United States Government Accountability Office

GAO

Report to Congressional Requesters

June 2009

REVERSE MORTGAGES

Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers

GAO

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GAO-09-606

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Highlights

Highlights of GAO-09-606, a report to congressional requesters

June 2009

REVERSE MORTGAGES

Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers

Why GAO Did This Study

Reverse mortgages—a type of loan against the borrower's home that is available to seniors—are growing in popularity. However, concerns have emerged about the adequacy of consumer protections for this product. Most reverse mortgages are made under the Department of Housing and Urban Development's (HUD) Home Equity Conversion Mortgage (HECM) program. HUD insures the mortgages, which are made by private lenders, and oversees the agencies that provide mandatory counseling to prospective HECM borrowers.

GAO was asked to examine issues and federal activities related to (1) the potential benefits and costs of HECMs to borrowers, (2) misleading HECM marketing, (3) the sale of potentially unsuitable products in conjunction with HECMs, and (4) oversight of HECM counseling providers. To address these objectives, GAO reviewed program rules; examined HECM advertisements; analyzed consumer complaint data; performed limited tests of HUD's internal controls; and interviewed HECM borrowers and agency, industry, and nonprofit officials.

What GAO Recommends

GAO makes recommendations designed to address potentially misleading marketing of HECMs and improve HUD's oversight of HECM counseling providers. The federal banking regulators agreed with our recommendations. HUD and FTC did not comment on them.

View GAO-09-606 or key components.
For more information, contact Mathew Scirè at (202) 512-8678 or sciremj@gao.gov.

What GAO Found

HECMs can provide borrowers with multiple benefits, but they also have substantial costs and are relatively complex. HECMs allow seniors to convert their home equity into flexible cash advances while living in their homes. Additionally, the borrowers or their heirs can fully pay off the HECM by selling the home, even if the amount owed exceeds the current home value. However, HECMs also have large insurance and origination costs. Furthermore, the long-term financial implications of a HECM can be difficult to assess because the borrower's remaining home equity depends on the amount of cash advances and interest rate and house price trends.

Various federal agencies have responsibilities for protecting consumers from the misleading marketing of mortgages. Although these agencies have reported few HECM marketing complaints, GAO's limited review of selected marketing materials for reverse mortgages found some examples of claims that were potentially misleading because they were inaccurate, incomplete, or employed questionable sales tactics. Federal agency officials indicated that some of these claims raised concerns. For example, the claim of "lifetime income" is potentially misleading because there are a number of circumstances in which the borrower would no longer receive cash advances.

Federal agencies have had a limited role in addressing concerns about the sale of potentially unsuitable financial products in conjunction with HECMs ("inappropriate cross-selling"). For example, an annuity that defers payments for a number of years may be unsuitable for an elderly person. HUD is responsible for implementing a provision in the Housing and Economic Recovery Act of 2008 that is intended to restrict inappropriate cross-selling, but the agency is still in the preliminary stages of developing regulations. Some of the states GAO contacted reported cases of inappropriate cross-selling involving violations of state laws governing the sale of insurance and annuities.

HUD's internal controls do not provide reasonable assurance that counseling providers are complying with HECM counseling requirements. GAO's undercover participation in 15 HECM counseling sessions found that while the counselors generally conveyed accurate and useful information, none of the counselors covered all of the topics required by HUD, and some overstated the length of the sessions in HUD records. For example, 7 of the 15 counselors did not discuss required information about alternatives to HECMs. HUD has several internal controls designed to ensure that counselors convey the required information to prospective HECM borrowers, but the department has not tested the effectiveness of these controls and lacks procedures to ensure that records of counseling sessions are accurate. Because of these weaknesses, some prospective borrowers may not be receiving the information necessary to make informed decisions about obtaining a HECM.

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Abbreviations

CSBS	Conference of State Bank Supervisors
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FINRA	Financial Industry Regulatory Authority
FTC	Federal Trade Commission
FTC Act	Federal Trade Commission Act
HECM	Home Equity Conversion Mortgage
HERA	Housing and Economic Recovery Act of 2008
HOC	Home Ownership Center
HUD	Department of Housing and Urban Development
NAIC	National Association of Insurance Commissioners
NCUA	National Credit Union Association
NFCC	National Foundation for Credit Counseling, Inc.
NRMLA	National Reverse Mortgage Lenders Association
MMI	Money Management International, Inc.
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
SEC	Securities and Exchange Commission
SSA	Social Security Administration
SSI	Supplemental Security Income
TALC	total annual loan cost

GAO

Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

June 29, 2009

The Honorable Herb Kohl
Chairman
Special Committee on Aging
United States Senate

The Honorable Claire C. McCaskill
United States Senate

A reverse mortgage is a loan that converts the borrower's home equity into payments from a lender and, typically, does not require any repayments as long as the borrower continues to live in the home. Available to homeowners aged 62 and older, these loans have become an increasingly popular financial tool for seniors, but concerns have emerged about the adequacy of consumer protections for reverse mortgage borrowers. The potential for rapid and continued growth of the industry has added to these concerns. By 2020, nearly 55 million people in the United States will be at least 65 years old, many of whom will own their homes. Furthermore, many senior homeowners rely only on Social Security payments to meet their financial needs, making reverse mortgages a potentially attractive source of additional income.

According to industry sources, almost all reverse mortgages are currently made under the Home Equity Conversion Mortgage (HECM) program, which is administered by the Department of Housing and Urban Development (HUD). The HECM program began in 1988, when Congress authorized HUD to insure reverse mortgages to meet the financial needs of elderly homeowners by reducing the effect of economic hardship at a time of reduced income for seniors, while protecting reverse mortgage lenders and borrowers from financial losses.[1] The volume of HECMs made annually has grown from 157 loans in fiscal year 1990 to more than 112,000 loans in fiscal year 2008. In addition, recent years have seen a rapid increase in the number of lenders participating in the HECM program, with more than 1,500 lenders originating their first HECM in 2008, bringing the total number of HECM lenders to over 2,700.[2]

[1]12 U.S.C. § 1715z-20 (a).

[2]About 10 percent of these lenders originated 80 percent of all HECMs in 2008.

The complicated nature of the product and the concern that older consumers can be more vulnerable to unscrupulous sales practices have brought reverse mortgages to the attention of consumer advocates, regulators, and policymakers. Since the inception of the HECM program, Congress has required prospective borrowers to obtain adequate counseling by an independent third party so that they could make informed decisions about whether to obtain a HECM. Borrowers must complete counseling with a HUD-approved housing counseling agency before obtaining the loan. Nevertheless, concerns about consumer protections persist. For example, some consumer advocates have expressed concern about misleading marketing and inappropriate cross-selling—the practice of encouraging borrowers to use reverse mortgage funds to purchase insurance or other products that may be unsuitable to the borrower's financial situation. The Housing and Economic Recovery Act of 2008 (HERA) acknowledged some of these concerns by putting in place additional consumer protection measures.[3]

In light of concerns about potentially misleading marketing practices and the adequacy of relevant consumer protections, as agreed with your offices, we examine in this report (1) the potential benefits and costs of HECMs to borrowers, (2) federal agency responsibilities for protecting consumers from misleading HECM marketing, (3) federal agency efforts to protect HECM borrowers from inappropriate cross-selling, and (4) HUD's oversight of HECM counseling providers.

To address these objectives, we spoke with agency, industry, and nonprofit officials, including those at HUD; federal and state banking regulators; AARP; and the National Reverse Mortgage Lenders Association (NRMLA). In addition, to examine the potential benefits and costs of HECMs to borrowers, we reviewed HUD's regulations, guidance, and consumer materials related to the program. We also spoke with 18 randomly selected HECM borrowers and constructed scenarios to determine how various borrower decisions and economic conditions could affect home equity over the long term. To examine federal agency responsibilities to protect consumers from misleading HECM marketing, we identified authorities, standards, and processes that HUD, the Federal Trade Commission (FTC), and four federal banking regulators use to identify and address misleading marketing practices. In addition, we

[3]HERA also mandated that GAO conduct a study on the cost and availability of HECMs under the new provisions established in the act. We plan to issue this report in July 2009.

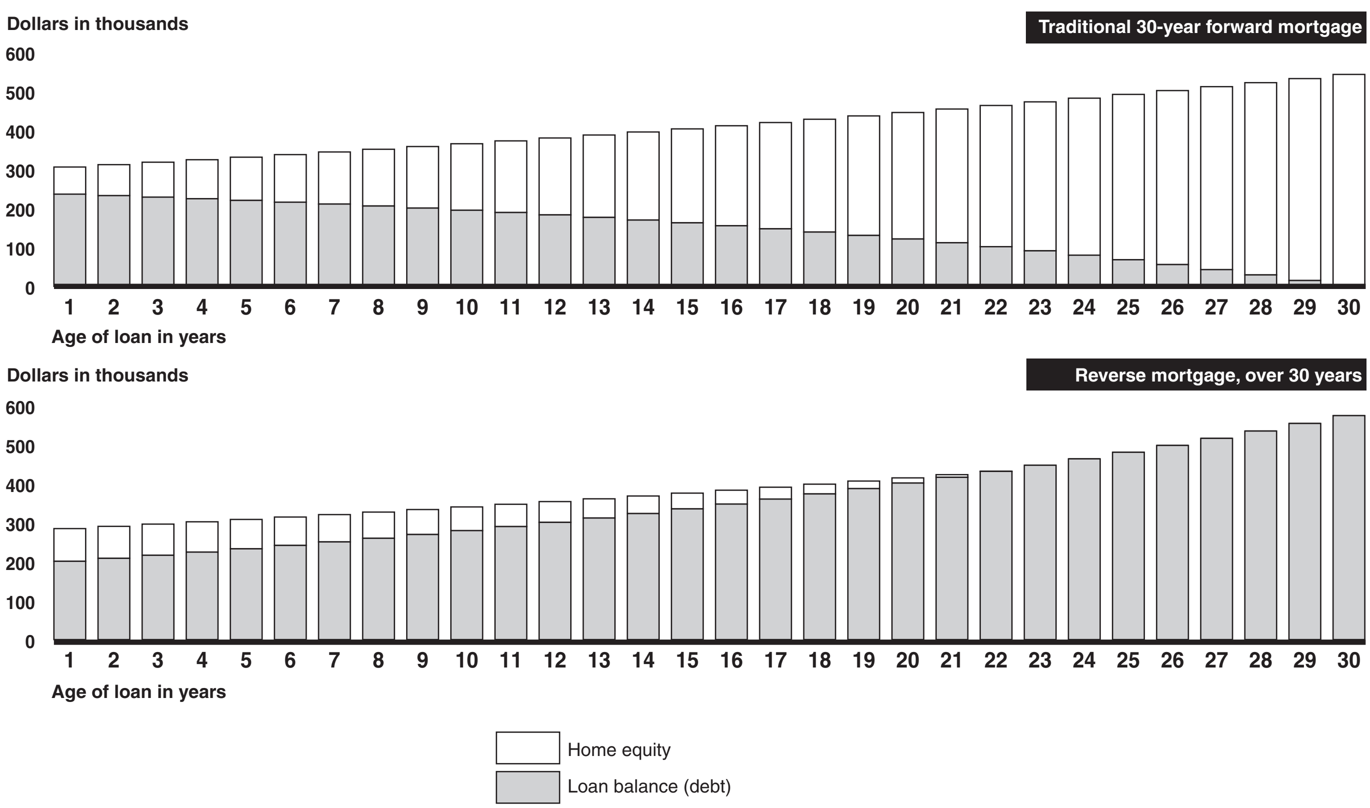
obtained agency information on complaints related to HECM marketing. We also conducted our own review of HECM marketing materials, which included a review of the Internet marketing materials for the 12 HECM lenders that originated at least 1,000 HECMs in fiscal year 2008, mailed materials from 11 of these 12 lenders, as well as DVDs and other materials from HECM lenders that advertise on television. We also conducted Internet searches for materials with potentially misleading statements and collected materials from seven reverse mortgage information seminars. We attended seminars in Florida and California—states with among the largest number of HECMs—and seminars in Maryland and Michigan, for purposes of geographic diversity. To examine the steps federal agencies have taken to protect HECM borrowers from inappropriate cross-selling, we reviewed the HERA provisions on cross-selling, HUD's actions to implement the provisions, and other HUD and federal regulator activities related to these practices. In addition, we compiled examples from state insurance regulators of cross-selling that violated state insurance laws. To examine HUD's oversight of HECM counseling providers, we identified the internal controls that HUD currently has in place to ensure compliance with HUD counseling requirements and tested the effectiveness of these controls by conducting 15 undercover counseling sessions with HUD-approved counselors. For each session, we determined whether counselors covered the required topics and met other requirements, such as accurately recording the length of the counseling session. We interviewed HUD field and headquarters staff about the procedures they use to evaluate counseling agency performance. Finally, we reviewed and conducted limited testing of HUD's controls over the process that HECM providers are required to follow for referring potential borrowers to counseling agencies.

We conducted this performance audit from April 2008 through June 2009, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our investigative work was performed in accordance with standards prescribed by the Council of the Inspectors General on Integrity and Efficiency. Appendix I contains a more extensive discussion of our scope and methodology.

Background

A reverse mortgage is a loan against the borrower's home that the borrower does not need to repay for as long as the borrower meets certain conditions. These conditions, among others, require the borrower to live in the home, pay property taxes and homeowners' insurance, maintain the property, and retain the title in his or her name.[4] Reverse mortgages typically are "rising debt, falling equity" loans, in which the loan balance increases and the home equity decreases over time. As the borrower receives payments from the lender, the lender adds the principal and interest to the loan balance, reducing the homeowner's equity. This is the opposite of what happens in forward mortgages, which are characterized as "falling debt, rising equity" loans. With forward mortgages, monthly loan payments made to the lender add to the borrower's home equity and decrease the loan balance. (See fig. 1).

Figure 1: Comparison of 30-Year Forward and Reverse Mortgages



Source: GAO.

[4]These conditions are also known as mortgage covenants.

Note: The data in this figure are based on a starting house value of $300,000, with an annual 2 percent home appreciation rate. The interest rates are assumed to be fixed at 5 percent for the forward mortgage and 3 percent for the reverse mortgage.

The Housing and Community Development Act of 1987 (Pub. L. No. 100-242) authorized HECMs as a demonstration program in HUD. It was the first nationwide reverse mortgage program—available in all 50 states, the District of Columbia, and Puerto Rico—that offered the possibility of lifetime home occupancy to elderly homeowners. Homeowners aged 62 or over with a significant amount of home equity are eligible, as long as they live in the house as the principal residence, are not delinquent on any federal debt, and live in a single-family residence. If the borrower has any remaining balance on a forward mortgage, this generally must be paid off first (typically, taken up-front from the reverse mortgage). In addition, the condition of the house must meet HUD's minimum property standards, but a portion of the HECM can be set aside for required repairs. The borrower makes no monthly payments, and there are no income or credit requirements to qualify for the mortgage.

The amount of money that a lender can advance to a HECM borrower (loan amount) depends on three main factors. First, the loan amount is based on the "maximum claim amount," which is defined as the lesser of the appraised value of the house or the Federal Housing Administration (FHA) loan limit (the highest mortgage value HUD will insure). In the past year, Congress has raised the FHA loan limit for HECMs twice, to the current limit of $625,500 nationwide.[5] Second, the age of the borrower affects the borrower's loan amount—the older the borrower, the higher the loan amount. However, if there is more than one homeowner, the loan amount is based on the age of the youngest borrower. Third, the interest rate also affects the loan amount. Typically, the lower the interest rate, the higher the loan amount.

Since the inception of the HECM program, Congress has mandated that borrowers receive information about the financial implications of these loans, allowing consumers to make informed decisions. In response, HUD developed a counseling program, working with nonprofits, such as the AARP Foundation,[6] to develop training courses and with a network of

[5]Previously, FHA loan limits were generally set at 95 percent of the local area median house price. HERA established for the first time a national limit for HECMs, which was set at $417,000. As a result of the American Recovery and Reinvestment Act of 2009, the national limit was raised again to $625,500.

[6]The AARP Foundation is AARP's affiliated charity.

qualified counselors. Counselors may conduct counseling sessions face-to-face or by telephone. HUD has stated that upon the completion of HECM counseling, prospective borrowers should be able to make an independent, informed decision on whether this product would meet their needs. While a lender may order a preliminary title search before the prospective borrower receives counseling, the lender may not process a loan application until the counseling has been completed. Furthermore, HUD requires lenders to provide prospective borrowers with a list of HUD-approved counseling agencies from which to choose.

A number of federal and state agencies have roles in overseeing the reverse mortgage market. FHA administers the HECM program and issues mortgagee letters to HECM lenders to communicate or clarify HUD requirements. HUD's four Home Ownership Centers (HOC) perform a number of insurance processing and quality control functions and conduct evaluations of HECM counseling providers. In addition, FTC, federal and state banking regulators, and state insurance regulators are involved with various aspects of consumer protections for HECM borrowers. Table 1 summarizes the agencies' responsibilities in this area.

Table 1: Government Agencies Involved with Consumer Protections for HECM Borrowers

Agency	Key HECM-related responsibilities
HUD	• Insures HECMs and enforces HECM program requirements. • Monitors counseling agencies' compliance with HECM counseling requirements.
FTC	• Enforces the Federal Trade Commission Act (FTC Act)—which prohibits unfair or deceptive acts or practices—with nonbank financial companies, such as mortgage brokers.
Federal banking regulators • Board of Governors of the Federal Reserve System • Office of the Comptroller of the Currency • Federal Deposit Insurance Corporation • Office of Thrift Supervision • National Credit Union Association	• For federally regulated lenders, including those that offer HECMs, enforce compliance with relevant laws and regulations, such as the FTC Act and the Truth in Lending Act, primarily through periodic examinations.
State banking regulators	• For state-regulated lenders, including those that offer HECMs, enforce compliance with relevant laws and regulations, primarily through periodic examinations.
State insurance regulators	• Enforce state insurance laws, such as those against the sale of unsuitable insurance products.

Source: GAO.

The Potential Benefits and Costs of HECMs Can Be Varied and Complex, and Concerns Exist That Some Consumers May Not Fully Understand the Product

While HECMs can provide senior homeowners with multiple types of benefits, including the flexibility to use the money received and protection against owing more than the value of the house when the loan comes due, HECM costs can be substantial. In addition, how borrowers draw down the loan, as well as changes in house values and interest rates, can affect the HECM borrowers' remaining home equity. Consumer advocates and others have expressed concern that some borrowers may not fully understand the complexities of HECM terms and costs, but some regulators have taken actions to promote better consumer understanding.

