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New Mortgage Insurer Offers Banks Increased Protection

By Kate Berry

At a time when several big banks are locked in bitter legal disputes with mortgage insurers, a new entrant is upending the traditional business model by underwriting every single loan it insures.

Before the financial crisis, lenders typically would submit loans to mortgage insurers for approval or would receive delegated underwriting authority, in which insurer would once a year underwrite a sample of 5% to 15% of insured loans. That model ultimately proved fatal to many insurers during the housing bust, leading to an estimated $30 billion in claims paid mostly to Fannie Mae and Freddie Mac. Often insurers also refused to pay claims and those rescissions led to massive litigation.

But newcomer National Mortgage Insurance is trying to differentiate itself by offering banks and mortgage lenders more beneficial terms and increased underwriting protection. It began writing policies in 46 states in April and has signed up roughly 100 banks and mortgage lenders as customers.

"We're underwriting every loan and providing feedback through a second set of eyes on what banks and lenders are originating," says Bradley Shuster, the firm's president and chief executive.

The Emeryville, Calif., insurer is also bucking industry trends by limiting the liability for lenders. It says it will not ask banks to buy back loans either for lender mistakes or borrower fraud as long as the homeowner makes 18 months of consecutive on-time mortgage payments.

Glen Corso, National Mortgage Insurance's general counsel, who had been managing director of the trade group Community Mortgage Banking Project, says rescissions were "a huge influence" on how the insurer created its master policy.

"I could analyze and see where the provisions weren't as clear as they could have been or were favorable to the mortgage insurer not the lender," Corso says.

Of course, National Mortgage Insurance has jumped into the business at a time when credit is tight, defaults have ebbed and lenders have to ensure that the borrower has the ability to repay the loan. Since it also has no legacy claims to pay, it can entice banks with better terms.

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Limiting lender liabilities is part of an overall effort to reduce risk and get lenders to make more loans. In January, the Federal Housing Finance Agency, which oversees Fannie and Freddie, said it would not ask banks to buy back loans for borrowers that have made 36 months of consecutive mortgage payments.

National Mortgage Insurance also is writing policies at a time when private mortgage insurance is significantly less expensive than government-backed loans from the Federal Housing Administration.

In April, the FHA increased its mortgage insurance premiums for the third time in two years, and starting next month it will require that borrowers pay mortgage insurance premiums for the life of the loan. (Homeowners with loans backed by Fannie and Freddie can cancel their mortgage insurance once their debt-to-income ratio falls below 78%.)

The price advantage over FHA means that borrowers will increasingly turn to Fannie and Freddie, which requires private mortgage insurance from borrowers who do not have a 20% down payment — and that could prove to be a windfall for insurers.

Alfred King, a spokesman at Genworth Financial (GNW), says private mortgage insurance is "making steady progress in regaining market share and volume from FHA."

Since banks and mortgage lenders typically select the insurer on loans with less than 20% down payments, "banks can pass this mortgage insurance pricing advantage on to customers in the form of lower payments," King says.

Shuster had been president of international and strategic investments at PMI Group, but was forced to wind down its overseas operations when the financial crisis hit. PMI stopped writing new insurance in August 2011 and currently is operating under the control of the Arizona Department of Insurance. Two other insurers, Triad Guaranty and Old Republic International, also stopped writing policies.

Last year, Shuster teamed up with Jay Sherwood, a former partner at hedge fund Eastbourne Capital Management, one of the largest shareholders of Milwaukee-based private insurer MGIC Investment (MTG). They raised $550 million in private capital and bought an insurance technology platform. They intend to take National Mortgage Insurance public by yearend. The firm says it can support $30 billion in mortgage loans to 150,000 borrowers. ▪