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PRIVATE MORTGAGE INSURANCE

Quintin Johnstone*

Private mortgage insurance ("PMI") is an important segment of the home mortgage market and has been a significant contributing factor to the high and growing incidence of occupant home ownership in this country, including particularly occupant home ownership by low- and moderate-income families. PMI is written by private PMI companies that are extensively regulated by state laws that in important respects vary from state to state. But the market role of the PMI companies is also heavily influenced by federal laws that have created and regulated both major competitors of PMI companies and major sources of these companies' business. The competitors are two federal agencies, the Federal Housing Administration ("FHA") and the Veterans Administration ("VA"), each of which insures a large volume of home mortgage loans. The sources of business are two mammoth private companies, the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), each of which was created and is heavily subsidized by the federal government and each of which purchases a high percentage of the mortgages insured by PMI companies. The extensive array of federal laws that has established the market interrelations among these various market participants is a subtle product of political and financial pressures. Many of these laws have changed over time and are vulnerable to further change.

This Article considers the nature of the PMI market and the principal participants in or affecting that market, with emphasis on the laws regulating the participants and the market. Coverage sequentially is as follows: Section I, The Market for Private Mortgage Insurance; Section II, Private Mortgage Insurance Companies and Their Operations; Section III, Government Regulation (reviewing both state and federal laws of relevance to PMI); Section IV, Possible Legal Changes (stressing proposals for

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In preparing this Article, I obtained very helpful information from some of the leaders in the mortgage insurance field. I am most grateful to them for their assistance. However, opinions expressed in the Article are mine.
change in federal law of relevance to PMI); and Section V, Conclusions (including some observations as to how the PMI market and market participants may change in the future).

I. THE MARKET FOR PRIVATE MORTGAGE INSURANCE

The market for home mortgages in the United States is massive. Mortgage debt outstanding on such loans was over $7.3 trillion in mid-2003, with more than 93% of this on 1- to 4-unit family residences. This is up from $5.2 trillion on all home mortgage debt outstanding in 1999, where also 93% was attributable to 1- to 4-unit family residences. A large percentage of these 1- to 4-unit home mortgages are covered by PMI. The market for PMI has long been heavily influenced by the market involvement of both federal agencies and private agencies subsidized by the federal government. Two of these federal agencies, the FHA and the VA, insure mortgage loans and are major competitors of PMI companies in the mortgage insurance market. VA coverage often is

1. The precise figure was $7,397,668,000,000 in mortgage debt outstanding on all home mortgage loans: $6,888,328,000,000 (93.11%) on 1- to 4-unit family residences and $509,340,000,000 (6.89%) on multifamily residences with more than four units. Mortgage Debt Outstanding, 89 FED. RES. BULL. A33 (2003) [hereinafter Mortgage Debt Outstanding, FED. RES. BULL.].

2. Id.

3. For statistical data on the amount of primary PMI mortgage insurance in force and PMI mortgage insurance risk in force, see infra note 35 and accompanying text.

4. Another federal agency, the Department of Agriculture's Rural Housing Service ("RHS"), also insures mortgage loans. Loans are insured by RHS for a variety of rural area needs, such as housing for domestic farm labor and low-income families. U.S. Gen. Accounting Office, Rural Housing Service: Opportunities to Improve Mgmt.: Hearing Before the House Subcomm. on Housing and Comm. Opp., Comm. on Fin. Servs., 108th Cong. (2003) (statement of William B. Shear, Acting Director Financial Markets and Community Investment). In terms of either the number of loans insured or the total dollar amount of all loans insured, the RHS's mortgage insurance program is miniscule compared to that of either the FHA or the VA. U.S. GEN. ACCOUNTING OFFICE, HOMEOWNERSHIP: FHA'S ROLE IN HELPING PEOPLE OBTAIN HOME MORTGAGES 16 n.1 (1996) (report to the Chairman, House Subcommittee on Housing and Community Opportunity, Committee on Banking and Financial Services).

A few states also have mortgage insurance programs, relatively modest in gross volume of coverage compared to that of the PMI companies or the FHA or the VA, in which the state or a state agency insures homes or nonresidential projects serving community needs that otherwise would have difficulty finding adequate financing. For state statutes authorizing such programs, see for example CAL. HEALTH & SAFETY CODE § 51347 (Deering 1997) (for home purchase assistance); id. §§ 129050, 129105 (Deering 1997 & Supp. 2004) (for construction, improvement or expansion of public and nonprofit corporation
referred to as a guaranty rather than insurance, but in essence it is insurance, and in this Article will generally be referred to as mortgage insurance. The FHA share of the home loan mortgage insurance market is much larger than that of the VA, as the VA only insures home mortgage loans of military veterans and, under some circumstances, their spouses. The secondary market for FHA and VA loans is aided considerably by another federal agency, the Government National Mortgage Association ("Ginnie Mae"), a unit within the Department of Housing and Urban Development. Ginnie Mae guarantees the timely payment of principal and interest on securities issued by private institutions backed by pools of federally insured mortgage loans, including loans insured by the FHA and the VA. Most FHA- and VA-insured loans are securitized and most of these securities are guaranteed by Ginnie Mae. Ginnie Mae charges a variety of fees for its services, including guaranty fees and commitment fees. Ginnie Mae has consistently operated at a profit and has never had to exercise its right to borrow funds from the U.S. Treasury in financing its operations.

In the competition among PMI companies and the FHA and the VA, each side has certain advantages over the other in attracting

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5. Many statutes also refer to PMI coverage as "mortgage guaranty insurance." In this article such coverage generally will be referred to merely as "insurance."

6. GINNIE MAE, 2003 ANNUAL REPORT 1 (2004). In fiscal 2003, Ginnie Mae guaranteed the issuance of $215.8 billion in mortgage-backed securities, and the balance of outstanding mortgage-backed securities guaranteed by the agency totaled $473.9 billion at the close of 2003. Id. at iv. Ginnie Mae has guaranteed $2 trillion of mortgage-backed securities in the past 35 years. Id.

7. In fiscal year 2003, 92.6% of the combined total of loans insured by the FHA and the VA were guaranteed by Ginnie Mae. Id. at 1. Losses covered by Ginnie Mae guarantees of FHA- and VA-insured loans are described in the 2002 Annual Report:

Ginnie Mae incurs losses when FHA and VA insurance and guarantees do not cover expenses that result from issuer defaults. Such expenses include (1) unrecoverable losses on individual mortgage defaults because of coverage limitations on mortgage insurance or guarantees, (2) ineligible mortgages included in defaulted Ginnie Mae pools, (3) improper use of proceeds by an issuer, and (4) non-reimbursable administrative expenses and costs incurred to service and liquidate portfolios of defaulted issuers.


8. GINNIE MAE, 2003 ANNUAL REPORT, supra note 6, at 20.

9. Id. at 25.
customers for their home mortgage insurance coverage.\textsuperscript{10} Among the advantages of FHA and VA coverage over PMI coverage are that underwriting standards for FHA and VA coverage are less strict than those for PMI companies, an attraction particularly to lower-income home buyers. The FHA also has a competitive advantage in that it insures the full amount of the mortgage loan loss, whereas PMI typically insures only the top 20 to 30\% of any such loss\textsuperscript{11} and the VA only insures 50\% or less.\textsuperscript{12} And some borrowers and some lenders apparently feel more protected if their loans are insured by the federal government than if they have private insurer protection, another competitive advantage of the FHA and the VA over PMI coverage. Advantages of PMI over FHA or VA coverage in attracting mortgage insurer customers include lower cost than FHA coverage;\textsuperscript{13} availability for large loans over the maximums that the FHA will insure;\textsuperscript{14} availability for a far greater number of loans than the VA can insure, given the VA's restriction to insuring loans only of qualifying veterans or their spouses;\textsuperscript{15} and lender preference for the more efficient settlement procedures of PMI companies than those of the FHA or the VA. If competition between PMI and FHA-VA mortgages is measured in terms of the number of new insured mortgage originations, in the past several years the PMI companies annually have had more new insured mortgage originations than the FHA and the VA combined.\textsuperscript{16} In 2002, PMI companies had 2.3 million such originations, compared to less than two-thirds that


\textsuperscript{11} \textit{MICA Fact Book 2004-2005}, supra note 10, at 13; \textit{infra} note 37 and accompanying text.

\textsuperscript{12} \textit{Infra} note 201 and accompanying text.


\textsuperscript{14} On the FHA maximums, see \textit{infra} notes 183-84 and accompanying text.

\textsuperscript{15} On these VA loan restrictions, see \textit{infra} notes 194-96 and accompanying text.

many for FHA-VA combined.\textsuperscript{17} The market for mortgage insurance is sufficiently volatile that there is no assurance that this origination volume dominance of PMI over the FHA and the VA will continue over the long term, particularly in periods of acute market volatility.

Despite the risk-spreading advantages of mortgage insurance, some lenders choose to make high loan-to-value residential mortgage loans without such insurance, thereby eliminating the insurance premium cost. In effect, the lender then is self-insuring. A common risk-spreading alternative to mortgage insurance that reduces the scope of lender self-insurance when a buyer is purchasing a home with a high loan-to-value ratio ("LTV") is what is commonly referred to as an 80-10-10 loan. A first mortgage lender and a second mortgage lender share risk in this type of loan arrangement, and the buyer makes a cash payment for a portion of the sale price, commonly 10%. There is no mortgage insurance.\textsuperscript{18} The recent increased volume of 80-10-10 loans has reduced PMI company revenues.

The PMI market has been extensively influenced by two private

\begin{flushright}
\textsuperscript{17} The exact number of PMI company originations in 2002 was 2,305,709, at a total dollar volume of $337,063,000,000, compared to 1,246,561 originations for the FHA, at a total dollar volume of $145,053,000,000, and 328,502 VA originations, at a total dollar volume of $41,945,000,000. \textit{Id.} at 14. In 2003 the PMI originations totaled 2,464,973 at a total dollar volume of $375,700,000,000 (excluding Radian Guaranty), compared to 1,398,499 originations by the FHA at a total dollar volume of $166,387,000,000, and 489,418 originations by the VA at a dollar volume of $63,254,000,000. \textit{Id.}
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\begin{flushright}
\textsuperscript{18} In 80-10-10 loan arrangements, there often is a first mortgage with an 80% LTV, a simultaneous second mortgage with a 10% LTV, and 10% paid in cash by the buyer. An advantage of 80-10-10 loans over high loan-to-value mortgage loans with mortgage insurance is that no mortgage insurance premium need be paid. Also, any added interest cost on the second mortgage is income tax deductible, whereas mortgage insurance premiums are nondeductible. On 80-10-10 loans and their use, see \textit{Genworth Fin., Prospectus: 5.25% Series A Cumulative Preferred Stock 30} (2004) [hereinafter \textit{Genworth Prospectus}]. This 389-page prospectus for stock of the holding company of General Electric Mortgage Insurance Corp. includes considerable background information and data on private mortgage insurance as well as the operation and significance of the GSEs; \textit{see also} Fitch Ratings, \textit{Review and Outlook: 2002-2003, U.S. Private Mortgage Insurance 4-5} (2003) (noting that "[s]ome lenders are aggressively marketing piggyback loans [80-10-10 mortgage loans] as a cost-effective alternative to mortgage insurance. Lenders' attraction to the product partially centers on the high-profit-margin second mortgage, which is usually held in portfolio"). Although 80-10-10 loans apparently are a significant percentage of mortgage originations, data is unavailable as to the total dollar volume of these loans. \textit{MGIC Inv. Corp., 2003 Annual Report 18} (2004) [hereinafter MGIC Ann. Rpt.].
\end{flushright}
companies heavily subsidized by the federal government, Fannie Mae and Freddie Mac. The major functions of Fannie Mae and Freddie Mac are purchasing conventional mortgages, securitizing and selling the securities on a large percentage of these mortgages, and guaranteeing the securities' interest and principal payments. Fannie Mae and Freddie Mac are often referred to as government sponsored enterprises ("GSEs"). The mortgage debt they hold, or that is backed by the outstanding securities they have issued, constitutes almost half of the total outstanding home mortgage debt in the United States on 1- to 4-unit family homes. Fannie Mae and Freddie Mac are private, for-profit, federally chartered, and stockholder-owned corporations whose subsidy benefits from the federal government are very helpful in enabling them to operate on such a vast scale. The influence of Fannie Mae and Freddie Mac on PMI principally is that a substantial proportion of the mortgages they purchase, those with loan-to-value ratios over 80% at the time of origination, generally must have PMI coverage.


20. GSEs have been defined as follows:

In general, GSEs are financial institutions established and chartered by the federal government, as privately owned entities, to facilitate the flow of funds to selected credit markets, such as residential mortgages and agriculture. In addition to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, the Farm Credit System and Farmer Mac [Farmer's Home Administration] are GSEs.

U.S. CONGRESSIONAL BUDGET OFFICE, FEDERAL SUBSIDIES AND THE HOUSING GSEs 1, n.2 (2001) [hereinafter CBO MAY 2001 REPORT]. Another Congressional Budget Office report states that: "The major defining characteristic of a GSE, however, is that the federal government is perceived to back the obligations of the sponsored enterprise with an implicit guarantee." CBO MAY 1996 REPORT, supra note 19, at ix.

21. As of mid-2003, the combined mortgage debt outstanding on one- to four-unit residences in the United States held by Fannie Mae or Freddie Mac, or securitized in securities issued and insured or guaranteed by one of the two companies, was $2,961,700,000,000. MORTGAGE DEBT OUTSTANDING, FED. RES. BULL., supra note 1. Fannie Mae's share of this total was $1,882,342,000,000 ($195,079,000,000 in mortgage debt held by Fannie Mae and $1,687,263,000,000 in mortgage securities issued and insured or guaranteed by Fannie Mae). Freddie Mac's share of the total was $1,079,358,000,000 ($36,941,000,000 in mortgage debt held by Freddie Mac and $1,042,417,000,000 in mortgage securities issued and insured or guaranteed by Freddie Mac). Id.

22. On the mortgages that Fannie Mae and Freddie Mac legally may purchase and why PMI coverage is usually the preferred choice, see infra notes
PMI companies a large share of the home mortgage insurance market. It also provides substantial financial protection to Fannie Mae and Freddie Mac.

II. PRIVATE MORTGAGE INSURANCE COMPANIES AND THEIR OPERATIONS

A. Companies Currently Offering Private Mortgage Insurance

A small number of private companies, currently seven of them, issue substantially all of the primary private mortgage insurance on 1- to 4-unit residential properties in the United States.23 These companies are generally restricted by law to writing mortgage insurance.24 All seven of these PMI companies insure mortgages in all parts of the United States or in large regions of the country, and some of the companies, their parents, or their parent companies'

216-18 and accompanying text.
23. The seven companies are General Electric Mortgage Insurance Corp., Mortgage Guaranty Insurance Corporation, PMI Mortgage Insurance Co., Radian Guaranty Inc., Republic Mortgage Insurance Company, Triad Guaranty Insurance Corporation, and United Guaranty Corporation. All seven companies are subsidiaries of larger companies, some of much larger companies. For example, G.E. Mortgage Insurance is a subsidiary of the General Electric Company, but in 2003 GE commenced the process of spinning off its interest in General Electric Insurance Company and its other insurance subsidiaries. A new company, Genworth Financial, Inc., acquired the assets and liabilities of these companies and a GE subsidiary became owner of most of the stock in Genworth, stock that GE expects shortly to sell. GENWORTH PROSPECTUS, supra note 18, at 5-7. The Genworth subsidiaries may use the GE brand name and logo for up to five years. Id. at 38.

CMG Mortgage Insurance Company, a joint venture equally owned by PMI Mortgage Insurance Co. and CUNA Mutual Investment Group, offers mortgage insurance for loans originated by credit unions. Some reports list CMG as an active PMI company in addition to the other seven. E.g., PMI GROUP, INC., 2003 ANNUAL REPORT 5 (2003) [hereinafter PMI ANN. RPT. 2003]. AGC Holdings, Inc., a company that has been writing some reinsurance, has announced that it intends to start writing primary PMI. MGIC ANN. RPT., supra note 18, at 17; ASSURED GUAR., COMMON SHARES 1 (2004) (stating that this Bermuda-based company had gross written mortgage insurance premiums in 2003 of $24.4 million, in addition to reinsurance premiums. But it is not stated whether any of the mortgage insurance premiums written were on U.S. mortgage loans).

