FEDERAL RESERVE BANK *of* KANSAS CITY

October 14, 2010

REVERSE MORTGAGE PRODUCTS: GUIDANCE FOR MANAGING COMPLIANCE AND REPUTATION RISKS

Attention: **Chief Executive Officer of Each Tenth District State Member Bank**

Subject: Guidance on Reverse Mortgage Products

In Brief: The Federal Reserve, along with other financial regulators of the Federal Financial Institutions Examination Council, adopted guidance on reverse mortgage products. The guidance was developed to address the compliance and reputation risks associated with reverse mortgages in light of the anticipated growth in the market as the U.S. population ages. While reverse mortgages allow senior citizens to access the equity in their homes, the loans are highly complex. Accordingly, lenders must manage the compliance and reputation risks associated with reverse mortgages and should disclose adequate information and provide other appropriate protections to consumers as discussed in the guidance. The guidance titled *Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risk* has been incorporated by the Federal Reserve as Consumer Affairs (CA) letter 10-11. Senior management of state member banks should ensure that risk management practices related to reverse mortgages incorporate this guidance. Compliance examinations of state member banks who offer reverse mortgage products will include a review of these products for compliance with the guidance. The guidance is effective on October 18, 2010.

Further Information: Questions regarding the guidance document may be directed to the Consumer Affairs Department at one of the numbers below:

Kansas City Office	Denver Office
(800) 333-1010, ext. 12488	(800) 333-1020, ext. 22605

Attachment: CA 10-11 and *Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risk*

Internet: Copies of CA 10-11 and the guidance document are available on the Board's web site at: http://www.federalreserve.gov/boarddocs/caletters/2010/1011/caltr1011.htm

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

CA 10-11

September 21, 2010

TO THE OFFICERS AND MANAGERS IN CHARGE OF CONSUMER AFFAIRS SECTIONS

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

The Federal Reserve, along with other financial regulators of the Federal Financial Institutions Examination Council [1], adopted the attached guidance on *Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risk* [2]. The guidance was developed to address the compliance and reputation risks associated with reverse mortgages in light of the anticipated growth in the market as the U.S. population ages. While reverse mortgages allow senior citizens to access the equity in their homes, the loans are highly complex. Accordingly, lenders must manage the compliance and reputation risks associated with reverse mortgages, and should disclose adequate information and provide other appropriate protections to consumers as discussed in the guidance.

Key Provisions of the Reverse Mortgage Guidance

The guidance focuses on ways to mitigate several areas of concern, including inappropriate or misleading communication with consumers through marketing and advertisements, and potential conflicts of interest and abusive practices in connection with reverse mortgage transactions.

Communication with and Counseling of Consumers. The reverse mortgage guidance emphasizes the responsibility of institutions to ensure that marketing materials and communications with consumers are balanced and refrain from providing misleading information about product features, loan terms, or product risks, or about a borrower's obligations. The reverse mortgage guidance also emphasizes the need for institutions to provide independent consumer counseling, similar to that which is currently required for federally-insured reverse mortgages [3].

Conflicts of Interest, Abusive Practices, and Third Party Relationships. The reverse mortgage guidance recommends that institutions adopt policies designed to ensure that loan originators and brokers do not have an inappropriate incentive to sell other products that appear to be linked to the granting of a reverse mortgage. Similarly, the guidance recommends that the institutions develop policies to guard against tying the purchase of certain nonbanking products from an affiliate to the granting or pricing of credit in violation of any applicable anti-tying restrictions. In addition, the guidance recommends that institutions should monitor ongoing compliance by third parties with applicable agreements, institution policies, and laws and regulations; institutions are also advised to implement appropriate corrective actions in the event that the third party fails to comply with them.

