Testimony of

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before the

Subcommittee on Housing & Community Opportunity

Thursday, October 8, 2009

Madam Chairwoman and Members of the Subcommittee:

Thank you for the opportunity to appear at this hearing to discuss reverse mortgages.

National Reverse Mortgage Lenders Association represents approximately 600 companies that are either engaged in the business of making reverse mortgages or provide capital or services to companies that do. We do not represent the entire industry. We represent those companies who take their involvement in this sector very seriously and are committed to core values of treating customers fairly and ethically. As a result, our members want to support the policy work, consumer education, ethics, self-enforcement, and professional development programs that NRMLA undertakes to assure an environment where any senior homeowner is able to obtain a reverse mortgage conveniently and fearlessly.

Our members understand that demographics present a vast opportunity. Our product serves many different types of homeowners facing a wide variety of needs. Those needs will surely continue as the population of age-eligible homeowners grows – and as our society comes to grips with the challenges of financing longevity.

While demographics might point to growth, our members recognize that will only occur if consumers believe that reverse mortgage products are safe and fair, and that those who deliver them are trustworthy. That is the underpinning of our association. We are dedicated to maintaining an environment where homeowners can easily access information and assistance on reverse mortgages, meet with counselors and other trusted advisors, make a thoughtful decision whether they want to obtain a reverse mortgage and, if they decide to do so. work with a reputable company.

Some of our signature undertakings include:

- As a foundation, our Code of Ethics & Professional Responsibility by which all members agree to abide. The Code focuses on core values of fairness, confidentiality, integrity, competence, diligence and professionalism. It covers detailed items such as advertising, compliance and communications with consumers.

- An Ethics Committee that continually reviews our Code and refines it whenever necessary, promulgates Ethics Advisory Opinions to help the industry better understand our position on matters of importance, and acts decisively on complaints filed by consumers, regulators, counselors and industry participants. Recent Ethic Advisory Opinions have been issued on advertising and lead generation, and several others are in process..

- Educational seminars that routinely focus on issues like understanding seniors' finances; recognizing cognitive impairment; reporting suspicions of elder abuse; understanding Medicaid, Medicare and SSI; and other topics that help our members understand the client base with whom they work and how best to serve its needs.

- An unyielding commitment to counseling, an important core principle for our organization. While counseling by an independent third party is required by statute under the FHA HECM program, we require it of our members in all cases, with all products, even where it is not required by law.

- A professional designation program, under which candidates must meet licensing and professional education requirements, participate in a symposium on ethics issues, undergo a background check, and pass a rigorous exam.

- We are in the process of developing a straightforward, uniform disclosure that will summarize in a succinct, comprehensible format all of the salient facts about a reverse mortgage that a prospective client might be considering, allowing the consumer to easily compare various offers side-by-side. We realize that we already give our customers plenty of papers to review – on some loans asking elderly homeowners with arthritic hands to sign their name as many as 40 times – but the lawmakers, regulators and in-house compliance experts won't let us address that. So, the best we can do is to try to consolidate and summarize what's contained in that thick sheath of papers in a user-friendly document.

Today, the reverse mortgage market is comprised, almost exclusively, of the FHA Home Equity Conversion Mortgage, commonly known as the "HECM." A HECM is simply an FHA-insured reverse mortgage, made to a homeowner of at least 62 years of age, by a HUD-approved lender or correspondent.

Under the HECM program, a borrower pays a mortgage insurance premium (MIP) to FHA and, in return, FHA insures the loan. The FHA insurance provides important protections and benefits to both homeowners and lenders.

From the borrower's perspective, the FHA insurance enables a lender to advance a significantly higher percentage of a home's value than would be available in an uninsured reverse mortgage, yielding a larger principal amount to a HECM borrower than could be obtained through a proprietary reverse mortgage. Furthermore, the insurance provides an iron-clad guarantee that the homeowner will have uninterrupted access to the reverse mortgage funds if anything should occur to disrupt a lender's operations.

From the lender's standpoint, the FHA insurance provides the comfort of knowing that if the value of the home at the time of loan termination is less than the balance due, the lender can file a claim with FHA for any shortfall, up to the maximum claim amount. The maximum claim amount is the lesser of the actual value of the house at the time of loan origination or the FHA HECM loan limit, currently $625,500 (until 12/31/09, unless extended by the Congress.)