In 1999, two PMI companies, CMAC Investment Corporation and American Corporation, merged to form the Radian Group, parent of Radian Guaranty, Inc. ROBERT P. RYAN & CHRISTINE M. MCELROY, PRIVATE MORTGAGE INS. INDUS.: UPSIDE REMAINS AS EARNINGS RISK DECREASES 40 (2002) (providing an industry-specialty overview by Banc of America Securities). Some industry participants consider more consolidations of PMI companies likely, reducing the number of such companies eventually to possibly as few as four. Id. at 29.

subsidiaries, write mortgage insurance on foreign real property mortgage loans.\textsuperscript{25} In the 1970s, affiliates of PMI companies insured a substantial volume of loans on commercial properties in the United States, but this proved to be too risky; the insurers suffered heavy losses, and they have since withdrawn from offering insurance coverage for those kinds of loans.\textsuperscript{26} Currently, due to the high risk, no PMI company is writing mortgage insurance on commercial property loans. Currently, only two of the PMI companies are writing PMI on second mortgages, another high risk type of coverage, and this insurance is being written by company affiliates. Mortgage insurance is considered a type of property-casualty insurance but, in terms of return on capital, has been much more profitable over the past decade or so than the return on capital for the overall property-casualty insurance sector.\textsuperscript{27} Despite the profitability of PMI companies, there are formidable deterrents to additional companies entering the field.\textsuperscript{28}

The seven PMI companies are highly competitive with one another and with the FHA and the VA in acquiring and retaining lenders as insureds and in reducing costs by increasing operational efficiency. This is reflected in their marketing, in their extensive use of the most advanced technology in providing mortgage insurance services, and in the diverse range of mortgage insurance coverage they offer. This market competitiveness is also reflected in the growing trend for the companies to offer customers ancillary real

\textsuperscript{25} For example, the parent company of one of the seven companies, The PMI Group, Inc., through its subsidiaries, also writes mortgage insurance in Australia, New Zealand, and some European countries. PMI ANN. RPT. 2003, supra note 23, at 22-25. Subsidiaries of Genworth Financial, the parent of G.E. Mortgage Insurance Corp., write mortgage insurance in Canada, Australia, the U.K., and continental Europe. GENWORTH PROSPECTUS, supra note 18, at 132. On mortgage insurance in foreign countries, see also Roger Blood, Mortgage Default Insurance: Credit Enhancement for Homeownership, 16 HOUSING FIN. INT'L, Sept. 2001, at 49; David J. Wallace, Radian Branches Out, MORTGAGE BANKING, Aug. 2004, at 34.

\textsuperscript{26} Blood, supra note 25, at 11.

\textsuperscript{27} At an annual average of about 21%, PMI companies' return on capital has been double or more that of the overall property-casualty insurance sector in recent years. See \textsc{Ryan \& McElroy}, supra note 23, at 45. However, a decline in this favorable PMI company return on capital seems imminent as the housing market becomes less active and competition facing PMI companies increases.

\textsuperscript{28} On these deterrents, see \textsc{Ryan \& McElroy}, supra note 23, at 41-42 (noting that among the deterrents are the financial commitments necessary to acquire the essential credit ratings and the time and resources to attract or develop the necessary skilled personnel, customer relations, and ancillary product offerings). High reserve requirements and legal restrictions on dividend payments are also deterrents.
estate-related services that provide mortgage insurance cross-selling prospects that may also be possible sources of profit. Among these ancillary services that one or more of the private mortgage insurers, their parent companies or their parent companies' subsidiaries now offer are: underwriting assistance to lenders,\(^\text{29}\) homebuyer counseling,\(^\text{30}\) and mortgage information to lenders through a website.\(^\text{31}\) Competition among PMI companies has been particularly intense to insure loans of large lenders, such as savings and loan companies and mortgage banking subsidiaries of commercial banks. This competition has been further enhanced by the increasing number of consolidations that has reduced the number of such large lenders. Some PMI companies have reported recently that their ten top customers have generated an increasingly large percentage of each company's total primary insurance coverage, and in a recent year, that figure was a third or more of this coverage.\(^\text{32}\) Acquiring and keeping these lenders is very important to the financial success of any PMI company.

Although the major PMI companies are highly competitive with one another, they do cooperate with each other through a trade association to which most of them belong. The trade association is the Mortgage Insurance Companies of America ("MICA"), based in Washington, D.C. Founded in 1973, MICA's functions are principally lobbying for PMI company interests, acting as a liaison with other housing trade organizations and the federal secondary market agencies, increasing the efficiency of member operations, and enhancing the general public's understanding of the role of PMI in making home ownership available in this country.\(^\text{33}\) The


\(^{31}\) Schneider, supra note 29, at 41-42.


association has a small full-time staff, and its members are six of
the seven major PMI companies. No other companies are members.
MICA's top officers are mostly presidents and CEOs of member
companies.

B. The Different Types of Private Mortgage Insurance Offered

There are three major types of PMI: primary, pool, and
reinsurance. They are considered separately below.

1. Primary Private Mortgage Insurance

Primary PMI is the form of mortgage insurance that provides
mortgage default protection, at specified coverage percentages, for
individual mortgage loans, and includes a separate insurer
commitment for each loan.\textsuperscript{34} The insureds are lenders, mostly
institutional lenders, such as savings and loan companies,
commercial banks, and mortgage banks. But mortgagors, the
borrowers, are usually responsible for payment of PMI policy
premiums. The total of all mortgages with primary PMI in force
was $733 billion at the close of 2002, up from $598 billion in 1999,
and the total PMI mortgage insurance risk in force for those
mortgages was $165 billion in 2002, up from $139 billion in 1999.\textsuperscript{35}
Some primary PMI results from bulk transactions. A bulk
transaction is one in which the insurer agrees with a lender to
insure a package of mortgage loans.\textsuperscript{36} Many bulk transactions

\begin{itemize}
\item\textsuperscript{34} One PMI company defines primary mortgage insurance as follows:
Primary insurance provides mortgage default protection on
individual loans up to a specified coverage percentage. This coverage
percentage is applied to the unpaid loan principal, plus past due
interest and certain expenses associated with the default (collectively,
the "claim amount"). Upon receipt of a valid claim the Company's
maximum liability is determined by applying the appropriate
coverage percentage to the claim amount.

\item\textsuperscript{35} MICA Fact Book 2003-2004, \textit{supra} note 33, at 13, 21. Excluding
Radian Guaranty, the totals in 2003 were approximately $619 billion in PMI
primary mortgage insurance in force and approximately $139 billion in net PMI

Primary mortgage insurance in force is “[p]rimary mortgage insurance, as
determined by the value of mortgage insurance policies that remain in effect,
based on the original principal amount of mortgages covered by such policies.”
\textit{Genworth Prospectus, supra} note 18, at G-6. Risk in force is “[t]he original
principal amount of mortgage loans, multiplied by the coverage percentage
under the mortgage insurance policies that remain in effect.” \textit{Id.}

\item\textsuperscript{36} A PMI company describes its bulk transaction activity as follows:
PMI acquires primary insurance on a loan-by-loan basis (flow
channel) and in bulk transactions (bulk channel). While their terms
involves loans being securitized.

a. *Risks Covered by Primary PMI.* PMI policies do not cover all of the insured's loss—only a contractually agreed percentage of it. The percentage is generally between the top 20% and the top 30% of the insured's loss claim if loan default and resulting loss to the insured occur.\(^37\) The loss covered by mortgage insurance, known as the claim amount, is calculated pursuant to the insurance agreement and includes a percentage of unpaid loan principal, past due interest, and certain expenses.\(^38\) Occasionally the coverage percentage exceeds the top 30%, with the top 40 percentage about as high as coverage ever goes, except for bulk insurance coverage, which often is 45 to 50% or more. The percentage depends on the perceived risk: the greater the risk, the higher the percentage. The limited percentage of PMI insurance coverage in effect creates a form of co-insurance, as the risk is shared by the insurer and the lender and results in the lender more carefully evaluating loan applications.\(^39\) A lower percentage also may result in a lower

\(^{37}\) One commentator notes:

> For example, if a borrower buys a home for $120,000 and makes a down payment of 5%, a lender can obtain private mortgage insurance on the mortgage amount of $114,000 and reduce its exposure to loss from $114,000 to $79,800. In this example, the mortgage insurance covers the top 30% of the mortgage.


Bulk primary insurance differs from pool insurance in that bulk primary insurance has no aggregate loss limit for all loans in the pool. *See also* RYAN & McELROY, *supra* note 23, at 52 (noting that “[b]ulk transactions, similar to regular flow business, usually involve the insurers’ guarantees on individual loans only and, therefore, are differentiated from pool insurance”). Some bulk transactions individually exceed $1 billion in total principal amount. *Id.* On pool insurance see *infra* notes 70-75 and accompanying text.

37. One commentator notes:

> For example, if a borrower buys a home for $120,000 and makes a down payment of 5%, a lender can obtain private mortgage insurance on the mortgage amount of $114,000 and reduce its exposure to loss from $114,000 to $79,800. In this example, the mortgage insurance covers the top 30% of the mortgage.


38. “The claim amount on a defaulted loan generally includes the outstanding balance on the loan, delinquent interest payments, expenses incurred during foreclosure, costs to maintain the property, and advances the lender made to pay taxes and hazard insurance on the property.” Canner 1996, *supra* note 10, at 1080, n.12.

39. This co-insurance position is asserted in an early study of one of the PMI companies. *See* CHESTER RAPKIN, *The Private Insurance of Home Mortgages: A Study of the Mortgage Guaranty Insurance Corporation, 32-
insurance premium, as the insurer’s exposure then is less than if the percentage were higher. Primary PMI generally has a high risk of borrower default and claim payment on the insured loan. The LTV at the time the insurance was written is an important indication of the extent of the loan risk; the higher the ratio, usually, the higher the risk of default. Most all mortgage loans insured by primary PMI policies have LTV at or above 80%, with many exceeding 90% and some exceeding 97%. Some companies in recent years also have been insuring a substantial number of mortgages at 103% LTV.

This subprime segment of the market has been growing and results in a larger share of the PMI market being high risk.

Master primary PMI policies limit coverage by a series of express exclusions. Typical of such exclusions are fraud, misrepresentation, or negligence by the insured with respect to the mortgage loan that contributed to loan default or increased the claimed loss. Coverage may also be limited if the insured mortgage, when originated, was not a first lien on the mortgaged property; if physical damage to the mortgaged property affects the claimed loss; or if the property was not residential property at the time the mortgage loan was closed and at the time a claim was filed for an insured loss.

b. Duration of Coverage. Primary mortgage insurance policies written by PMI companies generally are for the life of the loan. However, the lender-insured may cancel the policy at any time, the borrower in some circumstances may require the lender to do likewise, and most policies are legally cancelled when the mortgage LTV declines sufficiently. Duration of policies is usually only four

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33 (2d ed. 1973). Rapkin further argues:

This sharing of risk has fostered more careful loan selection than would ordinarily be the case, has encouraged more efficient, humane and responsible servicing, and has promoted a sound basis for property valuation. In essence, this has been an important element in promoting the growth of private mortgage insurance and is essential for its future soundness.

Id. at 33.

40. One of the major mortgage insurance companies, PMI, recently reported the LTV of its primary mortgage insurance in force at the end of 2003 to be as follows: 8.6% over 97 LTV, 7.4% at 97s LTV (between 95.01% and 97.00%), 37.6% at 95s LTV (between 90.01% and 95.00%), 37.0% at 90s LTV (between 85.01% and 90.00%), and the remainder below 90s LTV. PMI ANN. RPT. 2003, supra note 23, at 8. For fairly similar figures at the end of 2003 for another company, see RADIAN ANN. RPT., supra note 30, at 49.

41. See, e.g., England, supra note 29, at 60 (discussing United Guaranty Corporation’s Borrower Advantage Program that over a recent several year period has insured mortgages on 25,000 homes at very high LTV ratios).

42. On legal cancellation of mortgage loans, see infra notes 149-161 and accompanying text.
to five years. Persistency of policies is a serious problem for PMI companies due to the high rate of policy cancellation by lenders, borrowers, or by operation of law. PMI companies maintain data on the persistency rate, defined as the percentage of a company's mortgage insurance in force at the beginning of a 12-month period that remains in force at the end of the period. In a recent year, the persistency rate for individual PMI companies has only been about 50%. Contributing considerably to this low rate has been the recent high rate of both home sales and of mortgage refinancing, as such transactions often are accompanied by cancellations of existing mortgage insurance coverage.

c. **Premiums.** Premiums on primary PMI vary with the apparent risk, and they recently have been ranging between an annual rate of one-half and 2% of the outstanding balance of the insured loan. Among mortgage loans usually falling in the higher percentage range are those with high LTVs, longer-term loans, adjustable rate mortgage loans, and graduated payment loans. Variations also exist among mortgage insurance policies as to when premiums are due. Some premium plans require that the premium be paid annually, with the first premium to be paid in full in advance of the policy going into effect, usually at loan closing. Other premium plans permit the premium to be paid in monthly installments. Permitting premiums to be paid in future installments after closing is often helpful to low-income home buyers, as their financial resources at the time of closing generally are quite limited. When a mortgage insurance policy is terminated or cancelled, the insurer may be obligated to return to the mortgagor any unearned portion of the premium that has been paid. Premiums from mortgage insurance policies are the principal source of PMI companies' income, but investment income is also an important income source.

43. **RYAN & McELROY, supra** note 23, at 50.
44. **Id.**
45. **E.g., MGIC, 47.1% for 2003; MGIC ANN. RPT., supra** note 18, at 7; PMI, 44.6% for 2003, **PMI ANN. RPT. 2003, supra** note 23, at 6; Radian, 46.7% for 2003, **RADIAN ANN. RPT., supra** note 30, at 68; Triad, 50.7% for 2003, **TRIAD GUAR., INC. 2003 ANNUAL REPORT 17 (2004)** [hereinafter **TRIAD ANN. RPT.**]. Persistency rates have varied greatly over the past decade or so. For a listing of such rates by one company for each year from 1993 to 2003, see **PMI ANN. RPT. 2003, supra** note 23, at 7. In 1993, the rate for this company was 70%, in 1995 it was 86.4% and in 2002 it was 56.2%. **Id.**
47. The refund may be required by the terms of the premium plan or, in some circumstances, be required by the Homeowners' Protection Act. On the latter, see **infra** note 150 and accompanying text.
48. One study estimates investment income as 20 to 25% of PMI company
In most primary PMI transactions, the lender obligates the borrower to pay the premiums. However, in an appreciable percentage of PMI transactions, the lender has sole responsibility for paying the premiums. Almost always, in this latter situation, the interest rate is increased to compensate the lender for the premium cost. A borrower advantage of lender-paid premiums compared to borrower-paid premiums is that any increased interest rate resulting from lender-paid premiums is income tax deductible by the borrower.

d. Origination Procedures. Major efforts are made by all mortgage insurers to originate additional new policies that have acceptable risks. Attracting new business is a major concern of all types of insurers but it is particularly so for mortgage insurers, given the high incidence of private mortgage insurance policy cancellation or nonrenewal. Private mortgage insurers advertise to attract new business, with ads directed mostly at lenders. They also have sought to attract more new business by developing more efficient mortgage origination procedures that will reduce this cost to lenders, and usually to the insurers as well. An example of such a procedure is insurers reducing the paperwork needed to apply for mortgage insurance by electronically offering information about the insurance and accepting applications sent electronically. Private mortgage insurers do not charge an application fee to those individuals applying for coverage, an added inducement for new coverage.

A highly important feature of PMI originations is risk income. GEOFFREY M. DUNN, A PRIMER ON THE MORTGAGE INSURANCE INDUSTRY 43 (2003) (a research report of Keefe, Bruyette & Woods, Inc., specialists in banking and financial services). This figure may currently be unrealistically high. Cf. MGIC ANN. RPT., supra note 18, at 4 (reporting investment income as only 14% of MGIC Investment Corp.’s total income in 2003; net premiums earned were 81% of total income); TRIAD ANN. RPT., supra note 44, at 13 (reporting that net investment income and investment capital gains for Triad Guaranty were 14% of total resources in 2003, and earned premiums were 86%).

