Improving Economic Security Later in Life:

Meeting the Credit and Financial Services Needs of Older Persons

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Introduction

The financial situation of older persons has changed dramatically in recent years.

Where once this segment of the population was considered to be among the most economically secure, recent declines in the values of key assets such as home equity and stock portfolios have whittled away at the foundation of that financial security. Additionally, as the U.S. population continues to age, more and more individuals have limited retirement savings accumulated through employer-sponsored plans and personal assets. While these critical supplements to Social Security income have declined, the cost of living for older persons has increased. **The costs of utilities, food, property taxes, and medical care have all increased in recent years while the incomes of older persons have remained stagnant.**

With limited options for creating additional income, many older persons are turning to debt products to meet those increased costs. Unfortunately, a number of products have been developed by financial services providers that take advantage of the vulnerable financial position in which many older persons find themselves. High-cost subprime home equity loans, payday loans, and overdraft fees on checking accounts are all types of higher-cost, potentially abusive products that can strip wealth from older persons. In some cases these products are offered by lightly regulated fringe financial services providers, but in other cases they are offered by many of the largest banks in the country. In response to the proliferation of these higher cost products, some financial institutions have begun to offer lower cost alternatives. In some cases, such as with reverse mortgages, financial institutions designed these products specifically for the unique situation of older persons. In other cases, such as small dollar consumer loans or debit card-based transaction accounts, financial institutions found that products initially designed for other segments of the market have features appealing to older persons as well.

This report examines financial products that take advantage of the economic vulnerability of older persons and highlights key features of some alternatives.

The report is based on extensive conversations with leading members of the policy and advocacy community, financial services industry, and bank regulatory agencies. The report concludes with recommendations for both bank regulatory and financial institution policy to advance financial products that protect the economic security of older persons.

The Economic Vulnerability of Older Persons

There are growing concerns about the economic vulnerability of older persons. A recent report by the Institute on Assets and Social Policy at Brandeis University and Demos paints a distressing picture of the financial stability of older persons. The report revealed that 78 percent of all older households are "financially vulnerable" with 29 percent of older households being considered "high risk."[1] According to the report, some of the key causes of this vulnerability were a lack of financial assets such has as savings and stocks, high housing costs, and rising medical expenses. The report showed that only 31 percent of older households have budgets that allow for savings or give them a cushion for unexpected additional expenses. Other findings show that four out of five older households do not have sufficient assets and income to sustain them through their retirement years.[2]

This vulnerability is reflected in the increasing pessimism that many older persons have about their ability to afford their retirement years. An annual survey on retirement confidence produced by the Employee Benefit Research Institute (EBRI) found that, in 2009, only 25 percent of retirees surveyed felt "very confident" in their ability to provide for basic needs in retirement: down from 40 percent in 2007.[3] Of those surveyed in 2009 by EBRI, 40 percent had less than $10,000 saved for retirement, an alarmingly low savings rate considering that in 2008 an individual would have to have saved, on average, $102,000 just to cover Medicare premiums during retirement.[4]

Traditionally, the economic security of older persons has been made up of three key components: Social Security benefits, pensions, and savings. While some have expressed concerns about the long-term viability of the Social Security system in the United States, it is currently the most stable of these three sources of retirement income. Increasingly, private, defined benefit pension plans have become a luxury that many companies have eliminated in favor of employee-supported plans. Today, compared to 25 years ago, 50 percent fewer private sector workers participate in pension plans that pay guaranteed benefits throughout retirement.[5] Whereas, in traditional pension plans, the employer is primarily responsible for contributions and investment decisions, employee supported plans like a 401(k) or 403(b) place the responsibility of saving for retirement primarily on the worker. One of many major problems with this switch in savings vehicles is that most workers fail to save enough to reach a level of long-term financial security. Of additional concern is that much of the retirement savings people have is tied to funds invested in the stock market. Recent volatility and declines in the stock market have significantly eroded the retirement savings for many who may need it in the short-term. Between September 30, 2007 and May 5, 2009 assets held in retirement accounts lost 31 percent, or roughly $2.7 trillion dollars in value.[6]

1 Wheary, Jennifer, Thomas M. Shapiro, and Tatjana Meschede. *Living on Less New Economic (In) Security of Seniors.* (Waltham, MA: The Institute on Assets and Social Policy at Brandeis University and Demos, 2009).

2 Wheary, Jennifer, Thomas M Shapiro and Tatjana Meschede. *Living on Less New Economic (In) Security of Seniors.* (Waltham, MA: The Institute on Assets and Social Policy at Brandeis University and Demos, 2009).

3 Helman, Ruth, et al. *The 2009 Retirement Confidence Survey: Economy Drives Confidence to Record Lows; Many Looking to Work Longer.* (Washington, D.C.: Employee Benefit Research Intitute- Education and Research Fund, 2009).

4 Munnell, Alicia H. et al. *Healthcare Costs Drive Up the National Retirement Risk Index.* (Boston, MA: Center for Retirement Research at Boston College. 2008) and Helman, Ruth, et al. *The 2009 Retirement Confidence Survey: Economy Drives Confidence to Record Lows; Many Looking to Work Longer.* (Washington, D.C.: Employee Benefit Research Intitute- Education and Research Fund, 2009).

