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Testimony of

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The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Good morning Senator McCaskill, my name is Ann Jaedicke, and I am the Deputy Comptroller for Compliance Policy at the Office of the Comptroller of the Currency (OCC). Since 2003, I have been responsible for examination policies and procedures relating to consumer issues.

It is a pleasure to be in St. Louis this morning to discuss reverse mortgages, a financial product that many older consumers may find appealing and that has the potential to grow in popularity as the baby boom population ages, the economy stabilizes, and home prices begin to recover. Used correctly, these products can be beneficial to consumers by providing funding for home improvement projects, medical needs, or long-term financial security. For many seniors, this product allows them to stay in their home and avoid the trauma and costs of moving in their elder years. However, like many mortgage products, without proper underwriting and strong consumer protections in place, there is also the potential for their misuse.

As you may know, Comptroller of the Currency John Dugan recently gave a speech on reverse mortgages before the American Bankers Association's Regulatory Compliance Conference in Orlando, Florida.[1] There, Mr. Dugan shared a number of observations about these products including their risks and their benefits. While the primary product is the Department of Housing and Urban Development's (HUD) Home Equity Conversion Mortgage (HECM), the Comptroller noted that lenders may offer private, or "proprietary," reverse mortgages. As the proprietary market is in its infancy, Mr. Dugan urged regulators and lenders to act now and ensure appropriate consumer safeguards for these products. As the market for proprietary mortgages expands, he

[1] A copy of the Comptroller's remarks can be found at: http://www.occ.gov/ftp/release/2009-61a.pdf.

wants to prevent the types of problems that develop when, to use one example, borrowers agree to loan terms that they do not fully understand. He emphasized that providers need to make these loans in ways that are prudent for both lenders and borrowers. I will be echoing some of the Comptroller's comments today.

Because not everyone is familiar with the OCC, please allow me to provide a brief overview of our responsibilities. The OCC charters, regulates, and supervises all national banks. As of March 31, 2009, there were over 1,580 banks in the national banking system, with total assets of over $8.2 trillion. This includes 38 national banks here in Missouri. National banks include almost all of the country's largest, most complex banks, as well as many smaller community banks located across the country. The OCC's core mission is to ensure that national banks remain safe and sound, and to enforce banking laws and regulations, including those that protect consumers. OCC bank examiners who work on-site at the largest banks, as well as those who closely supervise the community banks across the country, are well-trained in both safety and soundness and consumer compliance supervision.

In my testimony today, I will provide some facts about reverse mortgages, discuss potential risks to consumers, and provide information about some OCC initiatives to make sure that this product is provided to consumers in an appropriate manner.

Reverse Mortgages and their Projected Growth

Reverse mortgages are unique and complex financial products. They are tailored to meet the income needs of older homeowners who have built up equity in their homes. Like home equity loans, 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 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. Because the loan is underwritten based on the value of the collateral and the life expectancy of the borrower, the borrower does not need to demonstrate income capacity or a creditworthy FICO score to qualify for a reverse mortgage. But the borrower must have the financial capacity to maintain the property and pay taxes and insurance.

Also unlike a traditional mortgage, a reverse mortgage provides a borrower with a number of options in terms of access to funds. Borrowers can choose to receive 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 to receive their funds as a line of credit and then draw down a substantial amount of credit at the time of origination.

A reverse mortgage provides some very attractive features to elderly homeowners who have equity tied up in their homes as it gives them the ability to access some of that equity while remaining in their homes. I can appreciate why reverse mortgages are a product worthy of serious consideration for many borrowers, and I anticipate this market will increase significantly as the population ages and home prices begin to stabilize.

