The Consumer Finance Podcast – Unlocking the Secrets of Reverse Mortgages
Host: Chris Willis
Guests: Megan Burns, Jason Manning, and Punit Marwaha
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Chris Willis:

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of the Troutman Pepper Locke's Consumer Financial Services Regulatory Practice. Today, we're going to be talking about reverse mortgages, and the regulatory and litigation challenges that surround them.

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As I said, today, we're going to be talking about reverse mortgages, and joining me to talk about that are three of my colleagues for our Consumer Financial Services Litigation practice, Jason Manning, Megan Burns, and Punit Marwaha. Guys, thanks for joining me on the podcast today.

Jason Manning:

Glad to be here.

Megan Burns:

Thanks for having us.

Chris Willis:

So, let's just jump right into it. Reverse mortgages are a somewhat unusual product. Not everybody has experienced one for themselves. So, Punit, do you mind starting us off by just telling the audience what is a reverse mortgage and how is it different from the kind of mortgage we're all more used to?

Punit Marwaha:

Sure. I think a lot of us are familiar with regular or forward-facing mortgages, where you take out a loan and you make monthly payments over however many years. Reverse mortgages differ in that. So, generally available to borrowers age 62 years or older. In a reverse mortgage, you are using the equity of your home as collateral for the loan. So, what that generally means is that, you're going to get a lump sum payout, which is the typical case when you first take out the loan. Or the other options are a regular fixed monthly payment as long as one borrower resides in the house or a line of credit that can be accessed as the borrower chooses. Now, the loan is repaid in an event of default, which is typically going to be either the death of the borrower, or the failure to pay taxes and insurance, or otherwise, if the borrower no longer resides in the property.

In a reverse mortgage, you're not making monthly payments to the bank. Instead, you're just responsible for taxes and insurance. It allows homeowners to borrow money using their homes as security for the loan. Since they're not making monthly payments, the loan balance is repaid when the borrower does not live in the home, no longer uses the home as a primary residence. Or otherwise, as long as they're keeping up with taxes and insurance, then, there is no default.

Though there are private label reverse mortgages, majority of them are regulated by HUD and HUD guidelines. They're also FHA insured too, which means that they are non-recourse loans. So, generally, the amount of liability for the borrower is capped in the value of their home. What that means is if the home continues to increase in price over the life of the reverse mortgage, the house is worth more than the loan amount at the time that the borrower, let's say, moves out of the home.

Then, the liability for the borrower is capped at what the loan amount is rather than any equity. Any shortfall after the sale of the property if the home value decreases less than the loan amount is covered by FHA insurance.

Megan Burns:

Hi, this is Megan Burns. I just wanted to add that these loans typically are what's called a non-recourse loan. We're all familiar with the fact that if you don't pay your mortgage, there may be a foreclosure. But in addition, you may be responsible for whatever—let's just say, your home isn't worth what the loan amount is. You're going to be responsible for what they call a deficiency. In a reverse mortgage, the lender of the servicer can only look to the value of the property. So, if, at the end of the day, when the borrower moves out of the house or dies, if the property is worth less than the loan balance, then, the heirs will not be on the hook for the deficiency.

And the only other thing I wanted to mention is, Punit mentioned that one of the requirements for a reverse mortgage is that, it be the principal residents of the borrower. And along those lines, the borrower has to certify every year that he or she is living in the property as his or her principal residence, as that's necessary. It's not like a forward mortgage or a regular mortgage where you don't have that requirement.

Chris Willis:

Okay. Thanks, Megan. It seems to me that, given that it's a product that's oriented towards exclusively older adults, that is, as Punit said, 62 and older, it seems like there would probably be some sensitivity around sort of elder financial abuse or exploitation. Tell me about sort of the situation there as it relates to reverse mortgages.

Jason Manning:

There's been a lot of litigation around this product. Typically, plaintiffs' counsels tried to seize upon exactly that theme that you were mentioning, Chris, where it's a vulnerable population. What is often ignored by the plaintiff's attorneys is that, this is a government program. This is a government product. It's regulated by HUD. The government is ensuring it. And so, there's a whole series of guidelines that servicers need to follow for compliance, but by following for compliance, you're able to demonstrate that, exactly that concern has been addressed.

There's counseling on the front end. There's additional services and notices that are required. If you comply, you're able to demonstrate very credibly to plaintiff's attorneys that this was done exactly as what the government required, and this is a program that the government believes is beneficial to that population.

Chris Willis:

Got it. Well, Jason, you introduced the idea of litigation and the fact that there is litigation around this product. Why don't we dive into that? What kinds of litigation have you all seen involving reverse mortgages?

