

PROPOSED GUIDANCE SUMMARY

Prepared by the NASCUS Regulatory Affairs Department
January 7, 2010

FFIEC

Reverse Mortgage Products

Guidance for Managing Compliance and Reputation Risks

The Federal Financial Institutions Examination Council (FFIEC)¹ is requesting comment on proposed *Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks* (guidance). When the guidance is finalized, it will be issued by the federal banking agencies, including NCUA (FBAs) to the institutions that they supervise. FFIEC's State Liaison Committee (SLC) will encourage state regulators to adopt the guidance as well. Upon issuance, institutions will be expected to use the guidance in their efforts to ensure that their risk management and consumer protection practices adequately address the compliance and reputation risks raised by reverse mortgage lending.

FFIEC states in its summary of the guidance that although the FFIEC agencies have not encountered widespread use of reverse mortgage products among their regulated entities, they are issuing the guidance in response to anticipated growth of the product as the US population ages.

Comments Due Date:

Comments must be submitted to FFIEC on or before **February 16, 2010**.

To view the proposed guidance:

<http://www.ffiec.gov/guidance/ReverseMortgageGuidance12-17-09.pdf>

Guidance Summary

Reverse mortgages are home-secured loans typically offered to elderly consumers (typically a qualifying consumer would have to be age 62+). FFIEC agency supervised institutions currently provide two basic types of reverse mortgage products:

- Lenders' own proprietary reverse mortgage products; and

¹ The six members of the FFIEC are the FBAs: the Office of the Comptroller of the Currency (OCC); the Board of Governors of the Federal Reserve System (Board); the Federal Deposit Insurance Corporation (FDIC); the Office of Thrift Supervision (OTS); the National Credit Union Administration (NCUA), and the State Liaison Committee (SLC) of the FFIEC.

- Home Equity Conversion Mortgages (HECM)².

Reverse mortgages generally are non-recourse, home-secured loans that provide one or more cash advances to borrowers and require no repayments until a future time. Both HECMs and proprietary reverse mortgages generally must be repaid only when:

- The last surviving borrower dies;
- All borrowers permanently move to a new principal residence; or
- The loan is in default (such as borrower's failure to maintain insurance, pay property taxes, or maintain the property itself).

When a reverse mortgage becomes due, the home must be sold or the borrower (or surviving heirs) must repay the full amount of the loan (including accrued interest).

The guidance reminds institutions that both HECMs and proprietary reverse mortgage products are subject to laws and regulations governing mortgage lending. Institutions must apply all applicable regulations such as §5 of FTCA, prohibiting unfair or deceptive acts or practices; Regulation Z disclosures for advertisements and loan applications; and RESPA and HUD's rules requiring disclosure of early estimated and final settlement costs and prohibiting referral fees and other charges for services not actually performed. Institutions must also be aware of state laws which may apply to reverse mortgage transactions.

In addition, HECM reverse mortgages are subject to the consumer protections and other special provisions set forth in HUD regulations, including several rules related to ensuring consumers have sufficient information to make informed decisions regarding reverse mortgages.

The guidance notes that these products, especially those proprietary products not subject to HUD's HECM rules, raise concern among regulatory agencies that consumers do not fully understand the products and loan features. For example, some entities have stressed that the loans cannot be foreclosed upon because the loan does not come due until the borrower leaves the house. However, borrower failure to maintain the property, pay property taxes and maintain insurance would void the loan agreement, triggering repayment obligation and the possibility of foreclosure.

To address the above concerns, FFIEC recommends the following policies and procedures:

- Institutions offering proprietary reverse mortgage products will be expected to follow or to adopt relevant HECM requirements such as mandatory counseling, disclosures, affordable origination fees, restrictions on cross-selling of ancillary products, and reliable appraisals.

² A HECM is a reverse mortgage product insured by the Federal Housing Administration (FHA), which is part of the U.S. Department of Housing and Urban Development (HUD), and subject to a range of federal consumer protection and other requirements.

- The Agencies expect institutions to take appropriate steps to determine that consumers will be able to pay required taxes and insurance.
- Institutions should review advertisements and other marketing materials to ensure that important information is disclosed clearly and conspicuously.
- Institutions also should be attentive to the timing, content, and clarity of all information presented to consumers.

Agencies will expect promotional material to contain useful information for the consumers such as:

- Borrower and property eligibility;
- The fact that these reverse mortgages are not government insured and the resulting risks to consumers;
- Determination of principal limits based on home value, borrower age, and expected interest rates;
- Lump sum and other disbursement options and their possible implications;
- The circumstances under which the loan must be repaid and the actions the borrower must take to prevent default, including the need to continue to pay taxes and insurance on the property;
- Fees and charges associated with reverse mortgages;
- Alternatives to reverse mortgage products that are offered by the institution and may address the homeowner's needs; and
- The importance of reverse mortgage counseling and information about how to find a qualified independent counselor so that the borrower is informed about possible alternatives to a reverse mortgage, the potential consequences of entering into a reverse mortgage, and the potential effect on eligibility for needs-based public benefits.

