

## **BROKER AND LENDER APPROVALS TO ORIGINATE REVERSE MORTGAGES**

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### **I. Participating in Reverse Mortgage Programs**

- A. Some type of approval or licensure is required regardless of which reverse mortgage product you offer.
  - 1. A state mortgage lender or mortgage broker license is required in each state in which you offer or make reverse mortgages.
  - 2. Some states also require additional registration or approval to broker or make reverse mortgages (Kriss will discuss these requirements).
- B. HUD (FHA) approval is required in order to broker or make Home Equity Conversion Mortgages (“HECMs”), HUD’s federally insured reverse mortgage product.
  - 1. The different levels of FHA approval are discussed below.
  - 2. You can act as an “advisor” in a broker advisor program without FHA approval, as is discussed below.

### **II. HUD Approvals for HECMs**

#### **A. Overview**

- 1. Since the HECM product still overwhelmingly dominates the Reverse Mortgage market, you probably want to obtain some type of HUD approval.
- 2. The type of HUD approval you obtain depends upon the level of activity in which you wish to engage and the amount of control you wish to exert over the loan process.
- 3. Any FHA–approved entity may participate in the HECM program.

4. A non-approved entity may only participate as an “advisor” under a broker/advisor program, which is discussed below.
5. Your options for HUD-approval include approval as a loan correspondent (a “mini-eagle”), a mortgagee (an “eagle”) or an investing mortgagee.

B. Types of Approved Mortgagees. FHA classifies approved mortgagees based on the functions they will perform and type of organization. FHA may approve the following types of mortgagees.

1. **Supervised Mortgagee.** The designation is limited to financial institutions that are members of the Federal Reserve System, and financial institutions whose accounts are insured by the Federal Deposit Insurance Corporation (FDIC), or the National Credit Union Administration (NCUA). Examples of supervised mortgagees are banks, savings associations, and credit unions. Supervised institutions may choose instead to apply as supervised loan correspondents or investing mortgagees.
  - a. **Permissible Mortgage Lending Activities.** A supervised mortgagee may originate, underwrite, purchase, hold, service, and sell FHA insured mortgages and submit applications for mortgage insurance.
  - b. **Branch Offices.** A supervised mortgagee may maintain FHA registered branch offices that originate insured mortgages. The Mortgage is fully responsible to HUD for the actions of its offices.
2. **Non-supervised Mortgagee (i.e., mortgage lenders).** This designation applies to non-depository financial entities that have as their principal activity the lending or investment of funds in real estate mortgages.
  - a. **Permissible Mortgage Lending Activities.** A non-supervised mortgagee may originate, underwrite, purchase, hold, service, and sell FHA insured mortgages and submit applications for mortgage insurance.
  - b. **Warehouse Line of Credit Requirement.** A non-supervised mortgagee must maintain a warehouse line of credit or other mortgage-funding program acceptable to the Department. Acceptable programs include table funding and concurrent funding arrangements. The program must be adequate to fund the mortgagee’s average 60-day origination production pipeline, but not less than a \$1 million warehouse line of credit or funding program. In

lieu of a warehouse line of credit, a mortgagee may have a letter from a financial institution stating that it will fund all mortgages originated by the mortgagee.

- c. **Principal Activity.** A non-supervised mortgagee must spend a majority of its time and assets in the production of real estate mortgages and in the lending or investment of funds in real estate mortgages, or a directly related field. For FHA purposes, the principal activity of a non-supervised mortgagee, other than one organized as a not-for-profit entity, must contribute at least one-half of the entity's gross revenues, unless otherwise approved by FHA.

3. **Non-supervised Loan Correspondent (i.e., mortgage brokers).** This designation applies to non-depository financial entities that have as their principal activity the origination of FHA-insured mortgages for sale or transfer to one or more Sponsors who underwrite the mortgages. Sponsors must be DE mortgagees.

