AARP®

August 15, 2006

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve Board
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Regs.comments@federalserve.gov

Docket no: OP-1253

Dear Ms. Johnson:

AARP commends the effort the Federal Reserve Board and its staff made in conducting the public hearings to gather information on how to ensure sustainable homeownership and consumer choice.

Homeownership not only supplies families with shelter, it also provides a way to build wealth and economic security. Unfortunately, too many homeowners are losing their homes, as well as the wealth they spent a lifetime building, because of harmful lending practices. Some lenders target elderly and other vulnerable consumers, and use an array of practices to strip equity from their homes or products that increase the risk of making loans unaffordable.

The ability to repay may be the single most important factor in determining whether a mortgage loan is abusive. Yet mortgage lenders and secondary market purchasers seem increasingly willing to downplay time-tested methods for obtaining information and verification of the ability to repay. While unaffordable lending was once reserved to the refinance market, it has now made its way into the home purchase market. AARP is concerned that several trends in the subprime mortgage market have begun to undermine the essential element of credit underwriting and may well lead to a far greater risk of default and foreclosure.

For many years, older homeowners in the subprime market have been victimized by mortgage brokers and lenders who inflated their income by manufacturing careers and false tax returns to verify income that did not exist. Fro example, in a case that was tried in 2003, a lender and mortgage broker papered over the real lives of six elderly homeowners by contriving computer-generated tax returns that claimed the homeowners were accountants and bookkeepers and attributed $8000-$30,000 of self-employment income to them. In one particularly striking case, the false tax return claimed that an 86 year old stroke victim, who had been a janitor during his working life, was “reborn” as a computer programmer with an additional $29,000 of self-employment income. Notably, these income verifications were contrived to comply with the underwriting guidelines of the secondary market purchasers of these mortgages who imposed debt-to-income requirements.[1]

While these fraudulent practices have been at play in the subprime market for some time, AARP has noted some alarming trends in recent years that seem to be supported – indeed sponsored by – the secondary market underwriting. We have noted, for example, a marked increase in the number of "low" or "no documentation" mortgages. While "no doc" loans have been available for some years, the number and variety of these loans have proliferated. We have seen middle income borrowers with readily verifiable income placed into "stated income" loans that are substantially more expensive than those that are fully documented. As a result of the secondary market relaxing its standards on documentation, it is no longer even necessary for the lender or broker to manufacture income verifications. They simply inflate the statement of income on the loan applications, resulting in qualifying borrowers for mortgages they cannot afford.

More troubling still is the secondary market sponsorship of the "no income, no asset" mortgages (called NINA loans) through which borrowers are "qualified" for mortgages despite the fact that the lender collects no information of any kind about their income or assets. The section of the standard Form 1003 on income and assets is simply *blank*. AARP attorneys have learned in discovery that the borrowers are "qualified" for NINA loans based on their credit reports – which, of course, contain no information about their income or assets. The lenders write the mortgages to the secondary market guidelines. To offset the risk of buying a mortgage that essentially disregards income, the secondary market entities require minimum credit scores (e.g., 640+ range) and lower loan-to-value ratios. These safeguards, however, do not protect the consumer from the risk of default on a loan he or she cannot afford.

The documentation issues are only one source of the increased risk. Non-traditional mortgage products such as option ARMS or interest only mortgages have become popular in the prime and subprime market because they offer home purchasers the opportunity to buy houses they could not afford with a traditionally amortizing loan. Many lenders do not underwrite these mortgages based on the maximum possible payment. Indeed, to do so would, to a large extent, eliminate their usefulness. Tens of thousands of these mortgages have interest rates that will reset in the near future. The risk inherent in them is obvious: homeowners who have chosen the minimum monthly payment and/or whose interest rate adjusts upward just as payments on principal are added to the monthly obligation frequently suffer serious payment shock. If the home

[1] The debt-to-income (DTI) ratios were typically quite lenient (e.g. 50%) but they did exist. In addition to these DTI maximums, there are and were residual income requirements that state that after the mortgage is paid, there must be a certain number of dollars remaining per household member. These are crucial for low and moderate income people for whom a mortgage payment equal to 50% of their monthly income may well leave the family with very little to live on.

has retained or increased in value *and* interest rates have gone down, they may be able to refinance. If not, they may be trapped in a mortgage they cannot afford.

