

GAO

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# REVERSE MORTGAGES

## Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers

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Highlights of [GAO-09-812T](#), a testimony to the Senate Special Committee on Aging

## Why GAO Did This Study

Reverse mortgages—a type of loan against the borrower’s home that is available to seniors—are growing in popularity. These mortgages allow seniors to convert their home equity into flexible cash advances while living in their homes. However, concerns have emerged about the adequacy of consumer protections for this product. Most reverse mortgages are made under the Department of Housing and Urban Development’s (HUD) Home Equity Conversion Mortgage (HECM) program. HUD insures the mortgages, which are made by private lenders, and oversees the agencies that provide mandatory counseling to prospective HECM borrowers.

GAO was asked to examine issues and federal activities related to (1) misleading HECM marketing, (2) the sale of potentially unsuitable products in conjunction with HECMs, and (3) the oversight of HECM counseling providers. This testimony is based on a GAO report being released today (GAO-09-606).

## What GAO Recommends

GAO’s report made recommendations designed to address potentially misleading marketing of HECMs and improve HUD’s oversight of HECM counseling providers. The federal banking regulators agreed with the recommendations. HUD and FTC did not comment on them.

View [GAO-09-812T](#) or key components. For more information, contact Matthew J. Scire at (202) 512-8678 or [sciremj@gao.gov](mailto:sciremj@gao.gov).

# REVERSE MORTGAGES

## Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers

### What GAO Found

While HECMs have the potential to play a key role in meeting the needs of seniors facing financial hardship or seeking to improve their quality of life, the product is relatively complex and costly and the population it serves is vulnerable. GAO’s work identified areas of consumer protection that require further attention, including the area of HECM marketing. Various federal agencies have responsibility for protecting consumers from the misleading marketing of mortgages. Although these agencies have reported few HECM marketing complaints, GAO’s limited review of selected marketing materials for reverse mortgages found some examples of claims that were potentially misleading because they were inaccurate, incomplete, or employed questionable sales tactics. Federal agency officials indicated that some of these claims raised concerns. For example, the claim of “lifetime income” is potentially misleading because there are a number of circumstances in which the borrower would no longer receive cash advances. Consumers who have not been cautioned about such claims could pursue HECMs with misunderstandings about the product.

To date, federal agencies have had a limited role in addressing concerns about the sale of potentially unsuitable insurance and other financial products in conjunction with HECMs (known as “inappropriate cross-selling”). States generally regulate insurance products, and some of the states GAO contacted reported cases of inappropriate cross-selling involving violations of state laws governing the sale of insurance and annuities. HUD is responsible for implementing a provision in the Housing and Economic Recovery Act of 2008 that is intended to restrict inappropriate cross-selling, but the agency is in the preliminary stages of developing regulations.

HUD’s internal controls do not provide reasonable assurance that counseling providers are complying with HECM counseling requirements. GAO’s undercover participation in 15 HECM counseling sessions found that while the counselors generally conveyed accurate and useful information, none of the counselors covered all of the topics required by HUD, and some overstated the length of the sessions in HUD records. For example, 7 of the 15 counselors did not discuss required information about alternatives to HECMs. HUD has several internal controls designed to ensure that counselors convey required information to prospective HECM borrowers, but has not tested the effectiveness of these controls and lacks procedures to ensure that records of counseling sessions are accurate. Because of these weaknesses, some prospective borrowers may not be receiving the information necessary to make informed decisions about obtaining a HECM.

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Chairman Kohl, Ranking Member Martinez, and Members of the Special Committee:

I am pleased to be here to participate in today's hearing on reverse mortgages. A reverse mortgage is a loan that converts the borrower's home equity into payments from a lender and, typically, does not require any repayments, as long as the borrower continues to live in the home. Available to homeowners aged 62 and older, these loans have become an increasingly popular financial tool for seniors, but concerns have emerged about the adequacy of consumer protections for reverse mortgage borrowers. For example, some consumer advocates have expressed concern about misleading marketing and inappropriate cross-selling—the practice of encouraging borrowers to use reverse mortgage funds to purchase insurance or other products that may be unsuitable for the borrower's financial situation. The Housing and Economic Recovery Act of 2008 (HERA) acknowledged some of these concerns by putting in place additional consumer protection measures. According to industry sources, almost all reverse mortgages are currently made under the Home Equity Conversion Mortgage (HECM) program, which is administered by the Department of Housing and Urban Development (HUD). This program has experienced dramatic growth with an increase in both the number of HECM loans and the number of lenders participating in the HECM program. Since the inception of the HECM program, Congress has required prospective borrowers to obtain counseling by an independent third party so that they can make informed decisions about whether to obtain a HECM.