5 Johnson, R. "Older Workers and the Recession." San Diego Union Tribune December 8, 2008.

6 Soto, Maurice. *How is the Financial Crisis Affecting Retirement Savings?* (Washington, D.C.: Urban Institute, 2009).

In the face of dwindling pension plans and low levels of retirement savings, older persons are faced with high costs tied to basic needs such as housing, medical care, and utilities. More than a third of older homeowners spend more than 25 percent of their incomes on housing costs, including utilities.[7] For older persons who are renters, similar costs exceed 40 percent.[8] Additionally, according to a 2005 study on increasing levels of debt for older persons, 22 percent of an older person's income goes to out-of-pocket medical costs. For older persons of modest means, these cost burdens are greater: nearly a third of a low-income older person's income is devoted to out-of-pocket health expenses.[9] Similarly, one in four low-income older persons spend at least 19 percent of their income on home energy costs.[10] And for all older persons, these costs are rising. According to a May, 2009 report by the Senior Citizens League, between 2000 and 2009 housing-related expenses for older persons (including utilities) rose between 30.8 to 96 percent, while medical-related expenses increased between 31.7 to 111.9 percent, depending on the particular expense.[11]

The trend of declining income and savings and rising costs for older persons has contributed to rising levels debt and bankruptcy. Americans aged 65 and older are carrying substantially larger amounts of credit card debt. For example, the percentage of older households "experiencing debt hardship" increased 56.3 percent between 1989 and 2004. During this same period, the average balance of credit card debt held by older persons increased by 194 percent.[12] This rise in unsecured debt has been followed by a subsequent rise in the number of bankruptcies filed by older persons. Between 1991 and 2008, the rate at which persons aged 65 and older have filed for bankruptcy doubled.[13]

[7] Demos' calculations from Department of Housing and Urban Development, "American Housing Survey for the United States in 2001, Current Housing Reports" H150/01.

[8] Demos' calculations from Department of Housing and Urban Development, "American Housing Survey for the United States in 2001, Current Housing Reports" H150/01 and Department of Housing and Urban Development, "American Housing Survey for the United States in 1993, Current Housing Reports" H150/93.

[9] McGee, Heather C. and Tamara Draut, Demos. *A Network for Ideas and Action, Retiring in the Red: The Growth of Debt Among Older Americans 3.* (New York, NY: Demos. 2005).

[10] Barnet, Nelda, "The Impact of Energy Prices on Older Americans: Hearing Before the Senate Special Committee on Aging," qtd. in Loonin, Deanne and Elizabeth Renuart. "The Life and Debt Cycle: The Growing Debt Burdens of Older Consumers and Related Policy Recommendations." (Harvard Journal on Legislation, 2007).

[11] The Senior Citizens League. "Loss of Buying Power Study Released". May 12, 2009.

[12] Garcia, Jose. Borrowing *to Make Ends Meet: The Rapid Growth of Credit Card Debt in America.* (New York, NY: Demos, 2007).

[13] Thorne, Deborah, Elizabeth Warren and Teresa A Sullivan. *Generations of Struggle.* (Washington, D.C.: AARP Public Policy Institute, 2009).

Higher-Cost Financial Products and Older Persons

The changing economic situation for older persons has made them increasingly vulnerable to abusive, higher-cost financial products. As indicated, older persons are experiencing stagnant and, in some cases, declining income levels tied to fewer defined benefit pension plans, limited retirement savings, and the declining value of existing assets. At the same time, the cost of basic living expenses such as housing, utilities, and medical costs have skyrocketed. Thus, many older persons have difficulty meeting basic needs with current income. Limited savings means that older persons have few options when emergency expenses arise. As older persons have limited alternatives for increasing levels of income, debt products are often the only available option to pay bills and meet basic needs. Unfortunately, unscrupulous financial service providers have created products that take advantage of the vulnerable position in which many older persons find themselves, and some of these products have substantial negative impacts on an older persons' long-term financial security.

The following section examines three such products: subprime mortgages, high-cost short-term consumer loans, and checking accounts with high-cost overdraft fees.

> subprime mortgages

> high-cost short-term consumer loans

> checking accounts with high-cost overdraft fees

Subprime Home Equity Mortgage Products

Beginning in the late 1990s, the mortgage lending industry began to change dramatically as subprime loans became an increasingly common option for many borrowers. Subprime loans are mortgages to borrowers with some type of damage or limitation in their credit profile such as a low credit score, limited equity or down payment, or an inability or unwillingness to document income. In exchange for originating a loan to a borrower with a higher risk profile, lenders charged a higher interest rate than they charged on prime loans. Driven by innovation in underwriting technology that allowed for a greater quantification of borrower risk and the creation of advanced financial instruments that allowed investors from around the world to channel money into funding subprime loans, the subprime industry gained a significant share of the mortgage market by 2006.

Although subprime lending was expanding lending opportunities for markets that previously had difficulty accessing mortgage credit, it rapidly became clear that the subprime lending industry was rife with opportunities for abuse. These opportunities arose largely due to limited state and federal regulatory oversight of key players in the industry. Mortgage brokers, who were often the individuals working directly with borrowers to qualify them for loans, typically faced only modest state licensing requirements. Brokers have been frequently cited for fraudulently stating borrower income and for putting borrowers into loans that were more costly than they would have otherwise qualified for in order to generate increased broker compensation. Additionally, many of the companies using brokers to originate subprime loans were mortgage finance companies. These firms also faced limited state and federal oversight of their lending activities. Finally, investment firms that packaged the subprime loans into mortgage backed securities, attracted investment, and increased flows of lending capital into the subprime market also faced virtually no state or federal regulation.

The standard products offered by subprime lenders typically were complex and deceptively marketed. Many mortgages were offered with fixed low introductory payments, however, at some point these monthly payments would adjust, often making the loans unaffordable. In many cases, traditional underwriting standards designed to ensure that borrowers could afford monthly payments over the life of a loan were ignored. Other products allowed for no or limited down payments and negative amortization. Both features limited or reduced the equity cushion homeowners have traditionally used as a safety net.

