

**FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL**

**Docket No. FFIEC-2009-0001**

**Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks**

**AGENCY:** Federal Financial Institutions Examination Council (FFIEC).

**ACTION:** Notice; request for comment.

**SUMMARY:** The Federal Financial Institutions Examination Council (FFIEC), on behalf of its members, requests comment on this proposed Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks (guidance). Upon completion of the guidance, and after consideration of comments received from the public, the Federal financial institution regulatory agencies will issue it as supervisory guidance to the institutions that they supervise and the State Liaison Committee of the FFIEC will encourage state regulators to adopt the guidance. Accordingly, 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.

**DATES:** Comments must be received on or before February 16, 2010.

**ADDRESSES:** Because paper mail in the Washington, DC area and received by the FFIEC is subject to delay due to heightened security precautions, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible.

Please use the title “Reverse Mortgage Comments” to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

Federal eRulemaking Portal – “Regulations.gov”: Go to <http://www.regulations.gov>, under the “More Search Options” tab click next to the “Advanced Docket Search” option where indicated, select “FFIEC” from the agency drop-down menu, then click “Submit.” In the “Docket ID” column, select “Docket Number FFIEC–2009–0001” to submit or view public comments and to view supporting and related materials for this notice of proposed rulemaking. The “How to Use This Site” link on the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.

Mail: Paul Sanford, Executive Secretary, Federal Financial Institutions Examination Council, L. William Seidman Center, Mailstop: D 8073a, 3501 Fairfax Drive, Arlington, Virginia 22226-3550.

Hand Delivery/Courier: Paul Sanford, Executive Secretary, Federal Financial Institutions Examination Council, L. William Seidman Center, Mailstop: D 8073a, 3501 Fairfax Drive, Arlington, Virginia 22226-3550.

Instructions: You must include “FFIEC” as the agency name and “Docket Number FFIEC–2009–0001” in your comment. In general, the FFIEC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received,

including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this notice of proposed rulemaking electronically by following these instructions: Go to <http://www.regulations.gov>, under the “More Search Options” tab click next to the “Advanced Document Search” option where indicated, select “FFIEC” from the agency drop-down menu, then, click “Submit.” In the “Docket ID” column, select “Docket FFIEC–2009–0001” to view public comments for this rulemaking action.

Docket: You may also view or request available background documents and project summaries using the methods described above.

**FOR FURTHER INFORMATION CONTACT:**

OCC: Karen Tucker, National Bank Examiner and Senior Compliance Specialist, or Jesse Butler, Bank Examiner and Compliance Specialist, Compliance Policy, (202) 874- 4428; Stephen Van Meter, Assistant Director, or Nancy Worth, Counsel, Community and Consumer Law Division, (202) 874-5750, Office of the Comptroller of the Currency, 250 E Street S.W., Washington, DC 20219.

Board: Kathleen Conley, Senior Supervisory Consumer Financial Services Analyst, (202) 452-2389; Brent Lattin, Senior Attorney, (202) 452-3667, Board of Governors of the Federal Reserve System, 20th and C Streets N.W., Washington, DC 20551. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263-4869.

FDIC: Michael R. Evans, Fair Lending Specialist, Compliance Policy Section, Division of Supervision and Consumer Protection, (202) 898-6611; Donna Nordenberg, Counsel, Legal Division, (202) 898-6595, Federal Deposit Insurance Corporation, 550 17th Street N.W., Washington, DC 20429.

OTS: David Adkins, Fair Lending Specialist, (202) 906-6716, or Richard Bennett, Senior Compliance Counsel, (202) 906-7409, Office of Thrift Supervision, 1700 G Street N.W., Washington, DC 20552.

NCUA: Matthew J. Biliouris, Program Officer, (703) 518-6394, Office of Examination & Insurance, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314.

## **SUPPLEMENTARY INFORMATION:**

### **I. Background Information**

The FFIEC is proposing to recommend to the Federal financial institution regulatory agencies guidance on managing compliance and reputation risks presented by reverse mortgage products. The six members of the FFIEC are the Federal financial institution regulatory agencies (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.

As part of its mission, the FFIEC makes recommendations regarding supervisory matters and the adequacy of supervisory tools to the Federal financial institution regulatory agencies. The FFIEC also establishes standards for examinations of financial

institutions that shall be applied by the agencies. These agencies expect that all financial institutions that they supervise – that is, banks and their subsidiaries, bank holding companies and their nonbank subsidiaries, savings associations and their subsidiaries, savings and loan holding companies and their subsidiaries, and credit unions (“institutions”) – will effectively assess and manage risks associated with their lending activities, including those associated with reverse mortgage products. Upon completion of the guidance, and after consideration of comments received from the public, the Federal financial institution regulatory agencies will issue it as supervisory guidance to the institutions that they supervise. Accordingly, such 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.