Jason Manning:

Obviously, there's individual cases and there's class. I'll let Punit talk through the individual, because I know he's done a huge number of those. Why don't you start there, Punit?

Punit Marwaha:

Sure. So, there are a few different cases that we have seen in the past. First category is NBS or non-borrowing spouse cases. That is a situation where prior to the reverse mortgage being entered into, there is an elderly married couple, and one of them quit claims, their interest in the property to the other spouse, who then takes out a reverse mortgage. So, on the loan documents, as well as the land records, there's only one borrower and one owner of the property. Now, on the event of a default, typically, when the borrowing spouse dies, it, in theory, would leave the non-borrowing spouse out to dry. They have this home that has a lien on it, and no real recourse to try to stay in the property.

HUD has introduced lots of guidelines, specifically for these NBS or non-borrowing spouse situations. The big one that we have seen in the past use is Mortgagee Letter 2015-15, which creates the mortgage optional election or MOE assignment program. What that is, when the deceased borrower is survived by the non-borrowing spouse, the mortgagee may either foreclose or utilize the MOE assignment. They typically have to notify the HUD secretary within 60 days of the borrower's death or determination that the home equity conversion mortgage or HECM is ineligible for the MOE assignment.

What the MOE assignment does is it modifies the reverse mortgage to defer the due and payable status due to the death of the borrower, or in other words, for the defaults. The deferral ceases immediately upon the death of the non-borrowing spouse, or otherwise, if the non-borrowing spouse no longer uses the property as their primary residence. And at that point, the loan becomes immediately due and payable. The non-borrowing spouse during the deferral must continue with all the obligations under the mortgage. Primarily, taking care of the property taxes and insurance, and there's a written acknowledgement by the non-borrowing spouse that no further disbursements will be made, and the reverse mortgage will become due and payable if those obligations are not met.

So, in a lot of the situations that we've seen, it's been foreclosure filed due to the death of the borrowing spouse. Non-borrowing spouse comes in and says, "This is inequitable. Why am I being kicked out of my house I lived in for 30 years?" In those situations, we have often utilized this MOE assignment program to resolve the litigation, which allows the non-borrowing spouse to stay in the house, resolves the foreclosure, and at least on the servicer end, makes it HUD's problem.

Jason Manning:

Yes, that's a great point, Punit. Because a lot of times, those individual cases can be resolved through an at-risk program that the government offers. Because again, conceptually, these HECM products, they're FHA insured back by HUD. The government doesn't want the foreclosure to occur if it's going to jeopardize or trigger a payout. And so, the government has done a really good job of providing at-risk programs, which are available and often utilized for resolving individual litigation.

Chris Willis:

Okay, got it. So, we've talked about the non-borrower spouse cases. It seems to me likely though that there's probably also litigation when the person who took out the reverse mortgage passes away, and then their heirs may argue there was something wrong with the origination of the reverse mortgage. Tell me a little bit about that.

Punit Marwaha:

Sure. So, a lot of the cases that we have seen have dealt specifically with fraud and the origination. There is a family of cases that Jason and I have worked on for a mortgage servicer involving a third party coming in scouting the area for elderly homeowners, likely have some equity in their property, and either no liens at all on the property or a tax lien, something small that can be resolved fairly quickly.

The third party will come in, promise home repairs under a free government program, or a free city program, and have the elderly homeowner fill out paperwork for reverse mortgage. Once they get the proceeds, the lump sum payment from the reverse mortgage, third party will abscond with the proceeds, run off. The heirs are left in the dark until a foreclosure is filed after an event of default. Typically, again, the death of the borrower. They get the foreclosure paperwork, and they say, "What's going on? "Why is there a foreclosure being filed? "I thought this house was paid off? I thought we were going to get this house." They will come in and argue that the origination of the mortgage was fraudulent due to some statement by a third party or otherwise. Someone who had some sort of control over the elderly homeowner, saying that they ran off with the proceeds. They didn't get any proceeds. There was no consideration for those reverse mortgage.

Those cases that we've dealt with have typically involved a third party, not a family member to the borrower coming in and making these promises of home repairs and pocketing the proceeds from the reverse mortgage. There, we have generally using agency arguments to say that there was no agency between the original lender of the mortgage and the third party who dealt with the borrower. We typically had a lot of success in the courts with this argument, because it's trying to tie in the mortgage broker or a third party to the original lender.

So, typically, it's been a high hurdle for heirs and non-borrowing spouses to try to overcome, just because of the heightened pleading standard that comes along with fraud. Generally, the documents are executed in the same handwriting, same signature as the elderly homeowner. So, it's hard to contest that they didn't read the document or that they didn't understand what they were signing when they executed the reverse mortgage documents.