In 2006 and 2007, the subprime mortgage market collapsed as property values declined across the country and refinance options dried up. Increasingly, subprime borrowers who had limited equity or whose loan terms were about to reset to higher rates found that they could not refinance their mortgage and could not afford the new higher payments. This led to a wave of subprime mortgage defaults that has continued to grow through the first half of 2009. Foreclosures and the vacant properties that subsequently follow have significant negative impacts on communities. Foreclosures decrease property values, increase violent crime rates, and displace renters.[14] These impacts have been disproportionately felt by communities of color. For example, a report by Woodstock Institute showed that in 2007 in Chicago, 35 percent of all properties that became lender-owned through foreclosure were in communities greater than 80 percent African American, while only nine percent of the region's total properties were in these communities.[15]

14 Immergluck, Daniel and Geoff Smith. *There Goes the Neighborhood: The Effect of Single-Family Mortgage Foreclosures on Property Values.* (Chicago, IL: Woodstock Institute, 2005) and Smith, Geoff. *Foreclosure Crisis Impacts Chicago's Rental Housing Market.* (Chicago, IL: Woodstock Institute, 2008) .

15 Smith, Geoff and Sarah Duda. *Lender Owned Largely Vacant Properties Disproportionately Impact Communities of Color.* (Chicago, IL: Woodstock Institute, 2008).

Subprime Lending and Older Homeowners

Older persons have been a prime target for subprime loans and have been significantly impacted by the ongoing foreclosure crisis. One factor that makes older persons such a prime target for unscrupulous lenders is the high levels of home equity older persons have accumulated in their many years of homeownership. On average, 78 percent of homeowners aged 65 and older own 100 percent of their homes.[16] This equity has proven attractive to lenders who target older persons for home equity loan products that are marketed as helping to pay for medical expenses, home repairs, or debt reduction. In some cases, lenders sell older persons products that may have deceptive terms or are priced far in excess of what they might otherwise qualify. Equity is stripped from older persons through high fees financed into the loan and through repeated refinancing. An AARP report documented that over 60 percent of older refinance borrowers were aggressively approached by mortgage brokers and convinced to take out loans they may have not taken out otherwise.[17] Additionally, as many as 50 percent of older subprime refinance borrowers would have qualified for a prime loan.[18]

The targeting of older persons for higher-cost subprime loan products has meant that older persons are being particularly impacted by the current housing crisis. A recent AARP report documents that Americans age 50 and older represent 28 percent of all mortgage delinquencies and foreclosures. Americans in this age group who hold subprime first mortgages are 17 times more likely to be in foreclosure than are those who hold prime loans. With repeated refinancing and equity withdrawals, many older persons saw their home equity reduced to low levels. Recent declines in property values have put many of these older households at mortgage loan-to-value (LTV) ratios exceeding 100 percent, meaning their property is worth less than the amount they owe on their mortgage. The AARP report shows that homeowners age 50 and older with LTVs in excess of 100 percent have foreclosure rates double that of other consumers in that age group. Additionally, the foreclosure crisis is hitting African American and Latino older persons particularly hard. African Americans represent 6.9 percent of all first mortgage holders age 50 and older, however they represent 14.4 percent of all foreclosures. Similarly, Latinos represent 7.5 percent of all first mortgage holders age 50 and older, but over 15 percent of all foreclosures.[19]

[16] Brown, Helen. AARP *Consumer Home Equity/Home Improvement Lending Survey.* (Washington DC.: AARP, 2000).

[17] Walters, Neal and Sharon Hermanson. *Older Subprime Refinance Mortgage Borrowers.* Research. (Washington, D.C.: AARP Public Policy Institute, 2002).

[18] Ibid.

[19] Walters, Neal and Sharon Hermanson. *Older Subprime Refinance Mortgage Borrowers.* Research. (Washington, D.C.: AARP Public Policy Institute, 2002).

Short-Term Consumer Lending

The short-term consumer lending industry offers small-dollar loans for a fixed period of time, usually unsecured; this is a niche that is not filled by mainstream financial institutions whose small-dollar products typically focus more on credit cards or overdraft loans.[20] Within the short-term consumer loan industry, a range of loan products exist for different purposes, loan sizes, and repayment terms. For example, payday loans are unsecured loans for small dollar amounts. Auto title loans are loans secured by the title on an automobile, and the amount of the loan is based on its appraised value. Consumer installment loans have longer repayment terms than payday loans and are typically for larger dollar amounts.

Concerns around the short-term consumer lending industry are tied to the extremely high costs to borrowers associated with such transactions and the opportunity for significant wealth stripping tied to charging additional fees for extending loan repayment periods. On a traditional payday loan, a borrower will pay a flat fee for borrowing a certain dollar amount for a fixed period of time. If at the time repayment is due the borrower is not able to repay the loan they often have the option paying an additional fee and extending the loan for another term, known as a "rollover". Repeated rollovers can send borrowers in a cycle of ever increasing debt from which it is difficult to emerge.

Currently, short-term consumer loans are typically originated by consumer finance companies, that are licensed and regulated at the state level. One of the challenges to regulating consumer lenders has been the constant evolution of products offered by the industry. The experience attempting to regulate the payday lending industry in Illinois is illustrative of some of these challenges. Initial regulation in the state focused on limiting fees and rollovers for traditional payday loan products. Regulation was focused on products with a term up to 120 days, and for these products the state instituted a fee cap of 25 percent of the borrower's gross monthly income or $1,000, whichever is less. In response to this legislation, the industry shifted much of its short-term lending business away from traditional payday loans to longer-term consumer installment loans that were not covered by the payday lending statute. Although these loans have lower monthly payments, they still have high annual percentage rates, longer -terms, and cost the borrower the same or more over the life of the loan.[21]

[20] Herrmann, Michael J. et al. *A Fundamental Need: Short-term, Small-Dollar Credit.* (Chicago, IL: Center for Financial Services Innovation, 2008).

[21] Feltner, Thomas and Sarah Duda. *The Illinois Payday Loan Loophole.* (Chicago, IL: Woodstock Institute. 2008. And Feltner, Thomas and Sarah Duda. *Beyond Payday Loans: Consumer Installment Lending in Illinois.* (Chicago, IL: Woodstock Institute, 2009).