The SLC, which is composed of representatives of five State agencies that supervise financial institutions, was established to encourage the application of uniform examination principles and standards by State and Federal supervisory agencies. Upon finalization of the FFIEC guidance, the SLC will encourage the adoption of the guidance by state regulators. Entities regulated by the state agencies that adopt the guidance would be expected to use it 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.

Reverse mortgages are home-secured loans typically offered to elderly consumers. Institutions under the FFIEC members’ supervision currently provide two basic types of reverse mortgage products: lenders’ own proprietary reverse mortgage

products and reverse mortgages offered under the Home Equity Conversion Mortgage (HECM) program.<sup>1</sup> Both HECMs and proprietary products are subject to various laws governing mortgage lending including the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Federal Trade Commission Act, and the fair lending laws. HECMs are also subject to an extensive regulatory regime established by HUD, including provisions for FHA insurance of HECM loans that protect both lenders and reverse mortgage borrowers.

Reverse mortgages enable eligible borrowers to remain in their home while accessing their home equity in order to meet emergency needs, supplement their incomes, or, in some cases, purchase a new home — without subjecting borrowers to ongoing repayment obligations during the life of the loan. The use of reverse mortgages could expand significantly in coming years as the U.S. population ages and more homeowners become eligible for reverse mortgage products. If prudently underwritten and used appropriately, these products have the potential to become an increasingly important credit product for addressing certain credit needs of an aging population.

However, reverse mortgages can be highly complex loan products, and it is particularly important to provide adequate information and other consumer protections. Typically, elderly borrowers are securing a reverse mortgage with their primary asset — their home. Thus, borrowers may depend on the reverse mortgage proceeds for the cash flow needed to pay for health care and other living expenses.

For these reasons, it is critical that institutions manage the compliance and reputation risks associated with reverse mortgages. The proposed guidance set forth in

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<sup>1</sup> 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. See 12 U.S.C. § 1715z-20; 24 C.F.R. Part 206.

this document is intended to assist institutions in their efforts to manage these risks. While the FFIEC members have not encountered widespread use of reverse mortgage lending by the institutions that they supervise, the FFIEC members are proposing this reverse mortgage guidance in light of the anticipated growth in this lending product.

## **II. Principal Elements of the Guidance**

The proposed guidance discusses the general features of, certain legal provisions applicable to, and consumer protection concerns raised by reverse mortgage products. In addition, it focuses on the need to provide adequate information to consumers about reverse mortgage products; to provide qualified independent counseling to consumers considering these products; and to avoid potential conflicts of interest. The proposed guidance also addresses related policies, procedures, and internal controls and third party risk management.

For example, the proposed guidance stresses the importance of avoiding potential conflicts of interest and abusive practices. In addition, the proposed guidance emphasizes the importance of independent credit counseling for consumers considering reverse mortgages. Pursuant to the proposed guidance, such counseling should cover the potential consequences of entering into these transactions, such as the potential effect on eligibility for needs-based public benefits.

The proposed guidance also recommends that consumers be provided clear and balanced information about the relative benefits and risks of reverse mortgage products, at a time that will help consumers' decision-making processes. Consistent with this advice, the proposed guidance suggests that institutions inform borrowers about reverse mortgage alternatives that they already offer.

### **III. Request for Comment**

Comment is requested on all aspects of the proposed guidance.

### **IV. Supplemental Guidance**

The FFEIC believes that illustrations of potential costs and benefits of reverse mortgages, relative to alternatives to reverse mortgages, may be useful to institutions as they seek to implement the Interagency Guidance recommendations relating to communicating fees and charges information to consumers. Thus, the FFIEC, on behalf of its members, is developing sample illustrations to assist institutions in providing consumers with information about the relative benefits and risks of reverse mortgages, as outlined in the proposed reverse mortgage guidance.

### **V. Paperwork Reduction Act**

In accordance with section 3512 of the Paperwork Reduction Act of 1995, 44 U.S.C. 3501-3521 (PRA), the Agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The proposed guidance includes reporting, recordkeeping, and disclosure requirements, some of which implicate PRA as more fully explained below.

Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the Federal banking agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;



(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments should be addressed to:

OCC: Please follow the instructions found in the **ADDRESSES** caption above for submitting comments.

FRB: Please follow the instructions found in the **ADDRESSES** caption above for submitting comments.

