FEDERAL RESERVE BANK OF PHILADELPHIA

SRC INSIGHTS

A newsletter published by the Supervision, Regulation & Credit Department for the institutions that it supervises.

Volume 4, Issue 2 Fourth Quarter 1999

Reprinted from SRC Insights

Ready or Not, New PMI Rules Are Here

by Elizabeth Rozsa, Compliance-CRA Writer/Editor

The Homeowner's Protection Act went into effect on July 29, 1999.[1] This law, passed by Congress in July 1998, affects originators and servicers of single family residential loans by requiring them to inform borrowers about their rights regarding the termination of private mortgage insurance (PMI). Prior to the enactment of the Act, PMI was not required after a loan reached 80% loan-to-value (LTV), but many mortgage servicers were not terminating the insurance, resulting in many borrowers paying unnecessary premiums.

The Act requires that borrowers be given disclosures informing them about their rights regarding PMI cancellation and termination upon loan consummation, annually, and upon cancellation or termination of insurance. Briefly, the Act requires that the borrower's request for cancellation upon reaching 80% LTV be granted as long as the loan is in good standing, and that PMI be automatically terminated when the loan is scheduled to reach a LTV of 78%.

[1] The Act, Pub. L. 105-216, can be found through the GPO's website at <www.access.gpo.gov/nara/publaw/105publ.html>. This website, which is not affiliated with or authorized by the Federal Reserve System, contains information that may be helpful to you. The Federal Reserve, however, has no control over the information contained therein and cannot guarantee its accuracy.

Disclosures…At Closing

For loans closed after July 29, 1999, the lender is required to provide the borrower with an initial amortization schedule at closing, as well as notify the borrower in writing about their PMI cancellation and termination rights.

Cancellation. For *fixed rate* mortgages, the disclosure must state that the borrower may request cancellation of PMI when, according to the loan's amortization schedule, the LTV is scheduled to reach 80%, or, if the loan reaches 80% before the scheduled date, at the time that it actually reaches 80%. The closing disclosures must also state that exemptions to cancellation exist, and whether or not the loan falls into an exempt category.

For *adjustable rate* mortgages, the disclosure must state that the borrower may submit a written request to cancel PMI when the amortization schedule or payments show the balance to be at 80% LTV. The loan servicer must also notify the borrower when 80% LTV has been reached. As with fixed rate loans, the closing disclosures must also state that exemptions to cancellation exist, and whether or not the loan falls into an exempt category.

Termination. Closing disclosures must also include PMI termination provisions. The disclosures for both fixed and adjustable rate loans must state that PMI will be terminated when the loan is scheduled to reach 78%

Is this loan affected by the Act?

Is it a single-family residential loan closed on or after July 29, 1999?	The loan may be covered by the Act.
Does it have borrower or lender paid PMI?	Yes, the loan is covered, but the provisions are different for lender paid PMI.
Is it conforming or nonconforming (jumbo)?	Yes, the loan is covered by the Act, but the provisions are different for nonconforming loans.
Is it "high-risk"?	"High-risk" loans are covered, but with special provisions.
Is the rate fixed or adjustable?	Both fixed rate and adjustable rate loans are covered, with slightly different provisions.

LTV if the borrower is current on payments at that time. If the borrower is not current, PMI will be terminated at the time the borrower becomes current. For fixed rate loans, the disclosure must also state the actual termination date, and, for adjustable rate loans, that the borrower will be notified at the time of automatic termination.

High-risk loans. In the case of a "high-risk" loan, the notice to the borrower at closing must state that PMI is not required beyond the midpoint of the amortization schedule as long as the loan payments are current. Fannie Mae and Freddie Mac will be determining the definition of "high-risk" for conforming loans. Individual lenders will define the criteria for "high-risk" nonconforming loans.

Disclosures… Annually

Loan servicers are required to make annual PMI disclosures to borrowers. These disclosures must inform borrowers of their right to cancel PMI, and provide them with an address and telephone number at which the servicer can be contacted. If a loan currently carrying PMI was closed before July 29, 1999, servicers must disclose to borrowers that PMI may be cancelable, as well as provide the servicer's address and telephone number.

Disclosures… At Termination, Cancellation, or Determination of Disqualification

If PMI is cancelled at the borrower's request or automatically terminated as provided in the Act, the servicer must notify the borrower that the PMI has been cancelled or terminated, and that the borrower will not be liable for any further premiums or fees, within 30 days. If a borrower does not qualify for cancellation or termination at the appropriate time, the servicer must provide the borrower written notice of the reasons for disqualification within 30 days, and, if an appraisal contributed to the decision, the results of the appraisal.