Short-Term Consumer Loans and Older Persons

Older persons are easy targets for high-cost short-term consumer loan products.

As described previously, many older persons have limited savings which make them vulnerable when emergency expenses arise. Additionally, most older persons also have a regular and fixed stream of income from Social Security benefits that appeal to payday lenders. A 2008 study by the Wall Street Journal and a geographer at California State University at Northridge found that in five large cities, payday lenders have clustered their businesses around subsidized senior housing.[22]

Although the Department of the Treasury requires that benefits, when directly deposited, must be put into FDIC-insured institutions and does not allow benefits to be assigned, transferred, or garnished, the Treasury allows the use of beneficiary approved master/sub account arrangements wherein funds can be transferred to a third party. Such arrangements exist so that older persons can deposit Social Security benefits into investment accounts, trusts, or as in kind payments for nursing home care.[23] As a means of collecting on a loan, alternative financial service providers have partnered with mainstream banks to provide third party direct deposit through master/sub account arrangements.[24] Research studying industry data has shown that Social Security benefits have been transferred to payday lenders and check cashers through the use of these accounts.[25]

These third party account arrangements can be very detrimental to older borrowers. While the Department of the Treasury has capped fees for direct deposit accounts at $3 per month, there is no similar cap for third party direct deposit accounts. Additionally, the agreements permitting the transfer of funds from the bank to the third party account typically allow payments of any loans outstanding to be paid before the benefit recipient can receive their funds. Such arrangements facilitate a debt cycle, as recipients are often short on funds after loan payments, forcing them to take out additional loans.[26]

[22] Schultz, Ellen E. and Theo Francis. "High-Interest Lenders Tap Elderly, Disabled". Wall Street Journal. February 12, 2008.

[23] LaCanfora, Mariana. "Social Security Testimony Before Congress." Congressional Testimony. Washington, D.C., 24 June 2008 and Consumer Federation of America, National Consumer Law Center, and Consumers Union National Association of Consumer Advocates. "Comments to the Social Security Administration Regarding the Use of Master and Sub Accounts and Other Account Arrangements for the Payment of Benefits." (Congressional Testimony. Washington, D.C., 20 June 2008).

[24] Ibid.

[25] Consumer Federation of America, National Consumer Law Center, and Consumers Union National Association of Consumer Advocates. "Comments to the Social Security Administration Regarding the Use of Master and Sub Accounts and Other Account Arrangements for the Payment of Benefits." (Congressional Testimony. Washington, D.C., 20 June 2008).

[26] Ibid.

Overdraft Products

Mortgage finance companies and fringe financial services providers are not the only institutions with products that can be damaging to the financial security of older persons. Many mainstream financial institutions also offer products with features that can strip critical wealth from older persons. One such product is checking and savings accounts that offer some type of automated overdraft loan product. In recent years, banks have experienced increased competition for mortgage loans from non-bank entities such as mortgage companies, which has resulted in declining revenues generated from interest. To offset these declines, banks have increasingly focused on generating fee income, typically sourced from ATM fees, late charges, and fees on overdraft loans.

Accounts with overdraft features that allow account holders to overdraw their account without the penalty of a bounced check. There are three primary types of overdraft protection offered by banks: overdraft lines of credit; linked transfer accounts; and automated overdraft loan programs. Overdraft lines of credit result from an agreement between the bank and a customer stating that the bank will lend a finite amount for a specified period of time to cover the amount overdrawn. These lines of credit are typically tied to a credit card, and borrowers pay relatively low interest rates on the funds borrowers. Linked transfer accounts link the checking account to a second account, typically a savings account or credit card account, from which the overdrawn amount is taken. However the most common type of overdraft product are automated overdraft loan programs. For these programs, banks honor the overdrawn amount, but charge a set fee for each overdraft as well as fees on daily overdrawn balances.[27] These automated overdraft loan programs have been particularly controversial in recent years.

Overdraft programs are quite widespread in the banking industry and can have significant costs for customers. A 2008 FDIC study showed that 86 percent of banks surveyed offered some type of overdraft program, with larger banks tending to offer multiple types. Customers often have little choice of participation in overdraft programs. The same FDIC report noted that over 75 percent of banks that offer an overdraft program automatically enroll their customers. This is particularly concerning given the way that these products are regulated. Because bank regulators currently treat these transactions as fees and not loans, banks are able to avoid certain consumer protections given to loans, and banks are not required to give borrowers the option to opt-in to an automatic overdraft loan program.[28]

Although banks could limit many overdraft fees charged to customers through a denial of service or a notification that a transaction will result in an overdrawn account, the majority do not. Nearly 91 percent of all bank overdraft fees occur at either a point of sale (POS) transaction or at ATMs, electronic transactions where a bank could easily deny the transaction or notify customers that they are about to overdraw. Only 7.9 percent of FDIC-surveyed banks informed their customers when a transaction would result in non-sufficient funds (NSF) for POS/Debit transactions; 23.5 percent of FDIC-surveyed banks notified customers for ATM transactions that would result in non-sufficient funds. For automatic overdraft loan products, fees range from $10 to $38, with a median of $27. In 2006, FDIC-surveyed banks earned $1.97 billion from overdraft fees, 90 percent of which was sourced from automated overdraft loan programs.[29]

[27] Federal Deposit Insurance Corporation. *FDIC Study of Bank Overdraft Programs.* (Washington, DC: FDIC. 2008).

[28] Ibid.

[29] Ibid.

