FannieMae
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Announcement 99-06 ***May 27, 1999***

Amends These Guides: Selling and Servicing

Termination or Cancellation of Mortgage Insurance for Conventional Mortgages

Since the early 1970s, shortly after we began purchasing conventional mortgages, we have provided for the cancellation of mortgage insurance. We have revised this policy periodically – by offering new options or specifying different eligibility criteria – to address changes in market conditions or new types of mortgage products. We were in the process of changing our mortgage insurance cancellation policy when Congress began considering legislation requiring automatic termination of mortgage insurance. We postponed implementation of our changes until after the legislation was passed not only to assure that our policy would be consistent with the new federal law, but also to use the additional time for fine-tuning our policy to make sure that it benefitted as many homeowners as possible. The new policy described in this Announcement accomplishes both objectives.

The Homeowners Protection Act of 1998 provides for automatic terminations of mortgage insurance and borrower-initiated cancellations based on the original value of the property for certain mortgages closed on or after 07/29/99. While the Act clearly benefits many consumers, some borrowers are not eligible for its benefits. Therefore, we are revising our mortgage insurance cancellation policy to extend benefits similar to those of the Act to other borrowers by announcing an automatic termination provision that applies to all mortgages closed before 07/29/99, as well as to any mortgages closed on or after 07/29/99 that are not covered by the Act's termination and cancellation provisions. We will also offer borrower-initiated cancellation based on the current value of the property, a cancellation option that is not required by the Act. To the extent possible, we have incorporated eligibility requirements specified in the Act – such as the definition of an acceptable payment history – into all of our cancellation options. We believe that this approach promotes consistency and thus helps to reduce some of the complexity of complying with the Act.

Because the Homeowners Protection Act of 1998 has numerous compliance requirements for lenders and there are many nuances in the provisions, lenders should seek advice about specific implementation issues from their legal counsel. Lenders can also find a great deal of information about how to implement the requirements of the Act in the book *Implementation Guide to PMI*

Cancellation: Understanding the Homeowners Protection Act of 1998, which is available from the Mortgage Bankers Association (MBA) and America's Community Bankers (ACB). To order this book, lenders should contact either the MBA or ACB, at the following address or telephone number:

Mortgage Bankers Association
7th Floor
1125 15th Street, NW
Washington, DC 20005

(800) 793-MBAA

America's Community Bankers
Suite 400
900 19th Street, NW
Washington, DC 20006

(202) 857-3119

The following pages of this Announcement include both a summary of the Homeowners Protection Act of 1998 and an overview of Fannie Mae's revised mortgage insurance cancellation policy. They also provide details about disclosures that must be made to borrowers, conditions for automatic terminations and cancellations of borrower-paid mortgage insurance, and procedures for reporting terminations and cancellations to us. Attachment 1 is a reference chart that summarizes key points of our termination or cancellation policy.

Summary of Homeowners Protection Act of 1998

The Homeowners Protection Act of 1998 requires that borrower-purchased mortgage insurance be automatically terminated on the applicable termination date for a mortgage closed on or after 07/29/99 if the loan proceeds are used for the purchase, initial construction, or refinancing of the borrower's one-family principal residence – provided the borrower's payments are current on the termination date. The Act also requires cancellation of the mortgage insurance for these mortgages at the borrower's request, if specific conditions are met.

Additional provisions require lenders to make specific disclosures to borrowers about the mortgage insurance termination and cancellation policy for mortgages subject to the Act's termination and cancellation provisions, both at loan closing and annually thereafter. Furthermore, the Act requires the servicer to make annual disclosures related to the termination or cancellation policy for borrower-purchased mortgage insurance for any mortgage closed before 07/29/99 that is secured by the borrower's one-family principal residence. Although the termination or cancellation provisions of the Act do not apply to lender-purchased mortgage insurance, the Act requires (1) lenders to make certain disclosures to prospective borrowers at origination for a mortgage that closes on or after 07/29/99, if the loan proceeds are used for the purchase, initial construction, or refinancing of the borrower's one-family principal residence and the lender requires lender-purchased mortgage insurance; and (2) servicers to make a one-time disclosure at a later date to advise borrowers who have this lender-purchased mortgage insurance that they may wish to consider other financing options that do not require mortgage insurance.

Generally, the Act does not require that all of its termination and cancellation provisions be applied to "high-risk" mortgages. The Act does allow us to provide a definition of "high risk" for mortgages that have original principal balances that do not exceed our conventional loan limits. Since we have decided not to exclude "high-risk" mortgages from any termination or cancellation provision at this time, we are not providing a definition of "high risk."

Overview of Revised Fannie Mae Mortgage Insurance Cancellation Policy

As of 07/29/99, we are revising our policy for cancelling borrower-purchased mortgage insurance for any mortgage closed on or after 07/29/99 for which the loan proceeds are used for the purchase, initial construction, or refinancing of the borrower's one-family principal residence to apply all of the Homeowners Protection Act's specific requirements related to automatic termination, borrower-initiated cancellation based on original property value, and borrower disclosures. Lenders should terminate or cancel mortgage insurance for these mortgages in compliance with the provisions of the Act (and should not use any criteria for such terminations or cancellations that are different from those of the Act, except as required by state law or specified by us). The provisions of the Act apply to both first and second mortgages. However, because the Act's threshold for automatic termination of mortgage insurance is tied to the loan-to-value ratio of the individual mortgage (rather than to the combined loan-to-value ratio for all outstanding mortgages secured by the property), applying it to a second mortgage results in the automatic termination of mortgage insurance at a loan-to-value ratio that is higher than the ratio applicable to a second mortgage under our *combined* loan-to-value eligibility criterion for second mortgage deliveries. Therefore, any second mortgage closed after 07/29/99 that is delivered to us will not be required to have borrower-purchased mortgage insurance.

