CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

November 4, 1997

S. 318
Homeowners Protection Act

As ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on October 23, 1997

SUMMARY

S. 318 would institute certain reforms in the private mortgage insurance industry. First, the bill would require mortgage lenders and loan servicers to notify borrowers of their right to cancel mortgage insurance and of the procedures to do so. For each loan made one year or more after enactment, the bill would provide for the automatic cancellation of mortgage insurance (including coverage provided by state and local governments) when the outstanding principal balance on the loan drops to 78 percent of the value of the home at the time the loan was issued, provided the borrower's payments are current. S. 318 would establish disclosure procedures for the providers of lender-paid mortgage insurance and would impose civil liability on any mortgage servicer who failed to comply with the requirements of this bill. S. 318 also would dissolve the Thrift Depositor Protection Oversight Board and transfer its remaining responsibilities to the Department of the Treasury. In addition , the bill would reduce from four to two the number of annual meetings the Affordable Housing Advisory Board must hold each year.

CBO estimates that enacting S. 318 would result in savings of about $250,000 a year in outlays from direct spending. Because the bill would affect direct spending, pay-as-you-go procedures would apply. We also estimate that enacting this bill would not result in any significant impact on federal spending subject to appropriation.

S 318 would impose both private-sector and intergovernmental mandates as defined in the Unfunded Mandates Reform Act of 1995 (UMRA). CBO estimates, however, that the direct costs of complying with the mandates would not likely exceed the thresholds specified in UMRA ($100 million for private-sector mandates and $50 million for intergovernmental mandates, in 1996 dollars adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

Direct Spending

Current law requires the Thrift Depositor Protection Oversight Board to monitor the operations and spending of the Resolution Trust Corporation (RTC). The RTC was a temporary agency established to resolve thrift failures beginning in 1989. In late 1995 the RTC was dissolved and its remaining assets were transferred to the Federal Deposit Insurance Corporation. The Oversight Board now retains responsibility for only two functions. The first is to oversee operations of the Resolution Funding Corporation (REFCORP), which issued bonds totaling $30 billion from 1989 to 1991 as part of RTC's initial funding. Second, the Oversight Board retains a nonvoting membership, through the end of 1998, on the Affordable Housing Advisory Board. By terminating the Oversight Board, the bill would eliminate the annual costs for the one employee of the board who prepares periodic reports required of all distinct entities of the government and performs other routine functions. Based on information from the Treasury, CBO estimates that transferring the statutory responsibilities of the Oversight Board to the Treasury would result in savings of about $250,000 annually in direct spending. Because the Oversight Board has the authority to pay its expenses without appropriation action, these savings would be a reduction in direct spending.

This bill also would affect insured depository institutions, including banks, thrifts, and credit unions that hold qualifying mortgage portfolios. As a result, the federal banking regulators–the Federal Reserve, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of Thrift Supervision–would have some responsibility to monitor and enforce the statute. Spending by these agencies is not subject to the annual appropriation process. However, CBO expects that the additional regulatory costs for these agencies would be small and offset by fees in most cases, resulting in no significant net cost to the federal government.

Spending Subject to Appropriation

Spending by the Treasury to carry out the routine functions of the Oversight Board would be subject to appropriation. CBO estimates that any additional spending would be minimal. In addition, reducing the number of times the Affordable Housing Advisory Board must meet annually is not expected to result in any significant savings. Also, CBO estimates that imposing civil liability on mortgage servicers who do not comply with the requirements under the bill would not result in any significant costs to the federal court system because the

caseload is expected to be minimal and any cases reaching trial would most likely be tried in state courts.

PAY-AS-YOU-GO CONSIDERATIONS

Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. Legislation providing funding necessary to meet the government's existing deposit insurance commitment is excluded from these procedures. CBO believes that requiring insured depository institutions to terminate private mortgage insurance would not meet the exemption for full funding of deposit insurance and thus would have pay-as-you-go implications. Spending by the federal banking regulators to monitor and enforce the provisions of the bill is estimated to be small, however, and in most cases would be offset by fees charged to the depository institutions, resulting in no significant net cost to the federal government. Eliminating the Thrift Depositor Protection Oversight Board would reduce direct spending, but these savings would also be insignificant.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 318 would impose both private-sector and intergovernmental mandates as defined in UMRA. The bill contains mandates on mortgage lenders, loan servicers, purchasers of mortgage loans, and private mortgage insurance (PMI) companies in the mortgage industry. Provisions in the bill would be enforced by private law suits. CBO estimates that the annual direct costs of complying with mandates identified in this bill are not likely to exceed the statutory thresholds for private-sector or intergovernmental mandates. Inasmuch as state and local governments finance mortgage loans and service and insure some of the loans extended, they would bear some of the costs of complying with these mandates. CBO estimates that at least 95 percent of all identified costs would fall on the private sector; less than 5 percent of the costs would be borne by state and local governments.

