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Statement of

Cassandra E. McConnell, Director
Community and Consumer Affairs
Office of Thrift Supervision

concerning

Financial Literacy and Education: The Effectiveness of Governmental and Private Sector Initiatives

before the

Committee on Financial Services
United States House of Representatives

April 15, 2008

Office of Thrift Supervision
Department of the Treasury

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Testimony on Financial Literacy and Education: The Effectiveness of Governmental and Private Sector Initiatives before the Financial Services Committee United States House of Representatives April 15, 2008

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Introduction

Good morning, Chairman Frank, Ranking Member Bachus, and Members of the Committee. Thank you for the opportunity to discuss the views of the Office of Thrift Supervision (OTS) on the importance of financial literacy, particularly since April is Financial Literacy Month. Although financial literacy initiatives are not a panacea, nor a substitute for prudent underwriting, strong enforcement of consumer protection laws and effective consumer disclosures, financial literacy initiatives are critical to enhancing the ability of consumers to make informed decisions about financial products and services.

At the OTS, we have long believed that financial education is an important objective for consumers and the savings institutions that serve them. Well-informed consumers are better equipped to make astute financial services choices, which, in turn, benefits financial institutions and contribute to the economic health and viability of communities.

The focus of today's hearing is: (1) an exploration of the continuing need for financial literacy and the status of current governmental and private sector financial literacy and education initiatives; (2) recommendations from the Financial Literacy and Education Commission (FLEC), which coordinates the federal government's financial education efforts and encourages the synchronization of public and private sector initiatives to promote financial literacy;[1] (3) an overview of current financial literacy activities and initiatives at the OTS and our recommendations for enhancing financial education efforts; and (4) related questions involving financial literacy. I will address these issues and look forward to a discussion concerning ways in which the OTS can continue to contribute to this important area.

The Importance of Financial Literacy in Today's Market

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[1] The Financial Literacy and Education Commission (FLEC) was established under Title V of the Financial Literacy and Education Improvement Act, which was part of the Fair and Accurate Credit Transactions (FACT) Act of 2003, to improve the financial literacy of persons in the United States. The FACT Act named the Secretary of the Treasury as head of the FLEC, which has a current membership that comprises 19 other federal agencies and bureaus. The OTS is a member of the FLEC.

There is growing awareness of the importance and value of financial education, beginning even during early stages of life. In today's economy, basic knowledge of everyday financial products such as credit cards and checking accounts is critical. In the current mortgage market environment, in particular, the need to reach out to prospective borrowers and homeowners with key information about the terms, features, and risks of different mortgage products can't be overstated.

In February 2007, in commemoration of National Consumer Protection Week, the OTS released a series of materials that highlighted various financial literacy issues for consumers and thrift institutions. In doing so, the OTS made resources available to consumers on financial literacy and education on our website through a series of press releases. The multi-part series was part of a wider initiative to enhance OTS efforts to assist institutions in working with their customers to improve financial literacy.

Our efforts to heighten consumer awareness include increasing informational materials on financial services topics of importance to consumers. For example, OTS produced a brochure about product features and terms that consumers should be aware of when purchasing or receiving a gift card – a product that has grown significantly in volume during recent years. OTS has also produced brochures that assist savings association customers when they wish to file and resolve a complaint against a savings association. In 2007, we resumed publication of the OTS Community Affairs newsletter, the *Community Liaison*, which provides information and identifies resources to help consumers navigate a broad range of financial services-related issues, including topics such as avoiding mortgage foreclosure prevention scams, reverse mortgages, and programs that can provide assistance for borrowers who are struggling to make their mortgage payments. I will provide more details on these publications later in the testimony.

Through issuance of materials and outreach, OTS has also emphasized how important it is that consumers monitor their credit reports and credit scores. Careful credit report monitoring helps consumers guard against identity theft and obtain credit at rates commensurate with their credit history. While some reports suggest that consumer awareness has helped identity theft abate in recent years, it remains a critical and costly issue for consumers and financial institutions. We have encouraged all of the institutions we regulate to work with their customers to increase awareness of the importance of periodically monitoring their credit reports. The OTS Web site, under "Consumer and Compliance/Consumer Inquiries" at www.ots.treas.gov, contains a link to the FTC's Web site for more information on credit report monitoring.

We are also upgrading the OTS's electronic dissemination of consumer-related information. We are currently developing a new Web site with greater navigation capability so that users can more easily locate information, including a more user-friendly interface for database searches on a number of topics. We are also reviewing, revising, and updating the "Consumer and Community Affairs" content our Web pages.

CRA's Role in Promoting Financial Literacy and Education Efforts

The OTS CRA Realignment

The Community Reinvestment Act (CRA) and its implementing regulations ensure that a mechanism exists to provide incentives for OTS-supervised institutions to develop programs, products and services that expand and enhance financial literacy efforts. In 2007, OTS realigned our CRA regulations with those of the other banking agencies. An important driver of that decision was to ensure OTS-supervised large savings institutions were evaluated under the lending, investment and service tests, consistent with the performance tests under which large institutions regulated by the other agencies are evaluated. Under the service test, large retail institutions are evaluated on their provision of retail and community development services.

Furthermore, establishing CRA uniformity allowed OTS-supervised institutions to be examined as intermediate small savings associations under a streamlined lending and community development test, respectively, which enables those institutions to receive favorable consideration for the provision of financial services and other activities that promote and expand financial literacy and education.

The OTS, like the other banking agencies, provides favorable CRA consideration for financial literacy programs. In order to receive favorable CRA consideration, community development services must benefit low- and moderate-income persons or neighborhoods, and must also have a financial component; for example, a qualifying community development service activity would include a situation in which a financial institution's officers provide training and technical assistance on financial analysis to a community-based organization that offers credit counseling to low-and moderate-income families.

OTS is routinely approached by non profit and commercial organizations that have developed financial literacy programs and are seeking guidance on whether or not their program qualifies for favorable CRA consideration. Accordingly, OTS devotes significant resources to the review of such requests and routinely provides guidance regarding whether the programs meet the regulatory requirements for favorable CRA consideration under the Community Reinvestment Act. Where issues or concerns are identified, OTS senior staff provide feedback. We are committed to providing such input in support of financial education initiatives.

Estimates of Financial Literacy Among Adults in the United States

You have asked that we provide data on the current level of financial literacy among U.S. adults. We do not maintain these data internally, but a review of current data from generally available sources shows that financial education training covering the basics of checking, savings, budgeting, and credit can positively change consumer behavior and improve financial confidence during a six- to twelve-month period following the course. For example, a recent study indicated that the rate at which survey respondents regularly saved money increased after taking a financial literacy course, and respondents were very likely to follow through on their goals of saving money in a savings account. Respondents were also much more likely to use a budget and regularly follow it.[2]

The Jump$tart Coalition's[3] biennial survey, funded by the Merrill Lynch Foundation, demonstrates that graduating high school seniors continue to struggle with financial literacy basics. High school seniors correctly answered only 48.3 percent of the questions. This mean score is a decrease from those posted by the senior class of 2006, which correctly answered 52.4 percent of the questions. While the financial literacy scores of the 2008 high school senior class rank lower than their 2006 peers measured in a national survey,[4] financial literacy scores are higher among college students.

This year marked the first-ever college students' survey. In comparison to their high school peers, participating college students answered 62 percent of the questions correctly. Scores among college students increased with their rank in school. For example, college freshman recorded a 59 percent score, while college seniors correctly answered 65 percent of the questions. The 2008 survey results underscore that while we must continue teaching personal finance to high school students, reinforcing and repeating financial literacy efforts at the college level yields positive results.

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[2] An April 2007 study conducted by the FDIC in cooperation with NeighborWorks America consisted of a three-part survey of participants in *Money Smart* courses across the country. FDIC engaged The Gallup Organization to assist with the development of the survey questions and to administer the survey. Overall, consumer confidence in financial matters substantially increased after completing the *Money Smart* course and was sustained over the survey period.

[3] Jump$tart is a national coalition of organizations dedicated to improving the financial literacy of kindergarten through college-age youth by providing advocacy, research, standards and educational resources. Jump$tart strives to prepare youth for life-long successful financial decision-making. The Jump$tart Coalition has grown to include more than 180 national partners and 48 affiliated state coalitions. During the Jump$tart survey's 12-year history, the data gathered have served as the basis for useful measures of what young adults do and don't understand about finances.

[4] The high school survey was given to 6,856 high school 12th graders in 40 states. The college survey was given to 1,030 full time students nationwide.

Challenges Faced in Identifying Target Audiences and Developing Effective Delivery Channels for Financial Literacy Programs

It is indisputable that the critical issues in today's economic climate have increased the need to ensure young people and older adults alike are provided with sufficient information to make informed decisions about financial products and services. Outreach strategies should be tailored to reflect the target population(s), including factors such as income levels, cultural or ethnic values, and other factors.