We are also making the following changes to our mortgage insurance cancellation policy for mortgages that have borrower-purchased mortgage insurance, effective as of 07/29/99:

- We are extending the provisions of the Act that relate to automatic termination and borrower-initiated cancellation based on *original* value to the following mortgages, if they are closed on or after 07/29/99: (1) first mortgages secured by one-family second homes (regardless of the use of the loan proceeds) and (2) first mortgages secured by one-family principal residences, if the loan proceeds are used for any purpose other than the purchase, initial construction, or refinancing of the property. Although we are extending the termination and cancellation provisions of the Act to these mortgages, lenders should not apply the disclosure requirements of the Act to them.

- We are adding a new provision that requires automatic termination of mortgage insurance based on the mid-point of the mortgage amortization period, and we will apply it to (1) any first or second mortgage closed before 07/29/99 and (2) any first mortgage closed on or after 07/29/99 that is secured by a one- to four-family investment property or a two- to four-family principal residence. We expect servicers to use their best business judgment in scheduling the automatic terminations for mortgages in their portfolio in a way that will assure that they complete – by 01/02/2001 – the terminations for all mortgages in their portfolio that become eligible for automatic termination of mortgage insurance before that date.

We encourage servicers to begin the process of applying our automatic termination policy as soon as possible after its effective date, both to mortgages that have already reached their mid-point and to those that reach their mid-point on or after the effective date of this new policy. However, because servicers have legislation to implement, Year 2000-related issues to address, and possibly a high volume of terminations to process, we understand that some servicers may prefer to use a phased approach for processing the automatic terminations or may prefer to postpone such terminations until well after Year 2000-related changes have been made and implemented in their systems.

- We are revising our existing policy that allows borrower-initiated cancellation of mortgage insurance based on the *original* value of the property, and we will apply it to (1) any first or second mortgage closed before 07/29/99 and (2) any first mortgage closed on or after 07/29/99 that is secured by a one- to four-family investment property or a two- to four-family principal residence. The revisions include redefinition of "acceptable payment record"; extension of the payment record eligibility criterion to mortgages closed as purchase money (as well as refinance) transactions; and modification of loan-to-value ratio eligibility criteria to take into consideration differences in lien status, occupancy status, and number of dwelling units.

- We are revising our existing policy that allows borrower-initiated cancellation of mortgage insurance based on the *current* value of the property, and we will apply it to all mortgages (regardless of their closing date). The revisions include redefinition of "acceptable payment record"; addition of a minimum seasoning requirement; and modification of loan-to-value ratio eligibility criteria to take into consideration differences in lien status, occupancy status, number of dwelling units, and seasoning of the mortgage.

We will retain our current policy of requiring that lender-purchased mortgage insurance remain in effect for the life of the mortgage. Lenders, however, will need to comply with all applicable disclosure requirements of the Act that pertain to mortgages that have lender-purchased mortgage insurance.

A lender must comply with federal law (and/or any state law to the extent that it is not pre-empted by federal law) related to the termination or cancellation of mortgage insurance and/or to any required disclosures about such terminations or cancellations to the extent that the law differs from our policy and does not permit the lender's compliance with our policy. Further, if we purchase or securitize a conventional mortgage as part of a negotiated transaction, we may specify other conditions for cancelling the mortgage insurance in the negotiated contract. When that is the case, the servicer cannot cancel the mortgage insurance unless the terms of both the negotiated contract and our new cancellation policy are met – unless state and/or federal law require otherwise. Any conflict between the terms of the negotiated contract and state and/or federal law related to the cancellation of mortgage insurance must be resolved in favor of the state and/or federal law. However, a servicer should keep in mind that the termination and cancellation provisions of the Homeowners Protection Act of 1998 do not apply to mortgages that closed before 07/29/99.

Disclosure of Termination and Cancellation Policy to Borrowers

The Homeowners Protection Act of 1998 requires lenders to make certain disclosures at closing for any mortgage that is subject to its termination and cancellation provisions. The Act also requires servicers to make certain annual disclosures to (1) borrowers who have a mortgage that closed on or after 07/29/99, if it is subject to the termination and cancellation provisions of the Act and (2) borrowers who have a mortgage closed before 07/29/99, if it is secured by the borrower's one-family principal residence. In addition, when a lender originates a mortgage after 07/29/99 that is secured by a one-family principal residence and will require lender-purchased mortgage insurance for it, the Act requires the lender to make a disclosure about the lender-purchased mortgage insurance to the prospective borrower at origination, if the loan proceeds will be used for the purchase, initial construction, or refinancing of the security property. The Act also requires the servicer to make a one-time disclosure later for these mortgages to advise the borrower that he or she may wish to consider other financing options that do not require mortgage insurance. More information about the different disclosures is provided below.

Initial Disclosure at Closing for Borrower-Purchased Mortgage Insurance

The Act requires a lender to provide certain disclosures at loan closing for borrowers who have borrower-purchased mortgage insurance for mortgages closed on or after 07/29/99, if the loan proceeds will be used for the purchase, initial construction, or refinancing of the borrower's one-family principal residence. The Act does not require initial disclosures at loan closing for any other mortgages. Lenders must not give initial disclosures that might be interpreted as meaning that the borrower has a statutory right that he or she is not given by the Act.

The initial disclosures required at loan closing differ depending on the type of mortgage:

- For fixed-rate mortgages, the lender must give the borrower a written initial amortization schedule and a written notice, which states that (1) the requirement for mortgage insurance will automatically terminate on the scheduled termination date if the borrower's payments are then current (and indicates the scheduled termination date); (2) the borrower may request cancellation of the mortgage insurance based solely on the initial amortization schedule (and indicates the date on which the borrower may request cancellation); (3) the borrower may request cancellation earlier than the cancellation date provided for under the initial amortization schedule based on actual payments that have been made; and (4) there are exemptions to the borrower's right to cancellation and automatic termination of mortgage insurance (and indicates whether or not the borrower's mortgage is subject to such an exemption).