- a. **Permissible Mortgage Lending Activities.** A non-supervised loan correspondent may originate FHA insured mortgages and submit applications for mortgage insurance.
  - i. **Sale only to Sponsor(s).** It may not sell or otherwise transfer any FHA mortgage to any mortgagee other than its registered Sponsor that underwrote the loan, without prior written approval from the Department.
  - ii. **May not hold, purchase or service.** It may not hold, purchase, or service FHA-insured mortgages.
- b. **Principal Activity.** A non-supervised loan correspondent must spend a majority of its time and assets in production of real estate mortgages and in the lending or investment of funds in real estate mortgages, or a directly related field. For FHA purposes, the principal activity of a non-supervised loan correspondent, other than one organized as a not-for-profit entity, must contribute at least one-half of the entity's gross revenues, unless otherwise approved by FHA.
- c. **Funding agreement.** It must have a written agreement with each of its Sponsors to fund all mortgages that is originated and that the Sponsor underwrites.

4. **Supervised Loan Correspondent.** A mortgagee that qualifies for approval as supervised mortgage may be approved as supervised loan correspondent and must have one or more sponsors who underwrite the mortgages. Sponsors must be DE mortgagees.
  - a. **Permissible Mortgage Lending Activities.** A supervised loan correspondent may originate FHA insured mortgages and submit applications for mortgage insurance.
    - i. **Sale only to Sponsor(s).** It may not sell or otherwise transfer any FHA mortgage to any mortgagee other than its registered Sponsor that underwrote the loan, without prior written approval from the Department.
    - ii. **Servicing.** A supervised correspondent may service FHA-insured mortgages in its own portfolio with the prior permission of the Department. Such request should be submitted to the Lender Approval and Recertification Division.
  - b. **Funding agreement.** A supervised loan correspondent must have a letter or written agreement from each of its Sponsors that the Sponsor will purchase all FHA mortgages that the loan correspondent originates and that the Sponsor underwrites.
5. **Investing Mortgagee.** This designation applies to an organization, including a charitable or not-for-profit institution of pension fund, which is not approved as another type of institution and that invests funds under its own control. It may purchase, hold, and sell FHA insured mortgages but may not originate them. Investing mortgagees may only service FHA insured mortgages with the prior permission of FHA.
  - a. **Permissible Mortgage Lending Activities.** An investing mortgagee may purchase, hold, and sell FHA-insured mortgages. It may not submit applications for mortgage insurance. It may not service insured mortgages without prior approval of the Department, and must arrange for an approved mortgagee to service all insured mortgages the investing mortgagee acquires and monitor the performance of any service they hire.
  - b. **Special requirements.** An investing mortgage must meet the following requirements:

- i. It must have lawful authority to purchase insured mortgages in its own name.
- ii. It must have available, or have arranged for, funds sufficient to support a projected investment in real estate mortgages of at least \$1 million. For example, a \$1 million line of credit is acceptable.

C. Significant Approval Requirements

1. Type of Entity – – Permanent organization having succession such as a corporation, partnership or chartered institution; a sole proprietorship or a trust is not eligible.
2. State Licensing – – All required state licenses necessary to perform the entity's proposed activities must be obtained.
3. Net Worth Requirement – – Mortgagees must meet specified net worth requirement for initial approval and to maintain approval. The net worth requirement for mortgagees increases after approval based upon its FHA-insured single-family mortgage volume.
  - a. Mortgagees:
    - i. Initial Approval – – At least \$250,000 net worth
    - ii. Continued Approval – – 1% of volume of FHA single family insured mortgages the mortgagee originated, purchased or serviced during the prior fiscal year, but not less than \$250,000 or more than \$1 million.
  - b. Loan Correspondents must have and maintain a net worth of at least \$63,000, plus \$25,000 for each registered branch office up to a maximum required net worth of \$250,000; net worth is not based on mortgage volume.
4. Liquid Assets – – Must maintain liquid assets (cash and cash equivalents) of 20% of net worth or \$100,000, whichever is less.
5. Operating Expenses – – Mortgagees must pay their own operating expenses.