Our experience suggests that the documentation and payment shock issues are often exacerbated by other risk factors. We have noted an escalation of the use of simultaneously originated first and second mortgages ("piggyback mortgages"), used to qualify a borrower to purchase a home with a combined loan-to-value ratio of 80-100% without requiring private mortgage insurance. While these "piggyback" mortgages may be suitable for young professionals buying their first homes, they are singularly risky for many AARP members who are on fixed incomes. Worse yet, we have seen programs in which the piggyback mortgages are originated under NINA, stated income, and other low documentation guidelines. AARP is very concerned that this explosive combination of mortgages with 95-100% LTV's originated without regard to income will ultimately prove disastrous for homeowners.

Recommendations:

1. Assignee liability: When HOEPA was passed, it was believed that assignee liability would encourage the secondary market to police the originators. Unfortunately, high risk, non-traditional mortgage products and "no doc" programs are often created and promoted by the secondary market. Indeed, there are an increasing number of lawsuits that have made direct claims against assignees. In light of these developments, we urge that HOEPA's crucial assignee liability provisions not be eroded but remain intact.

2. The risks inherent in many of the exotic mortgage products, NINA and no documentation mortgages grow exponentially in the context of HOEPA loans. We urge the Board to exercise its discretion under 15 U.S.C. 1639(I)(2) to prohibit the use of these non-traditional mortgage products and documentation methods in HOEPA loans.

Thank you for the opportunity to comment. Also, for your information, attached is AARP's previous statement to the Board on reverse mortgages provided at the June 16th, 2006, hearing in San Francisco.

Sincerely,

David Certner
Legislative Counsel and
Director, Legislative Policy

STATEMENT

BEFORE THE

BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

ON

REVERSE MORTGAGES

June 16, 2006
THE FEDERAL RESERVE BANK OF SAN FRANCISCO
101 MARKET STREET, SAN FRANCISCO, CA

WITNESS: Bronwyn Belling
Manager, Reverse Mortgage Education Project,
AARP Foundation

For further information, contact:
Roy Green
AARP Federal Affairs
(202) 434-3800

Good afternoon. My name is Bronwyn Belling, and I manage the AARP Foundation's Reverse Mortgage Education Project, which is funded by HUD and the AARP Foundation. In the 1980s, AARP spearheaded the effort to enact the federally insured Home Equity Conversion Mortgage (HECM) program. Since then, AARP and the AARP Foundation have worked to improve the program's counseling and disclosure requirements, which will be the focus of my comments today.

Reverse Mortgage Counseling

The single most important consumer safeguard in the reverse mortgage market is the counseling required by the HECM program. Over the past five years, the AARP Foundation's counseling project has developed a variety of tools to improve HECM counseling, including:

- basic and advanced counselor training,
- a rigorous national exam for HECM counselors,
- a detailed protocol of HECM-specific counseling policies and procedures,
- generic consumer information on HECM loans and other alternatives,
- model software for analyzing and comparing reverse mortgages,
- a multi-faceted program of counselor backup and support, and
- counseling evaluation by way of a client satisfaction survey.

Homeowners counseled by a select network of exam-qualified counselors who follow our counseling protocol have given consistently high marks to this counseling. While less than a third of these clients considered themselves to be well-informed about reverse mortgages before counseling, more than 9 out of 10 said they were well informed after counseling.

HUD has steadily increased the amount of funding to pay for counseling by these exam-qualified network counselors. It has also incorporated parts of the project's counseling protocol into its requirements for all HECM counselors. In the near future, we hope that HUD will require all HECM counselors to pass the exam and build more of the protocol into its requirements for all HECM counselors.

We support HUD's efforts to obtain significantly more funding for this high-quality HECM counseling and, until it is obtained, to permit counseling agencies to charge clients a modest fee for counseling if it is provided by exam-qualified counselors who follow a detailed counseling protocol. Until reliably sufficient funding is found, however, we are concerned that lenders and agencies may be tempted to create financial relationships that may compromise the independence and quality of the counseling.

Reverse Mortgage Cost Disclosures

Reverse mortgages can be very expensive. A HECM borrower at the average age of 74 with a home value equaling $362,790 or more could receive a creditline of approximately $209,000 this week in San Francisco. The total upfront costs on this loan could be about $16,900. In addition, the ongoing monthly fees could be about $16,600. So the total costs - not including interest - could be about $33,500. For some borrowers, these non-interest costs could be even greater, exceeding $50,000 in some cases.