HECMs Can Provide Multiple Types of Benefits

Congress established the HECM program as a way to alleviate economic hardship caused by the increasing costs of health, housing, and subsistence needs at a time in life when income is reduced. Consistent with this goal, HECMs allow senior homeowners to convert their home equity into cash advances, while maintaining ownership of their homes. HECM borrowers have indicated that the mortgages have helped them to meet their financial needs. According to a 2006 AARP survey of reverse mortgage borrowers, including HECM borrowers, 83 percent of respondents said their loans had completely or mostly met their financials needs, and another 12 percent said the loans partly met their needs.[7] In addition, we interviewed 18 randomly selected HECM borrowers, 11 of whom said their loans completely met their financial needs and 6 of whom said the loans partly met their financial needs.

The money that borrowers receive from a HECM can be used for any purpose, and the loan does not have to be repaid until the borrower dies, sells the house, moves, or violates other conditions of the mortgage. Because there are no restrictions on how the money received from a HECM can be used, borrowers can choose to use the funds for necessities, such as housing, medication, or groceries, or for other purposes, such as vacations. Borrowers surveyed by AARP cited "paying off an existing mortgage," "home repairs/improvements," and "improved quality of life" as

[7]See AARP, *Reverse Mortgages: Niche Product or Mainstream Solution? Report on the 2006 AARP National Survey of Reverse Mortgage Shoppers* (Washington, D.C.: December 2007). The national telephone survey portion of this study, which consisted of interviews with 1,509 individuals who completed reverse mortgage counseling between 2001 and 2006, was conducted in December 2006. We reviewed the methodology of this survey and concluded that the results were usable for the purposes of our report.

the most common “main uses” of reverse mortgage funds. In our interviews with HECM borrowers, borrowers cited additional reasons for looking into a reverse mortgage, including making insurance payments, providing money to children and grandchildren, paying off nonmortgage loans, and supplementing limited retirement income. Furthermore, some borrowers also may use HECM money to address issues associated with failing health. For example, a National Council on Aging report discusses the use of reverse mortgages to fund in-home services to allow seniors to age in place.[8] In addition to unrestricted use of the money, HECM borrowers are not required to make monthly interest or principal payments to the lender as long as the borrower lives in the house. However, borrowers must continue to pay property taxes and homeowners’ insurance, and they must maintain the condition of the house.

Borrowers also can choose different ways to receive money from a HECM—as monthly payments, a line of credit, or a combination of both. Monthly payments can be received for a fixed period (term payments) or for as long as the borrower has the loan (tenure payments), and lines of credit can be accessed at any rate the borrower chooses (including receiving all of the money up front). Borrowers who obtained HECMs in fiscal year 2008 mostly chose the line-of-credit payment option. According to HUD data, 89 percent of these borrowers chose to receive their money solely as a line of credit, and an additional 6 percent chose to receive a line of credit in combination with term or tenure monthly payments. Generally, those choosing a line of credit withdraw about 60 percent of their funds at the loan’s inception.

Another benefit of HECMs is the potential growth over time in the amount of funds available to the borrower under each of the payment plans. For example, for borrowers who choose a line of credit but do not draw down all of the funds up front, any remaining line of credit grows by the same rate as the interest rate on the mortgage, plus 0.5 percent. To illustrate this HECM feature, consider a borrower who receives a line of credit of $100,000, withdraws $20,000 up front, and keeps the remaining $80,000 in the line of credit. If the borrower does not draw down any additional funds during the next year, and the interest rate plus 0.5 percent mortgage

[8]National Council on Aging, *Use Your Home to Stay at Home: Expanding the Use of Reverse Mortgages for Long-Term Care: A Blueprint for Action* (Washington, D.C.: January 2005).

insurance premium were equal to 3 percent, the borrower's credit line would grow to $82,400 at the end of 1 year.

FHA mortgage insurance benefits borrowers in several ways. First, lenders can provide borrowers with higher loan amounts than they could without the insurance. Second, the insurance guarantees that HECM borrowers will have access to the full amount of promised loan funds, regardless of how long the borrower lives in the house, of changes in the home value, or of changes in the circumstances of the lender. For example, the lender may assign the loan to FHA once the loan balance reaches 98 percent of the maximum claim amount, and FHA will continue making payments to the borrower if the borrower has remaining funds in a line of credit or still is receiving monthly payments. According to HUD, program experience thus far suggests that lenders assign to FHA about 25 percent of HECMs made in any given year. Similarly, if a lender goes out of business, the lender can assign the HECM to FHA, protecting the borrower from any risk of losing promised loan funds. Finally, FHA insurance protects borrowers from owing more than the value of the house when the loan becomes due. When a HECM becomes due, the borrower or heir to the borrower can retain ownership of the home and repay the loan in full, including all accumulated principal and interest charges. However, if the borrower or heir sells the home, he or she will not be responsible for any loan amount above the value of the house.

Finally, HERA authorized a "HECM for Purchase" program for seniors who want to use a HECM to buy a new home. Unlike a traditional HECM, a HECM for purchase is made against the value of the home to be purchased, rather than against the value of a home the borrower already owns. Before the HECM for purchase program was available, seniors wanting both to buy a new home and obtain a HECM would have had to conduct two transactions—first to buy the home with a forward mortgage, then to obtain a HECM to pay off the balance of that forward mortgage. The HECM for purchase program allows a senior to simultaneously buy a new home and obtain a HECM in a single transaction with a single set of closing costs, thereby reducing the cost to the senior. For example, with the HECM for purchase program, a senior who wants to buy a $300,000 home could use a HECM to partially finance this purchase. In this example, the senior qualifies for an $180,000 HECM on the basis of his age, the interest rate, and the value of the home to be purchased—the same factors used to determine the amount of a traditional HECM. The senior would combine the $180,000 in loan funds with $120,000 of his own—for example, from personal savings or money from the sale of his current home—to fully purchase the new home. He then would have no monthly mortgage payments and would avoid the closing costs of first obtaining a forward mortgage. As with a traditional HECM, the loan would become due when the senior died, sold the house, or permanently moved out of the house.

HECM Costs Can Be Substantial

While HECMs can provide many benefits, the up-front insurance premiums and origination fees of HECMs can be substantial. HUD permits borrowers to finance these costs in the mortgage.

- *Mortgage insurance premium:* FHA charges insurance premiums to cover the potential cost of paying insurance claims. FHA assesses a one-time, nonrefundable initial mortgage insurance premium equal to 2 percent of the maximum claim amount. The maximum claim amount is always higher than the amount a borrower can receive in HECM payments from the lender. However, because the HECM loan balance (with accumulated interest and fees) will exceed the amount a borrower receives in payments and potentially reach the maximum claim amount, FHA charges the mortgage insurance premium on the basis of the maximum claim amount.
- *Origination fee:* At the time of closing, lenders can charge an origination fee equal to the greater of $2,500 or 2 percent of the maximum claim amount, up to $200,000 plus 1 percent of any portion of the claim amount greater than $200,000, with the total origination fee not to exceed $6,000.[9]

To illustrate these up-front costs, consider a HECM borrower with a home value of $300,000. In this case, the borrower would pay (either out of pocket or financed through the mortgage) total up-front insurance and origination costs of $11,000 ($6,000 for the mortgage insurance premium and $5,000 for the origination fee). HECMs also have other up-front closing costs, such as appraisal and title search fees.

In addition to the up-front premiums and fees, lenders add monthly servicing fees, interest charges, and monthly premiums to HECM balances.

- *Servicing fee:* A lender's monthly servicing fee may not exceed $30 per month for fixed-rate or annually adjustable loans, and $35 for monthly adjustable loans. To finance this fee with the loan, FHA requires lenders to determine a prescribed dollar amount and deduct that amount, called the

[9]The $6,000 maximum origination cap was the result of HERA. Before this, the origination fee was 2 percent of the maximum claim amount without a cap.

servicing fee set-aside, from the amount of loan funds available to the borrower. Each month, the lender deducts the servicing fee from this set-aside and adds it to the borrower's loan balance.

- *Interest charges:* Monthly interest charges are also added to the borrower's loan balance. Most HECMs have adjustable interest rates.

- *Monthly mortgage insurance premium:* Finally, in addition to the up-front mortgage insurance premium that we have previously described, FHA charges a monthly mortgage insurance premium based on the loan balance. FHA has set the monthly premium at an annual rate of 0.5 percent, and lenders also add this premium to the borrower's loan balance each month.

Because HECM borrowers do not make monthly payments to the lender, borrowers are responsible for the total amount of servicing fees, interest charges, and monthly mortgage insurance premiums accrued over the life of the loan, as well as any financed origination fees and up-front insurance premiums, when the loan becomes due. Therefore, the longer the borrower has the loan, the longer the borrower benefits from access to home equity without experiencing any of the costs.

Multiple Factors Can Affect the Borrower's Remaining Home Equity

Multiple factors, including borrower decisions, interest rates, and home values, can affect the amount of home equity remaining—that is, the value of the home minus any debt against it—when a HECM comes due. The contingent nature of remaining equity could have implications for borrowers who may hope to have equity left over—whether for themselves or their heirs—after the HECM is repaid. According to AARP Foundation consumer education materials, prospective HECM borrowers should consider the amount of home equity that might be left at the end of the loan. Most of the borrowers with whom we spoke said that having remaining equity was very or somewhat important to them, citing various reasons, such as wanting to leave remaining equity to children or grandchildren or to have money left over to fund their retirement.

As we have previously noted, the "rising debt, falling equity" nature of reverse mortgages means that over time, the amount of equity the borrower has in the home decreases as the loan balance increases (unless the home appreciates at more than a moderate rate). Several factors affect the rate at which equity changes and, therefore, the amount of equity the borrower will have to keep or pass on to heirs when the loan becomes due:

- *Borrower decisions:* The amount of the available funds borrowed will affect the amount of the remaining home equity. The more the borrower draws from the loan, the less remaining home equity the borrower will have.

- *Interest rates:* As we have previously discussed, because most HECMs have interest rates that vary, economic factors that determine interest rates also will affect the remaining home equity over the long term.

- *Home values:* The amount of home equity remaining for the borrower or heirs will be the value of the home, minus the amount owed on the HECM. Thus, whether and how much the value of the home appreciates also will affect the amount of remaining home equity.

Figure 2 illustrates how interest rates and home values can affect remaining home equity over a 10-year period. The figure reflects three different interest and house appreciation rate assumptions for a borrower who draws down the HECM funds in a manner consistent with historical average borrower profiles:[10]

1. Economic forecasts: Interest and appreciation rates follow economic forecasts for 2008 through 2017.[11]

2. Constant rates: Interest rates remain constant at the starting rate, and houses appreciate at a constant 4 percent per year.

3. Historical patterns: Interest and house appreciation rates repeat the pattern seen from 1998 through 2007.[12]

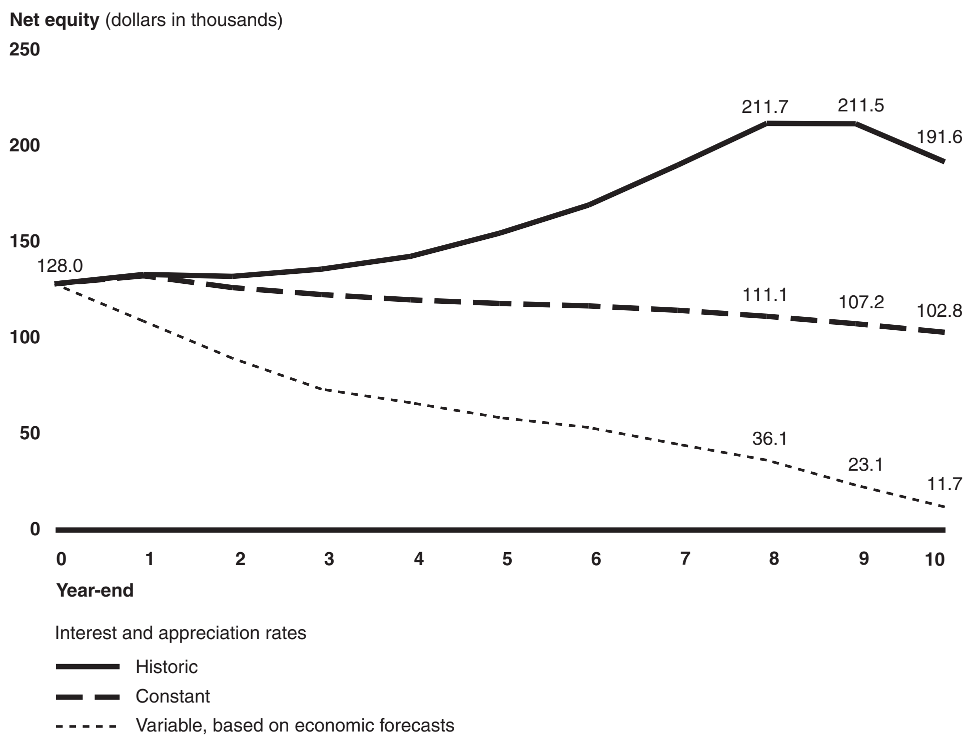
[10]For these scenarios, we used the average characteristics of a HECM borrower in fiscal year 2008. HUD data indicate that the average HECM borrower in fiscal year 2008 was aged 73, with a home valued at $239,357. According to HUD, the average HECM borrower draws down 58.3 percent of the loan up front, with subsequent draw downs ranging from 3 to 6 percent.

[11]For economic forecasts of house appreciation and interest rates, we used IHS Global Insight's 2008 through 2017 projections for the Federal Housing Finance Agency house price index and the 1-year Treasury yield, respectively. These projections were current as of October 2008 and are used here for illustrative purposes only. IHS Global Insight is a private company that forecasts a wide range of financial and economic indicators, including interest rates and house appreciation rates.

[12]For historical house appreciation and interest rates, we used 1998 through 2007 data on the Federal Housing Finance Agency house price index and the 1-year Treasury yield, respectively.

As shown in figure 2, if interest and appreciation rates were to vary monthly on the basis of economic forecasts for 2008 through 2017, the borrower would have about $11,750 of remaining home equity—after repaying the HECM—at the end of 10 years. However, if interest rates were to stay constant at the initial rate, and house values were to appreciate by 4 percent annually, the borrower would have more than $102,000 in remaining home equity. Finally, if interest and appreciation rates were to repeat the pattern seen from 1998 through 2007, the borrower would have the most remaining equity of the three scenarios—that is, more than $191,000.

Figure 2: Changes in Remaining Home Equity over a 10-Year Period under Three Economic Scenarios (Borrower Draws Down Loan According to Historical Patterns)



Source: GAO.

Concerns Exist That Some Consumers May Not Fully Understand HECM Complexities

HUD and industry officials indicated that the complex nature of HECMs may make them difficult for some borrowers to understand. Specifically, officials expressed concern about some borrowers' understanding of the nature and costs of the loan.

- *HECM is a loan product:* AARP officials told us that some borrowers were not aware that they were borrowing money, rather than drawing directly from the equity in their homes. Similarly, the president of NRMLA provided an example of a consumer who did not understand why she owed more than the amount she borrowed, not realizing that her loan was accumulating interest and fees. In our interviews with borrowers, 2 of the 18 borrowers with whom we spoke did not understand that the money they were drawing was accumulating interest, indicating that they may not have understood that their HECM was a loan.

- *Costs of HECMs:* Some borrowers may not readily understand some of the costs of a reverse mortgage. For example, 1 borrower we interviewed said he was surprised by the $35 monthly servicing charge, and another borrower said she had not known how high the fees would be and was surprised by the amount of servicing fees the lender charged in a year. Similarly, some borrowers may understand the concept of interest charges, but may not understand that their HECM interest rate is variable and can increase over time. For example, several borrowers with whom we spoke did not know the type of interest rate they had, and 1 borrower said he was surprised that his interest rate varied.

- *Effect of a HECM on remaining home equity:* AARP representatives told us that some seniors may not understand that reverse mortgages result in "rising debt and falling equity," which differs from the "falling debt, rising equity" result of a forward mortgage. Furthermore, our interviews with HECM borrowers illustrate how some may not be aware of all of the factors that can affect how much home equity they will have remaining after the reverse mortgage is repaid. For example, when we asked if changes in house values could affect their remaining home equity, several borrowers responded that they could not.

Regulators and others have taken some actions to promote better consumer understanding of the costs and terms of HECMs. For example, as we discuss later in this report, HUD has taken some steps to improve the types and quality of information provided to prospective HECM borrowers during the required HECM counseling sessions. In addition, various entities, including FTC, the Financial Industry Regulatory Authority (FINRA), state agencies, and consumer groups have issued fact sheets and tips for consumers interested in reverse mortgages. For example, FTC has issued a fact sheet on reverse mortgages to help borrowers understand the product, and the Federal Deposit Insurance Corporation (FDIC) has included information on reverse mortgages in its consumer financial education program. In addition, Massachusetts has a Web site on "What Borrowers Need to Know" about reverse mortgages.

Although Various Agencies Have Some Responsibility for Assessing HECM Marketing, Some Advertisements Contain Potentially Misleading Claims

Various state and federal agencies have some responsibility for assessing marketing for mortgage products, including FTC, federal and state banking regulators, and HUD. Agency officials indicated that while complaints are one factor that could trigger more extensive assessments of marketing materials, they have received few complaints about reverse mortgage marketing. Our review of selected advertisements found examples of marketing claims that were potentially misleading because they were inaccurate, incomplete, or used questionable sales tactics. Federal agency officials agreed that some of these advertisements raised concerns.

FTC, Banking Regulators, and HUD Share Responsibility for Assessing Marketing and Enforcing Standards

Several federal and state agencies have a role in assessing and enforcing standards for the marketing of mortgage products. These agencies have responsibility over different segments of the mortgage market and may focus on different aspects of marketing claims. However, the federal and state agencies involved with assessing reverse mortgage marketing have not specifically focused on this product.

FTC

FTC has responsibility for protecting consumers against unfair or deceptive practices originating from nonbank financial companies, such as mortgage brokers. Specifically, FTC enforces section 5 the FTC Act, which broadly prohibits unfair or deceptive acts or practices in commerce. Section 5(n) of the FTC Act defines “unfair” to mean practices that cause or are likely to cause substantial injury that cannot be reasonably avoided by consumers and is not outweighed by countervailing benefits to consumers or to competition. FTC has defined “deceptive” to mean any material representation or omission of information, or practice that is likely to mislead consumers who are acting reasonably under the circumstances. Misleading information is “material” to consumers if it is likely to affect the consumer’s decision to purchase a product or service. For some products, including forward mortgage products, FTC officials stated that they have conducted systematic searches of all forms of media, including Internet, print, and television advertisements for potential violations of the FTC Act. Violators of the FTC Act could be subject to actions ranging from warning letters to cease-and-desist orders. For example, in 2007, FTC sent warning letters to 200 forward mortgage lenders identifying potentially deceptive advertisements that the lenders had run and advising the lenders to review their marketing practices to ensure they complied with the law.

