

Date of Hearing: April 21, 2014

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Roger Dickinson, Chair

AB 1700 (Medina) – As Amended: April 9, 2014

SUBJECT: Reverse mortgages: notifications

SUMMARY: Prohibits a reverse mortgage lender from accepting a reverse mortgage application until seven days have passed from the date of mandatory loan counseling. Specifically, this bill:

- 1) Deletes the current requirement that the lender provide the borrower with a specific checklist prior to counseling, and instead provides for the following reverse mortgage worksheet guide in at least 14-point font.

EXISTING LAW

- 1) Requires a reverse mortgage to comply with the following requirements (Civil Code, Section 1923.2):
 - a) Prepayment, without penalty, must be allowed at any time;
 - b) The reverse mortgage may become payable and due under certain circumstances;
 - c) The lender must prominently disclose in the loan agreement any interest rate or other fees to be charged during the period that commences on the date that the reverse mortgage loan becomes due;
 - d) A lender or any other person that participates in the origination of the mortgage shall not require the applicant to also purchase an annuity;
 - e) Prohibits the lender from participating in, or be associated with any other financial or insurance activity, unless the lender maintains procedural safeguards that ensure that the originator of the reverse mortgage has no involvement, or incentive to provide the borrower with any other financial or insurance product;
 - f) Prohibits the lender from referring the borrower to anyone for purchase of annuity or other financial product;
 - g) The lender must provide a prospective borrower with a list of not fewer than 10 United States Department of Housing and Urban Development (HUD) certified counseling agencies; and,
 - h) Provides that the lender shall not accept a final and complete application for a reverse mortgage from the prospective applicant unless they first receive from the applicant certification that they have received counseling from a HUD certified counseling agency.

- 2) No reverse mortgage loan application shall be taken by a lender unless the loan applicant, prior to receiving counseling, has received from the lender the following plain language statement in conspicuous 16-point type or larger font, advising the prospective borrower about counseling prior to obtaining the reverse mortgage loan:

IMPORTANT NOTICE TO REVERSE MORTGAGE LOAN APPLICANT

A REVERSE MORTGAGE IS A COMPLEX FINANCIAL TRANSACTION. IF YOU DECIDE TO OBTAIN A REVERSE MORTGAGE LOAN, YOU WILL SIGN BINDING LEGAL DOCUMENTS THAT WILL HAVE IMPORTANT LEGAL AND FINANCIAL IMPLICATIONS FOR YOU AND YOUR ESTATE. IT IS THEREFORE IMPORTANT TO UNDERSTAND THE TERMS OF THE REVERSE MORTGAGE AND ITS EFFECT. BEFORE ENTERING INTO THIS TRANSACTION, YOU ARE REQUIRED TO CONSULT WITH AN INDEPENDENT LOAN COUNSELOR. A LIST OF APPROVED COUNSELORS WILL BE PROVIDED TO YOU BY THE LENDER. SENIOR CITIZEN ADVOCACY GROUPS ADVISE AGAINST USING THE PROCEEDS OF A REVERSE MORTGAGE TO PURCHASE AN ANNUITY OR RELATED FINANCIAL PRODUCTS. IF YOU ARE CONSIDERING USING YOUR PROCEEDS FOR THIS PURPOSE, YOU SHOULD DISCUSS THE FINANCIAL IMPLICATIONS OF DOING SO WITH YOUR COUNSELOR AND FAMILY MEMBERS.

- 3) Pursuant to Civil Code Section 1923.5, no reverse mortgage loan application shall be taken by a lender unless the lender provides the prospective borrower, prior to his or her meeting with a counseling agency on reverse mortgages, with a written checklist, or in the event that the prospective borrower seeks counseling prior to requesting a reverse mortgage loan application from the reverse mortgage lender, the counseling agency shall provide the prospective borrower with a written checklist. The written checklist shall conspicuously alert the prospective borrower, in 12-point font or larger, that he or she should discuss with the agency counselor the following issues:
 - a) How unexpected medical or other events that cause the prospective borrower to move out of the home, either permanently or for more than one year, earlier than anticipated will impact the total annual loan cost of the mortgage.
 - b) The extent to which the prospective borrower's financial needs would be better met by options other than a reverse mortgage, including, but not limited to, less costly home equity lines of credit, property tax deferral programs, or governmental aid programs.
 - c) Whether the prospective borrower intends to use the proceeds of the reverse mortgage to purchase an annuity or other insurance products and the consequences of doing so.
 - d) The effect of repayment of the loan on non-borrowing residents of the home after all borrowers have died or permanently left the home.
 - e) The prospective borrower's ability to finance routine or catastrophic home repairs, especially if maintenance is a factor that may determine when the mortgage becomes payable.

