NatEquity, Inc. National Equity Access For Senior Homeowners

NatEquity Knowledge Base

A History Lesson Why Lifetime Income Proprietary Reverse Mortgages Gave Way to Lump Sum Products

In 1992 the SEC mandated proprietary reverse mortgage companies could only recognize portfolio income that was equal to the internal rate of return (IRR) of their hypothetical portfolio of contracts[i]. They also mandated for GAAP accounting purposes that all contract costs be expensed in the year incurred. This threw the young industry into a tailspin. Providential Home Income Plan, the hottest IPO of 1991, and the target of the SEC ruling, was out of business in nine months. Transamerica HomeFirst (THF), the company I started and managed, survived the IRR mandate, but was forever hobbled by the current expensing of costs. The third market participant, Financial Freedom, was unaffected because their program was an insurance product – trade your house for a lifetime annuity.

Fast forward to 1999, when Transamerica sold HomeFirst's portfolio to a Wall Street bank and Financial Freedom. Freedom's management and the Bank sold off THF's shared appreciation lifetime contracts as Aaa securitized SASCO-RMs. This yielded a Hugh immediate profit. They kept THF's line of credit product and converted it to a lump sum government look-alike reverse mortgage. The 2008 mortgage crisis worked to Freedom's advantage because they could use the lump sum product to help senior homeowner's refinance using a reverse mortgage exemption allowing them to loan to senior homeowners without W-2 earned income. Dodd-Frank and CFPB rules make it difficult for conventional lenders to serve this non-qualified senior refinance market.

Many of today's proprietary reverse mortgage lenders worked for Financial Freedom and have copied the lump sum product. They have never reintroduced a lifetime income product even though lifetime products outsold line of credit/lump sum products by a factor of 10::1 for more. They seem satisfied to serve only 1-2% of the potential senior homeowner market. The reasons encompass both the operational easy of a onetime payment and then waiting for loan maturity; and two, they have been able to argue successfully that a lump sum portfolio of loans can be valued using less stringent Level-2 valuation method by comparing their portfolios to similar "like-kind" portfolios.

Starting in 2020, the mortgage industry, including proprietary reverse mortgages, became subject to GAAP "Mark-to-Fair-Value" Level-3 portfolio valuation rules. So far proprietary reverse mortgage companies continue to use Level-2 valuation methods and are reporting operational results on non-compliant financial statements. On December 3, 2021, the SEC issued Rule 2a-5[ii] requiring Level-3 asset and liability portfolios be valued at the net present value (NPV) of future portfolio cash flows. The SEC issued Rule 2a-5 at the request of the U.S. Financial Accounting Standards Board (FASB) and the international equivalent IFRSB. The FASB is rewriting/reissuing their audit standards to eliminate any ambiguity[iii] to assure the public that on the January 1, 2022, effective SEC enforcement date that financial statements of entities and their issued securities will present compliant financial statements.

This author was invited in November 2009, to testify before the SEC[iv][v] on Level-3 fair market valuation of longevity dependent assets. This was followed in 2011 with a peer reviewed published paper[vi]. My co-authors were Lynford Graham and P.J. Eric Stallard. Lyn Graham, over his career as Head of Audit Policy at Coopers & Lybrand and BDO, also Chaired many of the AICPA/FASB GAAP rule writing committees on fair value accounting. Eric Stallard is an actuary demographer at the Duke University Medical School. Eric is the author of the Morbidity and Mortality Longevity Predictive tool renamed the Longevity Cost Calculator (LCC). This algorithmic tool is more than 96% accurate in predicting the morbidity and mortality on an individual basis for people over age 65. The LCC is part of the Bayesian Inference GAAP compliant valuation methodology used by NatEquity to predict mortality and value longevity dependent pools of assets.

NatEquity is reintroducing a variety of proprietary lifetime income reverse mortgages to satisfy the needs of 98% of senior homeowners where lump sum products fail to meet homeowner needs and expectations. NatEquity's first product will be a shared appreciation lifetime product for the 3.5 million coastal California households over the age of 70. This product is tuned to this unique market where year-over-year annual home price appreciation has averaged 7% for the last 30+ years. Other products are less reliant or not reliant upon home price appreciation in inland California and other states.

Peter M. Mazonas, CPA
CEO, NatEquity, Inc.
August 3, 2021
peter.mazonas@NatEquity.com
https://www.NatEquity.com

---

[i] https://natequity.files.wordpress.com/2019/07/14jul1992-letter-from-sec-re-longevity-accounting-for-public-companies.pdf

[ii] [ii] *Good Faith Determination of Fair Value*, Securities and Exchange Commission, 17CFR Parts 210 and 270, 12/3/2020. Summary: https://natequity.files.wordpress.com/2020/12/natequity-knowledge-base-sec-clarifies-the-need-to-apply-sound-and-consistent-valuation-methodology-for-gaap-determination-of-new-present-value-16dec2020.pdf

[iii] *Fair Value Measurement* (Topic 820), No.2018-13, Disclosure Framework, Financial Accounting Standards Board, 2018.

[iv] https://natequity.files.wordpress.com/2019/02/press-release_testimony-befroe-the-sec-2nov09.pdf

[v] https://natequity.files.wordpress.com/2021/02/mazonas-iasb-presentation-march-2020.pdf

[vi] https://natequity.files.wordpress.com/2019/02/longevity-risk-in-fair-valuing-level-three-assets-in-securitized-portfolios-final-as-published.pdf