- For adjustable-rate mortgages, the lender must give the borrower a written notice, which states that (1) the requirement for mortgage insurance will automatically terminate on the scheduled termination date if the borrower's payments are then current and that, on the termination date, the servicer will either notify the borrower that the requirement for mortgage insurance has been terminated or that the requirement will be terminated as soon as the borrower's payments are current; (2) the borrower may cancel the mortgage insurance on the scheduled cancellation date (and the servicer will notify the borrower when that date is reached); and (3) there are exemptions to the borrower's right to cancellation and automatic termination of mortgage insurance (and indicates whether or not the borrower's mortgage is subject to such an exemption).

Initial Disclosure at Origination for Lender-Purchased Mortgage Insurance

The Act specifies that when a borrower seeks financing (or refinancing) for a borrower's one-family principal residence on or after 07/29/99 and the lender requires lender-purchased mortgage insurance for the mortgage, the lender must provide certain disclosures to the prospective borrower no later than the date on which the loan commitment is made – if the loan proceeds will be used for the purchase, initial construction, or refinancing of the security property. If a lender prefers to make the same disclosure to all borrowers who will have lender-purchased mortgage insurance, it may do so.

The written disclosure must state that (1) lender-purchased mortgage insurance is different from borrower-purchased mortgage insurance in that lender-purchased mortgage insurance cannot be cancelled by the borrower, while borrower-purchased mortgage insurance can be automatically terminated or cancelled at the borrower's request; (2) lender-purchased mortgage insurance usually results in the borrower having to pay a higher interest rate than would be paid if the mortgage had borrower-purchased mortgage insurance; (3) lender-purchased mortgage insurance is terminated only if the mortgage is refinanced, paid off, or otherwise liquidated; (4) lender-purchased mortgage insurance may be tax-deductible for federal income tax purposes, if the borrower itemizes deductions; and (5) lender-purchased mortgage insurance and borrower-purchased mortgage insurance both have benefits and disadvantages. The lender must also provide a generic analysis of the differing costs and benefits over a 10-year period (assuming prevailing interest and property appreciation rates) for a mortgage with lender-purchased mortgage insurance compared to the same mortgage with borrower-purchased mortgage insurance.

Servicer's Annual Disclosures for Borrower-Purchased Mortgage Insurance

The Act requires the mortgage servicer to make annual disclosures to borrowers who have borrower-purchased mortgage insurance, if their mortgage closed on or after 07/29/99 and the loan proceeds were used for the purchase, initial construction, or refinancing of their one-family principal residence. The servicer is also required to make annual disclosures if a mortgage that closed before 07/29/99 is secured by a borrower's one-family principal residence (regardless of the use of the loan proceeds). The annual disclosures may be made at any time, and may be included in other notices (such as the annual escrow analysis or the year-end tax statement) as long as the servicer discloses the information to the borrower at least once during each 12-month period. (The initial annual disclosure for mortgages closed before 07/29/99 must be made by 07/28/2000. For mortgages closed on or after 07/29/99, the initial annual disclosure must be made within one year of the closing date of the mortgage. A servicer that wants to schedule its future disclosures on a calendar year basis may schedule its first disclosure for the same calendar year in which the mortgage is originated and then make another disclosure shortly after the first of the next calendar year.)

The content of the annual disclosures differs slightly depending on when the mortgage was closed (and, in some cases, on the use of the loan proceeds):

- For mortgages closed on or after 07/29/99 for which the loan proceeds are used for the purchase, initial construction, or refinancing of the borrower's one-family principal residence, the servicer's written disclosure must state the borrower's rights to automatic termination and/or borrower-initiated cancellation of mortgage insurance under the Act. The servicer must also provide an address and telephone number that the borrower may use when contacting the servicer to obtain information about cancellation of the mortgage insurance.

- For mortgages closed before 07/29/99 that are secured by the borrower's one-family principal residence (regardless of the use of the loan proceeds), the servicer's written disclosure must state that the requirement for mortgage insurance may be cancelled at the borrower's request if certain conditions are met or as required by applicable state law. The servicer must also provide an address and telephone number that the borrower may use when contacting the servicer to obtain information about whether, when, and how the mortgage insurance can be cancelled. We also require the servicer to state that since the conditions for cancelling mortgage insurance for these mortgages are not statutory under federal law, they may be changed at any time (unless otherwise required by state law).

Further, since both termination and cancellation of mortgage insurance (whether under the provisions of the Act or Fannie Mae's policy) are based on certain conditions having been met, the servicer's annual disclosure must not imply that any particular borrower has already satisfied the conditions necessary for termination or cancellation or that the borrower has an absolute right to termination or cancellation. The servicer also may choose to disclose that the borrower may have to pay certain fees – such as those for obtaining a broker's price opinion, a certification of value, or a new appraisal – before a request for cancellation of the mortgage insurance can be granted.

Servicer's One-Time Disclosure for Lender-Purchased Mortgage Insurance

If lender-purchased mortgage insurance is required in connection with a mortgage closed on or after 07/29/99 and the loan proceeds are used for the purchase, initial construction, or refinancing of the borrower's one-family principal residence, the Act requires the servicer to make a one-time disclosure to the borrower no later than 30 days after the date mortgage insurance would have been terminated had the mortgage had borrower-purchased mortgage insurance. The disclosure must state that the borrower may wish to review refinancing options that could eliminate the requirement for mortgage insurance.

