SASKATCHEWAN LAW REFORM COMMISSION
REPORT ON REVERSE MORTGAGES

NOVEMBER, 2006

INTRODUCTION

Reverse mortgages are promoted as a financial tool that allows seniors to use the equity in their homes, while remaining at home, without making mortgage payments as long as they remain in their homes. Advocates present the reverse mortgage as a solution for the financial problems of seniors who are "home rich but income poor". A popular book on reverse mortgages has the title *Have Your Home and Money Too*. Critics, on the other hand, warn that reverse mortgages are relatively high-cost loans which may consume a large part of the home owner's equity in accrued interest and may make it difficult for seniors to leave their homes when health or other considerations make it necessary to do so.

The basic concept of the reverse mortgage, also known as a home equity conversion loan, is straightforward: A home owner mortgages part of the value of the home, receiving the proceeds as cash, a line of credit, or as an income-producing annuity. But instead of making monthly payments on the principal and interest owing under the mortgage, the interest is allowed to accumulate. The mortgage is paid off in a single payment when the home owner dies or leaves the home. Such arrangements are not new but have been routinely offered by financial institutions only in the last two decades. Because lenders are not willing to defer repayment for too long a time, reverse mortgages are available only to older home owners.

Even critics of reverse mortgages do not suggest that they have no place in financial planning. However, because they are aggressively marketed to seniors, a relatively vulnerable segment of the population, and because they are a recent innovation that is perhaps poorly understood by many potential customers, they may require closer scrutiny and enhanced regulation. At present, reverse mortgages appear to fall between the gaps in consumer protection legislation and cost of credit disclosure legislation.

Legislation governing reverse mortgages has been adopted in one Canadian province, Manitoba. A Saskatchewan organization, Senior Power, has publicly recommended regulation. The Canadian Centre for Elder Law Studies has recently issued a discussion paper recommending regulation. In the United States, which has had longer experience with reverse mortgages than Canada, both state and federal legislation regulating reverse mortgages have been adopted.

BACKGROUND

1. Reverse Mortgage Programs

Reverse mortgages appeared on the market in the United States in the 1960s. The Fannie Mae Foundation's Home Keeper mortgage, one of the first to be widely available, was promoted as part of the Foundation's strategy to encourage affordable home ownership. Commercial lenders entered the field soon after. Increasing popularity led the Housing and Urban Development Department (HUD) to introduce the Home Equity Conversion Mortgage (HECM) Program in 1987, which makes an approved form of reverse mortgage available through participating financial institutions. In Canada, reverse mortgages have been offered since 1986 by a private company, the Canadian Home Income Plan (CHIP) which markets its product through participating banks, credit unions and mortgage brokers.[1] No other financial institutions currently provide reverse mortgages in Canada.

Interest in reverse mortgages is a response to the demographic fact of an aging population and an increase in the value of real estate. The largest asset owned by many middle-class seniors is their home, accounting on average for 60% of the assets of senior home-owners. Statistics Canada estimates that there are 68,000 low-income home owners in Canada who are mortgage-free, and thus potential candidates for reverse mortgages.[2] As of 2003, CHIP had approved 6,000 reverse mortgages, providing $225 million in loans.[3] In Saskatchewan, the popularity of reverse mortgages appears to be below the national average, in part because home prices and thus home equity available for mortgage financing, is lower than the national average. However, the popularity of reverse mortgages now appears to have begun to increase here and elsewhere. In

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[1]CMHC, *Improving Quality and Affordability: Reverse Mortgages* (1996-2005).

[2]Statistics Canada, *Social and Economic Characteristics of Individuals, Families and Households, 2001 Census*.

[3]CMHC, *Improving Quality and Affordability: Reverse Mortgages* (1996-2005).

the United States, HECM applications rose by 112% from 2003 to 2004.[4] In Canada, the Canadian Mortgage and Housing Corporation (CMHC) predicts that reverse mortgages will become increasingly "important programs for seniors living on limited incomes"[5], and is investigating the possibility of a government-backed program similar to the American HECM. [6]

The Canadian Home Income Plan is a private corporation whose only business is reverse mortgages.[7] It accounts for most of the Canadian reverse mortgage market.[8] Reverse mortgages are available across the country through affiliated mortgage brokers and CHIP offices in some cities. Banks and credit unions often serve as a referral service and assist clients in making the application.[9] CHIP has no connection with government or CMHC.

Through CHIP, homeowners 62 years of age or older can borrow between 10% and 40% of the equity in their home depending on their age, sex, and the value of the home.[10] The minimum loan available through CHIP is $14,500; the maximum is $500,000. The percentage of equity that can be borrowed increases with age, since that is the principal actuarial factor affecting the probable duration of the loan. The loan is registered as a lien against the property. The interest rate is tied to the Canadian Treasury Bill rate, and is typically about 1½% above the interest rate for a conventional five-year mortgage. The interest rate is adjusted annually. Interest is compounded semi-annually. The borrower is responsible for legal, appraisal and administrative

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[4]Lance Williams, *Reverse Mortgage: for those twilight years* (mortgage-investments.com) and NCOA, *Reverse Mortgages for Long-Term Care: "Use Your Home to Stay at Home*", 2005.

[5]CMHC, *Improving Quality and Affordability: Reverse Mortgages* (1996-2005).

[6]*Canadian Business,* September, 2005.

[7]CHIP is a wholly owned subsidiary of Home Equity Income Trust (HOMEQ) listed on the Toronto Stock Exchange.

[8]The description of CHIP which follows is drawn primarily from CMHC, *Improving Quality and Affordability: Reverse Mortgages* (1996-2005) and CHIP, *Reverse Mortgages for Seniors* (2005).

[9]In Saskatchewan, CHIP reverse mortgages can be arranged through most chartered banks, Advantage Credit Union, Conexus Credit Union, Page Credit Union, Prince Albert Credit Union, and The Mortgage Alliance Company of Canada.

[10]For example, a 76 year old single female with a home worth $350,000 typically qualifies for a CHIP loan of $130,000, 37% of equity value. Near the other extreme, a 69 year old male with a female spouse 64 years old who owns a $130,000 home qualifies for a loan of $38,600, 21% of equity. These figures may vary according to local real estate market conditions.

fees, which average about $1,200.