In order to avoid even the appearance of conflict of interest, reverse mortgage lenders should adopt clear written policy and internal controls stating that neither the lender nor any broker will require the borrower to purchase any other financial or other product from the lender in order to obtain the reverse mortgage

Institutions choosing to use a third party to do their reverse mortgage lending must exercise proper due diligence in managing the relationship. Proper due diligence includes establishing appropriate parameters for the third party relationship consistent with the institution's policies, procedures and philosophy. Institutions should also maintain robust monitoring of the third party relationship to ensure it remains consistent with the institution's operational profile.

All of the above recommendation should be implemented through policies and procedures. In addition, institutions should have effective internal controls to monitor whether actual practices are consistent with their policies and operating procedures relating to reverse mortgages.

The complete text of the guidance follows

Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks

Introduction

The members of the Federal Financial Institutions Examination Council (FFIEC or Agencies) – consisting of the Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), and State Liaison Committee (SLC) – are issuing guidance to assist financial institutions¹ in managing risks presented by reverse mortgage products. Reverse mortgages are home-secured loans, typically offered to elderly consumers, which present consumer protection issues that raise compliance and reputation risks for the institutions offering them.

Expected increases in the elderly population of the United States and other factors suggest that the use of reverse mortgages could expand significantly in coming years as more homeowners become eligible for reverse mortgage products. These loan products enable eligible borrowers to access the equity in their homes in order to meet emergency needs, to supplement their incomes, or to purchase a new home.² Reverse mortgages can meet these objectives without subjecting borrowers to ongoing repayment obligations during the life of the loan, while enabling borrowers to remain in their homes. As a result, the Agencies believe that reverse mortgages, offered appropriately, could become an increasingly important mechanism for institutions to address credit needs of an aging population.

Nevertheless, reverse mortgages are complex loan products that present a wide range of complicated options to borrowers. Moreover, the need to provide adequate information about reverse mortgages and to ensure appropriate consumer protections is particularly high. This is because reverse mortgages are typically secured by the borrower's primary asset – his or her home. Consequently, a reverse mortgage may provide the only funds available to a consumer to pay for health care needs and other living expenses.³

¹ This guidance applies to all banks and their subsidiaries, bank holding companies (other than foreign banks) and their nonbank subsidiaries, savings associations and their subsidiaries, savings and loan holding companies and their subsidiaries, credit unions, and U.S. branches and agencies of foreign banks engaged in reverse mortgage transactions.

² The Federal Housing Administration (FHA) has announced a program that would enable eligible borrowers to use the proceeds of a federally-insured reverse mortgage for the purchase of a new principal residence. See U.S. Department of Housing and Urban Development (HUD) Mortgagee Letter 2008-23 (October 20, 2008) and HUD Mortgagee Letter 2009-11 (March 27, 2009).

³ In 2007, the typical reverse mortgage borrower was 73 years old, had a home valued at \$261,500, and had financial assets of less than \$33,000. AARP, *Reverse Mortgage: Niche Product or Mainstream Solution*, Dec. 2007 (available at http://assets.aarp.org/rgcenter/consume/2007_22_revmortgage.pdf).

For these and other reasons, reverse mortgages present substantial risks both to institutions and to consumers, and, as with any type of loan that is secured by a consumer's home, it is crucial that consumers understand the terms of the product and the nature of their obligations. While this guidance addresses consumer protection concerns that raise compliance and reputation risks, the Agencies recognize that reverse mortgage products may present other risks, too, such as credit, interest rate, and liquidity risks,⁴ especially for proprietary reverse mortgage products lacking the insurance offered under the federal Home Equity Conversion Mortgage (HECM) program.⁵

As explained in further detail below, the complex nature of reverse mortgages presents the risk that consumers will not understand the costs, terms, and consequences of the products. Consumers also may be harmed by any conflicts of interest or abusive or fraudulent practices related to the sale of ancillary products or services. In contrast to HECM reverse mortgages, proprietary reverse mortgages also present the risk that lenders will be unable to meet their obligations to make payments due to consumers.⁶

As with other lending products, institutions should manage the compliance and reputation risks associated with reverse mortgages. This guidance is intended to assist institutions in their efforts to manage these risks. This guidance focuses on ways an institution may provide adequate information about reverse mortgage products and qualified independent counseling to consumers and on ways to avoid potential conflicts of interest. The guidance also addresses related policies, procedures, internal controls, and third party risk management for institutions.