- f) The impact that the reverse mortgage may have on the prospective borrower's tax obligations, eligibility for government assistance programs, and the effect that losing equity in the home will have on the borrower's estate and heirs; and,
 - g) The ability of the borrower to finance alternative living accommodations, such as assisted living or long-term care nursing home registry, after the borrower's equity is depleted.
- 4) The checklist required in paragraph (1) shall be signed by the agency counselor, if the counseling is done in person, and by the prospective borrower and returned to the lender along with the certification of counseling required under subdivision (k) of Section 1923.2, and the loan application shall not be approved until the signed checklist is provided to the lender. A copy of the checklist shall be provided to the borrower.

FISCAL EFFECT: None

COMMENTS:

The key component of AB 1700 are the requirements that a borrower must wait 7 days from the day of counseling prior to turning in a final reverse mortgage loan application, and that the lender must provide the borrower with a reverse mortgage worksheet guide that is designed to address the various responsibilities and consequences of a reverse mortgage. The justification for this 7 day cooling off period is to give time to the potential borrower to consider the issues that are discussed during counseling and highlighted in the worksheet prior to entering into the complexities of a reverse mortgage.

The vast majority of reverse mortgages are insured by the Federal Housing Administration (FHA) as part of its Home Equity Conversion Mortgage (HECM) program. The FHA insurance guarantees that borrowers will be able to access their authorized loan funds in the future (subject to the terms of the loan), even if the loan balance exceeds the value of the home or if the lender experiences financial difficulty. Lenders are guaranteed that they will be repaid in full when the home is sold, regardless of the loan balance or home value at repayment. Borrowers or their estates are not liable for loan balances that exceed the value of the home at repayment – FHA insurance covers this risk.

Today, the market for reverse mortgages is very small. Only about 2 to 3 percent of eligible homeowners choose to take out a reverse mortgage. Only about 582,000 HECM loans are outstanding as of November 2011, as compared to more than 50 million traditional mortgages and more than 17 million home equity loans and lines of credit. But reverse mortgages have the potential to become a much more prominent part of the financial landscape in the coming decades. In 2008, the first baby boomers became eligible for reverse mortgages. The baby boom generation (48- to 66-year-olds in 2012) includes more than 43 million households, of which about 32 million are homeowners. As of 2009, the median home equity for baby boomer households was \$108,000. Many boomers may find that they will need to use their home equity in order to maintain the lifestyle they expect to have in retirement.

Many of the original product design concepts for the HECM program were developed during the 1980s by private companies offering proprietary (non-government insured) reverse mortgages of various types. Throughout the 1990s, when the HECM program was still a small pilot, and again in the mid-2000s, in the midst of the housing boom, a range of proprietary products were

available in the marketplace. For most consumers, however, the HECM offered a better value. Today, only one lender offers a proprietary product, which accounts for only a handful of loans per year.

The HECM program determines how much can be borrowed based on the value of the home, prevailing interest rates, and the age of the borrower (or youngest co-borrower). The loans require no monthly mortgage payments. Interest and fees are added to the principal balance each month, resulting in a rising loan balance over time. Borrowers may remain in the home indefinitely, even if the loan balance becomes greater than the value of the home – so long as the borrower meets certain conditions. In return for this protection, and protection against the possibility that their lender fails to make loan disbursements as agreed, borrowers pay a mortgage insurance premium (MIP) to FHA.

HECM borrowers have several options as to the structure of the MIP, the interest rate type (fixed or adjustable), and the way that they receive their loan proceeds. The range of options has increased in recent years, adding to the difficulty of the choices that prospective borrowers have to make around what is already a complex product. Prospective borrowers are required to attend mandatory pre-loan counseling, but the counseling may not be sufficient to fully equip prospective borrowers to make good decisions.

