The Homeowners Protection Act of 1998

Public Law Number 105-216

Summary

The Homeowners Protection Act of 1998 (the Act) offers residential mortgages borrowers three rights related to private mortgage insurance: disclosure, cancellation, and automatic termination. The Act requires lenders to inform mortgage borrowers of their rights under the Act. Also, the Act allows borrower-initiated cancellation of private mortgage insurance (PMI) and requires its termination by the lender when the borrower has accumulated a certain equity level in the home.

You must comply with the Act beginning July 29, 1999. The Act protects borrowers paying PMI who secure mortgages with their primary homes on or after July 29, 1999. The Act also requires special disclosures to borrowers who have existing mortgages on the effective date and to borrowers of loans carrying lender-paid PMI.

The following questions may arise in determining your duties under the Act:

Am I covered by the Act?

The Act covers lenders that grant "residential mortgages." A residential mortgage is defined as a "mortgage, loan or other evidence of a security interest created with respect to a *single-family dwelling* that is the primary residence of the [borrower]." A single-family dwelling is a "residence consisting of 1 family dwelling unit." Thus, the Act covers lenders who will grant home mortgages.

The Act also requires lenders that refinance or service home mortgages to comply with its terms. When you service a home mortgage that you did not originate, all the Act's terms apply to you except those relating to loan closing.

What loans are covered by the Act?

The Act covers adjustable- and fixed-rate home mortgages on primary residences. At a loan closing for either mortgage, you must disclose the borrower's right to cancel PMI and the lender's duty to terminate PMI at a predetermined date. Disclosure requirements vary depending on how the mortgage accrues interest.

The Act does not cover loans lacking PMI or loans secured by second or multifamily homes. Most provisions of the Act do not apply to home loans made before July 29, 1999, or to mortgages where the lender pays the mortgage insurance. However special disclosure rules apply to loans in these categories.

What must I disclose at the loan closing for a fixed-rate mortgage?

At the loan closing for a fixed-rate mortgage, you must provide an initial amortization schedule with a written notice stating:

1. The cancellation date; and
2. The automatic termination date.

<u>Cancellation Date</u>

The written notice accompanying the amortization schedule must include the "cancellation date." The cancellation date is the date the borrower may seek to cancel PMI and is based on the amortization schedule. The borrower may seek cancellation when the loan-to-value ratio reaches 80 percent of the loan's original value. The disclosure must state that the borrower may accelerate the cancellation date by making additional payments that bring the loan-to-value ratio to 80 percent.

The borrower's right to cancel PMI is limited by other rules explained below.

<u>Automatic Termination Date</u>

The written notice accompanying the amortization schedule must include the "automatic termination date." The automatic termination date is the date the lender must terminate PMI even without a borrower's request and is based on the initial amortization schedule. You must terminate PMI when the loan-to-value ratio reaches 78 percent, provided the borrower is current on payments.

Your responsibility to terminate PMI automatically is explained below.

What must I disclose at the loan closing for an adjustable-rate loan?

At loan closing for an adjustable-rate mortgage, you must provide borrowers with written notice explaining:

1. Their right to cancel PMI on the cancellation date; and
2. Your duty to terminate PMI automatically on the termination date.

Cancellation Date

Congress recognized that at the closing for an adjustable-rate loan, you cannot adequately forecast the date on which the loan-to-value ratio will reach 80 percent. Thus, the notice must explain that the borrower may cancel when the loan-to-value ratio reaches 80 percent and that you will contact the borrower when the loan reaches that ratio.

The disclosure must also state that the borrower may accelerate cancellation based on actual payments. The initial notice must explain that you will provide later notice if the borrower reaches the 80 percent loan-to-value ratio based on actual payments.

The borrower's right to cancel PMI is limited by other rules explained below.

Automatic Termination Date

You must provide notice to a borrower with an adjustable-rate mortgage that you will terminate PMI automatically when the loan-to-value ratio reaches 78 percent, provided the borrower's payments are current.

Your responsibility to terminate PMI automatically is explained below.

What other disclosures are needed after the loan closing?

You have five added disclosure requirements after loan closing:

1. Provide borrower with an annual statement.

You must provide annual statements detailing the borrower's cancellation and termination rights under the Act with an address and telephone number of a contact person. The annual notice may be given as part of an annual escrow account statement required under the Real Estate Settlement Procedures Act (RESPA) or as part of the disclosure of interest payments required by the Internal Revenue Service satisfies the Act. The Act also permits the use of standardized forms for this purpose.

2. Tell the borrower when his adjustable-rate loan reaches the cancellation date.

It is difficult to project when an adjustable-rate loan will reach its cancellation date at the loan closing. Thus, before the cancellation date or as soon as possible after that, you must provide notice that the cancellation date has been reached. This rule applies only to borrowers with adjustable-rate mortgages because those with fixed-rate mortgages received a cancellation date in their initial disclosure documents.

