Arch

MORTGAGE RISK TRANSFER

June 2019

FREQUENTLY ASKED QUESTIONS

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What is the purpose of Arch MRT?

- Arch MRT (Mortgage Risk Transfer) was designed in collaboration with both Fannie Mae and Freddie Mac (the government-sponsored enterprises or GSEs) to address key risk issues and reduce costs related to procuring and managing certain forms of credit protection. The structure was developed specifically to:
  - Let the GSEs select and manage their exposure to counterparties.
  - Broaden the sources of first-loss credit protection to include more highly rated and diversified counterparties.
  - Bolster counterparty strength with collateralized agreements.
  - Eliminate the cost of obtaining third-party credit protection that meets GSE origination and servicing guidelines.

What is the Arch MRT structure?

- Arch MRT is a protected cell captive insurance company, domiciled in the District of Columbia, and licensed to write mortgage insurance (MI).
- Arch MRT manages separate protected cells for both Fannie Mae and Freddie Mac. Those cells issue a direct MI policy to Fannie Mae and Freddie Mac to provide MI in a forward commitment with a maximum unpaid balance (UPB) acquired over a specified period.
- The protected cells insure loans from Freddie Mac's Integrated Mortgage Insurance℠ (IMAGIN℠) program and Fannie Mae's Enterprise Paid Mortgage Insurance (EPMI) program, which provide first-loss credit protection on a loan-by-loan basis.
- The cell insurance policy meets GSE charter requirement for purchasing loans with greater than 80% LTVs (loan-to-value ratio).
- The cell cedes 100% of the risk to a panel of reinsurers selected and approved by the GSEs. Allocation is through a quota share participation based on GSE-determined criteria.
- Reinsurers must collateralize a percentage of their liability, based on their respective financial strength rating, into a segregated trust account managed by Arch MRT. This gives the GSEs additional protection from any counterparty solvency issues.

What role does Arch have in MRT?

- Arch MRT manages all the protected cell activities, such as negotiating terms with the GSEs on behalf of the reinsurance market, overseeing the collateral trust account, remitting premiums, processing claims and filing regulatory documents.
- Arch Reinsurance Company participates alongside other reinsurers in the GSE approved panel.
- Arch MRT makes a recommendation for the initial loan level pricing for reinsurance market consideration and continuously monitors pricing by the monoline MI industry to avoid any adverse selection.
- Arch MRT coordinates the quality control function for the reinsurers by engaging in reporting with the GSEs and can administer an independent QC process when it's deemed appropriate and mutually agreed upon with the GSE.
- Arch MRT provides ongoing transaction tracking and monitors credit risk trends in the U.S. housing market for participating reinsurers.
- Arch MRT's services increase the number of reinsurers with diversified, highly rated sources of private capital willing to participate in loan level first-loss credit protection.

Is an originating mortgage lender required to use IMAGIN or EPMI?

- No. IMAGIN and EPMI are simply options for lenders originating greater than 80% LTV mortgages.

How does the GSE capture the insurance cost in order to purchase the MI from Arch MRT?

- The cost of the insurance provided by Arch MRT is built into the cost of the mortgage via a higher interest rate, discount points or a combination of both. This compares most closely to a lender paid MI execution.

What are the benefits of Arch MRT to the U.S. housing finance system and taxpayers?

- Encourages more reinsurers to participate in the U.S. housing finance industry, which gives the GSEs access to additional private capital — approximately $565 billion of proven, permanent, entity-based, equity capital globally.
- Reduces the GSEs' one-way counterparty risk to monoline MIs in the greater than 80% LTV mortgage segment.
- Gives the GSEs greater certainty of coverage due to partial collateralization and a better guarantee via a more robust MI policy.
- Improves first-time homebuyer access with more cost-effective charter-required coverage for the GSEs. These cost savings are passed to borrowers.

What are the benefits of MRT to lenders/ servicers?