Until recently, CHIP paid out the loan proceeds only in a single lump sum which can be used for any purpose the borrower chooses. It now offers a line of credit to draw upon the portion of equity available as loan security. Unlike some American reverse mortgage programs and the Royal Trust Fixed Term Reverse Annuity Mortgage, CHIP does not offer annuities, but the borrower may choose to use the proceeds to purchase an annuity from another financial institution.

The loan and the accumulated interest are due on the death of the homeowner or when the owner moves from the house.[11] However, under the terms of CHIP reverse mortgages, maximum indebtedness is capped at the market value of the home. In the case of a couple, if one spouse dies, the surviving spouse can continue to occupy the home until death or sale of the house. Pre-payment of part of the loan is not permitted and penalties apply if the loan is repaid in full before it becomes due.[12]

Most reverse mortgages available in the United States are similar in general outline to the CHIP product.[13] However, there is significant government involvement in the reverse mortgage market. The Housing and Urban Development Department (HUD) sponsored Home Equity Conversion Mortgage (HECM) Program has accounted for approximately 90% of reverse mortgages in recent years.[14] HECM loans are made by participating financial institutions.[15] The terms of the loan are specified by HUD and insured by the Federal Housing Administration (FHA). The Fannie Mae Foundation's Home Keeper mortgage is offered on terms almost identical to HECM loans.

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[11]The terms of the CHIP mortgage provide that the loan is due and payable (1) 120 days after the date of the borrower's death, (2) on transfer of the property to another person, or (3) on the date when the house ceases to be the borrower's principal residence.

[12]Pre-payment after five years is subject to the Canada *Interest Act* (R.S.C. 1985, c. I-15, s. 10), which limits the penalty to three months' interest charges. Earlier repayment attracts heavier penalties. Prior to 36 months, a pre-payment fee applies. After 36 months, an interest rate differential payment is applicable.

[13]The description of the HECM program which follows is drawn primarily from HUD, *Reverse Mortgages for Seniors,* 2005.

[14]Lance Williams, *Reverse Mortgage: for those twilight years* (mortgage-investments.com).

[15]There are approximately 150 participating lenders, including banks, credit unions, mortgage lenders, and savings and loan associations.

HECM loans, like CHIP reverse mortgages, are available to homeowners 62 years of age or older with no or small mortgage debt. Loans amounts are determined in the same manner as under CHIP reverse mortgages but limits are higher, as much as 60% of equity value in some cases, to a maximum of $219,900 (US).[16] Interest rates are tied to the U.S. Treasury Security rate and adjusted periodically. They are typically about 1½% higher than conventional mortgage rates.

As under CHIP reverse mortgages, the loan and accrued interest are due on the death of the homeowner or when the homeowner moves from the house. The borrower's liability is limited to the market value of the home but the lender may recover any shortfall from the FHA insurance fund. It appears to be the FHA insurance that accounts for the higher loan limits under HECM than CHIP which allows lenders to be less conservative in their lending practices.[17] The insurance is financed by a fee of 2% of the home's value plus 1/2% of the loan balance each year. The fee is charged to the borrower's loan balance. The borrower is responsible for legal, appraisal and administrative fees. These fees are partially regulated by HUD but appear to be higher in the United States than in Canada.

Unlike CHIP, HECM does not ordinarily advance funds as a lump-sum. Instead, borrowers may opt for a line of credit or one of several "tenure plans" which amount to annuities. The line of credit, which may be used to draw down the entire loan as a lump-sum, is the most popular.

Lenders participating in the HECM program must offer reverse mortgages on the terms approved by HUD. Since HECM loans dominate the American reverse mortgage market, this amounts to an indirect form of regulation. In addition, the HECM program attempts to protect consumers by requiring all HECM applicants to obtain counseling from a HUD-approved agency to ensure that the applicant understands the terms and implications of the loan.

2. Benefits and drawbacks

[16]This maximum applies in areas with higher real estate values. In lower real estate value areas, the maximum is currently $121,300 (US).

[17]CMHC, *Improving Quality and Affordability: Reverse Mortgages* (1996-2005).

Reverse mortgages are most attractive to seniors who are short of income and willing to convert part of the value of their homes to cash. They are promoted as a way for seniors to stay in their homes after retirement. P. J. Wade, author of a popular guide to reverse mortgages, argues that:

> At retirement, an individual's income usually drops drastically—often by 40 percent or more. Therefore, many older homeowners may not satisfy the income requirements for a mortgage of any useful size. Selling the home may be an acceptable solution for homeowners who feel their houses are too big for them, or who have found an attractive housing alternative. Yet, surveys show that most older people would prefer to stay in their homes as they age.
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> Home equity conversion offers a . . . choice . . . for older homeowners who cannot, or will not, arrange a traditional mortgage and who wish to stay where they are. Older homeowners can improve their financial well-being by using a reverse mortgage and related home equity conversion approaches to unlock the equity in their home.[18]

The money from a reverse mortgage may be used for any purpose, but is most typically used for home repairs and payment of property taxes, as a continuing income source, and to pay for in-home care of ill or infirm seniors.[19]

The Fannie Mae Foundation initially introduced reverse mortgages primarily as a means for low income seniors to keep their homes. Seniors on fixed incomes facing significant repair or renovation expenses to preserve their homes may find that giving up part of their equity to meet these expenses is a viable way to stay in their homes. If local real estate values are increasing, driving up property taxes, a reverse mortgage may allow seniors to avoid selling their homes.

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[18] P.J. Wade, *Have Your Home and Money Too: The Canadian Guide to Home Equity Management, Reverse Mortgages, and Other Innovative Housing Options*, John Wiley & Sons, 2000.

[19] See Roberta Leviton, "Reverse Mortgage Decision-Making," *Journal of Aging & Social Policy* (2001) Vol. 13. No. 4. This study was based on interviews with Florida seniors. It found that as of 2001, most seniors remained reluctant to mortgage the equity in their homes, and did so only as a last resort to meet pressing needs. However, the increased interest in reverse mortgages in the last few years may suggest that attitudes are changing.

