STATEMENT OF
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BEFORE THE
COMMITTEE ON AGING
UNITED STATES SENATE
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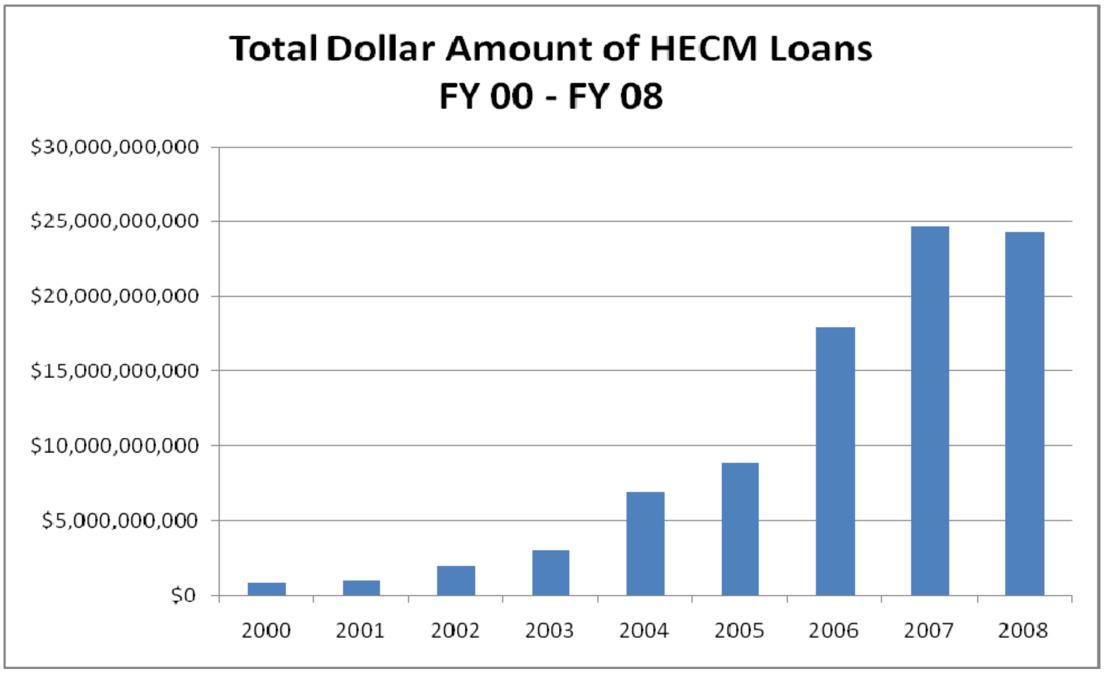
Chairwoman McCaskill, thank you for inviting me to testify today. I very much appreciate the opportunity to speak to you regarding the Federal Housing Administration's Home Equity Conversion Mortgage Program, popularly called "HECMs," or "reverse mortgages." HECMs are one of FHA's flagship mortgage loan programs. In the last few years, this FHA product has proven extremely popular.

In FY 2001, FHA endorsed only 7,757 reverse mortgages. The endorsements have increased at an exponential rate. In FY 2008, another 112,148 reverse mortgages were endorsed by FHA and demand for the product does not appear to have abated for this year.

HECM loans represent a significant investment by FHA, with considerable recent increases. The chart below shows a 253% increase in the dollar amount of HECM loans from 2004 through 2008:



FHA has insured more than $105 billion in HECM loans and it remains the premiere insurer for reverse mortgages. Furthermore, Ginnie Mae issued $228 million of HECM mortgage-backed securities in May, the highest month on record for the program.

The HUD Office of Inspector General has had some concerns about the HECM program including, among other things, any potential risk to the FHA insurance fund as home prices have devalued. These concerns are also reflected in the Department's budget for FY 2010 with a request for almost $800 million to cover potential losses due to declining home values. As you know, in cases where the value of the loan at termination is greater than the value of the insured property, FHA must make good the difference. I know the Secretary, in recent testimony, has stated his commitment to trying to keep on top of emerging issues to deal with them in an expeditious manner.

For many seniors, HECMs may be a good way to tap into equity to help pay for other expenses. The seniors most at risk are those who, because of taxes or expenses, find themselves cash-poor but with a lot of market value in their home – a home usually purchased 20 or more years ago and either owned outright or with a very low mortgage. The money available to seniors from HECMs in the form of a monthly payment, a line of credit or a lump sum payment makes these citizens a potential target of interest for shady operators. Financial exploitation of seniors, according to your Senate Committee on Aging, was around a third of all abuses specifically targeted at seniors but experts in the field know that these figures can be incomplete because many older Americans are too ashamed to admit that they were taken advantage of by family or strangers.

Several factors have increased the potential vulnerability of the HECM program to fraud. First, the recent and substantial popularity of the HECM program has brought many more people to the program, and turned it from a specialty item into a mainstream loan product. Second, the recently increased loan limits for HECMs to $625,500, have not only made HECMs viable in many new market areas, it may also be making them more lucrative for misdeeds as their previous limit increased significantly from $362,790. Third, certain systemic vulnerabilities, which we describe in greater detail later in our testimony, have all made the HECM program somewhat more attractive, and therefore potentially more susceptible, to perpetrators of fraud.