FTC officials said they have not systematically searched for potentially misleading reverse mortgage marketing, and have not brought any law enforcement actions related to reverse mortgage marketing. However, FTC officials did note that they are maintaining an awareness of the potential risks associated with reverse mortgage marketing. For example, FTC staff said that they monitor their consumer complaint database for complaints about reverse mortgage marketing. In addition, FTC formed a task force of state and federal regulators and law enforcement agencies, in part to learn about complaints related to reverse mortgages that may not be captured by FTC's database. The FTC officials said the task force will allow them to take early action if problems related to reverse mortgages begin to surface. In addition, FTC has developed educational materials for reverse mortgage counselors, which include information on identifying deceptive claims related to reverse mortgages. The FTC officials noted that because counselors are informed about the product, they may be well-positioned to help consumers identify questionable marketing claims and practices. Furthermore, FTC officials told us that they plan to speak about marketing issues at an upcoming reverse mortgage industry conference.

Federal Banking Regulators

HECM lenders that are regulated by one of the federal banking regulators—the Board of Governors of the Federal Reserve System (Federal Reserve), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), FDIC, or the National Credit Union Association (NCUA)—are subject to compliance examinations that could include a review of HECM marketing materials.[13] Each of the banking regulators with whom we spoke said that reverse mortgages have been included in compliance examinations of lenders, but because few of their regulated lenders offer reverse mortgages, they have not conducted many examinations that have included these loans. In addition, among lenders who offer the product, reverse mortgages do not make up a significant portion of bank activity—by one estimate, 1 percent of mortgage portfolios. Federal regulators said when compliance examinations are conducted, they could include an assessment of whether the materials comply with FTC Act standards. In addition, OTS prohibits the thrifts that it regulates from using marketing materials that contain inaccurate information or misrepresents the services offered—a standard that an OTS official described as being broader than that set by the FTC Act.[14] Officials

[13]We did not speak with officials at NCUA because none of the HECM lenders that originated at least 1,000 HECMs in fiscal year 2008 were credit unions regulated by NCUA.

[14]See OTS Advertising Rule at 12 CFR 563.27.

at each of these federal banking regulators noted that they are not aware of any violations related to reverse mortgage marketing. As FTC has been doing, federal banking regulators are maintaining an awareness of the potential risks associated with reverse mortgages, which could include those associated with reverse mortgage marketing. Specifically, the Consumer Compliance Task Force of the Federal Financial Institutions Examination Council—the interagency body that includes the federal banking regulators and develops guidance for federal bank examiners—recently formed a working group on reverse mortgages.

State Banking Regulators

Some HECM lenders are regulated at the state level, with HECM marketing materials subject to state compliance examinations. We obtained information on state agency efforts to review reverse mortgage marketing materials through the Conference of State Bank Supervisors (CSBS), which sent a set of standardized questions we developed to all 50 states and the District of Columbia. Of the 35 state banking regulators that responded to the questions, 22 said they routinely examine marketing materials as part of compliance examinations. However, only 1 state banking regulator—the Idaho Department of Finance—reported taking action against a lender because of reverse mortgage marketing. In addition, we learned that the Massachusetts Division of Banks issued a HECM lender a cease-and-desist order for marketing HECMs as "government benefits."

State banking regulators also are maintaining an awareness of the potential risks associated with reverse mortgages. For example, these regulators also formed a task force to examine consumer protections for reverse mortgages, including those related to reverse mortgage marketing. In addition, CSBS and the American Association of Residential Mortgage Regulators recently developed reverse mortgage examination guidelines for state regulators conducting reverse mortgage compliance examinations.[15] These guidelines contain items that state regulators could review, including whether the institution uses any form of solicitation that appears to be generated by the government or can be interpreted to be misleading to the consumer.

[15]State banking regulators are not required to follow the reverse mortgage guidelines when conducting compliance examinations, but these regulators can use these guidelines for determining whether reverse mortgage lenders are operating in an appropriate manner.

HUD

HUD also exercises limited regulatory authority over the marketing activity of HECM lenders to ensure that lenders' advertisements do not imply endorsement by HUD or FHA. Actions that HUD could take range from asking for the removal or clarification of a marketing claim to a referral to the Mortgagee Review Board.[16] HUD officials cited one instance in which they referred a lender to the board for misrepresenting the HECM as a "government rescue loan." HUD may also make a referral to the Department of Justice, which has jurisdiction over criminal prosecution.[17]

Of the federal regulators, HUD is the only agency that has taken action against an entity as a result of misleading reverse mortgage marketing. However, HUD officials said they do not actively monitor HECM marketing, and do not review HECM marketing materials as part of routine assessments of HECM lenders.

Agencies Have Received Few Complaints about HECM Marketing

Some agencies with whom we spoke indicated that while complaints could trigger more extensive assessments of marketing material, they have received few, if any, complaints about reverse mortgage marketing. For example, FTC officials said that they have not conducted systematic searches for misleading reverse mortgage advertisements as they have for products about which they have received many complaints. In addition, an FDIC official explained that consumer complaints related to a lenders' marketing are one of several factors that could cause compliance examiners to review marketing materials. Similarly, OTS officials said a consumer complaint could trigger an examination of a reverse mortgage lender. However, FDIC and OTS officials told us that they have received few complaints related to reverse mortgage marketing.

Consistent with these examples, FTC, the Federal Reserve, OCC, OTS, FDIC, and HUD all reported receiving few HECM marketing complaints from calendar year 2005 through 2008. FTC officials said they received 50 complaints related to reverse mortgage marketing in this period, out of more than 4 million complaints in their database. Of these 50 complaints,

[16]HUD's Mortgagee Review Board, an enforcement body chaired by HUD's Assistant Secretary for Housing–Federal Housing Commissioner, can impose administrative sanctions against lenders, including withdrawing the lenders' authority to make FHA-insured loans.

[17]See 18 U.S.C. §§ 709 (*false advertising or misuse of names to indicate Federal agency*), 1017 (*government seals wrongfully used*).

8 involved a reverse mortgage lender implying an affiliation with a government agency; 9 involved other questionable marketing tactics, such as a mailing appearing to be from a personal friend; and the others were not directly related to inaccurate claims within the marketing materials. OTS officials reported 1 HECM marketing complaint over this period, and officials at the Federal Reserve and FDIC did not report any complaints related to HECM marketing in this period. In addition, OCC officials said a review of reverse mortgage complaints in this period did not reveal any concerns with marketing. Similarly, among the 123 HECM complaints that HUD received from calendar year 2005 through 2008, only a few related to HECM marketing. In addition, representatives of state banking regulators told us that they have not received many complaints related to reverse mortgage marketing. However, while the low volume of complaints could indicate few problems with reverse mortgage marketing, FTC officials noted that it also could be a result of consumers not being aware that they have been deceived, consumers not knowing to whom to complain, or elderly consumers being less likely to complain.

Extent of Misleading HECM Marketing Is Unknown, but Selected Materials Contained Some Potentially Misleading Claims

While the extent of misleading HECM marketing is unknown, our limited review of marketing materials found some examples of claims that were potentially misleading because they were inaccurate, incomplete, or employed questionable sales tactics. We reviewed Internet marketing material from the 12 HECM lenders that originated at least 1,000 loans in fiscal year 2008, and reviewed mailed material from 11 of these 12 lenders.[18] In addition, we reviewed mailed, Internet, information seminar, and DVD materials from other entities that advertised HECMs, for certain potentially misleading claims (discussed in the following paragraphs). We found few such claims among the materials from the top 12 HECM lenders, and some examples in the materials from the other entities.[19]

Some of the potentially misleading marketing claims we found raised concern among officials at FTC, HUD, and the federal banking regulators. Among the materials we reviewed, we found 26 different entities that

[18] We requested but did not receive materials from 1 of these 12 lenders.

[19] It was not always clear from the marketing materials whether the entities were lenders, mortgage brokers, or third-party marketers.

made potentially misleading claims in their HECM marketing materials.[20] This group includes entities regulated by each of the federal banking regulators with whom we spoke, as well as FTC and state regulators; it also includes both members and nonmembers of NRMLA. NRMLA members are expected to adhere to the association's Code of Ethics, which contains specific rules on ethical advertising.[21] We selected seven advertisements that represented these claims and submitted them to FTC, HUD, the Federal Reserve, OCC, FDIC, and OTS for review. We asked officials at each of these agencies for their views on these claims and whether they would take any action if such advertisements were the subject of a complaint or surfaced as part of an examination. In general, the officials with whom we spoke agreed that the claims in six of the seven advertisements raised some degree of concern and might prompt further investigation.[22] In commenting on the advertisements, the officials indicated that the claims ranged from being confusing to false. Several of the officials noted that they would need to consider the fuller context of the advertisement to determine if the claims were misleading and the level of action they would take if these six advertisements were the subject of complaints or compliance examinations. For example, an official at FTC said that if its staff were to follow typical investigative procedures, they would request more information from the advertisers, such as data on the number of consumers who responded to the advertisement. Similarly, officials at OTS noted that an assessment of consumer reactions to the advertisements might be needed to determine if the advertisements violated the FTC Act. An FTC official also said that the counseling requirement for HECMs would factor into their assessment of HECM marketing. He said that the counseling requirement would not, as a matter of law, prevent FTC from taking law enforcement action against a HECM

[20]At least 1 of these lenders has corrected its potentially misleading claim since we first reviewed the materials, and another lender was issued a cease-and-desist order by a state banking regulator as a result of a misleading claim.

[21]These rules state that members shall not engage in "conduct involving dishonesty, fraud, deceit or misrepresentation, or knowingly making a material false or misleading statement to consumers or others," and requires members to "accurately describe both the costs and benefits of the products and services presented to consumers." According to NRMLA's president, the association does not conduct systematic reviews of marketing materials. However, NRMLA has asked members to remove or correct misleading marketing claims; suspended lenders' membership for a specified period as a result of misleading marketing claims; and, in one instance, withdrew a lender's membership because of its marketing practices.

[22]The Federal Reserve did not comment on the advertisements individually, but indicated that the advertisements generally raised concerns.

lender for deceptive marketing. However, FTC would consider the likelihood that counseling would mitigate the effect of the potentially misleading information. In addition to the regulators, we spoke with the president of NRMLA to obtain his views on these seven advertisements. He generally agreed with the regulators' assessment that these claims raised concerns.

The six potentially misleading claims that we identified and agency officials generally agreed raised concerns were as follows:[23]

- *"Never owe more than the value of your home":* The claim is potentially misleading because a borrower or heirs of a borrower would owe the full loan balance—even if it were greater than the value of the house—if the borrower or heirs chose to keep the house when the loan became due. This claim was made by HUD itself in its instructions to approved HECM lenders; however, in December 2008, HUD issued a mortgagee letter to HECM lenders explaining the inaccuracy of this claim. This was the most common of the potentially misleading statements we found in the marketing materials we reviewed. Of the potentially misleading statements found among the top 12 HECM lenders, variations of this statement were the most prevalent.

- *Implications that the reverse mortgage is a "government benefit" or otherwise not a loan:* While HECMs are government-insured, the product is a loan that borrowers or their heirs must repay, not a benefit. Examples of this type of claim include the following: "You may be qualified for this government-sponsored benefit program" and "Access the equity in your home without having to sell, move, or take out a loan." An FDIC official noted that consumers might be confused about the reverse mortgage being a loan because there are no monthly payments, and this claim plays on this confusion.

[23]The claim that did not raise as much concern stated that HECM closing costs average only 1 percent more than a regular FHA mortgage. We considered this statement to be inaccurate because while HECM origination fees are 2 percent, FHA forward mortgage origination fees are 1 percent—a difference of 100 percent. The officials with whom we spoke about this claim said they would consider this an "editorial error" or "confusing," but not intended to mislead. This is because origination fees and interest rates are commonly quoted as a percentage of the loan amount, and the claim would not necessarily be misleading when interpreted in this light. In addition, we found examples of claims that HECMs do not affect Supplemental Security Income (SSI). This claim is inaccurate because eligibility for SSI could be affected if a borrower's savings from HECM funds were to exceed SSI's monthly limits. However, because there were few examples of this type of claim, we did not submit it to the officials for review.

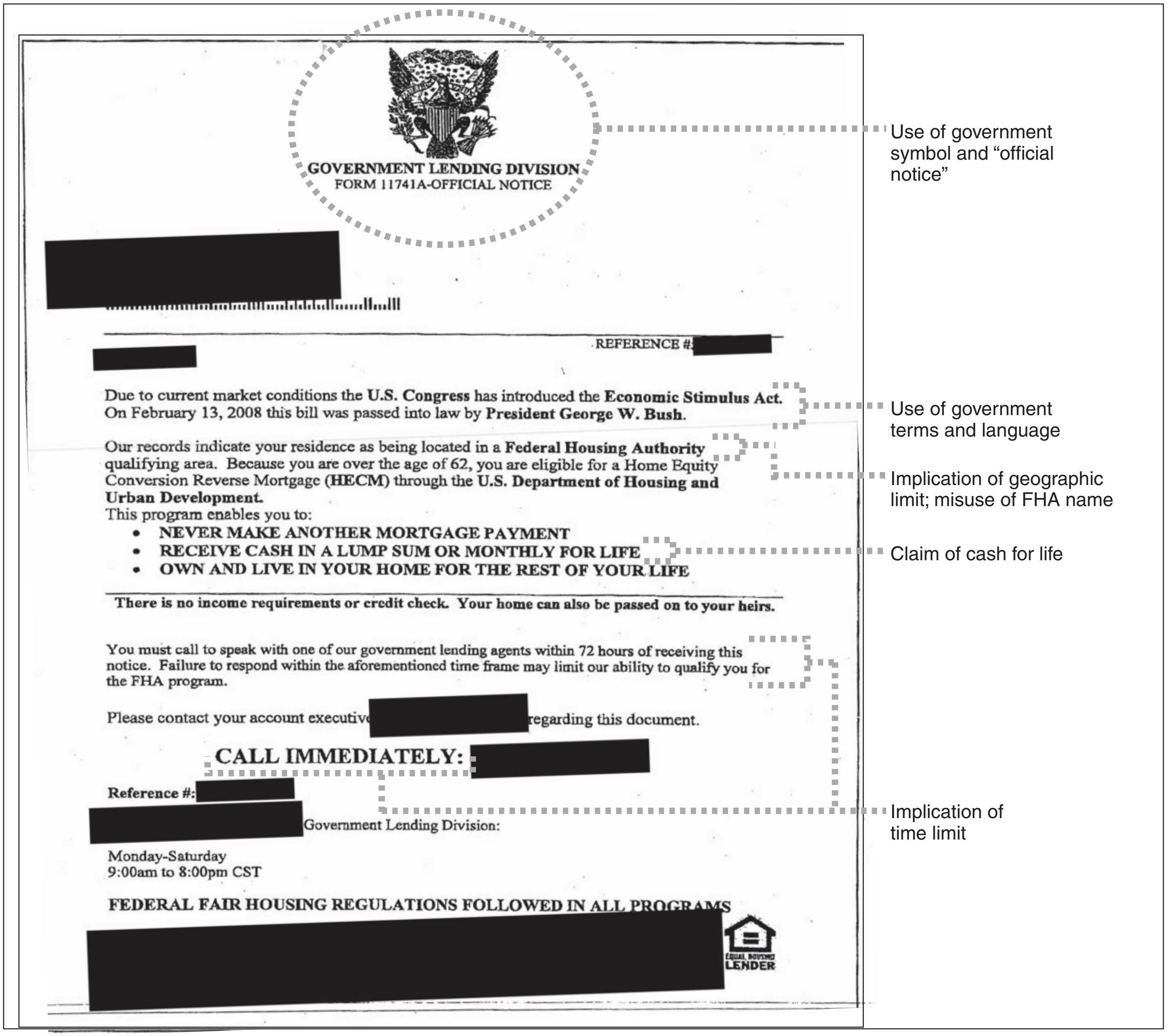
- *"Lifetime income" or "Can't outlive loan":* Although borrowers can choose to receive HECM funds as monthly tenure payments, even under this option, payments will not continue once the loan comes due (e.g., when the borrower moves out of the house or violates other conditions of the mortgage). HUD officials noted that this claim could be particularly harmful when paired with the claim that the reverse mortgage is a government benefit. In addition, claims that a HECM borrower cannot outlive the loan are inaccurate because a line of credit can be exhausted during the borrower's lifetime, and term monthly payments do not continue once the specified term has ended.

- *"Never lose your home":* This claim is potentially misleading because a lender could foreclose on a HECM borrower's home if the borrower did not pay property taxes and hazard insurance or did not maintain the house. HUD officials told us that they were aware of cases in which borrowers obtained a reverse mortgage without understanding these requirements and did not have the means to meet these obligations.

- *Misrepresenting government affiliation:* Figure 3 illustrates an example of this type of claim, including the use of government symbols or logos and claims implying that the lender is a government agency. HUD officials said that among the advertisements we asked them to review, this would be the only one they would refer to the Mortgagee Review Board. Officials at FDIC and OTS noted that in 2007, the federal banking regulators jointly issued an alert to warn consumers about similar advertisements that suggested that consumers could receive cash grants from a "Community Reinvestment Act Program" endorsed by the federal banking regulators. In addition, as we have previously noted, FTC has received consumer complaints about advertisements for reverse mortgages that appear to be from a government agency.

- *Claims of time and geographic limits:* These claims falsely imply that HECM loans are limited to a certain geographic area, or that the consumer must respond within a certain time to qualify for the loan. Examples include "must call within 72 hours" and "deadline extended," as well as the claim that a consumer's residence is "located in a Federal Housing Authority qualifying area." An OCC official said that he would consider these to be high-pressure tactics against which he would caution banks, even if they do not rise to the level of unfair or deceptive practices.

Figure 3: Example of a Reverse Mortgage Advertisement Containing Potentially Misleading Statements



GOVERNMENT LENDING DIVISION
FORM 11741A-OFFICIAL NOTICE

[redacted]

REFERENCE #:[redacted]

[redacted]

Due to current market conditions the **U.S. Congress** has introduced the **Economic Stimulus Act.** On February 13, 2008 this bill was passed into law by **President George W. Bush**.

Our records indicate your residence as being located in a **Federal Housing Authority** qualifying area. Because you are over the age of 62, you are eligible for a Home Equity Conversion Reverse Mortgage **(HECM)** through the **U.S. Department of Housing and Urban Development.**
This program enables you to:

- **NEVER MAKE ANOTHER MORTGAGE PAYMENT**
- **RECEIVE CASH IN A LUMP SUM OR MONTHLY FOR LIFE**
- **OWN AND LIVE IN YOUR HOME FOR THE REST OF YOUR LIFE**

There is no income requirements or credit check. Your home can also be passed on to your heirs.