As I noted previously, there are two basic types of reverse mortgage products in the market today: "Home Equity Conversion Mortgages" or "HECMs" that are insured by the Federal Housing Administration (FHA), and proprietary products offered by individual lenders. HECMs are administered by HUD, and regulations currently in place outline the rules and requirements for their use. While national banks may originate HECMs, the OCC does not have a role in the administration of the HECM program. The OCC does, however, have a role in ensuring that national banks comply with applicable laws and regulations, including the various consumer protection provisions set forth in HUD's regulations for HECMs.[2] In contrast, proprietary products are developed by individual banks and tailored to their specific audience, but are not insured by the FHA and thus are not subject to the specific consumer protections required for HECMs.[3]

To date, HECMs have dominated the reverse mortgage market, accounting for approximately 90 percent of all reverse mortgages. This trend is mirrored in the national banking system where the insured FHA HECM product, as opposed to proprietary products, is the predominant product offered by national banks. In 2008, more than 112,000 HECM loans were originated. Although the number of originations is small in comparison to traditional mortgages, the product has shown significant growth.

Within the next ten years, it is estimated that over 55 million people in the United States will be 62 or older, and thus eligible for a reverse mortgage. 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 home equity over the years. Moreover, economic difficulties including job losses, reduced pension benefits, and declining retirement accounts, may mean that many Americans will have an increased need to supplement their income as they grow older.

HECMs will probably continue to be the predominant reverse mortgage product, at least in the near term. Lenders, including national banks, find the product attractive

[2] HECM Regulations are set forth in 24 CFR part 206.
[3] Proprietary products, however, are subject to applicable consumer protection laws and regulations including the Truth-in-Lending Act, Section 5 of the Federal Trade Commission Act, and the Real Estate Settlement Procedures Act.

primarily because FHA insurance substantially limits their risk of loss with the product. 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 a maximum of $625,500 for 2009, and this expanded limit means that a large majority of elderly homeowners may qualify.

Nevertheless, we anticipate growth of the fledgling proprietary reverse mortgage market as well. Particularly if demand for this product accelerates, lenders are likely to develop more attractive proprietary products that will compete with HECMs.

Potential Risks to Consumers

As Comptroller Dugan noted in his recent speech and as you will no doubt hear from other witnesses at this hearing, the reverse mortgage product can, if not managed appropriately, raise significant 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. Although some consumers may choose a lump sum payment to pay off their existing mortgage, others may choose this option for medical expenses, home improvements, or vacations. Accessing a substantial amount of cash may leave some consumers vulnerable to unscrupulous lenders or other bad actors who may attempt to aggressively market investment, insurance, or annuity products or, worse, try to condition loan approval on the purchase of such products. Reverse mortgage borrowers also may fall victim to con artists who may persuade them to obtain reverse mortgages and to use the proceeds to pay upfront for unneeded or excessively expensive home repair services that may not be completed.

Consumers who choose to receive their proceeds in an upfront lump sum payment and do not have a steady income or do not set aside some portion of those proceeds may find themselves without sufficient funds to pay for future home maintenance, property taxes, or insurance. Such action can have disastrous consequences, as the failure to make those payments can result in foreclosure.

Other consumer risks include misleading marketing claims or difficulty understanding the complex nature and costs associated with reverse mortgages. In particular, because they have no immediate repayment obligations, borrowers may overlook or not fully understand the substantial fees and costs attached to these loans. These loans can be more costly than other types of mortgages because of origination and servicing fees and mortgage insurance premiums. 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.

Mitigating Reverse Mortgage Consumer Risks

Because of these risks, Congress and HUD carefully designed the HECM program to stave off many potential problems. 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. This includes the requirement that borrowers must receive independent 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. Furthermore, limits are imposed on the amount of loan origination fees that may be charged, and HECMs are subject to federal protections which prevent the lender from tying other financial products to the loan transaction and impose restrictions on how counselors may be compensated.

While the various consumer protections that apply to HECMs are meaningful, as the Comptroller noted, some particular issues have arisen over time as the program has evolved. One issue relates to the fact that the program permits the mandatory financial counseling to be conducted over the telephone. Obviously, telephone counseling may be the most convenient for some 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 complex 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. It may also leave the borrower vulnerable to having insufficient funds to pay for needed future home repairs, taxes, and insurance. We think these are issues that deserve some more attention. We also understand that HUD is aware of and focused on these issues.

