Private Mortgage Insurance (PMI)

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New Law Requires Lenders to Cancel PMI

If you are a homeowner, you will want to be aware of a new law that establishes rights for homeowners and rules for lenders regarding private mortgage insurance (PMI) cancellation. With this knowledge, you may eliminate premiums you may be paying unnecessarily.

What Is PMI?

PMI is extra insurance that lenders require from most homebuyers who obtain loans that are more than 80 percent of their new home's value. In other words, buyers with less than a 20 percent down payment are normally required to pay PMI.

Benefits of PMI

PMI plays an important role in the mortgage industry by protecting a lender against loss if a borrower defaults on a loan and by enabling borrowers with less cash to have greater access to homeownership. With this type of insurance, it is possible for you to buy a home with as little as a 3 percent to 5 percent down payment. This means that you can buy a home sooner without waiting years to accumulate a large down payment.

New PMI Requirements

A new federal law, the Homeowner's Protection Act (HPA) of 1998, requires lenders or servicers to provide certain disclosures concerning PMI for loans secured by the consumer's primary residence obtained on or after July 29, 1999. The HPA also contains disclosure provisions for mortgage loans that closed before July 29, 1999. In addition, the HPA includes provisions for borrower-requested cancellation and automatic termination of PMI.

Why a Change in PMI Requirements?

In the past, most lenders honored consumers' requests to drop PMI coverage if their loan balance was paid down to 80 percent of the property value and they had a good payment history. However, consumers were responsible for requesting cancellation and many consumers were not aware of this possibility. Consumers had to keep track of their loan balance to know if they had enough equity and they had to request that the lender discontinue requiring PMI coverage. In many cases, people failed to make this request even after they became eligible, and they paid unnecessary premiums ranging from $250 to $1,200 per year for several years. With the new law, both consumers and lenders share responsibility for how long PMI coverage is required.

The Homeowner's Protection Act (HPA) of 1998

What Loans Are Covered?

Generally, the HPA applies to residential mortgage transactions obtained on or after July 29, 1999, but it also has requirements for loans obtained before that date. This new law does not cover VA and FHA government-guaranteed loans. In addition, the new law has different requirements for loans classified as "high-risk." Although the HPA does not provide the standards for what constitutes a "high risk" loan, it permits Fannie Mae and Freddie Mac to issue guidance for mortgages that conform to secondary market loan limits. Fannie Mae and Freddie Mac are corporations chartered by Congress to create a continuous flow of funds to mortgage lenders in support of homeownership. As of January 1, 2000, mortgages in amounts of $252,700 or less are considered conforming loans. For non-conforming mortgages, the lender may designate mortgage loans as "high risk."

What Is a Residential Mortgage Transaction?

There are four requirements for a transaction to be considered a residential mortgage transaction: (1) a mortgage or deed of trust must be created or retained; (2) the property securing the loan must be a single-family dwelling; (3) the single-family dwelling must be the primary residence of the borrower; and (4) the purpose of the transaction must be to finance the acquisition, initial construction, or refinancing of that dwelling.

How Do You Cancel or Terminate PMI?

Cancellation

Under HPA, you have the right to request cancellation of PMI when you pay down your mortgage to the point that it equals 80 percent of the original purchase price or appraised value of your home at the time the loan was obtained, whichever is less. You also need a good payment history, meaning that you have not been 30 days late with your mortgage payment within a year of your request, or 60 days late within two years. Your lender may require evidence that the value of the property has not declined below its original value and that the property does not have a second mortgage, such as a home equity loan.

Automatic Termination

Under HPA, mortgage lenders or servicers must automatically cancel PMI coverage on most loans, once you pay down your mortgage to 78 percent of the value if you are current on your loan. If the loan is delinquent on the date of automatic termination, the lender must terminate the coverage as soon thereafter as the loan becomes current. Lenders must terminate the coverage within 30 days of cancellation or the automatic termination date, and are not permitted to require PMI premiums after this date. Any unearned premiums must be returned to you within 45 days of the cancellation or termination date.

