

# DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

## 24 CFR Part 206

[Docket No. FR-4306-P-01]

RIN 2502-AH10

### Home Equity Conversion Mortgages; Consumer Protection Measures Against Excessive Fees

**AGENCY:** Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

**ACTION:** Proposed rule.

**SUMMARY:** This proposed rule would amend the regulations for the FHA Home Equity Conversion Mortgage (HECM) program under part 206. The HECM program offers FHA-insured first mortgages providing payments to elderly homeowners based on the accumulated equity in their homes. These FHA-insured "HECMs" are commonly referred to as "reverse mortgages." The rule is designed to protect homeowners in the HECM program from becoming liable for payment of excessive fees for third-party provided services of little or no value.

**COMMENT DUE DATE:** May 15, 1998.

**ADDRESSES:** Interested persons are invited to submit comments regarding this proposed rule to the Rules Docket Clerk, room 10276, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410-0500. Comments should refer to the above docket number and title. A copy of each comment submitted will be available for public inspection and copying during regular business hours at the above address. Facsimile (FAX) comments are not acceptable.

**FOR FURTHER INFORMATION CONTACT:** Sandy Allison, Office of the Deputy Assistant Secretary for Single Family Housing, Room 9282, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410. Telephone: (202) 708-2733. (This is not a toll-free number.) For hearing- and speech-impaired persons, this number may be accessed via TTY by calling the Federal Information Relay Service at 1-800-877-8339.

#### SUPPLEMENTARY INFORMATION:

#### Background

On March 17, 1997, HUD issued Mortgagee Letter 97-07, which prohibited FHA-approved lenders from being involved in transactions for HECMs referred by estate planning entities charging what HUD deemed to

be exorbitant fees. Two estate planners engaged in the business of making referrals for reverse mortgages sued, seeking a temporary restraining order (TRO) and preliminary injunction to require HUD to withdraw the Mortgagee Letter on the ground that notice and comment rulemaking procedures should have been followed. A TRO was issued on March 26, 1997, and a preliminary injunction followed on April 11, 1997. Mortgagee Letter 97-07 was then withdrawn.

Due to the Secretary's concern about the need to protect senior citizens from practices which may subvert the HECM process, the Secretary has determined that it is in the public interest that a rule be proposed at this time. The preliminary injunction does not preclude the proposed rule set forth below.

With respect to the FHA insurance program for HECMs, current FHA requirements strictly limit the fees that a mortgagee can collect. The FHA regulations currently do not have any express provisions that protect mortgagors from fees collected by third parties. This proposed rule will fill that gap.

#### Content of Rule

The specific proposals that follow were developed to address actual practices that HUD has identified. HUD is aware that specific responses to such known practices may not be fully effective in addressing other potential future abusive practices that may develop. In addition to seeking comments on whether the specific proposals that follow are necessary or will be effective, therefore, HUD seeks information from the public on other known or potential areas of abuse directed at elderly homeowners who may be interested in the HECM program, and suggestions regarding additional regulatory provisions that HUD should consider to provide protection. Depending on the nature and extent of the additional identified problems and solutions and the need for additional public comment on additional or modified provisions not in this proposed rule, HUD may include such provisions either in a final rule, in an interim rule with opportunity for further public comment, or in a separate proposed rule.

The proposed rule consists of three new sections and amendments to two existing sections of 24 part 206.

#### 1. Definition of Estate Planning Service Firm

A key term—*estate planning service firm*—is defined in an amendment to

§ 206.3. The term identifies such firms as individuals or entities that are not HUD-approved mortgagees or housing counseling agencies and that charge any of three types of fees or charges characteristic of firms charging excessive fees for services to HECM mortgagors: (a) fees other than those charged by the lender that are contingent on the homeowner obtaining a HECM, and often based on a percentage of the mortgage amount, (b) fees for information that housing counseling agencies are otherwise required to make available to mortgagors at little or no cost, or (c) fees for services that are purported to improve the homeowner's access to the HECM program. Exceptions are provided for payment of fees for *bona fide* tax or legal or financial advice, and other services specifically authorized by HUD, including loan origination. This is intended to be an encompassing definition that cannot be exploited through a minor change in practices. Any legitimate service provider that is concerned about overbreadth of coverage can seek specific authorization from HUD to exempt it from the new provisions. HUD recognizes that there is likely to be a need for additional guidance and, if so, such guidance will be issued. It is expected that the public comments on this proposed rule will identify any areas of needed guidance.