Reverse mortgages may also be an alternative for seniors who are "home rich but income poor". Proceeds from a reverse mortgage can be invested in an income-producing annuity to produce a steady flow of income. HUD reports that seniors using reverse mortgages in the United States tend to have lower incomes and include more single females than the average elderly American home owner.[20] As an example of an ideal candidate for a reverse mortgage, a Canadian consumer affairs television program reported the case of a 69 year old divorcee who received the family home as her principal asset from division of matrimonial property. Her pension income is low but the value of her three bedroom west end Toronto home has appreciated significantly in recent years.[21]

In the United States, the National Council on Aging (NCOA) has promoted reverse mortgages as a way to finance long-term care for seniors who wish to remain in their homes. The NCOA study suggested that reverse mortgages could make a significant contribution to the in-home health care needs of almost half of senior home owners and could "dramatically increase the ability of seniors to pay for long-term care at home".[22] In Canada, medicare covers some of the expenses identified by NCOA and home care is generally more affordable. Nevertheless, a reverse mortgage might be a source of funds for renovations to a home to accommodate the needs of a handicapped family member or to provide nursing care that would allow an elderly home owner to remain at home.

Promotion of reverse mortgages usually places emphasis on the fact that loan proceeds from the mortgage are not taxable. Revenue Canada treats money received from a reverse mortgage in the same manner as loan advances from traditional mortgages and consumer loans which are not regarded as income and thus not subject to income tax. When reverse mortgages are used for investment purposes, for example to purchase an annuity, the mortgage interest is deductible against returns on the investment providing individuals with a stream of tax-sheltered income.

But as CHMC observes:

> While reverse mortgages have benefits, they are relatively expensive, and can

[20] HUD, *No Place Like Home* (Evaluation Report of FHA's Home Equity Conversion Mortgage Insurance Demonstration Contract), 2000.

[21]CBC *Marketplace*, April 11, 2000.

[22]NCOA, *Reverse Mortgages for Long-Term Care: "Use Your Home to Stay at Home*", 2005.

> deplete the equity available in the house. This could possibly leave those needing to sell without the resources to obtain alternative accommodation.[23]

Interest rates on reverse mortgages are typically higher than on conventional mortgages. In addition, because no payments are made on principal and interest until the borrower dies or sells the home, the total mortgage debt rises, doubling on average every seven or eight years.[24] Typically, property values do not rise as fast as interest accumulates. As the American Association of Retired People (AARP) warns, borrowers considering a reverse mortgage should be aware that a reverse mortgage is typically a “rising debt, falling equity” transaction, unlike a conventional mortgage which is characterized by “falling debt, rising equity” as the loan is repaid.[25]

Most independent financial planners caution that reverse mortgages are not suitable for all financial purposes or for all senior homeowners. But some promotional literature recommends reverse mortgages as a source of funds for such purposes as vacations and hobbies despite the long-term effect of accumulating interest. Reverse mortgage providers also suggest using them as a source of tax-free money as an alternative to cashing out a tax-sheltered investment such as a RIFF or RRSP. However, the tax savings must be balanced against interest charges which may equal or exceed the tax saving.

Advisors to seniors such as AARP and the Consumers Union caution that a reverse mortgage is suitable only for a limited set of purposes and, even then, as a last resort.[26] Even advocates of reverse mortgages such as Wade advise caution. She presents a series of five questions for seniors to ask when considering a reverse mortgage:

> 1. Do the benefits of home ownership clearly outweigh the burdens, now and in the foreseeable future?

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[23]CMHC, *Improving Quality and Affordability: Reverse Mortgages* (1996-2005).

[24]Jennifer Aitkens, “A Sobering Look at Home Equity Conversion,” *Canadian MoneySaver* 21:2 (February 2002).

[25]AARP, *Home Made Money: A Consumer’s Guide to Reverse Mortgages* (1987-2005).

[26]See AARP, *Home Made Money: A Consumer’s Guide to Reverse Mortgages* (1987-2005) and Consumers Union, *Guarding the Golden Years. Reverse Mortgages* (1998).

2. Can you relax and enjoy money from the reverse mortgage, knowing that debt is compounding against the value of your home?

3. Can you accept full responsibility for home maintenance, taxes, and insurance, given that failure to meet these obligations could authorize the lender to request full repayment of the mortgage debt?

4. Can you manage financially if the home equity is substantially or completely used up, and/or if you need alternative housing?

5. Do you know precisely what your alternatives are if you do not arrange a reverse mortgage?

She recommends that a reverse mortgage "may be premature, impractical, or ill advised" if the answer to any of these questions is "no".[27]

Perhaps the most obvious drawback of the reverse mortgage is that it depletes the homeowner's equity, reducing the value of the estate that can be left to heirs. If the mortgage is in place for even seven or eight years the loss of equity may be twice the benefit received from the loan. Because the value of the home will likely increase, CMHC estimates that, in most cases, nearly half of the equity in the home will typically remain intact when the loan comes due but the cost of borrowing is still high and homeowners who desire to leave the home to their children may instead leave them with a mortgage debt that will be difficult to repay. AARP recommends that seniors considering a reverse mortgage should always carefully consider the effect it will have on their estates and discuss alternatives with their heirs.[28] The Consumers Union recommends that a reverse mortgage is not a viable alternative if "you want to leave your home, free and clear, to your children or others who will inherit from you".[29]

But caution may be required even if the effect of the reverse mortgage on the borrower's estate

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[27]P.J. Wade, *Have Your Home and Money Too: The Canadian Guide to Home Equity Management, Reverse Mortgages, and Other Innovative Housing Options,* John Wiley & Sons, 2000.

[28]AARP, *Home Made Money: A Consumer's Guide to Reverse Mortgages* (1987-2005).

[29]Consumers Union, *Guarding the Golden Years. Reverse Mortgages* (1998).

is not an issue and even if the loan is being considered for the purposes for which a reverse mortgage is a viable alternative.

