
Date: June 2, 2000

Due-On-Sale Regulations - Reverse Mortgage Definition

The term “reverse mortgage” as used in OTS’s due-on-sale regulation (12 C.F.R. § 591.2(n)) includes an instrument providing for a lump-sum payment to a homeowner based on accumulated equity in the security property.

Subject: Home Owners’ Loan Act/Savings Association Powers

P-2000-8



Office of Thrift Supervision

Department of the Treasury

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6251

P-2000-8

Chief Counsel

June 2, 2000

[

]

Re: Due-On-Sale Regulations - Reverse Mortgage Definition

Dear []:

This responds to your inquiry on behalf of [], a subsidiary of []. You ask whether the definition of the term “reverse mortgage” in Office of Thrift Supervision (“OTS”) due-on-sale regulations at 12 C.F.R. § 591.2(n) includes instruments providing for a “lump-sum” payment to homeowners.¹ For the reasons discussed below, we construe the term “reverse mortgage” as used in § 591.2(n) to include an instrument providing for a lump-sum payment to a homeowner based on accumulated equity in the security property.

OTS regulations at Part 591² implement § 341 of the Garn St Germain Depository Institutions Act of 1982 (the “Act”) governing the permissibility of due-on-sale clauses in real property loans and the preemption of state prohibitions on such clauses.³

¹ Following various telephone conversations with OTS staff, you narrowed the scope of your original request to the question stated above.

² 12 C.F.R. Part 591 (2000).

³ Pub. L. 97-320, 96 Stat. 1469, 1505-07, codified at 12 U.S.C.A. § 1701j-3 (West 1989). The Act authorized OTS’s predecessor agency, the Federal Home Loan Bank Board (“FHLBB”), in consultation with the Comptroller of the Currency (“OCC”) and the National Credit Union Administration (“NCUA”), to issue regulations and to publish interpretations governing the Act’s implementation with respect to due-on-sale clauses. 12 U.S.C.A. § 1701j-3(e)(1) (West 1989). See also 12 C.F.R. § 591.6 (2000). The Act provided that such regulations may permit a lender to exercise its due-on-sale option with respect to a “real property loan and any related agreement pursuant to which a borrower obtains the right to receive future income.” 12 U.S.C.A. § 1701j-3(e)(2) (West 1989). For these purposes, the Act defines the term “lender” as a person or government agency making a real property loan or any assignee or transferee of either of them. 12 U.S.C.A. § 1701j-3(a)(2) (West 1989) (implemented by 12 C.F.R. § 591.2(g) (2000)). OTS is the successor agency to the FHLBB. OTS’s due-on-sale regulations at 12 C.F.R. Part 591 apply to all lenders, as defined by the Act, making real property loans. See 12 C.F.R. § 591.1(b) (2000).

OTS regulation § 591.2(n) defines a “reverse mortgage” as an

instrument providing periodic payments to homeowners based on accumulated equity, whether the payments are made directly by the lender, through purchase of an annuity through an insurance company or in any other manner. The loan may be due either upon a specific date or when a specified event occurs, such as the sale of the property or death of the borrower.⁴

This regulatory definition refers only to “periodic payments,” and does not mention “lump-sum” payments. When the FHLBB initially proposed this definition in 1983, it closely followed earlier regulatory language describing a “reverse annuity mortgage,” and it did not specifically incorporate the concept of lump-sum payments.⁵ However, the preamble to the proposed regulatory definition indicated that the definition “provides sufficient flexibility to include instruments based on the same principle [as a reverse annuity mortgage] which may evolve in the future.”⁶

⁴ 12 C.F.R. § 591.2(n) (2000). This regulation was originally promulgated by the FHLBB in 1983, 48 Fed. Reg. 21554, 21561 (May 13, 1983), and has remained substantially unchanged since that time.

⁵ The Proposed Rule on the Preemption of State Due-on-Sale Laws, 48 Fed. Reg. 2373, 2374 (Jan. 19, 1983), referred to an earlier regulation on reverse annuity mortgages, 12 C.F.R. § 545.6-4(c)(1) (1981), which had been removed in 1982. 47 Fed. Reg. 36612, 36620 (August 23, 1982).

When § 545.6-4(c) was adopted in 1981, the FHLBB had stated in its preamble that the regulation does not permit the distribution of the [reverse-annuity mortgage (RAM)] loan in one or even several lump sums during the term of the loan. The purpose of a RAM loan is to permit homeowners to use their accumulated equity to obtain a steady stream of monthly payments. . . . A RAM is a “rising-debt” loan. That is, interest is calculated based on the amount of time elapsed since the distribution of each monthly payment to the borrower. The only situation where a lump-sum disbursement would be permissible is where the loan proceeds are used to purchase an annuity for a RAM borrower from an insurance company.

Final Rule on Balloon-Payment Mortgage Loans; Reverse-Annuity Mortgage Loans, 46 Fed. Reg. 51893, 51895 (Oct. 23, 1981).

A 1982 proposed rule would have permitted “lump-sum disbursement of the loan proceeds, with payments deferred until maturity.” Proposed Rule for Home Loan Amendments; Adjusted Net Worth, 47 Fed. Reg. 19711, 19717 (May 7, 1982). However, that language did not appear in the text of the final rule. Final Rule on Home Loan Amendments; Adjusted Net Worth, 47 Fed. Reg. 36612, 36614 (Aug. 23, 1982). The preamble accompanying the final rule did not discuss why it was not included.