A majority of reverse mortgage borrowers report satisfaction with the product. A 2006 AARP survey found that the product completely met their needs (58%) or mostly met their needs (25%). Additionally, 79% of respondents said that the reverse mortgage helped them stay in their home, and 87% said it improved their quality of life. Over the last decade more borrowers take more cash up front than in years previous. By 2008, the median borrower was taking out 88% of loan proceeds within the first year.

Reverse Mortgage Market Dynamics

The origination side of the market has more than 2,000 loan originators making 70,000 loans a year, with only five company's actively securitizing new originations. The fixed-rate lump sum product dominates with a 70% share of the market. Previously, the largest two originators were Wells Fargo and Bank of America comprising 36% of the market. Both companies exited the reverse mortgage market in 2011. The reverse mortgage industry today is a crowded marketplace with low overall loan volume. Issuers need loans to fill their securitization pipelines, but there are few borrowers. In today's market, at least half of all loans are originated through wholesale and small correspondent lenders, and borrowers are scattered across many originators.

Prior to 2009, nearly all HECMs carried adjustable interest rates. In the very early years of the program, the rates adjusted annually based on the one-year constant maturity treasury (CMT) rate. In the late 1990s, monthly adjustable loans replaced annually adjustable loans as the dominant rate option, though the monthly adjustments were calculated using the same one-year CMT rate used in calculating annually adjustable HECMs. In October 2007, FHA published a rule allowing monthly adjustable rates to be calculated using the one-month LIBOR. By mid-2009, the monthly adjustable LIBOR had become the dominant adjustable-rate option. In late 2007, a fixed-rate product previously offered by only one or two banks became more widespread, though volume remained low through 2008 and early 2009. The development of

this product was enabled through the introduction of the Ginnie Mae securitization mechanism in late 2007, and a regulatory clarification issued by FHA in early 2008 that permitted the fixed-rate product to be structured as a lump-sum, closed-end loan. In mid-2009, Fannie Mae, the longtime buyer of HECM loans, began to exit the market. The new fixed-rate, lump-sum product rocketed from less than 10% of the market to more than 60% in less than six months. Since then, fixed-rate loans have ranged between 65% and 75% of the market. The reason for this spike is a result of secondary market dynamics where premiums paid in the secondary market are more than adjustable rate products. Some of this is related to consumer demand, but also a concern by investors that adjustable rate borrowers may prepay at a faster rate than fixed rate borrowers.

California currently has the most reverse mortgages with nearly 7,000 issued just this last year; Texas and Florida follow with 4,800 and 3,300 respectively.

Costs and Fees.

- *Upfront MIP*- FHA assesses a one-time, nonrefundable initial MIP equal to 2% (HECM standard mortgage) or .01% (HECM saver) of the appraised value of home. FHA also assesses an ongoing yearly MIP equal to 1.25% of the loan balance.
- *Origination fee*- For homes valued up to \$125,000 or less, lenders may charge an origination fee of up to \$2,500. For homes over \$125,000 the allowable origination fee is 2% of appraised value but is capped at maximum of \$6,000. (Due to existing market conditions origination fees are typically waived on fixed-rate HECMs).
- *Closing costs*- Appraisal, title search, insurance, inspections, recording fees, taxes, credit checks are typically paid for with loan proceeds.
- *Counseling Fee*- Due to federal budget cuts for counseling services many counselors charge fees. HUD allows fees, but only if they are "reasonable and customary."

REPORT OF CONSUMER FINANCIAL PROTECTION BUREAU (CFPB): KEY FINDINGS

CFPB produced a comprehensive report on reverse mortgages on June 28, 2012. CFPB, under Dodd-Frank, took responsibility from the Federal Reserve on crafting further regulations for reverse mortgages. CFPB has said that it will use the report to craft upcoming regulations. CFPB is planning a project to "improve and integrate" disclosure requirements under the Truth in Lending Act and Real Estate Settlement Procedures Act specifically related to reverse mortgages. To that end, the agency said, the CFPB will consider measures the Federal Reserve Board had proposed in 2010 — before Dodd-Frank transferred consumer policy to the bureau. That proposal would have imposed limits on misleading advertising by reverse mortgage providers, and strengthened restrictions related to cross-selling of reverse mortgage products.

