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REVERSE MORTGAGES:
PROMISE, PROBLEMS, AND PROPOSALS FOR A BETTER MARKET

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Introduction:

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Paper Presentations:

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Panel Discussion:

BENJAMIN HARRIS, Moderator
Executive Director of the Kellogg Public-Private Initiative
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LAURIE GOODMAN
Vice President of Housing Finance Policy, Urban Institute

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P R O C E E D I N G S

MR. BAILY: Welcome everybody to Brookings. My name is Martin Baily. I'm a Senior Fellow here at Brookings. And this meeting is part of an ongoing series on retirement policy reform, which is a joint effort with Brookings and the Kellogg School of Management.

This project has been funded generously by the Alfred P. Sloan Foundation and the Laura and John Arnold Foundation. Ben Harris and I lead this project. Ben is the Executive Director of the Kellogg Public-Private Interface.

In January, we held a meeting at Brookings on Working Longer and, in June, we held a meeting at Kellogg on Annuities. The papers from those events are on the Brookings Website.

In the spring, we'll be holding another meeting on Working Longer, looking at the impact of the changing labor market on older workers. And we have just recently been awarded additional funding by the Smith Richardson Foundation to turn the results of this project into a Retirement Policy Book.

There's a lot of interest in retirement policy especially in thinking new ways to help people live more secure and stable retirements. The old retirement paradigm involved company pensions, plus Social Security and Medicare. Today, defined benefit pensions have all but disappeared and Americans on average are living longer.

Together, this means that Americans now have to take more responsibility for funding their own retirement. And a fiscal pressure put on Social Security and Medicare leads to cuts retirees will have to take on even more of this responsibility.

Unfortunately, many households are reaching retirement age with low levels of financial assets and may be forced to live off Social Security benefits that are not very generous.

A portion of these households have accumulated substantial equity in their homes raising the possibility they could draw on this equity to help them consume more in retirement or just deal with unexpected expenses, especially health care costs.

Some will decide to sell their homes and realize the equity that way when others would much prefer to continue living in their old neighborhoods with friends or family nearby.

Reverse mortgages are one way for families to tap into their home equity. Are they a good idea or do they impose high costs on older people. Which families stand to benefit most from such mortgages and which families should avoid them. Can the reverse mortgage market work better.

We are fortunate today to have a very distinguished group of experts to talk about these issues and we are releasing three papers on the Brookings Website. The authors of two of these papers, Stephanie Moulton from Ohio State and Thomas Davidoff from the University of British Columbia are here and will present their insights into this market and suggest proposals to improve the way it works.

The third paper is by Ben Harris and myself and his mentors and an overview of the topic. We will not present that paper today, but it is available on the website.

Also here are distinguished experts, Chris Mayer from Columbia University and Laurie Goodman from the Urban Institute. They will comment on the papers and give their own views on the reverse mortgage market. It's hard to imagine a better group and we're lucky to have them.

Starting us off is Debra Whitman as AARPs Chief Public Policy officer. She leads policy development, analysis and research, as well as Global Thought Leadership. She oversees AARPs Public Policy Institute, AARP Research Office of Policy Developments and Integration, Thought Leadership, and AARP International.

Prior to her position at AARP, she was staff director for the U.S. Senate Special Committee on Aging and she worked for the Congressional Research Service as a specialist in the economics of aging.

Now, I don't want to miss this last one out. From 2001 to 2003, she served as a Brookings LEGIS Fellow to the U.S. Senate Committee on Health Education, Labor and Pensions.

Dr. Whitman is widely quoted in the media and she serves on several boards. She holds a master's and Doctorate degrees in Economics from Syracuse University.

After Dr. Whitman speaks, she will take questions from the audience. Then the authors will present their papers, followed by a panel discussion moderated by Ben Harris. It's my pleasure to introduce Deb

Whitman. (Applause)

DR. WHITMAN: Thank you so much. Good morning everyone. Thank you, Martin, and thank you, Ben. What I really like about what you're doing with this series is that you're showing us new solutions, both to help people work longer, to make their money last, and today's topic, to use their assets in their house to improve their financial security, because I believe that we need more solutions and we need them now.

This morning, I'd like to highlight for you some of the realities that people face when it comes to retirement security. Unfortunately, it's a pretty bleak picture. I believe there's far too many cracks in our system.

SPEAKER: Can you pull the mic a little closer.

DR. WHITMAN: Absolutely. Is that better? Let's try that. There are far too many cracks in our system. Social Security hasn't been touched since the 1980's. Our retirement system leaves nearly half of the population uncovered. And rapidly growing health care costs eat away at what people do have saved.

In the U.S., we have a do-it-yourself retirement system. It's hard to plan. It's hard to navigate, and our support systems are inadequate. And this is leaving many Americans feeling very unprepared.

According to a 2018 Retirement Confidence Survey, over 60 percent of Americans under age 50 say that preparing for retirement makes them feel stressed.

Well, I know that today's papers are focused on reverse mortgages. I want to provide a broader view about how financially secure Americans are in retirement.

As I said, we have a DIY retirement system. There are so many cracks that people can fall through and we have many warning signs that people are falling through those cracks.

Here are my top three signs to look out for. First, 4 out of 10 families with a breadwinner in their prime earning years have no savings for retirement at all.

Second, added years of life are bringing added years of expense. Health care costs at retirement are often in the hundreds of thousands of dollars. And that's not even including long-term care costs. According to the Employee Benefit Research Institute, they estimate that a retired couple will need to have saved roughly $300,000 just to cover health care expenses in retirement. And it's even higher if they have expensive prescription drugs.

More older Americans are facing a large burden of debt. A few years ago, a paper by AARPs Researcher, Dr. Lori Trawinski, found that the fastest rate of foreclosures increasing was for the people over age 75. Imagine losing your house at 75.

For a great many of adults, a sense of security seems out of reach at retirement. They haven't saved enough. They don't have much income. And even if they have saved something, they don't know how to make it last.

While the middle class has good reasons to feel anxious about the future, these problems threaten the financial well-being of people who have worked their entire lives and even the wealthy are not immune.

But I want to emphasize that all challenges are not equal. For millions of low income Americans, including women and disadvantaged groups, retirement security is an illusive dream. We all know that many women devote time during their working age years to care for families. They take extended leave from work to raise kids or provide care for a loved one like their parents. And when they're older, that translates to less in savings, less in benefits, and less in income.

So, it's no surprise that many older women end up near the poverty line or even below it. And this is even harder because women live longer than men, roughly two years longer at age 65.

So, if you look at retirement security through a racial or ethnic lens, you see particular challenges. According to the data from the Census Bureau's current population survey, the poverty for rates for older whites was 6 percent. Yet, for older African Americans, that rate swerved to 18 percent. And for older Hispanics, it was 16 percent.

Now, I have been speaking broadly so far because it's important to look at retirement security in a holistic way. But I want to take a few minutes to focus on the critical resources that people have or need to be financially secure as they age.

I'll start with Social Security. For most older adults, this is the single most important financial resource. And for many, it is the only resource they have. The good news about Social Security is the benefits last as long as you do and they protect you against inflation. Further, they're progressive, which provides some help for lower-paid workers.

But as critical as they are, benefits are modest. The average retired worker gets less than $18,000 and it can be significantly less. Yet, in many cases, that payment has to cover everything. I'm not sure I could survive on $18,000 a year in Washington, D.C. I'm not sure about you.

For many people, that's all they have. About 17 percent of older Americans rely on Social Security for 90 percent or more of their family income. Among older African Americans and Hispanics, it's more than one in four.

The meagerness of Social Security also highlights the needs for holistic solutions. AARP worked with Kaiser Family Foundation on a study that found, by 2030, out-of-pocket health care costs will eat up half of the typical Social Security check. Half of your Social Security check will be having to cover your Medicare premiums, your out-of-pocket costs, and other expenses.

And those numbers get worse the older and sicker you are. Right now, if you're over 85, about 71 cents of every dollar you get from Social Security is needed to pay for your out-of-pocket health care costs. By the year 2030, it's headed for 87 cents of every Social Security dollar you get. That would leave just 13 cents for all other necessities. I do not know how you'd pay for your heating bill, you housing costs, and other things.

So, Social Security is a pillar that needs reinforcing. The latest Trustee's Report found that, in 2035, which happens to be the year I turn 65, so I care about this greatly, benefits will be cut by 20 percent unless we do something.

Some proposals on Capitol Hill would cut benefits substantially. Other proposals would cut benefits not at all. Inaction by politician makes it really hard for any of us to prepare for our future and know what we will be getting.

Now, while Social Security is the foundation of financial security retirement, we know that, for most people, it's not enough. As Martin said, defined benefit pensions which really provide real protection are unfortunately fading into the past.

That means that building a nest egg is a crucial part of any plan for retirement security. Yet, we have an abysmal saving system in this country. Even if you want to save, it's really, really hard. About half of the labor force has no access to a retirement plan at work and many of the plans that do exist are not adequate.

Uncovered workers are often young female African American or Hispanic. They're typically lowered paid. Many are employed by small business or work part time. Now, this is completely unacceptable in today's age.

Other countries have national plans that cover all citizens for their entire life and we need one here, too. For too long, the Federal Government has ignored the coverage gap, which is why so many States are starting to get into the action offering workers a way to save when their employers don't have a retirement plan.

Currently, more than 30 States are considering retirement savings plans and seven States are already implementing them. States like California, Oregon, Illinois, Washington, Maryland, Massachusetts, New Jersey -- Washington, I already mentioned, all have passed legislation. And another 22 States across the country have legislation been introduced.

This is really exciting. This is the best thing happening in retirement security I think going on in the United States. But it also isn't ideal. The amount that people can save is based on IRA contributions. So, it's too small, and the differences between jurisdictions can be confusing. For example, New York City and New York State may have two different plans.

Now, for families that do have retirement savings, the amounts are often too small. Overall, the median value for those aged 31 to 62, is a pettily $5,000. For those with savings, they often don't roll over the savings when they change jobs, or they take money early. Perhaps a third of workers take cash out of their retirement accounts to use in the present.

So, from easy fixes, we need everyone to have access to workplace savings with payroll deduction. Second, we need employees to be enrolled automatically. And third, the savings rate should be increased as a worker's pay goes up. In shorthand, auto, auto, auto. We need to make it easy for everyone.

A do-it-yourself retirement plan presents other hazards. Consumers need to keep their eyes open when they work with a financial advisor. They should ask lots of questions and make sure they know about hidden fees which can really add up.

AARP supported the requirements that financial advisors serve as fiduciaries and were extremely disappointed that the Government reduced those standards. So even for those who have saved, it's hard to know how to make their money last for up to 40 years of retirement.

The broader point is that we put too much on individuals to build, safeguard, and make our nest eggs last. In addition, the changes in Federal policy. The private sector can really help. A growing variety of guaranteed lifetime income products can serve the real need on making a nest egg last. But these options should be more widely available, easy to understand, and provide a better value for the saver.

