

**DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT**
24 CFR Part 206
[Docket No. FR-4306-F-02]
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: Final rule.

SUMMARY: This final rule implements several measures designed to provide protection to elderly homeowners in connection with HUD's Home Equity Conversion Mortgage (HECM) insurance program. 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. This rule takes into consideration the comments received on a March 16, 1998 proposed rule.

EFFECTIVE DATE: February 18, 1999.

FOR FURTHER INFORMATION CONTACT: Vance Morris, Director, Home Mortgage Insurance Division, Room 9266, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410. Telephone: (202) 708-2700. (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Mortgagee Letter 97-07 was then withdrawn.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 that may subvert the HECM process, the Secretary decided that HUD should issue a proposed rule based on the consumer protection authority contained in section 255 of the National Housing Act as it then existed (see proposed rule published on March 16, 1998, 63 FR 12930).

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. The proposed rule was intended to fill that gap. The public comment period ended on May 15, 1998, and HUD has taken these comments into account in the preparation of this final rule.

Congress has now enacted legislation to specifically address the problem to which the proposed rule was directed, and this action makes it unnecessary for HUD to rely solely on the previously-existing authority under the National Housing Act. Section 593(e) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (P.L. 105-276 approved October 21, 1998) amended section 255 of the National Housing Act to require that: (1) a HECM shall have been executed by a mortgagor who has received full disclosure, as prescribed by the HUD Secretary, of all costs charged to the mortgagor, which disclosure shall clearly state which charges are required to obtain the HECM and which are not, and (2) a HECM shall have been made with such restrictions as the HUD Secretary determines to be appropriate to ensure that the mortgagor does not fund any unnecessary or excessive costs for obtaining the HECM. Section 593(e)(2) directs HUD to issue a final rule no later than 90 days after section 593(e) takes effect (i.e., by January 19, 1999), after notice and opportunity for public comment. Section 593 does not require that the notice and public comment procedure occur after, rather than before, enactment of section 593. HUD has concluded that the previously published proposed rule is fully consistent with the requirements of section 593, with one exception, and that all interested persons have been provided with an adequate opportunity for public comment, consistent with the desires of the Congress and the demands of HUD's "rule on rules" in 24 CFR part 10. In

order to address the one exception, HUD is adding an express requirement (based on statutory language) for a statement to the mortgagor of which charges are required and which are not. Therefore, HUD is proceeding with this final rule after considering the public comment previously submitted.

Section 593(e) also provides for immediate implementation of section 593, even in advance of consideration of public comments, through an interim notice procedure, if necessary. HUD already had received and reviewed public comments on the proposed rule by the time section 593 took effect and has taken those comments into account in this final rule. Therefore, HUD believes the procedure that it has followed, which accorded the public an opportunity to comment on a proposed rule that addressed the subjects of section 593(e), more than satisfies the intent of section 593.

Public Comments

The Department received 8 comments on its proposed rule. The comments are summarized below by pertinent section of the proposed rule, with other comments summarized at the end.

1. Section 206.3—Definition of "Estate Planning Service Firm"

Comment: Two commenters supported the definition but urged that it be extended to include an individual or entity that charges an annuity premium paid for by mortgage proceeds, if the premium is not disclosed as part of the total cost of the mortgage under the Truth in Lending Act regulations for reverse mortgages.

Response: The final rule includes this suggestion.

Comment: A commenter argued against use of the term "estate planning service firm" (while not arguing against the substance of the definition) as unfair to legitimate financial planning/estate planning firms. The lender suggested the narrower term "referral service firm".

Response: The firms that engaged in the practices that led HUD and Congress to conclude that protective measures were needed did not characterize themselves as engaging in "referrals" but as providing estate planning services and HUD concludes that a broad label—with a careful definition that does not focus solely on referrals—is appropriate. The definition permits any legitimate provider of services that is concerned that its services may be impaired by overbreadth of the rule to be exempted from the rule by HUD.

Comment: A commenter argued that the definition should explicitly

recognize bona fide mortgage brokers in the same manner that bona fide attorneys, accountants and financial advisors are recognized.

