Remarks by

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Before the

American Bankers Association Regulatory Compliance Conference

Orlando, Florida

June 8, 2009

"Consumer Protections for Reverse Mortgages"

I am very pleased to be here today to address this very important group. The ABA's annual regulatory compliance conference brings together so many people who do first rate work in the compliance field – work that is always important, but never more so than in these challenging economic times. Indeed, recent events painfully demonstrate that, as part of government efforts to get the economy growing again, we simply cannot divert our attention from consumer compliance issues. We have learned the hard way that many of our current economic problems were at least in part precipitated by the failure of lenders to adhere to basic consumer protection and underwriting standards, especially for certain mortgage products.

I believe the critical lesson here is the need to act early, before problems escalate. And on a number of occasions in the past, we did act early to head off looming compliance concerns, with actions that made a difference. For example, the OCC took a number of enforcement actions and issued guidance to curtail abuses with subprime credit cards and payday loans offered by national banks. Likewise, the federal banking agencies issued guidance to address emerging compliance risks with nontraditional mortgages, such as payment option ARMs, and the OCC took strong measures to ensure that that guidance was effectively implemented by national banks throughout the country.

But we haven't always acted as soon as we should have. For example, we all could have sounded the alarm earlier about risks that were developing in the subprime mortgage market, even though the overwhelming majority of that lending occurred outside of commercial banks. The record levels of foreclosures and losses on subprime loans resulted from a combination of risk factors, including these: a vulnerable customer segment; complex product features that were ineffectively, and sometimes deceptively, disclosed to customers; nontraditional underwriting that was heavily based on the value of the collateral, rather than the borrower's ability to repay; skewed incentives of key distributors of the product; and finally, a distribution chain that was heavily populated with nonbanking companies that were not subject to comprehensive supervision. We need to learn the right lessons from this very negative experience, because it clearly demonstrates the link between compliance and safety and soundness.

In that context, there is another mortgage product that (1) has not yet been widely accepted in the market, (2) has the possibility for rapid growth in the very near future, and (3) poses significant compliance risks. I'm talking about the reverse mortgage, a product that many believe will experience a surge in demand in the coming years as our population ages. While reverse mortgages can provide real benefits, they also have some of the same characteristics as the riskiest types of subprime mortgages – and that should set off alarm bells. I believe that now is the time to get out in front of this issue – <u>before</u> real problems develop – so that reverse mortgage providers make these loans in a way that is prudent for both lenders <u>and</u> borrowers.

Facts About Reverse Mortgages

Let me provide a few key details about reverse mortgages, and then describe key differences between types of these products and significant consumer protection concerns. First, as you know, these products are targeted at older homeowners that have built up substantial home equity. Like traditional mortgages, a reverse mortgage provides a homeowner with access to cash secured by his or her home. But unlike a traditional mortgage, a reverse mortgage does not require the borrower to make payments on an ongoing basis. Instead, the home itself is the primary source of repayment, and no such repayment is required until the homeowner dies, permanently moves out of the home, or fails to maintain the property or pay property taxes or insurance. In addition, the loan is usually non-recourse, with the amount the borrower owes at repayment generally capped at the value of the home. In these unique circumstances, the borrower has no need to demonstrate income capacity or a creditworthy FICO score to qualify for a reverse mortgage, because the loan is underwritten based on the value of the collateral and the life expectancy of the borrower.

Also unlike a traditional mortgage, a reverse mortgage provides a borrower with an array of choices in terms of access to funds. These choices include fixed monthly payments for as long as the borrower continues to live in the home or for a specified term; a lump sum payment; a line of credit; or a combination of these options. Most people choose the line of credit option and draw down a substantial amount of credit at origination.

In short, a reverse mortgage provides some very attractive features to elderly homeowners that have a lot of equity tied up in their homes: ready access to very substantial amounts of cash; no need to demonstrate income or creditworthy FICO scores; and in general, no need to make any payments on the loan for as long as the person stays in the home.

There are two basic types of reverse mortgage product: proprietary products offered under lender-specific criteria, and products insured by the Federal Housing Administration (FHA) called "home equity conversion mortgages," or "HECMs." To date, HECMs have predominated over proprietary products, accounting for approximately 90 percent of all reverse mortgages. Since the FHA program was authorized in 1988, HECM originations have grown substantially, from fewer than 200 in 1990 to more than 112,000 in 2008. While this rate of growth is noteworthy, the number of reverse mortgages is still very small in relation to the overall number of mortgages outstanding or, for that matter, the target market of elderly homeowners that have lots of home equity.

HECMs will probably continue to be the predominant reverse mortgage product, at least in the near term. Lenders find the product attractive first and foremost because FHA insurance substantially limits their credit risk. In addition, HECMs are eligible for purchase by Government-sponsored enterprises, providing a way for lenders to move the loans off their balance sheets. Moreover, Congress recently increased the FHA loan limit applicable to HECMs to $625,500 in 2009, and this expanded limit means that a large majority of elderly homeowners may qualify.