Surprisingly, one of the most widely used strategies to ensure financial security in retirement is actually to work. This enables people to hold up claiming Social Security and can help you steer more income into your savings. It reduces the price tag on retirement because you have fewer years to cover.

And this is exactly what we're seeing. From men age 65 and up, labor force participation in 2018 was 24 percent. This is a level not reached in almost 50 years. We know that many enjoy the social aspects of the workplace, but when AARP surveyed older adults and why they kept working, 87 percent said it was because they need money.

Unfortunately, the option to work longer is not available to everyone. Personal health issues or the need to care for a loved one force many people out of the labor force, sometimes a lot earlier than they planned. We also see that workers with less education run into major obstacles.

But I want to call attention to a barrier that affects workers at all levels of income, skill, and health, which is age discrimination. It's a serious problem in our culture. According to AARP research, 61 percent of adults age 45 and older believe they have seen or experienced age discrimination in the workplace. 61 percent, age 45 and older, have seen or experienced age discrimination.

Being out of work presents particular challenges. In fact, older job seekers face longer periods of unemployment than younger workers. And when they do get a job offer, they often have to settle for a big pay cut.

Rising debt is another reason nearly half of people under age 50 saying they're having a hard time preparing for retirement. And let's not forget the rising debt is also happening among older adults who may be paying college tuition or other major expenses.

Overall, people aged 50 and older held $6.6 trillion in debt in the second quarter of this year at a time when our economy is doing well. And last year, there were over 374,000 bankruptcy filings added to the credit reports of people over age 50.

People over age 50 also represent the fastest growing segment for student loan debt. You think of the typical borrower and person with debt in their twenties and thirties. But one in $5 of every student loan dollars is held by somebody over age 50 either for their own education or that because they cosigned for one of the loans of their family.

And it's not just tuition. 40 percent of empty nesters report they're still paying kids expenses. Well, my daughter is about to head to college. I expect both of these issues are going to be huge in my family.

More people are also carrying mortgage debt into retirement than in the past increasing by 17 percent between 1989 and 2016. In the second quarter of this year, homeowners 62 and above took on almost $15 billion in added mortgage debt.

Let me turn to today's topic on home equity. One of the single largest assets for most older adults is their home, the latest data showing that housing wealth for seniors hit an all-time record of more than $7 trillion. And while that may sound like a big pot of money, for most of the country, there aren't the crazy high of home values like we have in D.C. In most regions, home values are much lower and nowhere near enough to finance 30 years of retirement.

Further, accessing home equity is not simple. You have to sell your house and downsize or start renting or maybe refinance a mortgage or you could a home equity loan for reverse mortgage.

And I understand the appeal of reverse mortgages, especially if you're talking about someone who has a large amount of home equity and a serious need to unlock some income. But at AARP we do not see home equity or reverse mortgages as a major solution for all people for the retirement security problem.

In our view, even transparent well-designed reverse mortgages can only play a limited role in improving the financial outlook for the majority of people. The large aggregate number for home equity is somewhat misleading. If you're a homeowner, what matters to you is the value of your home and equity in your home.

The median home equity value in 2016 was just $145,000. Meanwhile, older adults are carrying more mortgage debt into retirement than every before. Well, we don't know the exact number of reverse mortgage foreclosures. The evidence suggests it's too high. Borrowers still have to keep up with property tax, homeowner insurance, and maintenance, and many are overwhelmed by these costs.

A recent JL analysis found out more than 100,000 had terminations between 2014 and 2019. So we need to get a better grasp on why this is happening.

FHA should require lenders to provide a reason for any termination and it should make sure that the data are accurate and more should be done to help older homeowners who fall behind on taxes and insurance. Mitigation programs needs to be improved and no one should be forced out of their home when they have just a minimal amount of delinquency.

In conclusion, fixing the holes in retirement security will require a great deal of work on many fronts, but we really need to act now. Actually, we needed to act yesterday, or a decade or two ago.

Too many people have no savings, no retirement plans, little or no home equity, and only modest Social Security to get through each month. And the situation will only get worse if we don't address it.

While better public policies are critical, private sector innovations are also part of the answer. We also want people to be equipped to help themselves and plan for their own future. But for that to happen, many need education and guidance.

Now I know I've highlighted a lot of problem, but I believe that by staying focused and working together we can make tremendous progress, and we all can make a role in moving the ball forward.

Again, I'd like to thank Ben Harris and Martin Baily for this really important series where we focus on solutions to the retirement crisis. I have about two minutes for questions. (Applause)

MS. NEPVEU: Yes, it's Julie Nepveu with AARP Foundation Litigation. And I was wondering -- you know, I heard you say a lot of really important things, but I didn't hear you talk about enforcement against banks that are doing some really bad things with reverse mortgages and really taking people's equity and just basically stealing their homes. Can you address that a little bit?

DR. WHITMAN: Julie, you'd probably address it better than I do. So, why don't you talk about the rate work that you're working on.

MS. NEPVEU: Oh, well, I'm just trying to get to the point that I think that there's a lot of banks out there that are not -- or that have been originating these loans for the purpose of stealing the equity out of people's homes, profiting tremendously.

And then, you know, when it comes time for them to either enforce the loan, get the insurance benefits, you know, the FHA Fund, the MMI Fund that holds the insurance for these properties for the banks is, you know, $14 billion in debt because the banks are basically taking the taxpayer dollars after they have taken all the equity out of the homes.

And I just think that, you know, somebody needs to be paying attention to what are the banks doing and how are they getting away with it. Because there's not a lot of loans out there, but it's worth a lot of money. So, that's all that I would say about that.

DR. WHITMAN: Said better than I would. Thank you, Julie.

MS. O'CONNOR: Good morning. I'm Jane O'Connor, retiree. AARP has a lot of (inaudible) and you referred to the problems of out-of-pocket medical expenses. And when I read various articles, I find that there's a gap in dealing with dental costs.

And you know for most people, it's not about cosmetics when you're in your sixties or your seventies. And if you have bad teeth, you don't eat right. You're in a lot of pain, blah, blah, blah.

And yet, financial planners and people that you cite often don't make clear if they're including or not dental expenses. So, I wonder if AARP would be willing to use a little muscle with people in clarifying the role of dental expenses for the elderly.

DR. WHITMAN: Thank you for asking that question. So, Medicare doesn't cover vision, hearing, or dental, three things which our body parts really don't often last until we're in our second half of our lives. It's a huge issue because it's not just your teeth. It's your ability to eat. Infections can cause all kinds of problems.

I was excited to see in the House Bill that is tackling the high cost of prescription drugs that they were adding some -- using some of the savings to provide vision, dental, and hearing benefits. I think they should be a basic part of Medicare. I think that there are far too many people that suffer from untreated dental issues. So, thank you for raising that.

MS. CARSON: My name is Ann Carson. I'm a retired lawyer and Foreign Service

Officer. I want first of all to congratulate your organization on taking a stand against reverse mortgages.

In 1975, my first job with SSU Legal Services, I experienced on behalf of my clients basically the same phenomenon, that the woman already spoke about, presented itself a little bit differently. Because in those years, of course, consumer unfriendly products like reverse mortgages were not allowed.

I'd like to ask you what, if anything, can be done to -- I guess to encourage your organization to stand firm. A lot of research is happening and a lot of people are saying that older people need to tap into their savings. And meanwhile, the banks are thinking, aha, there's an assessment fee I can charge. There's an evaluation fee I can charge, et cetera. So, how do we make sure that this reverse mortgage thing is (inaudible). Thank you.

DR. WHITMAN: Thank you. Well, I want to be clear. They're not bad for everyone. There can be a use for them in some cases. But we take a very strong consumer perspective and have a lot of concerns with the current marketplace, the transparency with oversight. I think Julie raised a whole bunch of issues that AARP has been incredibly strong on and we continue to be.

SPEAKER: Could you just specify the case with reverse mortgages would be better than perhaps a second mortgage?

DR. WHITMAN: I want to be careful about giving specific financial advice. But I know the next topic will be covering that in a lot more of depth. I have about no time left. So, thank you so much for having me today, again, for Brookings. (Applause)

MS. MOULTON: Great. Thank you so much for having me here. I'm excited to share some work that we're doing. We've been working on thinking about home equity and older adults for about a decade with my research team trying to understand how home equity can be used in retirement in a responsible way while protecting consumers, and I think some valid concerns and issues have been raised here.

And so the challenge that was put forth to us by Brookings was to think about how can we reform reverse mortgages to make the market better. So, acknowledging that there are challenges in the market that hasn't reached the scale, what can we do to reform this market to make it better.

And so the research I'm going to share today or the presentation I'm going to share today is going to describe some proposals that we think might help make this market better and also some (inaudible) perspectives.

So, the work that we're building on, we've had some funding from others including the MacArthur Foundation and HUD. They haven't funded this particular presentation, but just to say these comments are my own and not those of any of the prior funders that we've had.

So, the motivation, which I think has been teed up nicely, equity in the home is one of the primary sources of wealth for many households in the United States. So, if we think about in 2016, nearly one in five homeowners, age 62 years of age and older, had less than $10,000 in any financial assets, but had at least $40,000 in home equity. And while that may not seem like a lot, it is something.

And so if individuals are cutting their pills, if they're not paying for needed expenses, not buying food because of not having income, home equity could be a source of supplemental income for these individuals.

And you can see we've looked at individuals of different quintiles, the distribution. So, for an individual that has less than $10,000 in liquid assets but has at least $20,000 in home equity, half of them have a house value of about $117,000, home equity of about $83,000, but financial assets of only $1,500.

So, how do we think about home equity as part of a broader picture in retirement. Another motivation here is that many individuals are spending quite a bit on housing costs. So, maybe despite not having a mortgage, they're paying money for their property taxes, their homeowners insurance, and mortgage balances have been rising.

And so simply tapping some of these other options like a second lien or home equity loan are going to require monthly repayment. What we found is that about a third of older adults actually can't afford the monthly repayment required with a home equity loan or a second lien. And so, for these individuals, simply extracting equity through another forward mortgage may not be an option. And so that's another inspiration to kind of think about. What are the other alternatives that are out there.

Historically, reverse mortgages had provided a vehicle for individuals to access equity of their home without a monthly required payment. And there's various motivations for why individuals might obtain reverse mortgages.

With some recent research that we did on reverse mortgage borrowers, we looked at borrowers that received a reverse mortgage from 2006 to 2011 to understand their motivations for taking out a reverse mortgage. And nearly half of them, about 42 percent, said paying for everyday expenses. But interestingly, about 40 percent of them said to get rid of a forward mortgage.

So, the people getting a reverse mortgage, about 60 percent of them actually have a forward mortgage already and many of them are struggling to make that forward mortgage payment. So, the reverse mortgage actually provides a sort of annuity for them because they're actually able to repay that forward mortgage with a reverse mortgage and have that monthly cash flow in their pocket. And about 40 percent said that was the reason that they got the reverse mortgage was to free up liquidity.

And then we use that as part of our thinking about how do we reform this market. Knowing that individuals are using reverse mortgages for this purpose, how do we think about that more strategically in creating products that serve this consumer niche.