49. RYAN & McELROY, supra note 23, at 35.


51. No application fee for PMI probably results in more multiple applications for coverage of the same loan. But the percentage of all applications to PMI lenders for home loans that are multiple applications has been low. See Canner 1996, supra note 10, at 1096.
determination, an essential prerequisite to the insurer’s decision of whether or not to underwrite the mortgage and on what terms it is willing to take on the risk of default. Common guidelines considered by private mortgage insurers in determining risk are the borrower’s credit record, nature of the loan, value of the mortgaged property, the housing market, and the risk performance record of the lender. Detailed underwriting guidelines developed by Fannie Mae and Freddie Mac often are followed by private mortgage insurers, especially if the insured lenders are likely to try to sell the mortgages involved to one of these agencies. Of particular importance are requirements imposed by Fannie Mae and Freddie Mac as to financial strength ratings of PMI companies. To be eligible to insure loans that either Fannie Mae or Freddie Mac will purchase, a PMI company must have sufficiently high ratings by private credit rating agencies. All of the major PMI companies currently meet these requirements. Computer automated origination systems have also been developed and are relied on by some mortgage insurers in evaluating mortgage risks. Some PMI companies also largely eliminate their underwriting costs for a

52. The PMI Group has succinctly elaborated on these guidelines as follows:

PMI's underwriting guidelines consider five categories of risk:

Borrower. PMI analyzes the borrower's credit history, including FICO score, the borrower's employment history, income, funds needed for closing and the details of the home purchase.

Loan Characteristics. PMI analyzes four general characteristics of the loan product to quantify risk: (1) LTV; (2) type of loan instrument; (3) type of property; and (4) purpose of the loan. PMI generally does not insure certain categories of loans that are deemed to have an unacceptable level of risk, such as loans with scheduled negative amortization.

Property Profile. PMI reviews appraisals to determine the property value.

Housing Market Profile. PMI places significant emphasis on the condition of regional housing markets in determining its underwriting guidelines. PMI analyzes the factors that impact housing values in each of its major markets and closely monitors regional market activity on a quarterly basis.

Mortgage Lender. PMI tracks the historical risk performance of all customers that hold a master policy. This information is factored into the determination of the loan programs that PMI will approve for various lenders.


53. On these requirements, see infra note 220 and accompanying text.
lender-applicant whom they trust by delegating the underwriting function to that lender when the lender applies to the insurer for primary mortgage insurance coverage. The insurer then periodically monitors the underwriting record of the lender to determine if the delegation should continue for future insurance applications from that lender. The acceptance rate for primary PMI applications is high; in recent years, it has been about 75% for the industry. Acceptance rates do, however, vary among mortgage insurers, as some insurers are less risk averse than others. Accepting higher risk can increase dollar volume of coverage and result in conceivably greater profits but, of course, it carries greater chance of loss.

If the insurer’s response to an application for mortgage insurance is favorable, the insurer issues a commitment to the applicant. The commitment sets forth the terms and conditions pursuant to which the insurer will provide coverage, including, in some cases, any conditions that must be satisfied prior to coverage commencing. Following this commitment, if pre-issuance conditions required in the commitment are met, such as payment of any required advance premium, the insurer issues a certificate of insurance that includes coverage as provided for in a master policy of insurance issued to the lender. Master mortgage insurance policies are rather lengthy documents, usually varying from 25 to 50 pages in length, that set forth the terms and conditions of coverage. In scope and substance, each private mortgage insurer’s policies are much the same, but vary somewhat from state to state so as to comply with the varying laws of different states. Among matters covered in a typical primary master mortgage insurance policy are the default servicing requirements, renewal rights, cancellation rights, exclusions from coverage, losses covered, and claim procedures in case of loss. Some terms in the commitment are incorporated by reference into the policy.

e. Defaults and Claims. The default rate on loans insured by

54. E.g., PMI ANN. RPT. 2003, supra note 23, at 10; RADIUS ANN. RPT., supra note 30, at 32.
55. E.g., PMI ANN. RPT. 2003, supra note 23, at 10. On delegated underwriting, see also Blood, supra note 25, at 16 (“[D]elegated underwriting grew during the 1990s and now accounts for about half of new MI business volume. With delegated underwriting, the lender conveys loan level data to the MI periodically in batch electronic form after insurance has been placed. The MI then audits sample loan files on-site.”).
56. MICA FACTBOOK 2004-2005, supra note 10, at 13. This assumes that all the certificates issued are acceptances.
57. For more information on some of these state requirements, see infra Part III.A.
PMI is high, as is to be expected as most such loans are relatively high-risk.\(^{58}\) PMI claim payments also are high, even though many defaults are cured. From the PMI industry's 1957 revival to 2002, PMI companies paid approximately $15 billion in policy claims.\(^{59}\) The annual PMI default rate varies from year to year and from insurer to insurer, but in recent years the top rate for any company in any one year has been about 6% and the lowest rate for any one company about 2%.\(^{60}\) As mortgage interest rates go up, borrower defaults on insured mortgages will probably increase, as delinquent borrowers will have a more difficult time resolving their delinquencies by selling their homes and paying off their mortgages.\(^{61}\)

PMI policies set out in considerable detail claim procedures and calculations that insureds must follow when making claims. Claims must be filed with the insurer and within time periods prescribed in the policy, and preceded by timely notice to the insurer of loan default. Following notice of default, regular reports to the insurer may be required on the status of the loan and on efforts undertaken to remedy the default. If default occurs, appropriate legal or administrative proceedings by the insured to obtain title to the mortgaged property may be required by the insurer.\(^{62}\) The policy

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59. RYAN & MCELROY, supra note 23, at 34.
60. The highest and lowest primary PMI policy default rates for two of the largest private mortgage insurers in recent years were as follows: MGIC default rates were 2.17% in 1999 and 5.57% in 2003. MGIC ANN. RPT., supra note 18, at 5. PMI Mortgage Ins. Co. default rates were 2.12% in 1999 and 4.53% in 2003, PMI ANN. RPT. 2002, supra note 50, at 18, and PMI ANN. RPT. 2003, supra note 23, at 12. Genworth in 2003 had a default rate of 3.4%. GENWORTH PROSPECTUS, supra note 18, at 173. Radian in 2003 had a primary default rate of only 3.5%. RADIAN ANN. RPT., supra note 30, at 41. Default rates also vary among regions of the country. One company, PMI Mortgage Insurance Co., for 2003 had its lowest regional default rate of 3.18% in the Pacific Region and the highest of 6.50% in the Great Lakes Region. PMI ANN. RPT. 2003, supra note 23, at 12.

1. Appropriate Proceedings means any legal or administrative action by the Insured affecting either a Loan or title to a Property, including:

   a. Preserving a deficiency recovery by making a bid at the foreclosure sale and pursuing a deficiency judgment until the end of the Settlement Period, where appropriate and permissible and where directed by the Company; or

   b. Enforcing the terms of the Loan as allowed by the laws where
may also include a provision expressly authorizing the insurer to provide assistance in loan collection.\textsuperscript{63} PMI companies have developed highly efficient procedures for ascertaining whether a delinquent loan merits workout attention to reduce the risk of ultimate loss payment by the insurer. If workout attention appears merited, loss mitigation efforts are made by the insurer that may include one or more of the following: loan modification, extension of credit to make a loan current, agreement not to foreclose, sale of the property with consent of the borrower and lender, and deed-in-lieu of foreclosure to the insurer.\textsuperscript{64}

Foreclosure is a proceeding commonly brought by lenders following mortgage loan defaults, and lenders usually acquire title to the mortgaged property as the result of the foreclosure proceedings. If a mortgage loan is insured and the insured lender brings foreclosure proceedings, the insurer has the right to instruct the insured as to how much to bid at the foreclosure sale.\textsuperscript{65} If the

\begin{itemize}
  \item[c.] Acquiring Borrower's Title or Good and Merchantable Title to the Property, as either may be required under this Policy, but excluding such title as may be acquired by a voluntary conveyance from the Borrower; or
  \item[d.] Asserting the Insured's interest in the Property in a Borrower's bankruptcy.
\end{itemize}

\textit{Id.} § 1.2. "The insured must begin Appropriate Proceedings no later than when the Loan becomes six (6) months in Default unless the Company [insurer] provides written instructions that some other action be taken." \textit{Id.} § 5.5.

\textsuperscript{63} \textit{E.g.}, \textit{id.} § 5.13 which provides:

Collection Assistance—If the Company so requests, the Insured shall permit the Company to cooperatively assist the Insured in the collection of moneys due under the Loan, including obtaining information from the Borrower, attempting to develop payment schedules acceptable to the Insured, conducting Property inspections and requesting appraisals of the Property.

\textsuperscript{64} On loss mitigation by PMI companies, see \textit{GENWORTH PROSPECTUS}, supra note 18, at 175; \textit{RADIAN ANN. RPT.}, supra note 30, at 43-44. On workout options, aided by such procedures as credit-scoring, that have helped in keeping delinquent borrowers in their homes following mortgage default, see \textit{AMY CREWS CUTTS & RICHARD K. GREEN, INNOVATIVE SERVICING TECHNOLOGY: SMART ENOUGH TO KEEP PEOPLE IN THEIR HOUSES?} (July 2004) (unpublished paper in the Freddie Mac Working Paper Series), available at http://www.freddiemac.com/news/pdfs/fmw_0403_servicing.pdf.

\textsuperscript{65} \textit{E.g.}, \textit{MGIC MASTER POLICY}, supra note 62, § 5.5d. At the foreclosure sale, the insured shall act and bid "so that its ability to preserve, transfer and assign to the Company its rights against the Borrower are not impaired; and so that the rights of the Company under this policy against the Borrower are fully protected." \textit{Id.} The Policy further states:
insured acquires title to the property at the foreclosure sale, the insurer has an option. It may take title to the property from the insured and pay the insured the total claim amount. Or the insurer may elect not to take title to the property but pay the insured the percentage of the claim amount provided for in the mortgage insurance policy, generally 20 to 30%. The reason for the insurer paying the total claim amount under the first option is that the property, if the insurer elects to take title, quite possibly has value considerably above the foreclosure sale price, and to deprive the insured of the property under such circumstances, the insurer must pay the insured's full claim amount. Paying the percentage of the claim amount is the option generally chosen by the insurer. The insurer has a similar option if the insured acquires title pursuant to an agreement following default. Taking title is an insurer loss mitigation approach, but it can involve substantial transaction costs and fluctuating market risks to the insurer when seeking to mitigate loss by reselling after acquiring title. If a third party purchases the mortgaged property at a foreclosure sale, the insurer will pay the insured the lesser of the percentage of the claim amount provided for in the mortgage insurance policy or the insured's actual loss.

Once a PMI company has paid an insured's claim, the insurer may be able to recover some or all of this payment from its subrogation rights. Insurers who write PMI, as do insurers who write other kinds of insurance, generally are subrogated to their insured's rights against those who caused the insured's loss. This means that mortgage insurers occasionally are able to collect from the borrowers some or all of the claim payments made by the insurers to the insureds.

The Insured will be entitled to bid at the foreclosure sale held as part of the Appropriate Proceedings any amount which it determines necessary to obtain Borrower's Title to the Property, unless otherwise directed by the Company. The Company will be entitled to direct the Insured to bid an amount to be determined by the Insured within a minimum and maximum range as follows . . . .

Id. § 5.11.

67. For example, in 2003 PMI selected the percentage of the claim amount option 92% of the time. PMI ANN. RPT. 2003, supra note 23, at 14. Radian did so 99% of the time. RADIAN ANN. RPT., supra note 30, at 17.
69. Unpaid deficiency judgments following foreclosure by the insured lenders are among the rights to which insurers may be subrogated. If an insured lender forecloses, there is an unpaid deficiency judgment and if the insurer's loss payment includes the amount of the deficiency, the insurer is generally subrogated to the insured lender's deficiency judgment rights. If the
2. Pool Insurance

Pool mortgage insurance insures groups of individual mortgages. It generally provides 100% coverage for any default losses on mortgages in the pool but is subject to an aggregate loss limit on all mortgage loans in the pool. The pooling often occurs for the purpose of issuing securities on the assembled mortgages. Securitizing mortgages has emerged as an important development in the securities field. Hundreds of mortgages are often included in a pool. The liability of the pool insurer typically is limited to between 5 and 25% of the original principal balance of mortgages in the pool. Mortgage loans in the pool may or may not have primary mortgage insurance. One form of pool coverage, commonly referred to as modified pool insurance, adds to the aggregate loss limit on all borrower eventually is able to pay the deficiency, the insurer may be able to recover as subrogee for the amount of the claim payment previously paid the insured lender. PMI policies often include provisions amplifying the insurer’s subrogation rights. E.g., MGIC MASTER POLICY, supra note 62, § 7.3, which states:

Subrogation: Subject to Section 7.2(a), and only to the extent that the Company is entitled under applicable law to pursue such deficiency rights, the Company will be subrogated, upon payment of the Loss, in the amount thereof and with an equal priority to all of the Insured’s rights of recovery against a Borrower and any other Person relating to the Loan or to the Property. The Insured must execute and deliver at the request of the Company such instruments and papers and undertake such actions as may be necessary to transfer, assign and secure such rights. The Insured shall refrain from any action, either before or after payment of a Loss, that prejudices such rights.

Id. However, these subrogation rights may be restricted or prohibited in some states by laws governing foreclosure of mortgages covered by mortgage insurance.

70. One PMI company describes pool insurance as follows:
Pool insurance differs from primary insurance in that the maximum liability to the Company is not limited to a specific coverage percentage on each individual loan in the pool. There is an aggregate exposure limit (“stop loss”) on a “pool” of loans that is generally between 1% and 10% of the initial aggregate loan balance.

RADIAN ANN. RPT., supra note 30, at 17.


73. Id.
mortgages in the pool a separate loss limit for each individual mortgage in the pool. Lenders who sell mortgages to Fannie Mae or Freddie Mac are important purchasers of pool insurance from PMI companies. When Fannie Mae or Freddie Mac purchases pools of mortgages, the purchaser commonly charges the seller a guaranty fee to help cover default risks that exceed the primary mortgage insurance and any pool insurance on mortgages in the pool.

At the close of 2002, the total PMI net pool risk-in-force in the United States was $12.3 billion, up from $7.2 billion in 1999. In recent years, pool risk-in-force, net of reinsurance, has been about 5% of all mortgage insurance risk-in-force, the remaining 95% being non-pooled primary mortgage insurance risk-in-force.

3. Reinsurance

PMI reinsurance covers some of the initial insurer’s risk and is a commonly used risk-spreading device. It frequently is used to enable the initial insurer to limit its risk exposure to a maximum percentage on a loan as permitted by some state laws. Reinsurers are generally compensated by receiving a share of insurance premiums from the policies being reinsured. In the prevailing terminology, the initial insurer’s premium share is “ceded” to the reinsurer by the initial insurer. The initial insurer commonly receives a commission from the reinsurer for making the reinsurance agreement, in part to cover transaction costs. When a mortgage insurance policy is reinsured, the initial insurer’s obligation to the insured is not legally discharged but the reinsurer does agree to indemnify the initial insurer for a share of the loss.

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75. RYAN & McELROY, supra note 23, at 37.
76. RADIAN ANN. RPT., supra note 30, at 23, defines reinsurance as follows: Reinsurance is the commitment by one insurance company, the “reinsurer,” to reimburse another insurance company, the “ceding company,” for a specified portion of the insurance risks underwritten by the ceding company. Because the insured party contracts for coverage solely with the ceding company, the failure of the reinsurer to perform does not relieve the ceding company of its obligation to the insured party under the terms of the insurance contract. Similarly, the failure of the ceding company to perform does not relieve the reinsurer’s obligations under the reinsurance contract to the ceding company.
77. PMI ANN. RPT. 2003, supra note 23, at 18.
78. Ceded premiums in any one year by a private mortgage insurer can be substantial. E.g., MGIC ANN. RPT., supra note 18, at 32 (disclosing that in 2003, MGIC had direct earned premiums of $1,484,249,000 and $118,465,000 of ceded premiums).
the reinsurer is unable to pay, the initial insurer must pay for the entire insured loss. 79

The most common form of PMI reinsurance is captive reinsurance, and little reinsurance is now being written on U.S. home mortgage loans other than captive reinsurance. In the captive form of reinsurance, a subsidiary or affiliate of the lender is the reinsurer. Captive reinsurance is often favored by lenders because a subsidiary or affiliate of the lender then obtains the ceded portion of the insurance premium. PMI company revenues are being substantially reduced by the increasing prevalence of captive reinsurance agreements. 80 Large lenders particularly, because of their bargaining power, are able to obtain very favorable agreements for their captives, agreements often referred to as deep-cede captive agreements. 81 One PMI company recently announced that it will refuse to enter into most kinds of deep-cede captive reinsurance agreements currently prevalent in the mortgage insurance market. 82

C. Insurer Resources for Paying Claims

Currently, private mortgage insurers are in a financially strong position to pay claims on their policies when claim payments are due. This strong claim-paying capability has existed since the early 1990s. 83 Substantial recent increases in the volume of new mortgage

79. RADIAN ANN. RPT., supra note 30, at 23.
81. One report notes:
As a result of the lenders' power and influence, to gain their favor, MI companies have been increasingly willing to write insurance that is subject to captive arrangements. Currently, we estimate that between 40% and 50% of the policies the industry writes are subject to captives and a sharing of premiums .... The largest originators are increasingly seeking "deep-cede" excess of loss arrangements, some of which require that the primary insurance provider parts with as much as 40% of a policy's written premium .... We estimate that companies are now ceding between 10% and 20% of the gross premiums they write.
HOCHSTIM & COREN, supra note 80, at 5.
82. That company is Mortgage Guaranty Insurance Corp. On the reasons for and effect of this move, see id. at 20-25; MGIC ANN. RPT., supra note 18, at 8-9. G.E. Mortgage Insurance Corp. also refuses to enter into most captive reinsurance arrangements that involve premium cedes in excess of 25%. See GENWORTH PROSPECTUS, supra note 18, at 169.
insurance written has been helpful in this regard, as it has greatly increased the insurers' premium income. Rising market prices for residential real estate have also been helpful, as these increases have prevented many PMI policy defaults and loss claims.

