

DATE: January 21, 1999

SUBJECT: PMI CANCELLATION BILL SIGNED INTO LAW

The federal Homeowners Protection Act of 1998 (the "HPA"), calling for automatic cancellation of private mortgage insurance ("PMI") under certain conditions and required lender notices to borrowers regarding their cancellation rights, was signed into law on July 29, 1998 (Public Law 105-216). These PMI cancellation and notice provisions are effective *one year* after this date of enactment on July 29, 1999, and apply only to private mortgage insurance required by lenders in connection with *residential mortgage transactions* in which a mortgage or other consensual security interest is taken in a *single-family dwelling* that is the *primary residence* of the mortgagor to finance the purchase, initial construction, or refinancing of that dwelling.

Private mortgage insurance for this purpose includes any insurance or guaranty against non-payment, or default, of such a mortgage or other security interest *except* mortgage insurance or guaranty made available under FHA and VA loan programs. Mortgage lenders generally require PMI when financing a home purchase if the borrower's down payment is less than 20% of the purchase price or appraised value or in the refinancing of a home loan if the borrower's appraised equity in the property is less than 20%.

Cancellation and Termination of PMI:

The HPA generally requires automatic cancellation of private mortgage insurance imposed by the lender as a condition of the loan when the loan amount is paid down to 78% (or 77% for certain so-called *high risk* loans) of the original value of the property securing the loan. PMI is automatically cancelled in these cases on the date when, according to the initial amortization schedule for the mortgage, the loan is first scheduled to reach 78% of value (or 77% for high risk loans) *if* the borrower is current on his payments (or the first date thereafter in which the borrower becomes current). Borrowers with "good payment histories" generally are entitled to PMI cancellation upon written request when the loan amount similarly is scheduled to be paid down to 80% of the secured property's original value. To qualify for cancellation at 80%, the borrower must not have had a payment that was 30 days, or longer, past due during the preceding 12-month period (or that was 60 days, or longer, past due during the 12-month period preceding that) and must demonstrate that the secured property has not declined in value below the original value and is not encumbered by a subordinate lien. *Original value* for this purpose means the lesser of the actual sales price of the secured property or its appraised value at the time of loan closing. Even if a borrower is not otherwise entitled to PMI cancellation under any of these provisions, in no case may PMI be required beyond the date that is the mid-point of the amortization period of the loan if the borrower is then current on the payments required under the terms of the mortgage.

Disclosures and Notice Requirements:

Mortgage lenders, when requiring PMI in connection with residential mortgage transactions covered under the HPA, are required to provide borrowers written notices of their cancellation rights both at the time of loan closing and annually thereafter during the term of the loan. At closing, the mortgage lender must provide the borrower both a *written amortization schedule* and a *written notice* informing the borrower generally that the borrower may request PMI cancellation based solely on the initial amortization schedule, or earlier based upon a good payment history or actual payments; that the PMI requirement will automatically terminate on a certain date indicated in the notice; and that there are exemptions to cancellation and automatic termination under the HPA which may apply to the borrower's loan and whether such an exemption in fact applies at that time to the loan. This written notice varies slightly in its content if the loan is either an ARM or a so-called high risk loan. Each year, the mortgage lender or servicer must provide the borrower a similar written statement of cancellation rights and an address and telephone number that the borrower may use to determine whether PMI may be cancelled, which statement may be incorporated into the standardized form of Annual Escrow Account Statement required under applicable provisions of RESPA. Upon cancellation under any of these provisions, the

mortgage lender or servicer is also required to notify the borrower that the PMI has been cancelled within 30 days of the cancellation or termination and that no further premiums or other fees in connection with PMI shall be due. No fee may be charged or other cost imposed on the borrower in connection with the giving of any notice or information required of the mortgage lender under the HPA (including presumably the amortization schedule required at closing).

Protected State Laws:

The HPA does not supercede previously passed state laws in connection with private mortgage insurance that were in effect on or before January 2, 1998, and are not inconsistent with the provisions of the HPA. (The states of California, Connecticut, Maryland, Minnesota, Missouri, New York, and Texas had passed state laws before January 2, 1998. The states of Illinois and Washington passed state laws effective July 1, 1998.)

Texas law (Tex. H.B. 1755, Laws of 1997), while not requiring automatic cancellation of PMI, does require that a lender provide an annual notice to the borrower in the form of a promulgated Notice of Right to Cancel Private Mortgage Insurance, printed in at least 10-point type, regarding any rights of cancellation the borrower may have. However, the statute provides that any lender will be deemed to be in compliance with Texas law when giving the written notice required by federal law that contains substantially the same information as the Texas promulgated form of disclosure and that is given within the period prescribed by federal law.

Proposed Reg. Z Commentary Regarding Effect on Truth in Lending Disclosures:

Proposed Official Staff Commentary to Regulation Z (Truth in Lending), §226.18(g) published December 7, 1998 (63 F.R. 67436) would require that the Payment Schedule on Truth in Lending disclosures reflect the automatic termination of PMI at 78% of the original secured property value. The Commentary provides guidance on calculating payment schedules involving PMI. Comment 18(g) – 5 would be added in response to lenders’ requests for guidance on how the requirements of the HPA affect TILA disclosures. Noting that TILA disclosures must be based on the actual legal obligation between the parties, this Comment would require that the Payment Schedule reflect the borrower’s PMI payments “until the date on which the creditor must automatically terminate coverage under applicable law, even though the consumer may have a right to request that the insurance be cancelled earlier.” This means that the Payment Schedule on TILA disclosure statements must reflect all monthly PMI payments — ending on the precise month in which PMI payments would be automatically terminated under the HPA. The fact that any borrower with a demonstrated “good payment history” may be entitled to earlier termination apparently may be ignored for TILA disclosure purposes.

[NOTE: Reprogramming of computer software used to calculate the values of the APR, Finance Charge, and other TILA disclosures may be necessary to accommodate this new Payment Schedule disclosure requirement, if and when effective. The amount equal to 78% of the secured property’s appraised value (or sales price, if lower) with respect to any loan would first have to be calculated and the month in which the principal loan amount is scheduled to be paid down to that amount would have to be determined by reference to a loan amortization schedule. These variables would then have to be input to calculate a Payment Schedule in which PMI payments are reflected only until the month in which the lender must automatically terminate PMI coverage under the HPA.]

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