Nevertheless, there are reasons to anticipate growth of proprietary reverse mortgages in the future as well. One is simply the powerful demographic force that could produce a very large market for the product, extending to homeowners who for various reasons might not qualify for HECMs. It is estimated that, within the next ten years, over 55 million people in the United States will be 62 or older. Many of these individuals are homeowners, and, despite the recent downturn in house prices across the country, many own their homes outright or have built up substantial home equity over a period of many years. Moreover, given job losses, reduced pension benefits, and declining retirement accounts, a large number of "house-rich" Americans will have an increased need to supplement income as they grow older. A reverse mortgage may uniquely suit that need, and if demand for the product mushrooms, lenders are likely to develop more attractive proprietary products that will compete with HECMs and also become available for consumers who don't qualify for HECMs.

Risks for Consumers

In short, the reverse mortgage is a product that may grow substantially in coming years to meet consumer demand. But as I said at the outset, it is also a product that is fraught with consumer compliance concerns. One substantial risk arises from the ability of elderly consumers to access their home equity through immediate and large lump sum payments. This substantial pot of cash can tempt lenders to simultaneously and aggressively market investment, insurance, or annuity products or, worse, attempt to condition loan approval on the purchase of such products. Indeed, with access to large lump sums, elderly borrowers can be particularly vulnerable to coercive sales of annuity and long term care insurance products that are expensive and may not be appropriate to the borrowers' needs.

Another risk is that reverse mortgage borrowers, because they have no immediate repayment obligations, may overlook substantial fees that are attached to the loan. And consumers who spend their loan proceeds quickly or unwisely may end up short of the funds they need for home maintenance or property taxes, with disastrous consequences: the failure to make those payments can result in foreclosure.

Another consumer risk is that older borrowers may be the target of misleading marketing claims, especially when providers have loan origination incentives and fees that put more of a premium on making the sale than on providing a product that is appropriate for the consumer. Indeed, even when consumers are not subject to misleading or deceptive marketing, they still may have a hard time understanding the complex nature and costs associated with reverse mortgages. These loans can be more costly than other types of mortgages because of origination and servicing fees, mortgage insurance premiums, if applicable, and because lenders need to be compensated for the risk in proprietary products that the outstanding balance may exceed the value of the collateral over time. If a consumer doesn't fully understand how much the loan will cost, how much can be borrowed, or all the circumstances under which the loan can become due, then the risk increases for a transaction that is not appropriate to the consumer's needs.

In sum, consumer compliance risks with reverse mortgages are real, and indeed, I am struck by some of the similarities to the risks of subprime mortgages: a vulnerable customer class; complex product features that can be difficult to explain and can be susceptible to deceptive marketing; nontraditional, asset-based underwriting; and the potential for skewed incentives for key distributors of the product.

Consumer Protections Currently Provided

So what types of consumer protections are currently provided for reverse mortgages in law and regulation? There are essentially two types: the general types of consumer protections that apply to all mortgages, including all reverse mortgages, and the specific types of protections that apply to HECMs.

In the first category, all reverse mortgages are subject to most of the standard consumer credit laws, including the Truth in Lending Act (TILA), the Equal Credit Opportunity Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, and Federal Trade Commission Act. For example, TILA's right of rescission applies to reverse mortgages, as does its requirement for a creditor to disclose an estimated "Total Annual Loan Cost" rate. The Total Annual Loan Cost rate is calculated based on all charges the consumer pays (including the costs of any annuity purchased), and takes into account payments to the consumer, any equity taken by the lender in the transaction, and any limitations on the consumer's liability.

But not all TILA protections apply to reverse mortgages. For example, the rules recently issued by the Federal Reserve Board to address abusive practices in "higher-priced" mortgage transactions will not apply to reverse mortgages. I question that outcome, since some of these provisions would seem to be important for reverse mortgage borrowers, too. In particular, the required escrow of taxes and insurance for higher-priced mortgages would appear to be an appropriate protection for reverse mortgages as well, since nonpayment of taxes and insurance can be a condition of default for which elderly reverse mortgage borrowers may not adequately plan. The Board has stated its intention to continue to look at reverse mortgage issues in connection with future rulemaking under TILA, and the OCC will certainly provide input on these issues when that occurs.

In terms of specific consumer protections for HECMs, Congress and the Department of Housing and Urban Development (HUD) designed the HECM program to address a number of reverse mortgage risks to consumers. For example, although the HECM borrower may withdraw his or her loan proceeds in a lump sum, HUD regulations restrict the use of the funds to pay for certain third party services, such as loan arrangers or so-called "estate planning services." In addition, the HECM program has several features designed to improve consumer understanding of the costs and structure of reverse mortgages. An important one is that borrowers must receive financial counseling about alternatives to reverse mortgages, and about the financial, tax, and estate consequences of the transaction, before they take out a HECM. They also must receive special disclosures about the costs and terms of the loan.

