The new Consumer Financial Protection Bureau recently initiated “administrative proceedings” against New Jersey based mortgage insurance company PHH Corporation and its corporate subsidiaries. The CFPB has alleged that an investigation revealed a quid pro quo kickback scheme where PHH would lend, or “originate” a mortgage, and then refer that mortgagor to an insurance company that would insure the mortgage, in exchange for a cut of premiums. According to the CFPB, the deal allowed PHH to steer its new mortgagors to companies that would, in return, purchase re-insurance from PHH and its affiliates.

Many homeowners might not know of the need for mortgage insurance, or even if they have it on their home. In a typical scenario, a mortgagor (the homeowner) has mortgage insurance on a loan where they did not pay 20 percent down at closing. Mortgage insurance is not the same as traditional homeowners insurance – it does not pay the homeowner in the event of a loss. Instead, it pays the lender who loaned the homeowner the funds, in case the homeowner defaults on the loan. Traditional insurance premiums, like homeowners insurance, is paid by the homeowner, but protects the homeowner from loss in the case of, say, a fire to the home. Mortgage Insurance premiums, however, commonly referred to as “PMI,” are still paid by the homeowner as part of his or her mortgage payment, but the beneficiary of that policy is the bank or lender, not the homeowner. It is one of the few methods of insurance where the premium is paid by the person who is not the beneficiary of the insurance policy.

This scenario often means the lender picks the mortgage insurance company. Consumers can usually review their loan information through the website of their loan servicer, and find out whether they are making PMI payments as part of their mortgage, and who the PMI carrier is. All homeowners with a mortgage should know whether they are paying for PMI coverage, as certain federal laws permit a homeowner to stop paying on these policies if there is enough principal paid against the original loan amount.

If the mortgage insurance policy has to be called on because the homeowner defaults on their loan, the lender gets their money from the insurance company. At that point, however, the insurance company to whom the homeowner has been making payments can now go after the homeowner to recover the amount paid to the lender after default. This is typically referred to in most states as a “subrogation” action.