The reverse mortgage is a relatively expensive way to convert assets into an income flow. If the proceeds from the mortgage are used to purchase an annuity, the income received from the annuity will almost always be less than the interest that accumulates on the reverse mortgage loan.[30] Borrowers unconcerned with depleting equity who place a high value on retaining their present residence may find the trade-off acceptable. But many potential borrowers may not fully understand the cost of the reverse mortgage and might be better advised to consider selling their present home, purchasing lower-cost accommodation, and investing the difference in an annuity.

Reverse mortgages may make it possible for home owners to remain in their homes after retirement but if a move becomes necessary a reverse mortgage may make it more difficult to find affordable housing. Both AARP and CMHC identify this problem as a major drawback to the use of reverse mortgages.[31] Because a large part of equity is tied up in the mortgage, proceeds from the sale of the home may not be enough to purchase an adequate alternative. Increases in property values typically off-set the debt secured by equity but the homeowner will be purchasing a new home at increased market value. Even if the borrower plans to rent after selling the home the loss of equity reduces the resources available to pay the rent. AARP points out that if changed circumstances force a move before interest has accumulated for many years, penalties applicable on early repayment may nevertheless be a serious problem.

Many seniors may believe staying in the family home is their best option only to find that deteriorating health and mobility later force a move to smaller or more centrally located accommodations, or to a seniors retirement home. Thus, critics suggest that arranging a reverse mortgage to finance home care may be a less attractive strategy than NCOA and other proponents suggest. Critics also note that, while proceeds from a reverse mortgage are not taxable, they may compromise eligibility for means-tested social assistance programs seniors, particularly if ill or handicapped, may require.

As in the case of conventional mortgages, lenders require home owners to maintain fire

[30]Canadian Centre for Elder Law Studies, *Consultation Paper on Reverse Mortgages* (2005).

[31]See AARP, *Home Made Money: A Consumer's Guide to Reverse Mortgages* (1987-2005) and CMHC, *Improving Quality and Affordability: Reverse Mortgages* (1996-2005).

insurance, pay property taxes, and to keep the premises in good repair. Failure to do so is grounds for calling in the loan. Thus a reverse mortgage may not be a guarantee that the home owner can remain in the home. As the Consumers Union warns, seniors on low fixed incomes should be certain that they will be able to meet these expenses in the future before considering a reverse mortgage as a means of remaining in their homes.[32]

3. Regulation of reverse mortgages: An over view

At present, reverse mortgages are specifically regulated in Canada only in Manitoba.[33] The consumer protection measure identified as most valuable to seniors considering a reverse mortgage is full disclosure of the cost of the loan, including the effect of accumulating compound interest on the borrower's equity.[34] *The Cost of Credit Disclosure Act, 2002*, which was proclaimed in force this year, extends to mortgages.[35] Similar legislation has recently been adopted in other provinces. But the legislation is not tailored to the needs of borrowers considering reverse mortgages and requires less extensive disclosure than the Manitoba reverse mortgage legislation. In the United States, disclosure requirements similar to those in the Manitoba legislation are in place at federal and state levels.

The Manitoba legislation also regulates some of the terms of reverse mortgages. For example, it limits the lender's remedies to foreclosure so that the borrower is never liable for more than the value of the home. Some American states impose more extensive restraints on the terms of reverse mortgages and HUD dictates the terms of HECM loans insured by the federal government.

Almost all commentators on reverse mortgages regard financial counseling as an important consumer protection. The Manitoba legislation encourages borrowers to seek independent legal or financial advice. Consultation with approved counselors is mandatory on application for a HECM loan and some states require counseling of all applicants for reverse mortgages.

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[32]Consumers Union, *Guarding the Golden Years. Reverse Mortgages* (1998).

[33] *The Mortgage Act*, c. M200, C.C.S.M, Part III.

[34]See, for example, AARP, *Home Made Money: A Consumer's Guide to Reverse Mortgages* (1987-2005).

[35]C-41.01 (2002), as amended 2006, c. 5.

REGULATION OF REVERSE MORTGAGES

1. Reasons for regulation

Reverse mortgages are a relatively new product in Canada. They are heavily promoted as a solution for a range of financial problems facing seniors and are growing in popularity. At present, they are not subject to specific regulation in Saskatchewan or other Canadian provinces, except Manitoba, and are not adequately covered by consumer protection legislation. In the United States, which has had longer experience with reverse mortgages than Canada, federal legislation applying specifically to reverse mortgages has been adopted and regulation is becoming the norm at the state level.

Because the reverse mortgage differs in significant ways from conventional mortgages and other loan agreements there is a danger that its full cost and consequences will not be appreciated by borrowers. Even financial planners may not be fully aware of the practical implications of reverse mortgages for their clients. In particular, consumer advocacy groups question whether the "rising debt, falling equity" nature of reverse mortgages, and thus the full cost, is appreciated by borrowers.[36] As the Centre for Elder Law Studies observed:

> Reverse mortgages even have enthusiastic defenders, such as the reverse mortgage borrower who declared "[i]t's the closest thing I've found to getting something for nothing.,,I don't know why anyone would question the plan." The impression that one can get something for nothing raises consumer protection

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[36]AARP, *Home Made Money: A Consumer's Guide to Reverse Mortgages* (1987-2005).

> concerns for critics of reverse mortgages. These concerns focus on the need for plain and accurate disclosure of the risks of and other information regarding reverse mortgages.[37]

Although promotional literature for reverse mortgages usually warns that reverse mortgages are "not for everyone" it rarely fully sets out the drawbacks of reverse mortgages or meaningfully compares alternatives. While many financial planners and consumers' groups stress that reverse mortgages are a viable alternative only for limited purposes, they are often promoted as a low-risk option for nearly all home owning seniors in need of cash. A typical Internet advertisement for an American reverse mortgage provider promises:

> TAX-FREE lifetime income.
> NO REPAYMENT as long as the house is your primary residence.
> NO credit and NO income requirements.
> CASH, CREDIT-LINE, LIFETIME INCOME - or a combination.
> Use the funds for anything you want.
> No debt can ever pass to your heirs.
> RETAIN FULL OWNERSHIP[38]

Promotion of this type suggests the need for full disclosure of the costs and consequences of reverse mortgages and the importance of encouraging consumer counseling by independent advisors.