A lot of the fraud too does tie in with elder abuse and exploitation as well. I know that does vary from state to state. But generally, there can be issues that arise with elder abuse and fraud, specifically, with reverse mortgages, just due to their nature of being available to elderly homeowners as well. A lot of what we see is when someone comes in, and they gain the trust of an elderly homeowner and get them to sign these documents. Now, there are general civil and criminal penalties that go along with that, which do vary from state to state. But generally, those are going to be more the issue of the third party who is helping originate the loan, rather than the mortgage servicer itself.

Jason Manning:

Yes, I want to jump in there, because I really see two categories on the individual cases related to allegations of fraud. The first is, as Punit's been describing, that the third party, and in that case, that the originator, and then the subsequent servicer is actually also harmed. They didn't know about how those things were originated. And so, the defense to Punit's point becomes, they're not our agent. We had no reason to know and no knowledge to know, we weren't involved. So, that's one distinction.

The second distinction is often time the allegations of fraud are meritless. You really have a lot of HUD guidelines and HUD documentation that can support that on behalf of the servicer or the originator. For example, part of the origination process requires a HUD certified counselor, and also a HUD-certified designation of net benefit to the borrower. Both of those are very useful for defending allegations of alleged fraud.

Megan Burns:

Jason, as you want to mention unconscionability at all, it just seems like that's kind of not really fraud, but that's what we've seen a lot of. Claims on the part of the borrower that he or she has been unconscionably induced into the contract. This is a particular issue in, for instance, West Virginia, which has a statute that specifically flags unconscionable inducement as a cause of action.

Jason Manning:

Yes, there are certainly jurisdictions that have more robust statutes on behalf of consumers, and it doesn't have to be designated as elderly. So, you have that additional layer. But in terms of the protections that are provided, again, the part of the issue that we need to keep in mind is, HECM products are government-sponsored, and have government guidelines. That provides strong defenses in terms of both origination and servicing.

Chris Willis:

Jason, you mentioned something that reminded me of another episode of this podcast you've been on before, which was the one about junk fees. And it seems like there might be opportunities for people to contest the fees and interest that accrue on reverse mortgages in litigation too. Does that happen?

Jason Manning:

It does. Really, there's, I would say, there's probably three categories that I see these kind of class cases being brought in the reverse mortgage context. The first is, what you've referred to Chris, as alleged junk fees, and that's basically a label that plaintiff's attorney slap on anything they don't like. So, you have to dig into it, understand it, and then explain it. For example, in the context of a reverse mortgage, there are a number of services that are mandated by HUD guidelines.

So, as Megan mentioned occupancy certificates. If those are not completed, it triggers a property inspection. You have to. The servicer doesn't have a choice. You have to go in and do a property inspection. And oftentimes, as you'd expect, there's a vendor fee associated with that. It's a straight pass-through. It's a payment to that vendor for going out to the property.

Property inspections are an example of a type of fee that has been heavily litigated. Now, again, there are certain states that have nuances to that, where you can't seek to recover those fees from the borrower themselves. In this case, again, non-recourse, so it's being added to the loan balance. If the state prohibits that from being added to the loan balance as a recoverable fee from a borrower, then, it has to be submitted as an investor claim to FHA. There's a whole another series of regulations. That's another podcast, Chris, but we're not going to talk about investor claim submissions. As you imagine, it's highly regulated and very specific.

Chris Willis:

Yes, I'm sure it is. And probably gives rise to potential jeopardy under sort of a false claims act sort of theory. Let's save that for another day.

Jason Manning:

We won't go there. But if there's a default, as Punit mentioned early on, you've got death of a borrower as an event of default and failure to pay tax and insurance as an event of default. When that occurs, then, the servicer needs to go to HUD to demonstrate yes, this has occurred, and HUD actually approves proceeding with foreclosure pursuant to its guidelines. That's important because that triggers a whole series of additional services like an appraisal prior to a foreclosure, retaining counsel, giving notice, doing a title search. Those fees are all added to a loan balance, again, pursuant to both the contract and HUD guidelines. There's nothing unfair or unconscionable about them. They're required. The servicer must do that. Otherwise, the servicer is at risk of being required to repurchase that loan from the government.

Megan Burns:

But as you can imagine, these types of fees, inspection fees, situations where insurance is added to the loan, disputes over whether taxes have been paid or not generate class litigation, because I'm not talking about large sums of money in the individual. But when you aggregate them, you may be looking at a large amount of money over a nationwide class, for instance.

