



MI Opportunities In Emerging Mortgage Markets

Sacha Polverini

Head Of European Regulatory Affairs

UN-Habitat/EFBS Joint Congress - Berlin, 23rd September 2004

- **Introduction To Genworth Financial & Mortgage Insurance**
- **Mortgage Markets In Transition Economies**
- **Public Policies To Develop Market: Strengths And Shortfalls**
- **How MI Can Be A Significant Partner To Foster Home Affordability**
- **How MI Can Help Improve Capital, Risk & Operational Procedures**
- **Conclusion**

Introduction to Genworth Financial & MI

Genworth: Strong Growing International Company...

Genworth Financial: Great Growth Story & Value Added To Our Customers...

- 3 Business Lines... Protection, Retirement Income, Mortgage Insurance
- Financial Strength... €83B Assets, €8.2B Revenues, €771m Net Income
- Large Operations... 15m Customers Served By More Than 5,000 Employees In 20 Countries
- Financial Stability... Moody's: Aa3, S&P: AA-, Fitch: AA-
- Genworth **Monoline MI provider** With A Proven Track Of Record
- Genworth MI Independently **Rated AA**

Mortgage Insurance... The Breath Of Global Expertise And Local Experience



- **€300B** Insurance Written Worldwide
- More Than **10 Years Experience** In Europe
- First Mortgage Score Developed **10 Years Ago**
- **Mortgage Scores Running On 3 Continents** - Based On Market Specific Data And Knowledge
- **Leverages Across Countries Innovation** In Risk Management, Product Offering, Operational Procedure Optimization

GE's Heritage Ensures Quality Of Service And Financial Stability

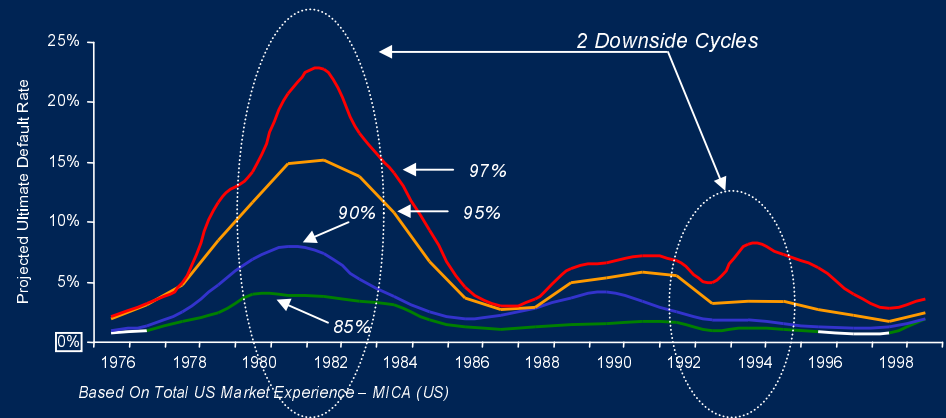
Historical Data Shows Higher Risk Of HLTV Lending...

High LTV Loans

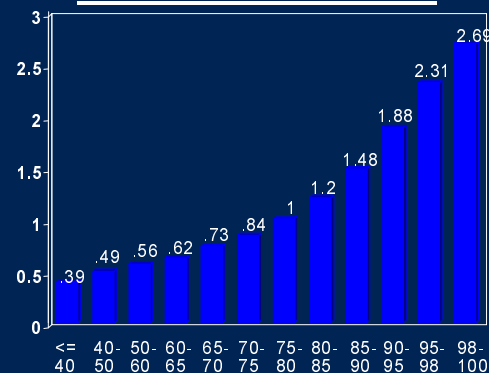
High LTV Loans Are More Volatile When Market Turns...