Because the target audience of reverse mortgage promotion is senior citizens, concerns about disclosure and counseling are heightened. As the Centre for Elder Law Studies observed:

> Reverse mortgages are currently only available to senior citizens. While this is a diverse class of people, it is also a class of consumers that has often been singled out for special consideration in consumer protection law. The most common reasons cited for senior citizens' vulnerability as consumers are age, infirmity, and social isolation. For reverse mortgage consumers the declining potential to

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[37]Canadian Centre for Elder Law Studies, *Consultation Paper on Reverse Mortgages* (2005).

[38]This promotional literature was published by a Florida provider of HECM loans and other reverse mortgage products. Canadian promotional literature is more restrained in tone but makes similar claims. Note that Canadians seeking information about reverse mortgages on-line will inevitably encounter advertising of this sort.

earn income also contributes to this sense of vulnerability.

> Financial vulnerability can lead a consumer to believe that a course of action is the only option. Enhanced disclosure can remedy this perception. However, disclosure rights alone cannot make up for the vulnerabilities of certain consumers. These rights require ancillary rights to make them effective.[39]

2. Scope of regulation

Both the Manitoba reverse mortgage legislation and American reverse mortgage regulation share common features. In summary, the Manitoba legislation provides for:

> (1) Detailed disclosure of the cost of borrowing and other information to borrowers.
> (2) A seven-day cooling-off period between disclosure and completion of the transaction.
> (3) Encouragement to borrowers to seek independent legal or financial advice.
> (4) Express authority for the courts to make orders varying unfair terms in a reverse mortgage, and regulation of some of the terms and conditions of reverse mortgages.[40]

In principle, effective reverse mortgage regulation should address disclosure, counseling, and at least some terms and conditions of mortgage agreements.

3. Disclosure

Disclosure of information about the full costs of credit is an important protection for consumers who are considering a loan of any kind. Because reverse mortgages are novel and complex, full disclosure is particularly important. As the Centre for Elder Law Studies observed :

> Critics point out that, in various ways, the cost of borrowing for a reverse mortgage is greater than for other loan products. Further, the special features of reverse mortgages can obscure this fact, and make it difficult for potential

[39] Canadian Centre for Elder Law Studies, *Consultation Paper on Reverse Mortgages* (2005).

[40] *The Mortgage Act*, c. M200, C.C.S.M, Part III.

> borrowers to compare reverse mortgages to other types of loans.… The concern is that, at the time they enter into the reverse mortgage, borrowers do not appreciate the effect of compounding interest coupled with no repayment of interest until the loan comes due.[41]

The Cost of Credit Disclosure Act, 2002 is a significant improvement in the law. It requires lenders to provide borrowers with disclosure statements that set out such matters as the interest rate, the method of determining and adjusting the rate, and non-interest charges.[42] At the core of the consumer protection function of the legislation is the concept of the "annual percentage rate (APR)"[43] which lenders will be required to calculate and disclose. The APR will reflect the "total cost of credit", the difference between advances made under the loan and interest and other charges.[44]

Although the APR is valuable information for consumers it does not directly address all of the concerns that have been raised about the cost and implications of reverse mortgages. AARP points out that the full cost of a reverse mortgage depends on several factors in addition to the interest rate and other charges, including how long a borrower remains living in the home, changes in the home's value during that time, and when cash advances are paid to the borrower if a line of credit is established. In addition, disclosure of rates may not make the effect of the loan on the borrower's home equity obvious.[45] Commenting on the British Columbia *Business Practices and Consumer Protection Act (Part 5)*[46], which is almost identical to *The Cost of Credit Disclosure Act, 2002*, the Centre for Elder Law Studies concluded that the legislation does "not adequately respond to the special qualities of reverse mortgages. Specific legislation tailored to these qualities is necessary".[47] However, even though *The Cost of Credit Disclosure*

[41]Canadian Centre for Elder Law Studies, *Consultation Paper on Reverse Mortgages* (2005).

[42]See s. 7. Details of the content of required disclosure will be contained in regulations made under the *Act*.

[43]See s. 2 (b).

[44]See s.2(kk).

[45]AARP, Model Specifications for Analyzing and Comparing Reverse Mortgages (2000).

[46]S.B.C. 2004, c. 2.

[47]Canadian Centre for Elder Law Studies, *Consultation Paper on Reverse Mortgages* (2005).

Act, 2002 does not make allowance for the unique features of reverse mortgages, regulations specifying disclosure requirements for reverse mortgages might be able to address these issues.

At present, CHIP, the only reverse mortgage provider in Canada, makes disclosure as required by existing legislation. It also goes some distance beyond the legal requirements. CHIP provides clients with an illustration of the accumulation of compound interest and the impact on the borrower's equity over a 20-year period. However , in the Commission's opinion voluntary disclosure, even if well motivated, is not an adequate substitute for uniform disclosure requirements mandated by legislation. Disclosure of the cost of credit has attracted close attention in recent years, culminating in the new legislation in Saskatchewan and other provinces. Disclosure of the cost of reverse mortgages should not be an exception.

The Manitoba legislation governing reverse mortgages requires disclosure tailored to the unique features of reverse mortgages. The disclosure requirements are set out in a disclosure form authorized by statute and contained in regulations under the *Mortgage Act.*[48] In addition to information about interest rates and other charges, the disclosure form requires lenders to provide information about the accumulation of compound interest and, perhaps most importantly, the effect of compounding interest and other charges on the borrower's equity. This disclosure is contained in a table that calculates the accumulated principal and interest and remaining equity in the home over a 25 year period (a) at the initial interest rate, and at a rate 2% higher, and (b) assuming no increase in property value, and assuming a 1% per annum increase in property value.

The *Mortgage Act* also requires a 7-day "cooling off period" between receipt of the disclosure form and completion of the reverse mortgage transaction. If the mortgage is signed before the cooling off period the borrower may void the transaction.[49] This is intended to ensure that borrowers have had an opportunity to carefully consider the information disclosed to them, preventing the disclosure form from becoming a formality.