My testimony today is based on work we conducted at the request of Chairman Kohl and Senator McCaskill for a report that we are issuing today.<sup>1</sup> My statement discusses federal agency activities for (1) protecting consumers from misleading HECM marketing, (2) protecting HECM borrowers from inappropriate cross-selling, and (3) overseeing HECM counseling providers.

To do this work, we spoke with agency, industry, and nonprofit officials, including those at HUD, federal and state banking regulators, AARP, and the National Reverse Mortgage Lenders Association (NRMLA). To examine

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<sup>1</sup>GAO, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers*, [GAO-09-606](#) (Washington, D.C.: June 29, 1999).

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federal agency responsibilities to protect consumers from misleading HECM marketing, we identified authorities, standards, and processes that HUD, the Federal Trade Commission (FTC), and four federal banking regulators use to identify and address misleading marketing practices. We also conducted our own review of HECM marketing materials, including Internet and mailed materials for major HECM lenders.<sup>2</sup> We also conducted Internet searches for materials with potentially misleading statements and collected materials from seven reverse mortgage information seminars. To examine the steps federal agencies have taken to protect HECM borrowers from inappropriate cross-selling, we reviewed the HERA provisions on cross-selling, HUD's actions to implement the provisions, and other HUD and federal regulator activities related to these practices. In addition, we compiled examples from state insurance regulators of cross-selling that violated state insurance laws. To examine HUD's oversight of HECM counseling providers, we identified the internal controls that HUD currently has in place to ensure compliance with HUD counseling requirements and tested the effectiveness of these controls by conducting 15 undercover counseling sessions with HUD-approved counselors. The findings from the 15 counseling sessions cannot be generalized to all HECM counseling sessions or sessions conducted by particular counseling agencies.

We conducted this performance audit from April 2008 through June 2009, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. In addition, our investigative work was performed in accordance with standards prescribed by the Council of the Inspectors General on Integrity and Efficiency.

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## Summary

While HECMs have the potential to play a key role in meeting the needs of seniors facing financial hardship or seeking to improve their quality of life, the product is relatively complex and costly and the population it serves is vulnerable. These factors, combined with the increasing number of borrowers and lenders participating in the HECM program, underscore the

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<sup>2</sup>This part of our review focused on materials from the 12 lenders that originated at least 1,000 HECMs in fiscal year 2008.

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need for federal agencies to be vigilant about emerging consumer protection risks. Our work identified areas of consumer protection that require further attention, particularly in the areas of HECM marketing and counseling.

- Although federal agencies reported few HECM marketing complaints, our limited review of selected marketing materials for reverse mortgages found some examples of claims that were potentially misleading because they were inaccurate, incomplete, or employed questionable sales tactics. The existence of these claims suggests that some HECM providers may not be maintaining sufficient focus on or awareness of federal marketing standards. Furthermore, prospective borrowers could pursue HECMs with misunderstandings about the product unless they receive corrected information.
- To date, federal agencies have had a limited role in addressing concerns about the sale of potentially unsuitable insurance and other financial products in conjunction with HECMs (inappropriate cross-selling). States generally have been responsible for regulating insurance products, and some of the states we contacted reported cases of inappropriate cross-selling involving violations of state laws governing the sale of insurance and annuities. However, HUD is now responsible for implementing provisions in HERA that are intended to restrict inappropriate cross-selling.
- HUD's internal controls do not provide reasonable assurance that counseling providers are complying with HECM counseling requirements. As previously noted, Congress mandated counseling to help prospective borrowers make informed decisions about HECMs. Our participation in 15 HECM counseling sessions found that while the counselors generally conveyed accurate and useful information, none of the counselors covered all of the topics required by HUD. Additionally, some overstated the length of the sessions in HUD records.

To strengthen consumer protections for HECMs, we are recommending that HUD, FTC, and the federal banking regulators take steps to strengthen oversight and enhance industry and consumer awareness of the types of marketing claims that we discuss in this testimony. We are also recommending that HUD take steps to improve the effectiveness of its internal controls, such as by verifying the content and length of HECM counseling sessions. In written comments on our report, the federal banking regulators agreed with our recommendations. HUD and FTC did not comment on them.