One way financial regulators can help to address the challenge of developing targeted materials and distribution mechanisms that reach the intended audience and create desired outcomes is to encourage regulated financial institutions to work in concert with community and consumer organizations and other private-sector participants. There are many existing cross-sector partnerships with the goal of fostering financial literacy.

Regulated financial institutions have detailed knowledge of their customer base and generally have well established delivery channels through which information, training, and technical assistance on a host of financial literacy topics can be disseminated. Banks and thrifts may also receive favorable CRA consideration for leveraging partnerships and establishing new alliances to promote financial education. OTS will continue to support our savings institutions in expanding this important effort.

Specific Measures Used in Evaluating the Effectiveness of Financial Literacy and Education Initiatives

During the OTS's participation in National Consumer Protection Week in February 2007, Director Reich noted that an important aspect of the OTS's efforts to upgrade our consumer awareness and protection program is monitoring emerging trends and evolving financial products, in order to develop appropriate and timely guidance for institutions and resources that assist consumers in making informed financial decisions.

OTS is developing strategies and tools to measure the impact of our financial literacy programs. We also continue to monitor market trends and their impacts on existing and evolving financial products. As members of the Committee are aware, we typically issue consumer regulations and companion guidance on an interagency basis to promote consistency for our regulated institutions. As necessary, however, we also issue consumer protection information to savings institutions, examiners, and consumer and community-based organizations, particularly as market conditions warrant. OTS has made available to our thrift institutions, for distribution and use in their local financial education campaigns, materials designed to enhance financial literacy.[5] We have also produced certain publications by partnering with the other banking agencies, which enables us to leverage our resources when developing materials on consumer-related topics. Several examples of such guidance are provided, below.

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[5] Complete information on financial literacy and consumer-related issues and resources is available at the OTS Web site under "Consumer and Compliance/Consumer Inquiries" at www.ots.treas.gov.

Guidance and Other Products to Promote Consumer Awareness and Enhance Financial Literacy

The OTS participates with the other federal banking agencies in helping consumers make sound decisions when choosing mortgage products that fit their financial services needs. Some examples include the following:

- In December 2006, the OTS, in conjunction with the Federal Reserve Board, released the Consumer Handbook on Adjustable Rate Mortgages, also known as the "CHARM" brochure. The brochure provides information to consumers about the features and risks of adjustable-rate mortgage (ARM) loan products such as the potential for payment shock and negative amortization. In recognition of the growing use of nontraditional or alternative mortgage products that allow borrowers to defer payment of principal and, sometimes, interest, the CHARM booklet was revised to include discussions about "interest-only" and "payment option" mortgages. The brochure also includes general information for consumers on how ARMs work and discusses some of the issues that consumers may face when financing or refinancing their home with an ARM.

- The OTS, along with the other federal banking agencies, issued guidance in September 2006 to address risks associated with alternative mortgage products, entitled "Interagency Guidance on Nontraditional Mortgage Product Risks." The agencies also issued supplemental guidance in the form of recommended, but not required, illustrations of mortgage products designed to help consumers better understand the features of nontraditional mortgages like interest only loans. The illustrations include information about cost, terms, features, and risks. Financial institutions are encouraged to use this information to assist consumers in comparing various types of loan products and making informed decisions when choosing among various mortgage loan options. The final interagency guidance on the consumer illustrations for nontraditional mortgage products was published in May 2007. The agencies are currently finalizing illustrations that can be used to help consumers understand subprime hybrid ARMs and related mortgage products.

- OTS also released the brochure entitled "Interest-Only Mortgage Payments and Payment-Option ARMs – Are They for You?" that was issued jointly with the Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and the National Credit Union Administration. The brochure focuses exclusively on issues involving "interest-only" and "payment option" adjustable rate mortgages (ARMs).

  The consumer guide features a glossary of mortgage-related terms, a mortgage shopping worksheet to assist consumers in comparing the features of different mortgage loan products, information on how monthly payments could increase over the life of an ARM, and information on additional resources available to consumers to help them make informed choices concerning different types of ARMs.

- "A Consumer's Guide to Mortgage Refinancings"

  The OTS is participating with the Federal Reserve Board to update this guide, first published in 1999. Although the information is intended for homeowners generally, the revised brochure is particularly useful as borrowers with higher-cost loans seek to refinance into more affordable mortgage products. The revised brochure is scheduled for publication in May/June 2008.

OTS has also issued guidance on important consumer issues. Examples include the following:

- In February 2007, the OTS released a consumer information brochure on the purchase and use of gift cards. The brochure, entitled "Consumer Fact Sheet: Buying, Giving, and Using Gift Cards," provides information to consumers regarding gift cards issued by financial institutions. The brochure is useful both to consumers and institutions in working with their customers to improve financial awareness about this increasingly popular financial product.

  The brochure highlights various issues to consider when buying and using gift cards, including understanding applicable fees, such as fees imposed for inactivity or non-use of a gift card, processing fees for purchasing the card, monthly maintenance fees, and fees that may apply if the card is used to obtain cash from an ATM. The brochure also reminds consumers about the importance of card security, including asking a sales clerk to verify the stored amount when a card is purchased, and remembering that a gift card should be treated the same as cash. Finally, the brochure provides general advice on addressing problems and resolving complaints about a gift card.

- Publication of *Community Liaison* newsletter, 2007 and 2008

  In the summer of 2007, the OTS resumed publication of our Community Affairs newsletter, *Community Liaison*. As mortgage loan delinquencies and defaults rose and the number of foreclosures mounted, the newsletter focused on products, programs and services that promote and sustain affordable housing, emphasizing delinquency intervention and foreclosure prevention strategies. A featured article described mortgage foreclosure rescue scams and advised consumers about how to avoid unscrupulous practices and obtain responsible foreclosure prevention assistance.

  In March 2008, as part of this year's National Consumer Protection Week activities, OTS published another edition of the newsletter that expanded on the theme of sustainable homeownership and foreclosure mitigation options, commensurate with the growing problems in the subprime mortgage market. The lead article described the foreclosure avoidance initiative jointly headed by the Department of Treasury and the Department of Housing and Urban Development and provided information about the HOPE NOW alliance, the HOPE hotline, and the FHASecure program. Recognizing that the elderly represent a vulnerable segment of the population, this issue also discussed various benefits and costs that senior homeowners should consider when determining the suitability of reverse mortgage products, which have become increasingly popular and more widely marketed.

Each issue includes a resource directory of Web sites that provide additional information and assistance to financial institutions and consumers alike. We have included a copy of the most recent edition with our written statement.

Assessing the Impact of the *National Strategy for Financial Literacy* on OTS's Efforts

In January 2007, Director Reich noted in remarks made to members of the FLEC that the *National Strategy for Financial Literacy*, published in April 2006, provided a valuable framework for accomplishments by the Treasury Department and other FLEC members. The accomplishments include: (1) Working with the Ad Council to develop a public service announcement focusing on increasing credit literacy among young adults; (2) Widespread distribution of a DVD on identity theft made available to the public through the 1-888-MyMoney hotline and the MyMoney.gov Web site; (3) Meetings hosted by the Department of Housing and Urban Development that promoted affordable homeownership; and (4) A series of regional conferences co-sponsored by the Treasury Department and the federal banking agencies to explore effective ways to reach the unbanked market.

The OTS will continue to participate as an active member of the FLEC in Washington, DC and throughout the country via our regional office staff. The National Strategy has helped shape our regional outreach efforts by working collaboratively with FLEC members to maximize our effectiveness in implementing the Strategy's goals and objectives. The National Strategy also provides a useful blueprint by which to exchange ideas and identify and implement best practices. The members of the FLEC should continue to explore constructive ways to harness the energy generated from a coalition of federal agencies motivated to achieve the purpose of promoting and expanding financial literacy.

Examples of several OTS's activities around the country in support of financial education are the following:

Northeast

In New York City, regional staff, in partnership with the Financial Literacy and Education Commission and other federal banking regulators, organized an Eastern regional conference on "Reaching Unbanked People." The conference attracted over 300 attendees, including bankers, representatives from community-based organizations, federal, state and local government representatives, students and academicians.

The event stressed the importance of financial literacy of the various segments of the unbanked and underbanked population and provided a forum for discussing strategies to reach the target group. Some of the topics that were covered during the day-long event included reaching the immigrant market with financial services, strategies for reaching youth, strategies for building community financial institutions, asset-building strategies, and lessons that mainstream financial institutions can learn from alternative lenders.

Southeast

OTS regional staff participated in a consumer education event in connection with Money Smart Week, sponsored by the Chicago Federal Reserve Bank. Ten regulatory agencies, both federal and state, distributed material. The OTS distributed material regarding mortgages and gift cards.

Midwest

OTS is participating in the FDIC's Alliance for Economic Inclusion (AEI) in Austin and Houston, TX. The mission of AEI is in part to improve the economic well being of low- and moderate-income individuals and families including the underserved and underbanked. Financial literacy efforts are included in the AEI mission. One of the AEI working groups is the Asset Building/Financial Education committee. The working group produced information on several financial literacy programs and services available to AEI members and people they serve within Texas.