3. Inform the borrower when the loan has reached the cancellation date based on actual payments.

If a borrower accelerates repayment of the loan, then you must notify the borrower when the loan reaches the cancellation date. This rule applies equally to fixed- and adjustable-rate mortgages.

4. Give reasons for denying borrower's cancellation request or for not granting automatic termination.

You may deny a borrower's request to cancel or refuse to terminate PMI. The rules vary for each action. When you deny a borrower's cancellation request, you must send written notice to the borrower of the grounds for denial of cancellation. You may deny a borrower's written request for cancellation if the borrower lacks a "good payment history." Alternatively, if the borrower fails to prove that the home's value has not depreciated or fails to certify that it is unencumbered by a subordinate lien, you may deny cancellation. You may refuse to terminate PMI if the borrower is not current on the mortgage.

When you deny a borrower's request to cancel PMI, you must send the notice of the denial not later than 30 days after the borrower's request or, if applicable, 30 days after the borrower satisfies any evidentiary requirements you have regarding other liens on the property or its current value. If you refuse to terminate PMI on the termination date, you must send the borrower written notice of the grounds for refusal not later than 30 days after the termination date.

5. Provide notice to borrower on cancellation or termination of PMI

After informing the mortgage insurer of cancellation or termination, you must send notice to the borrower that you canceled or terminated PMI. You must send this notice not later than 30 days after you have canceled or terminated PMI. The mortgage insurer then has 30 days to return any unearned premiums to you. You, in turn, have 45 days to return the unearned premiums to the borrower.

How do I calculate loan-to-value ratio under the Act?

Value in the loan-to-value ratio is "original value." The Act defines original value as the lesser of the property's sale price or its appraised value when the mortgage was created. This means that PMI is not cancelled or terminated solely based on the property's appreciation. By contrast, a decline in value between the date of the mortgage and the cancellation date provides a basis for denying the borrower's cancellation request. However, regardless of the property's decline in value, automatic termination must occur when the loan-to-value ratio on the mortgage reaches 78 percent of the original value.

The original value definition also applies to the refinancing of home mortgages. For example, suppose you lend a borrower $90,000 for a home valued at $100,000 in 1999. The borrower's home appreciates over the next five years to $200,000 and the principal amount outstanding on the loan is $82,000. On refinancing, the "original value" is still $100,000 (the lesser of the sales price or new appraised value at the time of the refinancing) while the loan increased. This may discourage refinancing because the borrower would not benefit from earlier cancellation and termination of PMI under the Act. Note the Act does not forbid use of the appraised value to calculate new PMI cancellation or termination dates.

When must I cancel a borrower's PMI?

A lender must cancel a borrower's PMI when:

1. The borrower's loan-to-value ratio reaches 80 percent;
2. The borrower makes a written request;
3. The borrower provides, on the lender's request, information showing that the property has not declined in nor is encumbered by any subordinate lien; and
4. The borrower has a good payment history.

Borrowers may initiate cancellation procedures once the loan-to-value ratio reaches 80 percent. On receiving a written request, you may then require the borrower to prove that the property securing the mortgage has not declined in value and is unencumbered by any subordinate lien. Thus, if the property has depreciated, or if the borrower has used any of the equity in the home to secure other financing, the Act will not compel you to cancel PMI.

Also, a borrower must have a "good payment history" to cancel PMI. Good payment history means the borrower neither:

1. Made a mortgage payment that was 60 days or longer past due during the 12-month period beginning 24 months before the date on which the mortgage reaches the cancellation date, nor
2. Made a mortgage payment that was 30 days or longer past due during the 12-month period preceding the date on which the mortgage reaches the cancellation date.

To illustrate, suppose a borrower's cancellation date is January 1, 2005. If the borrower made a payment anytime in year 2003 that was more than 60 days late, you may deny the borrower's request to cancel PMI. Alternatively, if the borrower made a payment in year 2004 that was more than 30 days late, you may deny the borrower's request to cancel PMI. Either type of late payment suffices to preclude borrower cancellation of PMI.

When must I automatically terminate a borrower's PMI?

You must automatically terminate PMI when:

1. The loan-to-value ratio reaches 78 percent; and
2. The borrower is current on the payments required by the terms of the loan.

Automatic termination differs from cancellation in a few important ways. First, the loan-to-value ratio triggers automatic termination at 78 percent, rather than at 80 percent. Second, the borrower need not have a good payment history; the payments must only be “current.” Third, you may not consider whether the property has depreciated.

The Act does not define the term “current.” Initially, you will need to decide how to track whether loans are current on the termination date. For example, you may decide that a borrower is not current if one day has passed since the due date of the payment. It may be easier to track a borrower’s status based on the date when you would report them to a credit reporting agency. Choose a method convenient for you.