As has been mentioned, the federally insured reverse mortgage, also called the HECM. So, you might hear people refer to the HECM today. The HECM is the number one dominant form of reverse mortgage today in the United States. There are private products and some of the panel members will talk about those. But the federally insured reverse mortgage is the primary reverse mortgage product in the market.

The share reverse mortgages, the market really didn't pick up. And for the last two decades it started -- the program became permanent in 1998. Really started picking up volume in 2005, 2006, when securitization of reverse mortgages began, hit its peak in 2009. Over 100,000 reverse mortgages originated that year, HECM, and we're down to about 40, 50,000 reverse mortgages originated in 2015.

Many of the problems and challenges that have been mentioned here have been the subject of a lot of policy reforms. I'm not going to go into those here, but if you're interested, we do have those in our broader paper where we unpack the different policy reforms that have happened and you can see some red lines here that show some of the reforms in the market and there's actually a lot more lines on this on the doc that have tried to shear up some of the problems in the market.

But one of the challenges that both Tom and I, I think rustle with in our papers, is this issue of crossover risk. So, with a reverse mortgage, your balance is going to grow in reverse, which means you're not making any monthly payments on the reverse mortgage. So, the principal and interest are going to be added to that balance.

And so one of the fundamental risks that we face is that when an individual no longer owns the home, if they pass away or they move into a nursing home, so they might end up in a situation where the balance on the reverse mortgage is going to exceed the value of the home, and we call that crossover.

The federally insured reverse mortgage or HECM covers that difference. So, the insurance pool steps in and says we're going to cover that difference and the individual borrower is not responsible for that difference. However, this creates a tremendous amount of cost to the Mutual Mortgage Insurance Fund as was mentioned.

And in fact, if you get this wrong, if you project out how long it's going to take for that reverse mortgage balance to meet home value and you don't project that correctly, you can end up with a large negative cost against the Mutual Mortgage Insurance Fund.

So, a lot of the innovations that both Tom and I will talk about, we keep this in the back of our mind, that we want to minimize this from happening. And there's a couple of reasons this can happen. One is that home values might drop.

So, this diagram shows you, you know, as we recently had in our recession, home values dropped, and so crossover occurred because of that. The balance is sort of exceeding the value of the home. So, the actuarial report for the MMI Fund shows that is in the red, in part, because home values dropped. And so the underlying value of collateral dropped. In some of these areas, as home values rebound, that might reverse itself.

It can also do this if the individuals undermaintain their homes. So, if home values aren't increasing at the rate that we expect because individuals undermaintain their homes, you can have a drop.

It could also happen if after a loan has been assigned, HUD or a lender, as they're working out the sale of that home, they actually are not able to collect as much on the home as they otherwise might.

So, for example, if it goes through a foreclosure, oftentimes, you get less on a foreclosed home than you would on a home selling in the market. So, trying to avoid foreclosures is another way to kind of prevent this crossover from happening.

So, there's various things we can do to prevent crossover. We can also loan less money upfront. That's going to keep that balance from growing as quickly. So, as we think about reform, these are things that we kind of keep in the back of our mind as ways to try to improve this market.

So we have two kind of buckets of proposals that are in our fuller paper, and I'm not going to be able to go into a lot of detail on the proposals here but I want to give you a highlight.

So, one of the proposals is to differentiate the product types by consumer segments. So, right now, the reverse mortgage, essentially, it provides different options to individuals. They can take a lump sum at closing, although that's limited, the amount that they can take in order to prevent that crossover risk that we talked about. There's been a policy change that limits the amount that they can take.

But they could take a lump sum at closing or they could structure it as a line of credit similar to a HELOC and draw on it over time or they could structure it as annuity and get a monthly payment from it, which I think is what a lot of us think of when we think of reverse mortgages. We think of the annuity. But, in fact, only 6 percent of borrowers are structuring it that way.

And so, while it's designed to do all of these things, how are people actually using the reverse mortgage. What do we see about their actually expressed preferences of how they might like to take a reverse mortgage.

And so there's two different product options that we think could be streamlined that would allow for meeting these consumer segments. One is a small dollar reverse mortgage, and I'm not the first to talk about this. Laurie Goodman, who is here from the Urban Institute, has also mentioned this as well.

And so the idea here is to virtually eliminate crossover risk by providing an amount of equity that is still meaningful to that older adult that's going to virtually eliminate the risk of that crossover occurring, and that allows you to price it much more cheaply. So, it allows you to charge lower interest rates potentially, lower upfront fees, maybe even waiving upfront fees all together. And it also allows that individual to still tap into that equity and prevent that crossover from happening.

So, we estimate that among older homeowners, about 12.8 million had at least -- would be able to access at least $20,000 in home equity with an LTD of 30 percent or less. So that's a very low-to-value ratio which means that that risk of crossover is virtually null in that situation. About 6.4 million would be able to tap $50,000 in home equity with an LTD of less than 30 percent.

And then we looked at the three individuals that had financial assets of less than $10,000, that group I mentioned to you before. About 3 million of them would be able to tap $20,000 in equity with a resulting LTD of less than 30 percent. They probably would not be able to afford the monthly payment on a second lien or on a HELOC, but they would be able to if we were to structure a reverse mortgage. To provide this, they would be able to tap it and make it very affordable.

The challenges right now, while they could do this, the upfront mortgage insurance premium, for example, is a flat 2 percent for everybody regardless of how much you draw. And that actually can make it more costly for somebody wanting a small-dollar reverse mortgage.

So, if we can price this most affordably, get the cost down, and make the small-dollar reverse mortgage more attractive to those individuals and investors, this could be a viable option.

There was something like this in the market previously called a HECM Saver you may be aware of, that was in 2009, but it was actually launched at a time when the market was all moving towards fixed rate reverse mortgages full draw and it really had difficulty competing at that time in the market. And we think that that kind of a product today might have better legs.

The second type of product that we talk about is a forward-to-reverse mortgage conversion product. So, this is acknowledging the fact that the primary way people are taking their reverse mortgage today is to pay off a forward mortgage.

So, if we understand that fact, how would we structure a product specifically for that purpose and perhaps nothing else. Perhaps we acknowledge that maybe one of the main motivations for an individual to take a reverse mortgage is simply to extinguish that forward mortgage payment.

And so we talk about, you know, 9.4 million older adults have mortgage debt of $10,000 or more, home values of $417,000 or less, and their housing costs are about 24 percent of their income currently, and that's the average of housing costs.

So, half of those individuals have housing costs that exceed that. So, the reverse mortgage could substantially increase liquidity for these individuals if we were to extinguish their forward mortgage balance.

So, we estimate there's about 5 million of them that we could eliminate their forward mortgage and they would still have less than 60 percent on the value ratio which again prevents that crossover. And about 3 million, we could eliminate the forward mortgage and set aside enough money and an escrow at closing to pay all future property taxes and homeowners insurance.

So, as you might know, another issue in this market is making sure that individuals are not in default in their property tax and homeowners insurance and that they have enough money to pay those expenses.

So, one of the things we talk about in our proposals is a mandatory or default lease option which is a Life Expectancy Set-Aside. So, it's setting aside money so individuals have enough to pay their future property taxes and insurance, particularly for these low wealth higher risk households making sure that they have that set-aside.

And currently, that's actually part of the product under the financial assessment, but we're talking about ways to kind of make that default option into the product itself.

So, our second bucket of proposals talk about implementing risk-based underwriting and preventative servicing. So, this is trying to help not only new product options, but to also think about how can we change the risk environment for reverse mortgages.

One thing that our research and some other research recently released by Fannie Mae shows is that, you know, if we look at the credit score of borrowers who are getting reversed mortgages, we can actually identify those borrowers who are going to be at greater risk in the future.

So, individuals that have credit scores below 680, for example, end up at higher risks of defaulting on their property taxes and insurance. They also end up having what we would call greater risk of crossover and they're more likely to have negative equity situations that end up costing the MMI Fund or lenders more.

And so, if we know this fact going into it, how might we structure the product with more knowledge of this information. And so right now, post 2015, there's a financial assessment that all applicants for reverse mortgage are required to go through. It's a very manual underwriting process. It's a huge improvement over I would say I think everybody in the industry and in policy circles would agree that it's a huge improvement over the world where we had no underwriting for reverse mortgages.

However, it's a very manual process. So, basically, you pull a credit report, you look for any interrogatory items on that credit report. You also do a financial assessment where you're checking their budget and their ability to pay property taxes and insurance.

In the forward mortgage world, this is much more manual than what you might experience. And it can put a lot of transaction costs on the borrowers and the individuals. It may provide incentives for lenders to not provide the loan to lower wealth borrowers.

And so what we would propose is that we streamline this. That we use credit scores as kind of a risk indicator knowing that above 680 is very little risk of default. Perhaps you could streamline underwriting for those individuals and require the more detailed financial assessment for individuals with credit scores below 680. And then perhaps even make the LESA, the Life Expectancy Set-Aside, which is going to help cover the property tax and insurance, the default option for anybody with credit scores below 680.

And you wouldn't even need to go through that manual underwriting process if you agree to set aside or have enough money to set aside funds for your property taxes and homeowners insurance, thereby preventing this horrible situation where individuals end up without enough money to pay those expenses.

The second bucket of reforms that we talked about, and this would apply -- I think there's also something important to think about. A lot of the issues in the reverse mortgage market today are issues from vintage books of business. So, the new policy reforms in 2013 and 2015, the new books of business are performing much better in general than the prior books of business. But we can't forget about those prior books of business because these are real older adults that own their homes that are facing foreclosures or facing issues, and so how do we help them.

And so we think preventative servicing, and many lenders are doing this, but this I think not all are. And to your point, I think there's (inaudible) in how lenders are thinking about servicing these loans.

And so we did a simple experiment with actually a counseling agency where we provided reminders to pay property taxes and insurance and we actually reduced default by almost half among individuals that got those reminders. Now, that seems like a no-brainer and many servicers again may be doing this already, but some aren't.

And so this is something that seems like a no-brainer. But having the money to pay that lumpy tax expenditure can be a huge shock for individuals.

And then other strategies that we can use to help maximize the collateral value of the property so that foreclosure really is the option of last resort, and we're figuring out ways to help kind of keep the collateral value higher. And in the paper, we talk about some of those.

But an example is like a cash for keys option. So, you don't get to the foreclosure situation, but you work with the individual prior to that so that they can exit gracefully from the home and you're able to maximize the collateral value if they're in that situation.

All right, I'm out of time, but thank you very much. (Applause)

MR. HAURIN: Okay. Thanks very much to Ben, Martin, and everybody at Brookings and everybody for being here and to Stephanie for doing the hard work of explaining what a reverse mortgage is. Usually, if I have explained within a 90-minute seminar what a reverse mortgage actually does, that that's a win.

Okay. But I want to just describe a policy reform that I think may be a fruitful direction. And the problem and solution I hope can be seen in this picture where we have the loan to value on the vertical axis in time since origination on the horizontal axis. And the number one, right where this black line is, is 100 percent. And exactly what Stephanie described as crossover risk is a real problem.