Consumers need to understand all the costs of these loans. In particular, they need to see the total projected cumulative cost of all ongoing monthly servicing fees and HECM insurance premiums. The method and assumptions for projecting the future dollar amount of these charges should be the same as those prescribed by Regulation Z for calculating Total Annual Loan Cost (TALC) rates.

We also need to correct the way that origination fees are disclosed to avoid misleading consumers. On other loans, this fee is expressed as a percent of the actual ***loan amount***. But on HECMs, HUD limits this fee to 2 percent of the ***home's value*** or a ***HUD limit*** for the county in which the home is located, whichever is less. Many HECM consumers nonetheless assume that their origination fees are 2 percent of their loan amounts. So they are surprised to learn that a HECM origination fee - when expressed as a percent of the maximum loan amount at closing - currently ranges from about 2.3 percent to 3.9 percent, which means that it more than doubles and may nearly quadruple the 1 percent origination fee charged on HUD's "forward" mortgages. All reverse mortgage origination fees, therefore, should be disclosed as a percent of the maximum loan amount at closing.

Thank you for the opportunity to comment on these matters. We will be submitting a supplementary statement providing more information on HECM counseling and reverse mortgage cost disclosures.

Analyzing the Cost of Home Equity Conversion Mortgages (HECMs)

A borrower of average age (74) living in a San Francisco home worth the largest value that can be used to determine loan amounts in the HECM program ($362,790) could get a HECM creditline of $209,151 on June 13, 2006. The upfront costs on this loan would be $7,256 for the HECM upfront mortgage insurance premium (MIP), up to another $7,256 for an origination fee, and an estimated $2,387 in third-party closing costs. So the total upfront fees could be about $16,899.

HECM borrowers also must pay a monthly servicing fee (limited to $35) and a monthly mortgage insurance premium (MIP) that equals 0.04167 percent of the loan balance. Assuming this borrower lives to the remaining life expectancy (12 years) prescribed by federal Truth-in-Lending disclosures for HECM loans, she would pay $5,040 in servicing fees (144 months x $35 = $5,040). The total amount of her monthly MIPs would depend on the timing and amounts of her creditline draws. The assumed creditline withdrawal pattern prescribed by federal Truth-in-Lending disclosures for HECM loans is a draw at closing equaling 50 percent of the available amount, and none thereafter. Using this assumption, this borrower would incur $11,609 in monthly MIP charges.

Table 1: Total HECM Fees until Life Expectancy for a 74-year-old San Francisco Borrower in $362,790 Home*

Loan Fee	**HUD Limit or Specification**	**Amount**
Origination Fee	Limited to 2% of home value or HUD's county equity limit, whichever is less	$7,256
Upfront Mortgage Insurance Premium (MIP)	Equals 2% of home value or HUD's county equity limit, whichever is less	$7,256
Third-Party Closing Costs	Limited to "customary & reasonable"	$2,387**
Monthly Servicing Fees	Limited to $35 per month	$5,040***
Monthly MIP	Equals 0.04167% of loan balance each month	$11,609***
	TOTAL FEES =	**$33,545**

* The average HECM borrower in FY 2005 was 73.8 years old.

** Estimate provided by national HECM lender; actual figures range from less than $2,000 to more than $6,000

*** Assuming borrower lives to the remaining median life expectancy (12 years) for a 74-year-old and withdraws 50 percent of the available loan amount at closing, which is the creditline usage pattern prescribed by Truth-in-Lending law for HECM disclosures. In this loan, the amount withdrawn from the HECM creditline at closing is $104,576, which is 50 percent of the available creditline amount. The assumed interest rate is the one that was in effect on 6/13/06, which was 6.54 percent. For additional information see the Methodological Note on page 7.

Table 2 shows all the costs on the HECM loan from Table 1. The "Loan Fees" column shows that the fees of $33,545 from Table 1, when added to the loan balance, generate $27,684 in interest charges over the 12 years of the 74-year-old borrower's remaining life expectancy.

The "Loan Advances" column shows that a creditline cash advance of $104,576 to the borrower at closing generates another $124,163 in interest charges. So at the end of the loan, the homeowner has borrowed $104,576, but now also owes $33,545 in loan fees plus $151,847 in total interest charges for a total cost of $185,392 – which is 177 percent of the loan amount ($104,576). The loan balance (amount owed) at this time is $289,968.