West

OTS staff participated in homeownership preservation workshops that highlighted financial education and consumer credit counseling training in San Francisco, San Diego, Los Angeles, and Phoenix. OTS staff also participated in the Los Angeles Neighborhood Housing Services homeownership preservation fair in Los Angeles, CA, and in the National Financial Education Network Summit in Seattle, WA.

Recommendations to Improve the Effectiveness of the FLEC

As I have noted, under the auspices of FLEC and consistent with the National Strategy issued in 2006, member agencies have worked in a cooperative and coordinated manner to implement the statutory objectives of increasing financial literacy in America. We recommend the FLEC continue to monitor, track and assess the impacts of specific initiatives undertaken by its members, and examine ways to increase the participation and contribution of other public, private and nonprofit resource providers in accomplishing its mission.

On January 22, 2008, the President created the Advisory Council on Financial Literacy within the Treasury Department. The Advisory Council comprises various representatives from the private sector who are involved with the delivery of financial education throughout the country. The Council is charged with working closely with FLEC members and other organizations in this mission to obtain information to help shape future policies. The OTS strongly supports the Advisory Council in fulfilling its mission.

Similarly, the diverse and extensive experiences of the Advisory Council membership, representing the financial services industry together with leaders of consumer organizations, should help determine the direction, goals, and strategies set forth by the FLEC. All parties should work in tandem to the maximum extent practicable to accomplish our mutual objectives.

Additional Legislative or Regulatory Changes to Improve Financial Literacy and Education

OTS strongly supports the efforts of the Federal Reserve Board and others to revise regulations to improve the quality of information contained in consumer disclosures for financial products and services. An important element of this goal is ensuring not only that the content of the information is timely and comprehensive but also that the information is "user-friendly" and states the risks, costs and benefits to consumers in a clear and straightforward format.

Despite documented low levels of financial literacy in the United States, only 18 states include financial education within required K-12 classes. More states should consider making personal finance a requirement for all students who seek a high school diploma. An early and sustained investment in financial education lays the groundwork for individual prosperity and economic independence. It is likely that financial products and the delivery systems that provide them will become even more complex in the coming years, so providing an early financial education will help ensure tomorrow's adult consumers have a good foundation with which to function in an increasingly complicated and sophisticated marketplace.

The Government Accountability Office (GAO) recently issued a report on the progress and effectiveness of the FLEC and the National Strategy. [6] The GAO's recommendations include augmenting the Strategy to reflect more specific performance measures and broadening efforts to develop sustainable partnerships involving FLEC member agencies and private and nonprofit entities. As we have noted, we believe such cross-sector collaboration is indispensable to maximize the reach and impact of financial literacy programs and activities.

Many outstanding financial education courses and programs exist. The challenge is sharing the best aspects of such programs with significant segments of U.S. consumers.

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[6] GAO-07-100: Financial Literacy and Education Commission – Further Progress Needed to Ensure an Effective National Strategy.

OTS recommends a study to explore ways to bring the most successful financial education programs to scale on a national basis in order to reach and positively impact as many Americans as possible.

Conclusion

OTS is fully committed to working with the savings institutions industry to help leverage financial literacy programs and resources to benefit their customers and their long-term interests. OTS will also continue to work independently, in collaboration with nonprofit organizations where possible, and under the auspices of the FLEC to explore ways to strengthen financial awareness and help consumers make informed choices. OTS stands ready to continue the dialogue in this important area. We reaffirm our support of concerted efforts by the FLEC, the Advisory Council and others to bring financial literacy programs to scale in order to reach as many Americans as possible.

Community Liaison

Volume No. 2008, Issue 1

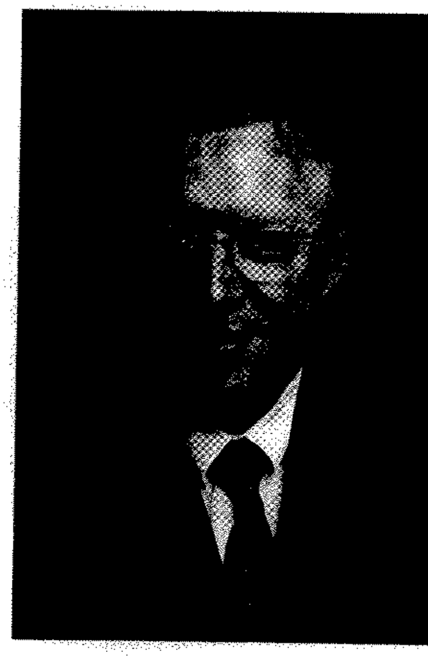
Community Affairs Newsletter

From the Director's Desk

John M. Reich, Director, Office of Thrift Supervision

The OTS and the other banking agencies have issued important guidance to the industry and our examiner workforce on nontraditional mortgage products, subprime lending and assisting financially troubled borrowers. At OTS, the Compliance Policy, Compliance Examination Operations, Consumer Protection and Community Affairs functions are under one "umbrella," coordinated in Washington, DC by Montrice G. Yakimov. These functional areas are substantially interrelated and comprise various complementary activities. As such, we are uniquely positioned to leverage our resources, which create an important multiplier effect for OTS and the institutions we supervise.

This edition of ***Community Liaison*** highlights issues that cross those functional boundaries, a type of interdisciplinary approach that couples significant compliance policy developments with outreach activities to thrift institutions and community and consumer organizations. We have chosen to publish the newsletter to mark National Consumer Protection Week (NCPW), held March 2 through March 8, 2008, which showcases broad-based consumer protection and financial education efforts throughout the country. Priorities for NCPW this year include the promotion of homeownership and counseling programs and the provi-



sion of information to help borrowers recognize and avoid abusive lending practices, two key areas whose importance to consumers is even more critical in the current mortgage environment.

What's in This for You?

In this issue, we provide information on the following:

- The joint Department of Housing and Urban Development and the Department of Treasury foreclosure avoidance initiative, which reaches out to community groups that provide foreclosure counseling and refinancing opportunities and products, including HUD's enhanced refinancing program, FHASecure. The article also discusses the nexus between foreclosure intervention and proposed changes to the Community Reinvestment Act (CRA), which would provide favorable consideration for a variety of activities that benefit financially distressed homeowners (see page 3).
- The critical role that NeighborWorks®America plays in providing foreclosure prevention counseling and related assistance to struggling homeowners. As a result of their longstanding accomplishments in this area, they are a pivotal entity in the multi-partner foreclosure avoidance initiative, HOPE NOW (see page 6).
- The opportunities — and important issues to consider — regarding FHA-insured reverse mortgage products available to senior citi-

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zens, and a discussion of one thrift's use of reverse mortgages (see pages 8 and 9).

- Policy guidance issued by the regulatory community during the past few months that also underscore key components of President Bush's mortgage foreclosure initiative (see page 14).
- A resource directory that lists Web sites that provide more information on the major topics covered (see page 16).
- We are also introducing a feature called "CRA Spotlight," which profiles CRA-eligible activities that present opportunities for our institutions, particularly smaller thrifts seeking community development lending, investment and service activities. The Senior Housing Crime Prevention Foundation serves as a conduit for banks and thrifts to make both loans and investments, and provide related services, which benefit senior housing residents. Since its inception, the program has enjoyed an effectiveness rate greater than 90 percent in combating elder abuse, neglect, fraud and theft (see page 11).

It is important that as regulators and policymakers focus on preventing avoidable foreclosures, we avoid blurring the line between responsible subprime lending and predatory lending. The objective should be to prevent predatory lending and mortgage fraud without constraining legitimate subprime lending. Poor underwriting and abusive lending practices have been problematic; subprime lending, per se, has not.

When we reintroduced ***Community Liaison*** in the summer of 2007, I noted the leadership posture of the thrift industry throughout the years in promoting and financing homeownership options. Despite the challenges they confront in today's lending environment, we expect our institutions to continue to deploy their resources and expertise to meet the credit needs of borrowers with appropriate products and services that help ensure the American dream remains within reach.