Response: The rule provides special recognition of individuals or companies "in the bona fide business of generally providing tax or other legal or financial advice". It recognizes that, in the ordinary course of their business of providing advice, such individuals or companies are likely to routinely provide to clients who are elderly homeowners information and advice that may overlap with the information that counselors are required to provide under the HECM program. The rule provides that charging a fee for such advice—if the fee is not contingent on obtaining a loan—does not by itself make the individual or company an estate planning service firm for purposes of the rule. The rule mentions attorneys and accountants as examples of individuals or companies who may qualify for this exception because their ordinary business is providing advice. In contrast, mortgage brokers typically provide to prospective borrowers services such as locating available sources of loans, prequalifying borrowers, and assisting them in applying for a loan. A mortgage broker may provide some information similar to that provided by a HECM counselor in the course of providing its brokerage services, but prospective borrowers would be unlikely to seek out a mortgage broker solely for the purpose of obtaining information or advice for a fee, rather than for obtaining services for a fee. It is unlikely that a typical mortgage broker business would be characterized—as required by the rule—as being in the business of generally providing tax or other legal or financial advice. For this reason, HUD has concluded that specific mention of mortgage brokers in connection with this part of the definition of estate planning service firm is unwarranted.

Comment: A commenter interpreted this definition as making explicit that housing counseling agencies may charge fees to borrowers, and applauded this position, and another commenter who noticed a reference to counselor fees urged HUD to clarify whether counselors can charge fees, how much, and who can bear the costs. If borne by the consumer, the commenter said they should be included in HECM financing.

Response: Under HUD's program of grants to HUD-approved housing counselors, the counselor is not authorized to charge counseling fees for HUD-related clients except in fiscal years where no funds are given to the counseling agency by HUD. In that

instance, the basis for any fees charged to a HUD-related client must be consistent with local practice and not duplicate other sources of HUD funding. Clients affected must be informed of the agency's fee structure in advance of services being provided.

2. Section 206.29—Initial Disbursement of Mortgage Proceeds

Comment: Two commenters who supported this provision urged that the lender be permitted to disburse an annuity premium if disclosed as part of the total cost of the mortgage under the Truth in Lending Act regulations for reverse mortgages.

Response: The final rule includes this suggestion.

Comment: A commenter requested that the phrase "disbursed at closing" be clarified because funds are actually not disbursed at closing because of a 3-day wait imposed by the Truth in Lending Act's right of rescission.

Response: The final rule includes this suggestion.

Comment: Two commenters believed that section 206.3 would permit counselors' fees and asked why mortgage proceeds could not be disbursed directly to counselors. One other commenter agreed and urged that all fees permitted to be paid by a mortgagee under HUD's Handbook 4235.1 REV-1 (including specifically mortgage broker fees and counselor fees) be disburseable to those parties at closing. That commenter interpreted § 206.29 and 206.31 together as reaching this result but requested clarification.

Response: See the previous response regarding counselor fees. Mortgage broker fees are allowed now under the HECM program only if the broker is engaged independently by the mortgagor and is paid from a source other than the mortgage proceeds. A broker's fee is prohibited if there is any financial interest between the broker and the mortgagee. The broker agreement must be submitted with the mortgage insurance application. Broker's fees can never be paid by the lender from HECM proceeds.

Comment: A commenter supported permitting disbursement of funds at closing to pay contractors who performed repairs required as a condition of closing.

Response: HUD supports this suggestion as long as the lender certifies that the work was done according to the appraiser's requirements based on HUD Handbook 4905.1 (Requirements for Existing Housing for One to Four Family Units) and in accordance with standard FHA requirements for repairs required

by appraisers. The final rule includes this change.

3. Section 206.32—No Outstanding Unpaid Obligations

Comment: A commenter specifically supported this provision, and commented that it could provide important protection against unscrupulous home repair firms and others in addition to the estate planning service firms that are the main target of the rule.

Response: No response required.

Comment: A commenter supported § 206.32(b) forbidding use of initial HECM payments to pay estate planning service firms, but opposed § 206.32(a), which prohibits mortgagor obligations that are incurred in connection with the mortgage transaction but will not be paid off at closing (except for certain repairs or mortgage servicing charges). The commenter interpreted this as precluding later use of HECM proceeds to pay outstanding bills that may have been part of the impetus for obtaining the HECM.

Response: This section does not prevent HECM proceeds from being used to pay bills that were incurred without any connection with the mortgage transaction (for example, pre-existing medical bills), or prevent use of HECM proceeds to pay obligations incurred after the closing. The section targets only those who charge excessive fees in connection with obtaining the HECM.

Comment: Two commenters urged that § 206.32 be deleted in its entirety because of the difficulty for a lender to determine what homeowner obligations exist and ensure that they would be discharged at closing. One of the commenters said it would not object if a lender's obligation were limited to requesting information.