You must call to speak with one of our government lending agents within 72 hours of receiving this notice. Failure to respond within the aforementioned time frame may limit our ability to qualify you for the FHA program.

Please contact your account executive[redacted]regarding this document.

CALL IMMEDIATELY: [redacted]

Reference #:[redacted]

[redacted]Government Lending Division:

Monday-Saturday
9:00am to 8:00pm CST

FEDERAL FAIR HOUSING REGULATIONS FOLLOWED IN ALL PROGRAMS

[redacted]

EQUAL HOUSING LENDER

Source: GAO.

Note: We removed those parts of the advertisement that would have identified the name of the lender.

As we discuss in this report, federal agencies have mechanisms to identify and address specific cases of misleading marketing. They also have various means, such as conferences and educational materials, for communicating more generally with mortgage industry participants and the public about consumer protection issues. However, our research showed that potentially misleading claims exist in the marketplace, which suggests that some HECM providers may not be sufficiently considering federal marketing standards in designing their marketing materials. We referred the claims we identified to FTC or the appropriate federal banking regulator for further review.

Development of HECM-Specific, Cross-Selling Regulations Is in Preliminary Stage, and States Have Uncovered Some Evidence of Inappropriate Cross-Selling

Concerns exist that reverse mortgage borrowers could be vulnerable to inappropriate cross-selling, a practice involving the sale of financial or insurance products that are unsuitable for the borrower's financial situation using the borrower's reverse mortgage funds. While the federal role in addressing this practice has been limited, recent legislation includes provisions to restrict inappropriate cross-selling in conjunction with HEMCs, and HUD is in the early stages of developing regulations to implement these provisions. Although the full extent of inappropriate cross-selling is unknown, state regulators have identified some instances of this practice in enforcing insurance laws.

Borrowers May Be Vulnerable to the Sale of Unsuitable Products, Which Could Have Adverse Financial Consequences

Because reverse mortgages allow borrowers access to a large amount of money at once, consumer advocates have expressed concern that reverse mortgage borrowers may be vulnerable to the sale of financial and insurance products that may be unsuitable for some borrowers. According to an AARP survey of reverse mortgage borrowers, 4 percent of respondents said they used a reverse mortgage to make investments or purchase an annuity or long-term care insurance.[24] Some consumer advocates, including representatives of AARP and the National Association of Consumer Advocates, have expressed concern that these products are sometimes sold inappropriately to reverse mortgage borrowers.

[24]See *Reverse Mortgages: Niche Product or Mainstream Solution?*

In particular, consumer advocates worry that reverse mortgage borrowers could be sold some annuity products that may be inappropriate to the borrower's circumstances. For example, there is concern that elderly reverse mortgage borrowers may be sold deferred annuities, where payments may not begin for many years and high fees may be charged for early access to the money. Inappropriate cross-selling could take different forms. For example, an individual who has financial incentive to sell an elderly client a reverse mortgage as well as another product, such as a deferred annuity, could sell both products to a senior without informing the client of the costs and potential implications. Multiple parties, such as HECM originators and insurance agents, also could work together for their financial gain. For example, an insurance agent could compensate a HECM originator for referring HECM borrowers to him, even if using the HECM money for an insurance product is not in the borrower's best interest.

While certain annuity products may be suitable for some HECM borrowers, such as those who want to receive payments for life regardless of where they live, HUD has noted that HECM borrowers should be fully informed of the advantages and disadvantages of using HECM funds to purchase these products. HECM counselors are instructed to inform prospective borrowers who are also interested in purchasing annuities that HECMs also offer monthly payment options, and while these monthly payments only last for a specified time or as long as the borrower lives in the house, they may be more suitable to the HECM borrower's needs.

Federal Role in Regulating Cross-Selling Has Been Limited, but Regulations to Be Developed Would Create HECM-Specific Federal Protections

Because cross-selling typically involves the sale of insurance products generally regulated at the state level, the role of federal agencies in addressing the issue of cross-selling in conjunction with HECMs has been limited and largely has been focused on consumer education and disclosures.[25] For example, federal agencies have had some role in informing HECM borrowers about the risks and costs of purchasing other financial products using HECM funds. As we discuss later in this report, HUD's HECM counseling protocol requires the provision of certain consumer education materials to counselees interested in purchasing an

[25]Banks and savings associations that offer insurance and annuities are prohibited from engaging in practices that would cause a reasonable consumer to believe that an extension of credit, including a HECM, is conditioned on the purchase of insurance or an annuity from the creditor. See *Consumer Protection in Sales of Insurance Rules*, 12 CFR §§14.30, 208.83, 343.30, and 536.30.

annuity with their HECM funds. Additionally, pursuant to Truth in Lending Act provisions, the Federal Reserve developed a disclosure, known as the total annual loan cost (TALC) to illustrate the short- and long-term costs of reverse mortgages. Lenders must provide reverse mortgage borrowers with this disclosure, and if the lender is aware that the consumer is purchasing an annuity with reverse mortgage funds, these costs must be accounted for in the TALC as part of the total mortgage costs.[26]

In addition, the Securities and Exchange Commission (SEC) is the federal regulator for variable annuity products—annuities that are tied to the stock market or other investments—and so has responsibility for ensuring the appropriate sale of these products. In May 2006, the three following entities began an initiative to protect seniors from the sale of unsuitable securities: SEC; FINRA, which is a nongovernmental regulator for securities firms; and the North American Securities Administrators Association. As part of this effort, SEC and other regulators conducted a review of 110 information seminars, many of which were targeted to seniors, where attendees were offered a free meal. These officials found that products sold at these seminars included annuities and reverse mortgages, and, in some instances, those holding the seminars recommended products that did not appear to be suitable for the consumers.[27] In addition, in September 2007, SEC approved a FINRA rule, which includes suitability standards for deferred variable annuities. As with the state suitability laws we discuss in the following text, these standards may limit the sale of unsuitable deferred variable annuities to seniors, whether purchased with HECM funds or not.

As we have previously noted, Congress passed HERA in 2008, which includes provisions intended to curb the sale of unsuitable financial products to consumers using HECM funds. According to the provisions of the act, a borrower cannot be required by the lender or any other party to purchase an insurance, annuity, or similar product as a condition of obtaining a HECM. In addition, the lender either must not be associated

[26]The TALC is expressed as a percentage—the estimated total dollar cost of a reverse mortgage, annualized into a rate, roughly comparable to the annual percentage rate in a forward mortgage. As up-front costs are spread over more years, the TALC rate declines.

[27]Office of Compliance Inspections and Examinations, Securities and Exchange Commission; North American Securities Administrators Association; and Financial Industry Regulatory Authority, *Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars* (Washington, D.C., September 2007).

with any other financial or insurance product or must maintain firewalls and other safeguards to ensure that its employees originating the HECMs do not also sell other financial or insurance products. Finally, HUD must conduct a study to determine appropriate consumer protections and underwriting standards to ensure that the purchase of other financial products is appropriate for the consumer.

HUD has responsibility for enforcing the cross-selling provisions in HERA, but the department is in the preliminary stages of developing regulations to implement them. According to HUD officials, HUD is drafting a Federal Register notification to solicit feedback on this issue. HUD officials noted that the draft notification poses a number of questions concerning several issues, including HUD's ability to monitor and enforce the provision; the usefulness of disclosures, education, and counseling in preventing inappropriate cross-selling; what would constitute "appropriate" firewalls; and what types of financial products should be covered. To further inform development of the new regulations, HUD also met with HECM lenders, some of which already have cross-selling policies. For example, one large HECM lender requires that loan officers follow up with HECM borrowers before and after closing to confirm that the borrower has not been sold any insurance products. Meanwhile, HUD has issued a mortgagee letter instructing HECM lenders that until HUD issues more definitive guidance, lenders must not condition a HECM on the purchase of any other financial or insurance product, and should strive to establish firewalls and other safeguards to ensure there is no undue pressure or appearance of pressure for a HECM borrower to purchase another product.

While HUD is considering regulations to implement the HERA cross-selling provisions, the reverse mortgage industry is also discussing the implications of these provisions. NRMLA representatives have noted that while HERA could prevent inappropriate cross-selling, it also could prevent seniors from purchasing beneficial products. In particular, the president of NRMLA noted that although some seniors who obtain reverse mortgages do so to cover everyday living expenses, others are financially sophisticated individuals who may desire to use their reverse mortgages as part of long-term financial and insurance strategies. He said that for the latter group of borrowers, purchasing other products in conjunction with a reverse mortgage may be beneficial. For example, some insurance products may be suitable if they still allow seniors some access to the funds when needed. NRMLA has submitted its legislative interpretation to HUD. According to the NRMLA General Counsel, this interpretation allows companies to sell multiple products to reverse mortgage borrowers, as long as (1) the company has separate sales forces for reverse mortgages and other products, and there is no compensation for referrals between the sales forces; or (2) the reverse mortgage transaction is separate from the sale of other products, and the sale of the reverse mortgage and other products is separated in time. The president of NRMLA also indicated that in any event, borrowers should receive a clear disclosure, informing them that they are under no obligation to purchase any other product or service with their reverse mortgage funds.

State Efforts to Enforce Insurance Laws Have Identified Instances of Inappropriate Cross-Selling

Many states have passed suitability laws that are designed to protect consumers from being sold unsuitable insurance products, including annuities. At least 26 states have adopted the National Association of Insurance Commissioners (NAIC) model regulation for suitability in annuity transactions. In addition, at least 10 other states have adopted other legislation or regulations related to the suitability of insurance products. The NAIC model regulation states that in recommending to a consumer the purchase of an annuity, the insurance producer shall have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer. In addition, a few states allow citizens to cancel policies of individual life insurance or individual annuity contracts within a certain period from the date of purchase, regardless of whether these products were purchased with reverse mortgage funds. Furthermore, certain states have enacted laws specific to reverse mortgages. For example, according to the California Civil Code, a reverse mortgage lender cannot offer, or refer the borrower to any other party who will offer, an annuity to the borrower before closing on a reverse mortgage.

A number of state insurance regulators reported recent examples of violations of their state insurance laws that involved HECM funds. Through NAIC, we sent a set of standardized questions on cross-selling practices to insurance commissioners from all 50 states and the District of Columbia. Of the 29 state insurance regulators that responded to our questions, 8 said that from 2005 through January 2009, they had at least one case of an insurance agent selling an unsuitable insurance product that a consumer had purchased using reverse mortgage funds. Of those 8 regulators, 4 said their states took formal or informal action against the companies that sold these products. Cross-selling cases that involved actual or potential violations of state insurance laws included the following:

- An official at the Insurance Division of the Hawaii Department of Commerce and Consumer Affairs described a case in which an independent mortgage broker was prosecuted for misrepresentation of an annuity product. The broker, who also owned his own insurance company, deceived 15 clients by including paperwork for an annuity in their HECM closing documents without their knowledge. The clients did not realize they were signing to purchase an annuity in addition to a reverse mortgage, and the broker collected fees from the HECM sale and commission from the annuity.

- A sales manager of an insurance company violated the Maine Insurance Code by allowing transactions that were not in the best interest of the customer. The sales manager had arranged for a representative of a large reverse mortgage lender to speak with his sales agents about reverse mortgages. The agents then referred 14 clients to the reverse mortgage lender, all of whom obtained reverse mortgages. One particular client, an 81-year old widow, was contacted continually until she obtained her reverse mortgage funds, and was then sold a deferred annuity. The interest rate accruing on the reverse mortgage was 4.12 percent, and the deferred annuity earned only 3.25 percent.

- In California, two insurance agents are accused of designing a seminar to teach licensed insurance and real estate agents how to sell reverse mortgages to senior citizens in conjunction with annuities. It is further alleged that they were teaching agents to convince senior homeowners that purchasing an annuity with reverse mortgage funds is a condition of obtaining the loan. The California Department of Insurance is currently investigating this case.

While state insurance laws have captured some cases of inappropriate cross-selling to HECM borrowers, regulators may not always be aware when suitability violations involve inappropriate cross-selling. For example, a FINRA representative noted that the source of funds used to purchase an unsuitable annuity may not be relevant for determining a violation of FINRA's suitability standards, so examiners may not always know if HECM funds were used. Consumer complaints also could indicate the potential extent of inappropriate cross-selling; however, federal and state agencies do not specifically track complaints related to this practice. For example, an NAIC official told us that while NAIC's complaint database contains a code for annuity complaints, it does not track whether these complaints involved reverse mortgages. In addition, of the 29 state insurance regulators who responded to our questions, 14 indicated that their agency does not have a searchable database for complaints.

HUD's Internal Controls Do Not Provide Reasonable Assurance That Counseling Agencies Are Complying with HECM Counseling Requirements

HUD's internal controls for HECM counseling do not provide reasonable assurance of compliance with HUD requirements. The results of our limited testing of HECM counseling sessions found that counselors omitted information required by HUD, particularly on alternatives to HECMs and the financial implications of these loans. We also found that HUD records did not always accurately reflect the content and length of counseling sessions, thereby undermining the usefulness of HUD controls that rely on these records. As a result of these control weaknesses, some prospective borrowers may not be receiving the information needed to make informed decisions about obtaining a HECM.

HUD Uses a Range of Internal Controls to Ensure Compliance with Counseling Standards, but Has Not Tested Their Effectiveness

HUD has a range of internal control mechanisms to help ensure that HECM counselors comply with counseling requirements. GAO's guidance entitled *Standards for Internal Control in the Federal Government* states that internal controls should provide reasonable assurance that agency objectives—in this case, ensuring that prospective HECM borrowers are well-informed—are being achieved.[28] According to HUD officials, HUD's internal controls include the following:

1. counseling standards as set forth in regulations, mortgagee letters, and a counseling protocol;
2. a counselor training and certification program;
3. a Certificate of HECM Counseling (counseling certificate) that, once signed by the counselor and the counselee, should provide HUD with assurance that counselors complied with counseling standards and that prospective borrowers were prepared to make informed decisions;
4. a monitoring process in which HOC staff oversee the performance of counseling agencies and HUD headquarters staff oversee grant agreements with HECM intermediaries; and

[28] GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999). Control activities include establishing and reviewing performance measures, monitoring activities, training to develop employee skills, and accurately recording transactions and events.

5. pre- and post-insurance checks by contractors and HUD field staff of HECM loan files to ensure that a signed counseling certificate is present for each loan.

Although GAO's internal control standards encourage agencies to test the effectiveness of their internal controls, HUD has not done so for the controls we have previously described. HUD officials told us that they recognize the importance of such testing and have pursued methods to determine whether HECM counseling clients were receiving required information. For example, HOC staff survey small samples of clients for all types of housing counseling about their counseling sessions, but staff from two of the HOCs told us that they receive few responses. While this survey does not currently contain any questions specific to HECM counseling, HUD staff have drafted a new survey that will focus exclusively on HECM counseling. Additionally, HUD funded the development of an AARP project to independently observe HECM counseling sessions and provide feedback to the counselors. However, a HUD official indicated that the project will not be implemented until fiscal year 2010 due to a transfer in project leadership from AARP to NeighborWorks® America, another nonprofit organization involved in the HECM counseling program. Representatives from Money Management International, Inc. (MMI), a national intermediary that received HUD fiscal year 2008 grant funds for HECM counseling, told us that they record and review recordings of counseling sessions as part of their quality control process.[29] However, HUD officials said that they do not see the overall results of those reviews. HUD staff also advised us that HUD had recently revised the review checklist used by its staff to evaluate counseling agency performance to include a section specifically on HECM counseling.

Our Evaluation of Counseling Sessions Indicated Noncompliance with Key HECM Counseling Requirements

Our independent evaluation of HECM counseling sessions found that counselors did not consistently comply with HECM counseling requirements. To test counselor compliance with key HECM counseling requirements, GAO staff posed as prospective HECM borrowers for 15 counseling sessions offered by 11 different agencies. We scheduled these sessions with HECM counselors who were employed by agencies that have

[29]A national intermediary is an organization that operates in multiple regions of the United States and provides counseling services through its branches or affiliates. In contrast, a HUD local counseling agency may have a main office, and one or more branch offices, in no more than two contiguous states.

provided some of the highest numbers of HECM counseling sessions.[30] These agencies included branches or affiliates of two national intermediaries—MMI and the National Foundation for Credit Counseling, Inc. (NFCC)—that received HECM counseling grant money in fiscal year 2008, as well as other HUD-approved agencies. For each session, we determined whether the counselors covered required topics, primarily those referenced in HUD's counseling certificate, which counselors are required to complete. The certificate identifies or refers to counseling requirements originally set forth in statute, HUD regulations, or mortgagee letters. (See app. II for a copy of a blank counseling certificate.) Our undercover counselees participated in telephone counseling sessions because HUD estimated that about 90 percent of all HECM counseling sessions were conducted in this manner.[31] Our assessment primarily focused on whether counselors conveyed basic information on required topics, not whether counselors exhaustively covered each topic. In addition, we assessed limited aspects of how the counselors presented the information (see app. III). The counselor for each session sent our undercover counselee a signed counseling certificate certifying compliance with HUD requirements.

Counselors Did Not Cover All of the Required Information to Which the Counseling Certificate Refers

Although none of the 15 counselors covered all of the required topics, all of them provided useful and generally accurate information about reverse mortgages and discussed key program features. For example, in discussing the financial implications of the loan, most counselors provided information on the growth in the HECM line of credit and explained that the loan balance would increase over time. In addition, most counselors also explained that the loan would become due and payable when no borrower lives in the property, and that borrowers must pay taxes and insurance. Counselors also often supplemented their discussions with useful information, such as a description of factors that affect available interest rates and the fact that borrowers would receive monthly statements from the lender, even though this information is not specifically referred to on the counseling certificate. When our undercover counselees specifically asked for help in finding a lender, or asked directly for a recommendation, the counselors appropriately explained that they

[30]HUD indicated that these numbers were only estimates because of the way it currently collects such data.

[31]Consistent with this estimate, MMI representatives estimated that 90 percent of their HECM counseling took place by telephone, and NFCC representatives estimated about 80 percent.

were not permitted to do so and some referred the counselees to the HUD Web site for a listing of lenders.[32] At the end of the sessions, all of the counselors informed the undercover counselees that they could call back with additional questions.

However, despite certifying on the counseling certificate that they had covered, in detail, all of the information HUD requires, all of the counselors omitted at least some required information (see fig. 4).

[32]HUD Mortgagee Letter 2004-25 states that housing counseling agencies are not permitted to promote, represent, or recommend lenders or to speak on behalf of lenders.