- Loss Frequency Experience Significantly Higher In Recession
- Books Written Pre-Recession Still Experience Increased Losses
- Combined Higher LTV's & Deteriorating Economic Factors Increase Probability Of Default

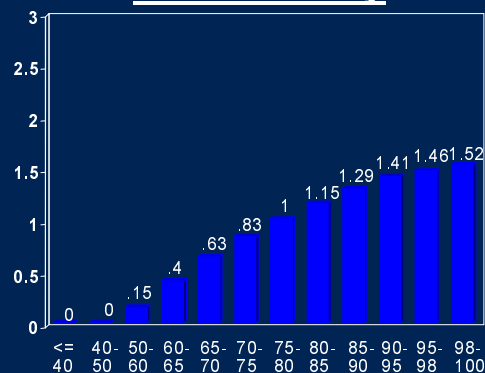
LTV Performance Over Two Down Cycles



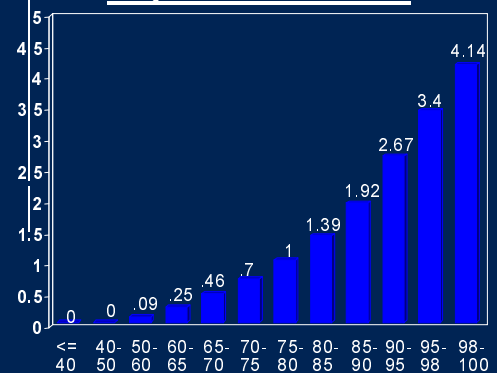
Default Probabilities



Loss Severity



Expected Losses



MI Helps Lenders To Tackle The High Volatility Risk Of HLTV Loans

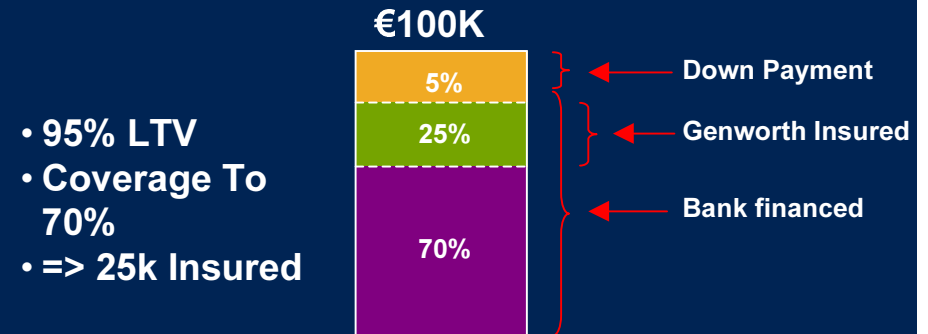
Source: Fitch IBCA

Introducing Mortgage Insurance

Product Features...

- Mortgage Insurance Protects Banks From Borrower Default On High LTV Residential Mortgages
- MI Providers Deal Directly With Banks, Not With Borrower
- Seasoned Loans On A Bulk Basis And/Or New Production Flow Can Be Insured
- Genworth Also Provides **Additional Scoring Capabilities** For New Loan Applications With Its Own Scoring System
- **Scoring System Can Be Integrated To Banks' IT Platforms**, Giving An Automatic Answer During Borrower's Loan Application, Usually In A Few Seconds
- In Most Markets, **Claims Are Paid Within 15 Days**

Practical Example



Borrower Defaults

3 Scenarios

Balance Of Mortgage	€ 80k	€ 80k	€ 80k
Property Sold	€ 60k	€ 65k	€ 90k
Foreclosure Costs	€ 5k	€ 5k	€ 5k
Lost Interest	€ 5k	€ 5k	€ 5k
LOSS	€ 30k	€ 25k	No Loss
Genworth Payment	€ (25)k	€ (25)k	(-)
NET LOSS To Bank	€ 5k	(-)	(-)

By Reducing Risk for Lenders MI Allows Earlier Homeownership For Borrowers

MI: A Success Story Worldwide...

Genworth Success Story In Spain

Mortgages Above 80% Require A Personal Guarantee From Other Individuals



Lenders...

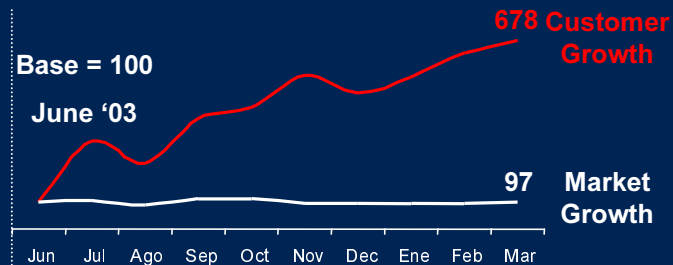
- Miss Market Of People With No Personal Guarantee
- Move The Credit Risk From One Individual To Another



Borrowers...