For high risk loans, mortgage lenders or servicers are required to automatically cancel PMI coverage once the mortgage is paid down to 77 percent of the original value of the property, provided you are current on your loan.

Final Termination

Under HPA, if PMI has not been canceled or otherwise terminated, coverage must be removed when the loan reaches the midpoint of the amortization period. On a 30-year loan with 360 monthly payments, for example, the chronological midpoint would occur after 180 payments. This provision also requires that the borrower must be current on the payments required by the terms of the mortgage. Final termination must occur within 30 days of this date.

What Disclosures Does the HPA Require?

For Loans Obtained on or after July 29, 1999

The HPA establishes three different times when a lender or servicer must notify a consumer of his or her rights. Those times are at loan closing, annually, and upon cancellation or termination of PMI.

The content of these disclosures varies depending on whether: (1) PMI is "borrower-paid PMI" or "lender-paid PMI," (2) the loan is classified as a "fixed rate mortgage" or "adjustable rate mortgage," or (3) the loan is designated as "high risk" or not.

At loan closing, lenders are required to disclose all of the following to borrowers:

- The right to request cancellation of PMI and the date on which this request may be made.
- The requirement that PMI be automatically terminated and the date on which this will occur.
- Any exemptions to the right to cancellation or automatic termination.
- A written initial amortization schedule (fixed-rate loans only).

Annually, your mortgage loan servicer must send borrowers a written statement that discloses:

- The right to cancel or terminate PMI.
- An address and telephone number to contact the loan servicer to determine when PMI may be canceled.

When the PMI coverage is canceled or terminated, a notification must be sent to the consumer stating that:

- PMI has been terminated, and the borrower no longer has PMI coverage.
- No further PMI premiums are due.

The obligation for providing notice of cancellation or termination is with the servicer of the mortgage.

For Loans Obtained before July 29, 1999

An annual statement must be sent to consumers whose mortgages were obtained before July 29, 1999. This statement should explain that under certain circumstances PMI may be canceled (such as with consent of the mortgagee). It should also provide an address and telephone number to contact the loan servicer to determine whether PMI may be canceled.

The HPA's cancellation and automatic termination rules do not apply to loans made before July 29, 1999.

Although parts of the new law apply only to loans obtained on or after July 29, 1999, many lenders report that they plan to follow the HPA's requirements for both new and existing loans. Making a call to your mortgage loan servicer will help you understand exactly how the law applies to you and your mortgage.

What If Your Home Value Has Increased?

When making mortgage payments, most of the payments during the first few years are finance charges. Therefore, it can take 10 to 15 years to pay down a loan to reach 80 percent of the loan value. If the home prices in your area are rising quickly, your property value may increase so that you can reach the 80 percent mark a lot faster. Your property value could also increase due to home improvements that you make to your home.

If you think your home value has increased, you may be able to cancel PMI on your mortgage. Although the new law does not require a mortgage servicer to consider the current property value, you should contact them to see if they are willing to do so. Also, be sure to ask what documentation may be required to demonstrate the higher property value.

To get a better idea of where you stand with your mortgage, try the following formula:

☐	**Line 1 = Present value of your mortgage**
×	
☐	**Multiply by 1.25**
=	
☐	**Line 2 = Minimum value of your property required to cancel PMI**
☐	**Line 3 = Purchase price of your property or a current appraisal that is acceptable to the lender or holder of the mortgage on your property**

- If the value of line 2 is larger than line 3, your lender will probably continue to require PMI.
- If the value of line 2 is less than line 3, you may be able to cancel PMI.

For More Information

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To learn about your specific PMI cancellation policies, call your lender or mortgage servicing firm.

To find more information about mortgage insurance and to use a specific formula to estimate when PMI may be canceled, visit the web site of the Mortgage Insurance Companies of America.

Mortgage Insurance Companies of America
727 15th St, NW, FL 12
Washington, DC 20005-2168
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The U.S. Department of Housing and Urban Development Customer Service Department can answer your questions about PMI and low down-payment loans.

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