So, you borrow money here when you're, you know, midsixties, early seventies, everything is okay. You move when you're 80, you've got a little bit of equity left, maybe not enough, which of course is an issue to try and finance the rest of her time, but if you're alive or to your estate if you're dead.

But if we go long enough and interest rates are high enough, because there's no payments, no amortization, and no interest, eventually, there's crossover. The loan balance exceeds the value of the house.

And that's a problem for two reasons. Now, there is the MMI --

SPEAKER: Can I stop you a second?

MR. HAURIN: Please.

SPEAKER: Is your lapel mic on, or do you want to --

MR. HAURIN: But I can talk into the mic. That's fine. I don't need to walk. It's fine. Okay, sorry. Thanks.

So, getting under -- over 100 percent loan to value, no equity left, is a problem for two reasons. In theory, there's nothing wrong with it. In fact, the reverse mortgage is a hedge against living a long time.

If you outlive the value of your house in this reverse mortgage, you have borrowed more in sort of present value than the value of your home. So, you have won and the lender or FHA as the insurer has lost. That's insurance against living a long time just like any annuity which we generally think of as not a bad thing.

If prices fall, this is protection against falling prices. And of course, with the house as the most important asset in the portfolio, insurance against a decline in the value of your house, which is hard to find in the market, is very attractive.

That said, there's a problem with that insurance. And I think all the evidence, both fancy and (inaudible) analysis and just talking to people suggests that seniors do not value that so-called Put Option, the ability to effectively sell your house for the loan amount, which is greater than the market value.

If you talk to people, they don't get it. If you look at the behavior of borrowers who have a credit line with money still on it and that credit line exceeds the value of the house, if they were ruthless, if they really valued that option, they'd grab the cash. They'd dine and dance right before they'd leave and it would be free money and it would be the bank's problem, but that never happens.

So that tells me where is FHA and the lender hates the underwater situation. Their servicing cost is expensive to ensure that value. There's a lot of value in that area between loan amounts and has no note. The future is uncertain. The end is always near. There could be a big gap between the loan balance and the value of the house.

And it's very scary to people who understand the product. But to seniors, it doesn't have a lot of value. So, offering a product where you have to provide expensive insurance that isn't appreciated by the borrower, not great.

So, that's one problem, a sort of bid-ask spread on this value here that you don't know how much they'll be, but it's potentially expensive.

Problem number two is what I would call a moral hazard on the date of exit from the home. When you're a homeowner with no debt, every day you stay in the house, your home equity is tied up in the house instead of free cash on which you can earn interest and spend money.

So, you know, there's a cost remaining in the home. Every day you don't sell, you lose the opportunity cost of that capital. One you have passed the date at which the loan balance exceeds the value of the house, you'll never leave. Even if you fracture your hip and you're not able to take care of yourself, why would you leave. It's free to stay in the house and it's expensive to find care out of the home.

So, there's going to be a mismatch between incentives to stay for the borrower versus the lender. And that's just the design problem with reverse mortgage when it's likely that you're going to get underwater.

So, what is the solution. It's annuitization. And this used to be something called a fixed debt reverse annuity mortgage. But now, since borrowers tend to be very liquidity constrained people who do not want annuities, they want immediate cash, we've taken away annuitization.

But you can think about the annuity with the reverse mortgage as having two components. The first component is the value of the home up until the date the borrower leaves.

The second component is the value of the home after. That second component is where the reverse mortgage comes from. The most a lender can give you is how much is the house going to be worth when you're out of the house. But that leaves in value the part of the value of the home that represents rents up until you leave. And you can think about that as a life annuity that would pay those rents. Okay.

If you took that component and add it to a line of credit or to a lump-sum proceed, so to take the loan balance and you add to the loan balance a life annuity that pays in favor of the lender during the life of the loan, that life annuity under sort of normal interest rate scenarios with no spread would pay just enough to the lender, that the initial cash to the borrower, plus the loan. Because the life annuity gets an interest rate because of the mortality premium greater than the interest rate in the economy, that loan, that annuity can pay off just enough interest so that the loan to value stays constant.

What I'm proposing is a tilt or a rotation of the loan to value. You increase loan to value early in the life of the loan to buy a life annuity. And that life annuity over the course of the loan, as long as the borrower is in the home, is paying down principal.

So, you do start with a higher loan to value, but you never get this rapid escalation. So, you can make it much less likely that if the loan lasts a long time, which is a big risk, that you get underwater that you've crossed over and that's the proposal.

And what does it do, it eats into this value. It makes it less likely that you're going to crossover. And when you do crossover, it's much less severe, the losses. Okay.

So, we have described why it's a problem. Now, I just want to show you the moral hazard. Here's a bunch of different borrowers or ages. Let's look at younger borrowers. Here's how much equity you have in the house. Here's zero equity, 50, 100. This is reverse mortgage borrowers. So, this is after they have taken on HECM. The vertical axis is the termination rate.

What we find is borrowers with no equity, the only way they leave is dead. There is no reason to move while alive, and they don't. Exit rates get much more rapid when there's a lot of equity in the house. Okay.

So, it's not necessarily any kind of strategic motives, but borrowers don't leave when they don't have equity in the home because, you know, there's just a lack of incentive. Okay.

So, let me just describe what I'm proposing as this annuity which pays to the lender during the life of the loan, and then if the borrower leaves while alive, the annuity reverts to the borrower as cash flow to support housing after they have left. Okay.

So, imagine a HECM with all other terms the same, so 50-ish percent loan to value, same interest rate, same mortgage insurance premium potentially, although I think this will allow a lower upfront mortgage insurance premium. Okay.

So, you add a life annuity to the debt amount. It pays interest during the life of the loan and it reverts to the borrower if the borrower moves while they are alive. Annuity is right, but the insurer keeps the principal after the borrower dies. So, they can pay the normal interest rate on savings plus a mortality premium. Okay.

Because of that, if you think about it, if you add this annuity to the loan, the annuity payment will be more than enough to cover the interest on the annuity part and, in fact, will pay some interest on the principal which means the total loan balance is growing much more slowly, and even zero if you went all the way. You wouldn't go all the way in practice because you would not want to start at 100 percent loan to value. So, you take maybe half of the remaining equity and buy in annuity. Okay.

So, the balance grows considerably more slowly than it would otherwise. And in a world without uncertainty, I showed you that picture, you can actually hold the loan to value ratio on the house constant with no growth over time. And what does that do, it eliminates the move date moral hazard.

Number one, the borrower is not underwater. But number two, when they move, they get this annuity payment which should be in a sort of perfect capital markets world. The way the math works is that annuity payment would be just enough to pay rent on a similar home. Okay.

So, you don't have the unfortunate situations say with the older husband, younger wife. The older borrower grabs a high loan to value by taking the wife off a title. He dies. There's no equity in the house. If the woman decides to move at that point, because she has, you know, no support, the good news is she can take that life annuity until death and pay rent somewhere else. In a worst-case scenario, she can use it to support expenditures in the house.

Okay. Is there any precedent? Is this some zany idea? You know, for a while, I thought this was totally crazy. It seems like it makes sense. But if it was such a good idea, why didn't anybody ever try it. And the answer is they have.

LESA, the Life Expectancy Set-Aside, it's not annuitized. So, there's no mortality premium. There's no transfer from people who die early in retirement to later. But it does have this element of an annual income to provide for expenses. It doesn't solve all the problems with move date moral hazard and it doesn't fix the problem of underwater because the loan balance can still grow.

Okay, and then but something in the old days they didn't. I discovered this in some ancient text from long ago in the 1980's when I was doing this project. So, I'm thankful I had the opportunity.

You know, they used annuitize. It was a reverse annuity mortgage and there were two kinds. There was just an annuity. So, you'd have something like 50, 60 percent loan to value. Probably lower in the world with very high interest rates because you just can't provide much proceeds. If you have a 14 percent interest rate, it gets underwater too fast. Okay.

So, the fixed at RAMs would take an annuity to the borrower and then a second annuity to the lender. And it was exactly the idea to keep the loan to value constant over time. So, you have less of this crossover risk and it's a less complicated product because there's just less insurance.

So, what about in the real world. I showed you a picture where prices are constant. There's no risk. You can definitely keep loan to value at 100 percent. That's not a realistic product.

So, I have done some numerical analysis. In a world with realistic volatility, the house can up or down 5 percent every year. And I showed you that picture of what real world terminations of loans look like.

And under realistic scenarios, if you take half -- so you have say a 50 percent loan to value. If you take 25 percent of the value of the house and you put a life annuity on it with payments to the lender through termination of the loan and if the borrower is still alive, they get the annuity. You can reduce the value of that default option. That sort of area of loan balance above home resale value, you can cut into that value by 2 percent which can be half the option value.

And currently, FHAs mortgage insurance premium upfront, you pay interest as well, is what Stephanie mentioned, 2 percent. So, you could almost eliminate that 2 percent up from premium. Probably better, lower the interest rate over the life of the loan which makes better incentives. Okay.

So, that is a significant reduction in risk under what I think are realistic scenarios. So, we accomplished two goals. One, we reduced the bid-ask spread by making that option less expensive to the lender that the borrower doesn't value. Okay.

And the one thing I will say is this doesn't work very well when price volatility is very, very high. And the reason is what I have proposed addresses one of two risks, longevity risk. The life annuity just eats into the problem of excessive longevity by the borrower, not excessive. I mean, it's nice if they live a long time. But it's not good for loan to value.

But if most of the problem is price volatility, I haven't addressed that problem. It's a very interesting financial fund because you've got the interaction of home price risk and longevity. It's mathematically interesting, but the life part is pretty easy to address.

Who wins, borrowers who live a moderate or long time. Why, they get a cheaper loan, lower mortgage insurance premium or lower rates. They'll probably have more equity at the end. And when they move out, they're protected against the scenario where they have to move out of the home because they get that annuity income.

(inaudible) are, of course, the short-lived borrowers estates. If you die young, your estate is worse off than it would have been without this annuity compliant.

Here's a picture of what realistic rotation with only 50 percent of the remaining equity. (inaudible) we see higher loan to value earlier in life but the gain is it takes a very, very long time to get to 100 percent loan to value, whereas with high interest rates you can get there, you know, well within a borrowers life. Thank you very much. (Applause)

(Recess)

MR. HARRIS: Thank you, Stephanie and Tom.

As everyone is getting seated I'll just start talking.

Let me just start by welcoming all the people online who are watching this. This is being streamed. I know there are many of my colleagues at the Keller School of Management that are watching and hundreds of others online.

So let me just start off with a few brief introductions. All of our panelists, many accomplishments are listed on the event page, but this is sort of a dream team of reverse mortgages, which is not a phrase you hear very often but this is I think the way I would describe this panel.

So to my left we have Laurie Goodman. Laurie is vice president at the Urban Institute and co-director of its Housing Finance Policy Center. She spent three decades as an analyst and research department manager on Wall Street. She's an expert on housing finance, including reverse mortgages, and she recently testified to Congress on this issue.