Unless the court orders otherwise, if the lender fails to comply with any of the disclosure requirements, the reverse mortgage remains in effect but the borrower is liable only for the

[48] *The Mortgage Act*, c. M200, C.C.S.M, Part III., s. 33(2).

[49] s. 33(1) and(3).

principal that has been advanced by the lender.[50]

In the United States, the *Truth in Lending Act* governs cost of credit disclosure in a wide range of loan transactions within federal jurisdiction.[51] It adopts the concept of the Total Annual Loan Cost (TALC) rate, which is similar to the Canadian APR, but regulations under the *Act* require additional disclosure in the case of reverse mortgages.[52] Similar rules are contained in the *National Housing Act* [53] which applies to all reverse mortgage lenders who offer HECM loans, and in legislation adopted in many states. The American disclosure legislation has several features in common with the Manitoba disclosure rules. In particular, it requires lenders to make a "good faith estimate" of the total cost of the reverse mortgage loan, taking into account factors such as the life expectancy of the borrower and appreciations in property value. This is an improvement over disclosure of the TALC rate alone and is similar in effect to the tabulated information in the Manitoba disclosure form. But unlike the Manitoba legislation, the American legislation does not require projection of the equity remaining in the home or disclosure of the effect of a change in the interest rate. AARP is critical of both omissions.[54]

The Centre for Elder Law Studies is of the opinion that the Manitoba and American reverse mortgage disclosure requirements "have many advantages over the more general provisions" in the new Canadian cost of credit legislation. The Centre concluded that:

> The additional information set out in the [Manitoba] disclosure form gives potential reverse mortgage borrowers a clearer picture of the transaction that they are about to enter into. Enhanced disclosure of information will lead to informed consumers, which is a desirable result.[55]

However, AARP has pointed to a deficiency that the Manitoba legislation shares with its

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[50]s. 33(4) and (5).

[51]15 U.S.C.S. §§ 1601 *et seq.* (1993).

[52]*Truth in Lending Act*, Regulation Z, s.226.33.

[53]12 U.S.C.S. §§ 1701 *et seq.* (1993).

[54]AARP, Model Specifications for Analyzing and Comparing Reverse Mortgages (2000).

[55]Canadian Centre for Elder Law Studies, *Consultation Paper on Reverse Mortgages* (2005).

American counterparts. Neither adequately addresses reverse mortgages that establish a line of credit against available equity. Although this form of reverse mortgage was not available in Canada when the Manitoba legislation was adopted, it has since become available. AARP suggests that disclosure of the effects of differing pay-out patterns could be made in tabular form.[56] The AARP recommendation could be adapted for use in the Manitoba disclosure form.

Adequate disclosure requirements is the single most important consumer protection measure that could be adopted to assist seniors who are considering a reverse mortgage. Although *The Cost of Credit Disclosure Act*, *2002* does not directly address all of the disclosure concerns covered by the Manitoba reverse mortgage legislation and recommended by seniors' advocates, regulations could be adopted under the Act specifically addressing reverse mortgages. This may be an alternative if broader legislation is not adopted.

4. Counseling

Because reverse mortgages are complicated and many borrowers lack the background and expertise to evaluate both the suitability of the mortgage for them and the terms of the mortgage offered to them, independent advice and counseling should be sought by most prospective borrowers. All applicants for HECM loans are required to obtain independent advice from an approved financial counselor and legislation in several states requires all applicants for reverse mortgages to obtain independent advice. In Canada, CHIP requires clients to obtain independent legal advice..

The Manitoba disclosure form includes a section that encourages applicants to obtain independent financial or legal advice:

> L. CONSIDER GETTING ADVICE
> 1. Review this disclosure document carefully.
> 2. This disclosure document is not a contract and does not contain all of the details of the mortgage you are considering.
> 3. It is strongly recommended that you talk to your lawyer about this reverse mortgage before you sign the mortgage or any other document that requires you

[56]AARP, Model Specifications for Analyzing and Comparing Reverse Mortgages (2000).

to sign the mortgage.

4. It is also recommended that you talk to someone employed by a bank, credit union or other financial institution or an accredited financial advisor to make sure a reverse mortgage is the best option for you.

Independent advice is not mandatory. However, on application to the court to vary terms of a reverse mortgage, the court may take into consideration whether or not the borrower obtained independent advice.[57]

While a mandatory independent advice requirement might be justified in principle, it is not practical unless there is a panel of approved advisors available, such as the list of HUD-approved agencies that has been established in the United States. As the Centre for Elder Law Studies observes, it would be difficult to establish such as panel in most provinces.[58] Few agencies or even financial planners have much experience with reverse mortgages at present. Mandatory independent legal advice might be more easily provided but is not an adequate substitute for financial counseling, since most of the difficult issues surrounding reverse mortgages are financial rather than legal.

5. Terms and conditions

Legislation governing reverse mortgages usually includes some regulation of the terms and conditions of reverse mortgages. The Manitoba legislation, for example, limits the lender's recourse against the borrower to foreclosure or sale,[59] and provides that when the mortgaged property is sold or otherwise disposed of the lender is entitled to no more than the lesser of the proceeds of the sale or the fair market value of the property regardless of the size of the mortgage debt. [60] Since reverse mortgages currently available in Canada limit indebtedness to the value of

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[57] *The Mortgage Act*, c. M200, C.C.S.M, Part III., s. 34(1)(c). Variation of terms is discussed below.

[58] Canadian Centre for Elder Law Studies, *Consultation Paper on Reverse Mortgages* (2005).

[59] *The Mortgage Act*, c. M200, C.C.S.M, Part III., s. 31(1).

