MEMORANDUM

TO: File No. DF Title IX - Asset-Backed Securities

FROM: Jay Knight
Attorney-Adviser
Office of Rulemaking
Division of Corporation Finance
U.S. Securities and Exchange Commission

RE: Meeting with HVP Inc.

DATE: January 5, 2011

On December 9, 2010, Paula Dubberly, Katherine Hsu, Rolaine Bancroft, and Jay Knight of the Division of Corporation Finance; Wesley Bricker from the Office of the Chief Accountant; and Stanislava Nikolova and Eric Emre Carr of the Division of Risk, Strategy and Financial Innovation met with the following representatives of HVP Inc.: James M. Connolly, Larry Flick, and John E. Marthinsen. Among the topics discussed was the definition of "qualified residential mortgage" under Title IX, Subtitle D, Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Attachment

HVP Inc.

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HVP Inc. Meeting with Securities and Exchange Commission Officials Regarding Dodd-Frank Wall Street Reform and Consumer Credit Act Implementation December 9, 2010

1. Who is HVP Inc.?
2. What is HVP Inc.'s business, and what are its products?
3. How does the Dodd-Frank Wall Street Reform and Consumer Credit Act Implementation relate to HVP Inc.?
4. HVP Inc.'s regulatory recommendations.
5. Summary.

HVP Inc.

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November 24, 2010

The Honorable Timothy F. Geithner
Secretary of the Treasury
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave
Washington, DC 20551

The Honorable Shaun L. S. Donovan
Secretary of Housing and Urban Development
United States Department of Housing and Urban Development
451 Seventh Street, SW
Washington, DC 20410

John G. Walsh
Comptroller of the Currency (Acting)
250 E Street, SW
Washington, DC 20219-0001

The Honorable Mary L. Schapiro
Chairman
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429-9990

Edward J. DeMarco
Acting Director
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

John E. Bowman
Acting Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 2055

Dear Ladies and Gentlemen:

As President and CEO of HVP Inc., I am writing to urge you, the officials charged with writing the regulations for the *Wall Street Reform and Consumer Protection Act of 2010*, to publish regulations pursuant to section 941(b) that promote home buying mortgage insurance products that are able to *reduce the risk of default on mortgages,* rather than traditional private mortgage insurance (PMI), which only protects lenders against losses upon foreclosure.

Specifically, I urge you to include language in the proposed regulations defining the "Qualified Residential Mortgage" exemption to the risk-retention provisions in Section 941 (b) that makes this important distinction clear by including regulatory language to the effect that:

> *"Only mortgage guarantee insurance or other types of insurance obtained at the time of origination that make a loan less risky by reducing the chance of default by the borrower shall qualify for an exemption from the risk-retention provision. Mortgage guarantee insurance or other types of insurance that solely mitigate losses to lenders upon default do not make a loan less susceptible to default and, therefore, do not meet the risk retention exemption criterion."*

Background:

HVP Inc. has developed a suite of innovative insurance products, that *substantially reduce the risk of foreclosures* and are, therefore, in full compliance with the new law's requirement for a "qualified residential mortgage" exemption under 941(b)'s "Section 15G(e)(4)". HVP's insurance products – either in the form of "home value protection" or "mortgage value protection" – are specifically designed to protect the home buying consumer and to *reduce foreclosures when real estate markets decline.* (For more detail on HVP's insurance products, please see Attachment 1).

Traditional private mortgage insurance (PMI) and HVP Inc.'s insurance products are fundamentally different. HVP's insurance products protect the borrower from the risks of value degradation, underwater mortgages, and foreclosures whereas traditional PMI protects a lender in the event of a default. The critical difference between HVP Inc.'s products and traditional PMI is the beneficiary. HVP Inc.'s policies designate the homeowner/borrower as the beneficiary, and indirectly protect the lender by substantially lowering the threshold at which it is economically advantageous to walk away from an underwater mortgage. By contrast, PMI's sole beneficiary is the lender, and it provides no benefit to a homeowner once the loan has been extended.

Even though HVP Inc.'s primary focus is on providing homeowners with a means of protecting their most valuable assets (homes), each policy comes with a safety-net feature for lenders, as well. This feature permits lenders to become the beneficiaries of our policies when borrowers are delinquent in their premium payments. Therefore, our suite of products not only reduces the risk of mortgage defaults but, if they occur, also affords lenders the same benefits they would have had with PMI

Our concept of home value insurance enjoys the support of a leading national consumer group. Recent testimony by John Taylor, President and CEO of the National Community Reinvestment Coalition, at a House Financial Services Subcommittee hearing on "The Future of Housing Finance: The Role of Private Mortgage Insurance" lauded HVP Inc.'s "new and innovative" products for their ability to *"[protect] the homeowner, not the lender, from swings in home values,...incentivizing homeowners to not walk away from the property as soon as home values* *drop,"* ... and "*[preventing] the domino effect documented in this economic crisis, in which neighborhoods are destroyed by cascading foreclosures, short sales, and walk-aways.*" See Attachment 3 for the complete text.