This guidance may be particularly useful for institutions that offer proprietary reverse mortgage products that are not subject to the regulatory requirements applicable to reverse mortgages offered under the HECM program. Depending on how they are structured, proprietary reverse mortgage products may contain a higher degree of risk than HECMs. Therefore, to address these risks effectively, proprietary products may warrant careful scrutiny under the principles, considerations, and risks discussed in this guidance.

The Agencies expect institutions to use this guidance to ensure that risk management practices adequately address compliance and reputation risks associated with reverse mortgages. Failure to address the risks discussed in this guidance could significantly affect the overall effectiveness of an institution's compliance efforts with respect to

⁴ Institutions also should manage these other risks appropriately. In this regard, institutions are advised to conform their reverse mortgage lending activities to any applicable guidance from their respective supervisory agencies, and to consult with those agencies with respect to any such safety and soundness issues.

⁵ A HECM is a reverse mortgage product insured by the FHA, part of the HUD, and is subject to a range of consumer protection and other requirements. *See* 12 U.S.C. 1715z-20; 24 CFR 206. A lender making a HECM loan may assign it to HUD when the outstanding balance reaches 98% of the maximum claim amount. *See* 24 CFR 206.107(a)(1).

⁶ Under the FHA insurance program for HECM loans, HUD will make payments to a consumer if a HECM lender fails to make a payment due to the consumer. *See* 24 CFR 206.117 and 206.121.

reverse mortgages. The Agencies will review risk management processes in this area and will request remedial actions if institutions do not adequately manage these risks.

Background

The reverse mortgage market currently consists of two basic types of reverse mortgage products: proprietary products offered by an individual institution and FHA-insured reverse mortgages offered under the HECM program. To date, HECM reverse mortgages have accounted for approximately 90% of all reverse mortgages.⁷

Reverse mortgages generally are non-recourse, home-secured loans that provide one or more cash advances to borrowers and require no repayments until a future time. Both HECMs and proprietary reverse mortgages generally must be repaid only when the last surviving borrower dies, all borrowers permanently move to a new principal residence, or the loan is in default. For example, repayment would be required when the borrower sells the home or has not resided in the home for a year. A borrower may be in default on a reverse mortgage when the borrower fails to pay property taxes, fails to maintain hazard insurance, or lets the property fall into unreasonable disrepair. When a reverse mortgage becomes due, the home must be sold or the borrower (or surviving heirs) must repay the full amount of the loan (including accrued interest), even if the balance is greater than the property value. If the home is sold, the borrower or estate generally would not be liable to the lender for any amounts in excess of the value of the home.

To obtain a reverse mortgage, the borrower must occupy the home as a principal residence and generally be at least 62 years of age. Reverse mortgages are typically structured as first lien mortgages,⁸ and require that any prior mortgage be paid off either before obtaining the reverse mortgage or with the funds from the reverse mortgage.

The funds from a reverse mortgage may be disbursed in several different ways:

- A single lump sum⁹ that distributes up to the full amount of the principal limit¹⁰ in one payment;
- A credit line that permits the borrower to decide the timing and amount of the loan advances;
- A monthly cash advance, either for a fixed number of years selected by the borrower or for as long as the borrower lives in the home; or

⁷ AARP, *Reverse Mortgage: Niche Product or Mainstream Solution*, Dec. 2007, at 1 (available at http://assets.aarp.org/rgcenter/consume/2007_22_revmortgage.pdf).

⁸ HECMs, by statute, must be first lien mortgages. 12 U.S.C. 1715z-20(b)(3).

⁹ While HECM payment plans do not include a separate “lump sum” option, HECMs provide an effective substitute for such an option through a line of credit that can be fully drawn at consummation.

¹⁰ The principal limit is the maximum payment that can be made to the borrower. The principal limit depends on the age of the youngest borrower, the expected interest rate, and the “maximum claim amount.” The maximum claim amount is either (1) the lower of the actual value or FHA loan limit (for HECMs) or (2) the loan-to-value ratio established by the lender (for proprietary mortgages). The maximum claim amount includes the principal limit (cash available to the borrower), accrued interest, and any set-asides for repairs or servicing fees required by the loan terms.

- Any combination of the above selected by the borrower.

Generally, the size of the loan will be larger when the borrower is older, the home is more valuable, or interest rates are lower. Interest rates on a reverse mortgage may be fixed or variable.