[60] s.31(2).

the mortgaged property, this provision would become necessary only if current lending practices change. Manitoba also stipulates that the borrower is not liable for any fees charged by the lender unless the mortgage transaction is completed in conformity with the *Act.*[61]

The Manitoba legislation also allows the court to vary terms of a reverse mortgage that are unconscionable. The legislation provides that:

> [E]ven if the judge determines that the lender did provide disclosure as required under subsection 33(2), if the judge is satisfied, having regard to all the circumstances, including whether or not the borrower received independent legal advice, that the terms of the loan are not just and reasonable, he or she may make an order varying the terms of the loan in any manner that in his or her opinion would be just and reasonable in the circumstances . . . the judge may make any order respecting costs or any other order he or she thinks fit.[62]

Legislation in some American jurisdictions regulate other terms of reverse mortgages. Some states, for example, give borrowers the right to pre-pay the mortgage in whole or part without penalty. Other terms that might usefully be regulated include the time allowed to settle the debt after death of the home owner, statutory definition of "principal residence" for the purpose of determining when the loan becomes due, and the rights of surviving spouses.

RECOMMENDATIONS

1. The Commission recommends that detailed disclosure of the cost of borrowing and other information to borrowers, similar to that required in the Manitoba *Mortgage Act*, be required in respect to all proposed reverse mortgage contracts.

2. The Commission recommends that a seven day "cooling off period" between receipt of the disclosure form and completion of the reverse mortgage transaction be required.

3. The Commission recommends that reverse mortgage providers be required to recommend to

[61] s.32. This stipulation does not apply to fees for independent advice.

[62]s.34(1)(c) and (e).

all reverse mortgage clients that independent financial advice should be obtained before completing the reverse mortgage transaction.

4. The Commission recommends that a lender's recourse under a reverse mortgage be limited to foreclosure or sale and that when the mortgaged property is sold the lender is entitled to no more than the lesser of the proceeds of the sale or the fair market value of the property, regardless of the size of the mortgage debt.

5. The Commission recommends that, unless the court orders otherwise, if a reverse mortgage lender fails to comply with any of the rules set out in these recommendations, the borrower's debt is limited to the principal amount of the mortgage loan.

6. The Commission recommends that the court be given authority to alter any term or condition of a reverse mortgage that is unconscionable, unjust, or unreasonable.

APPENDIX: MANITOBA REVERSE MORTGAGE LEGISLATION

MORTGAGE ACT

PART III

REVERSE MORTGAGE LOANS

Definitions
29 In this Part,

"borrower" means an individual who borrows money under a reverse mortgage loan and signs a reverse mortgage as a mortgagor, and includes

(a) an individual who applies for a reverse mortgage loan, and

(b) after the reverse mortgage is signed, a person from time to time deriving title under the original borrower; (« emprunteur »)

"Consumers' Bureau" means the Consumers' Bureau under *The Consumer Protection Act*; (« Office de la protection du consommateur »)

"lender" means a lender under a reverse mortgage loan, and includes

(a) a person from time to time deriving title under the original lender, and

(b) a prospective lender; (« prêteur »)

"minister" means the minister appointed by the Lieutenant Governor in Council to administer this Part; (« ministre »)

"person entitled to disclosure" means

(a) a borrower, and

(b) an individual whose consent is required under *The Homesteads Act*; (« personne devant recevoir des renseignements »)

"prescribed" means prescribed by a regulation made under this Part;

"reverse mortgage" means a document under which an individual grants a mortgage, whether statutory or equitable, of real property as security for a reverse mortgage loan; (« hypothèque inversée »)

"reverse mortgage loan" means a loan that is secured by a charge on real property owned by an individual, and under which

(a) no payment of principal or interest is due before the entire balance of principal and interest is due, or

(b) the borrower is not required to make periodic payments designed to reduce, from one payment to the next, the balance owing under the loan,

but does not include

(c) a loan under which no interest is payable,

(d) a loan where the borrower is required to make periodic payments, at least once every two years, to repay all accrued interest on the loan;

(e) a loan that is repayable only on demand, if there is no restriction on when the lender may demand payment; or

(f) a loan between persons who, in making the loan, are not dealing with each other at arm's length. (« prêt hypothécaire inversé ») S.M. 2001, c. 11, s. 3.

Application of this Part
30 This Part and the regulations under this Part apply to every reverse mortgage loan entered into after this Part comes into force, despite any agreement made or waiver given to the contrary before or after this Part comes into force. S.M. 2001, c. 11, s. 3.

Lender's limited recourse

31(1) A lender may enforce payment of the debt due under a reverse mortgage loan only against the borrower and only through a foreclosure of the mortgaged property or under an order for sale of the mortgaged property made under *The Real Property Act* or by a court of competent jurisdiction.

Borrower's limited liability

31(2) When a property encumbered by a reverse mortgage is sold or otherwise disposed of, the total liability of the borrower under the reverse mortgage loan at the time of the disposition is the lesser of the balance otherwise owing under the loan and

(a) the sale proceeds, if the property is sold

(i) by the lender, or
(ii) by the borrower to a purchaser in good faith for value; or

(b) the fair market value of the property at the time of the disposition, in any other case. S.M. 2001, c. 11, s. 3.

Application and other fees

32(1) A borrower is not liable for any fee, cost or penalty charged in connection with a reverse mortgage loan, including an application or processing fee, cost or penalty unless

(a) the lender has complied with subsection 33(2); and

(b) the borrower signs the reverse mortgage.

Refund to borrower

32(2) If a borrower has paid an amount for which he or she is not liable because of subsection (1), the lender must refund it to the borrower on written demand.

Exception for independent legal and appraisal fees

32(3) This section does not apply to a fee charged directly to a borrower

(a) by a lawyer for independent legal advice; or

(b) by an independent appraiser for an appraisal of the property to be mortgaged. S.M. 2001, c. 11, s. 3.

"Cooling-off period" defined

33(1) In this section, "cooling-off period" means the seven-day period starting on the day after the day every person entitled to disclosure in relation to a reverse mortgage loan has signed, before a person authorized to take affidavits under *The Manitoba Evidence Act*, a statement in prescribed form acknowledging receipt of the prescribed form to be provided to him or her under subsection (2).

Disclosure required

33(2) A lender must provide, in the prescribed manner, to each person entitled to disclosure, a prescribed form that provides full and accurate disclosure of prescribed information regarding the loan. The prescribed form must be provided at least seven clear days before any borrower signs the reverse mortgage or any other document that obligates a borrower to sign the reverse mortgage.