- Have To Put Their Family At Financial Risk Or...
- ... Save Money For Down Payment In A 20% House Price Increase Market

MI Implementation



Lender Starts Selling MI

Recognised And Used By Banks And Governments

Public Facilities

Belgium	Lithuania
Estonia	Latvia
France	Netherlands
Slovenia	Sweden
Canada	Hong Kong
United States	

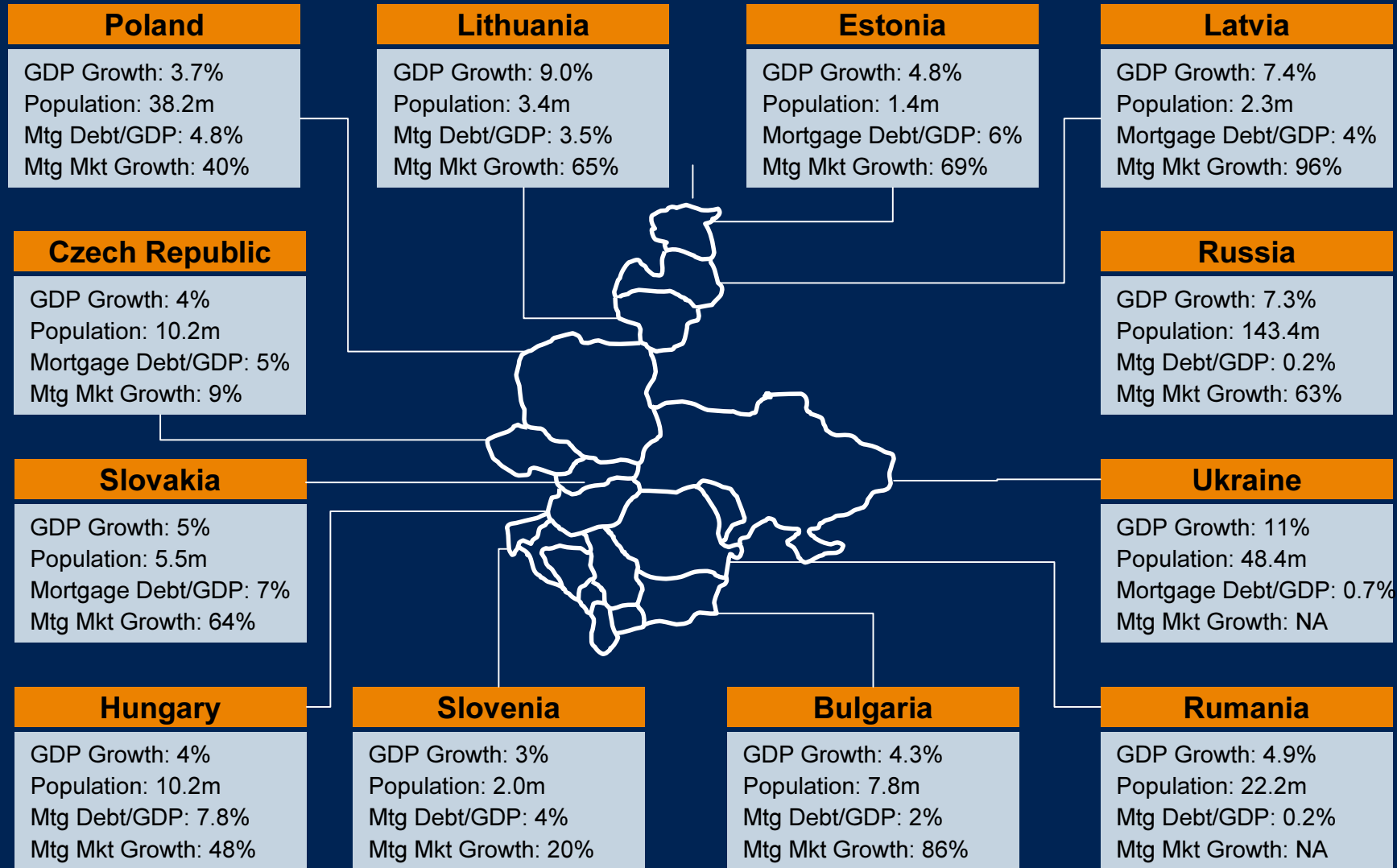
Private Facilities

Belgium	France
Ireland	Poland
UK	Spain
Italy	Sweden
Portugal	Australia
Canada	Israel
New Zealand	US
South Africa	South Korea

MI Has Developed Into A Significant Competitive Advantage For Lenders

Mortgage Markets In Transition Economies

Mortgage Markets At Early Stage In Transition Countries...