- 1) Reverse mortgages are complex products and difficult for consumers to understand.
 - a) Lessons learned from the traditional mortgage market do not always serve consumers well in the reverse mortgage market. The rising balance, falling equity nature of reverse

mortgages is particularly difficult for consumers to grasp;

- b) Recent innovation and policy changes have created more choices for consumers, including options with lower upfront costs. However, these changes have also increased the complexity of the choices and tradeoffs consumers have to make; and,
 - c) The tools – including federally required disclosures – available to consumers to help them understand prices and risks are insufficient to ensure that consumers are making good tradeoffs and decisions.
- 2) Reverse mortgage borrowers are using the loans in different ways than in the past, which increase risks to consumers.
- a) Reverse mortgage borrowers are taking out loans at younger ages than in the past. In FY2011, nearly half of borrowers were under age 70;
 - b) Taking out a reverse mortgage early in retirement, or even before reaching retirement, increases risks to consumers. By tapping their home equity early, these borrowers may find themselves without the financial resources to finance a future move – whether due to health or other reasons;
 - c) Reverse mortgage borrowers are withdrawing more of their money upfront than in the past. In FY2011, 73 percent of borrowers took all or almost all of their available funds upfront at closing. This proportion has increased by 30 percentage points since 2008. Borrowers who withdraw all of their available home equity upfront will have fewer resources to draw upon to pay for everyday and major expenses later in life. Borrowers who take all of their money upfront are also at greater risk of becoming delinquent on taxes and/or insurance and ultimately losing their homes to foreclosure;
 - d) Fixed-rate, lump-sum loans now account for about 70 percent of the market. The availability of this product may encourage some borrowers to take out all of their funds upfront even though they do not have an immediate need for the funds. In addition to having fewer resources to draw upon later in life, these borrowers face other increased risks. Borrowers who save or invest the proceeds may be earning less on the savings than they are paying in interest on the loan, or they may be exposing their savings to risky investment choices. These borrowers also face increased risks of being targeted for fraud or other scams; and,
 - e) Reverse mortgage borrowers appear to be increasingly using their loans as a method of refinancing traditional mortgages rather than as a way to pay for everyday or major expenses. Some borrowers may simply be prolonging an unsustainable financial situation.
- 3) Product features, market dynamics, and industry practices also create risks for consumers.
- a) A surprisingly large proportion of reverse mortgage borrowers (9.4%) are at risk of foreclosure due to nonpayment of taxes and insurance. This proportion is continuing to increase;

- b) Misleading advertising remains a problem in the industry and increases risks to consumers. This advertising contributes to consumer misperceptions about reverse mortgages, increasing the likelihood of poor consumer decision-making;
 - c) Spouses of reverse mortgage borrowers who are not themselves named as co-borrowers are often unaware that they are at risk of losing their homes. If the borrowing spouse dies or needs to move, the non-borrowing spouse must sell the home or otherwise pay off the reverse mortgage at that time. Other family members (children, grandchildren, etc.) who live with reverse mortgage borrowers are also at risk of needing to find other living arrangements when the borrower dies or needs to move;
 - d) The reverse mortgage market is increasingly dominated by small originators, most of which are not depository institutions. The changing economic and regulatory landscape faced by these small originators creates new risks for consumers;
- 4) Counseling, while designed to help consumers understand the risks associated with reverse mortgages, needs improvement in order to be able to meet these challenges.
- a) Reverse mortgages are inherently complicated, and the new array of product choices makes the counselor's job much more difficult. Counselors need improved methods to help consumers better understand the complex tradeoffs they face in deciding whether to get a reverse mortgage;
 - b) Funding for housing counseling is under pressure, making access to high-quality counseling more difficult. Some counselors may frequently omit some of the required information or speed through the material;
 - c) Some counseling agencies only receive payment if and when the reverse mortgage is closed (the counseling fee is paid with loan proceeds), which could undermine counselors' impartiality;
 - d) Some borrowers may not take the counseling sessions seriously. Additional consumer awareness and education may be necessary;
 - e) Counseling may be insufficient to counter the effects of misleading advertising, aggressive sales tactics, or questionable business practices; and,
 - f) Stronger regulation, supervision of reverse mortgage companies, and enforcement of existing laws may also be necessary.
- 5) Some risks to consumers appear to have been adequately addressed by regulation, but remain a matter for supervision and enforcement, while other risks still require regulatory attention.
- a) Cross-selling, previously a top consumer protection concern, appears to have been considerably dampened as a result of federal legislation, though some risks remain. Strong supervision and enforcement is necessary to ensure that industry participants abide by existing laws;