Next, we have Chris Mayer. Chris is the Paul Milstein professor of real estate finance at

Columbia University's School of Business. He's the co-director of the Paul Milstein Center for Real Estate. He's also the CEO of Longbridge Financial, which is a reverse mortgage company, and he is a director of the National Reverse Mortgage Lenders Association.

Then, of course, we have Stephanie Moulton. Stephanie is an associate professor and director of doctoral studies at the John Glen College of Public Affairs at Ohio State University, and she is widely published on reverse mortgages.

We also have Tom Davidoff. Tom has the Stanley Hamilton professorship in real estate finance. He's the director of the UBC Center for Urban and Economics in Real Estate. And like Dr. Moulton, he is widely published on reverse mortgages.

So let's just jump right in.

Laurie, let's start with you. Do you mind taking a few minutes and just reacting to -- we'll start with Stephanie's proposal. What do you think?

MS. GOODMAN: So I love Stephanie's proposal. She just makes a lot of common sense recommendations to increase the reach of the reverse mortgage product. And not only does she make these recommendations but she actually sizes the use of it.

So she recognizes the fact that the reverse mortgage program is not for everyone but then says, okay, there are two specific uses that are very, very common. Small dollar HECMs and forward mortgage HECMs. Both make a ton of sense. On the small dollar HECMs, I see how you can squeeze out costs, reduce insurance costs. You could do things like waive appraisals and use AVMs instead with the loan-to-value ratio that's that low.

With forward mortgage HECMs, I have a little bit more trouble seeing exactly how you would streamline the process, but conceptually I love the idea.

In terms of implementing risk-based underwriting and preventative servicing, the risk-based underwriting, again, very, very logical. FICO greater than 680, no underwriting. FICO less than 680, automatic LESA with an opt-out if you pass the financial assessment. Makes a ton of sense.

On servicing, reminders to pay property taxes. Again, who can disagree with that? And then she also makes some suggestions in terms of cash for keys. Right now you can pay up to $3,000 to a borrower to exit the home but only if it's a 2017 HECM or later. She says, well, why not extend to earlier borrowers? I think I would take that even further and say why limit it to $3,000? Why not in long foreclosure states limit it? Why not have substantially higher numbers. It's a very, very graceful exit all around.

So in short, I really thought this was a lot of very common sense suggestions and wholeheartedly endorse the paper.

MR. HARRIS: Chris?

MR. MAYER: So I basically agree with Laurie. Stephanie and her co-author, Don Haurin have been long-time researchers in this program and Stephanie brings an expertise of really, really understanding the program and how mortgages work and you know, previous work at Housing Counseling Agency. I think some of her work in talking about servicing brings a very practical element to it from somebody who really understands the business.

I'll say a couple things. I think Stephanie is really focused on the low moderate income market. I think that it is clear there are a large number of seniors who are relatively house rich and cash poor and the question is can they responsibly access their home equity using a program that I think is likely as to be provided by the government because this is a demographic that is relatively expensive to serve with relatively low home values. And there have been research that looks at home prices and what's happened to the collateral value for these folks, and unfortunately, these are people whose homes don't generally appreciate as much as the rest of the population, so it's the kind of market that I think would have a hard time existing absent the government. And the critical thing is try and figure out how can you serve this market without a large cost to taxpayers? Although I think this is a market taxpayers should look at the benefits of helping people stay in their home longer in terms of the healthcare system and in terms of the stability of their financial situation.

There are other sort of demographics and markets within this for people who have higher home values, higher incomes, and still face problems with healthcare at home, retrofitting their home, and so there are other markets beyond what Stephanie has identified. So I think there are many people for whom using liquidity of their home can be a benefit.

MR. HARRIS: And Chris, when you say a market is expensive to serve, what do you mean?

MR. MAYER: The collateral values don't hold their value very well. And this is a demographic that has challenges in terms of their ability to live well and meet their obligations. And I think financial assessment can help but part of the social purposes of the program, which is helping people have a better retirement and stay in their homes longer in this demographic is expensive. These are people who are nervous explaining, selling. Helping them understand what the program is about is a very time-consuming process. And the dollars involved from a lender's perspective are not huge. So I think there is a value to doing this. It's a place where the government needs to play a strong role in ensuring that people are appropriately -- products appropriately managed, sold in a way that's responsible. But it's also a market that I think wouldn't exist for some of these folks absent the government involvement in something like a HECM. So that's the cost challenge.

I would also say one other thing on Stephanie's comment and, you know, I'll wrap up, on the rolling a traditional mortgage into a reverse mortgage. We could talk more about this but the U.K. has a market that is essentially per capita six or seven times as large as the U.S. And the major insight in the U.K. that I think would be helpful for us to understand is that a 30-year fixed rate or a long-term mortgage with payments for somebody in their fifties or sixties, that they're going to be paying for another 30 years without a pension system is not clearly an appropriate product for many people. And it puts them in a situation where they're making payments in retirement that they then have to struggle with.

So some way of creating a product that serves those folks, that allows them to make payments for a period of time and then roll into a reverse or take out a traditional mortgage and roll it into a reverse, it allows them at some point to stop making payments. And a lot of these folks have loan-to-value ratios where this would be a workable product. It's something that I think has a lot of potential and it's something that's driving the growth in the U.K. market because the government has said you can't put somebody in a financial product which is sort of setting them up to fail. And a program where you can make the payments today but you can't make the payments five or 10 years from now is viewed as a program which is setting people up to fail.

So I do think this issue about how to transition people, you know, responsibly, -- you know, it's got to have counseling. It's got to have things explained to borrowers -- has a lot of potential to think about, although the logistics as Laurie said I think will take some work.

MR. HARRIS: So Tom's proposal, well informed like Stephanie's, but very different. Laurie, what did you think about what Tom had to say?

MS. GOODMAN: So first of all, I thought it was just incredibly clever. I thought, you know, that the annuity cash flows essentially provide a hedge for the reverse mortgage instruments. But then what I worried about is first that it would have a detrimental impact on the number of reverse mortgage borrowers because essentially you're requiring a borrower to make two decisions. You're requiring them to essentially decide to buy an annuity plus the reverse mortgage. And so I'm thinking about it. Well, if I die two minutes after I take out my reverse mortgage and annuity, I essentially lose the value of the annuity. So I have to make the decision to do both.

In addition, the product -- well, the idea again is very clever. It doesn't directly help the borrower, although it might do so through lower payments, through more favorable pricing as Tom points out in his paper. But it's really a hedge for the lender. And I wondered if there was any way for the lender to set up a fund that essentially pools reverse mortgages with an annuity so you essentially have the lender who is benefitting the most from this sort of create the hedge themselves. And I will leave it to you who is far more clever than I to figure out exactly how that can be implemented but I actually thought that might be a really cool idea for a fund.

This also, the third point about this paper is that it extracts from any default risk on the part of the annuity provider. So it's less useful in the U.S. where the government essentially provides that insurance. Why would the government then take out an annuity on somebody's life when that annuity provider might not actually be there? But again, I thought this was just incredibly clever and I wondered if there was some way for the lender to take the risk and get the benefit.

MR. HARRIS: Chris, what did you think?

MR. MAYER: So first, I agree with Laurie, also. I think it's a very interesting and creative idea, Tom. I will go further than that and essentially say this is an idea that actually in practice is happening, but it's happening at the pool level, and it's happening as people are already financing private label reverse mortgages. So in essence what Tom is suggesting is basically break a reverse mortgage into -- or the cash flows into two parts. Take a lower LTVP, which should have a higher -- which should be safer and have a lower yield associated with it, and finance that with relatively low-cost capital. And then you have this residual piece which is essentially the annuitization and finance that with higher cost capital for people who are financing, you know, funding annuities. And that's actually essentially how private label loans are done but they're done in a pool where you have payments that occur over time and pay down the balance. And so you securitize essentially the first seven years of payments at a relatively low cost to capital and then the remaining payments are the higher cost to capital.

The big difference and the thing that is not working as well today in the private label side, at least in the U.S. -- and again, in the U.K., and elsewhere, at least in some other countries, what you see is the right people to be lending on reverse mortgages are actually insurance companies or pension funds because they have very long-lived capital and that idea of sort of essentially getting payments that are going to last a very long time should be coming from people that that offsets their liabilities.

So you don't need to do an annuity if what's happening is that capital is getting directly provided by somebody who is willing to take that risk on their balance sheet and essentially take the other part and then you don't have the default risk associated with the annuity as well. That's not happening in the U.S. because at the moment it's sort of hedge funds or private equity funded vehicles that have a very high cost of capital that are funding that sort of long-lived risk piece. And it turns out if you discount that at 15 percent, you don't get a lot of value. And so that's a flaw right now in kind of how the U.S. has done this, but other countries have done this well. And frankly, you don't have to tranche it out. If you're an insurance company or a pension fund you're perfectly happy getting sort of a set of payments over a long period of time even in kind of a whole loan context.

So I apologize. That was like probably too high a level comment for, you know, a bunch of the, kind of the policy piece, but it's a way of basically saying I think the idea Tom is talking about makes a lot of sense and it's something that people who are looking at financing these things are doing today in some variation of the approach.

MR. HARRIS: So Tom and Stephanie, do you want to take a crack at responding to any of this, and then we'll jump into some other questions?

But, so Tom, do you have any thoughts on these?

MR. DAVIDOFF: Well, first of all, let me just say, I completely agree with the small value. To the extent there are borrowers who want small value loans, a low fee, HECM safer type product just makes a tremendous amount of sense. And on the forward side, at qualification, right, you could think about doing all the screening at the data qualification and that would make the loan cheaper at origination if you say we're going to provide you this option to roll over or, in fact, should you miss a payment or two or three payments we're going to immediately transition you to this at a certain age. You know, there's got to be economies of scale of doing two originations at once. So I think, you know, not surprising your ideas are excellent.

On Chris and Laurie's point, I originally presented this to a group as something yet even considerably more convoluted and the idea was to actually take the HECM mortgage-backed security and take a lower end tranche and essentially make the annuity a claim on that that the borrowers would get. So essentially, what the annuity that would be going first to the lender and then the borrower when they move would be a junior tranche of a reverse mortgage with almost a tontine that the last one standing would get a giant payoff to match the giant liability of loan versus product.

The other point is I agree the double sale is going to be very hard. To the extent there's value in the proposal, I think it's just to clarify what the sources of value are and to say we should think about this annuity that lasts as long as the borrower is in the home. You know, that's one part of risk and it can be used to somehow avoid crossover. How you exactly impellent it I'll leave to the very capable hands of Wall Street and Harlem.

MS. HARRIS: Stephanie?

MS. MOULTON: Yeah, sure. Some quick thoughts.

I think it was interesting reading Tom's proposal. We're both sort of thinking about crossover risk and different ways of going about crossover risk more incremental. And I think yours is much more kind of fundamentally transforming the market, although as Chris says, maybe it's happening anyways. But I really appreciate that.