Legal Considerations

Both HECMs and proprietary reverse mortgage products are subject to laws and regulations governing mortgage lending. The following are particularly relevant to the issues addressed in this guidance:

- *Federal Trade Commission Act (FTC Act)*. Section 5 of the FTC Act prohibits unfair or deceptive acts or practices.¹¹ The OCC, the Board, the FDIC, and the OTS enforce this provision of the FTC Act and any applicable regulations under authority granted in the FTC Act and section 8 of the Federal Deposit Insurance Act. The NCUA enforces this provision of the FTC Act and any applicable regulations under authority granted in the FTC Act and sections 120 and 206 of the Federal Credit Union Act.¹²

Practices may be found to be *deceptive* and thereby unlawful under section 5 of the FTC Act if: (1) there is a representation, omission, act, or practice that is likely to mislead the consumer; (2) the act or practice would be deceptive from the perspective of a reasonable consumer; and (3) the representation, omission, act, or practice is material.¹³ A practice may be found to be *unfair* and thereby unlawful under section 5 of the FTC Act if (1) the practice causes or is likely to cause substantial consumer injury; (2) the injury is not outweighed by benefits to the consumer or to competition; and (3) the injury caused by the practice is one that consumers could not reasonably have avoided.¹⁴

- *Truth in Lending Act (TILA)*. TILA and the Board's implementing Regulation Z contain rules governing disclosures that institutions must provide for mortgages in advertisements, with an application, before loan consummation, and when interest

¹¹ Supervisory guidance to financial institutions has been issued concerning unfair or deceptive acts or practices. See OCC Advisory Letter 2002-3—*Guidance on Unfair or Deceptive Acts or Practices*, March 22, 2002; Joint Board and FDIC Guidance on Unfair or Deceptive Acts or Practices by State-Chartered Banks, March 11, 2004. See also *Unfair or Deceptive Acts or Practices*, 74 FR 5498 (Jan. 29, 2009) (final rule issued by the Board, OTS, and NCUA discussing unfairness and deception standards). Federally-insured credit unions are prohibited from using any advertising or promotional material that is inaccurate, misleading, or deceptive in any way concerning its products, services, or financial condition. 12 CFR 740.2. The OTS also has a regulation that prohibits savings associations from using advertisements or other representations that are inaccurate or misrepresent the services or contracts offered. 12 CFR 563.27. This regulation supplements its authority under the FTC Act.

¹² 12 U.S.C. 1766 and 1786.

¹³ These principles are derived from the *Policy Statement on Deception*, issued by the Federal Trade Commission on October 14, 1983.

¹⁴ 15 U.S.C. 45(n). See also the *Policy Statement on Unfairness*, issued by the Federal Trade Commission on December 17, 1980.

rates change. Reverse mortgage borrowers must receive all disclosures that are required under TILA,¹⁵ including notice of their right to rescind the loan.¹⁶

Reverse mortgages may be structured as open-end credit or as closed-end credit within the meaning of Regulation Z. Disclosures required by TILA relating to open-end or closed-end mortgages must be provided, as appropriate.¹⁷ For closed-end, variable rate loans, lenders must provide the variable rate program disclosures,¹⁸ as well as required notices of interest rate adjustments.¹⁹

In addition, TILA requires that a Total Annual Loan Cost (TALC) form be provided to reverse mortgage borrowers.²⁰ The total annual loan cost rates shown on the TALC form include the upfront costs (e.g., origination fee, third-party closing fee, and any upfront mortgage insurance premium), interest, and ongoing charges (e.g., monthly service fee and any annual mortgage insurance premium).

- *Real Estate Settlement Procedures Act (RESPA)*. RESPA and HUD's implementing Regulation X contain rules that, among other things, require disclosure of early estimated and final settlement costs and prohibit referral fees and other charges that are not for services actually performed. As a general matter, an institution may neither pay nor accept any fee or other thing of value in exchange for the referral of business related to a reverse mortgage transaction.

Institutions that offer reverse mortgage products must ensure that they do so in a manner that complies with the foregoing and all other applicable laws and regulations, including the following Federal laws:

- Equal Credit Opportunity Act;
- Fair Housing Act; and
- National Flood Insurance Act.

State laws, including laws regarding unfair or deceptive acts or practices, also may apply to reverse mortgage transactions. Currently, more than twenty states have laws or regulations governing various aspects of reverse mortgages. In addition, all state financial institution regulators have the authority to supervise the mortgage-related

¹⁵ See 12 CFR 226.33(b), 226.5b(d), and 226.18.

¹⁶ 12 CFR 226.15 and 226.23. Rescission rights and notices are not available, however, for home purchase transactions.

¹⁷ See 12 CFR 226.33(b), 226.5b(d), and 226.18.

¹⁸ 12 CFR 226.19(b)(1). Closed-end, variable rate reverse mortgages, particularly under the HECM program, have been less common than the open-end line of credit structure.