Let me describe some of the loan schemes we have discovered through our investigations and audits:

- **Unauthorized Recipient –** Unauthorized individuals, including family members, friends or even neighbors, may keep HECM payments after the authorized recipient dies or permanently leaves the residence. In a recent HUD OIG audit, it was found that FHA did not ensure that lenders reported borrowers' deaths in accordance with federal requirements. For the 31 loans reviewed, the contractor failed to provide documentation to support that FHA lenders notified HUD of borrowers' deaths in writing. Further, the lenders failed to notify the contractor of borrowers' deaths for 11 of the 31 loans and, for 13 loans, did not report in a timely manner the dates of borrowers' death.

- **Annuities and Financial Cross-Selling** - Another activity that we currently have under investigation involves financial professionals convincing HECM borrowers to invest HECM proceeds in a financial product, such as an annuity, in an improper way. The financial professionals receive increased fees and, in the case of annuities, the victims are unable to get access to their savings for many years or even past their projected life expectancy. We are pleased that HUD, reacting to such cases, has enacted rules to prevent cross-selling. We, however, remain concerned that HECM borrowers may still be vulnerable to various cross-selling techniques and stratagems.

- **Consumer Fraud –** In a similar vein, just in the last couple of weeks, an OIG investigation led to an indictment in Maryland as a result of our participation in a local Elders Task Force. An elderly woman complained that her former health insurance representative stole approximately $200,000 from her HECM by convincing her that she needed to pay him a fee to process her loan application and to repay him the reverse mortgage loan amount. He told the victim she had to repay the loan by writing personal checks to him and she paid from funds received as well as from her retirement annuity and from cash advances on her credit card. We are currently in the process of identifying more reverse mortgage victims.

- **Recruitment of Straw Buyers and Property Flipping** - In several parts of the country, most notably in the upper Midwest and the Southeast, we have observed various solicitation efforts directed at recruiting "straw buyers" age 62 or over to act as "nominees" or "fronts" for certain HECM schemes. Typically, potential straw buyers are lured by the promise to "live rent-free for the rest of your life," or "seniors get a free house through a government program." In some cases, the straw buyers are not fully aware of the nature of the scheme. Straw buyers are "recruited" in residential areas with a high rate of renters. Often, the straw buyers are public housing residents or even homeless individuals. Since there are no specific credit or income requirements for HECMs, it is relatively easy to recruit eligible individuals.

  Typically, the scheme works in the following manner:

  Organizers obtain abandoned, foreclosed, or dilapidated properties for little money. They may apply some cosmetic improvements to the house. An inflated valuation or appraisal is obtained. This creates the basis for a larger HECM loan. The house is then quit-claimed to one of the straw buyers who have been recruited for the scheme. The quit claim deed is accompanied by some mechanism from which the scheme organizer is able to draw out the HECM proceeds.

  In some cases, the mechanism is a promissory note executed by the straw buyer. In other schemes, it is a lien incorporated in the quit claim deed. And, in other situations, the mechanism is some form of mortgage created to justify a payout. The organizer may create a fake mortgage company, which "lends" funds to the borrower (no money changes hands, no loan is given, but a mortgage is filed). The subject refinances the borrower into a HECM. At closing the title company pays all outstanding debt including the fraud organizer's fake mortgage and the organizer walks away with the payoff. In essence, the property has been "flipped."

  Once the straw buyer occupies the home, an application is made for a HECM. When the HECM is endorsed, the straw buyer requests a lump sum payout, which goes in whole, or in part, to the scheme organizers. The straw buyer is typically left in possession of the property. Some straw buyers are unaware that the cash due to them at closing has been diverted. The straw buyers are also often unaware that they must pay property taxes and other fees and costs associated with residing in, and maintaining, the property. In many cases, they do not have the resources to maintain the property, or pay necessary expenses, leading to abandoned properties, properties taken over by others, and eventual defaults when discovered.

  Current cases involve hundreds of properties in which the above-described conspiracy has been employed. These schemes clearly subvert the intention of the HECM program and create liability for FHA, which must assume responsibility for these over-valued properties.

Unlike forward mortgages, HECMs require that the potential borrower receive counseling from an FHA-approved counselor. The HECM counselor could be a valuable first line of defense against fraud. We have asked FHA officials to require that HECM counselors report suspected fraud to FHA and the OIG. We have also recommended that FHA instruct counselors to withhold certificates of counseling in suspected fraud cases that would allow borrowers to proceed with the loan process.

We feel that those in the forefront of the process, counselors and mortgagees, may be able to use their positions to safeguard these vulnerable borrowers. We also believe that, in most instances, face-to-face counseling should be required, especially when the borrower indicates his/her intention to receive a lump sum payout. The current allowance for telephone counseling, which was designed under the best of intentions, unfortunately can facilitate fraud schemes such as those I have described. Finally, FHA may need to require at least basic credit and financial histories for prospective borrowers, to screen out those clearly incapable of carrying forward the terms of the HECM. These changes to the program would make the program more resistant to fraud.

Lastly, I am also proud of our success in convincing the Congress to tie fraud against the FHA into the FIRREA statute, thereby raising the penalty to 30 years in prison and $1 million in fines. I hope this will provide an overall deterrent to those who make false statements to the program.

The repercussions of the abuse I described above are long-reaching. It could mean the degradation of an older person’s happiness, self-confidence, and well-being. It also reaches to the health of the overall FHA program (a program increasingly relied on by all our citizenry during these trying economic times) as evidenced by a potential need for appropriation. The Office of Inspector General will be vigilant in its efforts to protect the funds of the American taxpayers from predatory and improper practices and to safeguard the participants in the Department’s programs and looks forward to working with you to develop legislative safeguards to ensure an effective response at this critical time.