To the comment about, you know, I don't think the HECM is designed for everybody, or should be designed for everybody. I think we need both a private market and a HECM market.

And you asked a question, Ben, about what is the additional risk of serving these individuals. And I think there's somewhat of a misnomer.

So actually, about 75 percent of HECM borrowers have a credit score of 680 or above.

So like this idea of having a threshold of 680, these aren't -- even though a lot of them are lower income, so this idea that they are house rich, cash poor, the current HECM borrower population is still true. We do find that in general they do have very low levels of financial assets and higher home values, but that doesn't mean that they're poor credit individuals. So only 25 percent of them actually have credit scores below 680. But it's those 25 percent that we have to really worry about. And I think it's those 25 percent that are potentially going to struggle that we have to really design a product that's going to be made so that they can succeed. To Chris's point, like so whether it's a default lease or whatever we do to kind of make sure we protect those individuals, I think that's critical.

And then also the information of symmetries in the market potentially. So higher wealth borrowers may be more sophisticated, have access to financial planning. Lower wealth borrowers often don't have those resources and so there's a potential to be taken advantage of or just they have less information than others. And so I think the government's role in this market for those lower wealth borrowers is also because of the kind of potential for information asymmetry where the borrower knows less than the lender and so making sure that we design products that can be safe for those individuals.

MR. HARRIS: So we'll turn to a few more questions more broadly about reverse mortgages.

Can I just stop for one second and say I find this incredibly complex. So I usually study taxes. Reverse mortgages blow taxes away on complexity, both the details of the particular loans, how the programs work, the reforms that have happened. You saw Stephanie's chart up there. This is a program which is transforming before our very eyes almost every year. I find it really confusing. And that's before you even get to the economics and everything that Tom is talking about, this is an incredibly complex issue. So maybe we can just acknowledge that from the get-go. If you're interested in learning more about it, I encourage you to go to the papers, both the framing paper that Martin and I put out and also the framing that are part of both Stephanie's and Don's, and Tom's papers. So I encourage you to read it if you're confused.

We have a quick question in the back. Is it related to what I just said?

SPEAKER: Yeah.

MR. HARRIS: Yeah.

SPEAKER: Well, it's not a quick question though.

MR. HARRIS: So we're going to have questions at the end. Do you mind holding it for 15 minutes or so?

So Laurie, can we just talk more broadly? So we heard Deb Whitman come up during her keynote and talk about retirement security and all the challenges that are included in that. More broadly, should we be looking at home equity as a solution to our retirement challenge or is that not a first order of concern?

MS. GOODMAN: No, I mean, I think Deb did a great job of talking about how retirement savings is challenged. And so I'm just going to get -- 43 percent of seniors would have incomes below the poverty line were it not for Social Security. You know, home equity is their major asset but people don't think about it as a retirement tool. A Fannie Mae National Housing Survey in 2016 found 80 percent of homeowners 55 and over were not at all interested in borrowing from home equity in retirement. They view it as a tool for those in really bad shape and, well, that's not me.

Retirement planning has historically only included financial wealth and not housing wealth, even though most people have more of their assets in housing wealth than in financial assets. Financial advisors and planners aren't trained in and don't know much about products that allow the client to tap into home equity which makes them reluctant to endorse these types of products. In addition, as Shelly has stressed over and over again, financial advisors can't be legally compensated for recommending reverse products because RESPA, the Real Estate Settlement Procedures Act, prohibits people without a mortgage license from being paid on a mortgage transaction.

So even if a financial advisor knew about reverse mortgages, it wouldn't make sense for them to take the risk that someone uses a client's home equity inappropriate when there is no compensation whatsoever to them.

Now, addressing this is really complicated. We certainly don't want financial planners getting complicated to put seniors into inappropriate products. On the other hand, you do want tapping into home equity to be included in financial planning. And so perhaps including it in the certification procedures and putting rules into place as to what a financial planner can and can't say and limiting compensation would be very advantageous to the consumer. It makes no sense to think about planning for retirement without thinking about how to use what is the largest asset for most retirees, which is their home. That is, you really want to think holistically about retirement. Reverse mortgages could be an alternative to selling stocks in a bad market. It could be way more favorable than incurring penalties and withdrawing assets from individual retirement accounts. If an older adult is selling one home and buying another, financing the new home partially with a reverse mortgage can free up cash for daily living expenses. Moreover, the more homeowners know about the options the less susceptible they are to scams.

In addition, reverse mortgages can actually work very favorably with Social Security benefits to improve financial security. So a person who would elect to early Social Security benefits, if they tapped into home equity at age 62 and later elected a later Social Security draw, they could be better off in the long run. So sort of ignoring that holistic approach to retirement and ignoring your major financial asset makes no sense from a retirement planning point of view.

I just want to make one last point and that's that many lower income home rich, financial asset poor people don't use financial planners and we need to improve reverse mortgage counseling as well. So currently, counseling is by an independent third-party counselor approved by HUD and it has to be completed before a lender process a reverse mortgage application. The counseling includes information on how reverse mortgages work, payment options, benefits and drawbacks, and tax implications. But the counseling happens late in the process after the homeowner has decided to obtain a reverse mortgage.

Mandatory counseling could be enhanced by requiring lenders to refer borrowers to HECM counseling as their first step after initial contact. In addition, and this is an idea I stole from Stephanie a long time ago and I've repeated more times than she has, is that counseling could be targeted for different types of borrowers. That is, borrowers could be set down several tracks depending on their creditworthiness, needs, and assets.

For example, a borrower with a high credit score and significant household wealth may be better suited for a forward home equity product such as a HELOC. These borrowers might be better off looking at comparing a reverse mortgage to a HELOC. On the other hand, lower income borrowers with limited means could benefit from counseling that focuses on more appropriate use of HECMs and how to select the right amount to borrower. So a few different tracks would make the counseling more valuable to a diverse customer base.

MR. HARRIS: Thanks, Laurie.

So Tom, I think it's only a slight -- it's not exaggeration to say you've written more about the issue of reverse mortgages as a hedge against longevity and falling home prices than anyone on the planet. You've written about it mostly in academic papers as far as I can tell. Should consumers be thinking about reverse mortgages as a hedge against longevity and falling home prices more? Should we see this in the Wall Street Journal regularly? Should this be just sort of part of the consumer experience?

MR. DAVIDOFF: Yeah. You know, I was wondering, if only there was someone in the Federal Government who had a lot of credibility with seniors who could convince people that borrowing more money than in some cases you pay back can be a good idea. But I just can't think of any individuals in the Federal Government who might be able to play that role.

It is a difficult sell without the salesmanship of a Donald Trump. I think, you know, getting people to think of the idea, well, I'm going to borrow more than -- I think they think it's unethical. You know, there might be -- I don't know the credit score impacts honestly. I've tried to figure them out. It's a little bit opaque.

But yes. I mean, if you think about Sun City in 2006, when you had this large excess valuation in the Phoenix housing market and you have a product where you don't have to even borrow any money because the line of credit grows at the reverse mortgage interest rate. So you get a line of credit which back then could be more than 60 percent of the value of an overinflated home growing at a spread of something like two percent over the riskless rate. The likelihood that that line of credit, if either prices fell dramatically and/or you lived a long time, great to be more than the value of the house, you could pay six percent of the value of the house for the option that should it ever come to be the case, that that credit line grew to be more than the house, that would be incredible insurance against price decline or longevity that would have been worth much more by any calculation than six percent. So you're ensuring two very hard to ensure events -- price decline and longevity -- that are phenomenally important in the portfolio of a senior. You know, if we were all AI bots this thing would have been selling like hotcakes because it's great insurance. But, you know, the marketing I think is a real challenge. You know, not calling it underwater on a mortgage may be relabeling somehow but it's potentially really great insurance. And with diversification, it can be a great, great market.

I just want to say one thing about the concerns about unscrupulous lending, which I totally agree with. I just think in the current environment, you know, if I can just take a step away from risks to macro, if we really live in a world, especially in coastal markets or D.C., San Francisco, Vancouver, where I'm from, rents are going to grow at more than inflation. I think they just are. As the world gets less stable, you know, you have 200 million Americans who may need to move to Canada pretty soon. You know, you've got climate, what have you, China. You know, growth in supply-constrained cities of rents, it's not going to be inflation, it's going to be more than inflation. So you're looking at two and a half, three percent a year. And riskless rates, as far as I can tell, I think people on Wall Street think they're going to be two percent forever.

If you have riskless rates that are really, really low and rent growth that's high, it turns out the value of a home, which is sort of the rents coming from the home forever, the fraction of that value, that is the rents during a senior's remaining lifetime, gets really small. And the value after, which is what a reverse mortgage really can provide, gets very large. So should current conditions persist, we have to use home equity to fund retirement. There's no way.

The other side though is the beginning of life. There's no way that in somebody's working years they're going to be able to pay the true value of say a single detached home with land. No way. Because 30 years of work is going to be very small relative to the value of rents coming out of that house from today to infinity. And so I think we have to get more creative about mortgage finance. The 30-year mortgage makes sense in a 14 percent interest rate environment where home prices don't grow because there's plenty of new supply, but I think in our current macro system we really have to rethink housing finance, and especially that means at the beginning and the end of life.

MR. HARRIS: Stephanie, so I think if you look at -- well, my interpretation is if you look at a lot of the reforms in this market over the past seven or eight years, they're driven by fiscal concerns. Right? So concerns that this is expensive. It's supposed to have no net cost to Federal Government. How does that conflict with the desire to make this a broad-based program, to have broad coverage, to have this available to a wide swath of seniors who might want it in a lot of different circumstances? So basically, how does expanded coverage conflict with the desire to have a low-cost program?

MS. MOULTON: Yeah. And I think we have to worry about both of those things. I think some of the problems that we have, the fiscal constraints, the concerns that we have are legacy concerns. I mean, I do think, and this is a challenge to kind of make sure that we don't ignore the legacy HECMs that were originated before a lot of the good policy changes have been put into place while at the same time building product options that are actually appealing to individuals and not penalizing the future of seniors for kind of sins of the past, so to speak. So there's kind of two things to balance there.

And I think, you know, there's ways to address the fiscal concerns while still allowing for expansion of the market. And that's what we were trying to think about in some of our proposals was how can we address some of these fiscal concerns?

One of the big fiscal concerns, it results when the home -- after the home is assigned a HUD, for example, or when the home goes through a foreclosure process, I think it was the CBO that estimated that I think 25 percent of the home's value is lost through the disposition of the HECM. So what that means is that because the home -- after the home has been assigned a HUD or a servicer is processing it through a foreclosure process, it takes a long time. They add cost to that. They have to maintain the property and they actually end up selling it at a huge discount than what they would if it was just a third-party sale.

