025,647	$15,025,647
Claim Payments	n/a	($4,507,694)	($3,756,412)	($901,539)
REO Expense	$1,437,236	$1,437,236	$1,437,236	$1,437,236
Sale Proceeds	($8,400,000)	($8,400,000)	($8,400,000)	($8,400,000)
Lender Net Loss	$8,062,883	$3,555,189	$4,306,471	$7,161,344

The power of mortgage insurance is clear:

- Significant reductions in credit losses
- Coverage choices to fit your risk exposure appetite and manage loss reserves
- Solutions to optimize capital

Choosing the right MI company

This involves understanding the financial and operational strength of your MI provider. We have been in the business of providing mortgage insurance longer than any of our competitors. In fact, our founder Max Karl invented the modern private mortgage insurance industry when he opened MGIC's doors for business in 1957. Since then, we have weathered upturns and downturns. We take seriously our obligation to maximize the value of our policyholders' insurance through prudently managing our business.

As a GSE-approved insurer, we comply with the Agencies' Private Mortgage Insurer Eligibility Requirements (PMIERs). These rigorous standards require sufficient claims-paying resources to handle a severe nationwide economic stress. In addition, working with the GSEs, we introduced a new Master Policy that provides a significantly increased certainty of coverage and rescission relief offerings.

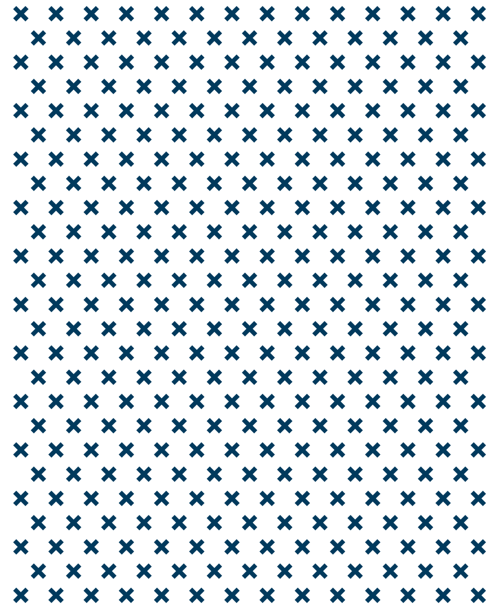
Beyond our financial strength, we are dedicated to superior customer service: quick turn times, listening to your needs, and most important, doing the right thing. Our success depends upon your success.

Sizing your coverage

Once you have decided on a trusted MI partner, such as MGIC, your next decision relates to coverage level. The examples in these pages demonstrate the importance of choosing the right coverage. In order to understand your coverage needs, you'll need to estimate expected and stress losses using your own in-house models — or models or services provided by third parties. While no model is able to predict the future with 100% accuracy, understanding possible outcomes will help you make an informed decision.

Our rate cards, mgic.com/mgicrates, offer an excellent starting point for primary MI with coverage options that vary by LTV, and can help you approximate the cost and benefit that MI can provide. You can get a quick MI rate quote with MiQ, mgic.com/MiQ. If you decide that something more customized is the right decision, your MGIC representative will engage our team in Milwaukee to help craft the right offering for your business needs.

71-43841 8/15/19



Our Portfolio Playbook mortgage insurance products can help you line up your coverage goals with your portfolio holdings, including jumbo loans, community lending loans, construction and renovation loans, and more.

For more information about Portfolio Playbook, go to mgic.com/playbook or contact your MGIC representative, mgic.com/contact.

Portfolio Playbook™ is an MGIC trademark.