Response: Paragraph (a) of § 206.32 is similar to § 203.32 for "forward" mortgages. As with that requirement, the lender is expected to ask the borrower and may rely on the information provided by the borrower in the absence of other information indicating that the borrower's answer is inaccurate or incomplete. Paragraph (b) focusses on the specific concern of borrowers using the initial disbursement of HECM proceeds to pay unreasonable or excessive fees to estate service planning firms. Section 203.29 prevents direct disbursement to such firms, and paragraph (b) of § 203.32 provides the lender with further assurance that the borrower understands that the borrower cannot use cash disbursed to the borrower as part of the initial disbursement to pay such firms as a

means of getting around the direct disbursement prohibition. A lender can rely on information provided by the borrower in complying with this section; for example, the lender should ask whether the homeowner has a contract with an estate planning service firm (with an explanation of how to recognize such a firm) and it will be sufficient to annotate the application form noting a negative response. Lenders should note that under § 206.43(b)(1) a lender has to have to make "sufficient inquiry" of a borrower who is taking a large initial cash disbursement, in order to confirm that § 203.32(b) will not be violated.

4. Section 206.41—Additional Information To Be Provided by Counselors

Comment: Four commenters commented favorably on this provision, but one of them urged that it be expanded to address any obligation that homeowners may believe they have to pay for home repairs or annuities and not just services provided by the estate planning service firms. Another commenter also supported expansion to cover annuities, and urged use of a form disclosure about annuities.

Response: The Department is considering this suggestion, but is not making changes in the rule at this time.

5. Section 206.43(a)—Additional Information To Be Provided by Mortgagees

Comment: One commenter supported this provision as written while another urged that it be deleted. The latter commenter felt that a lender should not be responsible for disclosure of costs paid outside of closing, or if so, the lender should be able to rely exclusively on a borrower certification on the loan application.

Response: The lender is only required to ask the borrower for the additional information and note on the loan application that the borrower was asked.

6. Section 206.43(b)—Limitations on Lump Sum Disbursement by Mortgagees

Comment: Three commenters supported this provision; one commenter urged that it be deleted or modified so that the information covered should be handled through the loan application and also suggested an overlap with information provided by the counselor.

Response: HUD wanted to emphasize the importance of this rule, and to ensure that the lender has made every effort to ensure that the HECM proceeds were not going to a party ineligible to

receive funds from the initial disbursement.

7. Other Comments.

a. Lack of Statutory Authority

Comments: A commenter argued that the proposed rule is beyond HUD's current statutory authority because Congress authorized a program to increase the number of reverse mortgages and the proposed rule would reduce the availability of reverse by eliminating "a proven source of promotion of reverse mortgages." The commenter also argued that the rule was a "subterfuge" for regulating third parties even though HUD's regulatory authority is limited to lenders.

Response: Even before amendment, section 255 of the National Housing Act and section 7(d) of the Department of Housing and Urban Development Act contained ample authority for a regulation to protect elderly homeowners against special risks identified by HUD in connection with the HECM program (see, e.g., sections 255(c)(2), 255(f)(5) and 255(k)(2)(E) of the National Housing Act.) HUD believes that any doubt about the scope of HUD's authority to implement these measures to protect elderly homeowners was settled when Congress enacted legislation and specifically requiring HUD to proceed with this final rule.

b. There is no Need for the Rule

Comment: The commenter described the rule as arbitrary and irrational because there was no factual basis to conclude that any abuse of elderly homeowners existed.

Response: HUD received many complaints that senior homeowners were being charged excessive fees for services that HUD or mortgagees provide for little or no charge. In any event, Congress felt that past abuse and the potential for future abuse was so serious that it mandated action by HUD.

c. Simpler Proposal Needed

Comment: One commenter did not comment on any specific provision of the proposed rule, but stated that it is difficult to obtain information about the HECM and that the proposed rule would make it harder. The commenter suggested that publishing a book about reverse mortgages could violate the rule. The commenter suggested as an alternative approach limiting any information provider to \$150 for any size mortgage.

Response: The rule only targets information providers that meet the definition of "estate planning service firms"—primarily firms that charge

excessive fees for information and services that one can receive for little or no charge and that are contingent on the elderly homeowner receiving a HECM loan. The rule should not interfere with book publishing, which can supplement HUD's own efforts to publicize the availability and benefits of HECMs. HUD's Homeownership Centers and field offices distribute housing information, including information on HECMs, in numerous homeownership fairs through the country. The American Association of Retired Persons (AARP), National Center for Home Equity Conversion (NCHC), many lenders and other entities have publicized the HECM program through various means including newsletters and radio broadcasts. Articles have been published in senior community newspapers and seminars have been given in senior community centers. The Housing Clearinghouse's toll-free number is provided on the Internet's World Wide Web. HUD continually looks for ways to improve, update and increase its marketing of this program to the public, but it will not tolerate abuse of elderly homeowners in the guise of providing legitimate information and services.

d. Mortgage Broker Fees

Comment: A commenter urged an additional provision that would allow mortgage broker fees for HECMs only if the broker performs settlement services as defined by RESPA and if the sum of the mortgage broker fee plus the loan origination fee does not exceed the \$1800 loan origination fee that may be financed through a HECM.

