

Homeowners Protection Act¹

Introduction

The Homeowners Protection Act of 1998 (the Act) was signed into law on July 29, 1998, and became effective on July 29, 1999. The Act was amended on December 27, 2000, to provide technical corrections and clarification. The Act, also known as the “PMI Cancellation Act,” addresses homeowners’ difficulties in canceling private mortgage insurance (PMI)² coverage. It establishes provisions for canceling and terminating PMI, establishes disclosure and notification requirements, and requires the return of unearned premiums.

PMI is insurance that protects lenders from the risk of default and foreclosure. PMI allows prospective buyers who cannot, or choose not to, provide significant down payments to obtain mortgage financing at affordable rates. It is used extensively to facilitate “high-ratio” loans (generally, loans in which the loan to value (LTV) ratio exceeds 80 percent). With PMI, the lender can recover costs associated with the resale of foreclosed property, and accrued interest payments or fixed costs, such as taxes or insurance policies, paid prior to resale.

Excessive PMI coverage provides little extra protection for a lender and does not benefit the borrower. In some instances, homeowners have experienced problems in canceling PMI. At other times, lenders may have agreed to terminate coverage when the borrower’s equity reached 20 percent, but the policies and procedures used for canceling or terminating PMI coverage varied widely among lenders. Prior to the Act, homeowners had limited recourse when lenders refused to cancel their PMI coverage. Even homeowners in the few states that had laws pertaining to PMI cancellation or termination noted difficulties in canceling or terminating their PMI policies. The Act now protects homeowners by prohibiting life of loan PMI coverage for borrower-paid PMI products and establishing uniform procedures for the cancellation and termination of PMI policies.

Regulation Overview

Scope and Effective Date

The Act applies primarily to “residential mortgage transactions,” defined as mortgage loan transactions consummated on or after July 29, 1999, to finance the

acquisition, initial construction, or refinancing³ of a single-family dwelling that serves as a borrower’s principal residence.⁴ The Act also includes provisions for annual written disclosures for “residential mortgages,” defined as mortgages, loans or other evidences of a security interest created for a single-family dwelling that is the principal residence of the borrower (12 USC §4901(14) and (15)). A condominium, townhouse, cooperative, or mobile home is considered to be a single-family dwelling covered by the Act.

The Act’s requirements vary depending on whether a mortgage is:

- A “residential mortgage” or a “residential mortgage transaction”;
- Defined as high risk (either by the lender in the case of non-conforming loans, or Fannie Mae and Freddie Mac in the case of conforming loans);
- Financed under a fixed or an adjustable rate; or
- Covered by borrower-paid private mortgage insurance (BPMI) or lender-paid private mortgage insurance (LPMI).⁵

Cancellation and Termination of PMI for Non High Risk Residential Mortgage Transactions

Borrower Requested Cancellation

A borrower may initiate cancellation of PMI coverage by submitting a written request to the servicer. The servicer must take action to cancel PMI when the cancellation date occurs, which is when the principal balance of the loan reaches (based on actual payments) or is first scheduled to reach 80 percent of the “original value,”⁶ irrespective of the outstanding balance, based upon the initial amortization schedule (in the case of a fixed rate loan) or amortization schedule then in effect (in the case of an adjustable rate loan⁷), or any date thereafter that:

³ For purposes to these procedures, “refinancing” means the refinancing of loans any portion of which was to provide financing for the acquisition or initial construction of a single-family dwelling that serves as a borrower’s principal residence. *See* 15 USC §1601 *et seq.* and 12 CFR §226.20.

⁴ For purposes of these procedures, junior mortgages that provide financing for the acquisition, initial construction or refinancing of a single-family dwelling that serves as a borrower’s principal residence are covered.

⁵ All sections of these procedures and Handbook apply to BPMI. For LPMI, relevant sections begin under that heading and follow thereafter.

⁶ “Original value” is defined as the lesser of the sales price of the secured property as reflected in the purchase contract or, the appraised value at the time of loan consummation. In the case of a refinancing, the term means the appraised value relied upon by the lender to approve the refinance transaction.

⁷ The Act includes as an adjustable rate mortgage, a balloon loan that “contains a conditional right to refinance or modify the unamortized principal at the maturity date.” Therefore, if a balloon loan contains a conditional right to refinance, the initial disclosure for an adjustable rate mortgage would be used even if the interest rate is fixed.