Table 2: Total HECM Fees, Interest, and Loan Advances until Life Expectancy for a 74-year-old San Francisco Borrower in $362,790 Home*

	Loan Fees	Loan Advances	TOTAL
Principal	$33,545	$104,576	$138,121
Interest	$27,684	$124,163	$151,847
TOTAL =	$61,229	$228,739	$289,968

* See Table 1 for details about this loan.

HECM costs depend on a variety of factors. Table 3 illustrates the impact of two key variables, showing that the costs for the loan in Tables 1 and 2 would be greater if:

- the home is located in an area with larger third-party closing costs; and
- the borrower is younger.

Table 3 shows the total costs

- in the areas with the largest third-party closing costs (Broward, Collier, Palm Beach, and Miami-Dade counties in Florida);
- for the youngest eligible HECM borrower (age 62).

Table 3: HECM Loan Costs for a 62-Year-Old Borrower Living in a $362,790 Home in Four Counties in Florida*

Loan Cost	Amount
Origination Fee	$7,256
Upfront Mortgage Insurance Premium (MIP)	$7,256
Third-Party Closing Costs*	$6,657
Monthly Servicing Fees**	$8,400
Monthly MIP**	$22,507
TOTAL FEES =	**$52,076**
TOTAL INTEREST =	**$294,409**
TOTAL COSTS =	**$346,485**
Loan Advance Amount =	**$78,763**
Total Amount Owed =	**$425,248**

*Actual third-party closing costs on a $362,790 home in Broward, Collier, Palm Beach, and Miami-Dade counties in Florida, according to a major national HECM lender

** Assuming borrower lives to the remaining median life expectancy (20 years for a 62-year-old) and follows the creditline usage pattern prescribed by federal Truth-in-Lending law for HECM disclosures, 50 percent at closing ($78,763) and none thereafter. See notes to Table 1 for additional explanation.

Methodological Note: The total of ongoing costs actually paid on the loans presented in Tables 1-3 would differ from the amounts estimated for the following reasons:

- The tables assume that the initial interest rate never changes over the life of the loan. But the interest on HECM loans is adjustable. So if the actual rate decreases, then ongoing interest and mortgage insurance premium (MIP) costs would be less, and if the actual rate increases, then ongoing interest and MIP costs would be more.
- The tables assume that the loans end when the borrowers reach their remaining median life expectancy. But some borrowers will remain in their homes longer than that, and others will leave or die sooner. The total costs for longer-lived borrowers would be greater than the estimated amounts, and the total costs for those who leave or die sooner would be less.

- The tables assume that creditline borrowers withdraw 50 percent of their available loan funds at closing and none thereafter, which is the withdrawal pattern prescribed for HECM disclosures by federal Truth-in-Lending law (as explained in the footnotes to Table 1). In reality, HUD research has found that creditline borrowers have withdrawn their available funds at a substantially earlier and greater rate. Since the amount of funds remaining available in a HECM creditline grows larger every month, this more aggressive actual withdrawal pattern would result in larger loan balances and, therefore, greater charges for interest and monthly mortgage insurance premiums.

Table 4: HECM Origination Fees as a Percent of Loan Amount

Home Value*	Age	HECM Loan Amount**	Maximum HECM Origination Fee (= 2 % of Value)	HECM Origination Fee as a Percent*** of Loan Amount	Origination Fee on FHA "Forward" Mortgage of Same Loan Amount (= 1% of Loan Amount****)
$100,000	62	$50,800	$2,000	3.9%	$508
	75	$64,800	$2,000	3.1%	$648
	95	$87,300	$2,000	2.3%	$873
$250,000	62	$127,000	$5,000	3.9%	$1,270
	75	$162,000	$5,000	3.1%	$1,620
	95	$218,250	$5,000	2.3%	$2,182
$362,790	62	$184,297	$7,256	3.9%	$1,843
	75	$235,088	$7,256	3.1%	$2,351
	95	$316,716	$7,256	2.3%	$3,167

* Assuming the home value is less than HUD's 203-b home value limit for the county in which the home is located.

** HECM principal limit assuming expected rate = 6.5 percent.

*** Percents listed may be minimums because unlike "forward" mortgages in which borrowers always receive the full loan amount at closing, a HECM borrower most often does not draw down the full loan amount at closing, and may not do so over the life of the loan. For example, a 75-year-old borrower in a $250,000 home is eligible for a loan of $162,000. If she only uses one-half of that amount ($81,000), her $5,000 origination fee would be 6.17 percent of her actual loan amount.

****http://www.hud.gov/offices/hsg/sfh/ins/203b--df.cfm