We hope you find the newsletter helpful and welcome your feedback and comments. ■

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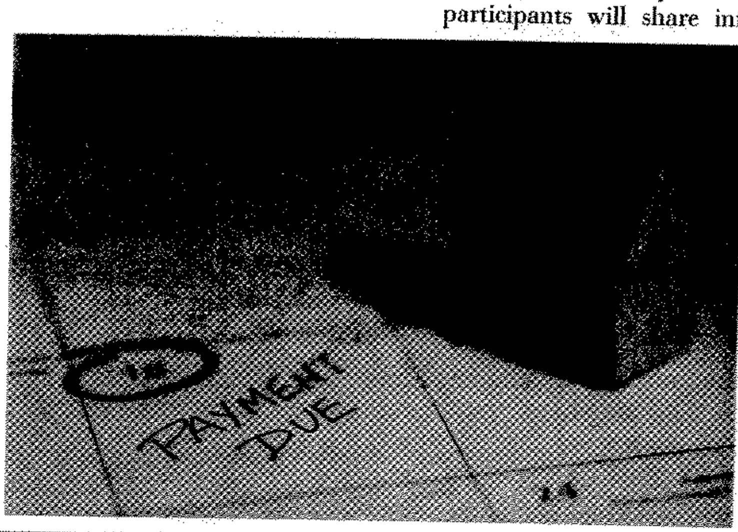
Finding Solutions:
Responding to Rising Foreclosures

Stephanie Caputo, Community Affairs Specialist, Washington, DC

Foreclosures create seriously adverse consequences for families and communities.[1] Analysts have questioned the sufficiency of underwriting transparency regarding the actual creditworthiness of many borrowers, and many consumer advocates have questioned the appropriateness of disclosures regarding certain mortgage products, particularly loans made to subprime borrowers. Beyond the challenges to individuals and communities, disruptions facing the mortgage markets are broad, also impacting investors both domestically and internationally.[2]

The federal government, the financial services industry, and consumer advocates are implementing strategies and programs, which include the active participation of the private and nonprofit sectors, to address this growing problem.[3] Some initiatives are:

- The Department of Housing and Urban Development (HUD) announced changes in the Federal Housing Administration (FHA)-insured loan program to enable more people to qualify for FHA-insured loans. HUD's program, FHASecure, is currently underway, and is expected to help up to 240,000 homeowners refinance into FHA-insured mortgages in 2008 (see FHASecure: A Good Way to Refinance Out of Trouble, page 5).



- The federal banking agencies have published policy guidance to communicate supervisory expectations relating to mortgage underwriting and consumer protections. (See Compliance Roundtable, page 14, for additional information on the guidance).

- The OTS is participating with the Federal Reserve, the Federal Trade Commission, state agencies represented by the Conference of State Bank Supervisors, and the American Association of Residential Mortgage Regulators to conduct targeted consumer-protection compliance reviews of selected nondepository lenders with significant subprime mortgage operations.[4] Project participants will share information, take appropriate corrective action, and explore ways to increase cooperation to ensure effective supervision of these entities. In applying a coordinated review program, the regulatory agencies will enhance their ability to more consistently assess subprime mortgage lending practices across a wide range of mortgage lenders and other industry participants.

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[1] The Government Accountability Office (GAO), in its report issued October 2007 on home mortgage defaults and foreclosures, cited a March 2007 study by Dr. Christopher Cagan entitled "Mortgage Payment Reset: The Issue and the Impact." The study estimated about 13 percent of adjustable-rate mortgages (ARMs), or about 1.1 million loans originated from 2004 through 2006, are projected to foreclose over a seven-year period as a result of interest rate resets. The Center for Responsible Lending, a consumer advocacy organization, has estimated that approximately 2.2 million subprime borrowers are facing foreclosure. According to RealtyTrac data, the number of foreclosure filings reported in December 2007 was up 97 percent from the December 2006 figure. The number of fourth-quarter 2007 foreclosure filings was 86 percent higher than the total number in fourth-quarter 2006.

[2] In remarks made to the National Association of Mortgage Brokers, February 6, 2008, OTS Director John M. Reich noted that adjustable-rate mortgage resets are projected to continue at high levels, with an estimated 1.8 million owner-occupied subprime mortgage resets expected in 2008 and 2009. Record-high home price appreciation and the flawed assumption that house prices would continue to rise rapidly have contributed to the current subprime delinquency crisis. Another major contributor was poor underwriting and, in some cases, fraud.

[3] HUD News Release No. 07-123, issued August 31, 2007.

[4] Per OTS press release 07-048, issued July 17, 2007. In remarks delivered in October 2007, Federal Reserve Governor Randall Kroszner noted that independent mortgage companies, specifically nondepository institutions, made approximately 46 percent of the higher-priced first-lien mortgages in 2006. In its October 2007 report on default and foreclosure trends, GAO noted that, in 2005, brokers accounted for about 60 percent of originations in the subprime market, compared with about 25 percent in the prime market.

- In October 2007, Secretary of the Treasury Henry M. Paulson and HUD Secretary Alphonso Jackson launched a private sector national alliance called HOPE NOW. The alliance includes mortgage servicers, housing counselors, investors, lenders, and trade associations that will maximize outreach efforts to homeowners who are in distress.[5] Among other activities, the newly created collective organization is conducting a direct mail campaign to urge troubled borrowers to contact their lenders or credit counselors. (See An Alliance for Hope, page 6).

- NeighborWorks® America is a national partner in the HOPE NOW collaboration, and the group's foreclosure hotline — 1-888-995-HOPE, discussed below — will serve as an ongoing resource for consumers at risk of foreclosure. (See also the Resource Directory, page 16, for additional information).

CRA's Role in the Foreclosure Mitigation Initiative

The OTS and the other federal banking agencies recognize that the Community Reinvestment Act (CRA) is an important incentive to encourage the participation of regulated financial institutions to address current housing and lending challenges. The federal banking agencies recently published an updated version of the Interagency Questions and Answers (Q&As) regarding Community Reinvestment, which includes a number of proposed and revised Q&As that address how financial institutions could receive favorable CRA consideration for various community development loans, qualified investments, and community development services that benefit financially distressed homeowners.[6] (See also Compliance Roundtable, page 14).

The agencies propose giving positive CRA consideration to the following activities:

- Investment(s) in a nationwide fund, including an example of a community development fund that provides foreclosure relief to low-and moderate-income (LMI) homeowners;[7]

- Providing credit counseling, homebuyer and home-maintenance counseling, financial planning or other financial services education to promote community development and affordable housing, including credit counseling to assist low- or moderate-income borrowers in avoiding foreclosure on their homes. The agencies are revising the examples of community development services to include those activities;[8]

- "Responsive lending activities," which include establishing loan programs that provide relief, through loan refinancings, restructures, or modifications, to homeowners who are facing foreclosure on their primary residences. The agencies encourage institutions to develop and participate in such programs, consistent with safe and sound lending practices.[9]

Expanding CRA consideration for these activities may prove particularly useful for smaller thrift institutions that are evaluated under the Intermediate Small Savings Association (ISSA) test. The ISSA test evaluates the performance of thrifts with total assets between $250 million and $1 billion, adjusted annually, in the provision of community development loans, qualified investments, and community development services. Smaller thrifts play a pivotal role in assisting homeowners in their communities, and the proposed CRA changes will reinforce their commitment to those efforts in the current lending environment.

NeighborWorks® America — A Leader in Foreclosure Prevention

NeighborWorks® America — created in 1978 as the Neighborhood Reinvestment Corporation — works with local communities to establish effective partnerships with the public and private sectors. These community-based, nonprofit entities comprise the NeighborWorks® network. Nationally, there are 235 NeighborWorks® organizations serving approximately 3,000 urban, suburban, and rural communities. All of the federal banking agencies, HUD, and the National Credit Union Administration serve on NeighborWorks® America's Board of Directors.

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[5] On February 12, 2008, six of the largest servicers, representing 50 percent of the mortgage market, announced the launch of Project Lifeline. This initiative expands on the original HOPE NOW activities, and is targeted to all homeowners who are 90 days or more delinquent on their mortgages, regardless of whether the loans are prime or subprime. The initiative provides for a 30-day suspension of foreclosure proceedings, during which time the lenders and borrowers will work out more affordable financing options. The six participants are Bank of America Corp., Citigroup Inc., Countrywide Financial Corp., JPMorgan Chase & Co., Washington Mutual Inc., and Wells Fargo & Co.

[6] The updated Q&As were published for comment July 11, 2007. The comment period closed September 10, 2007. The final Q&As have not yet been published.

[7] See proposed Q&A §___.23(a)-2.

[8] See revised Q&A §___.12(i)-3.

[9] See revised Q&A §___.22(a)-1.

FHASecure: A Safe Way to Refinance Out of Trouble

What is FHASecure?

The FHASecure initiative is designed to benefit homeowners with adjustable-rate mortgages (ARMs) with interest rates that already have reset[1] to a much higher rate, or will reset by December 2009. The FHA program changes could assist nearly 240,000 borrowers — approximately 95 percent of whom have subprime loans — to refinance into conventional mortgages during fiscal year 2008.[2] (See the Resource Directory, page 16, for specific Web site information on different aspects of FHASecure).

FHASecure gives homeowners with non-FHA adjustable rate mortgages the ability to refinance into an FHA-insured mortgage. Borrowers who are current on mortgage payments may refinance into any type of conventional loan with FHASecure.

FHASecure extends eligibility to borrowers who became delinquent under their current mortgage following the reset of their interest rate. If a borrower is delinquent, that delinquency must be the result of the payment shock of an interest rate reset or, in the case of a payment-option ARM, the recasting of the mortgage to fully amortizing payments.

FHA will permit arrearages (loan balances that are past due) to be added into the new loan amount provided the arrearages arose after the reset. If the new maximum FHA loan is not enough to pay off the existing first lien, closing costs and arrearages, the lender may take a second lien at closing to pay the difference.