Figure 4: Summary of Counselors' Compliance with HUD's HECM Counseling Requirements

	Counseling sessions															Summary		
HECM counseling requirements	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	Yes	Partly	No
1. Options other than a HECM that are available to the homeowner(s), including other housing, social service, health, and financial options.	Yes	No	No	Yes	No	Yes	Yes	Yes	Yes	Yes	No	No	No	No	Yes	8		7
2. Other home equity conversion options that are or may become available to the homeowner(s), such as other reverse mortgages, sale-leaseback financing, deferred payment loans, and property tax deferral.	Yes	No	No	Yes	No	Yes	Yes	Yes	Yes	Yes	No	No	No	No	Yes	8		7
3. The financial implications of entering into a HECM, explaining[a]	Partly	Partly	Partly	Partly	Partly	Partly	Partly	Partly	Partly	Partly	Partly	Partly	No	Partly	Partly	0	14	1
a. the advantages and disadvantages of each payment plan;[b]	Yes	No	Yes	No	No	Yes	Yes	Yes	No	Yes	No	No	No	No	No	6		9
b. the steps followed in determining the borrower's principal limit, including all loan costs and set asides;[c]	Yes	No	No	Yes	No	Yes	Yes	Yes	Yes	Yes	No	No	No	Yes	Yes	9		6
c. the increase in the loan balance and likely decrease in the borrower's equity over time;	Yes	No	Yes	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	11		4
d. the growth of the HECM line of credit;	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	Yes	12		3
e. the borrower's ongoing responsibility to pay property taxes, ground rents, and insurance either directly or indirectly by electing to require the mortgagee to withhold funds from monthly payments or to charge such funds to a line of credit; and[d]	No	No	No	No	No	No	No	No	No	No	Yes	No	No	No	No	1		14
f. calculating the maximum funds available to HECM borrower(s) and payment plan options using a computer software program.	No	Yes	No	No	Yes	No	Yes	Yes	Yes	No	Yes	Yes	No	Yes	Yes	9		6
4. A disclosure that a HECM may have tax consequences, affect eligibility for assistance under federal and state programs, and have an impact on the estate and heirs of the homeowner(s).	Yes	Partly	Partly	Yes	Partly	Yes	Yes	Yes	Yes	Yes	Partly	Yes	Partly	Partly	Yes	9	6	0
a. A disclosure about tax consequences.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	No	Yes	Yes	13		2
b. A disclosure that some federal or state programs, such as Supplemental Security Income, could be affected.	Yes	No	No	Yes	No	Yes	Yes	Yes	Yes	Yes	No	Yes	No	No	Yes	9		6
c. A disclosure about the impact on the estate and heirs of the homeowner(s).	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	13		2
5. Whether the homeowner(s) has signed a contract or agreement with an estate planning service firm that requires, or purports to require, the mortgagor to pay a fee on or after closing that may exceed amounts permitted by the Secretary or in Part 206 of the HUD regulations at 24 CFR.	No	No	No	No	No	No	No	No	No	No	No	No	No	No	Yes	1		14
6. If such a contract has been signed, the extent to which services under the contract may not be needed or may be available at nominal or no cost from other sources, including the mortgagee.[e]																		
7. The HECM will be due and payable when no remaining borrower lives in the mortgaged property, or when any other covenants of the mortgage have been violated.	Yes	Partly	Yes	Yes	Partly	Yes	Yes	Partly	Yes	Yes	Partly	No	Partly	Partly	Partly	7	7	1
a. When no borrower lives in the property.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	Yes	Yes	13		2
b. When any of the covenants have been violated.[f]	Yes	Partly	Yes	Yes	Partly	Yes	Yes	Partly	Yes	Yes	Partly	No	Partly	Partly	Partly	7	7	1
• Must pay taxes and insurance	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	No	13		2
• Must not change the title	Yes	No	Yes	Yes	No	Yes	Yes	No	Yes	Yes	No	No	No	No	Yes	8		7
Actual length of counseling time (in minutes)	**39**	**22**[g]	**26**[g]	**46**	**57**[g]	**30**[g]	**52**	**66**	**64**	**41**	**52**	**26**	**20**[g]	**39**	**45**[g]			

No
Partly
Yes
Not applicable

Source: GAO.

[a]Items "a" through "f" of this requirement are contained in HUD Mortgagee Letter 2004-25, which specifies the criteria that counselors must meet for explaining the financial implications of a HECM.

[b]Counselors who did not meet this requirement usually omitted a reference to the term payment plan, although they always discussed the line of credit payment plan and usually discussed the tenure and combination payment plans.

[c]Counselors who did not meet this requirement provided much of the required information, but omitted some information, such as an explanation of the servicing fee set-aside.

[d]While most counselors explained that borrowers must pay taxes and insurances (see row 7), they did not explain that borrowers could make these payments directly or require the lender to do so indirectly. We did not test for any mention of ground rents (rent paid for leasing land) during counseling sessions, because such payments are not common.

[e]This question did not apply, since none of our undercover counselees would have answered affirmatively to the prior question (i.e., Did you sign a contract?), had the question been asked.

[f]The counseling certificate does not refer to specific types of covenants. To verify this requirement, we identified whether counselors referred to the borrower requirements to pay taxes and insurance and to not change the title, because these are used as examples in the HUD counseling protocol.

[g]These counselors did not accurately record the length of the session on the counseling certificate.

The required information that counselors most frequently omitted included the following:

- *Other housing, social service, health, and financial options:* Seven of the 15 counselors did not discuss options, other than a HECM, that might be available to a homeowner, such as considering other living arrangements, meal programs, or health services that local social service agencies might provide. Our findings are consistent with findings in AARP and HUD Office of Inspector General reports suggesting that counselors may not always be discussing alternatives to a reverse mortgage with clients.[33] Although the other 8 counselors did present options, most did so broadly, referring our undercover counselees to a nationwide, toll-free telephone number for the National Association of Area Agencies on Aging for more information, rather than providing specific information about local resources. However, 1 counselor did provide our agents with specific telephone numbers or Web sites for specific programs, such as those

[33]See *Reverse Mortgages: Niche Product or Mainstream Solution?.* The study's authors compared the results of two surveys, both of which suggested counselors were omitting a discussion of options. In response to the 2006 survey, about 30 percent of counseling clients who had received counseling between 2001 and 2006 reported that their counselors had discussed alternatives to a reverse mortgage. In contrast, 60 percent of clients who responded to earlier surveys that AARP administered more immediately to all participants after the counseling session said counselors discussed other options. Also, see HUD, Office of Inspector General, *Audit Report from the Regional Inspector General for Audit, Fort Worth Region*: 2008-FW-1010 (Fort Worth: July 14, 2008). On the basis of interviews with 12 borrowers and a review of their loan files, the report concluded that counselors had not fully informed 9 of the 12 borrowers about financing options, other than a HECM, and about the costs of those options.

sponsored by a state's department of aging and organizations that assist senior citizens with meeting home energy needs and obtaining prescription drugs. Although HUD guidance on this point is not explicit, HUD officials told us that they expect counselors to be knowledgeable about local resources, even if the counseling sessions were conducted by telephone.

- *Other home equity conversion options:* The same 7 counselors likewise did not discuss other types of (and potentially lower-cost) reverse mortgages that state or local governments might sponsor for specific purposes. For example, some state governments provide reverse mortgages for payment of taxes or for making major repairs that do not need to be repaid until the house is sold. These loans, which also could be contingent on the income of the applicant, may be appropriate for borrowers who need to cover specific types of costs.[34]

- *The financial implications of entering into a HECM:* Fourteen counselors only partially met this requirement, and 1 did not, because they omitted information that HUD directs counselors to convey.[35] For example, 6 of the counselors did not provide estimates (using computer software) of the maximum amount of funds that might be available to the counselee under the HECM payment plan options. According to a HUD official, the purpose of providing these estimates is to help prospective borrowers understand how reverse mortgages would address their financial situations. For example, if a potential borrower needs to pay off an existing mortgage, receiving HECM funds in monthly payments might

[34]For example, according to an AARP Foundation consumer education booklet on reverse mortgages, many local and some state government agencies offer deferred payment loans for repairing or improving a home, with no repayment as long as the person lives in his or her home. In addition, some state and local government agencies offer property tax deferral loans that provide annual loan advances that can be used only to pay property taxes.

[35]As indicated in Mortgagee Letter 2004-25, to meet this requirement, a counselor must cover, at a minimum, (1) the advantages and disadvantages of each payment plan; (2) how a borrower's principal limit is determined, including all loan costs and set-asides; (3) the increase in the loan balance and likely decrease of the borrower's equity over time; (4) the growth of the HECM line of credit; and (5) the borrower's ongoing responsibility to pay property taxes and hazard insurance, either directly or indirectly by electing to require the mortgagee to withhold funds from monthly payments or to charge such funds to a line of credit. Furthermore, a counselor should use computer printouts generated by HUD's computer software, or similar software, for calculating the maximum amount of funds available to HECM borrowers and for each payment plan option. As of March 27, 2009, HUD more specifically required that the counselor document a client's budget on the basis of the person's income, assets, debts, and monthly expenses.

not be appropriate. Additionally, 14 counselors did not tell counselees that they could elect to have the loan provider withhold funds to pay property taxes and insurance, and 9 counselors omitted basic information about the advantages and disadvantages of each payment plan (i.e., they usually did not address the term plan).

- *A disclosure that a HECM may affect eligibility for assistance under other federal and state programs:* While most counselors discussed the tax consequences of a HECM, 6 of 15 did not indicate that eligibility for some federal and state programs could be affected if borrowers had more money in their bank accounts than allowed under such programs' terms. For example, eligibility for a means-tested program, such as the federal government's Supplemental Security Income (SSI), could be affected if borrowers deposited in their bank accounts an amount of money that exceeded the program's threshold for countable resources by the end of the month.[36]

- *Asking if a homeowner had signed a contract or agreement with an estate planning service*:[37] HUD implemented this requirement on the basis of a statutory provision intended to protect HECM borrowers from paying excessive fees for third-party services that are of little or no value. To illustrate, an estate planning service might charge a fee, unauthorized by HUD, because it "arranged" for borrowers to obtain a HECM. However, 14 of the 15 counselors did not ask this question, although of the 14, 4 cautioned the undercover counselees that such services were unnecessary to obtain a HECM. If a counselee responds affirmatively to this question, HUD requires the counselor to discuss the extent to which services under the contract may not be needed or may be available from other sources at no or nominal costs.

The results of our review indicate that signed counseling certificates are not a reliable indicator that the counselors complied with HUD requirements. Nevertheless, HOC staff (consistent with their procedures for reviewing counseling agencies) consider the presence of a signed certificate in a counseling agency's files to be a key compliance indicator.

[36] If the value of a person's countable resources exceeds the Social Security Administration's (SSA) allowable limit at the beginning of a month, the person cannot receive SSI for that month. The limit for countable resources is $2,000 for an individual and $3,000 for a couple. SSA does not consider the home a person lives in and the land upon which it stands as countable resources.

[37] HUD implemented this requirement in Mortgagee Letter 99-2, pursuant to a 1998 amendment to the National Housing Act.

Additionally, HUD requires a signed certificate as a condition of insuring a HECM and performs checks to ensure compliance with this requirement. Thus, the fact that we observed a substantial amount of noncompliance despite the existence of a signed counseling certificate for each undercover session raises questions about the effectiveness of HUD internal controls that rely on the validity of the certificate.

In addition, HUD considers having a network of examination-certified counselors as an internal control that helps ensure compliance with counseling requirements. HUD expects to issue regulations in 2009 that will require all HECM counselors to pass a written examination, establish a roster of eligible HECM counselors, require counselors to meet continuing education requirements, and allow HUD to remove counselors for cause.[38] HUD believes that this proposed rule will help improve the quality of HECM counseling. However, all but 1 of the counselors who conducted our counseling sessions were examination-certified, and they all omitted required information but still signed the counseling certificate. These results suggest that examination certification by itself does not ensure high levels of compliance.

Some Counselors Overstated the Amount of Time That They Spent Counseling Clients

In addition to requiring HECM counselors to convey certain information, HUD requires them to record the length of each counseling session on the counseling certificate. Although HUD has not issued guidance on the subject, HUD officials told us that the recorded time should reflect only the time spent counseling the client. HUD does not prescribe how long a counseling session should last, but the department uses this as a factor in monitoring the performance of counseling providers and awarding counseling grant funds.[39] For example, HUD officials told us that HOC staff responsible for overseeing HECM counseling providers examine the times on the counseling certificates to identify those sessions that are unreasonably short, to help identify potential performance problems. Staff from two of the HOCs noted that unusually short counseling times or

[38]See 72 *Fed. Reg.* 870 HECM Counseling Standardization and Roster; Proposed Rule (Jan. 8, 2007).

[39]As described in HUD's Fiscal Year 2008 Notice of Funding Availability for Discretionary Programs, the rating factor that addresses the quality and effectiveness of the applicant's historical and proposed housing activities is scored partly on the degree to which the applicant demonstrates, as compared with other applicants, that sufficient time and resources were devoted to ensuring quality counseling. HUD officials explained that HUD uses this information across the various counseling services to better understand the level of effort in order to award grants in a fair manner.

discrepancies between actual and recorded times would prompt follow-up actions. AARP's 2007 study indicated that counseling provided by examination-qualified counselors, who were obligated to follow the HECM counseling protocol in effect at the time, typically lasted over 1.5 hours.[40]

Six of the 15 counselors for our undercover sessions overstated the length of the counseling sessions on the counseling certificates. All 6 worked for counseling agencies that received or were eligible to receive HUD HECM counseling grant funds in 2008. In 3 of these cases, the sessions ranged from 22 to 30 minutes, but the recorded times ranged from 45 minutes to 1 hour. In a 4th instance, the session lasted about 20 minutes, but the counselor recorded 30 minutes. These 4 sessions, for which our undercover counselees were charged customary fees of $75 to $125, were the shortest we observed and omitted much of the required information, particularly the discussion of options and various aspects of the financial implications of a HECM. An intake staff person from 1 of the counseling agencies told us that the agency's counselors generally conducted 3 to 4 HECM counseling sessions every 2 hours, and a counselor from this agency indicated that a session likely would last no more than 10 minutes. The counselors for the remaining 2 sessions (1 of which was more comprehensive than many others) also overstated the time on the certificate, recording the sessions as lasting 2 hours, when 1 lasted 45 minutes and the other 57 minutes.

For the other 9 sessions, which typically lasted anywhere from about 30 minutes to about 1 hour (see fig. 4), the counselors recorded the entire length of the session on the counseling certificate and did so in a generally accurate manner. However, the times they recorded included the amounts of time they took to obtain and process credit card information and, in some cases, to read a disclosure statement describing the agency's counseling policies. The amounts of time differed by agency, but in one instance, the noncounseling time totaled about 13 minutes (out of a 39-minute session). While HUD has not issued specific guidance regarding what activities should be recorded as part of the counseling time, times recorded on the certificate do not necessarily reflect the amount of time that counselors spent on supplying HUD-required information.

The considerable variation both in the length of the sessions (ranging from 20 to 66 minutes) and in how counselors recorded time on the certificates

[40] *Reverse Mortgages: Niche Product or Mainstream Solution?*.

raises questions about the consistency of HECM counseling and the reliability of the information that HUD uses to monitor counseling providers. The lack of a mechanism to ensure that counselors record counseling times more accurately and uniformly undermines HUD's ability to identify and act on performance problems and ensure that counselees are getting their money's worth.

Counseling Agencies Did Not Always Obtain Minimum Information for Applying the Counseling Fee Means Test

In May 2008, HUD issued instructions allowing counseling agencies to charge a fee of up to $125 for HECM counseling, as long as the fee did not create a financial hardship for the client.[41] The instructions require counseling agencies to make a determination of the client's ability to pay (means test) by considering factors, including, but not limited to, the client's income and debt obligations. The instructions also stress that the client should be informed of the fee before receiving counseling, and that no client should be turned away due to an inability to pay. These requirements are particularly significant because federal resources dedicated to fund HECM counseling have been limited and lenders are prohibited from paying for counseling services.[42] As a result, prospective HECM borrowers are more likely to pay for the counseling themselves, either up front or by financing the fee in the mortgage.

Consistent with HUD requirements, 12 of the 15 counseling agency staff responsible for charging the fee, whether intake staff or counselors, informed our undercover counselees of the fee in advance of the session and charged $125 or less.[43] However, staff at most of the agencies did not collect the minimum amount of information that HUD requires to perform the means test. More specifically:

- For 4 of the 15 sessions, agency intake staff took the counselee's credit card information up front, without obtaining any information about income and debt obligations, although counselors for 3 of these sessions

[41]HUD issued these instructions in Mortgagee Letter 2008-12 pursuant to regulations published in 2007 (see 72 *Fed. Reg.* 55638) and codified at 24 C.F.R. Part 214. The instructions state that if an agency's cost of providing HECM counseling is less than $125, the maximum amount the agency can charge the client is the actual cost.

[42]In Mortgagee Letter 2008-28, HUD precluded lenders from paying HUD-approved counseling agencies for HECM counseling services in response to a provision in HERA.

[43]While 1 of our undercover counselees was not charged for a session, the counselor clearly stated that there would be a charge, even though the agency's recorded message indicated that HECM counseling was free.

later asked for the person's income but not their debt. The counselor for the other session did not ask for any additional financial information.

- Four other counselors asked about the undercover counselees' income, but not their debts.

- Four counselors, all from MMI, did not ask directly about income and debts, but asked a series of screening questions to identify certain types of potential financial hardship. Specifically, these counselors asked whether the undercover counselees were in a hospice or had declared bankruptcy, or whether the home was in foreclosure. The counselors also indicated that they could waive the fee if the counselee did not have the ability to pay. MMI confirmed that this approach was consistent with their screening policies and noted that should a counselee feel unable to afford the fee, qualification for a fee waiver would be determined by completion of a debt and income analysis during the counseling session. NFCC representatives indicated that many of their affiliates use these types of screening questions, as well, to determine if the counseling fee should be waived. Two counselors did not collect any financial information from the undercover counselees.

- Two other counselors did not collect any financial information from the undercover counselees.

- One counselor did collect information about the undercover counselee's income and debt, but did so to analyze the counselee's budget.

Although HUD has instructed counseling agencies to consider a client's debt and income, it has not developed criteria or thresholds for using this information. Additionally, HUD guidance states that agencies may use "objective criteria" in assessing a client's ability to pay, but does not specify what types of criteria are appropriate. Officials from the two national intermediaries told us that HUD's guidance could use clarification. In the absence of clear guidance, similarly situated counselees could be treated differently, and those facing financial hardships may be paying for counseling when they should not have to pay.