¹ This section fully incorporates the examination procedures issued under DSC RD Memo 03-049: Revised Interagency Examination Procedures for the Homeowners Protection Act.

² The Act does not apply to mortgage insurance made available under the National Housing Act, title 38 of the United States Code, or title V of the Housing Act of 1949. This includes mortgage insurance on loans made the Federal Housing Administration and guarantees on mortgage loans made by the Veterans Administration.

- the borrower submits a written cancellation request;
- the borrower has a good payment history;⁸
- the borrower is current;⁹ and
- the borrower satisfies any requirement of the mortgage holder for: (i) evidence of a type established in advance that the value of the property has not declined below the original value; and (ii) certification that the borrower's equity in the property is not subject to a subordinate lien (12 USC §4902(a)(4)).

Once PMI is canceled, the servicer may not require further PMI payments or premiums more than 30 days after the later of: (i) the date on which the written request was received or (ii) the date on which the borrower satisfied the evidence and certification requirements of the mortgage holder described previously (12 USC §4902(e)(1)).

Automatic Termination

The Act requires a servicer to automatically terminate PMI for residential mortgage transactions on the date that:

- the principal balance of the mortgage is first scheduled to reach 78 percent of the original value of the secured property (based solely on the initial amortization schedule in the case of a fixed rate loan or on the amortization schedule then in effect in the case of an adjustable rate loan, irrespective of the outstanding balance), if the borrower is current; or
- if the borrower is not current on that date, on the first day of the first month following the date that the borrower becomes current (12 USC §4902(b)).

If PMI is terminated, the servicer may not require further payments or premiums of PMI more than 30 days after the termination date or the date following the termination date on which the borrower becomes current on the payments, whichever is sooner (12 USC §4902(e)(2)).

There is no provision in the automatic termination section of the Act, as there is with the borrower-requested PMI cancellation section, that protects the lender against declines in property value or subordinate liens. The automatic termination provisions make no reference to good payment history (as prescribed in the borrower-requested provisions), but state only that the borrower must be current on mortgage payments (12 USC §4902(b)).

⁸ A borrower has a good payment history if the borrower: (1) has not made a payment that was 60 days or more past due within the first 12 months of the last 2 years prior to the later of the cancellation date, or the date that the borrower requests cancellation; or (2) has not made a payment that was 30 days or more past due within the 12 months prior to the later of the cancellation date or the date that the borrower requests cancellation.

⁹ The Act does not define current.

Final Termination

If PMI coverage on a residential mortgage transaction was not canceled at the borrower's request or by the automatic termination provision, the servicer must terminate PMI coverage by the first day of the month immediately following the date that is the midpoint of the loan's amortization period if, on that date, the borrower is current on the payments required by the terms of the mortgage (12 USC §4902(c)). (If the borrower is not current on that date, PMI should be terminated when the borrower does become current.)

The midpoint of the amortization period is halfway through the period between the first day of the amortization period established at consummation and ending when the mortgage is scheduled to be amortized. The servicer may not require further payments or premiums of PMI more than 30 days after PMI is terminated (12 USC §4902(e)(3)).

Loan Modifications

If a borrower and mortgage holder agree to modify the terms and conditions of a loan pursuant to a residential mortgage transaction, the cancellation, termination or final termination dates shall be recalculated to reflect the modification (12 USC §4902(d)).

Exclusions

The Act's cancellation and termination provisions do not apply to residential mortgage transactions for which Lender Paid Mortgage Insurance (LPMI) is required (12 USC §4905(b)).

Return of Unearned Premiums

The servicer must return all unearned PMI premiums to the borrower within 45 days after cancellation or termination of PMI coverage. Within 30 days after notification by the servicer of cancellation or termination of PMI coverage, a mortgage insurer must return to the servicer any amount of unearned premiums it is holding to permit the servicer to return such premiums to the borrower (12 USC §4902(f)).

Accrued Obligations for Premium Payments

The cancellation or termination of PMI does not affect the rights of any lender, servicer or mortgage insurer to enforce any obligation of a borrower for payments of premiums that accrued before the cancellation or termination occurred (12 USC §4902 (h)).

Exceptions to Cancellation and Termination Provisions for High Risk Residential Mortgage Transactions

The borrower-requested cancellation at 80 percent LTV and the automatic termination at 78 percent LTV requirements of the Act do not apply to "high risk" loans. However, high-risk loans are subject to final termination and are divided into two