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PRIVATE MORTGAGE INSURANCE

House Bills 5379 and 5380

(Substitutes H-4)

Sponsor: Rep. William Callahan

House Bill 5381 (Substitute H-4)

Sponsor: Rep. Rose Bogardus

House Bill 5382 (Substitute H-4)

Sponsor: Rep. Bob Brown

House Bill 5383 (Substitute H-4)

Sponsor: Rep. Gloria Schermesser

House Bill 5691 (Substitute H-2)

House Bill 5692 (Substitutes H-3)

Sponsor: Rep. Samuel Buzz Thomas III

First Analysis (4-28-98)

Committee: Commerce

THE APPARENT PROBLEM:

Financial institutions that lend people money to purchase homes often require the buyer to purchase insurance that protects the financial institution from default. This insurance, called private mortgage insurance or PMI, is usually required when new, first-time buyers do not have the minimum down payment (usually 20 percent of the purchase price) required by the lending institution to secure the loan.

Once purchased, the PMI insurance policy is renewed annually, generally at a cost of about \$1,200 each year, according to committee testimony. Different from homeowners' insurance, PMI is required by the financial institution (or mortgagee) as a condition of the loan, until the purchasing owner (the mortgagor) has paid a portion of the debt that is specified in the loan agreement as a percentage of equity, typically 20 percent. Usually after reaching the specified threshold, the mortgage agreement specifies that buyers are not required to carry the insurance that protects the financial institution. However, buyers often are unaware of this provision.

In order to alert home buyers to the PMI provisions in their loan agreements and to save them from unnecessary insurance costs, some argue that laws should be passed to require financial institutions that lend money to notify their mortgagors when the equity

threshold has been met. Others argue for more: automatic termination of the insurance coverage once the threshold has been crossed.

THE CONTENT OF THE BILLS:

These seven bills that would amend various acts, or in the case of House Bill 5691, create a new act, in order to require financial institutions and insurance companies to ensure notification of a mortgagor when his or her loan balance dropped below a financial institution's equity requirement.

House Bill 5691 would create a new act that would be called the "mortgage insurance limitation and notification act." The bill would require that any mortgagee who requires private mortgage insurance as a condition of receiving a loan for a single-family owner occupied residence, to provide the following information at the time of the closing: (1) the reason that private mortgage insurance is required; (2) the target percentage of equity to be acquired before the borrower could request cancellation of the insurance; and (3) the conditions under which a mortgagor may terminate the insurance. The bill also would require the mortgagee to annually notify the mortgagor of the conditions by which the insurance may be terminated,

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and to provide an address and telephone number that can be used to make that determination. Under the bill, that notice could be included with any other annual statements required by law. Finally, the bill specifies that compliance with federal law or regulation governing a mortgagor's right to cancel private mortgage insurance would be considered compliance with this bill. The bill would take effect January 1, 1999, and would apply to all mortgages closed on or after that date.

House Bill 5692 would amend the Insurance Code (MCL 500.3020) to require a new provision for written casualty insurance policies. The bill would require that each mortgage guaranty insurance policy issued for a single family owner occupied residence contain a provision that requires the insured to provide the mortgagor with information as required under the "mortgage insurance limitation and notification act."

Each of the remaining five bills is tie-barred to House Bill 5691. Each stipulates that if a financial institution requires private mortgage insurance as a condition of receiving a mortgage loan, the institution (or mortgagee) would be required to provide the information that is required under the "mortgage insurance limitation and notification act." Each bill defines "mortgagee," "mortgage insurance," "mortgagor," and "private mortgage insurance." House Bill 5379 would amend the Savings Bank Act (MCL 487.511a). House Bill 5380 would amend the Mortgage Brokers, Lenders, and Services Licensing Act (MCL 445.1623a). House Bill 5381 would amend the Credit Union Act (MCL 490.10a). House Bill 5382 would amend the Savings and Loan Act (MCL 491.702b). House Bill 5383 would amend the Banking Code (MCL 487.151k).

FISCAL IMPLICATIONS:

Fiscal information is not available.

ARGUMENTS:

For:

Mortgage insurance provides an opportunity for lower-to-middle income people to get a home loan for which they otherwise would not qualify. The insurance makes it possible to buy a home without paying a large down payment. Most financial institutions require private mortgage insurance until 20 percent equity has been attained. While most lenders do not require payment of mortgage insurance beyond that term, few give notice to the borrower. To encourage home

ownership, sound financial and business practices, and to ensure consumer protection, these bills require the lender to inform the borrower when she or he can discontinue private mortgage insurance.

Against:

These bills may increase banking costs, both for financial institutions and borrowers. For example, to accurately ascertain 20 percent home equity might require an appraisal. If so, it is likely those costs will be borne by home buyers.

Against:

These bills may conflict with other states' regulations of financial institutions, and consequently enforcement of out-of-state mortgage companies could prove difficult. Further, mortgages and mortgage-backed securities are traded nationally in the secondary market. It is important that mortgage insurance cancellation procedures imposed on Michigan lenders not be out of step with the requirements of the secondary market to the extent that Michigan mortgages become less desirable in the secondary market. What's more, there is legislation pending before the U.S. Congress in a conference committee (HR 607 and S 318) that would impose uniform standards for lending institutions regarding personal mortgage insurance. The U.S. Senate's version of the legislation includes a provision that would preempt any state legislation that was not in effect as of September 1988. Consequently, it would be wiser for the Michigan legislature to await action at the national level than to pass legislation that may well be superseded by federal law.

Response:

The bills that have passed the U.S. Senate and U.S. House contain very different approaches to PMI regulation. For example, the version that offers the most consumer protection requires that PMI be automatically terminated when it is no longer required to insure against default. No one can predict which, if any, law will be enacted by the U.S. Congress. These bills before the Michigan legislature do not require automatic termination of a PMI policy. Instead, they rely only upon notice, in order to allow consumers the opportunity to save themselves thousands of dollars in unnecessary insurance coverage. So that consumers can act in their own best interest, this legislation simply requires that every private mortgage insurance policy answer three questions, in writing: Why is PMI necessary? For how long? How is it canceled? Answers to these questions would be required in the "mortgage insurance limitation and notification act," in order to

provide basic information to home buyers. These provisions would then be enforced by the Michigan Insurance Bureau, on behalf of Michigan residents.

POSITIONS:

The Financial Institutions Bureau supports House Bill 5691, has no position on House Bill 5692, and opposes House Bills 5379, 5380, 5381, 5382 and 5383. (4-22-98)

The Mortgage Insurance Companies of Michigan support House Bill 5691 and House Bill 5692. (4-22-98)

The Michigan Credit Union League supports the bills. (4-22-98)

The Michigan Bankers Association has withdrawn its opposition to the bills and notes that the enactment of federal PMI legislation is imminent. (4-22-98)

The Mortgage Bankers Association of Michigan does not oppose the bills but prefers pending federal legislation. (4-27-98)

The Michigan League of Savings Institutions opposes House Bills 5379, 5380, 5381, 5382, and 5383, and has no position on House Bills 5691 and 5692. (4-22-98)

Analyst: J. Hunault

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.