Lenders should confer with their legal counsel about whether this disclosure should be given for any other mortgage for which they require lender-purchased mortgage insurance.

Automatic Termination of Mortgage Insurance

All conventional mortgages serviced for Fannie Mae will be subject to automatic termination of mortgage insurance. The borrower does not have to take any action to initiate an automatic termination, nor may the servicer impose a charge for processing the termination. The timing for the automatic termination will vary for different categories of mortgages, as explained below. A servicer should use the occupancy status of the property when the mortgage was closed to determine how the mortgage should be categorized when applying specific eligibility criteria related to automatic termination.

Mortgages Closed On or After 07/29/99 That Are Secured by a One-Family Principal Residence or Second Home

The servicer must automatically terminate the mortgage insurance on the applicable termination date for any mortgage closed on or after 07/29/99 that is secured by the borrower's one-family principal residence or second home – provided the borrower's payments are current on the termination date. (If payments are not current on that date, the mortgage insurance must be terminated later if, and when, the payments become current.) The applicable termination date is the date that the principal balance of the mortgage is *first scheduled* to reach a level that is 78% of the original value of the property. If the scheduled loan-to-value ratio for the mortgage does not reach 78% before the mid-point of the mortgage amortization period, the first day of the month following the date the mid-point is reached must be used as the termination date.

- For fixed-rate mortgages, the applicable termination date will be determined based solely on the initial amortization schedule, without regard to the actual outstanding mortgage balance.
- For adjustable-rate mortgages, the applicable termination date will be determined based on the amortization schedules for the mortgage, without regard to the actual outstanding mortgage balance. (The original amortization period should be used to determine the mid-point for a mortgage.)

All Mortgages Closed Before 07/29/99 and Mortgages Closed On or After 07/29/99 That Are Secured by a One- to Four-Family Investment Property or a Two- to Four-Family Principal Residence

The servicer must automatically terminate the mortgage insurance on the first day of the month after the date that is the mid-point of the original mortgage amortization period for any mortgage closed before 07/29/99 and for any mortgage closed on or after 07/29/99 if it is secured by a one- to four-family investment property or a two- to four-family principal residence – provided the borrower's payments are current on that date. (If payments are not current on that date, the mortgage insurance must be terminated later if, and when, the payments become current.) The mid-point of the original amortization period occurs after 7½ years for mortgages with an original amortization period of 15 years; after 10 years for mortgages with an original amortization period of 20 years; and after 15 years for mortgages with an original amortization period of 30 years. Our 7-year balloon mortgages will not be eligible for automatic termination of mortgage insurance since the balloon maturity date will occur before the mid-point of the amortization period; however, if the conditional refinancing option is exercised (thus refinancing the mortgage for an additional 23 years), the mortgage insurance for the refinance mortgage will be eligible for automatic termination 11½ years after the refinancing (which is the mid-point of the 23-year amortization period for the refinance mortgage).

We encourage servicers to begin terminating the mortgage insurance for all mortgages they are servicing for us as soon as possible after 07/29/99 – provided the mortgages satisfy our requirements for automatic termination. By no later than 01/02/2001, servicers must have completed the application of this termination policy to all mortgages that become eligible for automatic termination before that date (regardless of whether the mortgages were added to the servicer's portfolio before, on, or after 07/29/99).

When the termination takes place after the mid-point of the original amortization period for any mortgage subject to this automatic termination policy, the servicer is not obligated to return to the borrower any funds that it collected for mortgage insurance premiums after the mid-point date of the mortgage and subsequently paid to the mortgage insurer to keep the mortgage insurance in force. However, if the mortgage insurer sends the servicer a refund of unearned premiums following the termination of the mortgage insurance, the servicer must send the refund to the borrower.

On-Going Evaluation of Portfolio for Automatic Terminations

The servicer must establish appropriate monitoring procedures that provide for an on-going review of all mortgages in its portfolio (on at least a monthly basis) to assure that borrower-purchased mortgage insurance is automatically terminated when required by Fannie Mae or applicable law. The servicer's review must determine not only whether a mortgage is eligible for automatic termination of the mortgage insurance based on the scheduled termination date (or the mid-point of the amortization period, as applicable), but also on whether the borrower's payments are current on that date.

A borrower's mortgage payments are considered to be "current" if the payment due in the month preceding the scheduled termination date (or the mid-point of the amortization period, as applicable) and all outstanding late charges were paid by the end of the month in which the payment was due. For example, if the scheduled termination date for a mortgage is 04/01/2000, the borrower's mortgage payments will be considered current if the amount due on 03/01/2000 (which includes the payment and all outstanding late charges) is paid by 03/31/2000.

- If the borrower's payments are current and the mortgage is eligible for automatic termination based on its *scheduled* amortization, the servicer must terminate the mortgage insurance immediately. However, if the mortgage is eligible for automatic termination of mortgage insurance based on the mid-point of the amortization period, the servicer must terminate the mortgage insurance not later than the first day of the month following the mid-point date. Within 30 days after the termination occurs, the servicer must notify the borrower that the mortgage insurance has been terminated and indicate that no further escrow deposits for mortgage insurance will be required as part of the mortgage payment.

- If the borrower's payments are <u>not</u> current, the servicer must not terminate the mortgage insurance (even if the other eligibility criterion for automatic termination are met). The servicer must notify the borrower within 30 days after the *scheduled* termination date (or the mid-point of the amortization period, as applicable) that the mortgage insurance was not automatically terminated because the payments were not current. The servicer should re-evaluate the status of the borrower's payments as part of its next portfolio review (and subsequent reviews, if necessary). If, at the time of the re-evaluation, the borrower's payments have become current, the servicer must terminate the mortgage insurance immediately. Within 30 days after the termination occurs, the servicer must notify the borrower of the termination and indicate that no further escrow deposits for mortgage insurance will be required as part of the mortgage payment.

