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MORE BAD NEWS FOR MORTGAGE LENDERS? PMI COMPANIES ATTEMPTING TO RESCIND INSURANCE POLICIES

The last few years have presented many challenges for mortgage lenders. The latest challenge may be coming from an unlikely source - private mortgage insurance policies. Private mortgage insurance, or PMI, is the insurance that mortgage lenders purchase, or cause their borrowers to purchase, when the borrower does not make a down payment of at least 20% when purchasing a home. The PMI policy is intended to protect the lender in the event of a default by the borrower.

With so many mortgage loans in default today, PMI companies are likely facing the risk of significant liabilities. As a result, PMI companies are attempting to rescind many PMI policies, even though the policies were purchased and paid for years ago, may have been required by law, and were integral to the lender's decision to approve the borrower's loan application. The PMI companies are taking the position that they have discovered extensive amounts of fraud and misrepresentation by policyholders during the application process.

Some level of rescissions for fraud is commonplace in this industry. However, it appears that rescissions are reaching an unprecedented level. For example, in its first-quarter earnings call on April 29, 2009, the MGIC Investment Corporation reported:

"Historically, claims submitted to us on policies we rescinded were less than 5 percent of our claims resolved during a year. This increased to approximately 15 percent in the fourth quarter of 2008 and was over 20 percent in the first quarter of 2009. Rescissions have materially mitigated our paid losses in 2008 and 2009."

In its second quarter earnings call, MGIC did not report on the percentage of claims submitted in the second quarter that were rescinded, but it did state that the dollar amount of rescinded loans in the second quarter was more than 40% higher than the dollar amount of rescinded loans in the first quarter, which would indicate that the number of rescinded loans is continuing to escalate rapidly.

Of course, the PMI companies recognize that this approach (i.e., for MGIC a quadrupling of rescissions over the normal rate) will not go unchallenged. The MGIC spokesperson went on to state that "while we have a substantial pipeline of claims investigations that we expect will eventually result in rescissions during the second and third quarters of 2009, we can give no assurance that rescissions will continue to mitigate paid losses at the same level we have recently experienced. In addition, if the insured disputes our right to rescind coverage, whether the requirements to rescind are met ultimately would be determined by arbitration or judicial proceedings. Objections to rescission may be made several years after we have rescinded an insurance policy."

By increasing rescissions in this manner, PMI companies are attempting to avoid being held accountable for the consequences of their decisions, and leave their policyholders holding the bag.

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