Counselors Did Not Always Comply with Other Provisions in HUD's Counseling Protocol

The HUD HECM counseling protocol, which HUD adopted in 2006 and plans to issue in a substantially expanded version in 2009, summarizes counseling requirements and identifies procedures that HUD Network Counselors, which include counselors employed by the national counseling intermediaries, must follow.[44] While much of the protocol summarizes counseling requirements referenced in the housing certificate, it also requires counselors to (1) send clients information packages about the financial implications of reverse mortgages before or after the counseling session, (2) discuss an estimated TALC disclosure with the client, (3) collect specific information about the client's financial needs and goals, and (4) send certain educational materials to clients who express an interest in purchasing an annuity. HUD expects to issue regulations in 2009 that will make compliance with a revised protocol mandatory for all HECM counselors.[45] The revised protocol, currently in draft, expands on some of these requirements and requires counselors to ask a series of questions to determine whether the counselees understand the essential features of a reverse mortgage.

The counselors for all of our 15 undercover counseling sessions were required to follow the protocol because they were HUD Network Counselors. However, we found significant noncompliance with the protocol requirements that we previously cited.

- The protocol requires that the information package on financial implications be sent to the client before or after the counseling session. Among other things, the package should contain customized information, including estimates of cash advances that would be available to the counselee under the different payment options, an estimated TALC disclosure and estimates of projected loan costs, and a loan amortization table. However, only 1 of the 15 counselors sent an information package containing all of the required information (see fig. 5). Additionally, 8 counselors sent our undercover counselees a package that did not contain any customized information, and 3 others sent only some of the customized information. Furthermore, although the protocol requires counseling agencies to offer the client the option of receiving the information package before the counseling session, our undercover

[44] *HECM Counseling Protocol, HUD National HECM Counseling Network, December, 2006*. The 2006 protocol is essentially identical to a 2005 counseling protocol developed by AARP. MMI and NFCC officials told us that their counselors follow the 2005 AARP protocol and the 2006 HUD protocol, respectively.

[45] These regulations will be promulgated pursuant to the statute, which requires that HECM counseling be provided by counselors who meet qualification standards and follow uniform counseling protocols that HUD must establish within 12 months of July 30, 2008. See 12 U.S.C. §1715z-20(f).

counselees received no such offer in 13 cases.[46] Of the 2 counseling agencies that offered to send the package, only 1 actually did so. NFCC officials told us that sending an information package beforehand is important, especially before telephone counseling, so that the counselor and counselee can reference the same documents during the session. Our evaluation of the packages we received also suggests that the ability to refer to written material during the counseling session can enhance counselees' understanding of HECMs (see fig. 5 and app. III for additional information).

Figure 5: Summary of Information Packages

	Counseling sessions														
Package requirements	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**
HECM counseling certificates	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Estimates of cash advances and itemized costs for different payment plans and interest rates					●		●		●		●			●	●
Loan amortization schedule(s)					●		●	●			●			●	●
Estimates of projected costs, including the servicing fee and a representation of the TALC					●			●			●			●	●
A brochure on using an HECM to buy an annuity	●			●			●		●	●				●	
A one-page summary of "Important Information about HECM Counselors, Lenders, Loans, and Loan Costs"	●			●			●		●	●				●	
A one-page summary on "Steps in the Reverse Mortgage Lending Process"	●			●			●			●				●	●

● Information included in the package

Source: GAO.

Note: While only the counselors for sessions 4, 5, and 6 were obligated to include the information on annuities (because their counselees expressed interest), 5 other counselors included this information in their packages.

- The protocol requires that HECM counselors discuss an estimated TALC disclosure that HECM borrowers must sign at loan closing, but 8 counselors did not describe the disclosure or its implications during the sessions. The estimated TALC, which shows the average annual costs of a reverse mortgage at different points in time, is important because it illustrates that from a cost perspective, reverse mortgages are generally not a good choice for borrowers who plan on having the loan for only a few years. However, because the TALC is fairly complex, borrowers could

[46]The way in which most of the counseling agencies scheduled the counseling sessions may have complicated their ability to comply with the requirement. More specifically, most agencies used noncounseling staff to schedule the sessions, but HUD policy prohibits such staff from obtaining the type of information from clients that is needed to prepare beforehand a customized information package with financial information.

have difficulty understanding it without assistance. Furthermore, Federal Reserve officials indicated that this disclosure also allows borrowers to compare costs across lenders and should be explained at the time of counseling.

- The protocol also directs counselors to collect specific information about the client's needs and goals—such as why the client would like to obtain a HECM, their financial situation, the condition of their home, and how long they plan to stay in the home—because these factors can affect the suitability of a reverse mortgage. While almost all of the counselors asked why the undercover counselees wanted a reverse mortgage, none asked for all of the financial information (income, assets, liabilities, and debt) prescribed in the protocol. Furthermore, although the protocol instructs counselors to ask if the counselee has any unpaid federal debt (which would render a person ineligible for a HECM until the debt was paid), 13 did not ask this question. Six counselors did not ask how long the undercover counselees planned to stay in their homes or if the homes needed repairs.

- Finally, if counselees indicate that they are considering purchasing an annuity with their HECM funds, the protocol requires counselors to send them specific information, including comparisons of the costs and benefits of HECMs to those for different types of annuities.[47] For 3 different counseling sessions, our undercover counselees indicated that they were considering such a purchase.[48] Consistent with the protocol, the counselors provided information and observations about taking this step, and 2 of the 3 counselors also sent the required information. In addition, although required in the protocol, none of the 3 counselors annotated the counseling certificate with a note indicating that discussions about annuities took place.

Despite the importance of the protocol requirements, we also found that HOC staff responsible for assessing the performance of counseling agencies were not always familiar with the protocol and had not incorporated the protocol standards in their performance reviews. For

[47]This is the only condition under which HUD HECM counselors must discuss annuities. In comparison with the requirement to discuss the unnecessary fees that might be charged by estate planners, HUD decided not to require counselors to address potential borrower misconceptions that they might have to pay for annuities to obtain a HECM (see 64 *Fed. Reg.* 2984, Jan. 19, 1999).

[48]Our undercover counselees adopted one of several different financial scenarios for each session. One of the scenarios involved the potential purchase of an annuity.

example, the standard checklist that HOC staff use to conduct their reviews does not include protocol requirements, such as offering to send a package before the counseling session and providing information about annuities. HUD officials acknowledged this shortcoming and told us that they were planning to update the checklist to reflect a forthcoming revision of the protocol.

HUD Lacks Internal Controls with Which to Oversee the Counselor Referral Process

HUD lacks controls to ensure that lenders comply with the counseling agency referral process, which HUD designed to prevent lenders from steering potential borrowers to particular counselors. HUD requirements state that when first contacted by a prospective HECM borrower, a lender must provide the individual with a list of entities that perform HECM counseling. At the time of our fieldwork, HUD's written instructions required that the list contain six references, including no fewer than five HUD-approved counseling agencies in the local area or state (except in cases in which fewer than five agencies serve a particular state).[49] One of those agencies had to be located within reasonable driving distance so that the prospective borrower had the option of receiving face-to-face counseling. In addition, the list was to include a toll-free telephone number to reach a network of counselors approved to conduct telephone counseling nationwide. In March 2009, HUD increased the required number of references from 6 to 10 and restated the importance of lenders providing prospective borrowers with such a list.[50]

Despite HUD's renewed emphasis on the requirement, HUD officials told us that they do not have internal control procedures in place to check lenders' compliance. One official noted that it would be challenging to create such a control because a prospective borrower could obtain a list of counselors from one lender, receive the counseling, and then decide to get the HECM from a second lender. In that situation, HUD would have no way of knowing what the first lender provided the borrower because there would be no loan case file from that lender for HUD to examine. However, the frequency of this situation is unknown, and without a control

[49]HUD officials subsequently told us that they informed lenders of an additional requirement during training sessions. Specifically, lenders were instructed to add the toll-free telephone numbers for NFCC and MMI to the required list of agencies.

[50]Mortgagee Letter 2009-10 explicitly expanded the number of telephone counseling agencies that lender's must provide to prospective borrowers. The list must now include 5 such agencies.

procedure, HUD lacks assurance that its referral requirements are being followed. Furthermore, while some HECM borrowers may obtain a list of counselors from one lender and get the loan from another, this scenario does not rule out taking reasonable steps to assess the compliance of the lender ultimately selected. For example, HUD could require lenders to place the lists of counselors they provide to prospective borrowers in the loan files. HUD's periodic examination of loan files could include a check for these lists.

Furthermore, the results of our undercover work at reverse mortgage information seminars sponsored by seven HECM providers and the results of a HUD Inspector General audit suggests some noncompliance with the referral requirement.[51] Our staff, posing as prospective HECM borrowers, asked representatives of the seven providers for referrals to counselors. However, none of the five to whom this requirement applied and replied to our request, complied fully with HUD requirements.[52] More specifically:

- One representative provided the telephone number typically used to set up telephone counseling sessions with one of the two national intermediaries.
- Two representatives said that when our undercover staff were ready to speak with a counselor, they would make the appointment for them.
- Two California-based HECM representatives provided a list of counselors, but each list identified only five counseling agencies, and did not provide the minimum number of five state or local agencies.

Conclusions

HECMs have the potential to play a key role in meeting the needs of seniors facing financial hardship or seeking to improve their quality of life. However, the product is relatively complex and costly and the population it serves is vulnerable. These factors, combined with the increasing number of borrowers and lenders participating in the HECM program, underscore the need for federal agencies to be vigilant about emerging

[51] *Audit Report from the Regional Inspector General for Audit*. The Regional Inspector General found that the loan originator's practice of contracting with one counseling service to assign a counselor to the borrower did not meet HUD's requirement that the originator provide a list of eligible counselors.

[52] One of the seminar sponsors was an estate planning firm to whom this requirement did not apply.

consumer protection risks. Our work identified risks that require further attention, particularly in the areas of HECM marketing and counseling.

Although the extent of potentially misleading HECM marketing is unknown, the types of marketing claims discussed in this report are causes for concern, particularly in a market with potential for substantial growth. HUD, FTC, and the federal banking regulators have processes to address misleading marketing practices and have reported few problems. Nevertheless, the potentially misleading marketing claims we identified suggest that some HECM providers may not be maintaining sufficient focus on or awareness of federal marketing standards. Furthermore, consumers who have not been cautioned about such claims could pursue HECMs with misunderstandings about the product.

Counseling is a critical feature of the HECM program because the information provided can increase prospective borrowers' understanding of a complex product and help them make informed decisions. Although HUD is in the process of expanding and strengthening its counseling requirements, it lacks sufficient internal controls to ensure that counseling providers are complying with these requirements. HUD's controls rely to a significant degree on the presence of one document, the signed counseling certificate, as an assurance of compliance. However, our work indicates that HUD cannot rely on this certificate without additional verification of the content and length of the counseling session. In the absence of a verification process, HUD's counseling program is vulnerable to three main problems. First, and most importantly, counselees may not be receiving the information they need to make informed decisions. Second, HUD's information on the amount of time that counselors are spending with clients may be inaccurate and, therefore, of limited value to HOC staff responsible for monitoring counselor performance. Third, HUD lacks assurance that counseling agencies are consistently applying the means test for counseling fees, if at all; as a result, financially distressed individuals who are eligible for fee waivers may be paying for counseling that they could obtain without a fee. Additionally, HUD lacks detailed guidance on how to record counseling times and apply the means test, which may be contributing to counseling providers' noncompliance in these areas. Finally, because HUD lacks effective controls over the counselor referral process, it cannot ensure that prospective borrowers are receiving the required range of counseling choices, including options for face-to-face and telephone counseling.

Recommendations for Executive Action

To enhance consumer protection from potentially misleading marketing, we recommend that the Secretary of the Department of Housing and Urban Development; Chairman of the Federal Trade Commission; Chairman of the Federal Deposit Insurance Corporation; Chairman of the Board of Governors of the Federal Reserve System; Comptroller of the Currency, Office of the Comptroller of the Currency; and Director of the Office of Thrift Supervision, take steps, as appropriate, to strengthen oversight and enhance industry and consumer awareness of the types of marketing claims that we discuss in this report. These steps might include developing guidance, potentially through the Federal Financial Institutions Examination Council, to help bank examiners identify these types of claims; incorporating discussion of these claims in consumer education materials; and reviewing each advertisement we identified and referred to the appropriate agency and taking the appropriate follow-up actions.

To improve HUD's oversight of HECM counseling, we recommend that the Secretary of HUD improve the effectiveness of the agency's internal controls so that they provide reasonable assurance of compliance with HECM counseling requirements. In doing so, HUD should take the following steps:

- implement methods to verify the content and length of HECM counseling sessions;
- issue detailed guidance for HECM counseling providers about how to record the amount of counseling time on the counseling certificate;
- issue detailed procedures for HECM counseling providers on how to assess prospective counselees' ability to pay for HECM counseling; and
- implement internal controls to ensure that HECM providers comply with counselor referral requirements.

Agency Comments and Our Evaluation

We provided a draft of this report to the Department of Housing and Urban Development, Federal Trade Commission, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision. We received written comments from these agencies, which are summarized below. Appendixes IV through VIII contains reprints of these letters. FTC provided technical comments, which we incorporated into this report, where appropriate.

In their written comments, the federal banking regulators agreed with, or indicated that they were taking actions consistent with, our recommendation to strengthen oversight and enhance industry and consumer awareness of the types of marketing claims discussed in our report. Consistent with our recommendation, each of the regulators reported that they were working with other members of the Consumer Compliance Task Force of the Federal Financial Institutions Examination Council to develop supervisory guidance on reverse mortgages. In addition, each of the comment letters referred to other initiatives concerning reverse mortgages that the agencies had under way or had planned for the future.

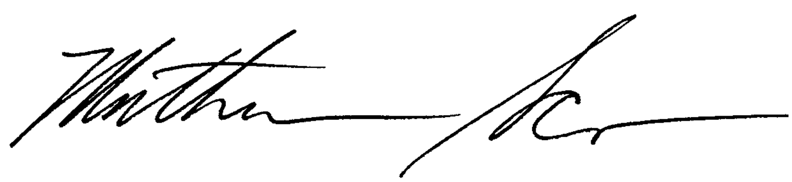
In its written comments, HUD did not specifically address our recommendations but noted that our draft report cited changes that HUD has undertaken to address many of the deficiencies in HECM counseling. HUD's letter also contained technical comments that we incorporated, as appropriate, in the body of the report. (See app. VIII for a copy of HUD's letter.) We also provided draft sections of the counseling portion of this report to representatives from NFCC and MMI—two major counseling intermediaries—to obtain their viewpoints.

NFCC conveyed to us its support of HUD's initiatives to improve and ensure the overall success of the HECM program. NFCC expressed its belief that the release of the new HECM counseling protocol, as well as HUD's recent revision of its counseling agency review checklist to include a section on HECM counseling, would address many of the issues highlighted in our report. In addition, NFCC indicated that HUD's plans to have counselors meet continuing education requirements and be reapproved every few years would afford greater consumer protections for HECM borrowers. However, consistent with our findings, NFCC also recommended that HUD provide additional guidance on defining what activities should be included in the counseling time reported on the HECM counseling certificate. NFCC also recommended that HUD require all counseling sessions to last at least 45 minutes, consistent with the requirements NFCC has established for its affiliated counseling agencies.

MMI expressed to us its belief that the findings in our report, as well as HUD's planned independent observation of counseling sessions, will be useful to HUD in improving the effectiveness of its internal controls. MMI also commended HUD on its recent initiatives to improve the quality of the counseling program, specifically noting the development of a new counseling protocol and the revision of HUD's counseling agency review checklist to include a section on HECM counseling. In addition, MMI provided suggestions for strengthening HUD's oversight processes, specifying that HUD should more clearly define counseling session learning objectives and identify how key concepts may be addressed. While affirming the importance of covering alternatives to HECMs, as counselors are currently required to do, MMI also suggested that HUD consider what information might be best conveyed by an alternative source, such as by a local Area on Aging Office, at no cost to seniors. MMI also suggested that HUD review its counseling requirements for current relevance to the market place, for example, by considering whether cautions against new types of predatory practices are necessary.

We are sending copies of this report to interested congressional parties, the Secretary of the Department of Housing and Urban Development; Chairman of the Federal Trade Commission; Chairman of the Federal Deposit Insurance Corporation; Chairman of the Board of Governors of the Federal Reserve System; Comptroller of the Currency, Office of the Comptroller of the Currency; and Director of the Office of Thrift Supervision, and other parties. The report also will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staffs have any questions about this report, please contact me at (202) 512-8678 or sciremj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs are on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IX.



Mathew J. Scirè
Director, Financial Markets
and Community Investment

Appendix I: Objectives, Scope, and Methodology

This report focuses on the Home Equity Conversion Mortgage (HECM) program, which insures reverse mortgages and is administered by the Department of Housing and Urban Development's (HUD) Federal Housing Administration. The objectives of this report were to examine (1) the potential benefits and costs of HECMs to borrowers, (2) federal agency responsibilities to protect consumers from misleading HECM marketing, (3) federal agency efforts to protect HECM borrowers from inappropriate cross-selling, and (4) HUD's oversight of HECM counseling providers.

Benefits and Costs of HECMs

To identify the potential benefits and costs of HECMs to borrowers, we reviewed HUD regulation, guidance, and consumer materials related to the program. To more specifically identify borrower experiences with HECMs, we analyzed AARP's 2006 survey, which included HECM borrowers, and interviewed 18 borrowers selected at random from among the approximately 19,000 borrowers who obtained HECMs from fiscal years 2001 through 2003. We selected borrowers from these years to ensure that borrowers had sufficient experience with the costs and benefits of their loans. For 16 of the 18 HECM borrowers, we also reviewed information about the terms of their loans from files that HUD provided to us. (HUD was not able to locate the other 2 files.) The results of our interviews cannot be generalized to all HECM borrowers. To obtain additional viewpoints on the benefits and costs of HECMs, including their risks, we interviewed representatives from HUD and the HUD Office of Inspector General; consumer advocates, including AARP, the National Consumer Law Center, and the National Council on Aging; and an industry group, the National Reverse Mortgage Lenders Association. To understand how borrower choices and economic conditions could affect the amount of home equity that a HECM borrower might have after 10 years, we constructed scenarios for a hypothetical HECM borrower illustrating changes in the borrower's loan balance, house value, and net equity under different circumstances. Using 2008 as our baseline year, we obtained information from HUD on the average age of HECM borrowers and the value of their homes. We used HUD HECM computer software to determine a HECM loan amount for a borrower with these characteristics. To illustrate how changing interest and house appreciation rates could affect the borrower's remaining home equity over time, we constructed several scenarios using different assumptions. For example, using data on historical 1-year Treasury yields and the Federal Housing Finance Agency's house price index, we determined the borrower's remaining home equity after 10 years if interest and house appreciation rate assumptions repeated the patterns seen from 1998 through 2007. In another scenario, we determined how much equity would remain for the same borrower if interest and house appreciation rates followed IHS Global Insight's projections for 2008 through 2017.[1] We consulted with HUD to verify the accuracy of our calculations.