Borrower-Initiated Cancellations Based on Original Property Value

A borrower may request cancellation of borrower-purchased mortgage insurance for any *conventional mortgage (regardless of its closing date)* based on the original value of the property. Generally, borrowers who request cancellation of mortgage insurance based on the original value of the property will be those who have been making payments on the mortgage for a number of years and those who have made additional principal payments that have accelerated the amortization of their mortgage balances. When a borrower submits a written request for cancellation of borrower-purchased mortgage insurance based on the original value of the property, the servicer must cancel the mortgage insurance if the borrower has an acceptable payment record and the servicer is satisfied that mortgage meets the applicable loan-to-value ratio eligibility criterion (as evidenced by the servicer's warranty, a broker's price opinion, a certification of value, or a new appraisal). A servicer should use the occupancy status of the property when the mortgage was closed to determine how the mortgage should be categorized when applying specific eligibility criteria related to this type of borrower-initiated cancellation. We will not require the servicer to obtain evidence about the title status of the property.

For any adjustable-rate mortgage closed on or after 07/29/99 that is secured by a one-family principal residence or second home, the servicer must notify the borrower on the date that the mortgage balance is *first scheduled* to reach (or actually reaches) 80% of the original value of the property that he or she may be eligible for cancellation of the mortgage insurance based on the original value of the property. This notification is not required for fixed-rate mortgages.

Evaluating Borrower Requests for Cancellation

If the borrower's request for cancellation includes all information necessary to reach a decision about the cancellation, the servicer should determine whether the borrower has an acceptable payment record and the loan-to-value ratio of the mortgage meets our eligibility criterion.

- A borrower has an acceptable payment record if he or she has had no payment 30 days or more past due in the 12 months preceding the applicable cancellation date and has had no payment 60 days or more past due in the 24 months preceding that date. If the mortgage has been outstanding for fewer than 24 months (or fewer than 24 months have elapsed since the current borrower assumed the mortgage), the servicer should apply the payment record acceptability criteria to the length of time that the mortgage has been outstanding (or that has elapsed since the borrower assumed the mortgage).
    - The applicable cancellation date for a mortgage closed on or after 07/29/99 that is secured by a one-family principal residence or second home is the date on which the mortgage is *first scheduled* to reach (or actually reaches) a level that is 80% of the original value of the property, regardless of the date on which the borrower actually requests the cancellation. (For a fixed-rate mortgage, the date

on which the mortgage is first scheduled to reach a level that is 80% of the original value of the property is based solely on the initial amortization schedule. For an adjustable-rate mortgage, that date is based on the amortization schedules for the mortgage.)

- The applicable cancellation date for any other mortgage is the date on which the lender determines that all eligibility criteria for cancellation have been satisfied.

- The loan-to-value (or combined loan-to-value) ratio eligibility criteria vary depending on the lien position of the mortgage, the closing date of the mortgage, and the number of dwelling units and occupancy status of the property:
  - For a first mortgage closed on or after 07/29/99 that is secured by a one-family principal residence or second home, the loan-to-value ratio eligibility criterion is met on the date that the mortgage balance is *first scheduled* to reach 80% of the original value of the property (or on the date that the mortgage balance actually reaches 80%).
  - For all other first mortgages, the loan-to-value ratio eligibility criterion is met on the date that the outstanding principal balance of the mortgage reaches the applicable percentage of the original value of the property. The applicable percentages are 80% for a mortgage secured by a one-family principal residence or second home and 70% for a mortgage secured by a one- to four-family investment property or a two- to four-family *principal residence*.
  - For all second mortgages, the combined loan-to-value ratio eligibility criterion is met on the date that the sum of the outstanding principal balances of all mortgages secured by the property reaches 70% of the value of the property at the time the second mortgage was originated.

If the borrower has an acceptable payment record and our applicable loan-to-value ratio (or combined loan-to-value ratio) eligibility criterion is met, a servicer that is satisfied that the property has not declined in value since the mortgage was closed must approve the request for cancellation. A servicer that approves a borrower-initiated request for cancellation of mortgage insurance based on the original value of the property warrants to us that the current value of the property is at least equal to the original value of the property.

When the servicer is concerned about its ability to make the property value warranty for any reason – for example, because there has been a decline in market values in a particular area since the mortgage was closed – the servicer may delay its decision on the request until after it obtains a broker's price opinion, a certification of value, or a new appraisal. The servicer must select the broker or appraiser; order the price opinion, certification of value, or appraisal; and receive the results directly from the broker or appraiser. The servicer may choose any of these alternatives for verifying that the value of the property is at least equal to its original value and may pass on the fee to the borrower. Generally, a broker's price opinion or a certification of value will be sufficient to confirm the property value. However, servicers may want to require an appraisal when the property is located in an area where values have declined since the mortgage was originated, particularly if the borrower has made additional principal payments to reduce the mortgage balance.

As soon as the servicer receives the applicable fee for the confirmation of value from the borrower, it should request a broker's price opinion, a certification of value, or a new appraisal.

- When the current value of the property is confirmed as being at least equal to its original property value, the servicer must cancel the mortgage insurance and notify the borrower accordingly.

- When the current value of the property is confirmed as being less than the original value of the property, the servicer generally should deny the borrower's request for cancellation. However, if the value of the property was determined based on a new appraisal, the servicer can approve the request for cancellation if the borrower has paid down the balance of the mortgage (or agrees to pay it down) to the point that it satisfies our applicable loan-to-value (or combined loan-to-value) ratio eligibility criterion, based on the actual principal balance of the mortgage and the new appraised value of the property. In this case, the servicer warrants to us that it has reviewed the appraisal and is satisfied that the estimate of value is both reasonable and adequately supported by market data.