FDIC: Interested parties are invited to submit written comments to the FDIC by any of the following methods. All comments should refer to the name of the collection:

- <http://www.FDIC.gov/regulations/laws/federal/notices.html>
- *Email*: [comments@fdic.gov](mailto:comments@fdic.gov) Include the name of the collection in the subject line of the message.
- *Mail*: Leneta G. Gregorie (202-898-3719), Counsel, Room F-1064, Federal Deposit Insurance Corporation, 550 17<sup>th</sup> Street N.W., Washington, D.C. 20429.
- *Hand Delivery*: Comments may be hand-delivered to the guard station at the rear of the 17<sup>th</sup> Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m.

OTS: Please follow the instructions found in the **ADDRESSES** caption above for submitting comments.

NCUA: Please follow the instructions found in the **ADDRESSES** caption above for submitting comments.

All Agencies: A copy of the comments may also be submitted to the OMB desk officer for the Agencies: Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Washington, D.C. 20503.

Title of Information Collection: Reverse Mortgage Products.

OMB Control Numbers: New collection; to be assigned by OMB.

Abstract: The proposed guidance includes reporting, recordkeeping, and disclosure requirements applicable to both proprietary and HECM reverse mortgages. However, a number of the requirements are currently standard business practice for proprietary and HECM reverse mortgages and, therefore, under the “usual and customary” standard do not require PRA clearance. There are also requirements currently covered under approved TILA-related information collections for propriety and HECM reverse mortgages, and an approved HUD information collection for HECM reverse mortgages.

Proprietary reverse mortgage products, however, are not subject to the consumer protection provisions of the HECM program, so these requirements would normally be submitted for approval under PRA. However, recent research has shown that, despite the significant growth in reverse mortgages since inception of the HECM program in 1989, currently the market for proprietary reverse mortgages has dissipated to the point that,

industry-wide, there are fewer than 10 lenders offering such products.<sup>2</sup> This is likely due to the recent decline in housing values, resulting in decreased equity in homes.

Given the minimal number of lenders currently offering proprietary reverse mortgages, the agencies are not now seeking OMB approval for the consumer protection provisions in the guidance applicable to propriety reverse mortgages. The agencies will, however, seek PRA approval once this sector of the market recovers.

Lastly, there are requirements that apply to both proprietary and HECM reverse mortgages that do not meet the “usual and customary” standard, are not covered by already approved information collections and, therefore, require PRA clearance.

#### Proprietary Reverse Mortgages

Institutions offering proprietary reverse mortgages will be encouraged under the guidance to follow or adopt relevant HECM requirements for mandatory counseling, disclosures, affordable origination fees, restrictions on cross-selling of ancillary products, and reliable appraisals.

#### Proprietary and HECM Reverse Mortgages

Institutions offering either HECMs or proprietary reverse mortgages are encouraged to develop clear and balanced product descriptions and make them available to consumers shopping for a mortgage. They should set forth a description of how disbursements can be received and include timely information to supplement the TILA and other disclosures. Promotional materials and product descriptions should include information about the costs, terms, features, and risks of reverse mortgage products.

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<sup>2</sup> See the Board’s Divisions of Research & Statistics and Monetary Affairs Finance and Economics Discussion Series paper “Reversing the Trend: The Recent Expansion of the Reverse Mortgage Market,” <http://www.federalreserve.gov/pubs/feds/2009/200942/200942pap.pdf>.

Institutions should adopt policies and procedures that prohibit directing a consumer to a particular counseling agency or contacting a counselor on the consumer's behalf. They should adopt clear written policies and establish internal controls specifying that neither the lender nor any broker will require the borrower to purchase any other product from the lender in order to obtain the mortgage. Policies should be clear so that originators do not have an inappropriate incentive to sell other products that appear linked to the granting of a mortgage. Legal and compliance reviews should include oversight of compensation programs so that lending personnel are not improperly encouraged to direct consumers to particular products.

Institutions making, purchasing, or servicing reverse mortgages through a third party should conduct due diligence and establish criteria for third party relationships and compensation. They should set requirements for agreements and establish systems to monitor compliance with the agreement and applicable laws and regulations. They should also take corrective action if a third party fails to comply. Third party relationships should be structured in a way that does not conflict with RESPA.

Affected Public:

OCC: National banks, their subsidiaries, and federal branches or agencies of foreign banks.

Board: Bank holding companies and state member banks.

FDIC: Insured state nonmember banks.

OTS: Federal savings associations and their affiliated holding companies.

NCUA: Federally-insured credit unions.

Type of Review: Regular.

Estimated Burden:

OCC:

Number of respondents: 77.

Burden per respondent: 40 hours to implement policies and procedures and to provide training; 8 hours annually to maintain program.

Total estimated annual burden: 3,696 hours.

Board:

Number of respondents: 18.

Burden per respondent: 40 hours to implement policies and procedures and to provide training; 8 hours annually to maintain program.

Total estimated annual burden: 864 hours.