Overdraft Fees and Older Persons

A June, 2008 report by the Center for Responsible Lending (CRL) found that consumers age 55 and older pay $4.5 billion in overdraft fees per year, mostly from point of sale and ATM transactions. Typically, overdrafts for debit transactions result in fees substantially higher than the original amount of credit extended by the bank for the point of sale purchase or the ATM withdrawal. For example, the median overdraft paid by a bank in the survey was $19.95, for which the bank charged the customer an average fee of $33—a median finance charge of $1.65 for every dollar borrowed.[30]

The CRL report also found that of all overdraft fees charged to consumers age 55 and older, 34 percent of fees were charged to beneficiaries of Social Security payments. CRL estimated the impact of overdraft fees on beneficiaries for whom Social Security benefits represent 50 percent of their incomes to be $981 million. For low-income older persons for whom Social Security benefits account for 90 percent or more of their monthly incomes, CRL estimated that $513 million is paid annually in overdraft fees. In contrast, 75 percent of older persons interviewed by CRL for the study stated they would rather have a transaction declined than incur an overdraft fee.[31]

[30] Parrish, Leslie and Peter Smith. *Shredded Security: Overdraft Practices Drain Fees from Older Americans.* (Durham, NC: Center for Responsible Lending. 2008).

[31] Ibid.

Meeting the Credit and Financial Services Needs of Older Persons

While the above products often take advantage of the unique and vulnerable financial position in which many older persons find themselves, a number of financial services products exist that seek to more affordably accommodate the needs of older persons. In some cases, providers have created products with the unique situation of older persons in mind, while in other cases, providers have found that certain existing products, or features of existing products, appeal to older persons.

The following section examines reverse mortgages, small-dollar loans, and basic debit card-based transaction accounts and gives examples of products and features of products that may make them more appropriate for the older persons.

> reverse mortgages

> small-dollar loans

> basic checking accounts

Reverse Mortgages

For many older homeowners, the equity they have accrued over many years of homeownership can become a necessary source of income if they are not able to meet expenses with other forms of retirement savings. As described previously, this equity has made many older persons targets for abusive subprime loans, but it also makes them uniquely positioned to take advantage of other types of mortgage products that use this equity to create a constant and stable stream of income.

One option that older persons are increasingly turning to are reverse mortgage products. These loans are structured to allow older homeowners the ability to convert a portion or all of the equity in their homes into cash without requiring monthly debt service payments. This cash can be dispensed to the homeowner in a number of ways, including a lump sum or a series of payments to the borrower either for a specific term, or for the entire time that at least one of the owners remains in the house. Reverse mortgages can also be structured to reserve a certain amount of equity to be used as a line of credit, if necessary. In order to be eligible for a reverse mortgage, the borrower(s) must be age 62 or older and either own their home outright or have enough equity that the reverse mortgage will pay off the remaining mortgage amount due.[32] The borrower is not required to make any payments, but is required to maintain the property as well as pay property taxes and utilities costs as long as they retain the title. The loan amount borrowed and the payment streams are not dependent upon the borrower's income or credit history, but, rather, are based upon the age of the borrower at the time of closing, the current interest rates available, and the appraised value of the home or the Federal Housing Administration's mortgage limits in the borrower's area.[33]

Borrower age is a key variable in determining the amount of monthly reverse mortgage payments. For example, two borrowers with identical levels of equity, but different ages will likely receive loans with different terms. Because most reverse mortgage loans are not required to be paid back until the death of the homeowner or upon the homeowner vacating the property and most reverse mortgages have clauses which prevent the borrower or the borrower's estate from owing more than the value of the home when the loan is repaid, it is in the lender's interest to keep payments lower for younger borrowers who are expected to live longer and therefore receive a longer string of payments.

Reverse Mortgages

Needs met for older Americans Allows older homeowners to convert home equity into an additional stream of income to supplement other forms of retirement income.

Positive features No monthly payments; no need to repay loan until homeowner leaves the home; can be used to refinance out of higher-cost mortgage debt in certain circumstances.

Product Challenges High fees; inappropriate for older homeowners with lower property values or homeowners who want to live in a property for a short period of time; concerns about opportunity for abuse.

[32] See: HUD http://www.hud.gov/offices/hsg/sfh/hecm/rmtopten.cfm (Date Accessed October 2008).

[33] Ibid.

While reverse mortgages can offer older homeowners an additional stream of income to supplement other forms of retirement income, these products have costs that limit their value to older persons. The most common type of reverse mortgage is the FHA-insured Home Equity Conversion Mortgage (HECM). Costs typically associated with the HECM include a closing cost equivalent to two percent of the property's value for FHA mortgage insurance; a loan origination fee typically equal to two percent of the first $200,000 of a property's value and one percent of any amount over $200,000 with a cap of $6,000; standard closing cost fees averaging $2,000; an annual FHA mortgage insurance fee of 0.5 percent of the loan's outstanding balance; and a monthly fee paid for servicing the loan.[34] These high costs can pose a significant burden to homeowners whose properties are of a lower value. Table 1 illustrates that although total fees are greater the larger the principal amount, closing fees represent a greater percentage of principal for lower valued homes. These high costs often make reverse mortgages unaffordable options for homeowners with lower valued properties given the limited stream of income these properties are likely to generate.

Table 1. Loan Principals and Estimated Closing Costs for HECMs

	LOAN PRINCIPAL			
	$ 300,000	**$ 200,000**	**$ 100,000**	**$ 50,000**
FHA Mortgage Insurance	$ 5,000	$ 4,000	$ 2,000	$ 1,000
HECM Loan Origination Fee	$ 6,000	$ 4,000	$ 2,000	$ 1,000
Other Standard Closing Costs	$ 2,000	$ 2,000	$ 2,000	$ 2,000
TOTAL Closing Fees	$ 13,000	$ 10,000	$ 6,000	$ 4,000
TOTAL Closing Fees as a Percent of Prinicpal	4.3 %	5.0 %	6.0 %	8.0 %

[34] See: NRMLA http://www.reversemortgage.org/Default.aspx?tabid=237 (Date Accessed: July 2009).