¹⁹ 12 CFR 226.20(c).

²⁰ See 15 U.S.C. 1648; 12 CFR 226.33(b)(2) and 226.33(c)(1) and related commentary in Supplement I to 12 CFR 226; and 12 CFR 226, Appendix K (including model TALC form).

activities of entities subject to their respective jurisdictions, including activities related to reverse mortgages.²¹

HECM reverse mortgages also are subject to the consumer protections and other special provisions set forth in HUD regulations.²² HECM consumer protections include information provided to consumers through qualified independent counselors. Before obtaining a HECM reverse mortgage, the borrower must receive counseling from a HUD-approved housing counseling agency.²³ The counseling agency is required to discuss with the borrower: (1) alternatives to HECMs, (2) the financial implications of entering into a HECM (including tax consequences), (3) the effect on eligibility for assistance under Federal and State programs, and (4) the impact on the estate and heirs of the homeowner.²⁴ HUD encourages, but does not require, that HECM counseling be conducted in person.²⁵ HECMs also carry particular disclosure requirements under HUD rules, including a requirement that the lender provide copies of the mortgage, note, and loan agreement to the borrower at the time that the borrower's application is completed.

Recent statutory changes to the HECM program established additional consumer protections.²⁶ For example, Congress adopted consumer protections to guard against potential conflicts of interest, including: (1) special requirements for HECM lenders that are associated with any other "financial or insurance activity," (2) a prohibition on lenders' conditioning the availability of the HECM on the purchase of other financial or insurance products (with limited exceptions), and (3) a requirement that the HECM borrower receive adequate counseling from an independent third party who is not compensated by or associated with a party connected to the transaction.

Compliance and Reputation Risks

While reverse mortgages may provide a valuable source of funds for some borrowers, they are complex home-secured loans offered to borrowers who typically have limited income and few assets other than the home securing the loan.²⁷ Thus, lenders must institute controls to protect consumers and to minimize the compliance and reputation risks for the institutions themselves. These concerns and risks are especially pronounced with respect to proprietary products that are not subject to the core consumer protection provisions of the HECM program.

²¹ Federal financial institution regulators also have the authority to supervise the activities of the entities subject to their respective jurisdictions to ensure their compliance with all applicable laws and regulations, and that the institutions are operating in a safe and sound manner consistent with supervisory standards.

²² HUD also provides model forms for HECMs. See *Home Equity Conversion Mortgage Handbook 4235.1* (available at <http://www.hud.gov/offices/adm/hudclips/handbooks/hsg/4235.1/index.cfm>)

²³ HUD has proposed regulatory changes and is developing counseling protocols that would require counselors to take a HECM examination before providing counseling on reverse mortgages. *Home Equity Conversion Mortgage (HECM) Counseling Standardization and Roster*, 72 FR 869 (Jan. 8, 2007).

²⁴ See 12 U.S.C. 1715z-20.

²⁵ Applicable state laws, however, may have other requirements pertaining to counseling for reverse mortgages, including requirements that counseling be conducted in person.

²⁶ Housing and Economic Recovery Act of 2008 (HERA), Pub. L. 110-289, § 2122(a)(9) (July 30, 2008).

²⁷ See note 3, *supra*.

The Agencies are concerned that:

- (1) consumers may enter into reverse mortgage loans without understanding the costs,²⁸ terms, risks, and other consequences of these products, or may be misled by marketing and advertisements promoting reverse mortgage products;
- (2) counseling may not be provided to borrowers or may not be adequate to remedy any misunderstandings;
- (3) appropriate steps may not be taken to determine and to assure that consumers will be able to pay required taxes and insurance; and
- (4) potential conflicts of interest and abusive practices may arise in connection with reverse mortgage transactions, including with the use of loan proceeds and the sale of ancillary investment and insurance products.

Consumer Information and Understanding – Litigation, consumer complaints, and testimony before Congress about reverse mortgage products have provided both anecdotal evidence of misrepresentations to consumers and clear indications that borrowers do not consistently understand the terms, features, and risks of their loans.²⁹

For example, consumers are not always adequately informed that reverse mortgages are loans that must be repaid (and not merely ways to access home equity). In fact, some marketing material has prominently stated that the consumer is not incurring a mortgage, even though the fine print states otherwise. Consumer misunderstanding about these matters also may be the result of advertisements declaring that reverse mortgage borrowers have no risk of losing their homes or are guaranteed to retain ownership of their homes for life. These advertisements do not clearly indicate the circumstances in which the reverse mortgage becomes immediately due and payable or in which borrowers may lose their homes. For example, advertisements that are potentially misleading include “income for life,” “you’ll never owe more than the value of your home,” “no payments ever,” and “no risk.” Consumer misunderstanding also may be the result of misrepresentations that reverse mortgages constitute “government benefits” or a “government program,” with no explanation that the products are loans made by private entities and that the only government program for reverse mortgages is the federally-insured HECM program.³⁰

