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Navigating in Reverse

Opportunity abounds in the reverse-mortgage niche – if you know the laws that apply

Illustration: Dennis Wunsch

THE CHANGING REGULATORY ENVIRONMENT touches almost every aspect of the mortgage industry. Reverse mortgages are no exception.

Brokers looking to develop a reverse-mortgage niche must understand a complex web of state and national regulations pertaining to loan origination and licensing. Here's how to sort them out.

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Reverse mortgages are fundamentally transactions secured by residential real estate. That means most laws — state and federal — applying to "forward" mortgage transactions also apply to reverse-mortgage transactions.

As the name suggests, in a reverse mortgage, payments essentially are reversed. This loan structure allows homeowners ages 62 years and older to borrow against the equity in their home on a nonrecourse basis. The loans aren't required to be repaid until a specific maturity events occur, such as the borrowers dying, selling the home or permanently vacating it.

Eligible homeowners may receive funds through a reverse mortgage in a number of ways, including monthly payments, a line of credit or both. They also may remain in their home as long as they're alive, continue to pay their property taxes and insurance, and maintain the home.

Under the Federal Housing Administration (FHA) Home Equity Conversion Mortgage (HECM) program, prior to completing a loan application, reverse borrowers must receive counseling from a U.S. Department of Housing and Urban Development (HUD)-approved agency.

Almost all reverse mortgages originated today are FHA-insured HECMs. Though some non-HECM programs exist, several loan-limit increases to the HECM program — first to $417,000 in 2008 and then to $625,500 earlier this year — make HECM loans competitive with any conventional loan brokers might wish to offer. The FHA updates HECM regulations in the Code of Federal Regulations.

HUD also created a HECM handbook and has issued numerous mortgagee letters to further guide the HECM program. Mortgage brokers who work with HECMs should become familiar with government documents about these types of loans (see sidebar) — and they must, at a minimum, be FHA-approved loan correspondents to originate HECMs. They also should know what documentation the loans require and what is customary and mandated.

Required disclosures

Reverse mortgages are consumer-credit transactions, for purposes of the federal Truth in Lending Act (TILA), and also are

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"federally related mortgage loans," for purposes of the Real Estate Settlement Procedures Act (RESPA). Exceptions for reverse mortgages structured as open-end credit exist under RESPA for certain disclosure requirements, such as the good-faith estimate and HUD-1.

Despite the exceptions, HECM regulations require that some of these disclosures — the HUD-1, for example — be given, and lenders typically provide other RESPA-related disclosures, as well.

Traditionally, most HECMs were offered as open-end credit, as defined by TILA. But it is now common for brokers to structure HECMs as fixed-rate, closed-end credit.

Under TILA, in addition to the general disclosures for consumer credit, creditors also must provide a total-annual-loan-cost disclosure for open- and closed-end reverse mortgages.

The annual-loan-cost rate combines all reverse-mortgage costs and converts them into a single annual rate. This makes comparative shopping for reverse mortgages easier for consumers. Special rules in TILA Appendix K explain how to calculate this rate. These rules are similar to the rules in Appendix J that explain the calculation for annual percentage rate (APR).

Brokers also must provide the federal Truth in Lending disclosure statement for closed-end reverse mortgages or the "Important Terms of Home Equity Line of Credit" disclosure for open-end credit.

State laws

Not all states have specific statutory or regulatory requirements for reverse-mortgage transactions or brokers. But several do.

State laws or regulations with specific requirements for reverse-mortgage transactions generally fall in three categories:

1. **Comprehensive statutory or regulatory schemes for the approval of originators,** as well as disclosures to reverse borrowers and substantive requirements or limitations on origination and lending practices
2. **Originator-approval or loan-program-approval requirements,** without detailed loan-program requirements

> ## On the Web
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> The Federal Housing Administration (FHA) Home Equity Conversion Mortgage (HECM) program is authorized by section No. 255 of the National Housing Act. The FHA issues and updates HECM regulations in the Code of Federal Regulations.
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> • The U.S. Department of Housing and Urban Development maintains HECM handbook 4235.1: sctsm.in/HECMhand
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> • More HECM info: sctsm.in/HECMmain

3. **Substantive requirements or limitations**

The laws of North Carolina, New York, Tennessee, Rhode Island and Washington state are examples of the first category of comprehensive schemes — although New York's laws and regulations specifically exempt HECMs. Massachusetts might fit into this category, as well, except that its laws don't require brokers to obtain separate regulatory approval at the entity level. Massachusetts, however, does require state-regulator approval for reverse-mortgage programs.