Notifying Borrowers About Status of Cancellation Requests

When our requirements for cancellation of mortgage insurance are satisfied, the servicer must contact the borrower within 30 days after the cancellation occurs to inform him or her that the mortgage insurance has been cancelled and that no further escrow deposits for mortgage insurance will be required as part of the mortgage payment.

If our requirements for cancellation are not satisfied, the servicer must notify the borrower that the request for cancellation has been denied and provide the grounds for the denial (including the results of any broker's price opinion, certification of value, or appraisal). This written notification must be sent within 30 days after the later of (1) the date on which the servicer received the borrower's request for cancellation or (2) the date on which the servicer received the broker's price opinion, certification of value, or appraisal.

Borrower-Initiated Cancellations Based on Current Property Value

A borrower may request cancellation of borrower-purchased mortgage insurance for any conventional mortgage (regardless of its closing date) based on the current appraised value of the property. Generally, borrowers who request cancellation of mortgage insurance based on the current value of their property will be those who have increased the value of their property because of improvements they made and those who believe that the value of their property has increased because of increasing property values in the neighborhood. When a borrower submits a written request for cancellation of borrower-purchased mortgage insurance based on the current appraised value of the property, the servicer must cancel the mortgage insurance – provided the borrower has an acceptable payment record and the mortgage satisfies our applicable loan-to-value ratio criterion. A servicer should use the current occupancy status of the property (as provided by the borrower) to determine how the mortgage should be categorized when applying specific eligibility criteria related to this type of borrower-initiated cancellation. We will not require the servicer to obtain evidence about the title status of the property.

Evaluating Borrower Requests for Cancellation

If the borrower's request for cancellation includes all information necessary to reach a decision about the cancellation and payment for the required appraisal, the servicer should determine whether the borrower has an acceptable payment record and the loan-to-value ratio of the mortgage meets our eligibility criterion.

- A borrower has an acceptable payment record for cancellation of mortgage insurance based on the current property value if he or she has had no payment 30 days or more past due in the 12 months preceding the date that the mortgage insurance will be cancelled and has had no payment 60 days or more past due in the 24 months period preceding that date. (If the current borrower assumed the mortgage and does not have a 24-month payment history for the mortgage, the mortgage insurance *may not* be cancelled until after he or she achieves a 24-month history.)

- The loan-to-value ratio for a first mortgage is determined by dividing the outstanding balance of the mortgage by the current appraised value of the property; the combined loan-to-value ratio for a second mortgage is determined by dividing the sum of the outstanding balances of all mortgages secured by the property by the current appraised value of the property. To determine the current appraised value of the property, the servicer must select an appraiser, order a new appraisal (which must be based on an inspection of both the interior and exterior of the property and be prepared in accordance with our appraisal standards for new mortgage originations), and receive the results of the appraisal. (The borrower is also entitled to receive a copy of the appraisal).

  The loan-to-value ratio eligibility criterion for a mortgage is based on the lien status of the mortgage, the number of dwelling units and occupancy status of the property, and the seasoning of the mortgage. Mortgage insurance generally cannot be cancelled for any mortgage that has been seasoned for fewer than two years. However, if a borrower who is the original borrower on the mortgage has made property improvements since the mortgage was originated and the property value has increased as a result of the improvements, we will waive the minimum two-year seasoning requirement (and will limit the borrower's payment history requirement to the length of time that has elapsed since the mortgage was originated). In this case, the applicable loan-to-value ratio will be the one that applies to mortgages that have between two and five years of seasoning.

- For a first mortgage secured by a one-family principal residence or second home, the loan-to-value ratio must be 75% (or less), if the seasoning of the mortgage is between two and five years, and 80% (or less), if the seasoning of the mortgage is greater than five years;
- For a first mortgage secured by a one- to four-family investment property or a two- to- four family principal residence, the loan-to-value ratio must be 70% (or less), regardless of the seasoning of the mortgage;
- For any second mortgage, the combined loan-to-value ratio must be 70% (or less), regardless of the seasoning of the mortgage.

If the borrower has an acceptable payment record and the current appraised value of the property results in a loan-to-value ratio that satisfies our applicable loan-to-value ratio (or combined loan-to-value ratio) criterion, the servicer must approve the request to cancel the mortgage insurance. A servicer that approves a request for cancellation of mortgage insurance based on the current value of the property warrants to us that it has reviewed the appraisal and is satisfied that the estimate of value is both reasonable and adequately supported by market data.

Notifying Borrowers About Status of Cancellation Requests

When our requirements for cancellation of mortgage insurance are satisfied, the servicer must contact the borrower within 30 days after the cancellation occurs and inform him or her that the mortgage insurance has been cancelled and that no further escrow deposits for mortgage insurance will be required as part of the mortgage payment.

If our requirements for cancellation are not satisfied, the servicer must notify the borrower that the request for cancellation has been denied and provide the grounds for the denial (including the results of the appraisal). This written notification must be sent within 30 days after the later of (1) the date on which the servicer received the borrower's request for cancellation, or (2) the date on which the servicer received the appraisal.

Effect of Mortgage Insurance Cancellation on Borrower's Payment

Within 30 days after borrower-purchased mortgage insurance is terminated or cancelled for any reason, the servicer must notify the borrower about the termination or cancellation and indicate that no further escrow deposits for mortgage insurance premiums will be due from the borrower. If the servicer does not perform a new escrow analysis for the mortgage at the time the mortgage insurance is terminated or cancelled, it must also advise the borrower that any escrow deposits that had accumulated for the payment of the next mortgage insurance premium that was to come due will be taken into consideration in the borrower's next escrow account analysis.

