COMMONWEALTH OF VIRGINIA

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STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

September 30, 1981

Administrative Letter 1981-14

MEMORANDUM

TO: All Mortgage Guaranty Insurance Companies Licensed in Virginia

On August 19, 1981 and September 11, 1981, I wrote to all mortgage guaranty insurance companies licensed in Virginia regarding, among other things, the concern my staff and I have about mortgage guaranty insurance on variable rate mortgages allowing negative amortization. The nature of the credit risk inherent in these mortgages, some of which have immediate negative amortization, is vastly different from the credit risk associated with traditional fixed-rate mortgages. My staff and I are particularly concerned about those situations where the mortgage guaranty insurer assumes liability for 100 percent of the negative amortization, even if there is a cap on this liability.

Apparently, others share some or all of the Bureau's concerns. One mortgage guaranty insurer wrote in a recent letter that ". . . a coverage and loss exposure (such as established by FNMA) may prove suicidal to the mortgage insurance industry." This company was particularly concerned about the absence of any shared risk with the lender or owner of the loan. Other companies voiced similar concerns.

Nevertheless, after consultation with others within the State Corporation Commission, the decision has been made that the Bureau of Insurance will approve policy form filings for mortgage guaranty insurance on loans involving negative amortization. It does not appear advisable for the Bureau to run the risk of seriously affecting the mortgage market in Virginia. The Bureau's concerns about insurance on these types of loans will have to be addressed by other means.

For example, I plan to make my concerns about negative amortization and related issues known to the chairman of the appropriate National Association of Insurance Commissioners (NAIC) committee so that these concerns can be dealt with at the national level. Also, my staff is going to review carefully rate filings associated with insurance for variable rate mortgages to make certain that rates remain adequate. This will be particularly true for rates applicable to mortgages without any cap on negative amortization. I hope mortgage guaranty insurers will recognize that it may not be possible to price this unlimited exposure and will insure this type of mortgage only with a percentage coverage or something similar.

In conclusion, I hope mortgage guaranty insurance companies will analyze carefully the risks inherent in new types of mortgages, develop a range of products suitable to these mortgages, and establish prices in a responsible manner.

Sincerely,

James W. Newman Jr.

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Commissioner of Insurance

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