Eligibility Highlights of the FHASecure Initiative

- The mortgage being refinanced must be a non-FHA ARM that has reset (or is scheduled to reset).
- The mortgagor's payment history on the non-FHA ARM must demonstrate that the homeowner made timely mortgage payments during the six months prior to the reset.
- As part of their underwriting process, mortgagees must determine that the reset of the non-FHA ARM caused the mortgagor's inability to make timely monthly payments, and that the mortgagor has sufficient income and resources to make the monthly payments required under the new FHA-insured refinancing mortgage.[3]

Advantages to Borrowers

FHA is already refinancing a significant number of non-FHA mortgages for borrowers who are making timely payments on their existing mortgage. FHA-insured mortgages do not include prepayment penalties, teaser rates, or balloon payments. They are offered at market rates with up to 30-year terms and are fully amortized, which means that borrowers make payments towards principal and interest on a monthly basis. Loan servicers and lenders can advise borrowers who are current on their non-FHA adjustable-rate mortgage to consider refinancing to an FHA-insured mortgage.[4]

Advantages to Lenders

FHASecure can benefit lenders by helping them avoid foreclosure expenses. Even if a lender takes a short payoff[5] in order to originate an FHASecure loan, it is still less expensive than foreclosure and property disposition, with less negative neighborhood impacts. Only FHA-approved lenders can originate FHASecure loans.[6]

FHA has developed Fact Sheets and promotional brochures for both lenders and consumers.

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1 FHA has purposely not defined "reset" because there are various reset periods associated with non-FHA adjustable-rate mortgages. In the case of payment-option ARMs, the ultimate "reset" or "recasting" of the loan to fully amortizing payments is an acceptable cause of default to qualify a borrower for FHASecure.

2 The application window for *FHASecure* mortgage loan refinancings opened September 5, 2007, and closes December 31, 2008. From program inception through February 12, 2008, HUD has received applications to refinance more than 228,000 conventional loans into FHA-insured mortgage products.

3 Although FHA cannot help borrowers who are delinquent prior to rate reset, there may be other options available. The Resource Directory, page 16, provides information on available options.

4 FHA recognizes there may be tax consequences resulting from debt relief. Since FHA does not provide tax guidance, it recommends that borrowers — and mortgage lenders — seek tax advice from reputable parties.

5 A short payoff, also referred to as a "short sale," occurs when the proceeds from the sale would not be sufficient to cover the secured obligations of the homeowner. Thus, a short payoff represents a debt forgiveness granted by a lender to a homeowner, in which the bank allows the homeowner to sell the property for a lesser amount than the amount owed to the bank.

6 In remarks made on February 12, 2008, HUD Secretary Jackson noted that 1,400 lenders have used *FHASecure* to date.

An Alliance for HOPE

HOPE NOW is an alliance of housing counselors, loan servicers, investors, and other parties in the mortgage markets.[1] This alliance, which launched October 10, 2007, is designed to maximize outreach efforts to distressed homeowners to help them avoid foreclosure. The initiative implements a coordinated approach to reduce obstacles and explore viable options for affected borrowers.

The alliance builds upon the synergy created by the financial industry, nonprofit organizations, and government agencies working collaboratively. A major tenet of the alliance's strategy focuses on contacting homeowners as early in the process as possible, before interest rates reset and loan delinquencies begin.

Anecdotal and empirical data show that reaching homeowners in trouble is the biggest hurdle that lenders confront. Once homeowners obtain mortgage counseling, nearly 50 percent are able to stave off foreclosure and remain in their homes. The alliance will pursue various ways to persuade borrowers to contact their lenders and/or take advantage of housing counseling services.

As discussed in the lead article, the HOPE NOW alliance utilizes the foreclosure prevention platform developed by NeighborWorks® America to reach out and counsel at-risk homeowners. Efforts underway include increasing the number of counselors staffing the Homeownership Preservation Foundation's foreclosure hotline to handle the expected rise in call volume as the alliance expands its outreach activities. Homeowners may also visit Web sites set up by HUD and the Department of Justice (DOJ) to obtain information on locating counseling agencies and similar resources. In addition, the alliance has created its own Web site that provides counseling resource information (see the Resource Directory, page 16 for further details).

Alliance members include the American Financial Services Association, the American Securitization Forum, Bank of America, Citigroup, Inc., the Consumer Bankers Association, the Consumer Mortgage Coalition, Countrywide Financial Corporation, Credit and Homeownership Counselors, the Financial Services Roundtable, the Homeownership Preservation Foundation, JPMorgan Chase & Co., NeighborWorks® America, the Mortgage Bankers Association, Option One Mortgage, PMI Mortgage Insurance Co., the Securities Industry and Financial Markets Association, State Farm Insurance Companies, SunTrust Mortgage, Inc., Washington Mutual, Inc., and Wells Fargo & Company.

— continued on page 7

1 The HOPE NOW membership has grown from 60 percent of the subprime mortgage servicer market to 94 percent; as of February 12, 2008, 25 mortgage servicers are represented. The membership includes counseling providers, servicers and other mortgage market participants, and trade associations.

The HOPE NOW alliance is drawing upon the experience of NeighborWorks® America.[10] NeighborWorks® America s has been a leader in homeownership education and counseling and sustainable homeownership efforts for over a decade. Since 1993, the NeighborWorks® network has educated and counseled more than 700,000 and assisted more than 150,000 households to become homeowners. NeighborWorks® America also advances quality national standards and best practices for homeownership education and counseling through the NeighborWorks® Center for Homeownership Education and Counseling.

Center for Foreclosure Solutions: A Ready Response

The Center for Foreclosure Solutions (CFS), an initiative of NeighborWorks® America, was created to preserve homeownership in the wake of rising foreclosure rates. In conjunction with national nonprofit, mortgage and insurance partners, CFS builds capacity among foreclosure counselors around the nation, conducts public outreach campaigns to reach struggling homeowners, and researches local and national trends to develop strategic solutions. In cities and states with high rates of foreclosure, CFS works with local

10 In response to the nationwide subprime foreclosure challenges, Congress approved legislation signed by President Bush on December 26, 2007, which authorized $180 million for the National Foreclosure Mitigation Counseling (NFMC) Program. The appropriation is designed as a one-time infusion of funds to support a rapid expansion of foreclosure intervention counseling capacity on a short-term basis by HUD-approved Housing Counseling Intermediaries and State Housing Finance Agencies. NeighborWorks® America was chosen to administer the NFMC Program, with priority consideration for use of the funds given to rural and urban areas demonstrating the greatest need.

An Alliance for HOPE — *continued*

Another key element of the alliance's strategy encompasses the American Securitization Forum's (ASF's) statement on reimbursement of counseling expenses. The statement provides for the reimbursement of counseling expenses associated with individual, securitized mortgage loans. Mortgage loan servicers have the discretion to determine if these fee expenses are reimbursable, in situations in which the loan is in default or in which default is reasonably likely to occur, and in situations in which counseling services have resulted, or are likely to result, in loss mitigation and loan recoveries.[2]

The primary objective of the ASF statement is to provide a uniform framework for the interpretation and application of loan modification provisions in securitized loan transactions. The framework is designed to help promote greater and more consistent use of loan modifications, as necessary and appropriate, and spur more workout arrangements to accommodate financially impaired borrowers.[3] The alliance is working with members of the investor community to facilitate the use of loss mitigation strategies in securitized transactions.

[2] The ASF's loan modification framework was adopted by some servicers in January 2008 after the Securities and Exchange Commission issued accounting guidance. In remarks made on February 12, 2008, Treasury Secretary Paulson noted that servicers and investors began providing funds for counseling activities even before implementation of the ASF framework.

[3] In the second half of 2007, the industry assisted an estimated 869,000 homeowners and, concurrent with the formation of HOPE NOW, the loan modification rate in the fourth quarter doubled over the rate in the third quarter.

leaders to create sustainable foreclosure intervention programs. Already CFS has reached thousands of homeowners.

CFS builds on NeighborWorks® America's profile and track record as a leader in sustainable homeownership efforts. CFS conducts a wide and complementary array of programs and activities, including the following:

- **Partnership with the Homeownership Preservation Foundation** — NeighborWorks® partnered with the Homeownership Preservation Foundation, which established the national toll-free foreclosure prevention hotline, 1-888-995-HOPE. The hotline is staffed by HUD-approved housing counseling agencies that provide assistance 24-hour/7-days per week. Counseling is available in English and Spanish. Callers receive budgeting assistance and expert guidance and are linked, as appropriate, with their lender, a local NeighborWorks® organization or other HUD-approved nonprofit organization with certified post-purchase housing counselors, for further assistance. More than 50,000 homeowners received counseling in 2007.
- **Public Awareness Media Campaign** — A multimedia public education campaign, developed in partnership with the Ad Council, is designed to reach homeowners in financial distress and spur them to take action by calling the HOPE hotline. The campaign's theme is "Nothing is worse than doing nothing." Outreach is conducted through TV, radio, print advertising, a dedicated Web site (refer to the Resource Directory, page 16), and brochures and outdoor media, such as billboards. Nearly 200 local groups, task forces, and municipalities have co-branded these advertisements.
- **Building Foreclosure Counseling Capacity** — The NeighborWorks® Center for Homeownership Education and Counseling provides training and certifies housing counselors that furnish post-purchase assistance to homeowners in financial distress. Over the next year, training will be provided to 5,000 housing counselors.
- **Supporting Local/Regional Foreclosure Coalitions/Task Forces** — The Center for Foreclosure Solutions provides technical assistance and small, capacity-building grants to local groups responding to the foreclosure crisis. In fiscal year 2007, NeighborWorks® America made $2 million in capacity-building grants to more than 30 local and regional nonprofit organizations that are delivering foreclosure intervention counseling activities.
- **Outreach to Borrowers Holding Mortgages with Resetting Interest Rates** — The Center for Foreclosure Solutions is developing targeted outreach to borrowers facing negative impacts from adjustable-rate mortgage loans with rates that reset from lower initial rates to higher rates.