Since the beginning of the economic crisis in late 2006, reverse mortgages have become increasingly popular options for older persons. The number of HECM reverse mortgage originations has grown dramatically over the past 18 years, increasing from 7,896 loans in 1998 to 112,154 in 2008. Much of this growth took place between 2006 and 2008, however, when HECM originations increased by 46.9 percent.[35] While the surge in popularity of reverse mortgages may seem counterintuitive to some given the steep property value declines seen across the country as a result of the subprime mortgage lending crisis, this trend is largely indicative of the growing number of individuals reaching retirement age and the increasing financial stress being experienced by many older households. Some reverse mortgage counselors have also seen a growing incidence in borrowers using reverse mortgages to pay off higher cost existing standard mortgages.[36]

The increasing popularity of reverse mortgages has raised concerns about possible abuse. Although borrower counseling is required prior to receiving an FHA-insured HECM reverse mortgage, there is a growing number of private reverse mortgages with no such requirements. Recently, the United States Comptroller of the Currency John Dugan warned about the possibility of abuse in the world of reverse mortgages tied to issues such as high borrower fees and the complexity of the mortgage structures.[37] Dugan raised additional concerns around the attractiveness of lump sums that might be paid to older homeowners through reverse mortgages. Some housing counselors have noted inflated appraisals for reverse mortgages and the cross marketing of other products that may strip reverse mortgage payments from older persons.[38] Others have noted that many of the lenders and brokers who were active in the subprime lending industry have now entered the reverse mortgage business, and this should raise concerns about future unscrupulous lending tactics.[39] In a recent FBI Intelligence Bulletin on mortgage fraud, the agency issued a warning around a potential increase in fraud tied to reverse mortgages, noting schemes such as equity theft, false foreclosure rescue, and investment scams.[40]

While reverse mortgages are a critical tool for many older persons, these products are appropriate only for a certain segment of the older homeowners who have a high level of home equity, whose homes have significant market value, and who plan on staying in the home for an extended period of time. For older persons who do not meet these criteria, the fee structure of reverse mortgages may be too high to provide a tangible benefit, and the stream of income provided may not increase cash flows enough to balance expenses.

[35] See NRMLA http://www.nrmla.org/RMS/STATISTICS/DEFAULT.ASPX?article_id=601 (Date Accessed: July 2009).

[36] Interview with Brenda Grauer, Office of the Illinois Attorney General.

[37] Dugan, John C. "Consumer Protections for Reverse Mortgages". Remarks Before the American Bankers Association Regulatory Compliance Conference. Orlando, FL. June 8, 2009

[38] Interview with Brenda Grauer, Office of the Illinois Attorney General.

[39] Interview with Todd Grayson, South Central Bank.

[40] See FBI: http://www.fbi.gov/hq/majorthefts/intelbulletin_reversemortages.htm (Date Accessed: July 2009).

CoVantage Credit Union Easy Reverse Home Equity Line of Credit

One product that seeks to provide an alternative to traditional reverse mortgages is offered by CoVantage Credit Union. CoVantage is a $700 million asset credit union with approximately 50,000 members, serving 14 counties in northern Wisconsin and the Upper Peninsula of Michigan. As noted, one of the biggest drawbacks of conventional reverse mortgage products is that reverse mortgages may not be suitable for homeowners with lowered valued homes because of high fees tied to originating and insuring a loan. CoVantage Credit Union created the Easy Reverse Home Equity Line of Credit to address the need for a reverse mortgage product for its membership whose homes were valued between $50,000 and $100,000 and who also had a need for shorter term credit. CoVantage found that many older homeowners in their market only wanted to stay in their homes for another three to five years, at which point, many wanted to sell due to the difficulty and cost of maintaining their properties.[1]

The Easy Reverse HELOC is a hybrid product that combines elements from a traditional reverse mortgage and a home equity line of credit. The product offers consumers the loan for a maximum term of ten years, at which point the entire balance of the loan is due. Like a traditional reverse mortgage, no monthly payment is required. However, the owner must continue to pay property taxes and insurance and borrowers must attend counseling sessions. Because the loan has a closed-end period of repayment, unlike a traditional reverse mortgage, the total equity drawn is lower and the loan origination costs, particularly those tied to insurance, are lower. CoVantage requires no monthly maintenance fee and the application process is simple. Both factors reduce costs and make the product suitable for homeowners with lower-valued homes. Homeowners aged 62-71 can draw a maximum amount of 5 percent equity per year and borrowers age 72 or older may draw a maximum of 6 percent a year. After five years the loan can be converted into a conventional reverse mortgage, should the borrowers decide they would like to remain in their home.

[1] Interview with Paul Grinde, Co Vantage Credit Union

Affordable Small-Dollar Loans

As described above, a lack of savings has put many older persons in a position where they are unable to pay for emergency expenses. While in many respects this situation is no different than that of many Americans, the unique situation of older persons makes it difficult to generate any additional income to extract themselves from a cycle of debt. For this reason, higher cost payday loans (and other types of short-term consumer loans) are particularly damaging to the financial security of older persons.