D. Direct Endorsement (DE) Lender – – (“Full Eagle”)

1. As a DE Lender, you may control all aspects of the loan, including processing, underwriting, closing and funding.

2. DE authority is granted on the bases of demonstrated qualifications, experience and expertise.
3. Direct endorsement authority allows Mortgagees (but not loan correspondents) to underwrite single-family mortgages without FHA's prior review and submit them directly for endorsement.
4. In addition to assuming control and all associated risks over underwriting duties, a DE Lender must obtain a warehouse line of credit.
5. DE Lenders must review and submit files directly to HUD for insurance purposes.
6. The following requirements, among others, must be satisfied to become a DE Lender:
  - a. HUD-approved mortgagee (not loan correspondents)
  - b. Non-supervised mortgagees must have a net worth of at least \$250,000.
  - c. Must have 5 years experience in the origination of single family mortgages or have a principal officer with a minimum of 5 years managerial experience in the origination of single family mortgages.
  - d. Have an underwriter on staff that meets certain qualifications and has completed a Direct Endorsement training program.
  - e. Have developed and implemented a Quality Control Plan which satisfied HUD's requirements.
  - f. Have satisfactorily completed the pre-closing case review phase of Direct Endorsement.

### III. Broker Advisor Programs

#### A. Program Description

1. A program under which an advisor is retained to perform certain services to educate the loan applicant about reverse mortgages and assist in the loan application process.
  - a. Increases access, and
  - b. Applicant understanding

2. Under the Program, an "advisor" is independently retained by the reverse mortgage applicant and enters into an agreement with the potential reverse mortgage applicants under which the applicant agrees to pay the advisor a fee (never exceeding, 25% of the HECM origination fee that the applicant will pay) in exchange for certain services.
3. These services generally include the following:
  - a. Advise and educate the applicant on the mortgage loan process generally and specifically about reverse mortgage products, including HECM reverse mortgage products and any unique issues with HECMs;
  - b. Advise and educate the applicant on the features, availability, benefits, typical costs and obligations of reverse mortgage loans, including HECMs;
  - c. Advise the applicant regarding the potential financial implications of reverse mortgages, the factors affecting qualification, and generally on the amount of benefit for which the applicant may qualify;
  - d. Assist the applicant in understanding credit problems that may arise in connection with a reverse mortgage;
  - e. Provide the applicant with telephone numbers and web sites for independent resources to obtain more information about reverse mortgages;
  - f. Advise and educate the applicant regarding how the condition of the applicant's home may impact qualification and use of the loan proceeds as well as the applicant's continuing obligation to maintain the structural integrity, good repair and condition of the home after the loan's closing;
  - g. Direct the applicant to, and advise the applicant of, counseling resources available in connection with HECMs;
  - h. Advise the applicant regarding the lenders in the applicant's area that offer reverse mortgage products;
  - i. Advise the applicant with respect to questions the applicant has in the process of completing a HECM or other reverse mortgage loan application and other forms to be submitted to one or more of such lenders;

- j. Assist the applicant in collecting documents that are part of the application process;
- k. Submit to lenders on the applicant's behalf any certificate or acknowledgment of counseling or other educational processes required by such lenders; and
- l. Assist the applicant in dealing with such lenders as the applicant completes the HECM or other reverse mortgage loan application, and during the processing, underwriting and closing of his or her HECM or other reverse mortgage loan request.

Note that the advisor may not take an application; origination, funding and closing are handled by the broker and/or lender.

- 4. The advisor enters into a written agreement with the applicant under which the advisor agrees to provide the services I just mentioned in exchange for an advisor fee which is to be paid out of the origination fee paid by the borrower to the lender. Typically, the advisors fee will never exceed 25% of the HECM origination fee.
- 5. After providing the specified services, the advisor issues an Advisor Certification under which the advisor certifies that he or she has performed the specified list of services.
- 6. The advisor also enters into an agreement with the broker under which the advisor agrees
  - a. to provide the specified services,
  - b. to enter into a written agreement with the applicants and
  - c. not to be paid anything more than the specified fee in the agreement with the applicant.
  - d. The broker agrees to pay the agreed fee to the advisor and agrees, with the advisor, to comply with all applicable law.
- 7. In most cases, the advisor interfaces between the applicant and a broker, although some lenders are beginning to work with advisors directly in connection with their retail operations, in which case, the lender and advisor enters into an agreement similar to the broker-advisor agreement.