Of major importance to the PMI industry’s financial strength are the reserves for possible future insured loss claims that PMI companies maintain. There are several kinds of these reserves: contingency reserves, loss reserves, and unearned premium reserves. Contingency reserves usually consist of half of each premium payment earned by the insurer and are generally retained by the insurer for 10 years after they are received, unless losses in a calendar year exceed a certain percentage of earned premiums in that year—that percentage commonly being 35%. If the loss percentage is exceeded, the insurer may withdraw funds from the reserve and use them for paying loss claims. Contingency reserves are safeguards particularly helpful in protecting against the risk of a serious recession in residential real estate and the resulting possibility of insurers being unable to pay insured loss claims.

A loss reserve is established upon delinquency being reported to the insurer and is increased as the delinquency continues. The amount of this loss reserve is what the insurer estimates the insured can validly claim under the policy if the default is not cured. The reserve is maintained until a loss payment on the defaulted loan is paid or the default is cured. The purpose of the loss reserve is to provide added assurance that the insurer will have funds available to meet its liabilities under the policy. This type of reserve also includes some fund allocations for probable losses on insured mortgage defaults that may have occurred but have not been reported to the insurer. These allocations are estimates by the insurer of the claim amounts of any such defaults not reported to the insurer.

84. See generally, e.g., id.
85. The MICA Factbook 2004-2005 notes: The backbone of the [PMI] industry's financial strength is its unique reserve system. This system is designed to enable the industry to withstand a sustained period of heavy defaults arising from serious regional or national economic downturns, as well as routine defaults and claims that occur normally throughout the cycle. Id. at 19.
86. On contingency reserve legal requirements see infra, note 126.
87. On loss reserves, see RYAN & McELROY, supra note 23, at 54; see also infra note 127 for loss reserve legal requirements.
88. See MGIC INVESTMENT CORP., ANNUAL REPORT 2002 8 (2003): [L]oss reserves for future claims are established only for loans that are currently delinquent. (The terms “delinquent” and “default” are used interchangeably by the Company.) Loss reserves are established...
Unearned premium reserves consist principally of premiums paid in advance of the coverage period and remain in the reserve until the premium is earned by lapse of time. These reserves are an added means of assuring that the insurer will have funds available to pay an insured loss on a policy if loss should later occur and to pay any required refunds of premiums. However, a large percentage of current PMI policies provide for monthly payment of premiums, with no payment due at closing, and for those policies, unearned premium reserves are of little significance. The financial reliability of any of the three kinds of reserves is largely dependent on how they are invested. Most PMI company reserves are held in federal, state, or local government bonds and high quality corporate debt obligations, and, while allocated as reserves, cannot be used for purposes other than paying for the kinds of losses for which they are being held. The total dollar amount of reserves held by all private mortgage insurers at any one time is tremendous. At the close of 2002, for the entire PMI industry, it was more than $15 billion.

Another important statistical indication of the PMI industry's ability to pay claims is the percentage of premium income that insurers pay in claims and expenses. In recent years, for the industry as a whole, this has been below 50%, although from 1993 to 1995 it was over 75%. Another statistical percentage indicative of

by management's estimating the number of loans in the Company's inventory of delinquent loans that will not cure their delinquency (historically, a substantial majority of delinquent loans have cured), which is referred to as the claim rate, and further estimating the amount that the Company will pay in claims on the loans that do not cure, which is referred to as claim severity. Estimation of losses that the Company will pay in the future is inherently judgmental. The conditions that affect the claim rate and claim severity include the current and future state of the domestic economy and the current and future strength of local housing markets.

Id.
89. See MICA Fact Book 2004-2005, supra note 10, at 20; infra note 128 for unearned premium legal requirements.
92. See MICA Fact Book 2004-2005, supra note 10, at 20. For particular kinds of reserves, the totals at the close of 2002 in thousands of dollars were these: contingency reserves, $12,788,543; loss reserves, $2,024,966; and unearned reserve premiums, $450,698. The total for all reserves was $15,264,207. Id. This total is almost double the total at the close of 1999. MICA Fact Book 2003-2004, supra note 33, at 20. Excluding Radian Guaranty, the total at the close of 2003 was $11,971,123,000. MICA Fact Book 2004-2005, supra note 10, at 20.
93. MICA Fact Book 2003-2004, supra note 33, at 17. The loss ratio, the ratio of net incurred losses to net earned premiums, between 1999 and 2002, for the entire PMI industry, varied from a low of 14.65% in 2000 to a high of
claim-paying capacity that every private mortgage insurance company calculates annually is the company's risk-to-capital ratio. This is the ratio of net risk exposure from mortgage insurance policies in force to capital, surplus, and contingency reserves available for loss payments. This ratio for the PMI industry as a whole has remained favorably low in recent years, at under 14%. As Section III considers in some detail, many of the business practices of PMI companies that enhance their ability to pay insureds' loss claims are mandated by state or federal law.

D. The Performance Record of Private Mortgage Insurance Companies in Severe Housing Recessions

A cloud that continues to hang over PMI companies' long histories is their catastrophic loss record in certain severe and protracted past housing recession periods. In the pervasive market collapse of the 1930s, a previously thriving mortgage insurance industry collapsed entirely, as all 50 or so PMI companies then in operation became insolvent. Most were based in New York, and these were liquidated by the State of New York. Thereafter, no appreciable amount of PMI insurance was written until 1957 when the Mortgage Guaranty Insurance Corporation ("MGIC") was established in Wisconsin. Other companies later entered the field. Then, in the housing market recession of the 1980s, PMI companies suffered such severe losses that about half of them stopped writing PMI or were prohibited by state insurance commissions from doing so, and one major company failed. Only

21.69% in 2002. MICA FACT BOOK 2004-2005, supra note 10, at 18. Excluding Radian Guaranty, the loss ratio for PMI companies in 2003 was 25.72%. Id.

94. MICA FACT BOOK 2003-2004, supra note 33, at 20-21. The risk-to-capital ratio for the entire PMI industry varied from a low of 11.03% in 2002 to a high of 13.51% in 1999. These figures include both net primary and net pool risk in force. Id. at 21. Concerning risk-to-capital legal requirements, see infra note 130.


96. RAPKIN, supra note 39, at 26.


99. NELSON & WHITMAN, supra note 10, at 72. The PMI company that failed in the 1980s was Ticor Mortgage Insurance. Concerning PMI company
about a dozen companies survived. It is quite obvious that the business practices of present-day PMI companies are much less speculative and risky than those of PMI companies in the 1930s and 1980s, and that legal regulation has been considerably tightened since earlier eras, further reducing company insolvency risks. Arguably, too, as a result of the stressful financial period of the 1980s, PMI companies have been managing risk more effectively, thereby strengthening their financial performance. But the concern remains: PMI companies have been in serious financial trouble in some past severe housing recession periods. Will this happen again when the next such severe recession occurs?

III. GOVERNMENT REGULATION

A. State Regulation

There are two principal objectives apparent in state laws regulating PMI companies. One is to assure the solvency of the PMI companies. The other is to protect the beneficiaries of PMI policies, both borrowers and lenders, from overreaching, incompetence, unduly risky action, and other unacceptable conduct by PMI companies that could be financially damaging to the policy beneficiaries. These two objectives are interrelated, as insolvency

losses in the 1980s and industry reaction, see RYAN & McELROY, supra note 23, at 40 (“The entire private mortgage insurance industry paid less than $300,000 in claims from 1957 through 1979, but paid more than $6 billion in claims in the 1980s”); see also Roger F. Blood, Managing Insured Risk: Which Way Will the Pendulum Swing?, MORTGAGE BANKING, Feb. 1987, at 8; William H. Lacy, MIs: After the Losses, a Second Chance, MORTGAGE BANKING, Sept. 1988, at 79. Lacy was then President and CEO of Mortgage Guaranty Insurance Corporation.

100. NELSON & WHITMAN, supra note 10, at 72.

101. Supporting this position, see, for example, Roger Blood, Managing Insured Mortgage Risk, in THE SECONDARY MORTGAGE MARKET 549 (Jess Lederman ed., 1987); C. Earl Corkett, Breaking with Tradition: New Mortgage Insurance Products for a Changing Environment, in THE SECONDARY MORTGAGE MARKET 575 (Jess Lederman ed., 1987) (Corkett was then Chairman and CEO of the PMI Group); Lacy, supra note 99, at 79.

102. For a brief discussion of objectives of law regulating insurance companies generally in the United States, with comparative consideration of German and Swedish laws, see Spencer L. Kimball, The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law, 45 MINN. L. REV. 471 (1961). The objectives of government regulation of insurance companies in the United States, as well as other countries, are also discussed in JEAN LEMAIRE & KRUPA SUBRAMANIAN, INSURANCE REGULATION IN EUROPE AND THE UNITED STATES (1997), and in Eun Sup Lee, Efficient Regulation of the Insurance Industry to Cope with Global Trends of Deregulation and Liberalisation, 13 BOND L. REV. 46 (2001).
of the insurer can be very damaging to the interests of policy beneficiaries, in addition to the interests of the insurers' creditors and investors. A miscellany of other objectives is apparent in certain state laws regulating PMI companies. Examples of these include limiting a state's expenditures and costs in regulating PMI companies\textsuperscript{103} and preventing discrimination by PMI companies in insuring or extending mortgage insurance.\textsuperscript{104}

Every state has laws regulating PMI companies. Although there is considerable similarity among the states as to what aspects of PMI company structure and operations are legally regulated, there is also considerable variation among the states as to the precise nature of the controls imposed. These variations require that PMI companies, all of whom do business in many states, must adapt to the differing regulatory requirements and be aware of relevant changes in these laws as they occur. State statutes are the basic source of PMI regulations in every state, and the statutory coverage generally is quite comprehensive and detailed. In every state, statutes applicable to most kinds of insurance companies impose extensive legal requirements on PMI companies, and in about half the states, there also are statutes applicable only to PMI companies. In some states, the statutes applicable only to PMI companies are quite detailed.\textsuperscript{105} In others, such coverage is much more limited.\textsuperscript{106} Some added restrictions on PMI companies are imposed by state insurance departments or commissions. Most of these restrictions, to the extent they exist, provide added details and specificity to statutory requirements.\textsuperscript{107} There is relatively little case

\textsuperscript{103} See infra notes 139-140 and accompanying text.

\textsuperscript{104} E.g., N.Y. INS. LAw § 2606(b) (McKinney 2000); N.C. GEN. STAT. § 58-3-25(c) (2003); Wis. ADMIN. CODE, INS. § 3.09(4) (2004) ("No mortgage guaranty insurer may discriminate in the issuance or extension of mortgage guaranty insurance on the basis of the geographic location of the property or the applicant's sex, marital status, race, color, creed or national origin.").

\textsuperscript{105} E.g., ARIZ. REV. STAT. ANN. §§ 20-1541 to 20-1560 (West 2002 & Supp. 2002); CAL. INS. CODE §§ 12640.01-.20 (Deering 1996 & Supp. 2004); N.J. STAT. ANN. §§ 17:46A-1 to 11 (West 1994 & Supp. 2004); N.Y. INS. LAw § 6501-07 (McKinney 2000 & Supp. 2004). A model act, the Mortgage Guaranty Insurance Model Act, has been adopted by the National Association of Insurance Commissioners. MORTGAGE GUAR. INS. MODEL ACT 630-1 (Nat'l Ass'n of Ins. Comm'rs 2004). The model act is quite comprehensive and has been a guide particularly to states adopting detailed statutes on requirements for PMI companies and their operations.


\textsuperscript{107} For example, North Carolina has an extensive body of rules issued by the State Department of Insurance regulating insurance companies. N.C.
law concerning state regulation of PMI companies and their operations that has current relevance to these companies. Among currently relevant state case law concerning regulation of PMI companies are cases in which a borrower-mortgagor made material misrepresentations to the mortgage insurer and cases as to the right of a borrower-mortgagor to terminate mortgage insurance or to be informed of termination rights when the LTV on the insured mortgage declines substantially.

ADMIN. CODE tit. 11 (June 2004). Some of these rules are applicable only to PMI companies. E.g., id. tit. 11, r. 11C.0403-0406 (2004). Wisconsin has a lengthy rule issued by the state's Commissioner of Insurance applicable only to PMI companies. This rule provides very detailed requirements for the transaction of PMI, including underwriting, investment, marketing, rating, accounting, and reserve activities of insurers. WIS. ADMIN. CODE § 3.09 (2004).

108. For cases on the misrepresentation issue, see, for example, Firstier Mortgage Co. v. Investors Mortgage Ins. Co., 930 F.2d 1508, 1511 (10th Cir. 1991) (citing the Oklahoma law that a mortgage insurer may void the insurance policy on becoming aware of material misrepresentation by the borrower-mortgagor in the application for mortgage insurance); Wis. Mortgage Assurance Co. v. HMC Mortgage Corp., 712 F. Supp. 878, 881-82 (C.D. Utah 1989) (agreeing with the Firstier case under Utah law); cf. Fed. Deposit Ins. Corp. v. Verex Assurance, Inc., 48 F.3d 1152 (11th Cir. 1995) (adopting response on Florida law as certified to the Florida Supreme Court, 645 So. 2d 427 (1994) (agreeing with the Firstier case under Florida law in finding statutory conflict at the time the certificates were issued but finding that the state statute had thereafter been altered to moot the outcome).

109. For cases on the cancellation issue, see, for example, Deerman v. Fed. Home Loan Mortgage Corp., 955 F. Supp. 1393 (N.D. Ala. 1997) (holding that, in not canceling mortgage insurance when the borrower-mortgagors acquired sufficient equity in the property, or in not informing the mortgagees of any cancellation rights they might have, the assignee of the mortgagees' interests did not violate the terms of the mortgage contracts, the deceptive trade practices acts of Alabama or New York, or the good faith and fair dealing obligations of the laws of Alabama or New York); Perez v. Citicorp Mortgage Inc., 703 N.E.2d 518 (Ill. App. Ct. 1998) (holding that the mortgagee did not violate the Illinois Consumer Fraud and Deceptive Business Practices Act, did not violate implied covenants of good faith and fair dealing, and was not unjustly enriched by not informing mortgagees of the circumstances under which the mortgagees could cancel their PMI coverage); White v. Mellon Mortg. Co., 995 S.W.2d 795 (Tex. Ct. App. 1999) (holding that a deed of trust holder and servicer did not violate the Texas Deceptive Trade Practices Act, duties of good faith and fair dealing, their fiduciary duties, or the terms of the mortgage contract by failing to inform the owner of property secured by a deed of trust of her right to cancel PMI coverage). The above cases concerning cancellation rights involved loans made before July 29, 1999. Any such loans on residential properties made after that date are subject to the Federal Homeowners Protection Act's disclosure and borrower cancellation rights. The federal act supercedes state laws inconsistent with it. Concerning the Federal Homeowners Protection Act's preemption of state law, see infra note 164 and
Most state statutes regulating the organization and operation of PMI companies fall under one or more of the classificatory headings listed below. Examples of the various kinds of statutory regulations under each of these headings are considered, with footnote citations to some of the state statutes that pertain to each particular type of regulation. No attempt is made to cite all relevant statutes. In selecting which statutes are cited in the footnotes, some preference is given to the statutes of larger population states and states, such as North Carolina and Wisconsin, in which the main office of one or more PMI companies is located. Examples of relevant state insurance department or insurance commission regulations also are added to some of the footnotes.