Beyond requiring disclosures, the HECM program further addresses reverse mortgage costs by imposing limits on the amount of loan origination fees that may be charged. In addition, HECMs are subject to federal protections against tying by the lender of other financial products to the loan transaction, and restrictions on how counselors may be compensated.

In sum, the various consumer protections that apply to HECMs are meaningful, and credibly address many of the risks of reverse mortgages. Nevertheless, the HECM program could be enhanced to address some particular issues that have arisen over time. One issue relates to the fact that the program permits counseling to be conducted over the telephone. Obviously, telephone counseling may be the most convenient for elderly or house-bound seniors. But this method may not always be the most effective in ensuring that the consumer fully understands the nature of this product.

In addition, a HECM borrower may draw down his or her line of credit in a single lump sum at any time, including at loan origination. This feature of the program provides borrowers with significant flexibility and allows them to obtain funds they may need immediately for medical and other expenses. It is also a popular option with HECM borrowers: HUD has estimated that borrowers choosing a line of credit typically withdraw at least 60 percent of their funds as soon as the loan is closed. But, as noted above, this feature also can present risks of borrower coercion and create opportunities for mortgage fraud. I understand that HUD is aware of these issues and is actively considering different policy options to address them.

OCC Initiatives to Address Reverse Mortgage Compliance Risks

Given this background, is there more that we should be doing today to address the risks to consumers of reverse mortgages? I think there is. For starters, the OCC has been working with the other federal bank regulatory agencies and state representatives on the Federal Financial Institution Examination Council to develop supervisory guidance on reverse mortgages. Because reverse mortgages involve an especially vulnerable group of customers, it is imperative that our consumer protection standards be robust. For example, I believe that any final guidance should direct banks to apply to proprietary reverse mortgages the same types of consumer protection standards applicable to HECMs, including the requirement for independent counseling.

The interagency guidance is still very much a "work in progress" at the agency staff level. But it will be a very important first step in setting standards for a proprietary reverse mortgage market that is still in the embryonic stage. And effective implementation of the standards in the guidance through our supervisory process will be critical to protecting reverse mortgage borrowers. At the OCC, we will examine national banks and their bank operating subsidiaries that offer reverse mortgages with respect to standards in the guidance.

Our compliance efforts will not stop there, however. 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 particular ones that use terms such as "income for life," "no payments ever," and "no risk."

In addition, banks are prohibited by law from conditioning availability of a reverse mortgage on the borrower's purchase of certain nonbanking products, such as an annuity or life insurance product. We can and will use this authority to take action to prevent any inappropriate and illegal cross-selling activities. As part of our supervision of national banks, we would expect them to have written procedures and internal controls to guard against conflicts of interest that may arise in connection with reverse mortgage products and with the sale of any ancillary products. And, we would expect national banks to have compensation policies that do not create inappropriate incentives for loan officers and third parties such as mortgage brokers, correspondents, and intermediaries.

We also may conclude that implementation of the interagency guidance and enforcement of existing regulations will not be sufficient to address all of the consumer protection concerns that may arise in connection with reverse mortgages. In these circumstances, more definitive regulatory standards may need to be adopted, and the OCC is prepared to do that – even if the standards we advocate initially apply only to reverse mortgage lending by national banks.

One area in particular that I think deserves attention is whether to impose additional requirements with respect to escrows of taxes and insurance. I mentioned earlier that the new Federal Reserve Board escrow requirements for "higher-priced" mortgages do not apply to reverse mortgages. Similarly, HUD does not currently require escrows to be established in connection with HECMs. We can debate the merits – and need for – escrows in connection with reverse mortgages, but my starting point is that they seem to make good sense from both the consumer's and the lender's perspective because of the significant home-loss risk that flows from nonpayment of taxes and insurance. Given the predominance of the HECM product in reverse mortgage lending, I think it would be a major step forward for HUD to issue guidelines or requirements addressing the escrow issue for HECMs, and I would like to begin a dialogue with them on the issue. Once they set the standards for escrows, we would ensure that they are followed by national banks for HECM products, and would ensure – by regulation, if necessary – that comparable standards apply in connection with proprietary reverse mortgages offered by national banks.

Conclusion

I have spent most of my time today focusing on the compliance risks raised by a particular loan product. That may seem to you to have been an unexpected topic for my speech given the significant forces that are buffeting regulatory compliance these days, including the economic downturn, scores of new regulations, and talk of new compliance regulatory structures. My simple response is that the discussion about reverse mortgages is intended not only to sound an early warning about aspects of that product, but also to serve as a general reminder that, despite everything else that is going on, we need to be on constant alert to emerging risks and vigilant in our regulatory compliance responsibilities. And that is the final message I would like to leave with you today.

Thank you very much.