Consumer Compliance Examination Considerations

In addition to assessing compliance with relevant consumer protection laws as they apply to reverse mortgages, including the Truth in Lending Act (and its implementing Regulation Z) and Section 5 of the Federal Trade Commission Act that prohibits unfair or deceptive acts and practices, the Reserve Banks are to evaluate whether an institution has incorporated the guidance into its compliance risk management program, policies and procedures, and whether it is using the principles set forth in the guidance to manage the risks associated with reverse mortgage lending. Findings should be considered in the evaluation of the institution's risk exposure, reflected in discussions of the compliance management program, and taken into account when determining an appropriate compliance rating and corrective measures.

Please distribute this letter and the attached guidance to supervised institutions in your district. If you have any questions, please contact Kathleen Conley, Senior Supervisory Consumer Financial Services Analyst, at (202) 452-2389 or Paul Robin, Manager, Oversight and Policy, at (202) 452-3140.

Sincerely,
(signed)

Sandra F. Braunstein
Director
Division of Consumer and Community Affairs

Notes:

1. The other financial regulators are the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the FFIEC State Liaison Committee. Return to text

2. The guidance can be found at http://www.ffiec.gov/press.htm Return to text

3. Federally-insured reverse mortgages, called Home Equity Conversion Mortgages, are insured by the Federal Housing Administration, which is part of the U.S. Department of Housing and Urban Development, and subject to a range of federal consumer protection and other requirements. Return to text

Attachment: Mortgage Products: Guidance for Managing Compliance and Reputation Risk (93 kb PDF)

CA letters | 2010 Letters

Last update: September 21, 2010

REVERSE MORTGAGE PRODUCTS:

Guidance for Managing Compliance and Reputation Risks

V. Guidance

Reverse Mortgage Products:

Guidance for Managing Compliance and Reputation Risks

Introduction

The Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA) (the Agencies) are issuing this guidance to assist their regulated financial institutions[1] 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

---

[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, U.S. branches and agencies of foreign banks engaged in reverse mortgage transactions, and any other entity supervised by those adopting the guidance. The guidance refers to all of those covered as "institutions."

[2] The Federal Housing Administration (FHA) has a program that enables 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).

provide the only funds available to a consumer to pay for health care needs and other living expenses.[3]

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 to lenders, 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]

---

[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).

[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 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.

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 and risk management efforts with respect to reverse mortgages. The Agencies will review risk management processes in this area during examinations of regulated institutions 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. 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.[8]

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, and generally require that any prior mortgage be paid

---

[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] For a further explanation of the non-recourse features of a HECM, *see* HUD Mortgagee Letter 2008-38.

off either before obtaining the reverse mortgage or with the funds from the reverse mortgage.[9]

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

- A single lump sum[10] that distributes up to the full amount of the principal limit[11] 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:

---

[9] HECMs must be first lien mortgages. 12 U.S.C. 1715z-20(b)(3). Only certain subordinate liens are permissible in connection with HECM loans. *See* HUD Mortgagee Letter 2009-49.

[10] 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.

[11] 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.

- *Federal Trade Commission Act (FTC Act).* Section 5 of the FTC Act prohibits unfair or deceptive acts or practices.[12] The OCC, the FRB, 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.[13] 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.[14] 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.[15]
- *Truth in Lending Act (TILA).* TILA and the FRB's implementing Regulation Z contain rules governing disclosures that institutions must provide for mortgages in

[12] 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 FRB and FDIC Guidance on Unfair or Deceptive Acts or Practices by State-Chartered Banks, March 11, 2004; and OTS CEO Mem. # 347, "Unfair or Deceptive Acts or Practices: Examination Procedures," May 7, 2010. 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.

[13] 12 U.S.C. 1766 and 1786.

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

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

advertisements, with an application, before loan consummation, and when interest rates change. Reverse mortgage borrowers must receive all disclosures that are required under TILA,[16] including notice of their right to rescind the loan, where applicable.[17]

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.[18] For closed-end, variable rate loans, lenders must provide the variable rate program disclosures,[19] as well as required notices of interest rate adjustments.[20]

In addition, TILA requires that a loan cost disclosure form be provided to reverse mortgage borrowers.[21] The total annual loan cost shown on the form includes 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.