1. State Licensing or Certification

Mortgage insurance may legally be transacted in a state only by companies with a license or certificate of authority from the state to do so. This is generally a requirement of state laws in this country. To acquire the requisite state approval, a PMI company must meet certain financial, business types, and other limitations imposed by the state. Special licensing requirements commonly apply to foreign insurers, those incorporated or organized in another state, and to alien insurers, which are those incorporated or organized in another country. Unlicensed companies engaged in prohibited insurance activities are, under the laws of many states, subject to criminal sanctions.

110. The main offices of four PMI companies are in North Carolina. These companies are General Electric Mortgage Insurance Corporation, Republic Mortgage Insurance Company, Triad Guaranty Insurance Corporation, and United Guaranty Corporation. Mortgage Guaranty Insurance Corporation’s main office is in Wisconsin. PMI Mortgage Insurance Co.’s main office is in California. The main office of Radian Guaranty, Inc. is in Pennsylvania. Two of the companies are legally domiciled in states other than where their main office is located. Triad Guaranty Insurance Corporation is domiciled in Illinois, and PMI Mortgage Insurance Co. is domiciled in Arizona.

111. E.g., CAL. INS. CODE § 12840.07(a) (Deering 1996 & Supp. 2004); FLA. STAT. ANN. § 635.021 (West 1996); N.Y. INS. LAW § 6503(a) (McKinney 2000 & Supp. 2004); N.C. GEN. STAT. § 58-3-85 (2003) (stating also that officers and agents of noncomplying companies “shall be deemed guilty of a Class I misdemeanor”).

112. E.g., N.Y. INS. LAW § 1106; N.C. GEN. STAT. §§ 58-1-5, 58-16-5 (defining “alien” and “foreign” companies in § 58-1-5, and outlining conditions for foreign and alien insurance companies to do business in North Carolina in § 58-16-5).

113. E.g., CAL. INS. CODE § 700(b); N.C. GEN. STAT. § 58-25-45(h).
2. Businesses In Which PMI Companies May Engage

State statutes permit PMI companies to provide mortgage insurance to lenders in states where the companies are licensed. Some state statutes include a general definition of mortgage insurance, usually referred to as mortgage guaranty insurance, and then add more detailed provisions as to what constitutes permissible mortgage insurance. Other state statutes set forth details as to what is permissible mortgage insurance. Some state statutes, for example, expressly authorize licensed mortgage insurers to insure pools of mortgage loans, and other statutes permit them to insure real estate rentals. And there are state statutes that restrict legally permissible real estate mortgage insurance to insuring real estate loans that certain state or federally regulated lending companies are authorized to make. Some state statutes further restrict permissible mortgage insurance to properties improved with buildings designed for occupancy for residential, industrial or commercial purposes. Many states also legally prohibit a PMI company from writing any kind of insurance other than real estate mortgage insurance, often referred to as a monoline restriction.

114. *E.g.*, N.Y. INS. LAW §§ 6501-02. For the New York general definition of mortgage insurance see *id.* § 6501(a) (“Mortgage guaranty insurance means insurance against financial loss by reason of nonpayment of any sum required to be paid under the terms of any instrument of indebtedness secured by a lien on real estate.”). *See also* CAL. INS. CODE § 12640.02.

115. *E.g.*, N.Y. INS. LAW § 6503(a)(2). Among restrictions imposed by New York are that the outstanding principal balances of mortgages in a pool shall not be less than $5 million; there must be at least 75 mortgages in each pool; and the insurer’s pool mortgage risk in force in any one listed geographic region shall not exceed 30% of the insurer’s mortgage insurance risk in force, net of reinsurance. N.Y. COMP. CODES R. & REGS. tit. 11, §§ 69.1(b), 69.1(c), 69.6 (2004). Forty-five U.S. regions are listed, including larger urban areas, certain states, or groups of states. *Id.*

116. *E.g.*, ARIZ. REV. STAT. § 20-1541-4(c) (1999 & Supp. 2002); CAL. INS. CODE § 12640.02(a)(4); FLA. STAT. ANN. § 635.011(1)(b) (West 1996 & Supp. 2003) (requiring that the lease be for real estate designed to be occupied for industrial or commercial purposes).

117. *E.g.*, FLA. STAT. ANN. § 635.031(2) (“Mortgage guaranty insurance may be written with respect to real estate loans only on those loans which a bank, a savings and loan association, or an insurance company regulated by this state or an agency of the Federal Government is authorized to make.”); N.J. STAT. ANN. § 17-46A-2(b)(1) (West 1994 & Supp. 2003); TEX. REV. CIV. STAT. ANN., art. 21.50, § 1(b)(1)(A) (Vernon Supp. 2003).

118. *E.g.*, ARIZ. REV. STAT. § 20-1541(4); N.J. STAT. ANN. § 17:46A-2(a); TEX. REV. CIV. STAT. ANN., art. 21.50, § 1(a).

119. *E.g.*, CAL. INS. CODE, § 12640.07(a) (Deering 1996 & Supp. 2004); CONN. GEN. STAT. ANN. § 38a-45 (West 2000); IOWA CODE ANN. § 515C.2.2 (West 1998); N.J. STAT. ANN. § 17:46A-4(e)(1) (West 1994); N.Y. INS. LAW § 6508(e).
However, if a company writing mortgage insurance is a subsidiary of a holding company, other subsidiaries of the holding company may engage in other kinds of insurance than mortgage insurance. The major PMI companies are all subsidiaries of holding companies, and subsidiaries of some of these holding companies also write other kinds of insurance than mortgage insurance.

3. Reserves and Other Financial Requirements

Every state imposes financial requirements on PMI companies doing business in their state, requirements varying somewhat from state to state. State laws universally require that substantial reserves must be maintained by PMI companies doing business in the state. The usual type of reserves legally required are contingency reserves, loss reserves, and unearned premium reserves.

120. On the merits of monoline restrictions, especially in prohibiting the same insurer from writing mortgage insurance and title insurance, see Dwight Jaffee, The Monoline Restrictions on Mortgage and Title Insurance (2003) (arguing, in a paper prepared for the Mortgage Insurance Companies of America, that given the vastly greater risk of default in mortgage insurance compared to title insurance, no company should be permitted to write both of these kinds of insurance). On monoline restrictions, see also Jaffee, supra note 95. The scope of the monoline restriction in California law currently is under consideration in an important case now pending before a California appellate court. The case is Radian Guaranty Inc., v. Garamendi. No. A105789 (Cal. Ct. App., Feb. 24, 2004). In 2001, the Radian plaintiffs began selling what they referred to as a Radian Lien Protection Policy (RLP), a pool policy sold only to lenders. A RLP pays for losses if a buyer defaults on mortgage payments due to undisclosed liens on the property. The State Department of Insurance held that RLP coverage was broad enough to include title insurance, as well as mortgage insurance, hence violates the California monoline statute, and the Department issued a cease and desist order. This order was upheld by a California Superior Court when the Radian companies sought a writ of mandate. The Radian companies then appealed and no decision has as yet been reached by the appellate court. All MICA members joined in filing amicus briefs before the insurance commission, trial court and appellate court.


122. E.g., PMI Ann. Rpt. 2003, supra note 23, at 23-25; Radian Ann. Rpt., supra note 30, at 68 (stating that Radian Insurance, Inc. "was formed to write credit insurance on mortgage-related assets that are not permitted to be insured by monoline mortgage guaranty insurers").

123. E.g., Fla. Stat. Ann. § 635.041(1) (West 1996) ("The insurer shall contribute an amount equal to 50% of the earned premiums into the
Another common financial requirement imposed on PMI companies is that, to transact business in a state, a company must maintain a certain minimum amount of paid-in capital and paid-in surplus. One or two million-dollar minimums are common required amounts for either paid-in capital or paid-in surplus. An added contingency reserve ( ). For a similar 50% requirement, see N.Y. INS. LAW § 6502(a)(2) (McKinney 2000). But in some states the amount of the required contingency reserve may vary somewhat from 50% of the earned premium. E.g., CAL. INS. CODE § 12640.04(a) (Deering 1996 & Supp. 2004); N.C. GEN. STAT. § 58-10-135(a) (2003); WIS. ADMIN. CODE § 3.09(14) (2004); N.C. ADMIN. CODE, tit. 11, r. 11C.0403(c) (June 2004).

Contingency reserves may be used to pay the insurer's losses only when those losses are substantial in any one year, more than 35% of earned premiums in any one year being a typical amount. E.g., FLA. STAT. ANN. § 635.041(2) (West 1996 & Supp. 2003) (including a requirement that payment is subject to approval by the insurance department of the insurer's state of domicile); N.Y. INS. LAW § 6502(a)(2) (requiring prior approval of the state superintendent of insurance before resort to the contingency reserve is permitted). Cf. FLA. STAT. ANN. § 635.011(2) (defining contingency reserves as "established for the protection of policyholders against the effect of adverse economic cycles").

Additions to the contingency reserve in any one year must be retained for a set number of months, 120 months in many states, except that earlier withdrawals may be made in some circumstances, such as heavy incurred annual losses. E.g., ARIZ. REV. STAT. ANN. § 20-1556A; CAL. INS. CODE § 12640.04 (Deering 1996 & Supp. 2004); FLA. STAT. ANN. §§ 635.041(3), (4); N.C. GEN. STAT. §§ 58-10-135(d), (e) (noting the Insurance Commissioner must approve early withdrawals).

124. E.g., N.C. GEN. STAT. § 58-10-130(c) ("The case basis method shall be used to determine the loss reserve which shall include a reserve for claims reported and unpaid and a reserve for claims incurred but not reported."). See also ARIZ. REV. STAT. ANN. § 20-1555 (West 2002); CAL. INS. CODE § 12640.16(c) (Deering 1996); WIS. ADMIN. CODE § 3.09(15).

125. E.g., N.C. GEN. STAT. § 58-3-71(a) ("Every insurance company, other than a life or real estate title insurance company, shall maintain reserves equal to the unearned portions of the gross premiums charged on unexpired or unterminated risks and policies"); id., § 58-10-130(a) (stating that unearned premium reserves for mortgage guaranty insurers consist of premiums paid in advance and such advance payments are then released from the reserves at varying percentages each month over the coverage period as provided for in the statute). Wisconsin requires mortgage insurers to maintain unearned premium reserves, and how those reserves must be calculated varies depending on whether premiums are paid in advance for one year or for more than one year. WIS. ADMIN. CODE § 3.09(13). In some states the state insurance commissioner or some other state official or agency is required to determine the method or standards for computing unearned premium reserves. E.g., ARIZ. REV. STAT. ANN. § 20-1554; IOWA CODE ANN. § 515C.3 (West 1998 & Supp. 2004); TEX. REV. CIV. STAT. ANN., art. 21.50, §3 (Vernon Supp. 2004).

126. E.g., N.J. STAT. ANN. § 17-46A-3(a) (West 1994) (requiring a minimum of one million dollars in paid-in capital and a minimum of one million dollars in paid-in surplus); N.Y. INS. LAW § 6502(a)(1) (requiring, for stock companies, a
restriction is the requirement in some states that each PMI company must maintain a risk-to-capital ratio that does not exceed 25 to 1.\textsuperscript{127} Some states also impose minimum policyholder position requirements on mortgage insurers.\textsuperscript{128}

There also are varying restrictions among the states as to investments that PMI companies legally may make. The range of permissible investments is very broad and includes, among others, a wide range of stocks, bonds, notes, other evidence of indebtedness, and real estate.\textsuperscript{129} Restrictions on PMI company dividend payments are an added restriction in some states.\textsuperscript{130}

4. Insurer Policies and Risk Exposure

Most state statutes require that master policies of PMI companies doing business in a state be filed for approval by the

minimum of $1 million in paid-in capital, a minimum of $1 million in paid-in surplus, and a minimum surplus of $500,000 thereafter; and requiring, for mutual insurance companies, a minimum initial surplus of $2 million with a minimum of $1.5 million thereafter); and cf. \textit{Ariz. Rev. Stat. Ann.} § 20-1542(B) (requiring that a stock or a mutual mortgage insurance company must maintain a policyholders' surplus of at least $1,500,000).

127. \textit{E.g.}, \textit{Fla. Stat. Ann.} § 635.042(2) (West 1996 & Supp. 2003) ("A mortgage guaranty insurer must possess sufficient capital and surplus so that the total outstanding aggregate exposure net of reinsurance under mortgage guaranty policies written by the insurer does not exceed twenty-five times its paid-in capital, surplus, and contingency reserve combined."); \textit{N.Y. Ins. Law} § 6502(b)(1) (providing also that "[n]o company which has outstanding total liability exceeding twenty-five times its policyholders' surplus shall transact new business until its total liability no longer exceeds twenty-five times its policyholders' surplus."). The net PMI industry risk-to-capital ratio has in recent years been well below the statutory 25 to 1 maximums. \textit{See supra} note 94.


129. \textit{E.g.}, \textit{Cal. Ins. Code} §§ 12480-12490; \textit{Mich. Comp. Laws Ann.} §§ 500.901-500.947 (West 2002); \textit{N.C. Gen. Stat.} § 58-7-173. A common statutory limitation on investments by PMI companies is a limitation on the amount of any particular security that the company may invest in. \textit{E.g.}, \textit{Cal. Ins. Code} § 12484(h) ("[N]o mortgage insurer shall acquire or invest in stocks, bonds, debentures, or other securities of any corporation in an amount greater than ten per cent of the then authorized, issued and outstanding capital stock of such mortgage insurer or in an amount greater than $25,000, without having first obtained the written consent of the commissioner.").

state's regulatory authority.\textsuperscript{131} In most states, premium rates or rate schedules also must be filed with the appropriate state authority,\textsuperscript{132} and adherence to the filed rate schedules without rebates is an added express requirement in some states.\textsuperscript{133} Exposure of a mortgage insurer on any particular insured loan also is restricted by maximum permissible loan-to-value ratios imposed by some state statutes.\textsuperscript{134} An added risk-spreading requirement imposed on PMI companies by some states is to restrict the amount of insurer exposure on any one housing tract or contiguous tract of land to 10% of the company’s policyholders’ surplus.\textsuperscript{135} Other state statutes affect PMI companies’ risk or loss exposure, some enhancing it\textsuperscript{136} and some limiting it, as by permitting reinsurance of risks with a qualified insurer.\textsuperscript{137}

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134. E.g., Cal. Ins. Code § 12640.07(a)(1) (Deering 1996 & Supp. 2004) (stating that the maximum on insuring loans secured by first mortgage liens is 103% LTV); N.Y. Ins. Law § 6501(c)(1) (requiring 103% LTV for first mortgage liens, but the amount in excess of 100% being used to finance the fees and closing costs on such indebtedness; certain reverse mortgages excepted); Ore. Rev. Stat. § 742.282 (2003) (mandating 95% LTV maximum for first mortgage liens).


136. E.g., N.Y. Ins. Law § 6503(g) (stating that “[a] mortgage insurer may not obtain a deficiency judgment against a borrower in the event of foreclosure”); id. § 6507 (listing rights of a mortgage insurer to reinsure).

137. E.g., Cal. Ins. Code § 12640.11(b) (preventing recovery under mortgage insurance policies if certain types of serious misrepresentation were made to the insurer in application or negotiation for mortgage insurance); N.J. Stat. Ann. § 17:46A-4(c) (stating that “[i]n lieu of paying the percentage of the loan insured as specified in the policy [if an insured loss occurs], a mortgage guaranty insurance company may elect to pay the entire indebtedness to the insured and acquire title to the authorized real estate security”).
5. Enforcement

The insurance department of each state, or an analogous state agency, generally has principal responsibility for enforcing state laws regulating PMI companies doing business in the state. A common enforcement power of these agencies is the right to examine a PMI company's operations, including its books and papers, to verify the company's compliance with the state's laws. In many states, the examination must be made at least every five years.138 The enforcement process is greatly facilitated by requirements on insurers to at least annually make extensive reports of their operations to state authorities.139 In some states, the company being examined must pay the state's costs of making the examination.140 Compliance with a state's laws also is a relevant consideration of state officials in determining whether to license PMI companies141 and whether to approve their master policies and insurance rates.142 Among possible sanctions that can be imposed on PMI companies found not to be in compliance with a state's laws are cease and desist orders143 and license suspension or revocation.144 Agents or employees of insurers also may be guilty of criminal conduct if they violate a state's laws regulating PMI company operations.145 In some states, if it is determined that an insurer doing business in the state is insolvent or seriously impaired financially, the state may

138. E.g., ARIZ. REV. STAT. ANN. § 20-156 (West 2002) (requiring domestic insurers to be examined at least every five years and others when the Director of Insurance deems it advisable); PA. STAT. ANN. tit. 40, § 323.3(b) (West 1999) (requiring examination at least every five years); WIS. STAT. ANN. § 601.43 (West 1995 & Supp. 2003); WIS. ADMIN. CODE § 50.50(1) (2004) (requiring examination at a minimum every five years).