Response: HUD cannot consider this comment for the final rule because it is outside the scope of matters exposed to public comment in the proposed rule.

Changes Made in Final Rule

New paragraphs (e) and (f) are added to § 206.29 to permit (1) disbursement of an annuity premium at closing if the premium was disclosed under the Truth in Lending Act regulations for reverse mortgages, and (2) payment of contractors who performed repairs required as a condition of closing if the lender makes a certification in accordance with standard FHA requirements for repairs required by appraisers. Section 206.29 is also amended to clarify that it applies to the initial disbursement of funds at closing (if the 3-day rescission period under the Truth in Lending Act regulations does not apply because of, e.g., a waiver in accordance with those regulations) or after closing (in the usual case when the 3-day rescission period does apply so

that no funds are disbursed at closing). The final rule also contains minor language and formatting changes in § 206.43, and adds an express requirement for a clear statement of which charges are required and which are not as required by section 593(e)(1)(C) of P.L. 105-276.

Findings and Certifications

Paperwork Reduction Act Statement

The information collection requirements in §§ 206.32, 206.41 and 206.43 of this rule have been submitted to the Office of Management and Budget (OMB) for review and approval under section 3507(d) of the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). OMB has approved the submission and assigned the following control number: 2502-0534. 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.

Regulatory Flexibility Act

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (the RFA), the Secretary, by approval of this rule, certifies that this rule does not have a significant economic impact on a substantial number of small entities. The rule codifies HUD's policy regarding consumer protection which is consistent with current part 206 provisions and the National Housing Act requirements, as amended by section 539(e) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999. This 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. This rule imposes no significant economic impact on law-abiding entities, small or large.

HUD's RFA provision in the March 16, 1998 proposed rule specifically invited small entities to comment on whether the proposed regulatory amendments would significantly affect them (see 63 FR 12930, at 12932). Only one commenter responded to this request. The commenter questioned HUD's assertion that the rule would not have a significant economic impact on a substantial number of small entities. Specifically, the commenter wrote that the rule might have an adverse impact on businesses that "may" be small entities within the meaning of the RFA. However, the commenter did not offer any data in support of its statement that the rule might potentially have a

significant economic impact on a substantial number of small entities.

Environmental Impact

This final rule is exempt from environmental review requirements under 24 CFR 50.19(c)(1). This rule 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 the policies contained in this rule will 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. As a result, the rule is not subject to review under the Order.

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 rule does not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

Executive Order 12866

The Office of Management and Budget (OMB) reviewed this final rule under Executive Order 12866, Regulatory Planning and Review as a significant regulatory action (but not economically significant).

Catalog. The Catalog of Federal Domestic 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, part 206 of the Code of Federal Regulations is amended as follows:

PART 206—HOME EQUITY CONVERSION MORTGAGE INSURANCE

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

Authority: 12 U.S.C. 1715b, 1715z-20; 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 chapter or a housing counseling agency approved under § 206.41 and that charges a fee that is:

(1) 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

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

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

(ii) 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

(3) 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, except where the fee is for services specifically authorized by the Secretary.

* * * * *

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

§ 206.29 Initial disbursement of mortgage proceeds.

Mortgage proceeds may not be disbursed at the initial disbursement or after closing (upon expiration of the 3-day rescission period under 12 CFR part 226, if applicable) 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;

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

(e) An annuity premium, if the premium was disclosed as part of the total cost of the mortgage under the disclosures required by 12 CFR part 226; and

(f) Funds required to pay contractors who performed repairs as a condition of closing, in accordance with standard FHA requirements for repairs required by appraisers.

4. A new § 206.32 is added 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 servicing 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.

* * * * *

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

(1) The information required by section 255(f) of the National Housing Act;

(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; and

(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. The mortgagee must clearly state to the mortgagor which charges are required to obtain the mortgage and which are not required to obtain the mortgage.

(b) *Lump sum disbursement.* (1) 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 § 206.29), 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.

(2) This paragraph does not apply to any part of the principal limit used for the following:

(i) 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

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

Dated: January 12, 1999.

William C. Apgar,

Assistant Secretary for Housing-Federal Housing Commissioner.

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