If the borrower’s loan is not current on the termination date (for example a borrower’s loan would qualify for termination after a payment and that payment is missed), as soon as the borrower is current, you must terminate PMI.

<u>Final termination at mid-point</u>

Assuming the borrower does not qualify for termination or cancellation earlier and is current on the loan, you must terminate PMI if on the first day of the month after the mid-point of the loan’s amortization period. For example, the mid-point on a 30-year loan is the 1st day of the 181st month. If a mortgage bears a high rate of interest, it will reach the mid-point of amortization before reaching the 80 percent or 78 percent loan-to-value ratio that triggers eligibility for cancellation or termination, respectively. Make reference to your amortization schedules in applying this rule to individual loans.

Are there any exceptions to the cancellation or automatic termination rules?

The Act excepts “high-risk” loans from the usual cancellation and termination rules. Congress intended to give lenders more flexibility to keep PMI beyond the cancellation and termination dates for high-risk loans.

This exception has little practical effect at present because the term “high-risk loan” has not been defined. The Act charges Fannie Mae and Freddie Mac with the duty of defining the term as it applies to loans under $240,000 but neither organization has done so. Thus, for any loan with an original principal balance under $240,000, the high-risk rules and exemptions in the Act do not apply. If the organization defines high-risk as it applies to loans under $240,000, the exception may become important. In that event, consult your counsel to determine the impact of the exception on the cancellation and termination rules.

For loans you originate over $240,000, you may establish policies for deciding if they are high-risk. If you do so, you must disclose two additional things to a borrower whose loan exceeds $240,000 and is classified as high-risk at closing: first, that you consider the loan high-risk; second, if any of the high-risk exemptions apply to that loan. Also, if you self-classify a loan as high-risk, all borrower-paid PMI must stop when the loan-to-value ratio reaches 77 percent. Even borrowers who neither have a good payment history nor are current on the loan would qualify for termination of PMI at that point. If you choose to adopt your own classification procedure for loans over $240,000, consult your counsel.

What must I disclose to borrowers who entered into mortgages before July 29, 1999 (the effective date of the Act)?

The Act's cancellation, automatic termination, or final termination protections do not extend to borrowers who entered into mortgages before the effective date of the Act. However, the Act does specify that you must send these borrowers an annual notice that PMI may be canceled in certain circumstances, for example under applicable law or with your consent. Also, you must provide an address and telephone number that the borrower may use to find out whether the borrower may cancel PMI.

The Act will not preempt state laws offering greater protections for cancellation and termination of PMI. California, Connecticut, Maryland, Minnesota, Missouri, New York, North Carolina, Oregon, Texas, and Virginia offer greater protections than available under the Act. Your notification to a borrower in one of these states should include disclosure of the borrower's rights in that state. Even if the borrower does not reside in a state offering greater protection to borrowers, you still must send an annual notice. Also, as stated above, if you have a policy on cancellation or termination of PMI, you should disclose those policies in the annual notice.

The annual notice may be given as part of an annual escrow account statement required under RESPA or as part of the disclosure of interest payments required by the Internal Revenue Service. The Act also permits the use of standardized forms for this purpose.

Must I follow the disclosure, cancellation, or termination rules when I pay PMI on a loan?

No. Lender-paid private mortgage insurance (LPMI) is subject to different requirements than borrower-paid PMI. Lender-paid PMI is not subject to any cancellation or termination rules in the Act. Disclosure requirements for lender-paid PMI differ from borrower-paid PMI disclosure requirements.

Lender-paid PMI Disclosure

Before or on the date of the loan closing, you must provide the borrower with written notice detailing the differences between lender- and borrower-paid PMI. You must also send written notice to the borrower not later than 30 days from the date PMI would have been terminated under the Act had it been borrower-paid. This notice must include a statement that the borrower may wish to review financing choices that could eliminate the need for lender-paid PMI.

Must I return unearned PMI premiums to the borrower?

Yes. Within 45 days of cancellation or termination, you must return unearned PMI premiums to the borrower. The mortgage insurer must return unearned premiums to you within 30 days.

May I charge any fees connected with disclosure?

No. The Act specifically forbids charging borrowers for disclosure or information provided under its terms.

What procedures will the Farm Credit Administration follow in enforcing the Act?

The Farm Credit Administration (FCA) is responsible for enforcing compliance with the Act among Farm Credit System institutions. When FCA examiners encounter a violation of the Act, they will notify you of the violation and require you to adjust the borrower's account to compensate for the violation. Corrective steps include requiring you to return any unearned PMI premiums to the borrower.

What if I do not comply with the Act?

System lenders are subject to civil liability for violations of the Act.

In actions brought by an individual, the borrower may recover actual damages, statutory damages (not to exceed $2,000), and costs and reasonable attorneys fees. In actions brought by a class, or series of classes, based on the same violation, the class may recover damages not exceeding the lesser of $500,000, or 1 percent of your net worth.