139. E.g., N.C. GEN. STAT. §§ 58-2-165 (2003); N.C. ADMIN. CODE tit. 11, r. 11A.0504, 11C.0403 (June 2004); WIS. STAT. ANN. § 601.42; WIS. ADMIN. CODE § 3.09(12).

140. E.g., PA. STAT. ANN. tit. 40, § 323.7; WIS. STAT. ANN. § 601.45(1), (4) (requiring payment unless it constitutes an unreasonable burden on the examinee).

141. On licensing of PMI companies, see supra notes 111-13 and accompanying text.

142. On such approvals, see supra note 131 and accompanying text.

143. E.g., N.C. GEN. STAT. § 58-28-20 (allowing such orders with right of review by a North Carolina Superior Court); id. § 58-28-25; OR. REV. STAT. § 731.252 (2003).

144. E.g., FLA. STAT. ANN. § 624.418 (West 2004); N.Y. INS. LAW § 1104 (McKinney 2000 & Supp. 2004); N.C. GEN. STAT. § 58-3-100 (2003).

145. E.g., CAL. INS. CODE § 12631 (Deering 1996); see N.C. GEN. STAT. § 58-2-180 (stating that a misstatement of information in statements required by the state insurance law is a felony); id. § 58-3-130 (stating that any person who violates any provisions of the state insurance law shall be deemed guilty of a misdemeanor).
take over the insurer's assets and liquidate or rehabilitate the insurer.\footnote{E.g., CAL. INS. CODE §§ 12629-12629.48; N.C. GEN. STAT. §§ 58-30-1 to 58-30-310; N.Y. INS. LAW §§ 7401-7436; PA. STAT. ANN. tit. 40, §§ 221.1-.63 (West Supp. 2004).}

B. Federal Regulation

1. Federal Regulation of PMI and PMI Companies

The federal government has left most regulation of PMI and PMI companies to the states, but two important federal statutes do impose significant restrictions on the operations of PMI companies. These statutes are the Homeowners' Protection Act\footnote{12 U.S.C. §§ 4901-4910 (2000). This Act was originally enacted in 1998 but amended in 2000. For a summary of the Act's provisions as originally enacted, with added sample disclosure forms and a compliance checklist, see James H. Pannabecker, The Homeowners Protection Act, 116 BANKING L.J. 529 (1999).} ("Act") and the Real Estate Settlement Procedures Act ("RESPA").\footnote{12 U.S.C. §§ 2601-2617. This Act was originally enacted in 1974 and has been amended at various times since. On RESPA, see Paul Barron, Federal Regulation of Real Estate, ¶ 2-1 to 2-54 (rev. ed. 1983); George Lefcoe, Real Estate Transactions 308-13 (4th ed. 2003); Joseph M. Kolar et al., RESPA: The Changing Landscape, 58 BUS. LAW. 1259 (2003); Grant E. Mitchell & Robert M. Jaworski, RESPA and Online Mortgage Lending, PHAC. REAL EST. LAW., May 2002, at 17; Eloisa C. Rodriguez-Dod, RESPA—Questioning Its Effectiveness, 24 HAMLINE L. REV. 68 (2000).} Both acts seek to reduce transaction costs of homeowners who mortgage their homes, either at the time of purchase or later.

The Homeowners' Protection Act is concerned with home mortgage loans that had high LTVs at the time of origination, and the Act is aimed principally at ending PMI and the homeowner's obligation to pay for it when the risk covered by the insurance has largely disappeared. For the Act to apply, the PMI must insure a home mortgage loan on a single-family dwelling that is the primary residence of the mortgagor.\footnote{12 U.S.C. §§ 4901(14).} The Act then provides that, when the principal balance of the loan is first scheduled to reach 78% of the original value of the property securing the loan, the coverage must be terminated.\footnote{Id. §§ 4901(18), 4902(b)-(d). The Act defines original value as follows: "The term 'original value,' with respect to a residential mortgage, means the lesser of the sales price of the property securing the mortgage, as reflected in the contract, or the appraised value at the time at which the subject residential mortgage was consummated." Id. § 4901(12).} This means that when the equity of the mortgagor in the mortgaged property increases sufficiently, as by installment
payments of principal by the mortgagor, termination is required. The Act also provides that the mortgagor has the option to cancel the PMI when the principal balance on the mortgage declines to 80% of the original value of the property. On termination or cancellation authorized by the Act, unearned premiums paid by the mortgagor must be returned to the mortgagor.

Some exceptions apply to the Act's PMI cancellation and termination rights. These rights apply only to mortgages made on or after January 29, 1999, one year after the Act's adoption, and do not apply to certain high-risk loans to PMI paid for by the lender rather than the borrower, or to loans as to which the mortgagor is not current in making payments in accord with required terms of the mortgage. Some added requirements are made by the Act for the right to cancel, requirements not imposed on the right to terminate. The Act also sets a final PMI termination requirement, one that takes effect if the mortgagor's equity in the property becomes substantial. The point at which this final termination occurs is the midpoint in the amortization period, if the mortgagor is then current in making payments required by the terms of the mortgage. At this point, a mortgagor's equity interest in the property would usually be more than 50%.

To assure that mortgagors are informed of their cancellation and termination rights, lenders and servicers of mortgages insured by PMI must, at appropriate times set forth in the Act, inform the mortgagors of their cancellation and termination rights. Any

151. Id. §§ 4901(2), 4902(a).
152. Id. § 4902(f)(1). For a definition of unearned premiums see GENWORTH PROSPECTUS, supra note 18, at p. G-7 (“Unearned premiums [are] [t]he portion of a premium, net of any amount ceded, that represents coverage that has not yet been provided or that will belong to the insurer based on the part of the policy period to elapse in the future.”).
154. Id. § 4902(g)(1). These are mostly loans determined to be high risk by guidelines published by Fannie Mae and Freddie Mac.
155. Id. § 4905(b).
156. Id. § 4902(a)-(c).
157. To cancel, the mortgagor must submit a cancellation request in writing to the mortgage servicer, have a good past payment record in making payments on the mortgage, have evidence that the value of the property securing the mortgage has not declined below the original value of the property, and certify that the equity of the mortgagor in the residence securing the mortgage is unencumbered by a subordinate lien. Id. §§ 4901(12), 4902(a).
158. 12 U.S.C. § 4902(c). This requirement applies to high-risk loans.
159. See id. §§ 4903-4905. No fees or costs may be imposed on mortgagors for these disclosures. Id. § 4906. However, the mortgagors possibly may be indirectly paying for disclosure expenses by somewhat higher interest charges by lenders.
violator of any provision of the Act is civilly liable to the mortgagor for any resulting damages, plus statutory damages not to exceed $2,000. The Act supersedes inconsistent state laws as to mortgage transactions consummated after July 29, 1999. Since the Homeowners' Protection Act went into effect, it has been uncontroversial; there apparently have been no serious compliance or enforcement problems concerning it, and it apparently has been fulfilling its principal purpose of canceling or terminating PMI in transactions covered by the Act when LTVs have reached the point where there is little or no need for this kind of insurance. But the cancellation requirement has tended to put some upward pressure on insurance premiums by eliminating policy coverage in its more profitable period for the insurer.

RESPA imposes restrictions on settlement procedures and their costs in mortgaging 1- to 4-unit residential properties. The Act requires certain disclosures by lenders, mortgage brokers and mortgage servicers that can help borrowers make more informed decisions when contemplating mortgage transactions. But the provisions of RESPA that most affect PMI companies are those prohibiting referral fees or kickbacks that tend to increase unnecessarily the costs of settlement services, services involved in making and closing real estate mortgage loans on residential properties. Mortgage insurance is one of the many kinds of settlement services covered by the Act. Although RESPA and supplemental HUD regulations elaborate extensively on what are and are not unnecessary settlement service charges within the meaning of the Act, considerable ambiguity has remained that has resulted in litigation. The litigation has included cases in recent years against most of the PMI companies. Among alleged violations by PMI companies are that illegal financial benefits by insurers were given to lenders when the insurers discounted rates on pool

160. Id. § 4907(a)(2)(A). In a class action against violators of the Act, total recovery is limited to the lesser of $500,000 or 1% of the net worth of the liable party. Id. § 4907(a)(2)(B).
161. Id. §§ 4903(a)(4), 4908.
162. See id. §§ 2603-05.
163. Id. § 2607.
164. The HUD Secretary is authorized to prescribe rules, regulations and interpretations that are necessary to achieve the purposes of RESPA. One such regulation defines settlement services as including a "provision of services involving mortgage insurance." 24 C.F.R. § 3500.2(b) (2004). Among other settlement services covered by the Act are title examination, title insurance, property surveys, loan processing, and mortgage transaction services of lawyers and real estate agents or brokers. 24 C.F.R. § 3500.2(b); see also 12 U.S.C. § 2601(b)(2).
insurance policies taken out by lenders, and the insurers did so in return for the lenders referring these primary mortgage insurance coverage requests to the insurers.\textsuperscript{165}

Another alleged RESPA violation by PMI companies involves captive reinsurance agreements.\textsuperscript{166} The allegation is that insurers overpaid lenders' subsidiaries for assuming a portion of primary insurance risks, in effect a kickback, and did so to obtain the primary insurance business.\textsuperscript{167} Other alleged RESPA violations by PMI companies to generate insurance referrals are discounted underwriting services for lender insureds and borrowing funds from lender insureds at excessive interest rates.\textsuperscript{168} The court proceedings brought against PMI companies for RESPA violations have generally been brought as class actions. Most of these cases have been settled by agreements under which PMI companies agree to pay large sums in damages and other settlement costs to the plaintiffs.\textsuperscript{169} RESPA kickback or referral fee violators, including PMI companies who violate, are liable to those who were charged for the illegal settlement services, and permitted recovery is three times what was charged.\textsuperscript{170} Violations are also a criminal offense.\textsuperscript{171} Violations may be enjoined by a court in an action brought by the Secretary of HUD or the Attorney General or Insurance Commissioner of any state.\textsuperscript{172} Some states have laws similar to RESPA, and under the McCarran-Ferguson Act, a federal statute,

\textsuperscript{165} This and other alleged RESPA violations by PMI companies were at issue in \textit{Mullinax v. Radian Guar., Inc.}, 199 F. Supp. 2d 311, 314-15 (M.D.N.C. 2002). One alleged effect of the kickbacks in \textit{Mullinax} was that, instead of competing for borrowers' business by offering lower prices, the insurer allegedly overcharged the borrowers and then used these excess profits to reward the lenders, who referred their borrowers to the insurer for the purchase of primary mortgage insurance. Radian prevailed in this case. \textit{Id.} at 336.

\textsuperscript{166} On captive reinsurance, see \textit{supra} notes 80-82 and accompanying text.

\textsuperscript{167} \textit{See Mullinax}, 199 F. Supp. 2d at 315.

\textsuperscript{168} \textit{Id.}


\textsuperscript{170} 12 U.S.C. § 2607(d)(2). Cases that have considered the question of the amount of the damages have concluded that the permitted recovery is three times the overcharge. \textit{E.g.}, \textit{Durr v. Intercounty Title Co.}, 14 F.3d 1183, 1185 (7th Cir. 1994); \textit{Mullinax v. Radian Guar.}, Inc., 311 F. Supp. 2d 474, 484 (M.D.N.C. 2004).

\textsuperscript{171} 12 U.S.C. § 2607(d)(1).

\textsuperscript{172} \textit{Id.} § 2607(d)(4).
no federal statute, with certain exceptions, shall override a state law regulating the business of insurance unless the federal law specifically relates to the business of insurance.\footnote{173} RESPA, in prohibiting kickbacks and referral fees by PMI companies, has been held by one federal court in a case against a PMI company to be a federal statute sufficiently related to the business of insurance, including mortgage insurance, to override state law concerning similar conduct.\footnote{174}

2. Federal Regulation of the FHA and the VA

Although the federal government has left most legal regulation of PMI companies to the states, its laws creating and regulating the activities of certain major participants in the home mortgage market have tremendous significance for PMI companies and their operations. Two of these market participants, the FHA and the VA, are major competitors of PMI companies. Both the FHA and the VA are federal agencies and subject to extensive federal statutory requirements and restrictions as to the mortgage insurance they provide.\footnote{175} Federal statutes also delegate to the FHA and the VA the

\footnote{173} The McCarran-Ferguson Act, 15 U.S.C. § 1012(b) (2000), states:
No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically relates to the business of insurance: [but the Sherman Act, Clayton Act and Federal Trade Commission Act] shall be applicable to the business of insurance to the extent that such business is not regulated by State law.


\footnote{174} Patton v. Triad Guar. Ins. Corp., 277 F.3d 1294, 1298 (11th Cir. 2002). This case also holds that the McCarran-Ferguson Act only protects against inadvertent federal regulation of insurance. \textit{Id.} at 1300. Compare Mullinax, 199 F. Supp. 2d 311, another RESPA kickback case, against a PMI company that holds a North Carolina law does not preempt RESPA under the McCarran-Ferguson Act. And RESPA can prevail because RESPA does not sufficiently impair the North Carolina law, so it is not necessary to determine if RESPA specifically relates to insurance concerning similar conduct. \textit{Id.} at 323.

\footnote{175} See generally 12 U.S.C.A. §§ 1706c to 1715z-22a (West 2001 & West Supp. 2004) (FHA); 38 U.S.C.A. §§ 3701-3764 (West 2002 & West Supp. 2004) (VA). The FHA's largest mortgage insurance program is the one insuring 1- to 4-unit homes. But it has a number of mortgage insurance programs for other kinds of residential properties. Among these programs, and their statutory authorization, are programs for certain rental housing projects, 12 U.S.C.A. § 1713; cooperative housing, \textit{id.} § 1715e; rehabilitation and neighborhood conservation housing, \textit{id.} § 1715k; multiunit housing for the elderly, \textit{id.} § 1715v; and nursing homes, intermediate care facilities, and board and care homes, 12 U.S.C. § 1715w (2000). The statutory authorization of the Rural Housing
authority to further regulate their operations and the terms of their insurance or guaranty coverage. This has resulted in very detailed agency regulations. The statutes and agency regulations determine to a large extent how competitive the FHA and the VA are with PMI companies. These statutes and regulations also have frequently been amended, an indication of the sensitivity of the political process to the agencies' mortgage insurance operations.

Most aspects of the FHA's mortgage insurance of home mortgage loans on 1- to 4-unit residential properties are regulated by federal laws. Federal statutes require that all mortgages insured by the FHA must be first liens on the mortgage property and lenders must be approved by HUD as responsible and able to service the mortgage property. A direct endorsement underwriting program exists for lenders who qualify. This is similar to the delegated underwriting adopted by some PMI companies. Mortgages submitted by a lender who meets program qualification requirements will be insured by the FHA in reliance on the lender's underwriting, the lender being responsible for determining the eligibility of the mortgages for insurance as required by applicable FHA regulations. Legal limits are imposed on the maximum dollar amount of a mortgage loan that the FHA is authorized to insure, limits that frequently have been increased and that vary between high-cost geographic areas and other areas. At present, under applicable statutory formulas, these limits on single-family homes range from $160,176 in standard cost areas to $290,319 in high cost areas. Added legal restrictions on FHA mortgage

Service mortgage insurance program is 7 U.S.C.A. §§ 1929(h), (j) (West 1999 & West Supp. 2004). On this federal agency program, which is far more limited in volume than that of the FHA or the VA, see also supra note 4.

176. For the FHA, see, for example, 12 U.S.C.A. § 1709 (West 2001 & West Supp. 2004); for the VA, see, e.g., 38 U.S.C.A. § 3703 (West 2002 & West Supp. 2004). Federal statutes and regulations that delegate authority to the FHA or the VA usually delegate the authority nominally to the HUD Secretary or the Secretary of Veterans' Affairs. But this delegation generally includes anyone authorized to act for the HUD Secretary or Secretary of Veterans' Affairs. See, e.g., 38 C.F.R. § 36.4301 (2003) (defining the term "Secretary").


