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The Reverse Mortgage Puzzle: Part III

By Kerry Pechter   *Thu, Apr 21, 2016*

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During lunch at a recent financial industry conference, an advisor was asked for his opinion of reverse mortgages. “I might recommend them to certain types of clients,” he said, chewing on his farm-raised salmon. “But don’t see how I could get paid for it.”

With rare exceptions, the nation’s hundreds of thousand of securities licensed investment advisors—a likely source of retirement advice for millions of Americans—don’t recommend Home Equity Conversion Mortgages, as reverse mortgage are formally called, nor do they typically consider them, even when circumstances might be appropriate.

There are understandable reasons for this avoidance. As a practical matter, advisors who don’t have mortgage licenses can’t make direct commissions from a HECM or earn a finder’s fee for a HECM referral. Second, most brokerage advisors don’t practice “life-cycle” investing, which considers an investors entire “household balance sheet,” including home equity. Third, FINRA, the self-regulator of broker-dealers, has long regarded them with suspicion.

The suspicion was well earned. Before 2009, the HECM market went through a Wild West phase. Some advisors steered people into reverse mortgages as a way to fund annuities. Some borrowers took out lump sum loans, squandered the money and skipped out on their taxes and insurance, leading to foreclosures. These episodes led to legislative outcry, regulatory alerts and changes to the HECM program that the public still hasn’t digested. The reputation of the reverse mortgage has yet to recover.

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The upshot is that, in addition to post-financial-crisis reductions in the generosity of the HECM program and the retreat of large financial institutions from the HECM business—plus a mandatory, client-paid pre-sale counseling requirement—the HECM program is hobbled by lack of demand on the part of broker-dealers and advisors. Little wonder that it isn’t thriving.

'Not even discussed'

Reverse mortgages aren't investments, so it should not come as a great surprise that investment advisors don't promote them. "In my 10+ years here, I've never heard reverse mortgages used in any way," Scott Stolz, vice president at Raymond James, the national broker-dealer, told *RIJ* recently. "I haven't even heard them discussed. We don't compensate the advisors in any way for recommending them."

"I am not aware of a prohibition on the use of reverse mortgages, but I am also not aware of a source of the product for the financial advisors," he added. If a Raymond James advisor wanted to recommend a HECM, he would be inviting scrutiny regarding the use of the loan proceeds. "We prohibit the use of HECM funds for investment purposes," Stolz said.

This sort of purposeful indifference to HECMs, of course, frustrates reverse mortgage advocates, who understand the gatekeeping role that financial advisors play in their clients' choices. "We hear this every day," said Shelly Giordano, principal at Longevity View Associates, a Washington, DC, HECM broker. "I am mystified that a planner would intentionally ignore a valuable asset just because he does not get paid to access it," she added. If advisors make recommendations about Social Security claiming, Giordano believes, it makes equal sense for them to advise on the use of reverse mortgages.

Compliance officers at many financial advisory firms and brokerages still tell their advisory staffs to "steer clear" of HECMs, she has found. "It can be extremely frustrating for someone to go to an advisor to whom they're paying a 1% fee, and say they want information about a reverse mortgage, only to hear the advisor say, 'I can't talk to you about that,'" Giordano, who is chairman of a HECM lenders group, Funding Longevity Task Force, and author of *What's the Deal with Reverse Mortgages* (People Tested Media, 2015), told *RIJ*.

But advisors know that their own self-regulatory agency, FINRA, is wary of the product.

FINRA once characterized HECMs as a "last resort" strategy for retirees who exhaust all other sources of liquidity. In 2014, it acknowledged the reforms made to the HECM program by HUD and, after lobbying by the Funding Longevity Task Force, revised its position and recommended that home equity be "used prudently."

Still, FINRA's May 2014 Investor Alert on HECMs hardly endorses the product. Titled, "Reverse Mortgages: Avoiding a Reversal of Fortune," its first paragraph says, "As more Americans near retirement age, some financial institutions are aggressively marketing reverse mortgages as an easy, cost-free way for retirees to finance lifestyles—or to pay for risky investments—that can jeopardize their financial futures."