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## Background

A reverse mortgage is a loan against the borrower's home that the borrower does not need to repay for as long as the borrower meets certain conditions. These conditions, among others, require that borrowers live in the home, pay property taxes and homeowners' insurance, maintain the property, and retain the title in his or her name. Reverse mortgages typically are "rising debt, falling equity" loans, in which the loan balance increases and the home equity decreases over time. As the borrower receives payments from the lender, the lender adds the principal and interest to the loan balance, reducing the homeowner's equity. This is the opposite of what happens in forward mortgages, which are characterized as "falling debt, rising equity" loans. With forward mortgages, monthly loan payments made to the lender add to the borrower's home equity and decrease the loan balance.

The HECM program began in 1988, when Congress authorized HUD to insure reverse mortgages to meet the financial needs of elderly homeowners.<sup>3</sup> While HECMs can provide senior homeowners with multiple types of benefits, including flexibility in how they use the loan funds and protection against owing more than the value of the house when the loan comes due, HECM costs can be substantial. The volume of HECMs made annually has grown rapidly, rising from 157 loans in fiscal year 1990 to more than 112,000 loans in fiscal year 2008. In addition, recent years have seen a large increase in the number of lenders participating in the HECM program, with more than 1,500 lenders originating their first HECM in 2008, bringing the total number of HECM lenders to over 2,700.<sup>4</sup>

A number of federal and state agencies have roles in overseeing the reverse mortgage market. These agencies include HUD, which administers the HECM program and oversees entities that provide mandatory counseling to prospective HECM borrowers. In addition, the Federal Trade Commission (FTC), federal and state banking regulators, and state insurance regulators are involved with various aspects of consumer protections for HECM borrowers.

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<sup>3</sup>12 U.S.C. §1715z-20 (a).

<sup>4</sup>About 10 percent of these lenders originated 80 percent of all HECMs in 2008.

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## Although Various Agencies Have Some Responsibility for Assessing HECM Marketing, Some Advertisements Contain Potentially Misleading Claims

Various state and federal agencies have some responsibility for assessing marketing for reverse mortgage products, including FTC, federal and state banking regulators, and HUD. The agencies each have a responsibility for different segments of the reverse mortgage market, but have reported taking few, if any, enforcement actions against an entity as a result of misleading reverse mortgage marketing. FTC has responsibility for protecting consumers against unfair or deceptive practices originating from nonbank financial companies, such as mortgage brokers.<sup>5</sup> FTC officials said they have not systematically searched for potentially misleading reverse mortgage marketing, but noted that they are maintaining an awareness of the potential risks associated with reverse mortgage marketing and have formed a task force of state and federal regulators and law enforcement agencies, in part to learn about complaints related to reverse mortgages. In addition, the federal banking regulators—the Board of Governors of the Federal Reserve System (Federal Reserve), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration (NCUA)—include a review of reverse mortgage marketing materials in their compliance examinations of lenders for whom they have responsibility, but, because few of their regulated lenders offer reverse mortgages, they have not conducted many examinations that have included these loans.<sup>6</sup> Like FTC, federal banking regulators are maintaining an awareness of the potential risks associated with reverse mortgages, which could include those associated with reverse mortgage marketing. For example, the Federal Financial Institutions Examination Council—the interagency body that includes the federal banking regulators and develops guidance for federal bank examiners—recently formed a working group on reverse mortgages. Finally, some HECM lenders are regulated at the state level, with HECM marketing materials subject to state compliance examinations. Information we obtained from 22 of the 35 state banking regulators that

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<sup>5</sup>Specifically, FTC enforces section 5 of the Federal Trade Commission Act (FTC Act), which broadly prohibits unfair or deceptive acts or practices in commerce. Section 5(n) of the FTC Act defines “unfair” to mean practices that cause or are likely to cause substantial injury that cannot be reasonably avoided by consumers and is not outweighed by countervailing benefits to consumers or to competition. FTC has defined “deceptive” to mean any material representation or omission of information, or practice that is likely to mislead consumers who are acting reasonably under the circumstances. Misleading information is “material” to consumers if it is likely to affect the consumer’s decision to purchase a product or service.

<sup>6</sup>We did not speak with officials at NCUA because none of the HECM lenders that originated at least 1,000 HECMs in fiscal year 2008 were credit unions regulated by NCUA.