⁶ 48 Fed. Reg. 2373, 2374 (1983). The preamble of the final rule does not indicate that the FHLBB received any comments on this definition, which was incorporated in the text of the final rule without modification. 48 Fed. Reg. 21554, 21561 (May 13, 1983).

Around the same time, in an interpretive letter affirming the power of a national bank to make a reverse mortgage loan, the OCC defined a reverse mortgage loan as

one in which the bank advances the principal amount lent—either at once at the initiation of the loan agreement or in installments over the term specified in the agreement—and repayment is set for a future date—after a certain period of years or on the occurrence of a specified event such as sale of the property or death of the borrower.⁷ (emphasis added.)

In 1994, OTS issued guidance on reverse mortgage loans reiterating that savings associations have the authority to originate or purchase reverse mortgages.⁸ Noting that “the product is not in widespread use,” the guidance focused its description on the more common form of reverse mortgage:

As the term implies, reverse mortgage loans are the converse of traditional mortgage loans. Instead of borrowing a lump sum and repaying it overtime, borrowers receive loan proceeds either in the form of a line of credit (typically about 30% to 40% of the property’s value, which they can draw on when they need it) or in regular monthly advances.⁹

Today, reverse mortgages are more common and it is not unusual for reverse mortgage loan proceeds to be disbursed in a lump sum.¹⁰ For example, both the Truth

⁷ OCC Interp. Ltr. 273 (Oct. 12, 1983).

⁸ OTS Memorandum to Regional Directors, “Guidance on Reverse Mortgage Loans” (September 30, 1994) (copy enclosed).

⁹ *Id.* at 1, 8. OTS regulations in effect at that time did not specifically authorize or contemplate lump-sum reverse mortgage loans. For example, the OTS regulation on amortization referred to loans “on which periodic advances are being made.” 12 C.F.R. § 545.33(a) (1994). In 1996, OTS deleted that regulation as part of a general regulatory reduction process. 61 Fed. Reg. 50951 at 50969 and 50972 (Sept. 30, 1996).

¹⁰ For example, Fannie Mae administers a program under which lenders originate, and Fannie Mae purchases, reverse mortgage loans called the Home Keeper Mortgage. *See* OTS Op. Chief Counsel (May 3, 1996). *See also* Harry W. Blondell et al., Practice Manual for the Maryland Lawyer, Elder Law, The Maryland Institute for Continuing Professional Education of Lawyers, Inc., Main Handbook, Ch. 16, Vol. II at 9 (1999) (indicating that the Department of Housing and Urban Development insures reverse mortgages); Gregory C. Larson & Melissa Hauer, Planning for Nursing Home Care in North Dakota, 74 N.D. L. Rev. 191, 197 (1998); Patricia B. Rumore, Elder Law: Pitfalls for the Unwary, Malpractice Criminal Penalties Code Violations, 58 Ala. Law 160, 163 (1997); Barbara Kreisler, Push is on to Expand Use of Reverse Mortgage, Wash. Times, Feb. 4, 2000, at F8. *See also* 10/23/95 NCUA Watch 4, 1995 WL 7333311 (lenders allow borrowers access to reverse mortgage loan funds by lump sum payments, lines of credit, monthly payments, or a combination of the last two options).

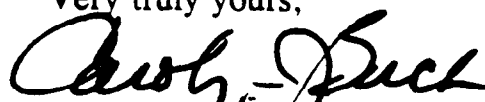
in Lending Act (“TILA”) and the Federal Reserve Board’s (“FRB’s”) implementing regulations, Regulation Z, define a “reverse mortgage transaction” as including a nonrecourse transaction or consumer credit obligation “securing one or more advances”¹¹ (emphasis added.)

In sum, OTS’s predecessor intended that the definition of the term “reverse mortgage” in the 1983 due-on-sale regulations be viewed flexibly. The OCC (in an interpretive letter), Congress (in TILA), and the FRB (in Regulation Z), each have recognized that a reverse mortgage loan may be made in one or more advances, that is, either in a lump sum or in periodic payments. OTS also deems it appropriate to recognize and adopt the view that a reverse mortgage loan may be made in a lump sum.

OTS is in the process of updating its due-on-sale regulations at Part 591. Until that process is complete and OTS issues an updated regulation, we will construe the term “reverse mortgage” in § 591.2(n) to include an instrument providing for a lump-sum payment to a homeowner based on accumulated equity in the security residential real estate.

If you have any questions regarding this matter, please feel free to call Evelyne Bonhomme, Counsel (Banking and Finance), at 906-7052.

Very truly yours,



Carolyn J. Buck
Chief Counsel

Enclosure

cc: Regional Directors
Regional Counsel

¹¹ 15 U.S.C.A. § 1602(bb) (West 1997); 12 C.F.R. Part 226, § 226.33(a) (2000). Appendix K to Part 226 (Total Annual Loan Cost Rate Computations for Reverse Mortgage Transactions) designates a symbol for “[t]he amount of each periodic or lump-sum advance to the consumer under the reverse mortgage transaction.”