In addition, consumers may not be provided sufficient information about alternatives to reverse mortgages that may be more appropriate for their circumstances. Such alternative products include home equity lines of credit, sale-leaseback financing, and deferred payment loans. Consumers may not be aware that the fees for both HECMs and

²⁸ If a HECM borrower finances his or her closing costs, the closing costs are included in the outstanding balance of the loan. Costs of a HECM loan include an origination fee, third-party closing costs, a monthly servicing fee, and mortgage insurance premiums determined by an FHA formula.

²⁹ See Testimony presented at Hearings of the U.S. Senate Special Committee on Aging conducted on December 12, 2007, available on the internet at http://aging.senate.gov/hearing_detail.cfm?id=296507. See also AARP report reference in note 7, above.

³⁰ Regulation Z prohibits misrepresentations about government endorsements in advertisements for closed-end credit secured by a dwelling. 12 CFR 226.24.

proprietary reverse mortgages – particularly up-front costs – may be higher than those for other types of mortgages, such as home equity lines of credit, that can be used to access a consumer’s home equity.³¹ Borrowers also may not receive sufficient information about other potential alternatives to reverse mortgages that may meet their financial needs, including state property tax relief programs, other public benefits, and community service programs.

The complex structure of reverse mortgages may prevent a borrower from fully understanding the products. For example, the ability to access the loan proceeds in a variety of ways may provide flexibility for a borrower. However, some payment options may adversely affect a borrower’s ability to qualify for needs-based public benefits, such as Supplemental Security Income.

In addition, reverse mortgages are not typically structured with a requirement to escrow account for taxes and hazard insurance (or for the lender to pay these amounts and add them to the loan balance). If the borrower does not pay taxes and insurance, the reverse mortgage itself may become due, which could result in the borrower losing the home. Without adequate analysis of the borrower’s ability to make these required payments through available assets or loan proceeds, or the establishment of an escrow, both the borrower and the lender can face substantial risks. Institutions offering reverse mortgages should clearly advise consumers about their obligation to make payments for taxes and insurance if they do not escrow.

Existence and Effectiveness of Consumer Counseling – Another risk to the consumer is that consumer counseling may not be effective. Further, while counseling is considered an integral part of the reverse mortgage process and is mandatory for HECM transactions, it may not be required for proprietary products, depending on applicable state law. Even when provided, consumer counseling may not be fully effective in helping borrowers make informed decisions about reverse mortgage products. Counseling conducted over the telephone, in particular, may not be adequate in all cases, in part because it may be more difficult for counselors to assess a borrower’s understanding of the product over the telephone. More generally, counseling may not always provide all the relevant information or answer all questions and concerns raised by homeowners. For example, at least one study has suggested that a significant proportion of HECM borrowers who received counseling did not understand the costs and other features of their loans.³²

Conflicts of Interest and Abusive Practices – The potential for inappropriate sales tactics and other abusive practices in connection with reverse mortgages is greater where the lender or another party involved in the transaction has conflicts of interest, or has an

³¹ For example, HECMs carry upfront origination and mortgage insurance fees that may total four percent of the loan amount (in addition to other closing costs and ongoing insurance and servicing fees). In HERA, Congress required the U.S. Government Accountability Office (GAO) to study ways of reducing borrower costs and insurance premiums. See GAO report entitled: “Reverse Mortgages: Policy Changes Have Had Mostly Positive Effects on Lenders and Borrowers, but These Changes and Market Developments have Increased HUD’s Risk” (GAO-09-836).

³² See AARP, *Reverse Mortgage: Niche Product or Mainstream Solution*, Dec. 2007, at 72, 98 (available at http://assets.aarp.org/rgcenter/consume/2007_22_revmortgage.pdf).

incentive to market other products and services. For example, when a consumer obtains funds through a reverse mortgage, the consumer could also be offered financial products, such as annuities, or non-financial products, such as home repair services. Such products and services may be inconsistent with consumers' needs, and, on occasion, have been known to be associated with fraud. The risk is especially strong where, for example: (1) the lender or its affiliate engages in cross-marketing of another financial product; (2) the other product is sold at the same time as the reverse mortgage product; (3) a significant portion of the proceeds of the reverse mortgage is used to purchase another product; or (4) in contrast to the reverse mortgage itself, the other product would not provide the consumer with funds to meet emergency needs or to pay ordinary living expenses.