#### 2. Initial Disbursement to Mortgagor

The proposed rule adds a new § 206.29 to ensure that funds disbursed at closing go to the mortgagor, a relative or legal representative of the mortgagor, or a trustee of a trust for the benefit of the mortgagor, and not to an interested third party such as an estate planning service firm. Exceptions are provided for the initial mortgage insurance premium paid to HUD, closing costs authorized under 24 CFR 206.31, and amounts required to discharge any existing liens on the mortgagor's home.

#### 3. No Payment to Estate Planning Service Firm; No Outstanding Obligations After Closing

The proposed rule adds a new § 206.32 to prevent the mortgagor from using the initial draw of loan proceeds to pay an estate planning service firm. The mortgagee must also ensure that no commitments that the mortgagor incurred in connection with the mortgage transaction, such as a commitment to pay an estate planning service firm, will remain outstanding after the initial draw at closing, except for allowable repairs and mortgage service charges. The proposed rule thus addresses a situation where an estate

planning service firm seeks to "lend" to a homeowner the amount of its fees and to demand reimbursement after closing. The proposed rule does not purport to interfere with any legally enforceable obligations that a homeowner might have incurred before closing, but it eliminates the HECM program as a possible source of funding for unapproved fees. The proposed rule would permit a homeowner to contract in connection with the mortgage transaction in advance of closing for post-closing repairs only if the repairs are required as a condition of the loan to meet FHA property standards for existing housing.

#### 4. Additional Counseling Item

The proposed rule amends § 206.41 to add a new requirement to the mandatory pre-loan counseling of HECM mortgagors. A counselor is required to discuss with the mortgagor whether the mortgagor has an agreement with an estate planning service firm to pay a fee on or after closing. If there is such an agreement, a counselor is required to discuss the extent to which services under the contract may not be needed or may be available at little or no cost from other sources, including a mortgagee. A counselor is not expected to provide any advice regarding whether the mortgagor is legally bound to honor the contract. The counselor should, however, make sure that a mortgagor understands that § 206.32, as discussed above, will prevent a mortgage from being eligible under the HECM program if a fee is to be paid at or after closing to an estate planning service firm.

#### 5. Disclosure of Costs

The Act requires full disclosure to the mortgagor of all costs of obtaining the HECM. This proposed rule adds a new § 206.43(a)<sup>1</sup> to clarify that the mortgagee is responsible for ensuring that the disclosure occurs. The mortgagee is required to ask the mortgagor about any loan-related costs or obligations that the mortgagor may have incurred to obtain the HECM (such as the obligation to pay a fee to an estate planning service firm if the mortgage closes) and that the mortgagee is not required to disclose in its Good Faith Estimate. The mortgagee has a limited duty; it may rely on information received from the mortgagor (unless the mortgagee has reason to believe that the information is faulty) and it need not ask about the fees of professionals providing bona fide tax, legal, financial advice or estate planning services who do not meet the definition of estate planning service firm.

#### 6. Lump Sum Disbursement

The proposed rule also adds a new § 206.43(b) to require the mortgagee to make special inquiries of any mortgagor requesting that at least 25% of the available funds (i.e., the principal limit amount after excluding closing costs and certain principal limit set asides, sometimes called "net principal limit") be disbursed at closing to the mortgagor (or as otherwise permitted by § 206.29, as discussed above). The mortgagee must ascertain whether the mortgagor plans to use the funds to pay an estate planning service firm, and if so, must advise the mortgagor that this use of funds disbursed at closing is prohibited by § 206.32, as discussed above.

This proposed rule would not prevent a mortgagor from obtaining and making appropriate payment for services with actual value. Any provider of services to HECM mortgagors may seek HUD authorization for the fees it imposes and the resultant exclusion from the definition of "estate planning service firm". HUD seeks to ensure that individuals or companies who provide services do not unfairly benefit from the substantial amount of cash that is made available to elderly homeowners through the HECM program. This would defeat the public purpose of the program.

