Reverse mortgage compliance challenge looms for banks (June 24, 2009)

Dugan speech leaves reverse mortgage lender fuming

By Steve Cocheo, executive editor

The commercials say, “A diamond is forever.” Unfortunately, says Jeff Lewis of Generation Mortgage Co., so is a Google entry. In particular, entries relating to a recent cautionary, sometimes critical speech by Comptroller of the Currency John Dugan on the subject of reverse mortgages. And that has Lewis worried.

“There was no great urgency for him to opine on this topic,” says Lewis, whose nonbank reverse mortgage company is one of the largest participants in that market. Reverse mortgages, sometimes called annuity mortgages, or, when part of a special
FHA program, “home equity conversion mortgages,” have at times been controversial. They enable the elderly to convert a paid-off home into fresh money they can tap for major expenditures or simply for living expenses when other income sources don’t amount to enough to support their lifestyle. Title to the home remains with the borrower. When the loan becomes due (usually when the borrower dies or leaves the home) the loan plus interest becomes due. It can be paid off from the sale or refinance of the home, or from another source. No payments need be made during the life of the borrowers.

Lewis says in spite of perceptions some have, America’s elderly do plenty of web surfing, and he worries that every time an interested reverse mortgage candidate does a web search, Dugan’s early June remarks will surface.

Referring to the Comptroller’s reference to soon-to-be-released guidelines, Lewis said the FHA’s Home Equity Conversion Mortgage (HECM) program “has been regulated quite effectively for 20 years by the Department of Housing and Urban Development.”

He also noted that Dugan’s indicated that many potential problems have not actually developed. “And he doesn’t point out any issues that are not addressed,” Lewis adds.

Here and there have been indications that commercial banks are becoming more interested in this product, which ties in with the graying of America, the decimation of many American’s conventional retirement savings and income, and the rising cost of health care and the need for long-term health care coverage by the elderly.

What Dugan said

The speech that’s giving Lewis angst was presented during ABA’s Regulatory Compliance Conference on June 8, in Orlando, Fla., to hundreds of assembled bank compliance officers, attorneys, and auditors. (ABA BJ will be presenting a July 7 special edition of ABA Banking Journal Report dedicated to extensive coverage of the conference. This will be sent to all recipients of the regular edition of report. If you have a compliance colleague who does not subscribe to Report, they can sign up at http://tinyurl.com/BJReportNow)

Dugan had opened his presentation reflecting on the need for regulators to act earlier on new and evolving products, before compliance problems and consumer protection gaps arise. Indeed, a number of conference sessions dwelled on heading off problems before they became compliance violations, or worse.

Acknowledging the current subprime crisis and similar developments, Dugan said, “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 to act early, before problems escalate.” He noted that OCC did take some actions to curtail abusive lending by national banks. He also pointed to the interagency guidance issued on nontraditional mortgages, issued several years back.

From this, he segued to reverse mortgages, a 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 believe that now is the time to get out in front of this issue—before real problems develop—so that reverse mortgage providers make these loans in a way that is prudent for both lenders and borrowers,” said Dugan. [You can read the entire speech at http://www.occ.gov/speeches.htm]

Dugan reviewed the appeal of the reverse mortgage concept, and then noted that while there are proprietary programs available, about 90% of the outstanding reverse mortgages are FHA HECM loans (coming to about 112,000 at the end of 2008). FHA’s program limits lender credit risk and the loans are eligible for purchase by GSEs, he said, adding that Congress recently raised the HECM maximum loan amount to $625,500, which expands eligibility.

“Nevertheless,” said Dugan, there are reasons to anticipate growth of proprietary reverse mortgages in the future as well.” These included a potential boom in demand that would include homeowners not eligible for the FHA program.

Dugan branded reverse mortgages as “fraught with consumer compliance problems.”

Dugan expressed concern with the huge and sudden availability of cash to the elderly.

“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,” Dugan said. “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 borrower’s needs.”

This section of the speech especially concerned reverse mortgage chief Jeff Lewis. “There was almost a presumption that any product sold to a senior citizen is a ripoff.” He added that the speech implied that “our customers are incapable of fending for themselves. These people are intelligent, independent, and capable of being adults.”

Lewis also indicated that products such as long-term care insurance have legitimate roles in today’s medical and old-age care picture.

Lewis noted that the FHA program includes consumer protection elements, and Dugan acknowledged these in his speech. One such protection is HUD restrictions on use of reverse mortgage proceeds for paying certain third parties, such as loan arrangers and “so-called ‘estate-planning services’,” said Dugan. HECM borrowers are also required to receive financial counseling prior to committing to the special loans.

Dugan also expressed concern with the size of the fees that can be charged for reverse mortgages. And he noted that some recent truth in lending changes made by the Federal Reserve don’t address reverse mortgages, although he said the Fed is monitoring these loans to consider further rulemaking.

Federal guidance coming

“In sum,” Dugan said, “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.”

In his speech Dugan said OCC and other federal banking regulators, as well as several state banking agencies, were attempting to get out in front of the risks they perceive in further bank involvement in reverse mortgages by issuing guidance.

“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,” said Dugan.

Speaking for OCC itself, Dugan said special attention would be paid to misleading marketing of reverse mortgages by banks, as well as to illegal conditioning of availability of the credits based on purchase of other services. Likewise, national banks’ compensation policies in regard to reverse mortgages would also be examined.

A postscript regarding timing and details:

Interviewed by ABA BJ directly after his June 8 presentation, Dugan predicted that the federal guidelines would be released in a matter of weeks—certainly within the third quarter. (He added that he did not see much abuse at this point, and that his intent was to move faster to avoid possibilities of abuse.)

However, later in the ABA conference’s program, Ann F. Jaedicke, deputy comptroller for compliance policy at the OCC, indicated that the interagency effort wasn’t moving quite that fast. Jaedicke said that she expected the guidelines to be published in the next couple of months, and said that the guidelines would be issued for comment, rather than being imposed without industry input.

Richard Riese, ABA senior vice-president in charge of the Center for Regulatory Compliance, moderating the panel discussion that Jaedicke participated in, commented that he wouldn’t be surprised if the pending interagency staff guidelines would include aspects of UDAP—unfair or deceptive acts and practices—philosophy. Jaedicke indicated that one point the document will make is that all consumer protection laws and regulations that apply to “forward” mortgages also apply to reverse mortgages. (Dugan did note Cross selling from the reverse mortgage base will also be addressed.

“It’s mostly general guidance,” said Jaedicke. “There’s nothing in there that should shock people.” [Editor’s Note: Longtime observers of compliance debates know that there can be a gap between what regulators think bankers know and what they see when such “guidance” or “guidelines” are published.]

Jaedicke also added her own summary of Dugan’s remarks to what the bankers had heard directly.

First, she said, the key message was, “if banks are going to do the reverse mortgage product, they need to get it right.”

Second, she said, Dugan expects the compliance fraternity to do more than just make sure proper disclosures are handed over to prospects and borrowers on a timely basis. She said he expects the compliance function to help ensure that banks’ potential push into reverse mortgages not produce any new risks.

We attempted to contact the National Reverse Mortgage Lenders Association for this article, but no spokesman was available by publication time. The NRMLA website does contain numerous consumer-protection related items, including an extensive code of ethics and professional responsibility. See www.nrmlaonline.org