Avoiding Bad Loans

Kentucky Department of Financial Institutions

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Training Objectives

• Understanding Reverse Mortgages
• Avoiding predatory loans / products
• Know what agencies to contact for help
What is DFI?

- Charters, licenses and registers various financial institutions, securities firms and professionals
- Conducts examinations and investigations
- Provides educational materials for consumers
Predatory Lending

- Some practices are illegal, while others are legal but not in the best interest of the borrowers

  - Illegal – Advance fee schemes; Internet payday or installment loans (not licensed)

  - Legal, but costly – Store-front payday lenders; Consumer Finance Companies; “Reverse Mortgage” products
What Is a Reverse Mortgage?

• Home Equity Conversion Mortgage or HECM

• Home equity is exchanged for cash

• Loan amount depends on appraised value, equity, interest rate and borrower’s age

• Does not require repayment during the borrower’s lifetime
Reverse Mortgage (continued)

• Loan balance increases – Interest and fees are added to the principal balance monthly

• Becomes due and payable when the last surviving borrower dies, home is sold, or borrower permanently moves out

• Is insured by the FHA

• Requires mandatory HUD-approved counseling
Who Qualifies for a Reverse Mortgage?

- Individuals age 62 or older
- Homeowner must reside in home offered as collateral; primary residence
- Homeowner must own home outright or have substantial equity in the home
- Participate in a consumer information session given by a HUD-approved counselor
Qualifications (continued)

- Not be delinquent on any federal debt
- Have financial resources to continue making timely payment of property taxes, insurances, and maintenance expenses
- Financial Requirements:
  - Timely payment of taxes and insurance will be verified
  - Income, assets, expenses, and credit history will be verified
  - Establish set aside accounts to pay taxes and insurance
Reverse Mortgage Costs

- Origination fee (based on appraised value, not the loan amount)
- Third party charges
- Mortgage insurance premium
- Interest
- Servicing Fees
What Triggers Repayment?

- Death: The borrower or last co-borrower dies
- Move out: The borrower(s) move out of the home permanently
- Extended absence: The borrower does not reside in the home for a period of 365 days + 1
Repayment Triggers (continued)

• Sale or gift of property: Transfer of title to third party; also cannot add owner or file bankruptcy

• Failure to fulfill obligations: If the borrower fails to pay taxes, insurance, or keep the home in good repair, the lender may foreclose
Trends/Risk to Consumers

- Using reverse mortgages to refinance existing traditional mortgages or consumer debt
- Removing younger spouses from the deed and not naming them as co-borrowers
- Borrowers not fully appreciating or understanding obligations
- Key elements omitted from counseling sessions
- Complicated products and/or aggressive sales tactics
- Underestimating long-term cost (looking only at short-term cost)
- Viewing products as a government entitlement program rather than a loan
- Not seriously evaluating alternatives
Potential for Fraud

- Misleading claims made by brokers
- Cross-selling (HERA of 2008)
- Manipulation of loan application and closing process to inflate appraisals and siphon off funds
- “Cash-out theft” by a family member or other person with power of attorney
- Inflating appraisals to allow borrowers to qualify
Reverse Mortgage Tips

• Do not decide about a reverse mortgage alone
• Beware of someone pushing a reverse mortgage who tells you what to do with the proceeds
• Understand the terms
• Know your alternatives
• Beware of “limited time only” offers
• Do not deal with an unlicensed lender
• Do not sign documents you don’t understand or that have incorrect information
• Do not provide false information to qualify
Warnings

• Do not draw more money than you need
• Do not use reverse mortgage for investing; Significant cost and fees
• Should not remove younger spouse from deed and mortgage
• Homeowner remains responsible for taxes, insurance, and upkeep
More Info on Reverse Mortgages

- AARP Foundation
  - www.aarp.org/money/credit-loans-debt/
- U.S. Department of Housing and Urban Development (HUD)
  - www.hud.gov/offices/hsg/sfh/hecm/rmtopoten.cfm
- Federal Trade Commission Consumer Response Center
  - www.ftc.gov/bcp/menus/consumer/credit.shtm
Financially Abusive Products or Practices

- Advance Fee Schemes
- Payday Loans / Internet Pay Day Loans
- Debt Buying by Debt Collection Company
- Debt Settlement Companies
Advance Fee Schemes

- Advance fee schemes are illegal
- Advertise online or use regional trade publications
- Company requests a payment up front for the “first payment” or “insurance”
- No loan is provided
- The up-front payment cannot be recovered
Internet Payday Lenders

• Internet payday loan companies are not licensed in Kentucky

• Kentucky law states that an unlicensed payday lender is not entitled to receive any form of payment

• DFI will issue a “cease and desist” on the borrower’s behalf
License Required (Check Cashers; i.e., Payday Loans)

• **KRS 286.9-020:**
  “Except as provided by KRS 286.9-030, no person shall engage in the business of cashing checks or accepting deferred deposit transactions for a fee or other consideration without having first obtained a license . . .”

• **KRS 286.9-035(1):**
  “Any deferred deposit transaction agreement made with a person who is not licensed under this subtitle shall be void, and the person shall not collect any principal, fee, interest, charges, or recompense whatsoever.”
Internet Consumer Loans

• Internet installment loan companies are not licensed in Kentucky

• Kentucky law states that an unlicensed lender has no right to collect any principal, charges or recompense whatsoever

• DFI will issue a “cease and desist” on the borrower’s behalf
Store Front Payday Lenders

- Sold as short term solution
- High Interest Rate - Triple Digit APR
- Kentucky requires a check to be presented at the business
Debt Settlement Companies

- Companies that advertise that “you can be debt free in 36 months” or “we can reduce your loan debt by up to 50%”

- Enrolling in debt settlement programs typically worsens financial situation
More Things to Watch Out For

- If it sounds too good to be true, it is
- Beware of “limited time only” offers
- Do not give out personal information over telephone or Internet
- Do not pay for credit counseling or credit repair
- Do not deal with an unlicensed lender
- Do not sign documents you don’t understand or that have incorrect information
- Do not provide false information to qualify
- Get all promises in writing
Consumers Can Call / Contact

- Call us to check out the background of your loan officer or to file a complaint:
- KY Department of Financial Institutions
  - 800-223-2579
  - www.kfi.ky.gov
- Consumers should be advised to file complaints with the Consumer Financial Protection Bureau
  - 855-411-2372
  - http://www.consumerfinance.gov/contact-us/
Other Contacts for Assistance

- Federal Trade Commission
  - 877-382-4357
  - www.ftc.gov

- OCC (Office of the Comptroller of the Currency)
  - Customer Service
  - 1301 McKinney Street, Suite 3400
  - Houston, TX  77010-9000
  - 800-382-4357