Arch Mortgage Insurance Limited
2nd Floor, Block 3, The Oval,
160 Shelbourne Road, Ballsbridge,
Dublin 4, Ireland.
Phone: +353(0)1 66 99 700
Fax: +353(0)1 66 43 749

Re: Consultation Paper CP87 on Macro-prudential policy for residential mortgage lending

12th November 2014

Dear Sir/Madam,

In relation to the above mentioned CP we wish to provide our feedback.

Arch Background

Arch Capital Group Ltd. (Arch Capital or ACGL), a Bermuda public limited liability company, writes insurance and reinsurance on a worldwide basis through operations in Bermuda, the United States, Canada, Europe, Australia and South Africa, with a focus on specialty lines.

The Arch Mortgage Insurance platform is dedicated to providing risk management and risk financing products to the mortgage insurance sector worldwide, through our three distinct platforms in the United States, Europe and Bermuda. Our group of dedicated mortgage insurance and reinsurance professionals understands the unique requirements and challenges of mortgage insurance markets around the globe. Our market-specific knowledge and expertise enable our teams to provide creative and commercially viable solutions for our clients. Superior analytics and risk assessment combined with outstanding client service are at the forefront of all our activities.

Arch Mortgage Insurance Limited is a mortgage insurer regulated by the Central Bank of Ireland and authorised to write mortgage insurance (non-life insurance Class 14, Credit) in a number of EEA Member States on a freedom of services basis.

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Question 1:
Which of the tools or combination of tools available to the Central Bank would, in your opinion, best meet the objective of increasing resilience of the banking and household sectors to shocks in the Irish property market and why?

We believe that a proportionate cap on LTIs is a good tool to meet the above objective. Once the Credit Register has become operational, we would encourage the Central Bank to move from LTI to DTI. In our experience from analysing mortgage risk in a number of countries, DTI is a better measure of borrower affordability than LTI. A further refinement is to calculate DTI at a stressed interest rate e.g. at an interest rate which includes a margin over the initial interest rate payable on the mortgage. DTI calculated using a stressed interest rate provides a good test of borrower affordability and borrower resilience to future interest rate increases.

While a proportionate cap on LTV does meet the objective of increasing resilience of the household sectors to shocks in the Irish property market, it has the drawback of rationing credit to those borrowers with low deposits. A low deposit mortgage may be a suitable financial product for borrowers who have been appropriately assessed from an affordability perspective, in particular for younger borrowers who have a long working life and career earnings ahead of them.

Question 5:
Should some adequately insured mortgages with higher LTVs be exempted from the measures and if so what should be the criteria for exemption?

Yes, we believe adequately insured mortgages with higher LTVs should be exempt from the proportionate cap on LTV. Mortgage insurance increases the resilience of the banking sector to property shocks by providing additional capital to absorb losses from stressed economic scenarios. The capital providing by mortgage insurers in respect of insured loans has the benefit of being diversified from the capital base of the banking sector. In addition mortgage insurance may help improve loan underwriting quality as the mortgage insurer will provide feedback to the banking sector in terms of changes in its underwriting standards and practices.

International experience of LTV caps demonstrate that countries which apply such caps often permit loans which have mortgage insurance from being exempt from the LTV cap. In Italy, Banca d'Italia permits mortgage loans to be advanced above 80% LTV when there is adequate mortgage insurance on the mortgage loan. Guarantees including mortgage insurance are used by lenders in Finland for higher LTV loans. In Canada, lenders who are regulated by OFSI are required to purchase mortgage insurance when they advance loans above 80% LTV. In Hong

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Kong, lenders are required to purchase mortgage insurance when they advance loans above 70% LTV.

Mortgage insurance may be provided by a government scheme or a private sector mortgage insurer. If the government provides mortgage insurance the contingent liabilities of the State increase, potentially exposing the State to large liabilities at the same time when the banking sector and household sector balance sheets are under pressure. A private sector mortgage insurer which operates internationally and writes other lines of insurance has the ability to absorb losses from mortgage exposure in one country.

When a mortgage insurance scheme is in place it is desirable that all of a lender's higher LTV loans are insured. On each insured loan the lender can retain a proportionate share of the risk above the LTV threshold with the remaining portion of risk above the LTV threshold being insured by the mortgage insurer. A proportionate cap on higher LTV loans could then be specified as the proportion of retained risk by the lender on higher LTV loans, rather than the proportion of uninsured loans.

Only insurance provided by a highly-rated insurer should be considered for the purposes of the exemption. We note that the Capital Requirements Regulations ('CRR') in respect of eligible providers of unfunded credit protection to IRB approach lenders require an equivalent rating of A- or above (*CRR Article 202*).

As the mortgage insurer is providing additional diversified capital, we believe that the lenders should benefit from capital relief in respect of the capital they are required to hold in respect of their insured mortgages. The recent Help-To-Buy scheme in the UK has been approved by the PRA as a structure able to provide capital relief to lenders also when it is offered by private sector mortgage insurers. We similarly recommend that High LTV Irish mortgages be exempt from the LTV cap when their portion of LTV in excess of the cap threshold benefits from credit protection satisfying the CRR eligibility requirements.

We are happy to answer any questions you may have in respect of our response.

Yours faithfully
Giuliano Giovannetti
CEO and President