In addition to its partnerships with the nonprofit community, NeighborWorks® America is working with representatives of the financial services industry to examine the foreclosure crisis and implement additional measures.

As these and other legislative and regulatory initiatives evolve to mitigate foreclosure, stop abuses, and reassure the capital markets, the OTS will ensure that access to credit by worthy borrowers is not cut off, and community banks that were not responsible for the creation of these problems are not penalized ■

Reverse Mortgages: *Information to Consider on Benefits and Risks*

Francis Baffour, Community Affairs Liaison, Northeast Region

Some experts note that workers in America may not have sufficient savings to live comfortably during their retirement. Many homeowners, however, do have sufficient equity in their homes that can supplement their retirement income. This group of homeowners includes the elderly; in fact, according to a 2006 survey by the Pew Research Center, 72 percent of people aged 65 and older have no home mortgage; this figure contrasts with the percentage — 32 percent — of all homeowners who do not have a mortgage on their home. The same study showed that 79 percent of seniors had experienced home value appreciation, which was particularly strong over the past several years.

There is a financing option that is becoming increasingly popular: seniors now have the opportunity to tap into their home equity through reverse mortgage loans.

This article explores who qualifies for reverse mortgages, how payments may be structured, and the advantages, as well as potential risks, of the product.

What are Reverse Mortgages?

The "baby boom" generation has started entering retirement age, and many analysts suggest that the so-called boomers hold most of their savings in the form of home equity. As of July 1, 2005, the U.S. Census Bureau estimated the baby boom generation — people born between 1946 and 1964 — to be 78.2 million people. The Census Bureau also estimated that 7,918 boomers turn 60 each day, which translates to 330 persons every hour.

According to Social Security Administration statistics, in 1935, life expectancy for people who were 65 years old was 12.5 years. Today, it is approximately 18 years. Thus, as the aging population lives longer, retirees will also have to depend much longer

on traditional sources of income, such as social security and pension funds, and may well find themselves turning to other funding sources, such as reverse mortgages.

Reverse mortgages are loans that allow homeowners to convert equity in their homes into cash, and at their option, provide them with periodic payments for as long as they live in their homes. Reverse mortgages may not be appropriate for some homeowners, such as those retirees who have pensions and other investments that provide adequate income for their lifestyles. Other retirees, however, such as those with limited income, may benefit. As this population continues to age and retire from the workforce, many will depend on their accumulated home equity savings as a source of income.

Potential Benefits

Many financial institutions have started to market reverse mortgages to seniors. The U.S. Department of Housing and Urban Development (HUD)'s Federal Housing Administration (FHA) reverse mortgage program is the most widely used product in the country.[1] Known as the Home Equity Conversion Mortgage (HECM), the mortgages are provided by FHA-approved private lenders and receive the benefit of FHA-insurance. However, only a small number of OTS-supervised institutions offer the program[2]; see page 9 for an example of one thrift's use of the product.

Fannie Mae has a similar reverse mortgage program called the Home Keeper® Mortgage. There are also variations of the Home Keeper® Mortgage that have slightly different features. (See the Resource Directory, page 16, for additional information.)

[1] According to May 2006 testimony by Peter H. Bell, President, National Reverse Mortgage Lenders Association, before the U.S. Senate Subcommittee on Housing and Transportation, the market share for FHA-insured HECMs is approximately 90 percent.

[2] Per listing of FHA-approved HECM lenders. Refer to the Resource Directory for details.

Reverse Mortgage Products: One Thrift's Growing Market

Wilmington Savings Fund Society (WSFS), based in Wilmington, Delaware, is one of a number of OTS-supervised institutions that originate reverse mortgages insured by FHA. Ms. Patricia Kauker, Vice President in charge of WSFS's program, believes that the market for reverse mortgages will continue to grow as the baby boom generation ages.

WSFS's Participation

Ms. Kauker offered examples of benefits to seniors who have used the product. Borrowers have used the additional funds to help pay property taxes, utility and medical expenses, and credit card debts; make home improvements; and help grandchildren pay for college. She noted that some seniors have been able to prevent foreclosures on their homes by using reverse mortgage proceeds to pay off existing mortgage debt. This can be vitally important to borrowers who are struggling in today's mortgage environment.

FHA mandates that all reverse mortgage borrowers undergo counseling from HUD-approved homeownership counselors before obtaining their loans. WSFS maintains a list of approved counselors with whom the thrift has worked, which has helped to reduce the processing time frame between loan application filing and closing. According to WSFS, the thrift typically closes a reverse mortgage loan in approximately 30 days, compared to the industry norm of about 60 days.

Counselors can provide additional valuable information about other programs and services that are important elements in the cost/benefit analysis. In Delaware, for instance, people over 65 years old can apply for a reduction in property taxes and water and sewer bills. Although many seniors are unaware of this benefit, the counselors with whom WSFS works advise qualified borrowers about the opportunity to lower their tax and utility expenses, as well as provide other relevant information that assists them in making an informed decision about reverse mortgage products.

Both FHA's and Fannie Mae's program guidelines require that qualified homeowners be at least 62 years old and have little or no mortgage balances on their properties.[3] Additionally, applicants for HECMs and Fannie Mae reverse mortgages are required to undergo an educational mortgage counseling session prior to the processing of the loan application. (Fannie Mae is not a direct lender; it purchases the reverse mortgage loans from its approved lenders for sale to the secondary market.)[4]

Homeowners with reverse mortgages can receive their payments in one of the following forms (items #2 through #6 represent the payment plan options for reverse mortgage proceeds; lump sum proceeds are not characterized as a payment plan):

- Lump sum cash payment at closing of the transaction;

This article explores who qualifies for reverse mortgages, how payments may be structured, and the advantages, as well as potential risks, of the product.

- Monthly or periodic cash advances for as long as the borrower uses the property as the primary residence ("tenure" payments);
- Monthly or periodic cash advances for a specific period of time ("term" payments);
- A line of credit having a specific dollar amount, from which the borrower determines when to withdraw, and the amount of the withdrawal;
- A combination of a line of credit and regular monthly payments for as long as the borrower lives in the primary residence ("modified tenure"); and
- A combination of a line of credit

[3] The first and second lien position is required for the HECM; therefore, the program requires existing mortgages to be repaid in full using the reverse mortgage proceeds, or subordinated.

[4] Wells Fargo is the largest producer of government-insured reverse mortgages, with a 21.6% share of the 99,870 loans originated since the beginning of October 2006 through August 2007. Financial Freedom Senior Funding Corp., a unit of IndyMac Bancorp Inc. of Pasadena, CA, is second, with a 10.94% share. Third-place Seattle Mortgage has a 2.75% share. (Statistics provided by American Banker, October 1, 2007.)

and a fixed term of monthly payments ("modified term").

Homeowners have the option of adjusting these payment structures at any time. The amount of the cash proceeds received depends on the age of the borrower(s), prevailing interest rates, and the value of the property. Simply stated, the older the borrower, and the higher the property value, the more cash is available.

Moreover, reverse mortgages are non-recourse, which means that borrowers are not personally liable in the event of default, and cannot be required to pay off the loan even if the amount of cash received exceeds the value of the primary property. When the property is no longer the primary residence of an HECM borrower, for reasons such as the home is sold, the borrower dies, or the homeowner vacates the property for a period of 12 months or longer, the mortgage becomes due and payable in full. The amount due would include the outstanding mortgage balance, accrued interest, and other finance charges or fees.

It is critical that prospective borrowers receive independent financial counseling on the financial implications of, and alternatives to, HECMs.[5] Calculating the costs of the loan and determining the most advantageous way to structure the payout of the funds to the borrower present significant issues, particularly when comparing product features and payment options offered by different lenders. Typically, questions will arise about the impact of the reverse mortgage payment stream on certain public benefits, such as Supplemental Social Security Income (SSI) and Medicaid.

The disclosures that lenders provide to potential borrowers must note that HECMs may have tax consequences, affect eligibility for assistance under federal and state programs, and have an impact on the estate and heirs of the homeowners. The lender can provide a listing of housing counseling agencies, or the borrower may consult the HUD Web site. Seniors can also contact the American Association of Retired Persons (AARP) for the names of qualified reverse mortgage counselors. (See Resource Directory, page 16, for more information on finding housing counseling assistance).