Many have questions about the risks that the various parties – borrowers, lenders and FHA – are exposed to under the HECM program. I would like to address those.

For borrowers, possible risks include: (1.) being sold a loan that they believe to be a HECM, with all of its features and safeguards, which turns out, in fact, not to be an FHA-insured loan; (2.) taking a HECM loan, but ultimately finding out that they cannot sustain the costs associated with living in the home -- particularly taxes and insurance -- and being forced to move out. These risks can be mitigated by having an effective network of competent counselors and making sure that seniors understand that they must attend counseling with a HUD-certified counselor, if they are getting a HECM. If counseling does not take place, the senior should beware. Furthermore, the counselor should, as part of a routine counseling session under HUD's new protocols, review with the client their sources of income, assets and recurring expenses to help determine if they could afford to sustain themselves in the home after the reverse mortgage.

Risks to a lender exist in a few areas. If a HECM loan is not originated properly, FHA can deny issuance of an insurance certificate, leaving the lender with a loan that it is obligated to fund, but which does not have insurance. A lender would not be able to sell that loan to an investor and would thus be forced to hold it in its portfolio for its entire duration. When lenders are forced to hold loans in their portfolios, it can have adverse impacts on their capital position, as well as significantly increase costs to service such loans.

Another area of risk exists under the rules for "assignment" of loans to FHA. An important feature of the HECM program, designed to provide liquidity to lenders, allows the lender the option of assigning a loan to FHA when its outstanding balance reaches 98% of the maximum claim amount. However, if a borrower is in arrears in real estate taxes or insurance at that time, HUD will not accept the assignment. If a loan had been placed into a GNMA guaranteed security and was not acceptable for assignment, the lender would have to buy the loan back out of the pool.

Risks to the FHA fund can arise from essentially three factors: (1.) loans remaining outstanding beyond their actuarial expectation, (2.) higher interest accrual due to rates rising over the expected rate and remaining there for a prolonged duration of time, or (3.) a prolonged or deep decline in property values. It typically would take a confluence of at least two of these factors for any particular loan to experience a loss, or a severe change in one of the factors. While this might occur on any particular loan, the likelihood of it occurring across the HECM portfolio is extremely remote.

To manage the HECM program with greater caution during the current downturn in property values, HUD has taken steps to mitigate risk by reducing the funds available to seniors through a HECM reverse mortgage. HUD's recently implemented reduction in the program's principal limit factors has negated the need for credit subsidy as initially requested in the President's proposed FY 2010 budget, returning the program to operating on a net neutral basis.

The HECM program has operated on a self-sustaining basis throughout its duration, requiring no taxpayer subsidy. Its income from mortgage insurance premiums and other sources has exceeded pay-outs for claims. In fact, according to a recent Congressional Budget Office (CBO) presentation on its credit re-estimate for 2009, the HECM program has generated a cumulative net gain for FHA of nearly $7 billion since its inception. Accordingly, the HECM program has not played a role in FHA's recent capital reserve account losses.

Until recently, the HECM program was part of the FHA General Insurance Fund, which includes several non-related programs, as well. While HECM itself generated income, other programs in that fund did not, effectively negating the earnings from the HECM program as they offset claims against that fund from other programs. Now, the HECM program falls under the Mutual Mortgage Insurance (MMI) fund, FHA's primary fund for the basic 203(b) "forward" mortgage program.

This has raised the question of whether the HECM program will require a positive or negative credit subsidy after 2010. A "negative credit subsidy" is a good thing and a "positive credit subsidy" would be bad. In other words, a negative credit subsidy means that the program generates income to cover its pay-outs and does not require subsidy. Positive credit subsidy means that subsidy funds must be provided because a program will incur costs beyond its receipts.

With the programmatic changes HUD has made, NRMLA believes that the HECM program in years ahead will operate on a break-even or better basis. Risk has been mitigated by reducing principal limits. As a result, all HECM borrowers will receive a reduced amount of loan proceeds

However, it should be noted that this adjustment to the program comes at a great cost to some seniors. In some cases, the end result is that seniors will not be able to utilize HECMs to preserve their ability to continue living in their homes, forcing them to move out.