The alert points out that HECMs can be "quite expensive" and that the HECM loan will come due if the borrower needs to move into a nursing home. It reminds prospective borrowers that "reverse mortgages were originally designed as a tool for allowing aging, low-income homeowners to keep their homes by providing a source of additional monthly income to meet expenses."

Much of this wariness is grounded in the Real Estate Settlement Procedures Act, which extends back to 1974 and whose enforcement is now under the Consumer Financial Protection Bureau. RESPA stops anyone without a mortgage license from getting paid in a mortgage transaction. To prevent financial advisors and others from getting finder's fees for sending clients to mortgage brokers, RESPA specifically "outlaws kickbacks that increase the cost of settlement service."

'Type A brokers'

A certain number of planners do say, [reverse mortgages] are better than I thought, but then they ask, 'How do I make money on this?'" said Michael Banner, founder of the AmericanCEInstitute, which teaches financial advisors about HECMs. "The only legal and ethical answer is: by becoming a licensed mortgage loan officer. No one can make money on any FHA loan, forward or reverse, unless they are properly licensed."

"If an advisor wanted to get licensed, and licensed with FHA-approved correspondent, they can earn a fee. They would have to take part in the transaction and adhere to the cross-selling law," he added.

But getting a license may not be as easy as taking an exam. If a certified financial planner (CFP) who is also securities licensed wanted to get a mortgage license, Banner said, he or she might have to get their broker-dealer's permissions first. And that permission may not be forthcoming.

"The majority of broker-dealers are still against their reps being able to do reverses. They're afraid that a type-A investment advisor will convince grandma to take a reverse mortgage loan and put the money into the stock market. FINRA knows that many of its 430,000 registered reps want to be the next Gordon Gekko, and it's afraid that it can't regulate all of them. Fear of the 'bad eggs' stops them from taking the risks that might help the masses."

Banner is talking about brokers' inclination to "cross-sell"—that is, to use reverse mortgages simply as a way to fund a product, such as long-term care insurance or a variable annuity, that will pay the broker a large commission. That practice inspired the so-called McCaskill amendment to the Restoring American Financial Stability Act of 2010, which specifically outlawed cross-selling. The sponsor was Senator Claire McCaskill of Missouri.

A fee-only perspective

Of course, that was several years ago, when the wounds of the financial crisis were still fresh. Changes in the design of HECMs and new regulatory safeguards, such as counseling requirements, are beginning to bring reverse mortgages in from the cold. They appeal to "life-cycle" planners, who prescribe different strategies for different stages in a person's life, rather than treating the entire lifespan as a wealth-gathering period.

One fee-only life-cycle planner, Paula Hogan, CFP, of Milwaukee-based Hogan Financial, is open to reverse mortgages. In a blogpost last fall titled, "Reverse Mortgages: Yes! Worth a fresh look," she wrote, "Thanks to some recent and welcome regulatory changes and the continuing low interest rate environment, reverse mortgages are now another tool" in the financial planning tool kit.

In a recent email, Hogan described some of the precautions that people over 62 should take when considering a reverse mortgage. She noted for instance, that paying upfront settlement costs out of pocket rather than financing them might be wise in some cases, that clients should be prepared for a long and detailed administrative process, that some people prefer to be debt-free in retirement, and that "with aging and dementia research, it's clear that simplicity for finances in old age has appeal."

But Hogan, a thought-leader in the fee-only advisor world, believes that some of the new uses for reverse mortgages are valid. "No longer relegated to late-night TV ads, reverse mortgage are becoming mainstream," her post said. "The traditional use of a reverse mortgage, providing cash when all other retirement wealth has been depleted, is no longer the go-to option. Instead, reverse mortgages are now being used for a range of other planning purposes. We anticipate that many of our clients will want to put a reverse mortgage in place."

Next Week: Repositioning HECMs for a comeback.