Iowa and Hawaii are examples of the broker- or program-approval category, though neither has laws that apply to FHA-approved lenders. Next year, Hawaii will require licenses for mortgage servicers, including reverse-mortgage servicers.

California is an example of the substantive-limitation category. A chapter in the California Civil Code defines a reverse-mortgage transaction and allows certain practices but limits others, including prohibiting lenders from requiring that reverse-mortgage applicants purchase an annuity as a condition of obtaining a reverse-mortgage loan.

Federal regulations also prohibit a lender or anyone who helps originate HECMs from participating in, associating with or employing any party that takes part in or associates with any other financial or insurance activity, unless it can be demonstrated to HUD that specific firewalls and safeguards exist. Federal rules also prohibit requiring reverse borrowers to purchase insurance, annuities or similar products as a condition of obtaining a HECM. Exceptions exist for title insurance; hazard, flood or other peril insurance; or similar products that HUD deems customary and normal.

State disclosures

In California, lenders must provide a pre-closing disclosure to reverse borrowers, informing them that:

- **Reverse mortgages are complex financial transactions;**
- **They must consult an independent loan counselor;** and
- **They should discuss their decision with family members** or others on whom they rely for financial advice.

As of press time, several bills are pending in the California Legislature that would add requirements regarding reverse mortgages, including that originators act honestly, in good faith and fairly toward potential borrowers. The bills also would add new disclosure requirements, including a checklist of items that borrowers should address with counselors before a reverse-mortgage transaction. They also would change delivery-timing requirements for mandated reverse-mortgage disclosures.

Arkansas, Delaware, Maine, Nebraska, South Carolina, South Dakota, West Virginia and Wisconsin are among the other states that have laws or regulations addressing reverse mortgages. Arkansas, for instance, requires a disclosure similar to that mandated in California. It also regulates reverse mortgages under the same high-cost-loan law as other mortgages made inside the state.

Reverse mortgages in Arkansas are subject to the same APR and point-and-fee thresholds as other loans.If one or both of those ceilings are broken, a reverse mortgage is considered a high-cost home loan, unless:

- **Within 60 days after closing,** the loan

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will be insured by, securitized or sold to a government agency or government-sponsored enterprise, including HUD, the Department of Veterans Affairs, Fannie Mae, Freddie Mac, the Rural Housing Service or the Arkansas Development Finance Authority; or

- **The lender can demonstrate in good faith** that the loan was intended to be so insured by, securitized or sold to a government agency or government-sponsored enterprise. Fannie Mae, however, indicated that it will not allow seller-servicers to rely upon this exception. As the largest secondary-market investor in HECMs, Fannie's stance impacts the market widely.

Illinois' high-cost-home-loan law, meanwhile, provides an exemption for home-secured, open-end lines of credit and does not specifically exempt reverse mortgages.

Licensing

Mortgage brokers also should know that unless an exemption applies, state laws affecting "forward" mortgage lending also apply to conducting reverse-mortgage operations. State lending laws have requirements that fit in one of four categories:

1. **Requirements for loan disclosures**
2. **Limits on or requirements regarding origination or lending practices**
3. **High-cost-home-loan limits,** which can be predatory-lending statutes or regulations — although most states' laws regarding high-cost home loans don't apply to reverse mortgages
4. **Regulatory approvals,** such as company and loan-officer licensing

As a result of the Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E. Act) and related individual state legislation, brokers must pay attention to the changes in loan-originator licensing. Even brokers who only work with reverse mortgages must follow licensing rules set forth in the S.A.F.E. Act.

When it comes to legal and regulatory compliance, reverse mortgages are first and foremost consumer-mortgage loans, meaning nearly all laws and regulations applying to traditional mortgage brokers also apply to brokers of reverse mortgages.

Brokers who intend to work with this growing niche must understand all state and federal regulations that apply. Reverse mortgages represent an important product to many homeowners. Brokers who make it their business to master the origination of such loans — and who do so ethically and with careful attention to legal requirements — could find themselves in high demand. •