The Department is also implementing more sophisticated information systems to better monitor HECM program performance and reduce operating costs. Better systems will enable HUD to gain deeper insight and make continual program adjustments, as necessary.

If such systems had been in place previously, we believe analysis of the HECM program would have revealed that the $798 million in credit subsidy in OMB's initial projection might not have been warranted. Based on our financial modeling of the program, NRMLA feels that to project that deep a subsidy need, one would have to make assumptions about future home values that are far more pessimistic than any of the major forecasting organizations have published.

It is also possible that the anticipated duration of loans could be overstated. HECM loan duration averages fewer than seven years, with very few loans lasting far longer. Loans to younger borrowers have durations similar to loans to older borrowers, a counter-intuitive outcome. Pay-off rates for borrowers who take out loans at age 65 are the same as for borrowers who take HECMs at age 75. Sixty-five year olds tend to terminate loans when they sell and move out after less than seven years. Seventy-five year olds tend to terminate loans in less than seven years, as well, often due to a mortality event. The average duration of loans made to eighty-five year old borrowers is approximately five years.

If expected loan durations are adjusted to reflect actual experience, and future home price assumptions are conservative, but not dire, the program could, in our opinion, continue to be allowed to operate without the principal limit reductions and not require credit subsidy. In any case, that is water under the bridge now. HUD has implemented the change it felt was necessitated by OMB and its own assessment and projections. However, HUD should continue to monitor program performance and adjust the principal limits factors upward, once it regains confidence that the program is operating on a sound basis.

The Department appears to have taken its cue from Congressional appropriators who, in the pending FY 2010 bills, are leaning towards instructing HUD to reduce principal limit factors (PLFs), in lieu of providing credit subsidy. The principal limit factor is used to determine the percentage of value that a HECM borrower could obtain from their home.

The House bill would require HUD to do what it has already done, reduce principal limit factors by an amount that would eliminate the need for the entire credit subsidy request ($798 million). Once again, it should be noted, this comes at a high cost to some seniors. The Senate bill would provide a partial credit subsidy ($288 million) and also instruct HUD to reduce the PLFs to cover the balance, but with a smaller cut.

NRMLA fully understands and supports the need to operate the HECM program on a "negative credit subsidy" basis. We support efforts to keep the program on a self-sustaining basis. However, we also believe that there are other options for achieving this objective --changes that would have a less detrimental impact on senior homeowners.

We recently conducted an informal analysis of the loans made year-to-date by three of the most active HECM lenders. When looking at the impact of what would have happened if PLF's had been reduced to the level they were lowered to on October 1, we found that over 20% of borrowers (approximately 23,000 homeowners) would have received loan proceeds that were less than their existing indebtedness. In other words, they would be "too short to close." Because they would not receive enough money from their reverse mortgage to pay-off the existing loan on their property, they would not be eligible for the HECM, forcing them to sell and move, or possibly face foreclosure.

An alternative we recommend would be to adjust the mortgage insurance premium (MIP) to generate more income to the FHA insurance fund. The current MIP is heavily front-loaded, creating what are perceived by many to be high upfront costs for a HECM. AARP has, in fact, been historically concerned with the upfront costs to seniors utilizing the HECM program. HUD could generate the income the program needs to operate, while reducing upfront costs, by restructuring the MIP with a lower front-end amount and a higher ongoing MIP.

Right now, the HECM MIP is 2% of the value of the home at closing, plus ½% per year on the outstanding loan balance. By reducing the up-front premium to 1% or less, while raising the ongoing premium an appropriate amount, the program can be operated on an easily-adjusted self-sustaining basis, senior homeowners would not have to experience any reduction in proceeds from a HECM, and up-front costs could be lowered -- a winning combination for all.

Going forward, the management team at HUD, with the new information systems and tools available to them, should be able to monitor HECM program performance and fine-tune mortgage insurance premiums, as necessary, to maximize the benefit of the HECM program to senior homeowners – while minimizing any impact on FHA's capital reserve fund. This would be prudent management of the program and remain true to the intent of serving senior homeowners, while minimizing the need for taxpayer subsidy.

NRMLA looks forward to continuing to work with members of the Subcommittee, OMB and the Department to implement program enhancements that will keep the HECM program viable for many years to come. We appreciate the fact that key personnel at both HUD and OMB have been helpful and responsive as we have all examined various HECM-related issues.