B. Issues Presented

1. Certain issues arise in connection with this program, particularly in connection with the origination of HECM loans. While HUD has tacitly permitted this program, some issues are particular to FHA and the HECM program. These issues include the following:
  - a. Who may act as an advisor?
  - b. How should the advisor fee be disclosed?
  - c. May the advisor work primarily with one broker or does the advisor have to present the loan products, etc. of more than one broker or lender?
  - d. Is the advisor fee permissible, and if so, how much can be charged?

HUD is currently looking into these issues and is in the process of drafting a mortgagee letter on the use of advisor.

2. Who May Act As An Advisor?
  - a. As an initial matter, an advisor may have to be licensed under state law as a mortgage broker. In some states, merely putting a borrower and a lender together will trigger the state mortgage broker licensing requirement.
  - b. Under FHA regulations, the issue is a bit more complicated.
    - i. FHA-approved loan correspondents may act as advisors.
    - ii. Non-FHA-approved mortgage brokers may act as advisors (note that the HUD alert issued in the fall regarding the use of and payment of non-FHA-approved brokers applies only to forward mortgages and does not apply to HECMs).
    - iii. A question exists as to whether FHA-approved mortgagees (eagles) may act as an advisor.
      - (a) HUD's initial position was that FHA-approved mortgagees may not act as advisors because they may not merely perform "advice and assistance" function.

- (b) I believe that the better position is to allow full eagles to act as an advisor. The FHA-approved mortgagee is an entity that HUD has approved and is familiar with FHA programs. Why wouldn't HUD want to allow a known entity to be advising HECM borrowers?

One way of reaching this outcome would be to create a Principal/Authorized Agent relationship (per Handbook 4060.1 Section 5-9 through 5-15) between two approved mortgagees. One mortgagee would be the principal, who will make the loan, while the other will act as the broker-advisor.

As section 5-9 of Handbook 4060.1 states:

The principal-authorized agent relationship provides mortgagees flexibility in the origination of FHA insured single-family loans in situations where a mortgagee wishes to collaborate with another mortgagee. This process provides mortgagees flexibility to offer diversified loan products or programs because of the ability to team with firms that may have more expertise in specialized areas. This includes products such as HECM or 203(k).

This relationship seems ideally suited to two mortgagees that want to collaborate in originating HECM loans. If one lender has clients or an applicant pool to which it would like to offer HECMs to better serve its client base, but does not have the expertise or the infrastructure to offer a HECM, why can't it team with another approved mortgagee that has the ability to underwrite and make HECM loans? There do not appear to be any impediments to using this structure to allow approved mortgagees to help originate HECM loans. The total fee charged to the borrower is not affected by this relationship since the borrower will only pay the permissible origination fee, part of which will be used by the principal to pay the authorized agent.

HUD is reviewing this position

### 3. Advisor Fee

- a. As is the case with all settlement service fees, fees paid in connection with a federally related mortgage loan are permissible if they are paid for a bona fide non-duplicative service, and the fee is equal to the market value of the services. Anything in excess of the market value will be deemed to be an impermissible referral fee.
- b. HUD has consistently advised that the issue under RESPA is whether the compensation to a mortgage broker in covered transactions is reasonably related to the value of

the goods or facilities actually furnished or services actually performed. If the compensation, or a portion thereof, is not reasonably related to the goods or facilities actually furnished or the services actually performed, there is a compensated referral or an unearned fee in violation of Section 8(a) or 8(b) of RESPA, whether the compensation is a direct or indirect payment or a combination thereof.

- i. In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with that amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets. If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA (See 24 CFR 3500.14(g)(2)).
- c. As with a broker fee, the advisor fee must be paid out of the HECM origination fee since a borrower may not be assessed more than this amount. Typically brokers, who are generally getting paid the entire origination fee, have been paying advisors a specified fee not to exceed 25% of the HECM origination fee for their services. Each broker must ensure that the advisor fee represents the market value of the services actually performed by the advisor.
- d. The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders.