Our country's recent real estate collapse revealed two important flaws in the mortgage market. First, banks made excessively risky real estate loans because they could securitize them and off-load the risks to investors. Second, Private Mortgage Insurance (PMI) did nothing (and can do nothing) to reduce millions of foreclosures in periods of rapidly falling prices.

One of the reasons Congress passed *The Wall Street Reform and Consumer Protection Act of 2010* was to remedy the first of these flaws by introducing a 5% credit-risk retention provision to *discourage* lenders from making risky loans. Congress addressed the second flaw by encouraging market-oriented solutions to reduce homeowner defaults. In particular, the legislation waived the 5% "skin-in-the-game" provision if a mortgage was supported by a secure form of credit enhancement that reduces the risk of homeowner default. Because you and your staffs are currently in the process of drafting and promulgating rules for the Wall Street Reform and Consumer Protection Act, we are writing to strongly oppose any proposed regulations that permit traditional PMI to qualify for the 5% waiver. Instead of reducing homeowner defaults, traditional PMI enables risky loans and subsequent foreclosures by paying the lender only after a default has occurred, with the recovery amount determined by the foreclosure sale. This is exactly the opposite of what the credit retention provisions of the Act are intended to achieve.

If PMI, as it is currently constituted, is deemed to meet this exemption qualification, then nothing has changed, and a reasonable scenario is for the misery of millions of foreclosures to be repeated. Preserving the status quo by recognizing PMI as a type of insurance that reduces default risk does nothing to reduce risky loans, or to protect the broader economy, or to support Congress's intentions. During its development, Section 941(b)'s "Section 15G.(e)(4)(B)(iv)" was modified and strengthened to protect against borrower defaults. All four of the other conditions that are necessary to qualify for a waiver of the 5% credit-risk retention provision have a common thread in their ability to reduce the risk that *borrowers* will default.[1] The language added to Subsection (iv) prescribes that mortgage guarantee insurance similarly reduce the risk that *borrowers* will default.

In the future, history need not repeat our recent economic devastation. One effective solution – as called for under Section 941(b)'s "Section 15G.(e)(4)(B)(iv)" – is a new kind of mortgage insurance, described above, that reduces the risk of default by a borrower. We believe that, induced by regulations that reflect this legislation, insurers will offer new products that protect borrowers rather than exclusively lenders, so that, if mortgages become underwater, homeowners can sell their homes and pay off their mortgages in full. By so doing, these homeowners avoid the negative externalities of foreclosure. (For further discussion of Section 941(b)'s "Section 15G.(e)(4)(B)(iv)" including its legislative history, please see Attachment 2).

We fully expect HVP Inc.'s innovative products to be imitated by competitors and developed (by us and others) to serve many varied market niches. Our company seeks neither a monopoly on

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[1]See for reference, Conditions i, ii, iii, v on pages 198-9 Title IX Final.

mortgage guarantee insurance nor any form of competitive advantage from the new federal regulations. On the contrary, we strongly believe that the rules on which you are working can lay the groundwork for a large market providing a better, more homeowner-friendly, and economically viable type of home value/mortgage guarantee insurance.

HVP Inc. hopes that you will embrace in your regulatory reforms this fundamental change in mindset, by encouraging mortgage guarantee insurance companies to focus on protecting homeowners, who otherwise have no way to protect the value of their homes. Simple, straightforward regulations by your working group can have a profound impact on the mortgage industry, the nation, and, by extension, the global economy. Here are some reasons why:

- Borrowers whose mortgages are under water are far more likely to act judiciously when they are the beneficiaries of mortgage guarantee insurance for which *they* are paying.
- When underwater borrowers pay off their mortgages in full, both lenders <u>and</u> investors benefit.
- When underwater borrowers sell their homes, some of them will re-enter the housing market to take advantage of lower market prices and reduced interest rates. Their demand will provide a needed boost to the market and hinder downward spiraling housing prices.
- We have witnessed the profound impact of plunging U.S. real estate prices on the world economy through the injudicious creation, purchase, and sale of mortgage backed securities. Products, such as ours, that stabilize housing prices have the potential to buffer economies from global real-estate panics, like the one we experienced in recent years.