When the mortgage insurance is automatically terminated, the servicer may not collect mortgage insurance premiums as part of the borrower's mortgage payment more than 30 days after the later of (1) the scheduled termination date (or the mid-point of the amortization period, as applicable) or (2) the date after the scheduled termination date (or mid-point date, as applicable) on which the borrower's mortgage payments became current. For a borrower-initiated cancellation of mortgage insurance, the servicer may not collect mortgage insurance premiums as part of the borrower's mortgage payment more than 30 days after the later of (1) the date on which the servicer received the borrower's request for cancellation or (2) the date on which all eligibility criteria for cancellation were satisfied. Within the applicable required timeframe, the servicer must reduce the borrower's mortgage payment by the amount that was being collected to pay the mortgage insurance premium. However, if the servicer performs a new escrow analysis for the mortgage at the time the mortgage insurance is terminated and determines that other escrow items need to be adjusted, the resulting change in the mortgage payment may not equal the amount previously escrowed for the mortgage insurance premium.

When the mortgage insurance premium was financed as part of the mortgage amount, the servicer must not reduce the borrower's payment. However, in some cases, the borrower may be due an unearned premium refund.

The servicer must forward any unearned mortgage insurance premium refund to the borrower as soon as it is received from the mortgage insurer. The servicer should establish appropriate follow-up procedures with the mortgage insurer to assure that it receives the unearned premium refund in sufficient time to send it to the borrower by no later than 45 days after the date the mortgage insurance is terminated or cancelled.

Reporting Mortgage Insurance Terminations and Cancellations to Fannie Mae

We will require the servicer to notify us about automatic terminations or borrower-initiated cancellations of mortgage insurance that take place on or after 07/29/99, by reporting the appropriate Action Code and Action Date on the LASER *Loan Activity Report*. To assure that a servicer will have sufficient time to make the necessary system changes for this reporting requirement – and to tie it to the mandatory date for completing the automatic termination of all mortgages in a servicer's portfolio that become eligible for termination by 01/02/2001 – we will not make the reporting requirement mandatory until 02/02/2001. However, our systems will be able to accept reports on mortgage insurance cancellations and terminations as of 10/04/99, if a servicer chooses to report cancellations and terminations as they are actually processed. If, on 02/02/2001, a servicer has not reported any cancellation or termination that took place between 07/29/99 and 01/02/2001, it must do so as part of the reports due on that date. The servicer must report all subsequent terminations or cancellations by the second business day of the month after the month in which the mortgage insurance is terminated or cancelled.

The Action Code that must be reported differs based on whether the mortgage insurance is automatically terminated or cancelled, and on whether the servicer uses electronic data interchange (EDI) for investor reporting. (Servicers that use the EDI codes should adjust their transaction set map or have their EDI translation software vendor make the appropriate adjustments.) The Action Date should be reported as the last day of the month in which the termination or cancellation occurs.

- For servicers that are using the transaction types and data element identifications that are currently part of the LASER record, the following Action Codes should be used:
  - Use Action Code 51 to report a borrower-initiated cancellation based on the original value of the property (or, in the case of a second mortgage, the value of the property at the time the second mortgage was originated).
  - Use Action Code 52 to report a borrower-initiated cancellation based on the current appraised value of the property.
  - Use Action Code 53 to report an automatic termination of mortgage insurance, whether the automatic termination is based on a *scheduled* termination date or the date that is the mid-point of the mortgage amortization period.
- For servicers that use the EDI Investor Reporting Transaction Set 203, the following EDI codes for reporting mortgage insurance terminations or cancellations, which are in Data Element 1376 of the IRA segment, should be used:
  - Use Action Code 1M to report a borrower-initiated cancellation based on the original value of the property (or, in the case of a second mortgage, the value of the property at the time the second mortgage was originated).
  - Use Action Code 1N to report a borrower-initiated cancellation based on the current appraised value of the property.
  - Use Action Code 1O (the letter O, not zero) to report an automatic termination of mortgage insurance, whether the automatic termination is based on a *scheduled* termination date or the date that is the mid-point of the mortgage amortization period.

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Servicers should contact their Servicing Specialist in their lead Fannie Mae regional office if they have any questions about our new policy related to the termination or cancellation of mortgage insurance for conventional mortgages.

Robert J. Engelstad

Robert J. Engelstad
Senior Vice President

Attachment

Attachment 1
Summary of Fannie Mae's Termination and Cancellation Policy for Borrower-Purchased Mortgage Insurance

Automatic Termination of Mortgage Insurance

Eligibility Criteria	Mortgages Closed On or After 07/29/99	Mortgages Closed Before 07/29/99
Earliest Date for Automatic Termination	First mortgages secured by 1 family principal residences/2nd homes Earlier of (1) the date that the mortgage balance is *first scheduled* to reach 78% of the original value of the property or (2) the first day of the month after the date that is the mid-point of the mortgage amortization period	First mortgages secured by 1 family principal residences/2nd homes The first day of the month after the date that is the mid-point of the mortgage amortization period Second mortgages secured by 1-4 family principal residences The first day of the month after the date that is the mid-point of the mortgage amortization period
	First mortgages secured by 2-4 family principal residences or 1-4 family investment properties The first day of the month after the date that is the mid-point of the mortgage amortization period	First mortgages secured by 2-4 family principal residences or 1-4 family investment properties The first day of the month after the date that is the mid-point of the mortgage amortization period
Payment Status	The payment due in the month before the termination date and any outstanding late charges must have been paid by the end of the month before the termination date. If this is not the case, the mortgage insurance must be cancelled later if, and when, the payments become current.	The payment due in the month before the termination date and any outstanding late charges must have been paid by the end of the month before the termination date. If this is not the case, the mortgage insurance must be cancelled later if, and when, the payments become current.