#### Findings and Certifications

##### Paperwork Reduction Act Statement

The information collection requirements proposed at §§ 206.32, 206.41 and 206.43 of this rule have been submitted to the Office of Management and Budget (OMB) for review, under section 3507(d) of the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection request displays a valid control number.

The public reporting burden for each of these collections of information is estimated to include the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Information on the estimated public reporting burden is provided in the following table.

Information collection	Number of respondents	Responses per respondent	Total annual responses	Hours per response	Total hours	Regulatory reference
Evidence of no payment to estate planning service firm and no outstanding unpaid obligations .....	8000	1	8000	.10	800	206.32
Information to be provided by counselor .....	16,000	1	16,000	.25	4000	206.41
Information to mortgagor .....	8000	1	8000	.25	2000	206.43
<b>Total annual burden .....</b>	<b>32,000</b>	<b>1</b>	<b>32,000</b>	<b>.....</b>	<b>6800</b>	

In accordance with 5 CFR 1320.8(d)(1), the Department is soliciting comments from members of the public and affected agencies concerning the proposed collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

<sup>1</sup> The former § 206.43 was deleted by a final rule published at 61 FR 49033 (September 17, 1996).

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information

technology, e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this proposal. Comments must be received within sixty (60) days from the date of this proposal. Comments must refer to the proposal by name and docket number (FR-4306) and must be sent to: Joseph F. Lackey, Jr., HUD Desk Officer, Office of Management and

Budget, New Executive Office Building, Washington, DC 20503.

#### *Executive Order 12866*

This proposed rule was reviewed by the Office of Management and Budget under Executive Order 12866 as a significant regulatory action. Any changes made in this proposed rule as a result of that review are clearly identified in the docket file, which is available for public inspection in the Office of HUD's Rules Docket Clerk, Room 10276, 451 7th Street, S.W., Washington, D.C.

#### *Regulatory Flexibility Act*

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this proposed rule, and in so doing certifies that this rule does not have a significant economic impact on a substantial number of small entities. This rule merely proposes to codify the Department's position which is consistent with the National Housing Act and part 206 regarding consumer protection. The rule has no adverse or disproportionate economic impact on small businesses. Small businesses are specifically invited, however, to comment on whether this rule will significantly affect them, and persons are invited to submit comments according to the instructions in the **DATES** and **COMMENTS** sections in the preamble of this proposed rule.

#### *Environmental Impact*

This proposed rule is exempt from the environmental review procedures under HUD regulations in 24 CFR part 50 that implement section 102(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332) because of the exemption under § 50.19(c)(1) which pertains to "the approval of policy documents that do not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate property acquisition, disposition, lease, rehabilitation, alteration, demolition, or new construction, or set out to provide for standards for construction or construction materials, manufactured housing, or occupancy." This proposed rule simply amends an existing regulation by increasing the information available to mortgagors and by limiting the manner in which funds are disbursed.

#### *Executive Order 12612, Federalism*

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, Federalism, has determined that this proposed rule

would not have substantial direct effects on States or their political subdivisions, or the relationship between the Federal government and the States, or on the distribution of power and responsibilities among the various levels of government. No programmatic or policy changes would result from this rule that affect the relationship between the Federal Government and State and local governments.

#### *Unfunded Mandates Reform Act*

Title II of the Unfunded Mandates Reform Act of 1995 (Pub.L. 104-4; approved March 22, 1995) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments, and on the private sector. This proposed rule would not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

*Catalog.* The Catalog of Federal Domestic Assistance number for the HECM program is 14.183.

#### **List of Subjects in 24 CFR Part 206**

Aged, Condominiums, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements.