– HECMs clearly require a greater amount and time and effort to educate, hand hold and assist in the pre-application and application process.

4. How should the advisor fee be disclosed?
  - a. HUD’s position is that the advisor fee must be disclosed on the HUD-1 if it is paid directly by the borrower or financed as part of the origination fee. The fee would be disclosed as payable to the advisor and marked “POC” since it is paid out of the origination fee paid to the lender or (indirectly) to the broker.
  - b. In the situation where an advisor enters into an agreement with a broker, where the lender is not involved, there is an argument that the advisor fee may not need to be included on the HUD-1. If the advisor is not required by the lender, and the broker wishes to outsource some of its activities and pay those parties from its own funds (i.e. its broker fee), it would appear that these third parties need not be disclosed. The advisor is not being paid out of closing and has no relationship with the lender. In many cases, the lender will not even be aware that an advisor has been involved.

However, HUD wants transparency and the Borrower knows fee is being paid to the advisor so the better practice would be to disclose the fee.

- c. Of course, if the lender enters into an agreement with an advisor directly and no broker is involved (i.e. in connection with a lender’s retail operation), the advisor and the advisor fee would be disclosed on the HUD-1 since the fee would be paid directly out of closing by the lender.
5. Is there any problem with the advisor working with only one broker or lender and advising applicants with regard to only that broker’s or lender’s products?
  - a. The best practice would to advise applicants about the products of more than one lender. Recommending only one lender to the applicants may be deemed to be steering – and the advisor fee deemed to be a referral fee.
  - b. The 1994 HUD policy statement on broker fees indicates that:

- i. HUD is concerned that a fee for steering a customer to a particular lender could be disguised as compensation for "counseling-type" activities. Therefore, the letter states that if an agent or contractor is relying on taking the application and performing only "counseling type" services such as educating, pre-qualifying, clearing credit problems, collecting financial data and forms, and maintaining contact with the applicant throughout the processing of the loan to justify its fee, HUD would also look to see that meaningful counseling not steering is provided. In analyzing transactions addressed in the IBAA letter, HUD said it would be satisfied that no steering occurred if it found that:
  - (a) Counseling gave the borrower the opportunity to consider products from at least three different lenders;
  - (b) The entity performing the counseling would receive the same compensation regardless of which lender's products were ultimately selected; and
  - (c) Any payment made for the "counseling-type" services is reasonably related to the services performed and not based on the amount of loan business referred to a particular lender.

Following this **"safe harbor"** position would help avoid any HUD scrutiny.

- C. However, to the extent that the advisor is performing legitimate, non-duplicative services (that defray the amount of work or time the lender or broker need to spend on the applicant), the fee should be deemed to be a permissible fee for services rendered even if less than three lenders/brokers are recommended.
  1. Section 8 prohibits compensation for the referral of settlement service business and for the giving or accepting any portion, split or percentage of any charge other than for services actually rendered. (24 CFR 3500.14(c).) Regulation X provides that a charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates the unearned fee prohibition. (See 24 CFR 3500.14(c).) Moreover, 24 CFR 3500.14(g)(1)(iv) clarifies that Section 8 of RESPA permits "[a] payment to any person of a bona fide salary or

compensation or other payment for goods or facilities actually furnished or for services actually performed."

2. Accordingly, if the services are bona fide and not duplicative should be permissible if fee is reasonably equivalent to the market value of the services.

D. Conclusion

1. The broker advisor program has been out in the marketplace for well over a year and can be operated in a legal and compliant manner.
2. We are anxiously awaiting HUD's mortgagee letter on the subject, which I understand is in a draft stage and will be coming out shortly. The letter should address some of the issues I raised today. The letter received input from the HECM group, the RESPA group, as well as the HUD-approval group, so it should be comprehensive.
3. If you have thoughts on the subject you may want to talk to Erica Jessup or Meg Burns to convey your position.