---

[16] *See* 12 CFR 226.33(b), 226.5b(d), 226.18, and 226.19
[17] 12 CFR 226.15 and 226.23. Requirements related to rescission rights and notices are not applicable, however, for home purchase transactions.
[18] *See* 12 CFR 226.33(b), 226.5b(d), 226.18, and 226.19.
[19] 12 CFR 226.19(b)(1).
[20] 12 CFR 226.20(c).
[21] *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.

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.[22]

HECM reverse mortgages also are subject to the consumer protections and other special provisions set forth in HUD regulations.[23] 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.[24] 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

---

[22] Federal financial institution regulators also have the authority to supervise entities subject to their respective jurisdictions.

[23] 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/hsgh/4235.1/index.cfm)

[24] Counselors are required to pass an examination to be included on a HUD roster before they can provide counseling on HECMs. *See* 24 CFR 206.300 *et seq.*

homeowner.[25] HUD encourages, but does not require, that HECM counseling be conducted in person.[26] 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.[27] 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.[28] 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:

---

[25] *See* 12 U.S.C. 1715z-20.
[26] Applicable state laws, however, may have other requirements pertaining to counseling for reverse mortgages, including requirements that counseling be conducted in person.
[27] Housing and Economic Recovery Act of 2008 (HERA), Pub. L. 110-289, § 2122(a)(9) (July 30, 2008).
[28] *See* note 3, *supra*.

(1) consumers may enter into reverse mortgage loans without understanding the costs,[29] 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.[30]

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

---

[29] 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.

[30] *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.

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.[31]

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 (under which the consumer sells the home and then leases it from the purchaser), 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.[32] 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.

---

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

[32] 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).

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 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 a set-aside or an escrow, in compliance with applicable laws,[33] both the borrower and the lender can face substantial risks. To ensure consumer understanding, institutions offering reverse mortgages should clearly advise consumers about their obligation to make direct payments for taxes and insurance if there is no provision for an escrow or set aside to pay these obligations.

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,

[33] *See* 24 CFR 206.205(e)(1) and 24 CFR 3500.17.

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.[34]

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

[34] *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).

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.[35] Institutions offering proprietary reverse mortgage products should follow or adopt as appropriate, relevant HECM requirements, as amended from time to time, in the general areas of mandatory counseling, disclosures, restrictions on cross-selling of other products, and reliable appraisals. In addition, the Agencies expect institutions offering proprietary reverse mortgages to reasonably price such products, including with respect to origination fees, consistent with safe and sound banking practices, and appropriate consideration of costs, risks, and returns. Taking these steps would 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 or ensure 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

[35] 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.

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 prominently. 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 or any other applicable law.

Institutions also should be attentive to the timing, content, and clarity of all information presented to consumers, from the moment a consumer begins shopping for a loan to the time a loan is closed. For example, institutions should develop clear and balanced product descriptions and make them available when a consumer is shopping for a mortgage--such as when the consumer makes an inquiry to the institution about a reverse mortgage and receives information about reverse mortgages, or when marketing materials relating to reverse mortgage are provided by the institution to the consumer--not just upon the submission of an application or at consummation.[36] Information is

[36] 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-

balanced when it fairly presents the risks and costs as well as the potential benefits of the product. The provision of timely and descriptive information would serve as an important supplement to the disclosures required by specific laws and regulations. The Agencies will review any information provided to consumers and take appropriate action to address any marketing that violates the FTC Act prohibition on deception or any other applicable law.

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, or maximum loan limits, based on home value, borrower age, expected interest rates, and program limitations;
- Lump sum and other disbursement options and their possible implications for the borrower's ability to obtain public benefits;
- 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 and to maintain the property as required;
- Fees and charges associated with reverse mortgages;

---

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).

- The requirement to make direct payments for real estate taxes and insurance if there is no provision for an escrow or a set-aside to pay these obligations;
- 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.