Accordingly, the Department proposes to amend part 206 of title 24 of the Code of Federal Regulations as follows:

#### **PART 206—HOME EQUITY CONVERSION MORTGAGE INSURANCE**

1. The authority citation for 24 CFR part 206 continues to read as follows:

**Authority:** 12 U.S.C. 1715b, 1715z–1720; 42 U.S.C. 3535(d).

2. Section 206.3 is amended by adding a new definition of "estate planning service firm" to read as follows:

#### **§ 206.3 Definitions.**

\* \* \* \* \*

*Estate planning service firm* means an individual or entity that is not a mortgagee approved under part 202 of this title or a housing counseling agency approved under § 206.41 and that charges a fee that is:

(a) Contingent on the homeowner obtaining a mortgage loan under this part, except the origination fee authorized by § 206.31 or a fee specifically authorized by the Secretary; or

(b) For information that homeowners must receive under § 206.41, except a fee by:

(1) A housing counseling agency approved under § 206.41; or

(2) An individual or company, such as an attorney or accountant, in the *bona fide* business of generally providing tax or other legal or financial advice; or

(c) For other services that the provider of the services represents are, in whole or in part, for the purpose of improving an elderly homeowner's access to mortgages covered by this part 206, except where the fee is for services specifically authorized by the Secretary.

\* \* \* \* \*

3. A new section 206.29 is added to read as follows:

#### **§ 206.29 Initial disbursement of mortgage proceeds.**

Mortgage proceeds may not be disbursed at closing except:

(a) Disbursements to the mortgagor, a relative or legal representative of the mortgagor, or a trustee for benefit of the mortgagor;

(b) Disbursements for the initial MIP under § 206.105(a);

(c) Fees that the mortgagee is authorized to collect under § 206.31; and

(d) Amounts required to discharge any existing liens on the property.

4. A new section 206.32 is added to read as follows:

#### **§ 206.32 No outstanding unpaid obligations.**

In order for a mortgage to be eligible under this part, a mortgagor must establish to the satisfaction of the mortgagee that:

(a) After the initial payment of loan proceeds under § 206.25(a), there will be no outstanding or unpaid obligations incurred by the mortgagor in connection with the mortgage transaction, except for repairs to the property required under § 206.47 and mortgage service charges permitted under § 206.207(b); and

(b) The initial payment will not be used for any payment to or on behalf of an estate planning service firm.

5. Section 206.41 is amended by revising paragraph (b) to read as follows:

#### **§ 206.41 Counseling.**

(a) \* \* \*

(b) *Information to be provided.* A counselor must discuss with the mortgagor:

(1) The information required by section 255(f) of the NHA; and

(2) Whether the mortgagor has signed a contract or agreement with an estate planning service firm that requires, or

purports to require, the mortgagor to pay a fee on or after closing that may exceed amounts permitted by the Secretary or this part.

(3) If such a contract has been signed under § 206.41(b)(2), the extent to which services under the contract may not be needed or may be available at nominal or no cost from other sources, including the mortgagee.

\* \* \* \* \*

6. A new § 206.43 is added to read as follows:

**§ 206.43 Information to mortgagor.**

(a) *Disclosure of costs of obtaining mortgage.* The mortgagee must ensure that the mortgagor has received full disclosure of all costs of obtaining the

mortgage. The mortgagee must ask the mortgagor about any costs or other obligations that the mortgagor has incurred to obtain the mortgage, as defined by the Secretary, in addition to providing the Good Faith Estimate required by § 3500.7 of this title.

(b) *Lump sum disbursement.* If the mortgagor requests that at least 25% of the principal limit amount (after deducting amounts excluded in the following sentence) be disbursed at closing to the mortgagor (or as otherwise permitted by § 203.29), the mortgagee must make sufficient inquiry at closing to confirm that the mortgagor will not use any part of the amount disbursed for payments to or on behalf of an estate

planning service firm, with an explanation of § 206.32 as necessary or appropriate. This paragraph does not apply to the following:

(1) Initial MIP under § 206.105(a) or fees and charges allowed under § 206.31(a) paid by the mortgagee from mortgage proceeds instead of by the mortgagor in cash; and

(2) Amounts set aside under § 206.47 for repairs, under § 206.205(f) for property charges, or § 206.207(b).

Dated: February 3, 1998.

**Nicolas P. Retsinas,**

*Assistant Secretary for Housing-Federal Housing Commissioner.*

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