Mortgage signed before end of cooling-off period

33(3) If a reverse mortgage is signed by a borrower before the end of the cooling-off period,

(a) the borrower is not obligated to accept an advance of funds under the reverse mortgage loan or to sign a new reverse mortgage after the end of the cooling-off period; and

(b) unless funds have been advanced under the reverse mortgage loan, the lender must

(i) return the signed mortgage to the borrower, and

(ii) if the mortgage or any other document has been registered in a land titles or registry office, take all steps necessary to have the registration discharged at the lender's own cost.

Statutory terms

33(4) Unless a judge orders otherwise under section 34, when a lender advances funds under a reverse mortgage loan where

(a) the reverse mortgage was signed before the end of the cooling-off period;

(b) no disclosure has been given by a lender as required under subsection (2); or

(c) there is a material error or omission in the information provided under subsection (2) by a lender;

the terms of the loan are deemed to be amended as necessary from the time that the funds are advanced, so that

(d) the total liability of all borrowers under the loan is limited to the unpaid balance of the funds advanced under the loan, less any portion of those funds that was used to pay a fee, penalty or cost for which no borrower is liable because of section 32;

(e) the amount calculated under clause (d) is due only

(i) when the term of the loan expires, if it is for a fixed term,

(ii) on the 120th day after the death of the borrower or, if there is more than one borrower, of the last of them to die, or

(iii) when any of the mortgaged property is sold or otherwise disposed of,

whichever occurs first; and

(f) the borrower may at any time prepay all or any part of the amount calculated under clause (d) without notice, fee or penalty.

Set-off and refund

33(5) A borrower who has paid an amount under a reverse mortgage loan for which he or she is not liable because of subsection (4), may set it off against the balance owing under the loan. If that amount exceeds the balance owing, the lender must refund the excess to the borrower or to his or her legal representative on written demand.

Order for discharge and costs

33(6) If a lender fails to have the registration of a reverse mortgage or any other document discharged as required by clause (3)(b) or, if subsection (4) applies, when the borrower's liability under the reverse mortgage loan has been fully discharged in accordance with that subsection, a judge of the Court of Queen's Bench may, on summary application by a registered owner of the land affected by the registration,

(a) order the registration to be discharged; and

(b) award costs, on a solicitor and client basis, to the owner. S.M. 2001, c. 11, s. 3.

Application to court

34(1) On summary application by a lender or a borrower under a reverse mortgage loan, or by a borrower's legal representative, to a judge of the Court of Queen's Bench,

(a) the judge shall determine whether the lender provided disclosure as required under subsection 33(2);

(b) if the judge determines that the lender did not provide disclosure as required under subsection 33(2), the judge may make an order varying the application of subsection 33(4) or substituting any other terms or conditions for the loan that in his or her opinion would be just and reasonable if he or she concludes that it would not be just and reasonable in the circumstances for subsection 33(4) to apply;

(c) even if the judge determines that the lender did provide disclosure as required under subsection 33(2), if the judge is satisfied, having regard to all the circumstances, including whether or not the borrower received independent legal advice, that the terms of the loan are not just and reasonable, he or she may make an order varying the terms of the loan in any manner that in his or her opinion would be just and reasonable in the circumstances;

(d) the judge may order the lender to set off against the balance owing under the loan, or to refund to the borrower, any amount paid by the borrower for which he or she was not liable because of section 32, subsection 33(4) or the judge's order under clause (b) or (c); and

(e) the judge may make any order respecting costs or any other order he or she thinks fit.

Onus re disclosure

34(2) In an application under subsection (1), the burden of proof to prove that the borrower was provided with disclosure as required under subsection 33(2) is on the lender.

Limitation period

34(3) An application under subsection (1) may be brought not later than six years after the registration of a reverse mortgage or other document has been discharged. S.M. 2001, c. 11, s. 3.

Consumers' Bureau

35 The director of the Consumers' Bureau or any person acting under the authority of the director is responsible for

(a) receiving and investigating complaints involving reverse mortgage loans; and

(b) mediating disputes involving reverse mortgage loans;

and in performing these duties has the powers, duties and protection given under sections 73 and 92 of *The Consumer Protection Act*, with such changes as the circumstances require.
S.M. 2001, c. 11, s. 3.

Offence

36(1) A person is guilty of an offence who

(a) fails to provide a borrower with the form required by subsection 33(2);

(b) provides a form required by subsection 33(2) which contains material errors or fails to disclose information required under that subsection;

(c) advances funds under a reverse mortgage loan where the reverse mortgage was signed by a borrower before the end of the cooling-off period;

(d) fails to refund an amount to a borrower as required by subsection 32(2) or 33(5); or

(e) fails to comply with clause 33(3)(b).

Liability of directors and officers

36(2) If a corporation commits an offence, any officer, director or agent of the corporation who directed, authorized, assented to, acquiesced in, participated in or permitted the commission of the offence is also guilty of an offence and is liable on summary conviction to the penalties set out in clause (3)(a), whether or not the corporation has been prosecuted or convicted.

Penalty
36(3) A person who is guilty of an offence under subsection (1) is liable on summary conviction,

(a) in the case of an individual, to a fine of not more than $20,000, or imprisonment for a term of not more than three months, or both;

(b) in the case of a corporation, to a fine of not more than $50,000. S.M. 2001, c. 11, s. 3.

Limitation period
37 A prosecution for an offence under this Part may be commenced not later than one year after the day on which evidence sufficient to justify a prosecution for an offence came to the knowledge of the director of the Consumers' Bureau. S.M. 2001, c. 11, s. 3.

Regulations
38 The minister may make regulations

(a) enlarging or restricting the meaning of "reverse mortgage loan";

(b) prescribing for the purpose of subsection 33(1) the form and content of a statement acknowledging receipt of the prescribed form required by subsection 33(2);

(c) prescribing information to be provided under subsection 33(2), and the form and manner in which it is to be provided;

(d) respecting any other matter the minister considers necessary or advisable to carry out the purposes of this Part. S.M. 2001, c. 11, s. 3.