- b) The risk of fraud and other scams is heightened for this population. Vigorous enforcement is necessary to ensure that older homeowners are not defrauded of a lifetime of home equity;
- c) Special disclosures are required for reverse mortgages, but existing disclosures are quite difficult for consumers to understand; and,
- d) There are general prohibitions against deceptive advertising, but there are no specific federal rules governing deceptive advertising with respect to reverse mortgages.

On October 14, 2012, The New York Times reported, *A Risky Lifeline for Elderly is Costing Some Their Homes*, on the growing risks of reverse mortgages as the market has become flooded with small brokers, including former subprime lenders. The article highlighted many of the same issues found in the CFPB report. For example, seniors not understanding the risks associated with the product such as fees, mandatory upkeep of property taxes and maintenance. Additionally, they highlighted how some seniors were encouraged to make their older spouses the sole borrower on the loan, which can earn brokers larger fees if the older spouse is the only borrower. The jeopardy in this approach is that if the sole borrower dies, the non-borrower occupant of the property loses all rights to stay in the home. This is a risk that CFBP found was often not highlighted sufficiently in the reverse mortgage counseling process.

Arguments in support.

Consumers Union writes:

AB 1700 is necessary because senior homeowners in California who are reverse mortgage eligible are being targeted and aggressively marketed to by the reverse mortgage industry, and they need more information to fully appreciate the consequences of purchasing a reverse mortgage when it may be an inappropriate choice. Sellers know the barriers to entry are low, the consequences for peddling an inappropriate reverse mortgage are negligible, if any, and the profit potential is large. As a result, the sales pitches being employed are highly sophisticated. The ads directed at seniors focus primarily on the "positive parts" of reverse mortgages and down play, or altogether avoid mentioning any negative aspect of these expensive loans. It is unrealistic to think it would be otherwise since it is not in the lenders' interest to have borrowers dwell on suitability issues or contemplate the ramifications of having a loan that depletes equity.

Marketers of reverse mortgages have been erroneously telling seniors that borrowers never have to worry about leaving their homes. This is not true. There is much to worry about. Defaults occur when borrowers fail to make their insurance or property taxes payments, and for failure to keep up with the maintenance of their homes. Failure to meet these obligations will lead to default on the loans. There are currently more than 54,000 reverse mortgages in default. This represents 10% of the reverse mortgages that have been sold since 2007.

Because reverse mortgage decision-making involves a number of complex issues, before committing to a loan every senior should contemplate possible negative consequences. While reverse mortgages may have attractive features, seniors need to be wary of the

possible downsides and understand that some product aspects may make them unsuitable for a senior's needs and long-term financial objectives. Whether a loan is "suitable" or right for the borrower who is considering it can only be determined by looking at the totality of that particular borrower's circumstances, goals, and needs. The AB 1700 pre-counseling worksheet would help make these issues more transparent, giving potential borrowers the full picture before committing to a reverse mortgage.

Previous legislation.

AB 329 (Feuer), of 2009 provided that a lender or any other person that participates in the origination of a reverse mortgage shall not participate in, or be associated with, or employ any party that participates in or is associated with any other financial or insurance activity, unless the lender maintains certain safeguards or refer prospective borrowers to anyone for purchase of financial or insurance products. (Chapter 236, Statutes of 2009)

AB 553 (Medina) of 2013, was very similar to AB 1700 except that it required that the potential borrower not received counseling until at least seven days elapsed since their contact with the lender. (Died in Assembly Banking & Finance, pursuant to Art. IV, Sec. 10(c) of the Constitution)

REGISTERED SUPPORT / OPPOSITION:

Support

Center for Responsible Lending
Consumers Union
California Retired Teachers Association (CalRTA)
California Advocates for Nursing Home Reform (CANHR)
Consumer Federation of California
AARP

Opposition

None on file.

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