Mortgage insurance

Mortgage insurance (also known as **mortgage guarantee**) is an insurance policy which compensates lenders or investors for losses due to the default of a mortgage loan. Mortgage insurance can be either public or private depending upon the insurer. The policy is also known as a mortgage indemnity guarantee (MIG), particularly in the UK.

For example, suppose Ms Smith decides to purchase a house which costs $150,000. She pays 10% ($15,000) down payment and takes out a $135,000 ($150,000-$15,000) mortgage on the remaining 90%. Lenders will often require mortgage insurance for mortgage loans which exceed 80% (the typical cut-off) of the property's sale price. Because of her limited equity, the lender requires that Ms Smith pay for mortgage insurance that protects the lender against her default. The lender then requires the mortgage insurer to provide insurance coverage at, for example, 25% of the $135,000 ($33,750), leaving the lender with an exposure of $101,250. The mortgage insurer will charge a premium for this coverage, which may be paid by either the borrower or the lender. If the borrower defaults and the property is sold at a loss, the insurer will cover the first $33,750 of losses. Coverages offered by mortgage insurers can vary from 20% to 50% and higher.

To obtain public mortgage insurance from the Federal Housing Administration in the United States, Ms. Smith must pay an *upfront mortgage insurance premium* (UFMIP) equal to 1.75 percent of the loan amount at closing.[1] This premium is normally financed by the lender and paid to FHA on the borrower's behalf. Depending on the loan-to-value ratio, there may be a monthly premium as well. The United States Veterans Administration also offers insurance on mortgages.[2]

Private mortgage insurance

Private mortgage insurance is typically required when down payments are below 20%. Rates can range from 0.5% to 6% of the principal of the loan per year based upon loan factors such as the percent of the loan insured, loan-to-value (LTV), fixed or variable, and credit score.[3] The rates may be paid in a single lump sum, annually, monthly, or in some combination of the two (split premiums). In the U.S., payments by the borrower were tax-deductible until 2010.

Borrower-paid private mortgage insurance

BPMI or "Traditional Mortgage Insurance" is a default insurance on mortgage loans provided by private insurance companies and paid for by borrowers. BPMI allows borrowers to obtain a mortgage without having to provide 20% down payment, by covering the lender for the added risk of a high loan-to-value (LTV) mortgage. The US Homeowners Protection Act of 1998 allows for borrowers to request PMI cancellation when the amount owed is reduced to a certain level. The Act requires cancellation of borrower-paid mortgage insurance when a certain date is reached. This date is when the loan is *scheduled* to reach 78% of the original appraised value or sales price is reached, whichever is less, based on the original amortization schedule for fixed-rate loans and the current amortization schedule for adjustable-rate mortgages. BPMI can, under certain circumstances, be cancelled earlier by the servicer ordering a new appraisal showing that the loan balance is less than 80% of the home's value due to appreciation. This generally requires at least two years of on-time payments. Each investor's LTV requirements for PMI cancellation differ based on the age of the loan and current or original occupancy of the home. While the Act applies only to single family primary residences at closing, the investors Fannie Mae and Freddie Mac allow mortgage servicers to follow the same rules for secondary residences. Investment properties typically require lower LTVs.

In Australia, borrowers must pay Lenders Mortgage Insurance (LMI) for home loans over 80% of the purchase price.

Lender-paid private mortgage insurance

LPMI is similar to BPMI except that it is paid for by the lender, and the borrower is often unaware of its existence. LPMI is usually a feature of loans that claim not to require Mortgage Insurance for high LTV loans. The cost of the premium is built into the interest rate charged on the loan.