So what seems like a little thing like that, if we can maximize that value then that will help keep the insurance fund from being in the red, so to speak, and so that addresses some of the fiscal concerns, which then allows us to kind of think more creatively about the front end of the product. So I think we have to address both the back end and the front end. We can't just do one without the other. But I think some of the current concerns, the $14 billion that you recently cited with the actuarial report is real but it's also an actuarial report. So it's a projection based on what house values are going to do and also based on the legacy book of business and the future book of business is probably going to perform better than that. So I think there's this challenge of not letting ourselves get so concerned about shoring that up that we don't think about how to create innovative product options that are going to help address future needs as well. So there's definitely a balance to strike there.

And I do think some of the streamlined underwriting, thinking about the risk of borrowers and how do we address their underlying risk of individuals. I mean, the forward market has known this for decades that we can use underwriting to help address risk, and I think it's time that we think about that in a smarter way. The financial assessment is certainly a step but it's very manual. And if we want to bring this scale, if we want to bring the big lenders back in, if we want reputation risks to go away, part of what is bringing in big players again to the market. Then I think, you know, that is going to require more automated processes and not this very manual process that we have currently.

MR. HARRIS: Thank you.

So Chris, let me ask you a question. When I mention to people, mainly economists, because that's who I talk to, that Martin and I, we're putting on this event, I would say sort of the modal response is an eye roll. And they'd say, oh, reverse mortgages, those are sold at 3:00 a.m. by some huckster. So, let me just ask you, you know, what do you think about reputational concerns in this market? Are they outdated in light of recent reforms? Is the eye roll fair?

MR. MAYER: So the first thing is when you look around the world, you actually hear the same comments in many, many countries with very different structures. So as American's, we're always used to understand kind of how we look at the world but you could travel to Spain. You could travel, literally, I did a retirement conference in Spain last December and, you know, was asked by their sort of top business magazine, they did this whole Sunday section on U.S. expert comes and talks about reverse mortgages and one of the questions was basically about a U.S. Netflix show that, you know, had a comment about an aging actor who decided, oh, I'm never going to do a reverse mortgage ad because it's crazy. So that's in Spain. You could go to Australia. You could go to the U.K. Same sets of questions. So there's something more about this than how we've managed the HECK program in the U.S.

I think some of it has to do with serving a protected class, which is a vulnerable class and the concerns associated with that. I think some of it has to do with how we've designed and built the program which is imposing risk on seniors that I think is completely unnecessary and shouldn't be the case. So we should really be designing a program, you know, when you talk to folks in the U.K. where they've started to get around the reputation issue, they just laugh at the idea that the enforcement of a contract should be to foreclose on a senior. There are better ways to design and build programs that don't leave seniors at risk of losing their homes. And to underwrite and design around those things. So some of what Stephanie is talking about is managing risk at the front end and some of it is sort of managing the challenges that people have in meeting their obligations and staying, you know, able to maintain the home. And so you have to take on those issues if you want to think about designing a program that's responsible.

I will sort of say, the AARP has done a really good job of standing up in cases for seniors where, you know, the HECM program was just designed in ways that was, you know, I will say, is unfortunate. And I think that idea that there is non-barring spouses even allowed and not underwritten into the program where somebody could pull their, almost always, wife off the deed. The wife is younger. We can qualify for more money and then, you know, the husband dies and the wife then faces the loss of the home.

So these are just all things about how you design a program that I think we really, many of which we fixed, not all of which, some of which can be designed by better servicing. But there are things that modern financial products shouldn't have as attributes.

So I think some of it is American. Some of it is the perception of the product. In the U.K., you have Legal and General who is one of the largest insurance companies who came into the business at some point, and I would be surprised if we don't see, you know, we have -- Mutual of Omaha is the closest we have to a brand name company. I think we're going to see more of them come in because this is an important market and demographic. And as we find ways to deal with it responsibly, we're going to see more folks get in.

Two other observations. One of them, I think Laurie's comment, it really is impossible if you're a financial advisor to ignore the home and believe you're giving somebody credible advice about retirement. It just is. You have to get up to the 90th percentile of the wealth distribution before home equity isn't the largest single asset that people have. And you know, not counting the present value of social security and pensions. And to ignore that and think that you're giving somebody credible advice is just really hard. And whether that's a fiduciary duty, whether it's sort of some kind of other duty to serve, the idea that you can look at somebody, you know, sort of look and say, well, you've got mortgage payments to make but I'm not going to think about how you might deal with those just strikes me as you're not really providing the kind of advice you should be providing. And I think most advisors know this. But we haven't yet gotten around to a position where they can talk about it.

The last thing is I think on the complexity of the product, the product should not be this complex. If you think about a standard HECM line of credit product, what is it? It's a product where you are guaranteed an amount of money that you can borrow. You can make payments if you want. You cannot make payments if you want. It's basically sort of like a safer version of HELOC which you also have to make property taxes and insurance. Start with the fact that I think we should deal with that issue better than we have. Or reserve some portion of the HELOC to cover that with a LESA. But it's actually not a terribly complicated product. And I think we've made it more complicated than needs to be. I think maybe we should have fewer options for people to convert back and forth with plans, to have to look at different kinds of products. You know, to show consumers different kinds of products which are very different. Maybe we should have sort of one standard line of credit product. You can't take all the money out up front. And I really think for most seniors, the surveys show this and the data show this. The reason people don't want to annuitize, I think, is because annuitizing does not meet the kinds of financial obligations people really have. When you're older, your expenses are not I have X dollars a month, X dollars a month, X dollars a month. Social security or some kind of other draws will cover that. They're lumpy things. You know, I've got to fix my house. I want to, you know, take a family vacation, you know, with the grandkids. I want to help out. You know, I just got put in the hospital and I need three months of at-home care, you know, to deal with my broken hip. They tend to be lumpy, irregular kinds of payments where having a line of credit substantially helps their ability to meet those obligations. And I think having a base of Social Security with a line of credit to help is for most people the right solution. And I think if we thought about the product and helped people understand the product and had disclosures and, you know, counseling around that idea and we figure out, ensure ways to make the product safe for people not to face foreclosure, that to me seems like a path forward for a product that should be much more mainstream and responsible than it is today. And it's not an irresponsible product today but it's a product that fan be and should be better. And I think those are the kinds of things that will help grow the market.

I'm an optimist. I sort of believe we're headed there. I think the government has slowly but surely made progress, and I think we're going to see private label products come out that are not government products that are going to address those needs. But as you do, the question that Stephanie has raised, which is with the government, where in the market is this? Is the government everything? Is it up to 727, which is a very high home price for taxpayers to be involved with a program? Right now they're cross subsidies. People with homes over $300,000 or $400,000 are actually subsidizing people with lower home values. So if you lower that limit, you're actually going to put the program in financially dicier terms just like, you know, most FHA, other FHA programs, you have cross-subsidies going on. So the high-end homes right now are subsidizing the lower-end homes. So if you lower that limit and open up the market you're then actually going to make it harder or more expensive for taxpayers to serve the other market I talked about earlier.

So tons of issues but I think there are lots of ways to address them. And I do think we are generally moving in a direction where I expect us to continue to make progress, both with the government and in the private sector.

MR. HARRIS: So let me ask one more question and then we'll turn it over to the audience.

If we do see, Chris, if you're right, if we do see an expansion in this market we're going to have to deal with the foreclosure issue. And both proposals address that. But can I ask a few, just to the four of you, a sort of clarifying question around foreclosures.

The first is, foreclosures -- so foreclosures happen when an older American can't make the property tax or home insurance payments. Is that person better or worse off with the reverse mortgage? So if they can't make the payments with a reverse mortgage, were they going to be able to make the payments without one? That's the first question.

The second question is, GAO had a report where they sort of explained what was happening with foreclosures and they said that the majority of people who were foreclosing were not foreclosed upon because they weren't making the payments but because they weren't physically in the house. So do we have this sort of fundamental misunderstanding of what foreclosure means in practice for the bulk of borrowers?

Stephanie, do you want to start?

MS. MOULTON: Yeah. I'll speak to that.

So I mean, I think the tax and insurance default issue has got a lot of headlines, and actually very few of those actually end in foreclosure. Getting the exact proportion that end in foreclosure, it's a tough stat to nail down. It's like Jell-O to the wall, but it is a very small proportion.

The majority of foreclosures for reverse mortgages are actually when the person is at end of life. So, and some of the recent reports show, the actuarial report will show that it's when an individual reaches the end of their life and they're in a crossover situation, they basically, they put the loan back to HUD or the lender. The (inaudible) aren't responsible for any negative equity. And then the lender will process that, or HUD will process that, the FHA servicer will process that through a foreclosure process. And that's just seen as a natural end of life to the reverse mortgage. The challenge is that, again, this is why we want to get rid of the crossover, when a home goes through the foreclosure process, even though that's a normal process for a HECM in many situations, it's costly because homes that sell through a foreclosure process sell for a big discount relative to homes that sell in the market generally. So that just adds to this insurance fund deficit. So one, it's costly. Two, it's headline risk. I mean, any time, even if HUD is the one going through the foreclosure process, even if an individual isn't being put out of their home. So there's like eviction-related foreclosures, which are actually quite rare in the reverse mortgage world versus this natural foreclosure that happens when the individual passes away, even then it's a foreclosure and HUD is kind of the one behind that foreclosure. And so it creates a headline risk to the program that you're foreclosing on a home in the neighborhood. And then the eviction-related foreclosures do occur but it's not as common as we might think. And in fact, it was in 2011 that HUD clarified that lenders even needed to pursue a foreclosure for individuals that were defaulted on their taxes and insurance. Prior to that there was some just kind of fronting the past due tax and insurance balance, adding it to the loan. The problem is then that you're increasing the growth of the balance and that could grow indefinitely if you don't foreclose. And then you're exacerbating this cost over risk as well. So it's kind of damned if you do, damned if you don't because if you don't pay it, then the individual could face foreclosure. You have to kick them out. But on the other hand, if you just continue to pay it, the balance continues to grow. So, but I think that foreclosure is misunderstood in the reverse mortgage world because we think about it like a forward mortgage foreclosure and it's very different. Many of them are this natural end process.

MR. DAVIDOFF: Stephanie has done some amazing work on tax and insurance default which is how can you default on a reverse mortgage, you don't have to make any payments? But you do have to pay property taxes and insurance. And then your question is a good one. Should you be offering a product to somebody who is so on the edge that even after they take this reverse mortgage and give themselves some liquidity they still can't make tax and insurance payments? And that's an interesting question.

I think it highlights why you don't annuitize the payments going to Chris's point, and maybe to put it a little bit differently, a lot of lower income, and up to 50th percentile would be lower income. Probably what many of us would consider lower income would be up to the 75th percentile of retirees, who doesn't have a relative who needs to go through drug rehab somewhere in the extended family? Or a relative paying 18 percent credit card debt? Or some relative with a giant leak or some kind of structural problem with the house that they're going to have a hard time financing? So extended families that are realistic families, somebody has a project that's essentially an 18 percent rate of return project that's going to get finance one way or the other. And it could be a lot less savory than a federally guaranteed reverse mortgage. So these families in financial trouble, the ability to borrow at four or five percent interest is another benefit that I think people don't understand. They think, oh, well, you know, this is bad for the kids. It's a fantasy for the kids that grandma is now going to have the ability to finance these really high value projects because I suspect a lot of them are family related. It's a real opportunity. And without HECM, I don't know where the money would come from. So counterfactual, you know, there may be unsavory practices but there's probably unsavory practices in that other finance world as well.