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responded to our information request indicated that their states routinely examine marketing materials as part of compliance examinations.<sup>7</sup> However, only 1 state banking regulator—the Idaho Department of Finance—reported taking action against a lender because of reverse mortgage marketing.

In addition, HUD exercises limited regulatory authority over the marketing activity of HECM lenders to ensure that lenders' advertisements do not imply endorsement by HUD or the Federal Housing Administration. HUD officials cited one instance in which it referred a lender to the Mortgagee Review Board for misrepresenting the HECM as a "government rescue loan."<sup>8</sup> However, HUD officials said they do not actively monitor HECM marketing, and do not review HECM marketing materials as part of routine assessments of HECM lenders.

Some agencies with whom we spoke indicated that while complaints are one factor that could trigger more extensive assessments of marketing materials, they have received few, if any, complaints about reverse mortgage marketing. However, FTC officials noted that the low volume of complaints could be a result of consumers not being aware that they have been deceived, not knowing to whom to complain, or elderly consumers being less likely to complain.

While the extent of misleading HECM marketing is unknown, our limited review of marketing materials found some examples of claims that were potentially misleading because they were inaccurate, incomplete, or employed questionable sales tactics. Among the materials we reviewed, we found 26 different entities that made potentially misleading claims in their HECM marketing materials.<sup>9</sup> This group includes entities regulated by each of the federal banking regulators with whom we spoke, as well as FTC and state regulators; it also includes both members and nonmembers

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<sup>7</sup>We obtained information on state agency efforts to review reverse mortgage marketing materials through the Conference of State Bank Supervisors, which sent a set of standardized questions we developed to all 50 states and the District of Columbia.

<sup>8</sup>HUD's Mortgagee Review Board, an enforcement body chaired by HUD's Assistant Secretary for Housing–Federal Housing Commissioner, can impose administrative sanctions against lenders, including withdrawing the lenders' authority to make HUD-insured loans.

<sup>9</sup>At least one of these lenders corrected its potentially misleading claim since we first reviewed the materials, and another lender was issued a cease-and-desist order by a state banking regulator as a result of a misleading claim.



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of NRMLA.<sup>10</sup> We selected seven advertisements that represented these claims and submitted them to the regulators for review. In general, the officials with whom we spoke agreed that the claims in six of the seven advertisements raised some degree of concern and might prompt further investigation.<sup>11</sup> Several of the officials noted that they would need to consider the fuller context of the advertisement to determine if the claims were misleading and the level of action they would take if these six advertisements were the subject of complaints or compliance examinations.

The six potentially misleading claims that we identified, and agency officials generally agreed raised concern, were as follows:<sup>12</sup>

- *“Never owe more than the value of your home”*: The claim is potentially misleading because a borrower or heirs of a borrower would owe the full loan balance—even if it were greater than the value of the house—if the borrower or heirs chose to keep the house when the loan became due. This was the most common of the potentially misleading statements we found in the marketing materials we reviewed. This claim was made by HUD itself in its instructions to approved HECM lenders; however, in December 2008, HUD issued guidance to HECM lenders explaining the inaccuracy of this claim.
- *Implications that the reverse mortgage is a “government benefit” or otherwise, not a loan*: While HECMs are government-insured, the product is a loan that borrowers or their heirs must repay, not a benefit. Examples of this type of claim include the following: “You may be qualified for this government-sponsored benefit program,” and “Access the equity in your home without having to sell, move, or take out a loan.”

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<sup>10</sup>NRMLA members are expected to adhere to the association’s Code of Ethics, which contains specific rules on ethical advertising.

<sup>11</sup>The Federal Reserve did not comment on the advertisements individually, but indicated that the advertisements generally raised concerns.

<sup>12</sup>The claim that did not raise as much concern stated that HECM closing costs average only 1 percent more than a regular HUD mortgage. We considered this statement to be inaccurate because, while HECM origination fees are 2 percent, origination fees for FHA-insured forward mortgages are 1 percent—a difference of 100 percent. The officials with whom we spoke about this claim said that they would consider this an “editorial error” or “confusing,” but not intended to mislead.