The Agencies recognize that institutions may not be able to incorporate all of the practices recommended in this guidance when advertising reverse mortgages through certain forms of media, such as radio, television, or billboards. Nevertheless, institutions should seek to provide clear and balanced information about the risks and costs as well as the benefits of these products in all forms of advertising. An advertisement that says "We offer reverse mortgages to borrowers who are 62 or older. Call us for more information" is clear and balanced because it does not make any representations about the benefits or risks of the product, and is not deceptive or misleading.

Qualified Independent Counseling — To further promote consumer understanding and manage compliance risks, reverse mortgage lenders offering proprietary products should require that the consumer obtain counseling from qualified independent counselors before an institution processes an application for a reverse mortgage loan or charges an application fee. Before counseling, institutions may provide information to consumers that both consumers and counselors may find useful in evaluating proprietary and HECM reverse mortgages. For example, the institution may explain the difference between proprietary and HECM products; discuss whether the borrower is eligible; provide information on fees; and provide a copy of a sample mortgage, note, and loan agreement. In addition, if an institution does not charge a fee to the consumer, it may use an automated valuation model to perform a preliminary assessment of the value of the consumer's property.

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. For example, institutions could provide a list of counseling agencies that provide reverse mortgage counseling.[37] Similarly, an institution's policies should 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, whenever possible, 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.

Institutions should be aware that the purpose of the counseling session is to provide adequate time to discuss these matters in detail and to address questions and concerns raised by homeowners, and to inform the consumer about the following and other relevant matters:

- The availability of other housing, social service, health, and financial options;

[37] HECM lenders must provide a list of 10 counselors for reverse mortgages. HUD Mortgagee Letter 2009-10.

- 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;[38]
- 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 regarding consumer counseling in connection with HECM loans.

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 and violation of applicable laws and rules. For example, an institution should:

- Adopt clear written policies and internal controls designed to ensure that the institution does not violate any applicable anti-tying restrictions.[39] For example, an

[38] Because counselors may not be knowledgeable on all proprietary products, an institution may provide relevant information about its proprietary products to a consumer before the counseling session in order to facilitate the counseling session.

[39] The anti-tying provisions of Section 106(b) of the Bank Holding Company Act of 1970 for banks and their subsidiaries, as applicable, 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, from the institution or an affiliate as a condition to obtaining or varying the price of credit. Exceptions from these anti-tying prohibitions are permitted if the required products are loans, discounts, deposits, or trust services (*i.e.*, traditional banking products). *See* 12 U.S.C. 1464(q), 1467a(n), and 1972. 12 CFR 225.7. 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. Tying arrangements also remain subject to the general antitrust laws.

institution risks violations if it: (1) requires the borrower to purchase any annuity, insurance or any product other than a traditional banking product in order to obtain the reverse mortgage from the institution or an affiliate, or (2) varies the price of the reverse mortgage based on a condition that the borrower purchase such other product. Further, the Agencies expect that institutions will not do either of these things indirectly through brokers acting as agents;

- Adopt clear written policies and internal controls designed to ensure that the institution complies with restrictions designed to avoid conflicts of interest.[40] For example, an institution risks violations if it requires the borrower to purchase any annuity, insurance (other than appropriate title, flood or hazard insurance), or similar financial product from the institution or third party in order to obtain the reverse mortgage from the institution or broker;
- Adopt clear policies designed to ensure that loan originators and brokers acting on behalf of an institution do not have an inappropriate incentive to sell other products that may appear to be linked to the granting of a reverse mortgage or to engage in inappropriate cross-marketing of other products. Such policies should ensure that any such cross-selling is clearly consistent with the FTC Act standards; 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.

---

[40] *See* 12 U.S.C. 1715z-20(n)-(o) for anti-tying provisions related to HECMs.

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, policies, or laws and regulations. Due diligence and monitoring activities should include a review of promotional materials used by third parties to ensure compliance with the TILA, the FTC Act, and other laws, as applicable.

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.