OCC Initiatives to Address Potential Risks

OCC recently provided its perspectives and experience with reverse mortgages to GAO as part of its study on this product. We look forward to working with the GAO to implement any recommendations that they may make to improve consumer protections for this product.

Although many of the standard consumer credit laws such as the Truth in Lending Act and the Real Estate Settlement Procedures Act do apply to reverse mortgages, uniform protections similar to those developed by Congress and HUD for HECMs currently do not exist in the proprietary reverse mortgage market. Thus, it is critical that banks offering proprietary products closely consult with their compliance officers as they develop this line of business in order to manage and mitigate the potential for risk and to ensure that consumers understand both the benefits and costs of this product. OCC will do its part to ensure that banks are utilizing appropriate risk management strategies including proper underwriting standards, clear and meaningful disclosures, and accurate marketing materials. As the proprietary market grows out of its infancy, banks have a unique opportunity to develop a strong and robust program that is prudent for both consumers and banks. Getting ahead of the potential pitfalls before real problems develop is critical.

As the market for reverse mortgages continues to develop, OCC will continue to work to raise awareness about these products, their benefits, and their potential compliance concerns. Discussing the products within OCC and through industry outreach efforts will foster a healthy dialogue with national banks that may be exploring entry into the proprietary mortgage market.

Formal guidance to insured depositories is under development. The Federal Financial Institutions Examination Council (which includes the OCC, the Office of Thrift Supervision, the Federal Reserve, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and State Liaison Committee) is developing supervisory guidance for managing the risks presented by reverse mortgages. OCC has been leading the interagency working group to develop this guidance that will apply to all nationally-chartered banks, savings and loans, credit unions, and state banks. We expect the guidance to address the agencies' concerns that consumers may not understand the costs, terms, risks, and consequences of reverse mortgage products; that counseling may not be provided or may not be adequate to ensure understanding; and that potential conflicts of interest and abusive practices may arise in connection with these transactions.

The guidance is an important first step in setting strong expectations for the proprietary reverse mortgage market. We also 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. Ensuring appropriate implementation of the standards in the guidance through our supervisory process will be critical to protecting reverse mortgage borrowers. Once issued, OCC will supervise national banks and their operating subsidiaries to ensure the standards in the guidance are established and maintained. While the interagency guidance is still very much a "work in progress," we are on track to issue the guidance for public comment later this summer.

To supplement this guidance, we also will rely on regulations currently in place to address two particular consumer protection risks: misleading marketing and conditioning the mortgage on the purchase of other nonbank products. National banks are subject to an OCC regulatory requirement that prohibits engaging in unfair or deceptive practices, as those terms are defined in the Federal Trade Commission Act, in connection with making, arranging, purchasing, or selling a real estate loan. The OCC was the first federal banking agency to issue regulations prohibiting such conduct. Our rules apply only to the national banks we supervise. We will use this authority to require immediate correction of any potentially misleading marketing claims by a bank in connection with reverse mortgage products. Indeed, the OCC has, on a number of occasions, taken enforcement actions when we have found deceptive practices.

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 annuities or life insurance products. We will use this authority to prevent inappropriate and illegal cross-selling activities. As part of our supervision of national banks, we will 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 will 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.

If we 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, we may determine that more definitive regulatory standards need to be adopted. If this is the case, the OCC is prepared to do that – even if the standards we advocate initially apply only to reverse mortgage lending by national banks.

To better track trends and identify emerging risks in the reverse mortgage market, the OCC, other federal banking agencies, and the State Liaison Committee are considering proposing a change to the information that banks provide in their Report of Condition and Income reports. This change would require the collection of information about reverse mortgage products, including the volume and type (i.e., HECM versus proprietary) of reverse mortgages being originated.

Finally, the OCC is committed to increasing the public's awareness of reverse mortgages and is developing Public Service Announcements to be issued in the coming weeks on the product. These announcements will include print and radio spots that will run in both English and Spanish to advise consumers about the potential risks of this product.

Conclusion

Thank you, Senator McCaskill, for convening this hearing and for your leadership on this important issue.