In recent years, a number of financial institutions have attempted to develop small-dollar loan products that are low cost and have features that prevent customers from becoming trapped in a cycle of debt. Between 2005 to 2006, a number of credit unions participated in a pilot program sponsored by the National Federation of Community Development Credit Unions and JP Morgan Chase called the Alternatives to Payday Lending Program. In a 2007 study evaluating the success of these programs, Woodstock Institute found that loans offered by participating credit unions were lower cost than payday loans offered by the short-term loan industry. The study also showed that many credit unions were able to add asset building features, such as automatically saving a portion of the payment, to the loan products. These features allow borrowers to build savings and prevent the need for future payday loans. The study also showed that larger credit unions were able to more easily reduce the transaction costs associated with originating small loans though efficient underwriting technology and automatic loan payment methods. Finally, the report documented that one of the key successes of the program was the ability to use these short-term loans to help develop stronger customer relationships.[41]

In February 2008, the Federal Deposit Insurance Corporation (FDIC) began a two-year pilot project to review responsible small dollar loan programs in different financial institutions around the country and identify best practices around these programs. Thirty-two banks with assets ranging from $26 million to $10 billion are participating in the pilot. The program allows individual institutions to set the terms of their respective programs. However banks are required to provide terms that are affordable and appropriate loans for customers. Loans offered must be longer than two weeks in term length, and APRs must be capped at 36 percent. The principal amounts have been divided into two categories; small loans of up to $1,000 and nearly small loans with principals between $1,000 and $2,500. While not required, the FDIC encouraged banks to create products linked to a savings vehicle.[42]

By the end of the fourth quarter of 2008, over 16,027 loans had been originated with a total dollar value of nearly $18.5 million, with most loans originated to borrowers in low- and moderate- income communities. Borrowers of the small-dollar loans typically have low- and moderate-incomes and are in need of quick and short-term cash to meet unexpected needs. Other common users of the loans are students, people without credit history, and new immigrants. Financial institutions with the most successful products have modified underwriting requirements over time, tailoring products to borrower needs.[43] The average loan size of the "small loans" was $675 with an average APR of 15 percent. Many banks also offered slightly larger loan products to customers averaging $1700 with an APR between 14 and 15 percent. At the end of the fourth of quarter 2008, 7.3 percent of small loans were 30 days or more delinquent.[44]

41 Williams, Marva. *Cooperative Credit: How Community Development Credit Unions are Meeting the Need for Affordable, Short-Term Credit.* (Chicago, IL: Woodstock Institute, 2007).

42 Interview with Rae-Ann Miller, Federal Deposit Insurance Corporation.

43 Ibid.

44 See FDIC: http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_2/SmallDollar.pdf (Date Accessed: July 2009).

One concern around payday loan alternatives is the profitability of such products. Given their small dollar amounts and short repayment periods, small-dollar loans are difficult to make profitably at a low interest rate. While Woodstock Institute's evaluation noted many of the positive benefits of the programs for customers, there was a more limited discussion of the long-term viability of such loans. It was noted that larger credit unions with better technology and more efficiencies in place were able to keep the cost associated with the loans lower. In discussions with banks around the FDIC Small Dollar Loan Pilot Program, most banks said that they did not offer the loan to make money on that product alone. Instead, many cited the opportunity for increased credit on Community Reinvestment Act examinations, while others cited opportunities to attract or retain customers who may be interested in using such products.

Pilot program participants stated that they did not currently target small dollar loans to older persons. For marketing, many institutions have relied on word of mouth and community group relationships. Although no bank in the pilot project reported to direct marketing to older persons, many rural banks reported a large older customer base and indicated that an affordable small dollar loan product may help them meet unexpected medical debt or rising property tax bills.[45] In other cases, banks noted possible opportunities for expanding the reach of their small dollar loan programs through increased marketing to older persons.[46]

Affordable Small-Dollar Loans

Needs met for older Americans Provides affordable small dollar loan alternative to payday loans to help meet unexpected expenses such as emergency medical costs or rising property taxes.

Positive features APRs capped at 36 percent; opportunity for banks to reach untapped part of senior market; many banks include a savings vehicle to help build future safety net.

Product Challenges Questions about profitability and scalability.

[45] Interview with Steve Malone and Kay Brink, Benton State Bank; Interview with Angela Preston and Reggie Little, Austin Bank of Chicago.

[46] Interview with Jamie Maloney, Mitchell Bank.

Bank Accounts with Pre-Paid Cards

The previous section on higher cost financial products and services described fees for overdraft loans as a key feature of bank checking and savings accounts that has the potential to strip significant wealth and retirement assets from older persons. In discussions with some financial institutions, it became clear that a number of their older customers were frustrated by the complexity and potential high fees tied to bank checking and savings account products and desired a simpler and lower-cost option. While many financial institutions offer senior-focused checking products, many of these products do not have some key features some identified as most valuable for older persons seeking to avoid incurring high overdraft fees.

One type of product many bankers noted as having appeal to older persons is basic transaction accounts that use only prepaid debit cards. In recent years, such products have gained popularity with many banks and credit unions as a way to attract unbanked and underbanked persons. For example, 500,000 people nationwide currently receive Social Security and Supplemental Security Income benefit payments on prepaid cards.47 In many ways, prepaid debit cards function similarly to traditional checking accounts, but funds are loaded directly to debit card products through direct deposit or at certain designated retail locations. While these are basic accounts that do not have the full functionality of a checking account, customers can use these cards to take care of basic needs such as paying bills through debit transactions, making purchases, buying money orders, and withdrawing cash. However, pre-paid card users are unable to write checks using these products. For some of these products, a key feature has been the addition of a savings vehicle that allows for users to build modest assets while using the account, although many prepaid debit card products still lack such a feature. Banks stated that the key appeal of these types of accounts for older persons was that they do not allow customers to spend more money than is currently available in their account.[48]

[47] Hernandez, Will. "Government Benefit Cards Catch on with Consumers". American Banker. July 23, 2009.

[48] Interview with Paul Grinde, Co Vantage Credit Union.