MR. MAYER: I would say one other thing. Foreclosure is simply the worst way to manage a problem under every circumstance. It's bad for the lender. It's bad for whoever it is, whether it's an estate. It's obviously bad for a borrower in the home. And so finding more cost-effective ways to deal with it, cash for keys, other kinds of things is just sort of an obvious thing. It saves taxpayers literally billions of dollars in this program and it's the kind of thing that people should virtually never bump into as a solution to a problem. And it creates headline problems. Designing a program around that makes incredibly little sense. And there are reforms taking place and more that need to that I think are being considered that will help with that.

MS. GOODMAN: Let me say just one last thing, and that is that I think the issue with non-borrowing spouses certainly got a lot of publicity where, you know, people took out more money than they would have otherwise been able to if they didn't include their spouse. The spouse is now required to be included for when you apply for a HECM, even if they are not on the HECM. And if the borrower dies, obviously, the non-borrowing spouse can remain in the house. I think the one thing that still needs to be fixed is when the borrowing spouse is disabled and moves out of the house, leaving the non-borrowing spouse in the house, that's the one little -- that's the one, actually, not little, but that's the one issue that I think still needs to be addressed.

MR. HARRIS: Thank you. Good point.

All right. Let's turn to questions.

Let's start in the back, over here, please.

MR. PULZER: Thank you. Sorry I jumped up so eagerly before but I heard the complexity and low income.

So I'm Carl Pulzer and I have two interests. One is I co-chair a group that for many years we called the Long-Term Care Discussion Group. We talk about all kinds of policy issues, a nonpartisan way here. The other is I have a project that looks at inequality and especially tries to advocate for the people at the bottom.

So both my questions have to do with the complexity issue. So with this population, it's really vulnerable because there's not just an asymmetry of information. There's an asymmetry of cognition. So a lot of times people are moving out of their house after a traumatic event, like a stroke or onset of Alzheimer's. So 40 percent of the population of assisted living has Alzheimer's or other dementia and 55 percent in nursing homes.

So that's why I think there's always aligned with financial products a lot of hemming and hawing about giving up, you know, fiduciary. I'm glad you said the word "fiduciary." It's sort of elevated to that level. I think there should be a fiduciary duty required, and I think especially people with low income and low wealth should get automatic government assisted financial advice and there should be insurance that protects the elder from fiduciary malpractice or negligence in some way. And so I like the British.

So the other question I have with regard to complexity has to do with the annuitization.

I'm working on right now how divergence in lifespans is an issue for Social Security; right? With Deaton and Case's work and Chetty and all that stuff. So my concern there for the lower income would be if they're pulled in with the rich guys, because you hit the winners. The winners are going to be the people that live a long time. The rich are now living longer and longer and longer. And the lower income, the lower quintile hasn't gained any lifespan since Social Security was created according to the National Academy for Sciences. So that's going to affect their payoff a lot, whether they're pooled separately or pooled together. So I just threw that in. Thank you.

MR. HARRIS: So what do you guys think?

MS. MOULTON: Yeah. I think the idea of the individual being more vulnerable is spot on and I think, you know, it isn't just information asymmetry to your point. There's also cognitive decline in older age. There's lots of reasons why, and this is like Laurie and I have talked about, the customized counseling. How do we think about it beyond just an information packet but something that's actually more tailored to the individual? And actually, maybe that extends post-purchase. So, you know, thinking about individuals on the back end. We tried offering actually, in the experiment where we did reminders, we had a thousand individuals we randomized to get reminders. We had a thousand that we randomized to get free financial counseling. And we tried to not call it counseling. And these were already reverse mortgage borrowers. I can count on my hand the number that took it up, unfortunately. But we thought, yes, they need financial planning, they need more, and these are individuals that already have reverse mortgages and now they're going to want to have help, you know, figuring out how to navigate that. And it was really hard to get people to take that up. So I think how do we back that in from the front end so that it kind of sticks with the life of loan. We talked about like life of loan type products. It's not just a one shot. Here's information, but actually with the person.

MS. GOODMAN: And actually, let me pick up a point Chris made earlier. A very good point about simplifying the product. This product is just, you know, as he mentioned, so complicated. When you go in to get a forward mortgage, do you want a fixed or adjustable rate mortgage and what kind of mortgage term do you want 15 or 30 years? That's it. You go in for a reverse mortgage. Do you want fixed or adjustable? Do you want a lump sum disbursement, line of credit, term annuity, 10 year annuity? Oh, by the way, you can have any combination of these. Choose your ice cream flavor. And then also, the timing and pace at which funds are going to be withdrawn. It's just such a complicated program.

I mean, I would actually just, basically, get rid of the annuity option entirely because only about six percent of borrowers took advantage of it. Two percent of borrowers opted for a term or 10-year annuity, and another four percent opted to combine that with a line of credit. So just get rid of that. And then on the line of credit put a 10-year restriction. So you can have your payment up front. You can do a line of credit. You can do a combination of both and your line of credit is good for 10 years. That way it's a much, much simpler, simpler product and actually, what I've described is exactly the proprietary product as I understand it.

And so one thing we could argue about, government products versus proprietary products, but one thing that proprietary products do is they're much more innovative. They basically are very quick to spot this is what people use, this is why we use it, and this is what we're going to offer. And so sort of taking some lessons from that product might be very valuable.

MR. MAYER: I'll just say two quick things. The first is you identified a critical point of ex-ante versus ex-post risk, which is to say people, when you price and create a product you can put people in a solution that is workable at the time. But if they have something bad happen to them, some percentage of them will eventually end up with problems. You have to underwrite it to deal with that. But just because some people end up in financial problems with the product does not mean that there was a problem with the product. It may mean that 80 percent of the people it worked fine, 20 percent it didn't, and you have to deal with that kind of, how do you manage that risk after the fact? But it doesn't meant that the product or what they chose was inappropriate at the time they did it.

The second is your point about shorter life expectancy is a really critical thing because it's an offsetting trade off of serving the low-moderate income households. The fact that they have a shorter life expectancy makes the product financially easier to offer because there's lower cross over risk. The product has a shorter duration. I think that's something that I haven't seen written up systematically in any research and I think it is well worth looking at that question because I think it would cut towards making it more financially viable to serve the LMI demographic. So I think that's a great point to bring to the table.

MR. HARRIS: Do we have -- yes, over here, please.

MR. POLLNER: Yeah, hi, my name is John Pollner. I used to be at the World Bank in the financial sector.

There are, indeed, some pretty complex things in this product. I had a question on the annuity proposal that Tom mentioned and correct me if I made some wrong assumptions, but my understanding, of course, is that it helps pay some of the loan interest fees, other issues, change in valuations so to avoid the crossover risk. But then you mentioned that at the end when it's time to, so to speak, move out of the home, the annuity would revert to pay the ex-homeowner. And it could be used as rent. But I was trying to understand how that amount of annuity could actually suffice as rent because, indeed, it's not really the principal part of the payment because the principal was already paid off to the borrower through the capture of the equity. So is it really enough as a rent? I mean, it doesn't, I don't know, seem to me but maybe you can explain.

MR. DAVIDOFF: Okay, so let me give it a shot. And let's imagine we live in a 14 percent interest rate world instead of a two percent interest rate world. It may be easier to see how that's conceivably true. Or imagine you live in Vancouver or New York where rent is one or two percent of the value of the house just to see how it could be conceivably be true that this annuity can make the payment.

I'll give this a shot. Again, think about the value of the house as two components. The value of rents while the borrower is alive and in the house and the value of rents after. Right? The present value up till they leave, that's the annuity, and then there's the proceeds to the borrower, which the most that can be is the expected value of the house when they're gone. Okay? So if you think about it that way, the difference between 100 percent and that lump sum of cash or credit line that the borrower gets is exactly the value of an annuity that covers rent as long as the borrower is in the house. That's what we're giving in favor of the bank. The borrower gets the value of the house after the part that's going to the bank, and then the borrower is exactly the value of rent every year until they're out of the house. Okay? So that annuity amount can exactly cover it in that stylized. With risky prices you can't quite get there but that's the conceptual reason why that works.

MR. HARRIS: So we have one last question there in the back.

MS. DEMANI: Hi, this is Patina Demani from SP Group.

I had a question for you, Stephanie. Servicing enhancements. The suggestion you made appears like a low-hanging fruit and your experiment was pretty, I think it was -- the fact that you can reduce default risk by 50 percent is significant. What would it take for HUD to require something like this from its servicers, at least (inaudible) short pool, why is it that HUD cannot require such simple actions from its servicers?

MS. MOULTON: I actually think Chris might be better suited to handle this as somebody that's more experienced in the lender world but, I mean, I think some of the lenders are proactively doing these things because they know it's a no-brainer. And I think we've gotten that response from some, well, of course we've done that, but there are a lot of servicers that aren't doing this. So I don't know if you want to --

MR. MAYER: I mean, I think the problem is often what HUD allows and reimburses. Lenders for the most part, on most legacy loans, for example, there's no reimbursement for lenders for cash for keys. There's very limited reimbursement, you know, up until recently, there just was a mortgagee letter that came out that had very strict limits on the kind of repayment plans lenders could put into place and strict rules about if the borrower in any way didn't do what they were supposed to then the servicer is on the hook. And so the problem is if you don't follow the HUD rules, as a servicer you then take on the risk yourself of the losses associated with that or you face curtailment on full reimbursement. So in a sense, HUD is working to change some of those but there's more obvious things that can be done and it's really a matter of in part what HUD allows you to do and still get the insurance. If you don't follow the rules, you lose the insurance and you lose the protection that a servicer relies on financially to manage.

MS. MOULTON: And one caveat I would say, it's not clear. So we actually had the counseling agency provide these reminders. It's not clear to me if it would be the same effect if the servicer were to provide the reminder. So it's possible that it should be, maybe HUD funds the counseling agencies to continue to do this. It's a very low cost. I forget. It was less than like a dollar a person. The reminder intervention was super cheap. I mean, if you were to budget something like that in and a counseling agency were to continue to send those reminders, or HUD, we automated them. So we just kind of searched to see when the property tax due dates would come due and then we automated the reminders to go out. It wasn't a manual process. We set it in place with all thousand individuals from the get-go. So I think it's not clear if the servicer did it. I mean, sometimes borrowers get confused. And we were talking about this. I mean, they get a lot of mail. They may throw it away. They may think somebody is trying to offer them another product. So who is the best person to give them this information, this reminder? It could be that it should be HUD or the counseling agency and not the servicer.

MR. HARRIS: Thank you, Stephanie. Thank you, Chris.

So as the clock ticks to zero, I just want to thank you all for coming today. Thank you to everyone listening at home. And please join me in thanking our distinguished panel. Thanks so much, guys.

(Applause)

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