With this in mind, we urge you to create regulations that encourage companies, such as ours, not only to provide improved mortgage guarantee insurance or home value insurance but also to simultaneously afford lenders substantial protection when default occurs. We feel that HVP Inc.'s products are the best insurance solution for mortgage borrowers, lenders, and investors, and that they will add stability to our economy and the global financial system, as well.

Thank you for your consideration of these views. I would be pleased to meet with any of the appropriate federal agency officials to discuss any aspect of this further, including how HVP Inc.'s business model works. HVP Inc. seeks only the public good from forthcoming regulations and obviously does not seek any kind of recognition or benefit specific to our company.

Sincerely yours,

James V. Connolly

cc Congressman Barney Frank Senator John Kerry Senator Scott Brown

Attachment 1

The Company

Home Value Protection, Inc. (HVP Inc.) is a private insurance company founded to safeguard the market value of real estate or the face value of a mortgage. For these safeguards there could be, in some cases, either no net cost[2] or a substantially reduced cost to homeowners.

The Products

HVP Inc. offers a suite of three products, which empower homeowners to safeguard either the market value or mortgage value of their homes.

- ***Home Value Protection (HVP)*** offers homeowners rapidly rising protection on a maximum of 20% of their homes' market values. In policy years 1 and 2, coverage is provided on 5% and 10%, respectively, of a home's market value. Thereafter, coverage is provided on 20% of the insured (original market) value.
- ***Mortgage Value Protection (MVP)*** offers homeowners rapidly rising protection on a maximum of 20% of their mortgages' face values. In policy years 1 and 2 coverage is provided on 5% and 10%, respectively, of a home's mortgage face value. Thereafter coverage is provided on 20% of the mortgage face value.
- ***Super Home Value Protection (SHVP)*** offers homeowners rapidly rising protection on a maximum of 30% of their homes' market values. In policy years 1 and 2, coverage is provided on 7½% and 15%, respectively, of a home's insured (original market) value. Thereafter coverage is provided on 30% of the insured value.
- **Non-Payment Option** – In the event that an insured homeowner fails to pay premiums for a period of six months, notice of termination is given. Upon notice of termination, an option is provided to the lender / owner of the mortgage loan to assume delinquent and future premium payment obligations, whereupon the beneficiary changes from the borrower to the lender / owner of the mortgage loan.

[2] When banks retain mortgages on their books the risk weighting of mortgage loans and concomitant capital requirements will be lower by virtue of home value insurance. Consequently banks will be able to reduce their mortgage rates in order to compete for good loans.

Attachment 2

Qualified Residential Mortgage Exemption Discussion

- The exemption for "qualified residential mortgages" from the "not less than 5%" risk retention" requirement on securitizers will be spelled out in regulations that define what a "qualified residential mortgage" is. The regulatory definition will define the term based on five criteria, all of which are criteria that seek to *reduce the risk of default* by a borrower. The five criteria are:
    1. Verification of a borrower's financial resources.
    2. Standards with respect to a borrower's income.
    3. Mitigating payment shock to the borrower.
    4. Promoting mortgage insurance available to a borrower that *reduces the risk of default*.
    5. And prohibiting risky mortgage products to borrowers such as balloon payments etc. that have higher risks of defaults.

We urge your agency to take special note of specific language in the *Wall Street Reform and Consumer Protection Act of 2010* that addresses *mortgage guarantee insurance,* and we hope you will strengthen Congress' intention in your April 2011 regulations. Subtitle D Sec 941 b (4) (B) provides an exemption from credit risk retention for "qualified residential mortgages." In particular, Subsection B lists five conditions that qualify for such an exemption, one of which is: "(iv) mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination <u>to the extent such insurance or credit enhancement reduces the risk of default.</u>"

Originally, the conference committee's Base Text was predisposed to traditional PMI by listing it as an exemption qualifier. But an important phrase in subsection (iv) was intentionally changed from a Senate conference committee offer: "mortgage guarantee insurance obtained at the time of origination for loans <u>with combined loan-to-value ratios greater than 80 percent</u>" to the ultimately agreed upon language,"mortgage guarantee insurance or other insurance or credit enhancement obtained at the time of origination for loans <u>to the extent that such insurance or credit enhancement reduces the risk of default</u>." HVP briefed the House Financial Services Committee staff on the case for a new home value protection product that pays borrowers when real estate values decline and houses are sold. The language in the final conference report and enacted into law as Section 941(b)'s "Section 15G.(e)(4)(B)(iv)" is consistent with our discussions with the House Financial Services Committee staff and was proposed in conference by the House Committee staff as a counteroffer to the Senate offer.