Although the costs associated with using pre-paid cards have come down recently, they remain higher than those associated with standard bank transaction accounts. The features and costs vary by pre-paid card provider, but typically include a standard set of fees, such as an activation fee ranging anywhere from $10 to $30 and monthly fees that can reach as high as $10. In many cases, activation fees are waived if the customer signs up for direct deposit and in some cases monthly fees are lower if a customer uses direct deposit or deposits a certain balance per month on the card. Additionally, some pre-paid card providers will reduce monthly fees in exchange for a fee per point of sale transaction. These fees can be as low as $.50 and as high as $2.00. These fees have come down in recent years and a recent survey of industry executives showed that nearly 50 percent believe fees will continue to be reduced in the near future. Comparatively, for customers with strong credit histories and minimum balances, standard bank checking accounts often have no start-up costs, minimum monthly fees, and no transaction costs.[49] However, many bankers stated that many of their older customers prefer the higher, upfront defined fees on pre-paid cards to the risk of incurring punitive overdraft fees.[50]

Bank Accounts with Pre-Paid Debit Cards

Needs met for older Americans Eliminates risk of incurring significant overdraft fees typically found on standard checking account products.

Positive features Defined, upfront fee structure; simple to use; no opportunity to overdraw account.

Product Challenges Can be higher cost than a standard checking account with no overdrafts; limitations to use such as no paper checks; products often lack savings vehicles.

[49] Schneider, Rachel. "The Industry Forecast for Prepaid Cards 2009". CFSI. March, 2009.
[50] Interview with Paul Grinde, Co Vantage Credit Union.

Recommendations for Policy and Advocacy

Declining levels of retirement income and savings, and rising costs are making older persons vulnerable to abusive, higher cost financial products. As more and more Americans reach retirement age, these vulnerabilities have the potential to impact millions of Americans each year. Although the financial services industry has developed a set of more responsible, lower-cost products as alternatives, in many cases they still remain niche products. The following recommendations for financial institutions, regulatory agencies, and elected officials are designed to ensure that appropriate financial products are developed and made widely available to older persons and that older persons have the resources necessary to have a comfortable retirement.

For Financial Institutions

Many financial institutions lack of awareness of the unique needs of older persons. In the case of both small-dollar loans and basic checking accounts, products with features that were desired by older persons were often not marketed directly to older persons. In these cases, more market research and outreach to older persons is necessary to raise bank awareness of the unique needs of this market. Also, working with organizations such as AARP, AARP Financial, and others to understand emerging trends in this market and products that are being developed to meet the needs of older persons will be critical.

For Bank Regulators

There are a number of opportunities for bank regulatory agencies to have a significant impact on financial services for older persons. The Office of the Comptroller of the Currency, the Federal Reserve, Federal Deposit Insurance Corporation, and the Office of Thrift Supervision currently have the authority to enforce both consumer protection laws and examine bank lending practices. It is critical that regulatory agencies have a thorough understanding of the unique financial situation of older persons. As indicated by the Comptroller of the Currency's warning on possible risks to consumers around reverse mortgages, the banking agency is aware of possible future abuses in the mortgage market for older persons. However, in the past, such as during the build up to the subprime mortgage crisis, bank regulators have acknowledged potential risks, but failed to act to effectively regulate those risks. Regulators need to closely monitor financial institutions to make sure that appropriate options are available to older persons. Bank relationships with payday lenders through the creation of master/sub accounts should continue to be closely monitored or prohibited. Regulators should undertake a thorough investigation and analysis of the appropriateness and cost of overdraft loan fees and consider regulating them as loans that customers would have to affirmatively choose. Regulators also need to be responsive to input from groups with deeper understanding of the needs of older persons.

For Congress

There are also a number of opportunities for Congress to act to protect the economic security of older persons. In terms of financial products, Congress should create and vest with sufficient power an independent agency to investigate and regulate financial products for all Americans. Within this agency, the appropriateness of financial products for older persons must be a central concern. Congress must also consider legislation protecting the security of federal benefits for older persons. Master/sub account relationships between banks and short-term consumer lenders threaten to strip critical federal retirement benefits. Finally, Congress should consider changing the way Americans save for retirement by creating mandatory or opt out retirement savings accounts to supplement Social Security benefits for older persons.

Appendix A: Case Study Informants

AARP Financial
Tony Gould, Director of Banking Products and Services

AARP Public Policy Institute
George Gaberlavage, Associate Director

Austin Bank of Chicago (ABC Bank)
Angela Preston, Marketing Coordinator
Reggie Little, Consumer Loan Officer

Center for Financial Services Innovation
Sarah Gordon, Nonprofit Relationship Manager

Consumer Federation of America
Jean Ann Fox, Director of Financial Services

Co Vantage Credit Union
Paul Grinde, Senior Vice President

Benton State Bank
Steve Malone, President
Kay Brink, CRA Officer

Federal Deposit Insurance Corporation
Jenny Dandridge, Community Affairs Specialist
Rae-Ann Miller, Special Advisor to the Director – Division of Insurance and Research

Guaranty Bank
Nina Johnson, Director – Community Relations and Community Development
Doug Levy, President

Lake Forest Bank
Cassandra Slade, Vice President/CRA Officer

Mitchell Bank
Jamie Maloney, Chairman

National Credit Union Foundation
Lois Kitsch, National Program Director – Real Solutions Program

Office of the Comptroller of the Currency
Paul Ginger, Community Affairs Officer

Office of the Illinois Attorney General
Brenda Grauer, Policy Advisor/ Assistant Attorney General

South Central Bank
Todd Grayson, Executive Vice President

Improving Economic Security Later in Life:

Meeting the Credit and Financial Services Needs of Older Persons

Woodstock Institute

Woodstock Institute, a Chicago nonprofit incorporated in 1973, works locally and nationally to promote sound community reinvestment and economic development in lower-income and minority communities. It collaborates with community organizations, financial institutions, foundations, government agencies, and others to promote its goals.

The Institute engages in applied research, policy analysis, technical assistance, public education, and program design and evaluation. Its areas of expertise include: CRA and fair lending policies, financial and insurance services, small business lending, community development financial institutions, and economic development strategies.