Guidance

The consumer protection concerns discussed above raise compliance and reputation risks for institutions offering reverse mortgages. The Agencies have developed the guidance set forth below to assist institutions in managing these risks effectively. Institutions should manage the compliance and reputation risks raised by reverse mortgage lending through implementation of communication, disclosure, and counseling practices such as those discussed below and by taking actions to avoid potential conflicts of interest. The Agencies will assess whether institutions have taken adequate steps to address the risks discussed in this guidance.

Lenders offering proprietary products should be especially diligent regarding effective compliance risk management since proprietary reverse mortgages are not subject to the consumer protection requirements applicable to HECM reverse mortgages.³³ The Agencies expect institutions offering proprietary reverse mortgage products to follow or to adopt as appropriate relevant HECM requirements in the general areas of mandatory counseling, disclosures, affordable origination fees, restrictions on cross-selling of ancillary products, and reliable appraisals. Taking this step should help to ensure that institutions are addressing the full range of consumer protection concerns raised by reverse mortgages. Moreover, the Agencies expect institutions to take appropriate steps to determine that consumers will be able to pay required taxes and insurance.

Communications with Consumers – Many of the consumer protection concerns regarding reverse mortgages relate to the adequacy of information provided to consumers. Institutions offering reverse mortgage products should take steps to manage compliance and reputation risks by providing consumers with information designed to help them make informed decisions when selecting financial products, including reverse mortgages and the options for receiving loan advances from them.

To promote effective risk management, institutions should review advertisements and other marketing materials to ensure that important information is disclosed clearly and conspicuously. For example, institutions should review the prominence of marketing

³³ HECM lenders must comply with requirements of the HECM program. This guidance is intended to supplement, and not conflict with, existing guidance and rules for HECM lenders. It is also intended to provide HECM lenders guidance on managing compliance and reputation risks.

claims and any related clarifying statements to ensure that potential borrowers are not misled or deceived. Institutions also are responsible for ensuring that marketing materials do not provide misleading information about product features, loan terms, or product risks, or about the borrower's obligations with respect to taxes, insurance, and home maintenance. The Agencies will evaluate potentially misleading marketing materials and take appropriate action to address any marketing that violates the FTC Act prohibition on deception.

Institutions also should be attentive to the timing, content, and clarity of all information presented to consumers. For example, institutions should develop clear and balanced product descriptions and make them available when a consumer is shopping for a mortgage and not just upon the submission of an application or at consummation.³⁴ Such information should describe how disbursements from the reverse mortgage can be received. The provision of timely and descriptive information would serve as an important supplement to the disclosures currently required under TILA and other laws.

Accordingly, in order to assist consumers in their product selection decisions, an institution should use promotional materials and other product descriptions that provide information about the costs, terms, features, and risks of reverse mortgage products. This information would normally include but need not be limited to:

- Borrower and property eligibility;
- When marketing proprietary products, the fact that these reverse mortgages are not government insured and the resulting risks to consumers;
- Determination of principal limits based on home value, borrower age, and expected interest rates;
- Lump sum and other disbursement options and their possible implications;
- The circumstances under which the loan must be repaid;
- The actions the borrower must take to prevent the loan from becoming in default and therefore due and payable, including the need to continue to pay taxes and insurance on the property;
- Fees and charges associated with reverse mortgages;
- The requirement to make payments for real estate taxes and insurance if not escrowed;
- Alternatives to reverse mortgage products that are offered by the institution and may address the homeowner's needs; and
- The importance of reverse mortgage counseling and information about how to find a qualified independent counselor so that the borrower is informed about possible alternatives to a reverse mortgage, the potential consequences of

³⁴ When developing consumer information, institutions should: (1) focus on information that is important to consumer decision making; (2) highlight key information so it will be noticed; (3) employ a user-friendly and readily navigable format for presenting the information; and (4) use plain language, with concrete and realistic examples. A consumer may benefit from comparative tables describing key features of reverse mortgages (including the different draw options).

entering into a reverse mortgage, and the potential effect on eligibility for needs-based public benefits.

Qualified Independent Counseling — To further promote consumer understanding and manage compliance risks, reverse mortgage lenders offering proprietary products should require counseling from qualified independent counselors before a consumer submits an application for reverse mortgage loan or pays an application fee. To ensure the independence of counselors, institutions should adopt policies that prohibit steering a consumer to any one particular counseling agency and that prohibit contacting a counselor on the consumer's behalf. Similarly, an institution's policies could prohibit the institution from contacting a counselor to discuss a particular consumer, a particular transaction, or the timing or content of a counseling session unless the consumer is involved. Institutions should also strongly encourage borrowers to obtain counseling in person and to attend counseling sessions with family members. Family members or other trusted individuals may be able to help explain the transaction and its consequences to the consumer.