Attachment 3

Testimony of John Taylor, President and CEO of the National Community Reinvestment Coalition, at a House Financial Services Subcommittee hearing on "The Future of Housing Finance: The Role of Private Mortgage Insurance"

> "Other new and innovative products, including a product recently developed by Home Value Protection, can also augment private MI, to the benefit of consumers. This product protects the homeowner, not the lender, from swings in home values. It also has the benefit of incentivizing homeowners to not walk away from the property as soon as home values drop; it prevents the domino effect documented in this economic crisis, in which neighborhoods are destroyed by cascading foreclosures, short sales, and walk-aways."

Note: All of HVP's products provide the same protections for lenders afforded by conventional Mortgage Insurance.

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James M. Connolly Sr.

CEO – Responsible for innovation and team leadership

For the past 14 years Jim has served as Chairman & CEO of Warehouse Products Testing Inc., where he founded the company, developed its retail testing program, developed its patent pending analytical model, and sold the company's testing program to BJ's Wholesale Club, CompUSA, Staples, The Sports Authority, Best Buy, Albertsons, Rite Aid, and RadioShack. WPT has tested thousands of SKUs as well as myriad merchandising techniques and promotions at these retailers. Previously, Jim served as Chairman & CEO of Landwide Foods Inc., where he founded the company, developed its below-zero soft ice cream technology and sold four of the company's patents to General Foods Corp for 35 times the invested capital. Jim served as Chairman & CEO of Megafoods Inc., where he founded the company, developed its moisture vapor barrier technology, and licensed the company's two patents to Procter & Gamble and Continental Baking. Jim served as Vice President, Sales & Marketing for Forster Inc., where he managed the Marketing and Sales Depts, which had three Divisions and 31 brokerage firms. At Forster Inc., Jim also supervised all key accounts, including Wal-Mart, Costco, K-Mart, Sam's Club, and others. Jim served as Vice President, Sales & Marketing for Rochester Shoe Tree Company, where he increased sales by 80%, doubled profits, and supervised major accounts, including Nordstrom, Macy's, JC Penney, Bloomingdales, Costco, Sam's Club, Wal-Mart and others. Jim began his career in sales at Procter & Gamble and worked for Hunt-Wesson Foods, Fanny Farmer Candy Shops, and Hendrie's Inc. He received a BA, Economics degree from Holy Cross College.

HVP Inc.

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CRO - Responsible for identifying, managing, and monitoring the critical, interdependent risks that affect operational and non-operational activities, and for developing risk-management strategies.

John is *Professor of Economics and International Business* at Babson College in Babson Park, MA, where he holds *The Distinguished Chair in Swiss Economics* of the Glavin Center for Global Entrepreneurial Leadership. John holds a Ph.D. from the University of Connecticut in Storrs (1974), where he was also inducted into the Phi Beta Kappa and Phi Kappa Phi academic honor societies. John has extensive consulting experience, having worked for both domestic and international companies, as well as the U.S. government. He has served on the United Nations Association's Economic Policy Council, lectured at the Universities of Bern and Basel in Switzerland and the University of Nurnberg, Germany, and, from 2000 to 2009, he was a member of the Board of Directors of Givaudan SA, a multi-billion dollar, Swiss-based flavors and fragrances company. At Givaudan, John was the chairman of the board's Finance and Investment Committee, and a member of the Strategy Committee, Audit Committee, and Nomination and Corporate Governance Committee. John is an award-winning teacher and the author of many articles and books. Among his most recent books are *Risk Takers: Uses and Abuses of Financial Derivatives* 2nd ed. (Pearson Prentice Hall, 2009) and *Managing in a Global Economy: Demystifying International Macroeconomics* (Thomson South-Western, 2008). John is fluent in German, having worked in Switzerland for the investment banking arm of a universal bank (HandelsBank N.W.) and large pharmaceutical company (Roche Holding).

SECTION 941(b)

residential mortgages from the risk retention requirements of this subsection.

"(B) QUALIFIED RESIDENTIAL MORTGAGE.—The Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency shall jointly define the term 'qualified residential mortgage' for purposes of this subsection, taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default, such as—

"(i) documentation and verification of the financial resources relied upon to qualify the mortgagor;

"(ii) standards with respect to—

"(I) the residual income of the mortgagor after all monthly obligations;

"(II) the ratio of the housing payments of the mortgagor to the monthly income of the mortgagor;

"(III) the ratio of total monthly installment payments of the mortgagor to the income of the mortgagor;

"(iii) mitigating the potential for payment shock on adjustable rate mortgages through product features and underwriting standards;

"(iv) mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risk of default; and

"(v) prohibiting or restricting the use of balloon payments, negative amortization, prepayment penalties, interest-only payments, and other features that have been demonstrated to exhibit a higher risk of borrower default.