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- *“Lifetime income” or “Can’t outlive loan”*: Although borrowers can choose to receive HECM funds as monthly tenure payments, even under this option, payments will not continue once the loan comes due (e.g., when the borrower moves out of the house or violates other conditions of the mortgage).
  - *“Never lose your home”*: This claim is potentially misleading because a lender could foreclose on a HECM borrower’s home if the borrower did not pay property taxes and hazard insurance or did not maintain the house.
  - *Misrepresenting government affiliation*: An example of this type of claim would include use of government symbols or logos and claims that imply that the lender is a government agency.
  - *Claims of time and geographic limits*: These claims falsely imply that HECM loans are limited to a certain geographic area, or that the consumer must respond within a certain time to qualify for the loan. Examples include “must call within 72 hours,” and “deadline extended,” as well as the claim that a consumer’s residence is “located in a Federal Housing Authority qualifying area.”

The potentially misleading marketing claims we identified suggest that some HECM providers may not be maintaining sufficient focus on or awareness of federal marketing standards. Furthermore, consumers who have not been cautioned about such claims could pursue HECMs with misunderstandings about the product. Therefore, the report we are issuing today recommends that HUD, FTC, and the federal banking regulators take steps to strengthen oversight and enhance industry and consumer awareness of the types of marketing claims discussed in this testimony.

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## Development of HECM-Specific, Cross-Selling Regulations Is in Preliminary Stage, and States Have Uncovered Some Evidence of Inappropriate Cross- Selling

Concerns exist that reverse mortgage borrowers could be vulnerable to inappropriate cross-selling, a practice involving the sale of financial or insurance products that are unsuitable for the borrower's financial situation using the borrower's reverse mortgage funds. While certain annuity products may be suitable for some HECM borrowers, such as those who wish to receive payments for life regardless of where they live, there is concern that elderly reverse mortgage borrowers may be sold other products that may be inappropriate to the borrower's circumstances. For example, there is concern that elderly reverse mortgage borrowers may be sold deferred annuities, where payments may not begin for many years and high fees may be charged for early access to the money.

Because cross-selling typically involves the sale of insurance products generally regulated at the state level, the role of federal agencies in addressing the issue of cross-selling in conjunction with HECMs has been limited and largely has been focused on consumer education and disclosures. However, with the passage of HERA, HUD now has responsibility for enforcing the cross-selling provisions in the legislation and is in the preliminary stages of developing regulations to implement them. The provisions are intended to curb the sale of unsuitable financial products to consumers using HECM funds. According to HUD officials, HUD is drafting a *Federal Register* notification to solicit feedback on issues concerning these provisions, including HUD's ability to monitor and enforce them; the usefulness of disclosures, education, and counseling in preventing cross-selling; what would constitute appropriate firewalls between a firm's reverse mortgage sales and sales of other financial products; and what types of financial products should be covered. HUD has also instructed lenders that until HUD issues more definitive guidance, lenders must not condition a HECM on the purchase of any other financial or insurance product, and should strive to establish firewalls and other safeguards to ensure there is no undue pressure or appearance of pressure for a HECM borrower to purchase another product.

A number of state insurance regulators have reported cases of inappropriate cross-selling involving violations of state laws governing the sale of insurance and annuities. Many states have passed suitability laws that are designed to protect consumers from being sold unsuitable insurance products, including annuities. Of the 29 state insurance regulators that responded to questions we sent all states and the District of Columbia, 8 said that from 2005 through January 2009, they had at least one case of an insurance agent selling an unsuitable insurance product that a consumer had purchased using reverse mortgage funds. For example, an official at the Insurance Division of the Hawaii Department of

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Commerce and Consumer Affairs described a case in which an independent mortgage broker was prosecuted for misrepresentation of an annuity product. The broker, who also owned his own insurance company, deceived 15 clients by including paperwork for an annuity in their HECM closing documents without their knowledge. In another case, a sales manager of an insurance company violated the Maine Insurance Code by allowing transactions that were not in the best interest of the customer. The sales manager had arranged for a representative of a large reverse mortgage lender to speak with his sales agents about reverse mortgages. The agents then referred 14 clients to the reverse mortgage lender, all of whom obtained reverse mortgages. One particular client, an 81-year old widow, was contacted continually until she obtained her reverse mortgage funds, and was then sold a deferred annuity. The interest rate accruing on the reverse mortgage was 4.12 percent, and the deferred annuity earned only 3.25 percent.