As a general matter, qualified independent counselors should provide adequate time to discuss these matters in detail and to address questions and concerns raised by homeowners, and should be able to inform the consumer about the following and other relevant matters:

- The availability of other housing, social service, health, and financial options;
- Financing options other than reverse mortgages, including other mortgage products, sale-leaseback financing, and deferred payment loans;
- The differences between HECM loans and proprietary reverse mortgages;
- The financial implications and tax consequences of entering into a reverse mortgage;
- The impact of a reverse mortgage on eligibility for federal and state needs-based assistance programs, including Supplemental Security Income; and
- The impact of the reverse mortgage on the estate and heirs.

The Agencies note that the provision of such information would be consistent with HUD guidance for HECM lenders regarding consumer counseling.

Avoidance of Potential Conflicts — To manage the compliance and reputation risks associated with reverse mortgages, institutions should take all reasonably necessary steps to avoid any appearance of a conflict of interest. For example, reverse mortgage lenders should:

- Adopt clear written policy and internal controls stating that neither the lender nor any broker will require the borrower to purchase any other financial or other product from the lender in order to obtain the reverse mortgage;³⁵

³⁵ The anti-tying provisions of Section 106(b) of the Bank Holding Company Act of 1970 applicable to banks, and comparable anti-tying provisions for savings associations, savings and loan holding companies,

- Adopt clear policies so that originators do not have an inappropriate incentive to sell other products that may appear to be linked to the granting of a mortgage. For example, the institution's policy could state that neither the lender nor any broker will offer to the borrower or refer the borrower to a provider of an annuity or other product or service prior to the closing of the reverse mortgage or, if applicable, the expiration of the borrower's right to rescind the loan; and
- Adopt clear compensation policies to guard against other inappropriate incentives for loan officers and third parties, such as mortgage brokers and correspondents, to make a loan.

In addition, conflicts are less likely to be a concern if the borrower has received information and access to independent counseling as described above.

Policies, Procedures, and Internal Controls — Institutions should have policies and procedures to address the concerns expressed in this guidance, including those involving conflicts of interest and the provision of consumer information. In addition, institutions should have effective internal controls to monitor whether actual practices are consistent with their policies and operating procedures relating to reverse mortgages. To achieve these objectives, training should be designed so that relevant lending personnel are able to convey information to consumers about product terms and risks in a timely, accurate, and balanced manner. Furthermore, institutions' independent monitoring should assess how well lending personnel are following internal policies and procedures and evaluate the nature and extent of policy exceptions. Findings should be reported to relevant management. In addition, institutions' legal and compliance reviews should include oversight of compensation programs to ensure that lending personnel are not improperly encouraged to direct consumers to particular products. Finally, institutions should also review consumer complaints to identify potential compliance and reputation risks.

Third Party Risk Management — When making, purchasing, or servicing reverse mortgages through a third party, such as a mortgage broker or correspondent, institutions should take steps to manage the compliance and reputation risks presented by such relationships. These steps would include: (1) conducting due diligence and establishing criteria for entering into and maintaining relationships with such third parties; (2) establishing criteria for third-party compensation that are designed to avoid providing incentives for originations inconsistent with the institution's policies and procedures; (3) setting requirements for agreements with such third parties; (4) establishing internal procedures and systems to monitor ongoing compliance with applicable agreements, institution policies, and laws and regulations; and (5) implementing appropriate corrective actions in the event that the third party fails to comply with such agreements,

and their affiliates, prohibit these institutions from, among other things, requiring a customer to purchase certain nonbanking products or services, including insurance and annuity products, as a condition to obtaining or varying the price of credit. See 12 U.S.C. 1972, 1464(q), and 1467a(n), respectively. In addition, banks and savings associations that offer insurance and annuities are specifically prohibited from engaging in practices that would cause a consumer to believe that an extension of credit is conditioned on the purchase of insurance or an annuity from the creditor. See 12 U.S.C. 1831x and Consumer Protection in Sales of Insurance Rules, 12 CFR 14.30, 208.83, 343.30, and 536.30. The Agencies examine institutions for compliance with these legal requirements and will take appropriate action to address any violations.

policies, or laws and regulations. In addition, institutions should structure third party relationships so as not to contravene RESPA's general prohibition against paying or receiving any fee or other thing of value in exchange for the referral of business related to a reverse mortgage transaction. Fees must be paid only for the permissible services provided by the third party, consistent with the provisions of Section 8 of RESPA. Moreover, institutions should not accept fees from any third party without providing appropriate services to warrant any such fee.