180. Id. § 1715z-21; see also 24 C.F.R. §§ 203.3-203.6 (2004).
181. On PMI company programs, see supra note 55 and accompanying text.
182. 24 C.F.R. § 203.5(a).
184. Higher limits are set for two-family, three-family and four-family
insurance are limits on the LTVs of home mortgage loans that the FHA may insure. These LTVs are high, varying from slightly above to slightly below 100%, somewhat lower for mortgaged properties with higher appraised values.185

The legally imposed mortgage insurance premium for most 1-to 4-unit FHA-insured home mortgage loans is an upfront one-time payment not exceeding 2.5%, approved by the HUD Secretary,186 plus an annual premium of 0.50% of the remaining insured principal balance.187 For many FHA-insured home mortgage loans, the obligation to make annual mortgage insurance premium payments continues for only part of the loan term.188 FHA home loan mortgage insurance may be terminated without a termination fee at the request of the mortgagor and mortgagee.189 An important feature of FHA mortgage insurance is that, unlike PMI or VA coverage, the

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185. The LTVs range from 98.75 for mortgaged properties with an appraised value less than $50,000 to 97.15 for mortgaged properties with an appraised value in excess of $125,000. 12 U.S.C.A. § 1709(b)(2)(B)(ii) (West 2001 & Supp. 2004). However, these LTVs can be slightly higher, as the amount of any upfront mortgage insurance premium paid at the time the mortgage is insured is added to the appraised value of the property for purposes of calculating these LTVs. Id. § 1709(b)(2)(B)(i). An added proviso is that a mortgage over 97% LTV executed by a first-time homebuyer may not be insured by the FHA unless the mortgagor has completed an FHA-approved “program of counseling with respect to the responsibilities and financial management involved in homeownership.” Id. § 1709(b)(2). This requirement, however, may be waived by the FHA. Id.
188. Id. For loans with principal obligations of less than 90% LTV at the time the mortgage was accepted for insurance, the annual premium payment obligation is only for the first eleven years of the mortgage term. But for loans with 90% or more LTV at time of mortgage origination, the annual payment is for the first 30 years of the mortgage term. Id. A 4% penalty sum is added to any late payment. 24 C.F.R. § 203.265(a) (2004).
FHA insures the full amount of the mortgage loan. 190

VA mortgage guaranty operations also are extensively regulated by federal statutes and regulations. With minor exceptions, it is legally required that to qualify for VA insurance (guarantee), the mortgage being insured must be a first lien on the mortgaged property. 191 Home loans by most any lender can qualify for VA coverage, but advance loan underwriting approval by the VA is not required for most important classes of lenders to acquire such coverage. 192 Lenders who are exempt from the necessity of obtaining advance underwriting approval from the VA are then obligated to submit loans for VA coverage that meet the VA requirements for coverage. Failure to comply with this obligation, or engaging in other practices prejudicial to the interests of veterans or the government, may result in this exempt status being withdrawn. 193

Only veterans and, under some circumstances, the spouses of veterans may qualify for VA home mortgage insurance. Most people who have served more than six months in the armed forces of the United States, if credit-worthy, are considered veterans entitled to VA home mortgage insurance. 194 The spouse of a veteran qualifies and has the same rights to coverage if jointly liable with the veteran on the insured loan 195 and is also entitled to VA coverage if the veteran died in active military service or from a service-connected disability. 196 However, to qualify, the veteran or spouse also must be a satisfactory credit risk, and this is determined by the VA's credit underwriting standards. 197

192. Automatic exemption from loan approval by the VA is generally granted any bank or other lender that is subject to examination and supervision by the federal government or any state, by any state agency, or by other lenders approved by the VA. 38 U.S.C.A. § 3702(d) (West 2002); 38 C.F.R. §§ 36.4202, 36.4301 (2003) (defining “automatic lender”); 38 C.F.R. §§ 36.4349 (2003).
193. 38 U.S.C.A. § 3702(e) (West 2002); 38 C.F.R. § 36.4349. More serious lender offenses may result in the lender being excluded from participating in further loan insurance transactions with the VA. 38 C.F.R. §§ 44.300-44.325.
194. This includes those on active duty in the armed forces. 38 U.S.C. § 3701(b)(4) (2000). A shorter period of service than six months is sufficient to qualify for those who served in World War II or certain other military conflicts. Id. § 3701(b)(1); 38 U.S.C.A. § 3702(a)(2) (West 2002). Also, those discharged or released from active duty due to service connected disabilities can qualify. 38 U.S.C.A. § 3702(a)(2)(B) (West 2002). Persons who have completed at least six years of service in the selected reserve also may qualify. 38 U.S.C. § 3701(b)(5) (2000).
196. Id. § 3701(b)(2).
197. Id. §§ 3710(b)(3), 3710(g)(2), 3712(e)(2), 3712(g). For the VA's
VA home mortgage insurance is available only for residential properties that the veteran is purchasing, constructing, or improving. But the residence may be on farm property the veteran is acquiring, a one-family unit in a condominium, or a manufactured home to be permanently affixed to a lot that the veteran owns. To qualify for VA mortgage insurance the residence must be the veteran's home or one the veteran intends to occupy as his or her home. No limit is imposed on the size of a home mortgage loan that the VA may insure, except that the loan may not exceed the reasonable value of the mortgaged property. Loans at 100% of LTV thus may be insured, which means that for such loans the veterans need make no cash down payment at the time of loan origination. But there are substantial limits on the percentage of any home loan that can be covered by the VA. The percentage varies between 50% and somewhat under 25%, the smaller the original principal loan, the higher the percentage. A funding fee, analogous to an insurance premium, is charged for housing loans that the VA insures. This fee, payable at insurance of the loan, commonly is 2%, but can vary between 3.3% and .50%, depending on such factors as the type of veteran, amount of down payment and type of mortgaged property. A penalty of 4% of the total fee due is charged for late payment of the funding fee. However, the veteran may be required to pay certain mortgage loan and insurance origination fees, such as those for appraisal, recording, and credit reports. The mortgage debt may be repaid at any time, but no fee may be charged for the prepayment.

underwriting standards, see 38 C.F.R. § 36.4337.

199. Id. §§ 3704(c), 3710(a), 3710(e)(1)(F).
200. Id. § 3710(b)(5). Further restrictions on the amount that will be guaranteed may be imposed on loans to refinance prior loans. Id. § 3710(b)(7)-(8).

201. 38 U.S.C.A. § 3703(a)(1)(A) (West 2002); 38 C.F.R. § 36.4302(a) (2003). The variations are these: 50% for original loan amounts of $45,000 or less; $22,500 if the original loan amount exceeds $45,000 but is not more than $56,250; the lesser of $36,000 or 40% of the original loan amount if the original loan amount is over $56,250 but less than $144,000; and the lesser of $60,000 or 25% of the original loan amount if the original loan amount is over $144,000. 38 C.F.R. § 36.4302(a).

202. 38 U.S.C.A. § 3729(b) (West Supp. 2004). But no fee may be collected from a veteran receiving compensation for service-connected disability or the surviving spouse of a veteran who died from a service-connected disability. Id. § 3729(c).

204. Id. § 36.4312(d).
205. Id. § 36.4310.
3. Federal Regulation of Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac are federally chartered, private corporations. The stock of each is listed on the New York Stock Exchange and held by many thousands of stockholders. The original Fannie Mae was first authorized by Congress in 1934 and chartered as a corporation wholly owned by the federal government in 1938. In 1968, the original Fannie Mae was partitioned into two separate but distinct corporations, one retaining the original Fannie Mae name of Federal National Mortgage Association, and the other to be known as the Government National Mortgage Association ("Ginnie Mae"). The new Fannie Mae is not only a private company but also a GSE. Ginnie Mae is a federal government corporate entity, fully federally owned, and a unit within the Department of Housing and Urban Development. Ginnie Mae was created to take over some of the higher risk mortgage programs of the original Fannie Mae that were considered to be in need of more extensive federal financial backing. Freddie Mac was created in 1970, but since its inception has been a private company and classified as a GSE.

Fannie Mae and Freddie Mac long have had much the same objectives, have performed much the same functions, and have been subject to the same or very similar legal regulations. Their principal objectives are apparent from federal statutes and regulations and can be briefly summarized as these: increasing home ownership by residents; increasing the flow of capital to housing; increasing the liquidity of mortgage loans on housing; promoting access to credit for housing in all geographic areas, including underserved areas; and stabilizing mortgage credit over time. The principal functions


208. On the definition of GSEs, see supra note 20.


The Federal Agricultural Mortgage Corporation (Farmer Mac), another GSE, has similar objectives to those of Fannie Mae and Freddie Mac, but on a vastly
of both Fannie Mae and Freddie Mac are the purchase and the securitization of home mortgages, both conventional mortgages and those insured by the FHA or guaranteed by the VA.\textsuperscript{211} When mortgages are securitized by Fannie Mae or Freddie Mac, the mortgages are pooled, and shares in the pool are sold to investors. Fannie Mae and Freddie Mac guarantee timely payment of interest and principal on the mortgage-backed securities they issue.\textsuperscript{212} So far as is practicable, and whether or not the mortgages are later securitized, the mortgages purchased by either company must meet the quality, type, and class standards generally imposed by private institutional mortgage investors.\textsuperscript{213} High risk conventional mortgages on 1- to 4-unit dwelling units, those with LTVs over 80\% at time of purchase, may not be purchased by either company unless the credit quality of the mortgage at the time of purchase has been enhanced in one of three ways: a qualified insurer has insured or guaranteed the mortgage; the seller has retained a participation in the mortgage of not less than 10\%; or the seller has agreed to repurchase or replace the mortgage on demand of the company in the event of default.\textsuperscript{214} Of major importance to PMI companies is that the usual lender preference for loans they will make is for the first option, and a PMI company is the usual qualified insurer selected.\textsuperscript{215} This has greatly increased the insurance volume of PMI

\begin{itemize}
\item more limited scale, and it deals only in mortgages on certain agricultural properties. On Farmer Mac's organization, operation, and power, see 12 U.S.C. §§ 2279aa-1 to 2279aa-4. On the expanded role of Farmer Mac after adoption of the Farm Credit System Reform Act of 1996, see Mark Fogarty, Farmer Mac Gets a Boost, U.S. BANKER, Nov. 1997, at 81.
\item 12 U.S.C. §§ 1717(b), 1719(d) (2000) (Fannie Mae purchase and securitization of mortgages); id. §§ 1454(a), 1455(a) (Freddie Mac purchase and securitization of mortgages). A conventional mortgage is one "other than a mortgage as to which the Corporation has the benefit of any guaranty, insurance or other obligation by the United States or any of its agencies or instrumentalities." Id. § 1451(i); cf. id. § 1717(b)(2) (noting that conventional mortgages include mortgages, liens, or other security interests in the stock or membership certificates issued to tenant-stockholders or resident-members of cooperative housing corporations, and on proprietary leases, occupancy agreement, or rights of tenancy in tenant-stockholder's or resident-member's dwelling unit in that corporation).
\item 212. On Fannie Mae's and Freddie Mac's guarantees of mortgage-backed securities, see CBO MAY 2001 REPORT, supra note 20; FANNIE MAE, 2002 ANNUAL REPORT 25 (2003); FREDDIE MAC, 2001 ANNUAL REPORT 23 (2002).
\item 213. 12 U.S.C. §§ 1454(a)(1), 1719(a)(1).
\item 214. Id. §§ 1454(a)(2), 1717(b)(5)(C).
\item 215. Lenders usually avoid the other two options because of the added cost this may entail. The added cost may result from the higher level of capital that may be required of a lender selecting one of the other two options. PMI ANN. RPT. 2002, supra note 50, at 9.
\end{itemize}
companies. But to be eligible to insure mortgages sold to Fannie Mae or Freddie Mac, an insurer must be a qualified insurer as determined by whichever of the two companies purchases the mortgages. 216 All of the PMI companies now writing mortgage insurance in the United States currently qualify. An important qualification requirement imposed by both Fannie Mae and Freddie Mac is that to be eligible to insure loans sold to either Fannie Mae or Freddie Mac, the insurer must have at least two of the following three credit ratings by designated credit-rating agencies: "AA-" by Fitch or Standard & Poor, or "Aa3" by Moody's. 217 One private securities company report on PMI companies states that the insurers are so diligent in their efforts to meet and stay ahead of these ratings that the rating agencies are the de facto regulators of the PMI industry. 218

Principal federal government regulatory authority over Fannie Mae and Freddie Mac since 1992 has been in the Office of Federal Housing Enterprise Oversight ("OFHEO"), an office within HUD. 219 Creating this office was an effort by Congress to provide more effective regulation of Fannie Mae and Freddie Mac and thereby reduce the risk of either company failing. 220 A statutory finding provision states that the office should have the authority "to establish capital standards, require financial disclosure, prescribe adequate standards for books and records and other internal controls, conduct examinations when necessary, and enforce compliance with the standards and rules that it establishes." 221

217. PMI ANN. RPT. 2003, supra note 23, at 22. On agency rating criteria, see also GENWORTH PROSPECTUS, supra note 18, at 198 (stating that Fitch and S&P AA ratings are considered "very strong," and Moody's Aa is considered "excellent"). Although all PMI companies now writing mortgage insurance in the United States currently have credit ratings sufficiently high to qualify under Fannie Mae and Freddie Mac requirements, some companies' ratings have declined recently. On the credit rating of each PMI company as of 2003, see Dunn, supra note 48, at 14.
218. RYAN & McELROY, supra note 23, at 44. This report also states that the favorable aspects of the rating agency scrutiny include:
(1) [T]he increased likelihood of ongoing customer and investor confidence in the industry; and (2) the downside support on profitability, based on the need to generate sufficient returns to satisfy the rating agencies. The rating agencies evaluate mortgage insurers' claims-paying abilities, using a long list of criteria with a common focus—capital adequacy in light of the size and nature of the insured risks.

Id.
220. Id. § 4501(2).
221. Id. § 4501(6).
Statutory provisions then proceed to grant this authority,\textsuperscript{222} subsequently further implemented by lengthy OFHEO regulations.\textsuperscript{223}

Of tremendous importance to the financial viability and competitive effectiveness of Fannie Mae and Freddie Mac are the financial benefits, in essence subsidies, the federal government makes available to the two companies.\textsuperscript{224} Among these subsidies, mandated by statute, are exemptions of Fannie Mae and Freddie Mac from state and local government taxes\textsuperscript{225} and from costly Securities and Exchange Commission requirements and fees.\textsuperscript{226} There also are subsidies that provide each company with substantial additional financial support. This additional financial support includes authorizing the U.S. Treasury to lend up to $2.25 billion to each company and legally qualifying each company’s debt as being eligible for use as collateral for public deposits, for unlimited


\textsuperscript{223} 12 C.F.R. §§ 1700.1-1780.81 (2004). One provision of these regulations has caused considerable concern to PMI companies. The risk-based capital stress test for Fannie Mae and Freddie Mac could be adverse to PMI companies by reducing Fannie Mae and Freddie Mac purchases of mortgages that are insured by any PMI company with less than top claims-paying ability ratings. The OFHEO Director is required by statute to establish such a test and the statute provides:

When applied to an enterprise [Fannie Mae or Freddie Mac], the risk-based capital test shall determine the amount of total capital for the enterprise that is sufficient for the enterprise to maintain positive capital during a 10-year period in which the following circumstances occur [in this section referred to as the ‘stress period’]: [circumstances then set forth].

12 U.S.C. § 4611. On the risk-based capital stress test computation, see 12 C.F.R. §§ 1750.10-1750.13 and 12 C.F.R. Pt. 1750, Subpt. B App. A (2004). See also Paul Muolo, Credit Rating Crunch, U.S. Banker, Sept. 2001, at 64 (concluding that the risk-based capital rule would considerably benefit the two PMI companies that then had AAA ratings, G.E. Mortgage Insurance and United Guaranty Corporation); cf. Ryan & McElroy, supra note 223, at 32 (stating that, as a result of the rule, “we do not expect any major changes in market share or profitability by the double-A or triple-A insurers”). On PMI companies’ reactions to the risk-based capital stress test provisions, see, for example, PMI ANN. RPT., supra note 50, at 10; MGIC ANN. RPT., supra note 18, at 13.

\textsuperscript{224} For the various federal subsidies of Fannie Mae and Freddie Mac, see CBO May 1996 Report, supra note 19, at 9-11; CBO May 2001 Report, supra note 20, at 13-14. These studies are among the series of studies on the effects of the privatization of Fannie Mae and Freddie Mac that are required by statute, 12 U.S.C. § 4602 (2000).

\textsuperscript{225} 12 U.S.C. § 1723a(c) (excepting real property taxes from the exemption).