To identify actions that federal agencies and others have taken to promote better consumer understanding of HECMs, we reviewed consumer guidance distributed by the Federal Trade Commission (FTC), federal banking regulators, HUD, the Financial Industry Regulatory Authority (FINRA), state agencies, and consumer groups. We also spoke with representatives of FTC and state and federal banking regulators about reverse mortgage task forces initiated by these agencies.

Federal Agency Responsibilities for Protecting Consumers from Misleading HECM Marketing

To examine federal agency responsibilities to protect consumers from misleading HECM marketing, we identified authorities, standards, and processes that agencies use to identify and address misleading marketing practices. These agencies included HUD, FTC, and four federal banking regulators—the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation. We also interviewed officials from these agencies and obtained information about complaints they received about reverse mortgages from calendar years 2005 through 2008. These four banking regulators oversee and examine at least 1 of the 12 largest HECM lenders, which we define as lenders that originated more than 1,000 HECM loans in fiscal year 2008, based on HUD data.[2] We also asked these regulators to provide information about any marketing violations found through compliance examinations. Finally, through the Conference of State Bank Supervisors, we sent a set of standardized questions to all of the state banking regulators, asking if they examine reverse mortgage marketing materials, have received any complaints about or come across any misleading reverse mortgage marketing materials, or have taken any actions against banks or other entities as a result of their reverse mortgage marketing. We received and reviewed responses from 35 states.

[1] IHS Global Insight is a company that forecasts a wide range of financial and economic indicators, including interest rates and house appreciation rates.

[2] We did not obtain data or interview officials from the National Credit Union Administration because this regulator does not oversee any of the top HECM lenders.

In addition, to identify potentially misleading statements about the HECM program, we conducted a limited review of HECM marketing materials, including the following:

- Internet materials for the 12 HECM lenders that originated at least 1,000 HECMs in fiscal year 2008, and mailed material for 11 of these 12 lenders.[3]
- Three DVDs from HECM lenders that advertised on television, including a DVD from 1 of the 12 lenders that we previously noted.
- Internet material from 5 other HECM lenders.
- Materials presented at seven HECM information seminars that GAO staff attended undercover from June 2008 through December 2008 in 4 states. More specifically, we attended seminars in Florida and California—states with among the largest number of HECMs—and seminars in Maryland and Michigan, for the purposes of geographic diversity.

We identified eight types of claims that were inaccurate, incomplete, or employed questionable sales tactics and reviewed the materials we gathered for statements implying the following:

1. The borrower cannot owe more than the value of the home.
2. The borrower cannot foreclose on a HECM or cannot lose the home.
3. HECMs will not affect a federal benefit (e.g., Supplemental Security Income).
4. Costs are the same as those for a forward mortgage, or all HECMs have the same costs.
5. The borrower can access lifetime income or cannot outlive a reverse mortgage.
6. A reverse mortgage is a government “benefit” or “entitlement” or any implication that the HECM is not a loan.
7. Geographic or time limits for obtaining a reverse mortgage.

[3]We requested but did not receive mailed material from 1 of these 12 lenders.

8. Government affiliation through the use of government language and symbols.

In total, we identified 26 entities that made one or more of these potentially misleading claims, and we asked officials at the Federal Reserve to identify the regulators for each of these entities. Because our review was of a limited number of advertisements, the results of our work cannot be used to ascertain the extent of potentially misleading HECM marketing. We also submitted examples of each potentially misleading claim to officials at HUD, FTC, and the banking regulators to obtain their viewpoints on these claims (based on the regulatory standards they would apply to HECM marketing materials they review). In addition, we submitted these claims to the president of the National Reverse Mortgage Lenders Association for his opinion on these marketing claims.

Steps that Federal Agencies Have Taken to Protect Consumers from Inappropriate Cross-Selling

To examine the steps federal agencies have taken to protect consumers from inappropriate cross-selling, we reviewed HUD guidance and regulator actions to inform HECM borrowers about the costs and risks of purchasing annuities in conjunction with HECMs. We also reviewed the cross-selling provisions in the Housing and Economic Recovery Act of 2008, and spoke with HUD officials about their planned implementation of these provisions.[4] In addition, we spoke with representatives of the National Reverse Mortgage Lenders Association to obtain their perspectives on these cross-selling provisions. We spoke with officials at the National Association of Insurance Commissioners (NAIC) and obtained information on state insurance laws related to the sale of insurance products, such as annuities. Through NAIC, we sent standardized questions to all of the state insurance regulators, asking if the state tracked complaints, had received any complaints or had any cases of inappropriate cross-selling with reverse mortgages, or had taken any action against entities for cross-selling practices. We reviewed the 29 responses received, and obtained additional information from the 8 respondents that reported the cross-selling of unsuitable products with reverse mortgages. We also reviewed FINRA suitability standards for

[4]According to the provisions of the act, a borrower cannot be required by the lender or any other party to purchase an insurance, annuity, or similar product as a condition of obtaining a HECM. In addition, the lender either must not be associated with any other financial or insurance product or must maintain firewalls and other safeguards to ensure that its employees originating the HECMs do not also sell other financial or insurance products.

deferred annuities, and interviewed a FINRA representative about these standards. In addition, we spoke with an official at HUD's Office of Inspector General about investigations related to inappropriate cross-selling in conjunction with HECMs.

HUD's Oversight of HECM Counseling Providers

To determine the steps HUD has taken to ensure compliance with HECM counseling requirements, we first identified the standards with which counselors and agencies must comply.[5] We examined relevant statutes, regulations, the HUD's HECM counseling protocol, and mortgagee letters for applicable standards and discussed them with HUD officials.[6] To understand how the provisions of the HECM protocol might apply, we interviewed HUD officials and representatives from the two national intermediaries—MMI and NFCC—that received HECM grant funding from fiscal years 2006 through 2008.[7] We also reviewed their fiscal year 2008 grant agreements to more fully understand their counseling obligations. Our interviews with AARP officials provided additional perspective on the historical development of the HECM counseling program with which AARP has been involved. To better understand HECM counselor training requirements, we also attended HECM training courses sponsored by NeighborWorks® Training Insititute.[8]

Second, we identified the range of internal controls that HUD uses to ensure compliance with HECM counseling requirements. As a basis for identifying activities that qualify as internal controls, we consulted GAO's *Standards for Internal Control in the Federal Government*.[9] To identify

[5]Since the inception of the HECM program, HECM borrowers must receive information about the financial implications of HECMs, allowing consumers to make an informed decision about taking out a HECM. In response, HUD developed a counseling program, working with nonprofits, such as the AARP Foundation, to develop a network of qualified counselors. Counselors may conduct counseling face-to-face or by telephone.

[6]*HECM Counseling Protocol, HUD National HECM Counseling Network, December, 2006.*

[7]HUD Network Counselors and counselors employed by the national intermediaries must comply with the provisions of a uniform counseling protocol.

[8]NeighborWorks® America is a national nonprofit organization created by Congress to provide financial support, technical assistance, and training for community-based revitalization efforts. The course materials were sponsored in part through a grant from HUD.

[9]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00.2.1.3.1 (Washington, D.C.: November 1999).

the types of internal controls that HUD applies to the HECM counseling program, we interviewed HUD headquarters and field staff and obtained relevant documentation. HUD headquarters staff have responsibility for general oversight of the grant agreements with the national intermediaries, and HUD field staff are responsible for conducting on-site performance reviews of counseling agencies. We interviewed HUD field staff at all four HUD Home Ownership Centers (HOC), which are located in Atlanta, Georgia; Denver, Colorado; Philadelphia, Pennsylvania; and Santa Ana, California, about the procedures they use to evaluate counseling agency performance, and obtained relevant documentation. We also interviewed MMI and NFCC staff to identify what internal controls they have to maintain the quality of their HECM counseling. To better understand the nature of these performance evaluations, we reviewed performance reviews conducted by each HOC for counseling agencies, including those that conduct high numbers of HECM counseling sessions.[10]

Third, to determine whether HUD's internal controls provide reasonable assurance that counselors comply with HECM counseling requirements, GAO staff posing as potential HECM borrowers participated in 15 counseling sessions with 11 different counseling agencies during January and February 2009. For each session, the counselor sent our undercover counselee a signed counseling certificate that certified compliance with HUD requirements and recorded the length of the session. Because HUD estimated that about 90 percent of counseling takes place by telephone, we conducted the sessions by telephone. While our findings from the 15 counseling sessions cannot be generalized to all HECM counseling, the sessions allowed us to test compliance with HECM counseling requirements. For these sessions, which we recorded to facilitate our review of counselors' performance and the length of the calls, we determined whether counselors covered key topics, particularly those referenced on the counseling certificate. Our assessment primarily focused on whether counselors conveyed basic information on these topics, not whether they covered them exhaustively. We also compared the time each counselor recorded on the counseling certificate with (1) the actual length of the session and (2) the amount of time they spent specifically on counseling.

[10]HUD staff indicated that these numbers were only estimates because of the way it currently collects such data.

These sessions took place with counseling agencies that provided some of the highest numbers of HECM counseling. Of the counselors we contacted

- 4 were employed by MMI,
- 5 were employed by five different agencies affiliated with NFCC, and
- 6 were employed by five other agencies (three of these agencies also received HUD grant funding for HECM counseling).

Since all of the counselors for our undercover sessions had been certified as HUD Network Counselors and passed the HECM examination, or were associated with MMI or NFCC, they were all required to comply with HUD's 2006 HECM counseling protocol. Accordingly, we also determined whether the counselors complied with selected elements of the protocol, such as sending information packages to counselees and discussing an estimated total annual loan cost disclosure.

To evaluate how counselors might adapt their presentations on the basis of the unique situation of prospective borrowers, we created five different borrower profiles, including borrowers who intended to stay in their house indefinitely and those who intended to move within a few years. Each borrower profile included a set of predetermined responses to questions a counselee might be asked, such as home value, existing debt on home, and length of time the person planned to stay in the home. The undercover agents were instructed to indicate that they had little preexisting knowledge of reverse mortgages, to provide counselors with the opportunity to speak comprehensively about the program.

We also evaluated selected aspects of the counselor's presentation, including the clarity of terminology, delivery (e.g., the rate of speed at which the counselors presented the information), and the use of visual aids (i.e., any information that counselors might have sent prior to the session). For this purpose, individuals from our Learning Center listened to the recordings of the sessions and independently evaluated the portion of the counseling sessions in which counselors presented information on HECM costs. See appendix III for more information on the Learning Center's evaluation.

Finally, to test compliance with HUD's counselor referral requirements, GAO undercover staff who attended seven HECM information seminars (previously discussed) sponsored by HECM providers, asked for referrals to counseling agencies if the seminar presenters had not already provided them.[11] We compared the number and type of referrals we received with HUD's requirements in effect at the time of our fieldwork.[12] For example, we identified whether the list of referrals included at least five agencies that were located in the local area or state. The results of our work cannot be generalized to all HECM providers. In addition, we interviewed HUD officials responsible for developing the counselor referral requirements.

We conducted this performance audit from April 2008 through June 2009, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our investigative work was performed in accordance with standards prescribed by the Council of the Inspectors General on Integrity and Efficiency.

[11]In one case, we were unable to reach the seminar sponsor at the provided phone numbers when we attempted to follow up by phone.

[12]HUD established the counselor referral requirements in effect at the time of our fieldwork in December 2004. As discussed in the body of this report, HUD expanded these requirements in March 2009.

Appendix II: Copy of a Blank Certificate of HECM Counseling

Certificate of HECM Counseling

U.S. Department of Housing and Urban Development
Office of Housing

OMB No. 2502-0524 (expires 2/28/2011)

Provision of this information is required to obtain benefits. HUD may not collect this information, and you are not required to complete this form, unless the form has a currently valid OMB control number.
Privacy Act Notice: The United States Department of Housing and Urban Development, Federal Housing Administration, is authorized to solicit the information requested in the form by virtue of Title 12, United States Code, Section 1701 et seq., and regulations promulgated at Title 12, Code of Federal Regulations. While no assurance of confidentiality is pledged to respondents, HUD generally discloses this data only in response to a Freedom of Information Act request.

Homeowner(s) Name(s):

Property Address City/State/Zip

The U. S. Department of Housing and Urban Development (HUD) requires that homeowner(s) interested in pursuing a Home Equity Conversion Mortgage (HECM) receive information about the implications of and alternatives to a reverse mortgage. The HECM counselor must adhere to all of FHA's guidelines regarding information that must be provided to the potential HECM mortgagor and must tailor the session to address the unique financial circumstances of the household being counseled.

Counselor Certification:

In accordance with Section 255 of the National Housing Act and 24CFR 206.41, I have discussed in detail the following items with the above referenced homeowner(s)

1. Options other than a Home Equity Conversion Mortgage that are available to the homeowner(s), including other housing, social service, health and financial options.
2. Other home equity conversion options that are or may become available to the homeowner(s), such as other reverse mortgages, sale-leaseback financing, deferred payment loans, and property tax deferral.
3. The financial implications of entering into a Home Equity Conversion Mortgage.
4. A disclosure that a Home Equity Conversion Mortgage may have tax consequences, affect eligibility for assistance under Federal and State programs, and have an impact on the estate and heirs of the homeowner(s).
5. Whether the homeowner has signed a contract or agreement with an estate planning service firm that requires, or purports to require, the mortgagor to pay a fee on or after closing that may exceed amounts permitted by the Secretary or in Part 206 of the HUD regulations at 24 CFR.
6. If such a contract has been signed, the extent to which services under the contract may not be needed or may be available at nominal or no cost from other sources, including the mortgagee.
7. The Home Equity Conversion Mortgage will be due and payable when no remaining borrower lives in the mortgaged property, or when any other covenants of the mortgage have been violated. (Borrowers are those parties who have signed the Note and Mortgage or Deed of Trust.)

I hereby certify that the homeowner(s) listed above have received counseling according to the requirements of this certificate and the standards of the U.S. Department of Housing and Urban Development, as described in mortgagee letters, handbooks, regulations, and statute. This interview was held: ☐ Face-to-Face ☐ Telephone and the amount of time required to cover the above items was as follows: _______________.

Counselor's Name (Printed):	HUD-Approved Counseling Agency Name:	
Counselor Name (Signature & Date):	Address (City/State/Zip)	
X _________________________ ____________	Telephone No:	Agency Employer Identification No:

HomeOwner Certification:
I/we hereby certify that I/we have discussed the financial implications of and alternatives to a HECM with the above Counselor. I/we understand the advantages and disadvantages of a HECM and each type of payment plan, as well as the costs of a HECM ***and when the HECM will become due and payable***. This information will enable me/us to make more informed decisions about whether I/we want to proceed with obtaining a HECM.

Homeowner Signature & Date:	Homeowner Signature & Date:
X ___________________________________ _____________	X _________________________________ ______________

(All homeowners shown on the deed must sign the mortgage and this counseling certificate.)
Date Counseling Completed: _____________ Certificate Expiration Date: _______________
(180 days from date HECM counseling completed)

form **HUD-92902 (**9/2006)

Source: HUD.

Appendix III: Our Learning Center's Evaluation of Selected Information Presented during the Undercover Counseling Sessions

Given the potential challenges of conveying complex information to seniors by telephone, we undertook a limited assessment of the communication and presentation skills of the 15 counselors with whom we spoke. (See app. I for more information about the counseling sessions.) This evaluation was conducted by staff in GAO's Learning Center with expertise in making oral presentations, who reviewed the recordings we made of the counseling sessions. Our analysis focused on the portion of each counseling session that explained HECM costs. We chose this portion because the subject matter can be complex and because all of the counselors explained costs to some degree, so this approach provided us with a basis for comparison. We found that most of the counselors—10 of 15—generally presented information in a manner that was reasonably clear and easy to follow, although many of the sessions might have been more effective if prospective borrowers had received reference materials beforehand.[1]

We assessed criteria in the following three categories: delivery of the presentation, clarity of information presented, and use of reference materials to convey technical content.

- *Delivery of the presentation:* To assess each counselor's delivery, we evaluated rate of speech; whether the counselor varied intonation, pitch, and pace to sustain the listener's attention; and whether the counselor's speech had natural pauses, especially after an important point was made. We found that most (11 out of 15) generally did well in most dimensions of this category, although our evaluators felt that 2 spoke too quickly, 1 spoke too slowly, and 6 of the counselors only sometimes incorporated natural pauses into their speech patterns, especially after an important point was made. Although our assessment did not factor in hearing impairments that are sometimes associated with senior citizens, academic research has shown that older adults have more difficulty than younger adults understanding information as speech rate increases.
- *Clarity of information presented:* To assess the clarity of the presentations, we noted whether each counselor explained or defined cost-related concepts, terms, and principles when they were first introduced. We also evaluated the clarity of the counselor's explanations, and we noted whether the counselor tried to determine if the listener

[1]Ten of the counselors did well in both areas of assessment—delivery of presentation and clarity of information presented, but two other counselors did well in one area of assessment, but not the other.

understood the subject matter, for example, by asking questions to confirm understanding or by responding if the listener asked questions, started to interrupt, or sounded confused. We found that most (11 out of 15) counselors generally did well in most dimensions of this category, although 5 counselors were less clear than the others with respect to explaining cost-related terms.

- *Use of reference materials to convey technical content:* The HECM counseling protocol requires that counseling agencies give prospective borrowers the option to receive an information package on financial implications before or after the counseling session. As noted in the body of this report, only four counselors sent information packages with all the customized financial estimates, including the one counselor whose package contained all of the required information. Of these, only one counselor offered and sent the required information before the counseling session. For the 3 counseling sessions for which the information package came after the session, our evaluators agreed that for 2 of the sessions, it would have been easier to understand the presentation had they received the reference material beforehand. However, for the other session, the evaluators were uncertain if the presence of the reference materials would have helped, but then they also agreed that the counselor only "sometimes" explained or defined cost-related concepts and terms when they were first introduced. Our evaluators also agreed that for the 1 counseling session for which the reference material was available in advance, the presentation was easy to understand with the assistance of these reference materials.

Although, according to HUD, about 90 percent of HECM counseling takes place by telephone, the HECM counseling protocol does not contain any specific procedures for telephone counseling. HUD officials indicated that HUD is considering developing such standards and is in discussion with one of their intermediaries.