FDIC:

Number of respondents: 48.

Burden per respondent: 40 hours to implement policies and procedures and to provide training; 8 hours annually to maintain program.

Total estimated annual burden: 2,304 hours.

OTS:

Number of respondents: 20.

Burden per respondent: 40 hours to implement policies and procedures and to provide training; 8 hours annually to maintain program.

Total estimated annual burden: 960.

NCUA:

Number of respondents: 85.

Burden per respondent: 40 hours to implement policies and procedures and to provide training; 8 hours annually to maintain program.

Total estimated annual burden: 4,080 hours.

The text of the proposed interagency Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks 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 institutions<sup>1</sup> in managing risks presented by reverse mortgage products. Reverse mortgages are home-secured loans, typically offered to elderly consumers, which present

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<sup>1</sup> 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.

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.<sup>2</sup> 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.<sup>3</sup>

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,<sup>4</sup> especially for proprietary reverse mortgage products lacking the insurance offered under the federal Home Equity Conversion Mortgage (HECM) program.<sup>5</sup>

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

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<sup>2</sup> 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).

<sup>3</sup> 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](http://assets.aarp.org/rgcenter/consume/2007_22_revmortgage.pdf)).

<sup>4</sup> 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.

<sup>5</sup> 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).

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.<sup>6</sup>

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 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.<sup>7</sup>

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

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<sup>6</sup> 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.

<sup>7</sup> AARP, *Reverse Mortgage: Niche Product or Mainstream Solution*, Dec. 2007, at 1 (available at [http://assets.aarp.org/rgcenter/consume/2007\\_22\\_revmortgage.pdf](http://assets.aarp.org/rgcenter/consume/2007_22_revmortgage.pdf)).



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,<sup>8</sup> 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 sum<sup>9</sup> that distributes up to the full amount of the principal limit<sup>10</sup> 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
- 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.<sup>11</sup> The OCC, the Board, the FDIC, and the OTS enforce

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

<sup>9</sup> 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.

<sup>10</sup> 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.

<sup>11</sup> 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,

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.<sup>12</sup>

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.<sup>13</sup> 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.<sup>14</sup>

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

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.<sup>17</sup> For closed-end, variable rate loans, lenders must provide the variable rate program disclosures,<sup>18</sup> as well as required notices of interest rate adjustments.<sup>19</sup>

In addition, TILA requires that a Total Annual Loan Cost (TALC) form be provided to reverse mortgage borrowers.<sup>20</sup> The total annual loan cost rates shown on the TALC form include the upfront costs (e.g., origination fee, third-party closing fee,

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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.

<sup>12</sup> 12 U.S.C. 1766 and 1786.

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

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

<sup>15</sup> See 12 CFR 226.33(b), 226.5b(d), and 226.18.

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

<sup>17</sup> See 12 CFR 226.33(b), 226.5b(d), and 226.18.

<sup>18</sup> 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.

<sup>19</sup> 12 CFR 226.20(c).

<sup>20</sup> 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).

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 activities of entities subject to their respective jurisdictions, including activities related to reverse mortgages.<sup>21</sup>

HECM reverse mortgages also are subject to the consumer protections and other special provisions set forth in HUD regulations.<sup>22</sup> 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.<sup>23</sup> 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.<sup>24</sup> HUD encourages, but does not require, that HECM counseling be conducted in person.<sup>25</sup> HECMs also carry particular disclosure requirements under HUD rules, including a requirement that the lender provide copies of the mortgage, note,

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<sup>21</sup> 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.

<sup>22</sup> 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>)

<sup>23</sup> 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).

<sup>24</sup> See 12 U.S.C. 1715z-20.

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

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.<sup>26</sup> 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.<sup>27</sup> 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.

The Agencies are concerned that:

- (1) consumers may enter into reverse mortgage loans without understanding the costs,<sup>28</sup> 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.<sup>29</sup>

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

<sup>27</sup> See note 3, *supra*.

<sup>28</sup> 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.

<sup>29</sup> 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](http://aging.senate.gov/hearing_detail.cfm?id=296507). See also AARP report reference in note 7, above.

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.<sup>30</sup>

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 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.<sup>31</sup> 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

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

<sup>31</sup> 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).

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.<sup>32</sup>

*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 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.

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<sup>32</sup> 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](http://assets.aarp.org/rgcenter/consume/2007_22_revmortgage.pdf)).

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.<sup>33</sup> 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 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.<sup>34</sup> 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.

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<sup>33</sup> 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.

<sup>34</sup> 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).

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 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;<sup>35</sup>
- 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

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<sup>35</sup> 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, 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.

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, 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.

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Federal Financial Institutions Examination  
Council.

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Paul Sanford,

Executive Secretary

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