Counseling will also help inform the borrowers' decision-making process and prevent them from falling victim to abuse and scams. Seniors have lost their homes as a result of unscrupulous lending practices and have even had family members take financial advantage of them.

HUD emphasizes that the flexibility of HECMs is a major benefit for seniors. Holders of reverse mortgages may also refinance their loans; financial counseling is required for product refinancings, unless certain conditions are met.

Although HUD does not have current statistics for homeowners in distress who have applied for reverse mortgages, troubled homeowners who meet eligibility requirements may use reverse mortgage payments to address financial hardships (See Reverse Mortgages: One Thrift's Growing Market, page 9).

Not for Everyone: Risks Associated With Reverse Mortgages

Reverse mortgages are not suitable for all homeowners. While there are significant benefits to using the product, there also are disadvantages for some borrowers.

The complexity of reverse mortgage transactions, particularly for uninformed borrowers, is one drawback to product use. Prospective borrowers should carefully review the payment structure and method for receipt of the funds with the financial counselor to ensure it suits their particular situation.

The costs of reverse mortgage products are generally high compared to those associated with traditional mortgages. Costs include origination fees, closing costs, servicing fees and mortgage insurance premiums.[6] A 2 percent mortgage insurance premium fee is charged upfront at closing, and a small percentage is added to the interest rate that is charged on the rising loan balance.

Reverse mortgage loan origination fees are based on the home's value, which typically is greater than the loan amount. Thus, the origination fees are greater than those associated with other mortgage loans. Interest rates are also generally higher than the average 30-year mortgage loan.[7] Closing costs can range between $7,000 and $15,000, depending on the amount of reverse mortgage proceeds.[8]

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[5] It is advisable for prospective borrowers to consult with an attorney or financial adviser about tax implications specific to their circumstances.

[6] The FHA insurance protects the lender if the loan balance exceeds the value of the property, provides a higher loan principal amount, and ensures payment to the borrower in the event the lender defaults.

[7] Lenders now have the option of using different indices, including LIBOR and the rate on one-year Treasury securities. The margin may vary depending on the lender and investor(s).

[8] Estimates provided by HUD.

A homeowner who may sell or move out of the property within a few years of taking out a reverse mortgage loan may not find the product appropriate because of the high associated costs. Borrowers in those situations would owe substantial amounts of fees and interest but may not have received a sufficient amount of cash advances to offset these costs, which is an important factor in the decision-making process. As with any loan scenario, however, lender fees and third-party costs will vary, so HUD and AARP advise prospective borrowers to shop around and negotiate for the most favorable deal.

In sum, borrowers should be prepared to work closely with certified financial counselors and approved lenders to perform the necessary cost/benefit analysis of different reverse mortgage products, and, based on their financial circumstances, determine the most advantageous ways to structure their payment plan options ■

CRA Spotlight

Combating Elder Abuse

A CRA-Eligible Program Helps Prevent Crime in Senior Residential Communities

Spend a few minutes speaking with Peter Gwaltney, Vice Chairman and Chief Executive Officer of the Senior Housing Crime Prevention Foundation, and you start sharing his enthusiasm for programs that make a difference, improving the quality of life for many elderly people.

Spend a few more minutes reading the examples of how relatively small amounts of money provided by financial institutions have generated very positive outcomes and your enthusiasm quickly turns into admiration and — if you're a banker — very likely translates into financial support, too.

The Senior Housing Crime Prevention Foundation (SHCPF), located in Memphis, Tennessee, is a nonprofit 501(c)(3) corporation. Its mission is to reduce crime in senior housing facilities and provide ongoing, effective crime prevention programs that provide safe, secure and high-quality living environments for residents.

SHCPF has established and implemented the Senior Crimestoppers Program in senior residential facilities, which has significantly contributed to accomplishing that mission. Major program activities include:

- Providing lock boxes to residents and their families for storage of personal items of value;
- Operating a 24-hour per day toll-free call center for callers, whose anonymity is safeguarded, to report crimes in the nursing home or other senior facility;[1]
- Paying up to $1,000 in rewards for information that helps resolve crimes; and
- Offering crime prevention counseling and related training materials to help deter criminal activity against residents, staff members and the facility.

[1] Two incidents reported in September 2007: In a nursing home in Denver, CO, an anonymous tipster reported seeing an employee physically assaulting a patient. Following an investigation, the employee was identified and a $1,000 reward was paid. Another tipster reported two people selling drugs in the parking lot of a HUD-assisted project in Illinois. One community resident was identified and police made the arrest. A $500 reward was paid to the tipster.

Other important elements of program sponsorship are the annual Time of Your Life "nostalgia" video for the enjoyment of the residents and the annual Wish Comes True grant program, which provides residents with simple, yet meaningful, items or services that they would most like to have for them or others in their family or community. These components of the program create valuable "touch points" for participating financial institutions to interact with their sponsored facilities and residents.

Statistics maintained by SHCPF show that the program's success rate in reducing crime incidents in participating facilities has reached or exceeded 90 percent nationally since its inception, currently hovering at 92 percent.

Statistics maintained by SHCPF show that the program's success rate in reducing crime incidents in participating facilities has reached or exceeded 90 percent nationally since its inception, currently hovering at 92 percent. The types of crimes covered include fraud, abuse, neglect, theft and damage to property on the campus of the sponsored facility. The Foundation maintains crime incident records on every facility in the program and provides quarterly reports to sponsoring institutions.

CRA Plays an Important Part in SHCPF's Success

SHCPF was established as a conduit for financial institutions to make community development loans and investments that would qualify for favorable Community Reinvestment Act (CRA) consideration. The federal banking agencies recognize that the Senior Crimestoppers Program satisfies CRA eligibility criteria. SHCPF ensures that the resident population in each of the bank-sponsored facilities meets low- and moderate-income (LMI) requirements for CRA purposes.

OTS-supervised institutions have provided financial support to the Foundation in the past, and other thrifts may benefit by exploring different ways to structure their participation in SHCPF activities (see Doing Well by Doing Good, page 13) ■

Doing Well by Doing Good: How Banks Can Provide CRA-Eligible Loans, Investments and Services to the Senior Housing Crime Prevention Foundation

There are several ways a financial institution may participate in SHCPF activities and receive positive CRA consideration.

A bank or thrift takes a bond out of its portfolio or buys a new bond, and puts it in the name of the Senior Housing Crime Prevention Foundation (SHCPF). The bond is held by the Foundation's custodian. SHCPF receives the income paid on the bond coupon. The Foundation retains 1 7/8 — or 1.875 percent — of the yield and uses it to fund the operations of the Senior Crimestoppers program (see Combating Elder Abuse: A CRA Success Story, page 11). The financial institution receives the remainder of the yield in the form of interest income on its loan to the Foundation, or as dividend income on its investment in the Foundation.

If an institution seeks CRA community development loan consideration, it would structure its participation in SHCPF as a five-year interest-only loan, which is secured by the bond that collateralizes the transaction. The interest rate on the loan is the difference between the coupon rate on the bond and the administrative portion of 1.875 percent retained by the Foundation.

If an institution wants to make a qualified investment under CRA, it would purchase preferred stock in the Senior Housing Crime Prevention Investment Foundation.[1] The dividend the bank receives is the coupon rate on the bond minus the 1.875 percent administrative allocation made to the Foundation.

The benefits to the financial institution include:

- Risk and yield management. The institution chooses a non-amortizing investment grade bond (typically a government or government-sponsored enterprise — GSE — bond) to fund and collateralize its loan or investment;
- Flexible CRA consideration through the use of loan and/or investment structures; and
- Relatively short-term commitment (5 years).

The bank or thrift receives dollar-for-dollar CRA consideration for the entire length of its financial participation. To date, no financial institution has failed to renew its financial support when the term expired. An institution may sponsor one facility or multiple senior living facilities, depending on the level of its financial involvement.[2]

In addition, there are opportunities for institutions to receive CRA favorable consideration under the community development service test. Many nursing home employees are low- and moderate-income individuals, and many of them are unbanked. With an average employee-to-resident ratio of 1:1, a typical nursing home will have a significant workforce to which banks and thrifts can offer direct deposit and low-cost banking services.[3] SHCPF advises participating institutions in the development of various consumer and commercial banking activities. Institutions may also provide other activities, such as financial literacy training and first-time homebuyer education programs to members of the larger residential community.

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[1] Two foundations were established to facilitate the financial institutions' making loans and investments. The Senior Housing Crime Prevention Foundation, Inc., a 501(c)(3) nonprofit corporation, was established for CRA-eligible loan transactions, and a separate entity, the Senior Housing Crime Prevention Foundation Investment Corporation — a for-profit corporation — was formed for investment transactions. The investment foundation operates exactly as the 501(c)(3) entity does; the for-profit status enables it to issue preferred stock for CRA investment test consideration.