Appendix IV: Comments from the Board of Governors of the Federal Reserve System

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

SANDRA F. BRAUNSTEIN
DIRECTOR
DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

June 16, 2009

Mr. Mathew J. Scirè
Director
Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, N.W., #201
Washington, D.C. 20548

Dear Mr. Scirè:

The Federal Reserve appreciates the opportunity to comment on the draft report entitled, "Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers," (GAO-09-606). We concur with the recommendation in the draft report that the Federal Reserve, along with other federal agencies[1] involved with consumer protection for federally-insured reverse mortgages, take steps to strengthen oversight and enhance industry and consumer awareness of the types of marketing claims discussed in the draft report. The report indicates these steps might include developing guidance through the Federal Financial Institutions Examination Council (FFIEC) to help bank examiners identify the types of marketing claims identified in the GAO report and incorporating discussion of these marketing claims in consumer education materials. In addition, the GAO asked each agency to review and follow-up on specific marketing material forwarded to it by the GAO.

The Federal Reserve shares the concerns expressed by the GAO that reverse mortgages, while offering financial benefits to senior citizens, present risks to this vulnerable and growing population, due to the product's complexities. This response outlines initiatives we have underway to address these concerns.

In 2008, the FFIEC's Task Force on Consumer Compliance established a working group to review reverse mortgage issues as they relate to the banking industry and to consumers. The working group is drafting proposed guidance to the industry on consumer protection concerns raised by reverse mortgage products. The draft guidance focuses on the need to provide adequate information to consumers about reverse mortgage products, to provide qualified independent counseling to consumers considering these products, and to establish policies, procedures, internal controls, and third party risk management as they relate to reverse mortgages. We anticipate publishing this guidance for public comment in the *Federal Register* in the coming months.

[1] The U.S. Department of Housing and Urban Development, the Federal Trade Commission, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

Mathew J. Scirè, Director
Financial Markets and Community Investment
U.S. Government Accountability Office (GAO)
Page 2

This same interagency working group is enhancing examination procedures for use when reviewing an institution's compliance with consumer protection laws related to reverse mortgage products. Specifically, current interagency examination procedures for Regulation Z (Truth in Lending) address the regulatory requirements for reverse mortgages, focusing on the disclosure of total annual loan cost (TALC) rates for a reverse mortgage. The interagency working group is reviewing the current procedures to enhance examiner guidance relating to the accuracy of the TALC. The working group also will consider the GAO's recommendation to provide guidance to examiners when reviewing reverse mortgage marketing materials. The additional guidance is expected to be final by year-end 2009.

To highlight our concerns to the public about reverse mortgages, Federal Reserve staff members have published articles in several Federal Reserve publications. Specifically, the Federal Reserve System's publication, *Consumer Compliance Outlook*, has recently had two articles on reverse mortgages. The third quarter 2008 issue had an article entitled, "Reverse Mortgages and Consumer Protection Issues."[2] The first quarter 2009 issue included an article entitled, "Disclosure Requirements for Reverse Mortgages."[3] Finally, in the publication, *Partners* (Issue #3, 2008), published by the Federal Reserve Bank of Atlanta,[4] an article entitled "Reverse Mortgages Revisited" discussed consumer protection issues and reverse mortgages.

In addition to its supervisory activities, the Federal Reserve Board has exclusive rulewriting authority for the Truth in Lending Act (TILA), which is implemented through the Board's Regulation Z (12 CFR 226). As noted previously, Regulation Z requires a specific TALC disclosure for reverse mortgages. In its draft report, the GAO acknowledges the complexities of reverse mortgage products and notes that, for federally-insured reverse mortgages, a lender must certify that a borrower has participated in credit counseling that includes a discussion of the TALC. The GAO's study found that borrowers may not readily understand some of the costs of a reverse mortgage. In its rulewriting capacity, the Federal Reserve conducts regular reviews of its regulations, including Regulation Z. The GAO's findings will be considered as the Federal Reserve reviews Regulation Z to ensure the existence of strong consumer protections for reverse mortgages. As part of its review process for Regulation Z, the Board will conduct consumer testing to ensure that required disclosures provide consumers with meaningful information in a format that they can understand.

The Federal Reserve has several venues by which it provides financial information to consumers. In developing this financial information, the Federal Reserve reviews data on the consumer complaints it receives in order to inform its consumer outreach programs. One venue for this outreach is the community affairs program at each of the twelve Federal Reserve Banks. The Reserve Banks conduct outreach throughout the country either directly to consumers or indirectly through community organizations. In addition, the Federal Reserve publishes informational material on a variety of topics, such as mortgages and credit cards, that is available on its website. In its continuing efforts to improve consumer education, the Federal Reserve will review GAO's findings for potential unmet opportunities and respond accordingly.

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[2] http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2008/third-quarter/q3_01.cfm

[3] http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2009/first-quarter/q1_03.cfm

[4] http://www.frbatlanta.org/invoke.cfm?objectid=844CE47E-5056-9F12-1236D9E3BC8947D7&method=display_body

Mathew J. Scirè, Director
Financial Markets and Community Investment
U.S. Government Accountability Office (GAO)
Page 3

Finally, we are carefully reviewing the reverse mortgage marketing materials from the two entities under our supervision that were forwarded to us by your office, and will take appropriate follow-up actions with the entities, as needed.

Again, we appreciate the opportunity to review and comment on the draft report. We also appreciate the efforts and professionalism of the GAO's review team in conducting this study.

Sincerely,

Sandra F. Braunstein
Director

Appendix V: Comments from the Federal Deposit Insurance Corporation

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990 Division of Supervision and Consumer Protection

June 18, 2009

Mr. Richard J. Hillman, Managing Director
Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Hillman:

Thank you for the opportunity to review and comment on the Government Accountability Office's (GAO) report entitled, *Reverse Mortgages – Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers (GAO-09-606).* In this report, the GAO examined issues and federal activities related to: (1) the potential benefits and costs of Home Equity Conversion Mortgage (HECM) program loans to borrowers; (2) misleading HECM marketing; (3) the sale of potentially unsuitable products in conjunction with HECMs; and (4) oversight of HECM counseling providers. The GAO recommends the FDIC, Board of Governors of the Federal Reserve (FRB), Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) take steps, as appropriate, to strengthen oversight and enhance industry and consumer awareness of the types of marketing claims discussed in the report. The FDIC agrees with this recommendation.

Currently, a Reverse Mortgage Working Group of the Federal Financial Institutions Examination Council's Consumer Compliance Task Force is drafting guidance for financial institutions to use in managing the consumer protection and other risks of reverse mortgage products to ensure compliance with requirements regarding disclosures and advertising, and to review potentially unfair or deceptive practices. This Working Group is comprised of representatives from the FDIC, OCC, FRB, OTS, National Credit Union Administration, and State Liaison. We will make certain that your findings and recommendations are considered in this guidance which we expect to finalize by June 30, 2010, or sooner.

Also by June 30, 2010, the FDIC will publish in an *FDIC Consumer News* issue information about the potentially misleading claims in advertisements for reverse mortgages of the nature discussed in your report. The FDIC has issued industry and consumer awareness information on the complexities of reverse mortgages through our *FDIC Consumer News* and *Supervisory Insights Journal* in recent years. However we agree that more information should be made available specifically addressing advertisements for reverse mortgages. We are committed to providing that information to consumers in our publications.

We appreciate the opportunity to comment on your review and your suggestions on how the FDIC may enhance our industry oversight and consumer outreach on reverse mortgages.

Sincerely,

Sandra L. Thompson
Director

Appendix VI: Comments from the Office of the Comptroller of the Currency

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

June 19, 2009

Mr. Mathew J. Scirè
Director, Financial Markets and Community Investment
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Scirè:

We have received and reviewed your draft report titled "Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers." Your report responds to a Congressional request for information concerning the benefits and costs of home equity conversion mortgages (HECM) to borrowers.

You found that: (1) the potential benefits and costs can be varied and complex and may not be fully understood by consumers; (2) some advertisements contain potentially misleading claims; (3) borrowers may be vulnerable to the cross-selling of unsuitable products; and (4) counseling agencies may not be complying with requirements.

You recommended that several federal agencies, including the Office of the Comptroller of the Currency (OCC), take steps to strengthen oversight and enhance industry and consumer awareness of the types of marketing claims discussed in your report.

We agree that there is more we should be doing today to address the risks to consumers of reverse mortgages. The OCC has been working with the other federal bank regulatory agencies and state representatives on the Federal Financial Institutions Examination Council to develop supervisory guidance on reverse mortgages. The interagency guidance is still very much a "work in progress," but it will be a very important first step in directing banks to apply to proprietary reverse mortgages the same types of consumer protection standards applicable to HECMs, including the requirement for independent counseling. Effective implementation of the standards in the guidance through our supervisory process will be critical to protecting reverse mortgage borrowers.

We already have regulations in place that we will use in our supervision of reverse mortgage lending by national banks to supplement our implementation of the interagency guidance in addressing two particular consumer protection risks. The first is misleading marketing. National banks are subject to a requirement in OCC regulations that prohibits engaging in unfair or deceptive practices, as those terms are defined in the FTC Act, in connection with making, arranging, purchasing, or selling a real estate loan. We will use this authority to require immediate correction of any potentially misleading marketing claims by a bank in connection with reverse mortgage products. In the case of the specific advertisements you provided us for review and followup, we found that the national banks had revised their materials, as necessary, to accurately reflect the features of their products.

In addition, banks are prohibited by law from conditioning availability of a reverse mortgage on the borrower's purchase of certain nonbanking products. We can and will use this authority to take action to prevent any inappropriate and illegal cross-selling activities. And, we would expect national banks to have compensation policies that do not create inappropriate incentives for loan officers and third parties.

Should we conclude that implementation of the interagency guidance and enforcement of existing regulations is not sufficient to address all of the consumer protection concerns that may arise in connection with reverse mortgages, the OCC is prepared to adopt more definitive regulatory standards. We also look forward to working with the Department of Housing and Urban Development as it develops options to enhance protections available under its federally-insured HECM program.

We appreciate the opportunity to comment on the draft report.

Sincerely,

John C. Dugan
Comptroller of the Currency

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Appendix VII: Comments from the Office of Thrift Supervision

Office of Thrift Supervision
Department of the Treasury

Timothy T. Ward
Deputy Director, Examinations, Supervision, and Consumer Protection

1700 G Street, N.W., Washington, DC 20552 • (202) 906-5666

Mathew J. Scire
Director, Financial Markets and Community Investment
Government Accountability Office
441 G St., NW
Washington, DC 20548

SUBJECT: Government Accountability Office (GAO) Reverse Mortgage Draft Report 09-606: "Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers"

Office of Thrift Supervision (OTS) Comments

Dear Mr. Scire:

Thank you for the opportunity to review Draft Report 09-606, which discusses a number of issues that arise when reverse mortgages are offered. Because the senior citizens who obtain these complicated products may be vulnerable to misleading marketing techniques, we share the concerns that prompted GAO to undertake this study.

GAO's Draft Report 09-606 recommends that the federal banking regulators consider whether reverse mortgage advertisements are potentially misleading in describing the costs and benefits of Home Equity Conversion Mortgage loans. GAO also recommends that OTS, along with other agencies, take steps to strengthen oversight and enhance consumer awareness of the types of marketing claims contained in the report. Draft Report 09-606 suggests that these steps might include developing examination guidance and consumer education materials.

Consistent with these recommendations, OTS is working with the other members of the Federal Financial Institutions Examination Council (FFIEC) Consumer Compliance Task Force to develop guidance on the origination of reverse mortgages. In addition, OTS has already published material intended to educate consumers about reverse mortgages[1] and is working with the other FFIEC agencies to update the procedures used by examiners to evaluate how institutions are calculating and disclosing the cost of reverse mortgages under the Truth in Lending Act.

[1] See "Reverse Mortgages: Information to Consider on Benefits and Risks," *Community Liaison*, Community Affairs Newsletter Volume No. 2008, Issue 1 (Winter 2008).

Draft Report 09-606 also notes that the GAO referred certain advertisements that made potentially deceptive claims to the appropriate federal banking regulators for review. As it is now written, Draft Report 09-606 suggests that OTS is among these regulators.[2] While OTS staff did review certain advertisements, it does not appear that any of these samples were used by an institution currently under OTS supervision. Should OTS find that any institution under its jurisdiction is making use of misleading or deceptive advertising in the future, we will take appropriate action.

Please contact Montrice G. Yakimov, OTS Managing Director for Compliance and Consumer Protection at (202) 906-6173 or Montrice.Yakimov@ots.treas.gov if you have any questions or comments on this response.

Sincerely,

Timothy T. Ward

Timothy T. Ward
Deputy Director

[2] See Draft Report 09-606 at pages 28 and 53-54.

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Appendix VIII: Comments from the Department of Housing and Urban Development

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

JUN 17 2009

Mr. Mathew J. Scire, Director
Financial Markets and Community Investment
441 G St., NW
Washington, D.C. 20548

SUBJECT: GAO Draft Audit Report: Reverse Mortgages
Report No.: GAO-09-606
Report Issue Date: June 2009

Dear Mr. Scire:

This is in response to subject Draft audit report of the Reverse Mortgage Program (HECM) performed by the Government Accountability Office (GAO). The Draft report indicates the audit was performed to determine: 1) the potential benefits and costs of HECMs to borrowers; 2) the extent and impact of misleading HECM marketing; 3) the sale of potentially unsuitable products in conjunction with HECMs, and 4) oversight of HECM counseling providers. GAO determined during its review of HUD's role and responsibilities with respect to HECM mortgages that the Department's internal controls do not provide reasonable assurance that counseling providers are complying with HECM counseling requirements.

The Office of Housing (Housing) reviewed the Draft audit report and determined that while GAO noted deficiencies with respect to HUD's oversight of HECM mortgages, the report includes proactive changes HUD has taken to address many of the deficiencies. For example, GAO noted that HUD's internal controls over the HECM counseling process needs to be improved. Notwithstanding this issue, the Draft indicates that GAO takes into consideration HUD's efforts to conduct surveys of HECM counseling. The Draft also indicates that GAO acknowledges HUD's development of a project in collaboration with the AARP Foundation to independently observe HECM counseling sessions.

The Office of Housing appreciates the opportunity to provide a written response to the findings noted in the Draft and submits the following comments to be considered by GAO.

GAO's Determination:
Page 10 in the Draft implies that there is potential growth in the amount of funds available to borrowers over time should the mortgagor exercise the line of credit option.

Housing's Response:
During the exit conference with GAO, Housing stated and would like to reiterate that the "growth" that occurs is not limited to the line of the credit option but also occurs with any of the

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payment plans. Housing recommends that GAO clarify its statement regarding this matter in the final report.

GAO's Determination:

Page 11 in the Draft states the upfront insurance premium (UFMIP) and origination fees associated with HECMs can be substantial.

Housing's Response:

Housing disagrees with OIG's determination. The Draft does not indicate that the stated costs were substantial when compared to costs associated with another similar mortgage product such as forward mortgages. Therefore, the statement is inadequate without a baseline that shows a comparison to a similar mortgage product was made. For example, the UFMIP, for a HECM is 2.0 percent compared to 1.75 percent for forward mortgages. Housing concludes that the .25 percent difference is not substantial. In addition, the annual premium for a HECM mortgage is .50 percent compared to .55 percent charged on forward mortgages. Lastly, origination costs on forward mortgages are approximately 3% excluding pre-paid items and UFMIP, and falls within the same range for HECM mortgages.

GAO's Determination:

Page 16 in the Draft states a report written by the Office of Inspector General (OIG) indicates that 12 borrowers interviewed during an audit did not understand the fees or interest costs of their HECM loan.

Housing's Response:

Housing does not agree that a reference to OIG's report is appropriate. The 12 borrowers OIG interviewed may have had an unrelated issue with the originating lender and therefore are not representative of the HECM borrower population as a whole. Also, OIG's targeting is generally based on adverse selection; therefore, their findings may not be representative of the vast majority.

GAO's Determination:

Pages 31-32 in the Draft indicates a HUD official expressed concern about the Department's "capacity" and "authority" to enforce HERA no cross-selling provisions.

Housing's Response:

During the exit conference with GAO, Housing stated and would like to reiterate that the Department is not questioning its capacity and authority to address noncompliance with HUD/FHA requirements. HUD/FHA through its MRB process has and does exercise the authority to sanction any FHA approved lender that egregiously violates the Department's loan origination requirements. Also, it should be noted that insurance sales are regulated at the state level. HUD does not have jurisdiction over these activities. Housing requests that GAO clarify the distinction between HUD's oversight and the state's role.

GAO's Determination:

Page 50 in the Draft is written in such a way that it appears GAO has misinterpreted the numbers of counseling agencies that are supposed to be on the list both previously and in accordance with the new Mortgagee Letter 2009-10. GAO reports that at the time of the audit, lenders were required to provide borrowers with a list that includes six entities located within the local state area that perform HECM counseling including one agency located within reasonable driving distance to meet HUD/FHA face-to-face requirements. GAO further reported that in March 2009, HUD increased the number of references from 6 to 10.

<u>Housing's Response:</u>
Housing takes exception to GAO's interpretation of HUD's requirements. Prior policy required lenders to provide potential HECM borrowers with the contact information for 5 counseling agencies in the local area or state with one of those agencies located within reasonable driving distance. The list was to also include contact information for three intermediaries that provided telephone counseling. The intermediaries were MMI, NFCC and AARP. ML 2009-10 increased the number of intermediaries to five; CCCS of Greater Atlanta and NCOA were added to the list. The total number of counseling agencies required to be on the list in accordance with ML 2009-10 is now ten and consists of five local agencies and five intermediaries. Housing requests that GAO correct or remove its statement regarding this matter.

If you have any questions regarding this matter, please feel free to contact Mrs. Ruth Roman, Director, of HUD's Program Support Division at 202.402.2112.

Sincerely,

Brian D. Montgomery,
Assistant Secretary for Housing-
Federal Housing Commissioner, H

Appendix IX: GAO Contact and Staff Acknowledgments

GAO Contact

Mathew J. Scirè, Director, 202-512-8678 or sciremj@gao.gov

Staff Acknowledgments

In addition to the contact above, Steven K. Westley (Assistant Director), Sonja J. Bensen, Christine A. Hodakievic, John T. McGrail, Marc W. Molino, Carl Ramirez, Barbara M. Roesmann, Jennifer W. Schwartz, Winnie Tsen, and James D. Vitarello made key contributions to this report. In addition, members of the GAO Learning Center contributed to this report, including Ann M. Commeree, Chris Dionis, Linda S. Garcia, and Carol E. Willett.

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