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## HUD's Internal Controls Do Not Provide Reasonable Assurance That Counseling Agencies Are Complying with HECM Counseling Requirements

HUD's internal controls for HECM counseling do not provide reasonable assurance of compliance with HUD requirements. HUD has a range of internal control mechanisms to help ensure that HECM counselors comply with counseling requirements.<sup>13</sup> These controls include (1) counseling standards as set forth in regulations, mortgagee letters, and a counseling protocol; (2) a counselor training and examination program, and (3) a Certificate of HECM Counseling (counseling certificate) that, once signed by the counselor and the counselee, should provide HUD with assurance that counselors complied with counseling standards and that prospective borrowers were prepared to make informed decisions. Although federal standards encourage agencies to test the effectiveness of their internal controls, HUD has not done so for its controls for HECM counseling.

Our independent evaluation of 15 HECM counseling sessions found that counselors did not consistently comply with HECM counseling requirements.<sup>14</sup> To test counselor compliance with key HECM counseling requirements, GAO staff posed as prospective HECM borrowers for 15

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<sup>13</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: Nov. 9, 1999). GAO guidance states that internal controls should provide reasonable assurance that agency objectives—in this case ensuring that prospective HECM borrowers are well-informed—are being achieved.

<sup>14</sup>While our findings from the 15 counseling sessions cannot be generalized to all HECM counseling sessions or sessions conducted by individual agencies, the sessions allowed us to test compliance with HECM counseling requirements.

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counseling sessions offered by 11 different agencies. For each session, we determined whether the counselors covered required topics, primarily those referenced in the counseling certificate. The certificate identifies or refers to counseling requirements originally set forth in statute, HUD regulations, or mortgagee letters. Our undercover counselees participated in telephone counseling sessions because HUD estimated that about 90 percent of all HECM counseling sessions were conducted by telephone. All but one of the counselors who conducted our counseling sessions were examination-certified by HUD to provide HECM counseling.<sup>15</sup>

Although none of the 15 counselors covered all of the required topics, all of them provided useful and generally accurate information about reverse mortgages and discussed key program features. For example, most counselors explained that the loan would become due and payable when no borrower lives on the property, and that borrowers must pay taxes and insurance. Counselors also often supplemented their discussions with useful information, such as a description of factors that affect available interest rates and the fact that borrowers would receive monthly statements from the lender, even though this information is not specifically referred to on the counseling certificate.

However, despite certifying on the counseling certificate that they had covered all of the information HUD requires, all of the counselors omitted at least some required information. The required information that counselors most frequently omitted included the following:

- *Other housing, social service, health, and financial options:* Seven of the 15 counselors did not discuss options, other than a HECM, that might be available to a homeowner, such as considering other living arrangements, meal programs, or health services that local social service agencies might provide. Our findings are consistent with findings in AARP and HUD Office of Inspector General reports.<sup>16</sup>

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<sup>15</sup>HUD expects to issue regulations in 2009 that will require all HECM counselors to pass a written exam. The regulations will also establish a roster of eligible HUD counselors and allow HUD to remove counselors for cause.

<sup>16</sup>See AARP, *Reverse Mortgages: Niche Product or Mainstream Solution? Report on the 2006 AARP National Survey of Reverse Mortgage Shoppers* (Washington, D.C.: Dec. 2007) and HUD Office of Inspector General, *Audit Report from the Regional Inspector General for Audit, Fort Worth Region*, 2008-FW-1010 (Fort Worth, July 14, 2008).

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- *Other home equity conversion options:* The same 7 counselors, likewise, did not discuss other types of (and potentially lower-cost) reverse mortgages that state or local governments might sponsor for specific purposes. For example, some state governments provide reverse mortgages that do not need to be repaid until the house is sold for payment of taxes or making major repairs.
  - *The financial implications of entering into a HECM:* Fourteen of the 15 counselors only partially met this requirement, and 1 completely did not meet the requirement, because they omitted information that HUD directs counselors to convey.<sup>17</sup> For example, 6 of the counselors did not provide estimates of the maximum amount of funds that might be available to the counselee under the HECM payment plan options. A HUD official said that this information would help counselees understand how reverse mortgages would address their financial situations. Additionally, 14 counselors did not tell counselees that they could elect to have the loan provider withhold funds to pay property taxes and insurance.
  - *A disclosure that a HECM may affect eligibility for assistance under other federal and state programs:* While most counselors discussed the tax consequences of a HECM, 6 of 15 did not indicate that eligibility for some federal and state programs could be affected if borrowers had more money in their bank accounts than allowed under such programs' terms.
  - *Asking if a homeowner had signed a contract or agreement with an estate planning service:*<sup>18</sup> HUD implemented this requirement based on a statutory provision intended to protect HECM borrowers from paying excessive fees for third-party services of little or no value. However, 14 of the 15 counselors did not ask this question, although of the 14, 4 cautioned the undercover counselees that such services were unnecessary to obtain a HECM.