Private mortgage insurance protects lenders–or the ultimate purchaser of a mortgage loan, such as Fannie Mae or Freddie Mac–against financial loss if a borrower defaults on a mortgage loan. Industry data show that the lower the down payment, as a percentage of the property value, the greater is the risk that the loan will default. Mortgage insurance is generally used when a borrower makes a down payment of less than 20 percent of the value of the home–that is, when the mortgage has a loan-to-value (LTV) ratio greater than 80 percent. In 1996, the eight PMI companies backed nearly one million residential mortgage loans and a total of $127 billion in loans were covered by PMI.

Mandates

S. 318 would allow borrowers to request cancellation of a PMI policy after paying off 20 percent of the property's original value. To be eligible for policy cancellation at 20 percent equity, the bill would require that a borrower (1) make a written request for cancellation; (2) be current on mortgage payments; (3) certify that he or she holds no second mortgages on the property; and (4) demonstrate that the property's value has not depreciated below its value at closing. S. 318 would require that private mortgage insurance be canceled once a borrower has reached 22 percent equity unless the insurance covers a "high-risk" loan. Borrowers with loans deemed to be high risk according to guidelines to be developed by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation would not qualify for early cancellation. Such borrowers, however, would have their insurance terminated at the half-life of the loan. Upon termination of PMI insurance, the bill would require that servicers (and PMI companies) refund to the borrower any premiums already paid for the period beyond the termination date.

Beginning one year after enactment, S. 318 would require lenders and servicers to provide written disclosures about insurance cancellation rights to borrowers who are required by creditors to obtain private mortgage insurance as a condition for entering into a residential mortgage agreement. S. 318 would require that the lender notify the borrower in writing at or before closing of his cancellation rights under PMI and give the borrower an amortization schedule. The amortization schedule would be used to determine a termination date at which the borrower would no longer be required to pay insurance premiums. The bill also would require, before closing, mandatory disclosures to purchasers of lender-paid mortgage insurance indicating that lender-paid mortgage insurance may not be canceled. After the initial disclosure at loan origination, loan servicers would be required to notify borrowers with "borrower-paid" PMI (including existing loans with PMI) of their cancellation rights in an annual written statement.

Estimated Costs of Mandates

In the first year after enactment, the total costs of the mandates would consist of the costs to lenders and servicers of modifying systems to accommodate the transmittal and storage of additional data. Lenders and servicers would also have to modify software programs to provide the required additional disclosures to borrowers and to develop the procedures to trigger automatic termination of PMI insurance for eligible borrowers. In total, the initial "set-up" costs should be somewhat below $100 million dollars. After an initial set-up period of about one year, costs would likely drop. The bulk of costs in the second year would cover disclosure at or before settlement to roughly one million borrowers required to purchase PMI

insurance and annual disclosure to about five million borrowers who already have borrower-paid PMI insurance.

CBO estimates that costs to the mortgage industry would gradually start to rise again in a few years as the cost to servicers of terminating PMI policies, and the loss of premium income to PMI companies start to accumulate. Most loans to which automatic termination would apply would not reach an LTV ratio of 78 percent to qualify for termination until well after the five-year period of analysis required by UMRA.

Estimated Impact on State, Local and Tribal Governments

Because state and local governments participate in mortgage financing, they would bear some of the compliance costs of S. 318. CBO estimates that the state and local share of such costs would total less than $5 million a year. All 50 states and some local governments finance mortgages (primarily with mortgage revenue bonds), 21 states service at least a portion of their own mortgage portfolio, and seven states insure mortgages. (The definition of private mortgage insurance used in this bill includes insurance provided by state governments. Only insurance provided by the federal government is excluded.) Based on data from the National Council of State Housing Agencies and Standard and Poors, CBO estimates that state and local governments are involved in less than 5 percent of mortgages that have private mortgage insurance. Their share of the costs would thus be relatively small.

S. 318 would also impose an additional mandate on state governments by preempting certain state laws pertaining to the termination or cancellation of private mortgage insurance or the disclosure of certain information addressed by the bill. Based on discussions with mortgage industry officials and a review of certain state mortgage insurance laws, CBO estimates that this mandate would impose no significant costs on state governments nor would it result in the loss of any revenue.

PREVIOUS CBO ESTIMATES

On April 7, 1997, CBO provided an estimate for H.R. 607, the Homeowners Insurance Protection Act, as ordered reported by the House Committee on Banking and Financial Services on March 20, 1997. While both H.R. 607 and S. 318 would require that borrowers be notified of their rights to cancel mortgage insurance, these bills differ in their requirements for automatic cancellation of mortgage insurance. H.R. 607 would require automatic cancellation of mortgage insurance when the mortgage has an LTV of 75 percent

(or less) while S. 318 would require automatic cancellation of mortgage insurance when the mortgage has an LTV of 78 percent (or less).

On September 17, 1997, CBO provided an estimate for H.R. 2343, a bill to terminate the Thrift Depositor Protection Oversight Board, as ordered reported by the House Committee on Banking and Financial Services on September 9, 1997. S. 318 would also eliminate the Oversight Board and would transfer its remaining responsibilities to the Department of the Treasury.

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