Conditions for Cancellation

There are certain conditions that a borrower must meet in order to be eligible for PMI cancellation upon request at 80% LTV. These conditions include:

- the cancellation request is in writing;
- the borrower can provide evidence that the property value has not decreased to below the original value;
- the borrower can demonstrate that there are no subordinate liens on the property; and
- the borrower has a good payment history.

The lender must provide the borrower with the requirements for demonstrating property value "promptly" after the request for cancellation. The property's current value will be compared against the original value, which is defined as the lesser of the sale price or appraised value of the property at loan origination. For purposes of these provisions, a good payment history is defined as no past due payments of 30 days or more in the past 12 months and no past due payments of 60 days or more in the past 24 months. Written notice of cancellation or disqualification of the borrower for cancellation must be made within 30 days of the borrower's request.

Conditions for Automatic Termination

Servicers are required to terminate PMI on the date the loan is scheduled to reach 78% LTV, without regard to the existence of subordinated liens or the value of the property. This date is determined by the initial amortization schedule. The borrower must be current on the loan at this time; however, if not current, PMI will be terminated at such time as the loan becomes current. If PMI is still carried on the loan at the midpoint of the amortization period, it must be terminated at that time, providing the loan is paid up to date.

If a *nonconforming* loan is defined by the lender as "high-risk," PMI will terminate when the LTV is scheduled to reach 77%, regardless of the actual balance, as long as payments are current.

If a *conforming* loan is determined by Fannie Mae or Freddie Mac to be "high-risk," then PMI must be terminated no later than the first day of the month following the month during which the midpoint of the amortization schedule is reached, as long as payments are current.

Exceptions to the Law

The new law does not pertain to loans insured by the Federal Housing Administration, or loans on which the lender pays PMI. However, for lender paid PMI (LPPMI), certain written disclosures are required within 30 days of the date of commitment. These disclosures must inform the borrower that a loan with LPPMI usually results in higher interest rates than with borrower paid PMI, and may not be cancelled by the borrower nor will be terminated by the lender unless the loan is terminated. The notice must also disclose the advantages and disadvantages of both LPPMI and PMI, including a 10 year comparison of the costs and benefits of both, and a statement that LPPMI may be tax deductible.

PMI payments should be included in the finance charge until the date on which PMI must automatically terminate.

Within 30 days after the termination date that would apply if the borrower had PMI, the servicer must provide written notice to the borrower stating that the borrower may want to change their financing in such a way that would eliminate the necessity of LPPMI.

Form of Disclosure

There are no specific forms required for use under the Act; standardized forms are permitted, but no one form is mandated. In addition, the Act allows the annual disclosures to be provided with certain other disclosures made annually to borrowers.

Enforcement and Penalties for Noncompliance

The Homeowner's Protection Act will not be enforced by any single governmental agency. The Act does give enforcement authority to the federal banking agencies with regulatory authority over lending institutions. This authority allows them to correct violations by requiring the banks to adjust loan accounts that had been subject to improper disclosures or improper application of the Act. Enforcement actions may be brought for a maximum of two years after the discovery of the violation, and federally regulated entities are liable for up to $2,000 statutory damages in an individual case.

Unresolved Issues

Many questions have arisen regarding the Act, due in part to the lack of specific authority for the federal banking regulatory authorities to write rules and regulations to implement the Act. However, the Board of Governors of the Federal Reserve System did address one of these issues in the revision to the official staff commentary of Regulation Z. The March 31, 1999 commentary stated that the borrower's PMI payments should be included in the finance charge until the date on which the servicer must automatically terminate coverage under the law. The question of the impact of rounding on the date at which insurance must be terminated (must it be terminated when the LTV is 78.4%, for example, or only at exactly 78%) will be addressed in the Commentary for Regulation Z in the coming months. It is also possible that the precise method to be used in calculating the appropriate dates for cancellation and termination for adjustable rate mortgages will be addressed by Congress.

Other issues which need to be addressed include: whether “current” means the date of the payment or when funds from a payment are collected; how Fannie Mae and Freddie Mac will define “high-risk” conforming loans; how lenders should define “high-risk” nonconforming loans; and how borrowers will certify the existence or absence of subordinate liens.

The Federal Financial Institutions Examination Council is developing interagency examination procedures to examine banks’ compliance with the Act, and many of the open questions may be answered by these procedures. In the interim, however, the regulatory agencies, including the Federal Reserve Board, have made it clear that banks are expected to develop forms and procedures to ensure their compliance with the Act.

In light of these expectations, it is very important that bankers are aware of the new law and its affect on their capacity as loan originators and servicers, and implement procedures and forms to ensure compliance with the law as it stands. If questions or concerns arise regarding compliance in general or with respect to a specific situation, banks should contact their primary regulator for assistance. Look for more details soon. ■