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<sup>17</sup>As indicated in Mortgagee Letter 2004-25, to meet this requirement, a counselor must cover specific information, including the advantages and disadvantages of each payment plan and the borrower's ongoing responsibility to pay property taxes and hazard insurance, either directly or indirectly by electing to require the mortgagee to withhold funds from monthly payments or to charge such funds to a line of credit. As of March 27, 2009, HUD more specifically required that the counselor document a client's budget based on the person's income, assets, debts, and monthly expenses.

<sup>18</sup>HUD implemented this requirement in Mortgagee Letter 99-2, pursuant to a 1998 amendment to the National Housing Act.

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In addition to requiring HECM counselors to convey certain information, HUD requires them to record the length of each counseling session on the counseling certificate. Although HUD has not issued guidance on the subject, HUD officials told us that the recorded time should reflect only the time spent counseling the client. However, 6 of the 15 counselors for our undercover sessions overstated the length of the counseling sessions on the counseling certificates. In 3 of these cases, the sessions ranged from 22 to 30 minutes, but the recorded times ranged from 45 minutes to 1 hour. In another instance, the session lasted about 20 minutes, but the counselor recorded 30 minutes. These 4 sessions omitted much of the required information, particularly the discussion of options and various aspects of the financial implications of a HECM. The counselors for the remaining 2 sessions recorded the sessions as lasting 2 hours when 1 lasted 45 minutes, and the other 57 minutes.

Another area of noncompliance we identified concerned the requirement that counseling agencies assess a client's ability to pay the counseling fee. In May 2008, HUD issued instructions allowing counseling agencies to charge a fee of up to \$125 for HECM counseling, as long as the fee did not create a financial hardship for the client.<sup>19</sup> The instructions require counseling agencies to make this determination by considering factors including, but not limited to, the client's income and debt obligations. While HUD guidance states that agencies may use "objective criteria" in assessing a client's ability to pay, the guidance does not specify what types of criteria are appropriate. Consistent with HUD requirements, 12 of the 15 counseling agency staff responsible for charging the fee, whether intake staff or counselors, informed our undercover counselees of the fee in advance of the session and charged \$125 or less. However, staff at most of the agencies did not collect the minimum amount of information that HUD requires to assess the counselee's ability to pay. For example, for 4 of the 15 sessions, agency intake staff took the counselee's credit card information up front, without obtaining any information about income and debt; and counselors for four other sessions, asked about the undercover counselees' income but not their debts. In the absence of clear guidance, similarly situated counselees could be treated differently, and those facing financial hardships might be paying for counseling when they should not have to.

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<sup>19</sup>HUD issued these instructions in Mortgagee Letter 2008-12, pursuant to regulations published in 2007 (see *Federal Register* at 72 FR 55638) and codified at 24 C.F.R. Part 214. The instructions state that if an agency's cost of providing HECM counseling is less than \$125, the maximum amount the agency can charge is the actual cost.

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Because of the weaknesses in HUD's internal controls, some prospective borrowers may not be receiving the information necessary to make informed decisions about obtaining a HECM. Therefore, we are recommending that HUD take steps to improve the effectiveness of its internal controls, such as by verifying the content and length of HECM counseling sessions.

In closing, HECMs can provide senior homeowners with multiple types of benefits, but borrowers may not always fully understand the complexities of the product's terms and costs. Thus, the types of marketing claims discussed in this report, as well as the potential for seniors to be sold unsuitable products with their HECM funds, are causes for concern, particularly in a market with potential for substantial growth. These factors underscore the need for improvements in HUD's controls over HECM counseling.

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Mr. Chairman, Ranking Member Martinez, and Members of the Special Committee, this concludes my prepared statement. I would be happy to respond to any questions that you may have at this time.

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## Contact and Staff Acknowledgments

For further information about this testimony, please contact Mathew J. Scirè, Director, at 202-512-8678 or [sciremj@gao.gov](mailto:sciremj@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Steven K. Westley (Assistant Director), Sonja J. Bensen, Christine A. Hodakievic, Winnie Tsen, and Barbara M. Roesmann.



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