Contracts

As with other insurance, an insurance policy is part of the insurance transaction. In mortgage insurance, a master policy issued to a bank or other mortgage-holding entity (the policyholder) lays out the terms and conditions of the coverage under insurance certificates. The certificates document the particular characteristics and conditions of each individual loan. The master policy includes various conditions including exclusions (conditions for denying coverage), conditions for notification of loans in default, and claims settlement.[4] The contractual provisions in the master policy have received increased scrutiny since the subprime mortgage crisis in the United States. Master policies generally require timely notice of default include provisions on monthly reports, time to file suit limitations, arbitration agreements, and exclusions for negligence, misrepresentation, and other conditions such as pre-existing environmental contaminants. The exclusions sometimes have "incontestability provisions" which limit the ability of the mortgage insurer to deny coverage for misrepresentations attributed to the policyholder if twelve consecutive payments are made, although these incontestability provisions generally don't apply to outright fraud.[5]

Coverage can be rescinded if misrepresentation or fraud exists. In 2009, the United States District Court for the Central District of California determined that mortgage insurance could not be rescinded "poolwide".[5]

History

Mortgage insurance began in the United States in the 1880s, and the first law on it was passed in New York in 1904. The industry grew in response to the 1920s real estate bubble and was "entirely bankrupted" after the Great Depression. The bankruptcy was related to the industry's involvement in "mortgage pools", an early practice similar to mortgage securitization. The federal government began insuring mortgages in 1934 through the Federal Housing Administration and Veteran's Administration, but after the Great Depression no private mortgage insurance was authorized in the United States until 1956, when Wisconsin passed a law allowing the first post-Depression insurer, Mortgage Guaranty Insurance Corporation, to be chartered. This was followed by a California law in 1961 which would become the standard for other states' mortgage insurance laws. Eventually the National Association of Insurance Commissioners created a model law.[6]

In 1998 the Homeowners Protection Act of 1998 came into effect in 1999 as a federal law of the United States, which requires automatic termination of mortgage insurance in certain cases for homeowners when the loan-to-value on the home reaches 78%; prior to the law, homeowners had limited recourse to cancel[7] and by one estimate, 250,000 homeowners were paying for unnecessary mortgage insurance.[8] Similar state laws existed in eight states at the time of its passage;[9] in 2000, a lawsuit by Eliot Spitzer resulted in refunds due to mortgage insurers lack of compliance with a 1984 New York state law which required insurers to stop charging homeowners after a certain point.[10] These laws may continue to apply; for example, the New York law provides "broader protection".[11]

For Federal Housing Administration-insured loans, the cancellation requirements may be more difficult.[12]

References

1. http://www.fha.com/fha_requirements_mortgage_insurance.cfm
2. Home Loan Guaranty Services. United States Department of Veteran Affairs.
3. Texas Department of Insurance. Private Mortgage Insurance (PMI).
4. Mortgage insurance master policies and other documents are filed with state insurance regulators and are available for public inspection. Some states make these filings available online, such as the State of Washington Office of Insurance's Online Rates and Forms Filing Search. For example, see OIC tracker ID 202889 for the mortgage insurance policy of Republic Mortgage Insurance Company of Florida.
5. Ellison JN. (2010). Emerging Mortgage Insurance Coverage Disputes. Reed Smith LLP. MBA Legal Issues/Regulatory Compliance Conference.
6. Jaffee D. (2006). Monoline Restrictions, with Applications to Mortgage Insurance and Title Insurance. *Review of Industrial Organization*.
7. Federal Reserve Board. The Homeowners Protection Act (HOPA) Revised Examination Procedures. Consumer Affairs CA 04-5.
8. Harney K. (1998). Congress Promises To End Unnecessary Mortgage Insurance Bill. *Daily Press*.
9. Harney K. (1998) New Mortgage Insurance Bill Could End Unnecessary Overpayment. *Daily Press*.
10. Fried JP. (2000). 10,000 Homeowners to Get Mortgage Insurance Refunds. *NY Times*.
11. NY Ins. Section 6503(d) per FAQ: MI CANCELLATION UNDER THE HOMEOWNERS PROTECTION ACT AND REFUNDABLE VS. NON-REFUNDABLE PREMIUM. United Guaranty.

12. McMahon B. (2011). Mortgage Insurance Cancellation: The Myths and Realities. RISMedia.

Source: http://www.answers.com/topic/mortgage-insurance-1?cat=biz-fin
April, 2014