- An Arch MRT insurance policy is between Arch MRT and the GSE, ensuring 100% alignment with GSE Seller Guide eligibility. In the case of greater than 80% LTV loans, there is no MI involvement. This means no additional credit overlays, no additional servicing obligations and no MI rescission risk.
- Arch MRT provides reduced coverage options for certain affordable programs.
- Under Arch MRT, the mortgage originator uses the same processes for a greater than 80% LTV conventional loan as for a conventional loan with an LTV of 80% or less.
- Reduced costs for mortgage servicing mean higher mortgage servicing rights (MSR) values. Costs are less because there are no internal insurance department requirements for escrow analysis and premium remittance, no additional MI delinquency and claim reporting and 100% alignment with GSE Servicing Guides on loss mitigation solutions.

What are the benefits to borrowers?

- The streamlined and scalable operating model significantly reduces the cost of providing credit enhancement to the GSEs and those savings are passed on to borrowers.
- A lower operating cost model means lower borrowing costs, which can be passed to borrowers.
- A broader and more diverse pool of borrowers receives lower cost access to affordable and sustainable credit.

Who manages the lender relationships when it comes to sales, marketing and training?

- All front-end sales, marketing and training are led by the GSEs through their respective product groups.

How transparent and sustainable is the pricing provided by Arch MRT to the GSEs?

- Arch MRT solicits open bids from the reinsurance market for the loan level pricing offered to the GSEs for first-loss coverage
- This gives regulators, policymakers, consumers and other key stakeholders insight regarding the health of the U.S. housing finance system.
- IMAGIN and EPMI loan level pricing is transparent and uniformly offered to all lenders regardless of size and/or mortgage origination volumes.

Do affiliates of other MI companies participate on the panel? What benefits does the program provide the MI companies?

- Including Arch Reinsurance Company, 50% of the MI industry is currently participating as Arch MRT panel members.
- MIs gain an alternative, efficient coverage option with no acquisition and/or fixed expenses related to underwriting and servicing.
- To the extent Arch MRT insures loans with an LTV of 80% or below, MIs could insure this new market.

How are claims calculated in Arch MRT compared to the monoline MI master policy?

- The claims calculation mimics the third-party sales option in the monoline master policies, including claimable expenses and accounting for the net sales proceeds of a property after a third-party sale.
- Physical damage losses are also removed from the net loss, as with MI master policies.

Why reinsurance?

- Global reinsurers have long supported the U.S. insurance industry and have remained committed to established business lines throughout multiyear loss and underwriting cycles.
- Private MI has relied on reinsurers as a significant source of capital for many years.
- Reinsurers provided the U.S. mortgage market with significant capacity that was a critical new source of financial support after the Financial Crisis.

MORTGAGE RISK TRANSFER EXPLAINED

Benefits of MRT

- Immediate, first-loss, loan-level coverage on mortgages from a panel of well-capitalized insurers and reinsurers.
- Efficient model for sourcing reinsurance.
- Programmatic nature results in the most attractive pricing for insurance.
- Charter compliant solution offering flow-based commitment from a qualified insurer.
- Broader availability of mortgage credit.
- Less risk for taxpayers.
- Structured to ensure that BPMI remains with private mortgage insurers.
- Lower cost for borrowers.

1. The GSE wants to offer lenders another option for delivering loans above 80% LTV.
    - The program will let lenders concentrate on origination and not worry about attaching MI, dealing with MI claims, etc.
2. GSE approaches Arch MRT requesting pricing for placing immediate (front-end) mortgage insurance on the loans to be originated according to the established parameters.
    - Assumes that originated loans adhere to established GSE Guides.
3. Arch MRT organizes the GSE's parameters to help facilitate the transaction.
    - Arch MRT makes documents available through its digital platform to efficiently distribute information to panel participants.
4. Arch MRT holds an auction process among a panel of previously vetted reinsurers and insurers that have been deemed acceptable counterparties by the GSE.
5. Arch MRT receives pricing from the panel participants.
6. Arch MRT presents results of bid process to the GSE.
7. GSE accepts or declines proposals.
    - If accepted, GSE determines allocation for each panel participant.
    - If declined, program is abandoned or bid (auction) process is revisited.
8. Selected reinsurers and insurers post collateral to a trust account to support their insurance obligations.
9. GSE activates the program with the lender participants.
10. GSE reports on the progress and capacity of the programming to Arch MRT on an ongoing basis.
11. Arch MRT provides ongoing reports to the reinsurers, insurers and GSE.

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