...A Combination Of Different Factors Still Hamper Market Development

Source: World Bank, EIU, EBRD, Central Banks

These Markets Encounter Recurring Challenges...

Funding

- Limited **Secondary Market**, Restricting Banks' Resources To Public Interventions Or Deposits
- **Volatile Environment (Inflation, Incomes, Interest Rates)** Make It Challenging For Investors (And Borrowers) To Put Capital At Risk In The Mortgage Sector

Production

- **Restricted Competition**, Market Often Concentrated Within Few Banks
- **Limited Product Innovation** And Response To Customer Needs
- **Cultural Aspect** , People Not Used To Borrowing Money, Demand Fairly Weak

Loan Management

- **Lack Of Experience Data**, Scoring Expertise, Geographical Diversification, Experienced People Make The Undertaking Riskier
- **Improving Market Information:** Credit Bureaus, Ratings Agencies & I-Banks Increasingly Showing Their Interest

Recoveries

- **Slow Mortgage Registration Procedures**, Unclear Property Rights
- **General Reluctance To Deprive People Of Their Homes**, Even If They Don't Meet Their Financial Commitments

...State Has Often Helped To Make Up For Private Economy Shortfalls

Public Policies To Develop Market: Strengths And Shortfalls

Public Facilities Already Present In Transition Countries...

5 Countries Have Introduced MI

LITHUANIA

- MI Operated By The Mortgage Insurance Company, A Government Sponsored Institution. Insures 1 Out Of 3 Loans
- Scheme Introduced In 1999 With 100% Coverage, Changed To 25% In 2002 To Share Losses With The Lender

LATVIA

- State Has Given A €35m Guarantee To The Mortgage And Land Bank of Latvia. Programme Sponsored By The World Bank
- Coverage Is 22% And Max LTV 90%

ESTONIA

- State Credit and Export Guarantee Fund Gives Individual Guarantees To Young Families And Professionals
- Bank Of Estonia Recently Advised To Terminate The Guarantee

KAZAKHSTAN

- Mortgage Guarantee Fund Of Kazakhstan Created In 2003, Signed First Master Policy In May '04
- Partially Financed By USAID

SLOVENIA

- Handled By State Insurance Triglav Insurance Company

Lessons Learned

- **Programmes Are Often A Success....** Create Both For Lenders And Investors Confidence In The Market
- **...But Depth Of The Programmes Are Often Much More Limited Than In Western European Countries...** Accessibility To The Guarantee/Insurance Is Restricted By Social Status, Earnings, LTV, etc...
- **Adequate Coverage Means Sharing Losses With Lenders** To Ensure A Sound Underwriting. 100% Coverage Is Not The Safest Way To Go In A Booming Mortgage Market
- **All Programmes Are State Financed...** Private MI Providers Need An Adequate Regulatory And Economic Environment To Enter Transition Countries, But Will Bring Significant Value-Added With International Diversification And High LTV Insurance Expertise

...Governments Need To Take It To Next Level With Private MI Providers

Examples Of Insurance Company Terms And Implied Risks

	Insurance in force-to capital ratio	Premium as an upfront fee	Premium as annual interest payment	Claim coverage	Maximum loan to value ratio	Implied volatility	Rank
Canada	57	3.75%	0%	100%	95%	2.3%	9
Estonia	10	3 – 3.5%	0%	24%	90%	4%	3
France	28	2%	0.15%	100%	100%>	3.4%	6
Kazakhstan	20	4%	0%	20%	85%	2.6%	8
Latvia	2	0%	1%	22%	90%	18.8%	1
Lithuania (old program)	12	7.78%	0%	100%	95%	5.8%	2
Netherlands	227	0.3%	0%	100%	100%>	1.4%	11
Sweden (old stock)		0%	0.5%	30%	100%>	0%	12
Sweden (new stock)	62.5	0%	0.5%	30%	100%>	1.66%	10
USA (FIs)	33	0%	0.07%	100%	80%	3.1%	7
USA (Private Insurance)	11.2	0%	0.5%	20 – 30%	95%	3.8%	4
USA (Public Insurance)	25	1.5%	0.5%	100%	97%	3.5%	5