Borrower-Initiated Cancellation of Mortgage Insurance Based on Original Value

Eligibility Criteria	Mortgages Closed On or After 07/29/99	Mortgages Closed Before 07/29/99
Earliest Date for Borrower-Initiated Cancellation Requests	First mortgages secured by 1 family principal residences/2nd homes Either (1) the date that the mortgage balance is *first scheduled* to reach 80% of the original property value or (2) the date that the mortgage balance actually reaches 80% of the original property value First mortgages secured by 2-4 family principal residences or 1-4 family investment properties The date that the mortgage balance actually reaches 70% of the original property value	First mortgages secured by 1 family principal residences/2nd homes The date that the mortgage balance actually reaches 80% of the original property value Second mortgages secured by 1-4 family principal residences The date that the combined balances of all outstanding mortgages actually reaches 70% of the property value at the time the second mortgage was originated First mortgages secured by 2-4 family principal residences or 1-4 family investment properties The date that the mortgage balance actually reaches 70% of the original property value
Evidence of Property Value	Servicer's warranty that current property value is at least equal to the original property value. If the servicer is not comfortable with making this warranty, it may require a broker's price opinion, a certification of value, or a new appraisal to confirm the value. The servicer may charge the borrower for the cost of the applicable confirmation of value.	Servicer's warranty that current property value is at least equal to the original property value. If the servicer is not comfortable with making this warranty, it may require a broker's price opinion, a certification of value, or a new appraisal to confirm the value. The servicer may charge the borrower for the cost of the applicable confirmation of value.

Eligibility Criteria	Mortgages Closed On or After 07/29/99	Mortgages Closed Before 07/29/99
Payment Status	Borrower must have had no payment 30 days or more past due in the 12 months preceding the date that the mortgage balance is *first scheduled* to reach 80% of the original property value or the date that the mortgage balance actually reaches 80% of the original property value (regardless of when the request for cancellation is actually made) and must have had no payment 60 days or more past due in the 24 months preceding that date. If the borrower has had the mortgage for less than 24 months, the payment history requirement will be based on the length of time the borrower has had the mortgage.	Borrower must have had no payment 30 days or more past due in the 12 months preceding the date on which the mortgage insurance will be cancelled and must have had no payment 60 days or more past due in the 24 months preceding that date. If the borrower has had the mortgage for less than 24 months, the payment history requirement will be based on the length of time the borrower has had the mortgage.

Borrower-Initiated Cancellation of Mortgage Insurance Based on Current Value

Eligibility Criteria	Mortgages Closed On or After 07/29/99	Mortgages Closed Before 07/29/99
Earliest Date for Borrower-Initiated Cancellation Requests	First mortgages secured by 1 family principal residences/2nd homes The date that the mortgage balance actually reaches (1) 80% of the current property value, if the seasoning of the mortgage is greater than 5 years or (2) 75% of the current property value, if the seasoning of the mortgage is between 2 and 5 years.	First mortgages secured by 1 family principal residences/2nd homes The date that the mortgage balance actually reaches (1) 80% of the current property value, if the seasoning of the mortgage is greater than 5 years or (2) 75% of the current property value, if the seasoning of the mortgage is between 2 and 5 years. Second mortgages secured by 1-4 family principal residences The date that the combined balances of all outstanding mortgages actually reaches 70% of the current property value
	First mortgages secured by 2-4 family principal residences or 1-4 family investment properties The date that the mortgage balance actually reaches 70% of the current property value	First mortgages secured by 2-4 family principal residences or 1-4 family investment properties The date that the mortgage balance actually reaches 70% of the current property value
Minimum Seasoning Requirement	Generally, cancellation is not permitted unless the mortgage has at least two years of seasoning. This requirement is waived if the borrower is the original borrower on the mortgage and has, since the mortgage was originated, made improvements to the property that resulted in an increase in property value.	Generally, cancellation is not permitted unless the mortgage has at least two years of seasoning. This requirement is waived if the borrower is the original borrower on the mortgage and has, since the mortgage was originated, made improvements to the property that resulted in an increase in property value.

Eligibility Criteria	Mortgages Closed On or After 07/29/99	Mortgages Closed Before 07/29/99
Evidence of Property Value	Servicer must obtain a new appraisal that is based on an inspection of both the interior and exterior of the property. Servicer warrants that it has reviewed the appraisal and is satisfied that the estimate of value is both reasonable and adequately supported by market data. The servicer may charge the borrower for the cost of the appraisal.	Servicer must obtain a new appraisal that is based on an inspection of both the interior and exterior of the property. Servicer warrants that it has reviewed the appraisal and is satisfied that the estimate of value is both reasonable and adequately supported by market data. The servicer may charge the borrower for the cost of the appraisal.
Payment Status	Borrower must have had no payment 30 days or more past due in the 12 months preceding the date on which the mortgage insurance will be cancelled and must have had no payment 60 days or more past due in the 24 months preceding that date. If our two-year mortgage seasoning requirement is waived because a borrower who is the original borrower made improvements to the property, then the borrower's payment history requirement will be based on the length of time that has elapsed since the mortgage was originated. However, if a borrower who assumed the mortgage after it was originated does not have a 24-month payment history for the mortgage, the mortgage insurance may not be cancelled until he or she achieves that history.	Borrower must have had no payment 30 days or more past due in the 12 months preceding the date on which the mortgage insurance will be cancelled and must have had no payment 60 days or more past due in the 24 months preceding that date. If our two-year mortgage seasoning requirement is waived because a borrower who is the original borrower made improvements to the property, then the borrower's payment history requirement will be based on the length of time that has elapsed since the mortgage was originated. However, if a borrower who assumed the mortgage after it was originated does not have a 24-month payment history for the mortgage, the mortgage insurance may not be cancelled until he or she achieves that history.