Chris Willis:

Understood. That makes sense. All of you have mentioned the role of HUD in not only backing reverse mortgages via insurance, but also, in terms of the regulations, the requirements of counseling, and all the forms, and paperwork, and things. But we have a new federal administration. Have there been any changes in the program, or are you anticipating any changes in the program from the federal government as a result of the administration change that we've just been through?

Punit Marwaha:

Yes, Chris. Though, we are still early on in the administration, there is a lot of uncertainty as to how HUD and FHA are going to handle reverse mortgages going forward. So far, the only direction we have from HUD came out back on March 26 with Mortgagee Letter 2025-9. That mortgagee letter revises the residency requirements for FHA-insured mortgages, including the HECM reverse mortgages. With this mortgagee letter, the mortgagee must determine the residency status of the borrowers at the initial application stage.

So, when the paperwork is being filled out, the application is submitted, the mortgagee must take a look and determine whether the applicant is a citizen, or otherwise, has permanent resident status. The rationale that HUD is using for this is the ability to fulfill long-term financial obligations depends on stable residency and employment. I think we're generally seeing a push with this administration to strengthen up citizenship and permanent resident status as well, which ties into kind of the broader themes that this administration is putting forward in the first few months. Where citizenship, and residency status, legal status is going to be more of a factor in whether loans are given out, or whether people can take advantage of government programs.

Chris Willis:

That's really interesting, Punit, and it has a fair lending overlay too. Because about two years ago, the CFPB and the Department of Justice issued a joint statement that said, that limiting eligibility for a loan product to U.S. citizens and permanent residents might be a violation of the Equal Credit Opportunity Act. And there was significant private litigation along those lines, especially in California, starting a few years ago.

You've had immigration status added as a protected characteristic to several state's anti-discrimination laws like California, Washington, and New York. So, to see the federal government essentially say, "You must be a U.S. citizen or permanent resident," seems to sort of contradict that earlier statement. Which of course was made in another administration, so, I guess, they don't care about it. But it is an interesting point that I wanted to raise for the listeners.

Punit Marwaha:

Absolutely, Chris. I think that we will see some litigation stemming from this as well, given the number of applications that generally come in. Especially with what you mentioned with the Equal Credit Opportunity Act as well. I think that this is going to be right for litigation and possible claims of discrimination based on the Equal Credit Opportunity Act going forward as well. However, since the mortgagee letter did just recently come out, I don't think that we have seen that yet, but I can see that being a trend over the next few years with reverse mortgage litigation.

Chris Willis:

Okay. Any other changes coming down the pipe from FHA or HUD on this?

Megan Burns:

The only other thing that I think might be important to note is that there have been changes to the maximum claim amount, which has now gone up to approximately $1.2 million, which allows borrowers who are living in more pricey homes to also access the HUD-backed reverse mortgage. Prior to that, many of those individuals had to borrow under what would be like a private jumbo reverse mortgage, and the government-backed mortgage has some definite advantages.

Chris Willis:

Got it. Anything else you all would like to close with in terms of your predictions for what may happen with reverse mortgages and regulation and litigation over the next couple of years?

Jason Manning:

One favorable trend, Chris is, we've had a couple of cases that were brought as a class and were able – through very similar themes to what we've been talking about today, to have that class portion of the case dismissed on an early dispositive motion. One of which we took all the way the remaining individual claims through a jury trial and obtained a complete defense verdict. The second went all the way to class certification and the court denied it, and that's another important precedent. Because what you'll see in a lot of these reverse mortgage cases is the facts are very individualized, and there's a lot of loan level analysis that occurs on things like, what type of fee was charged, why was it charged, when was it charged, was it added to the balance, what type of product it was. And all of that is really important from a defense standpoint when opposing a class.

Megan Burns:

The other thing I just would add really quickly there is that, it's often difficult for plaintiffs to prove that they have damages. Because as we've all mentioned, these fees are not a personal responsibility of the borrowers. They're added to the loan balance. And so, there really is no damage here if you're talking like a breach of contract case. Unless and until the property sells and there's equity in it.

Chris Willis:

Makes sense. Well, Punit, Megan and Jason, thank you all for being on the podcast today. This has been a really interesting discussion of a product that a lot of people don't have a whole lot of exposure to. So, I appreciate you sharing it with the audience. And of course, thanks to the audience for listening to today's episode as well. Don't forget to visit and subscribe to our blogs, TroutmanFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. While you're at it, why not visit us on the web at troutman.com, and add yourself to our Consumer Financial Services email list. That way, we can send you copies of the alerts and advisories that we send out from time to time, as well as the invitations to our industry-only webinars. And of course, stay tuned for a great new episode of this podcast every Thursday afternoon. Thank you all for listening.