Terms and Risk Vary By Country And Need Individual Approach

Source: B. Buckley, World Bank, 2003

How MI Can Be A Significant Partner To Foster Home Affordability

Private MI IS A Critical Tool To Complement Public Initiatives

High Downpayment Required In Strong Increasing Prices Environment. Most Transition Countries Require 40% Downpayment



Easier Access to Homes, By Ensuring First Loss, MI Allows Lenders To Require Lower Downpayments And Gives Home Access To More People

Low Quality Of Dwellings, Despite High Level Of Homeownership. Properties Acquired After Privatizations Need Refurbishment And Financing Hard To Find Due To Low Value Of Asset



Homes Quality Improvement, Consistent Access To Low-Cost Mortgage Finance Allows Individual Wealth Accumulation, Strengthens Communities And Reinforces Popular Support For Private Property Rights

Funding And Regulatory System Still Developing, Hence With Limited Resources, Lenders And Regulators Struggling To Access The Foreign Investor Base And Ensure Financial Stability



Acting As A Risk Transformer To Normalize Risk For Mortgage Investors, Through Acting As The “Investor’s Eyes” And Providing A Source Of Credit Enhancement For MBS And Mortgage Bonds

Limited Credit History. With Banking Industry Developing Only Since 90s, Limited Knowledge Of Creditors Behaviour Patterns



Providing Highly Rated Specialist Risk Protection, Through Long-Term Commitment Of Risk Capital As Part Of A Global MI Franchise

Government Subsidies & Personal Guarantees Don’t Fully Tackle The House Affordability Issue



MI Brings Significant Advantages In Geographical Diversification, Risk Management, Population Targeting, 2ndary Market Development

Encourages Development Of Data Driven And Risk Sensitive Lending

MI Compares Favorably To Other Home Affordability Tools...

Personal Guarantees

Government Subsidies

Principle

Borrower Needs To Find Somebody Willing To Honour His Debt, Should He Default

Government Encourages Savings Through Subsidies For People To Reach Lower LTVs.

Used In...

Spain, Finland, Italy, Greece

France, Germany, Croatia, the Czech and Slovak Republics, Hungary,

Pros

- Make Home Buying Process Easier Without Additional Cost For Borrower
- Fits Well In Countries Where Lender-Family Relationship Well Established

- Replace Private Sector When Economic Conditions Don't Allow Sustainable Private Fostering Home Affordability
- Fairly Quick To Put In Place & Consistent With National Economic Orientations

Cons

- Puts Whole Family At Risk In Tough Economic Environment
- Not Adapted To Scoring Procedures
- Not Valued By Rating Agencies & Authorities As Mitigation Tool ⇒ More Difficult To Securitize Portfolios

- People Can Subscribe To The Savings Schemes Only To Get The Subsidy, Tool Is Not Efficiently Targeted At Home Buyers
- Difficult To Assess The Efficiency Of A Standardized Subsidy Whereas In The MI Case, Only People Using MI Pay For It, And Pay In Proportion Of The Service Rendered

Not Adequate For Standardized U/W Procedures In HLTV Environment

Not Cost Efficient And Properly Targeted

MI Provides Numerous Supervisory Benefits...

- **Acts As An Early Warning System** On The Riskiest Portion Of Residential Mortgages ... Since Unreasonably Risky Credits Will Be Refused Insurance
- **Maintains The Integrity Of The Property Valuation Process** ... Since Misstated Property Values Affect Loan-To-Value Ratios, A Key Underwriting Consideration
- **Reduces Operational Risks** Associated With Mortgage Lending ... Through Process Focus And Error Tracking And Measurement
- **Stimulates Demand For High Quality Credit Reporting** ... To Extend Credit More Appropriately On An Objective Basis
- **Introduces New Methods Of Delinquency Management** ... Since Mortgage Insurers Have First-Loss Exposure
- **Transfers Credit Risk Outside Banking System** To Highly Solvent, Well-Regulated Third Parties ... Distributing Loses More Widely If An Economic Downturn Occurs
- **Brings Global Experience And Private Sector Rigor** To Transitional Countries ... By Using The Same Service Standards And Products Offered Successfully In Other Markets
- **Coordinates Efforts To Adapt To Basel II** Regulatory Capital Revisions ... Through Joint Modeling And Best Practices Exercises