\textsuperscript{226} Id. § 1719(e) (applicable to Fannie Mae); id. § 1455(g) (applicable to Freddie Mac).
investment by federally chartered banks and thrifts, and for purchase by the Federal Reserve.\textsuperscript{227} The special legal status granted to Fannie Mae and Freddie Mac by the federal government has enhanced the companies' profitability and increased the credit standing, market acceptance, and the liquidity of the mortgage-backed securities that the companies guarantee. This preferred treatment by the federal government has also led the financial markets to perceive that the federal government is implicitly guaranteeing the companies' securities, adding still further to the companies' financial strength and profitability.\textsuperscript{228} A 2001 study by the Congressional Budget Office estimated that the federal subsidies to the two companies in 2000 totaled $10.7 billion, with about $1 billion of this from tax and regulatory exemptions and the remainder from subsidies reducing the companies' borrowing costs and reducing the cost to the companies of guaranteeing the mortgage-backed securities they issue.\textsuperscript{229} These annual subsidies undoubtedly have remained very substantial in the years since 2000.\textsuperscript{230}

\begin{footnotesize}
\item\textsuperscript{227} Id. § 1719(c) (applicable to Fannie Mae); id. § 1455(c) (2000) (applicable to Freddie Mac).
\item\textsuperscript{228} June E. O'Neill, former director of the Congressional Budget Office, has noted:

The largest source of federal subsidies to Fannie and Freddie is the perception of investors that the government, if necessary, would act to prevent the enterprises from defaulting on their obligations. That perception of an implicit federal guarantee gives the debt and mortgage-backed securities issued by Fannie and Freddie super-triple-A status and enables them to borrow at lower interest rates than comparable private firms, which lack their special advantage. The implicit backing of the federal government also permits Fannie and Freddie to sell very large quantities of unique financial instruments, including callable debt. It gives the enterprises the singular ability to enter into financial obligations (off the balance sheet) with other parties who regard the transactions as essentially free of default risk.

June E. O'Neill, Remarks Before the Conference on Appraising Fannie Mae and Freddie Mac (May 14, 1998), at 3.

The market assumption that the federal government is guaranteeing Fannie Mae and Freddie Mac securities exists despite statutory requirements that the securities include a statement that the companies' obligations are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the issuing company. 12 U.S.C. § 1455(h)(2) (2000) (Freddie Mac); id. § 1719(c) (Fannie Mae).

\item\textsuperscript{229} CBO May 2001 Report, supra note 20, at 23.
\item\textsuperscript{230} However, the federal government's subsidy to Fannie Mae and Freddie Mac from the SEC registration fee exemption has been reduced somewhat as a result of a 2002 statute requiring the SEC to lower considerably its registration fees. See 15 U.S.C.A. § 78m(e)(3) (West Supp. 2004).
\end{footnotesize}
IV. POSSIBLE LEGAL CHANGES

Laws concerning PMI companies have evolved over time and no doubt will continue to do so, with major changes occurring periodically. Major changes in any field of law are usually triggered by some development that creates or acutely accentuates problems that the law then attempts to alleviate. One such development affecting PMI companies that seems certain to occur in the future is a sharp decline in much or all of this country in the market for residential properties, including a decline in sales, sales prices, and volume of new mortgage originations and an increase in mortgage defaults and foreclosures. Such a market decline, especially if substantial and protracted, could threaten the solvency of PMI companies and result in bankruptcy of one or more of these companies. This has happened in the past, notably in the depression of the 1930s and in the real estate recession of the 1980s, and it could happen again. A drastic and protracted decline in the residential real estate market could also greatly enhance the risks of Fannie Mae and Freddie Mac becoming insolvent, with resulting law reforms that could have very significant implications for PMI companies.

Among other possible developments in the foreseeable future that could trigger law reforms concerning PMI companies is increasingly intense competition among PMI companies, with the possibility of consolidation of some existing companies and the possibility of new companies entering the field. In such a highly competitive market, with each company pushing hard to achieve more market share, reduce costs, and increase profits, lawmakers may become convinced that new laws are needed. They may conclude that this competition among PMI companies is causing some of these companies to assume undue risks that could lead to their insolvency and that stricter laws are needed to help prevent such insolvencies and the widespread harm they can cause. The lawmakers also may conclude that in the aggressive competition among PMI companies, the interests of consumers, particularly homebuyers whose mortgages are insured, often are adversely affected and that law reforms are needed to provide greater consumer protection.

Still another possible development that could trigger law reforms of considerable relevance to PMI companies also involves competition among mortgage market participants. More precisely, it is the possibility that Fannie Mae and Freddie Mac will seek to enhance their profitability by changes in the law that permit them

231. See supra notes 96-100 and accompanying text.
to expand their operations into segments of the mortgage market from which they now are legally excluded. The two companies are now among the nation's largest business entities, and they can and do exert tremendous political pressure to further their interests.

Given the preferences and economic support they receive from the federal government, Fannie Mae and Freddie Mac would have a substantial competitive advantage, in good economic times and bad, if legally permitted to enter additional segments of the mortgage market.

A variety of proposals for changes in the law of significance to PMI companies have been made in recent years. Most are responses to concerns over one or more of the possible developments discussed above. Predicting what future changes in the law will actually occur is always conjectural, but reform proposals recently advanced are indicative of what changes may actually take place. Targets of major legal change that could have significant implications for PMI companies are Fannie Mae and Freddie Mac. Some conservative political interests generally opposed to government attempts to regulate business and restrict competitive market forces consider the preferences and subsidies that the federal government provides Fannie Mae and Freddie Mac to be unjustified interference with free markets. They favor full privatization of both companies or at least legal changes drastically curtailing the support that the federal government makes available to the two companies, including expressly asserting that the federal government does not guarantee payment of either company's debt if it becomes insolvent.

232. For an elaboration of this possible development and its consequences, see WALLISON & ELY, supra note 19, at 21.


234. This position is supported in a carefully reasoned research report, WALLISON & ELY, supra note 19, at 49. But see Franklin D. Raines, An Open Letter from Frank Raines, MORTGAGE BANKING, April 2004, at 43 (aggressively supporting Fannie Mae's current role and denying that Fannie Mae is engaged in "mission creep") (Raines is Chairman and CEO of Fannie Mae). The popular press occasionally has considered the Fannie Mae and Freddie Mac privatization issue. See, e.g., Robert J. Samuelson, Fixing Fannie and Freddie, NEWSWEEK, Sept. 8, 2003, at 41, in which this comment is made:

The odds of Fannie's and Freddie's causing a financial crisis may be small. But if one occurred, the consequences could be huge. Even now, about 3,000 U.S. banks hold GSE debt equal to all their capital. The Bush administration is reconsidering its policy toward Fannie
Another approach to legal regulation of Fannie Mae and Freddie Mac that recently has received some attention (but as yet no legislative change) is tightening the federal government’s oversight over the two companies. This would include shifting regulatory control over Fannie Mae and Freddie Mac to a new agency with powers that would include placing either company in receivership if in danger of insolvency. If Fannie Mae and Freddie Mac were fully privatized, it is impossible to predict precisely what the effect on PMI companies would be. But the legal requirements that have resulted in a substantial percentage of loans acquired by Fannie Mae and Freddie Mac having PMI coverage quite possibly would be eliminated, and the likely resulting expansion in self-insurance of mortgage default risk could result in a sharp reduction in the total volume of PMI coverage.

Other changes in federal laws recently have been proposed that could significantly affect PMI companies. One of these is increasing the maximum loan amounts for mortgage loans the FHA can insure or in other respects expanding the terms of FHA mortgage insurance coverage. Maximum loan amounts that the FHA can insure have periodically been legally increased in the past in response to widespread increases in market prices of residential properties, and presumably such FHA maximums will periodically be increased in the future if residential market prices escalate further.

Regulations authorized by RESPA are another area of federal law of significance to PMI companies as to which important changes

235. On this intensified regulatory approach, see Janet Reilley Hewitt, *Falcon on GSE Reform*, MORTGAGE BANKING, Apr. 2004, at 31 (interviewing Armando Falcon, Director of the OFHEO on proposed regulatory reform of Fannie Mae and Freddie Mac). Falcon supports stricter oversight of the two companies and enhanced funding of the oversight function; see also Clyde Mitchell, *GSE Regulatory Update*, N.Y.L.J., Apr. 21, 2004, at 3; Richard Shelby and Barney Frank, *Two Views (GSE Reform)*, MORTGAGE BANKING, Jan. 2004, at 52 (updating the current regulatory reform issue by interviewing a Republican and a Democrat member of Congress).

236. On these legal requirements, see supra notes 215-17 and accompanying text.

237. FHA Single Family Loan Limit Adjustment Act of 2004, H.R. 4110, 108th Cong. (2004). This is a bill introduced by Barney Frank, a Democrat, and Gary Miller, a Republican, which would alter the formulas for determining FHA mortgage insurance ceilings in ways that would increase the maximum dollar amount of mortgages that the FHA could insure.
have been proposed. RESPA prohibits referral fees or kickbacks in providing settlement services, including mortgage insurance, for most kinds of mortgage loans. But RESPA permits HUD to issue rules permitting exceptions to RESPA restrictions. In 2002, HUD proposed a rule that, among other provisions, would permit lenders to offer borrowers packages of settlement services when making mortgage loans. Mortgage insurance is one of the settlement services that typically would be included in the package. Each package would be at a fixed price and that price could include a profit to the lender that without the HUD rule would violate the RESPA prohibition on referral fees and kickbacks. The net effect of the proposed rule for mortgage insurers, if adopted, would likely be lower insurer profits, as lenders would generally insist on package terms that included a profit for them when negotiating with mortgage insurers. The proposed HUD rule is very long, and in its attempt to reshape the mortgage market in important respects, mortgage insurer premiums are but one of many aspects of the mortgage market that it would affect. The rule attracted widespread comment from both business and consumer groups, much of it expressing opposition to one or another of its provisions. The result was that, in early 2004, HUD withdrew its proposed rule for further review and consideration. Another proposal recently

239. Id. § 2607(c)(5).
240. The proposed rule is published at Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumer, 67 Fed. Reg. 49,134 (July 29, 2002). On the provisions of the rule and some of the reactions to it, see PMI ANN. RPT. 2003, supra note 23, at 79 (stating that the proposed rule, if adopted, would harm the company’s profitability); RADIAN ANN. RPT., supra note 30, at 13 (stating that if the proposed rule is adopted “the premiums charged for mortgage insurance could be negatively affected”); Kenneth A. Markison, HUD's Proposal to Overhaul the Mortgage Process to Lower Costs and Increase Homeownership, 12 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 62 (2002) (stressing how, from HUD’s point of view, the rule will simplify the process of obtaining home mortgages, create greater transparency for borrowers regarding mortgage costs, and reduce mortgage settlement costs); Sheldon E. Hochberg, HUD's RESPA Regulations: The Proposals, the Comments, the Future, TITLE NEWS, Jan./Feb. 2003, at 13 (criticizing the proposed rule and noting that there were over forty thousand comments in response to it); Joseph M. Kolar & Nikita M. Pastor, Referendum on RESPA Reform, MORTGAGE BANKING, Feb. 2003, at 58 (reviewing public reaction to different components of the rule).
242. On some of the reactions to the rule see supra note 240.
243. On the withdrawal, see HUD Withdraws RESPA Rule for Further Review and Consideration.
considered by Congress is making PMI payments by borrowers tax deductible under the federal income tax.\textsuperscript{244} One such proposal would make PMI payments fully deductible for lower and moderate income taxpayers and partially deductible for those with higher incomes.\textsuperscript{245}

V. CONCLUSIONS

PMI is an important form of risk sharing that makes lenders more willing to provide mortgage loans for home buyers, especially those home buyers with very limited cash resources. It also makes higher risk home mortgage loans more salable in the secondary mortgage market and thereby contributes considerably to the volume of securitized mortgages, a large and growing sector of the securities market. The net effect of PMI is that it helps substantially in increasing the percentage of occupant home ownership, particularly for families with lower or moderate incomes.

PMI companies, the insurers that write PMI, are extensively regulated as to their structure and operations by state laws, laws that in important respects vary from state to state. But federal government programs, created and regulated by federal laws, have had a particular strong influence on PMI companies, some of it favorable to PMI companies and some of it unfavorable. The principal aims of these programs are expanding the percentage of occupant home ownership in this country and encouraging the allocation of financial resources to the home mortgage market rather than other markets. How these laws affect PMI and PMI companies is largely determined by an intricate and very detailed body of federal laws, especially laws creating and regulating two federal government agencies, the FHA and the VA, and those laws creating and regulating two private companies heavily subsidized by the federal government, Fannie Mae and Freddie Mac. The federal programs have a diverse impact on PMI and the companies writing this form of insurance. The FHA and the VA insure a large volume of home mortgages and compete with PMI companies in doing so. Fannie Mae and Freddie Mac greatly expand the market for PMI by purchasing a large percentage of the mortgages insured by PMI companies.


\textsuperscript{244} See Curt Culver, \textit{Tax Deductibility of Private MI Seems So Logical, and Yet...}, \textit{Mortgage Banking}, Sept. 2003, at 21 (stating that last May, Congress failed to include in its $350 billion tax-cut package an amendment "that would have made mortgage insurance (MI) premiums paid by more than 12 million home owners annually tax deductible").

\textsuperscript{245} On tax deductible proposals, see Dunn, \textit{supra} note 48, at 58; Culver, \textit{supra} note 244, at 21 (predicting that one result of such tax deductibility would be to make PMI coverage more competitive with 80-10-10 mortgage loans).
Although relatively modest changes recently have been made in federal laws regulating the federal mortgage insurance programs of the FHA and the VA and the mortgage purchase and securitization programs of Fannie Mae and Freddie Mac, drastic changes in these laws seem unlikely in the foreseeable future unless there is a severe and protracted depression in the home mortgage market. Support for the existing programs from diverse and powerful political and financial interests will presumably prevent drastic changes in these laws, absent a very severe and protracted depression in the home mortgage loan market. The programs help expand home ownership, particularly home ownership by lower- and moderate-income families, a major objective of liberal political interests. The programs also have an appeal to very important sectors of the business community that usually oppose government intervention in market operations. Fannie Mae and Freddie Mac, whose market position and profitability are heavily dependent on government subsidies, are now among the nation's largest corporations, each with many thousands of stockholders and a vast body of lenders quite satisfied with the availability of the two companies as purchasers of their mortgage loans. Also, the PMI companies and their holding companies, beneficiaries of legal inducements for Fannie Mae and Freddie Mac to purchase mortgages covered by PMI, are politically influential business entities frequently supportive of Fannie Mae and Freddie Mac as entities extensively regulated by the federal government. Even the FHA and the VA, government agencies, have support within significant segments of the business community, as their mortgage insurance programs have helped expand the private home mortgage market.

But a very severe and protracted depression in the home mortgage market no doubt would result in drastic changes in federal laws, including laws affecting PMI companies, especially if accompanied by extensive decline in home prices or a sharp increase in home mortgage defaults, and if many mortgage lenders, most PMI companies, and Fannie Mae and Freddie Mac became insolvent or on the verge of insolvency. Possible changes might include substantially expanding the availability of FHA and VA insurance, liquidating Fannie Mae and Freddie Mac if they were in serious financial trouble, and increasing federal control of PMI company structure and operations. A severe and protracted depression in the home mortgage market would also almost certainly result in further tightening of relevant state laws concerning PMI companies and stricter enforcement of those laws.

Leaving aside the possible effects on PMI companies of a severe and protracted depression in the mortgage loan market, what changes may occur in these companies and their operations in the
years immediately ahead? PMI companies probably will be somewhat less profitable in the near term as the volume of home sales decline and home prices decline, both of which presumably will take place in much of the United States. But over the longer term, an increased population of lower- and moderate-income families in the United States desirous of home ownership could increase considerably the demand for PMI. It also seems likely that some of the existing PMI companies or their affiliates will expand their operations considerably by insuring a much enhanced volume of home mortgages in other countries and, as well, expanding in other business fields, such as financial guaranty.\textsuperscript{246} PMI seems certain to become increasingly a global business for American companies. Another development that seems certain to occur is even more intense competition among PMI companies for mortgage insurance business, both here and abroad, with the probability of additional companies becoming mortgage insurers and some of the existing PMI companies merging or being taken over by much larger holding companies.

Although companies writing PMI may change over time, it is quite apparent that PMI has become, and for the foreseeable future will remain, a very important form of risk sharing in the vast home mortgage market.

\textsuperscript{246} On these possible developments, see Wallace, \textit{supra} note 25.