[2] One bank has made an investment of $11 million, which sponsors 50 facilities.

[3] The SHCPF's financial analysis indicates that banks are achieving a 20 percent penetration rate within the total senior housing facility environment of new retail customers. The projected total yield from a bank's investment, net of the administrative portion allocated to SHCPF, and factoring in the revenues derived from cross-marketing opportunities, is approximately 7.40 percent in year one.

Compliance Roundtable

Below is a summary of major compliance policy guidance — and an advanced notice of proposed rulemaking by OTS — published since May 31, 2007.

Proposed Guidance: Mortgage Lending

Refer to: http://www.ots.treas.gov/ and click on "laws and regulations" for the following issuance.

- **Illustrations of Consumer Information to Support the Interagency Subprime Statement**

  Issued August 14, 2007

  The federal banking agencies and the NCUA issued proposed illustrations of consumer information for certain adjustable-rate mortgage (ARM) products, described in the Subprime Statement issued July 10, 2007. The illustrations are intended to assist institutions in providing clear, balanced, and timely information to consumers about the relative benefits and risks of certain ARM products.

  The proposed illustrations consist of an explanation of some key features and risks that the Subprime Statement identifies, including payment shock, and a chart that shows the potential consequences of payment shock in a readily understandable manner.

  The comment period closed October 15, 2007. The final guidance has not been published.

Refer to http://www.ots.treas.gov/docs/7/73373.pdf for the following issuance.

- **Advanced Notice of Proposed Rulemaking — Unfair or Deceptive Acts or Practices**

  Issued August 6, 2007

  The OTS issued an Advance Notice of Proposed Rulemaking (ANPR) relating to unfair or deceptive acts or practices (UDAP), which seeks public comment on approaches that OTS should consider in determining whether, and to what extent, additional regulation is needed to ensure customers of OTS-regulated entities are treated fairly.

  The ANPR solicits comment on the scope of entities, practices, products and/or customer relationships that a revised UDAP regulation should cover. It further seeks comments on whether there is a need for the OTS to expand its regulation in this area, and whether other approaches, including guidance, may be appropriate.

  The ANPR affirms the importance of consistency in rules and guidance by the federal banking agencies, including consistent interagency standards relating to unfair or deceptive acts or practices. The OTS will pursue consistency with the other regulators in this area.

  The comment period closed November 5, 2007.

Proposed Guidance: Community Reinvestment Act

Refer to http://www.ots.treas.gov/docs/7/777047.html for the following issuance.

- **Revisions to Interagency Questions and Answers Regarding Community Reinvestment**

  Issued July 11, 2007

  The agencies are proposing new questions and answers as well as substantive and technical revisions to the existing policy guidance. Some of the proposed revisions are intended to encourage institutions to work with homeowners who are unable to make mortgage payments by highlighting that they can receive CRA consideration for foreclosure prevention programs for low- and moderate-income homeowners, consistent with the April 2007 interagency Statement on Working with Mortgage Borrowers.

  In addition, the revisions would clarify that institutions of all sizes should receive favorable consideration for providing credit in a manner that is responsive to the needs of their communities. Such activities include, for example, offering affordable small loan programs and programs that transition low-and moderate-income homeowners from higher-cost loans to lower-cost loans.

  The comment period closed September 10, 2007.

Final Guidance: Mortgage Lending

Refer to
http://www.ots.treas.gov/resultsort.cfm?catNumber=44&dl=1&edit=1 for each of the following issuances.

Consumer Illustrations for Nontraditional Mortgage Products

Issued May 31, 2007

The consumer illustrations are intended to assist financial institutions in implementing the consumer protection portion of the Interagency Guidance on Nontraditional Mortgage Product Risks (the Interagency NTM Guidance), adopted on October 4, 2006. The federal banking agencies and the National Credit Union Administration (NCUA) collectively issued the guidance.

The Interagency NTM Guidance recommends that promotional materials and other product descriptions provide consumers with information about the costs, terms, features, and risks of nontraditional mortgage products that can assist consumers in their product selection decisions. This includes information about potential payment shock and negative amortization and, where applicable, information about prepayment penalties and the costs of reduced documentation loans. Institutions may elect to use the illustrations, or provide information based on the information, including using an alternate format.

Statement on Subprime Mortgage Lending

Issued July 10, 2007

The guidance clarifies how institutions can offer certain adjustable-rate mortgage (ARM) products in a safe and sound manner, and in a way that clearly discloses the risks that borrowers may assume. The federal banking agencies and the NCUA collectively developed the Statement on Subprime Mortgage Lending (the Subprime Statement) to address emerging issues and questions relative to certain subprime mortgage lending practices. The agencies are concerned that borrowers may not fully understand the risks and consequences of obtaining products that can cause payment shock.

The Subprime Statement incorporates a section on workout arrangements that references the principles of the April 2007 Interagency Statement on Working with Borrowers. Prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower.

[Note: The Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators have developed a parallel statement for state supervisors to use with state-supervised entities.]

Refer to http://www.ots.treas.gov/docs/7/777062.html for the following issuance.

Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages

Issued September 4, 2007

The federal banking agencies, the NCUA, and the Conference of State Bank Supervisors released a statement encouraging federally regulated institutions and state-supervised entities that service securitized residential mortgages to determine their authority under pooling and servicing agreements to identify borrowers at risk of default and pursue appropriate loss mitigation strategies designed to preserve homeownership. Loss mitigation strategies include loan modifications, conversion of adjustable-rate mortgages to fixed-rate mortgages, deferral of payments, or extending amortization periods. Institutions should also consider referrals of borrowers, as appropriate, to qualified homeownership counseling services that may assist the parties in avoiding foreclosure ■

Resource Directory

The following summary provides additional information for the articles in this newsletter. Please note that the OTS makes no representations as to the accuracy of the information contained on these sites.

Finding Solutions: Responding to Foreclosure

http://www.fha.gov/about/fhascusqa.cfm

This Web page contains Frequently Asked Questions (FAQs) about FHASecure.

Borrowers may search online for an FHA-approved lender, or call 1-800-225-5342 (1-800-CALLFHA).

http://www.fha.gov/foreclosure/index.cfm

This FHA site provides detailed information to homeowners experiencing financial trouble, which includes how to contact lenders to discuss workout arrangements, how to obtain housing counseling services, and ways to avoid predatory lending schemes and other scams.

http://www.hopenow.com

This Web site for the newly created HOPE NOW alliance assists financially distressed homeowners in contacting their mortgage lender and finding housing counseling providers.

http://nw.org/network/neighborworksprogs/foreclosuresolutions/default.asp

The NeighborWorks® Center for Foreclosure Solutions, an initiative of NeighborWorks® America, was created to preserve homeownership in the face of rising foreclosure rates. In conjunction with national nonprofit, mortgage and insurance partners, the Center builds capacity among foreclosure counselors around the nation, conducts public outreach campaigns to reach struggling homeowners, and researches local and national trends to develop strategic solutions. In cities and states with high rates of foreclosure, the Center works with local leaders to create sustainable foreclosure intervention programs.

The toll-free hotline number is 1-888-995-HOPE (1-888-995-4667).

Related Web information for the foreclosure avoidance initiative

http://www.foreclosurehelpandhope.org

http://www.995hope.org/

http://www.nw.org/nfmc

This Web site contains detailed information about the National Foreclosure Mitigation Counseling Program, administered by NeighborWorks® America.

Reverse Mortgages

http://www.hud.gov/offices/hsg/sfh/hecm/hecmhome.cfm

This is the HUD home page for FHA-insured Home Equity Conversion Mortgages. The site contains links to locate FHA-approved HECM lenders and identify FHA-approved HECM counselors, including participants in the National HECM counseling network.

http://www.fha.gov/reverse/index.com

The site provides information on finding FHA-approved lenders that offer HECMs, calculating closing costs, and obtaining various resources to aid homeowners in the use of the HECM program.

http://www.hecmresources.org/network.cfm

This site provides additional information on HECM counseling services.

To find a HUD-approved housing counseling agency, borrowers may call 1-800-569-4287 or visit **http://www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm.**

http://www.fanniemae.com/homebuyers/pdf/findamortgage/mortgages/Homekeeper_Fact_Sheet.pdf

The site provides a consumer Fact Sheet (August 2004) with basic questions and answers about Fannie Mae's Home Keeper Mortgage® program. Interested consumers may also call 1-800-7Fannie (1-800-732-6643) for more information and a list of participating lenders.

http://www.aarp.org/money/revmort/

This site contains reverse mortgage information maintained by the American Association of Retired Persons (AARP), including basic features of, borrower eligibility, payment options, and related issues.

Crime Prevention and the Elderly

Senior Housing Crime Prevention Foundation

http://www.shcpfoundation.org/

Senior Crimestoppers Program

http://www.seniorcrimestoppers.org

Editors Note: Our thanks to the many contributing writers throughout OTS who continue to make this a viable and informative publication. Editions of the *Community Liaison* newsletter are available online at www.ots.treas.gov