Encourages More Responsible Lending Without Additional Supervisory Resources

Public Private Partnership (“PPP”) Is A Great Way To Combine Different Powerful Attributes

Public Sector Strengths

Favorable Risk Weighting

A Government Guarantee Allows Banks To Carry 0% Risk Weighted Assets For Regulatory Capital Purposes

Standardization

The Government Can Specify Standards And Ensure Uniformity, Which Creates Necessary Precondition For Easier Loan Origination/Sale And Greater Liquidity

Private Sector Strengths

Risk Appetite and Expertise

Mortgage Credit Risk Specialists Like Genworth Offer Their Services Developed In Other Markets On A Long-Term Basis

Innovation and Efficiency

Customers Expect New Products And Services, And Shareholders Expect Increasing Returns, So Companies Like Genworth Are Under Constant Pressure To Improve

PPP Can Be Used To Encourage Low Downpayment On A Cost Effective Basis

How MI Can Help Improve Capital, Risk & Operational Procedures

MI Not Only A Credit Risk Mitigation Tool...

✓ More Control Of Operational Risk


Genworth's Six Sigma Approach To Understanding And Measuring Customer Repeatable Processes' Provides Historical And Real-Time Data On Process Monitoring That Should Reduce Regulatory Capital Charges Assigned To Operational Errors

✓ Favourable Supervisory Treatment

Like The Rating Agencies, Regulators Have Emphasized The Value Of A Well-Known, Highly-Rated Monoline Credit Risk Counter Party With Global Franchises And Risk Diversification, Particularly For Lenders New To High LTV Mortgage Lending In Smaller Markets.

✓ Improved Investor Disclosure

For Lenders Interested In Public Funding, GE's Brand, Service Guarantees, And Experience As A Global Provider Of Mortgage Default Loss Protection Make Disclosures Regarding How High LTV Mortgage Risk Is Managed Easy For Investors To Understand.



Mortgage Insurers Are An Indispensable Partner Under Basel II For Large And Small Lenders

...MI Is Also A Way To Better Prepare For Basel II Changes

Credit Risk Mitigation

General Principles

- The Guaranteed Exposure Should Not Attract A Risk Weighting Lower Than That Of Direct Exposure To The Guarantor.
- Guarantees Shall Be *Direct, Explicit, Irrevocable And Unconditional*.

Revised Standardized Approach

- MI Not Explicitly Recognized CRM
- MI Eligible If Performs As Non Financial Guarantee
- Guarantor Should Be At Least A- Rated

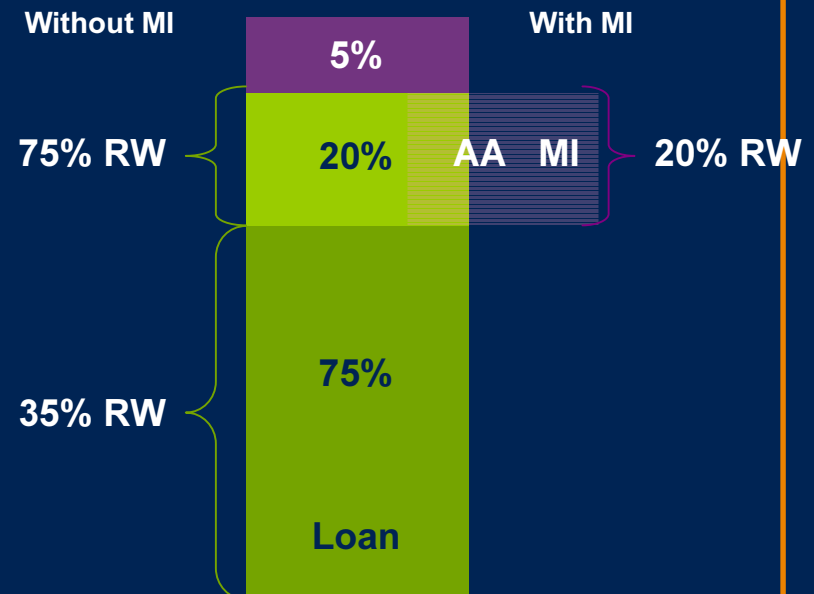
IRBA

- No Restrictions On Types Of Eligible Guarantors
- Conditional Guarantees May Be Recognized Under Certain Conditions
- MI Discipline Can Reduce Probability Of Default
- MI Reduces LGD.....Lower Capital Requirements
- Process Focus Reduces Operational Risk