"(C) LIMITATION ON DEFINITION.—The Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency in defining the term 'qualified residential mortgage', as required by subparagraph (B), shall define that term to be no broader than the definition 'qualified mortgage' as the term is defined under section 129C(c)(2) of the Truth in Lending Act, as amended by the Consumer Financial Protection Act of 2010, and regulations adopted thereunder.

"(5) CONDITION FOR QUALIFIED RESIDENTIAL MORTGAGE EXEMPTION.—The regulations issued under paragraph (4) shall provide that an asset-backed security that is collateralized by tranches of other asset-backed securities shall not be exempt from the risk retention requirements of this subsection.

"(6) CERTIFICATION.—The Commission shall require an issuer to certify, for each issuance of an asset-backed security collateralized exclusively by qualified residential mortgages, that the issuer has evaluated the effectiveness of the internal supervisory controls of the issuer with respect to the process for ensuring that all assets that collateralize the asset-backed security are qualified residential mortgages.

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December 20, 2010

Mr. Jay Knight
Securities and Exchange Commission
Attorney
Division of Corporation Finance
United States Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549

Dear Mr. Knight,

Thank you for meeting with John Marthinsen, Larry Flick and me on December 9, 2010.

We are delighted with your reaction to HVP's Inc.'s home value and mortgage value insurance policies, which are novel because they designate the borrower as beneficiary and also provide the lender/investor with an option to assume premium payments and become the beneficiary if the borrower defaults. In accordance with the letter and spirit of the *Wall Street Reform and Consumer Protection Act of 2010*, we designed our products to minimize the likelihood that buyers will walk away from underwater mortgages by giving them the opportunity to sell their houses, pay off the mortgages, and avoid any negative impacts on their credit ratings. Free and clear of any mortgage obligations, buyers will then be in a position to re-enter the marketplace and buy a comparable (or better) house at a lower price. By encouraging demand and promoting an orderly supply of houses to the market, we feel strongly that that our products can prevent massive downward spirals in housing prices.

<u>Historical Performance Data</u>

In response to one of your suggestions last week, we have been working to address the Act's provision asking regulators to *consider* historical loan performance data. Because HVP Inc. is a new company selling innovative insurance products, we cannot produce historical figures showing hard evidence of the cause-and-effect relationship between our insurance policies and homeowner defaults. Rather, we are compiling historical performance data on analogous insurance and credit enhancement policies to show how they reduce the likelihood of default. Our hope is that, by inference, examples of similar products will fortify our case for the efficacy of HVP Inc.'s policies.

A long put option is one of the first examples that came to our minds. For example, European Union (EU) exporters often bill U.S. importers in euros, and many U.S. importers agree to make payment by means of loan-secured letters of credit. By hedging against the dollar's depreciation, these importers can reduce the credit (default) risks associated with these loans. The purchase of dollar (for euro) put options allows U.S. importers to enjoy the benefits of a dollar appreciation without any worries about the currency's depreciation. HVP Inc.'s insurance policies are similar to long put options in the sense that they allow homeowners to benefit from any appreciation in their homes' values but protect them from reductions in real estate prices, thereby, reducing the risk of borrower default. In the coming days, we will be looking for similar examples to bolster our contention that HVP Inc.'s policies reduce the risk of default.

To empower the full potential of the U.S. marketplace to solve our housing problem, we urge you, in your rule-writing capacity, to draft language that encourages new, innovative insurance products, such as ours. To this end, the language you draft should allow safe and sound entrepreneurial ventures, such as ours, to offer products that are eligible for status as "Qualified Residential Mortgages." We respectfully and kindly propose the following language to clarify criterion (iv) (page 529) of Section 941(b) in *The Wall Street Reform and Consumer Protection Act of 2010:*

> The phrase "Mortgage guarantee insurance or other types of insurance obtained at the time of origination" refers to contracts that make a loan less risky by reducing the chance of default *by the borrower*. Examples of contracts that meet this criterion are home value insurance, mortgage value insurance, and credit enhancement policies that designate the borrower as the beneficiary and might also allow the lender/investor to assume premium payments and become the beneficiary in rare cases when a borrower defaults."

Let me end by expressing, again, how grateful we were for the opportunity to meet with you and your colleagues to discuss HVP Inc.'s novel insurance policies. We believe that our products reduce the risk of mortgage defaults, lower the incidence of foreclosures, and buffer panic-driven downward housing spirals. Our products also have a salutary effect on both the U.S. economy and global marketplace

Sincerely yours,

Jim

James M Connolly

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