Risk Weighting [RSA]

Application Of the Substitution Principle

Loan: €100K LTV: 95%



Capital Requirements

W/O MI: $[2.8\% * 75] + [6\% * 20] = [€2.100 + €1.200] = €3.300$

With MI: $[2.8\% * 75] + [1.6\% * 20] = [€2.100 + €320] = €2.420$

MI Provides Capital Relief... Under Both Approaches

Credit Risk Mitigation (Continued)

Standardized Approach		
	Normal	High LTV
Capital Requirement	8%	8%
<u>No MI</u>		
Assigned Risk Weight	35%	75%*
Capital Allocated	2.8%	6%
<u>With AA MI (100% Cover)</u>		
Assigned Risk Weight	20%	20%
Capital Allocated	1.6%	1.6%
Potential MI Benefit	1.2%	4.2%
Rated MI = Lower Capital Requirement Under Standardized Approach		

* Local Regulators Determine LTV Level And Partial Or Whole Loan Application

IRB Approach		
	Normal	High LTV
Capital Requirement	8%	8%
<u>Expected IRB Results</u>		
No MI	<2%	~2%-4%
With AA MI	<1%	<1%
Potential MI Benefit	~1%	~1%-3%
<p>Computation Of Capital Allocated For Credit Risk Under IRB Approach</p> $\text{Probability Of Default (Frequency)} \times \text{Loss Given Default (Severity)}$		
MI = Lower Capital Requirement Under IRB Via Reduced Loss Given Default		

Rated MI Eligible As CRM Under Basel II ... Deeper Cover Encouraged

Conclusion

MI Works For All Participants In The Industry...

LENDERS



- ✓ Transfers High LTV Risk Outside Banking System To Mortgage Risk Specialists
- ✓ Expands High LTV Lending Market ... A Prudent Growth Opportunity
- ✓ Improvement Of RAROC Figures ... Reduces Volatility Of Return
- ✓ Insurance And Mortgage Loan Processing Are Integrated Within The Same Process
- ✓ Innovative Products Improves Loyalty, Increases Customer Satisfaction

CONSUMERS



- ✓ Gets Borrowers Into Their Homes More Quickly ... With Lower Downpayments
- ✓ Attractive To Young Client Base With More Competitive Pricing

CAPITAL MARKETS



- ✓ Increases The Efficiency And Profitability Of Securitization
- ✓ Facilitate Liquidity & Lower Sale Execution Cost

HOUSING POLICIES



- ✓ Improves Housing Affordability Without Government Subsidies
- ✓ Facilitates Macro Economic Goal Of Increasing Home Ownership

MI Meets The Needs Of All Constituents

Involvement Of Private MI Providers Need Structural Changes

Capital Treatment

- **Regulatory Recognition** Of Significant Increased Risk From High LTV Lending On The Banking Sector
- Adequate Capital Requirements, Giving Lenders Capital Relief For Loans Guaranteed By An Insurance Company Meeting **Minimum Rating Requirements**

Borrowers Legislation

- **Quick & Clear Mortgage Registration Procedures**
- Possibility To Run A **Positive Credit Bureau**
- **Indebtedness Rules**, Although Necessary, Should Not Allow Borrowers To Constantly Delay Their Financial Obligations

Secondary Market

- **Securitization Legislation** To Allow Lenders To Efficiently Grow Mortgage Business. Rating Agencies See MI As Powerful Credit Risk Mitigant For Portfolio Sale
- **Adequate Covered Bonds Legislation**, Recognizing MI And Allowing Higher LTVs When Is Used In A Portfolio

Foreclosure Procedures

- **Clear Foreclosure Processes And Title Legislation** Allowing Rapid Sale Of The Asset Active Measures **Against Corruption** To Ensure Consistent Law Application
- **Adequate Judiciary Staffing** Ensuring Property Seizure Procedure Is Processed Timely

Establishing The Right Regulatory Environment Is Critical To MI Success

Sacha Polverini

Head Of European Regulatory Affairs

2 - 4 Rond Point Schuman

B- 1040 Brussels

sacha.polverini@genworth.com

