

1 FEDERAL TRADE COMMISSION  
 2 PUBLIC WORKSHOP:  
 3 PROTECTING CONSUMERS IN THE NEW MORTGAGE MARKETPLACE  
 4  
 5

6 I N D E X  
 7

8	WELCOMING REMARKS		PAGE
9	Ms. Twohig		3
10	Chairman Majoras		6
11			
12	PANEL	SUBJECT	PAGE
13	1	Alternative Mortgage Products and the Key Players in Today's Marketplace	12
14	2	Evaluating Consumer Benefits and Risks	60
15	3	Protecting Consumers: Current Regulatory and Law Enforcement Issues	104
16	4	Protecting Consumers: Beyond the Existing Regulatory Framework	165
17	5	Consumer Literacy and Education in the Mortgage Marketplace	225
18			
19			
20			
21			
22	CLOSING REMARKS		PAGE
23	Ms. Parnes		285
24			
25			

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

FEDERAL TRADE COMMISSION

PROTECTING CONSUMERS IN THE ) File No.  
NEW MORTGAGE MARKETPLACE: ) P064812  
PUBLIC WORKSHOP )  
-----)

WEDNESDAY, MAY 24, 2006

Federal Trade Commission  
601 New Jersey Avenue, N.W.  
Washington, D.C. 20580

The above-entitled workshop commenced,  
pursuant to notice, at 8:30 a.m.

## P R O C E E D I N G S

- - - - -

1  
2  
3 MS. TWOHIG: Good morning, everyone. You are  
4 such a well behaved crowd. You started quieting down,  
5 and I didn't even say anything. My name is Peggy  
6 Twohig. I'm the Associate Director of the Division of  
7 Financial Practices at the Federal Trade Commission, and  
8 it's wonderful to see so many of you here so bright and  
9 early, for Washington, in any event, to attend this  
10 workshop on this important topic.

11 Before I introduce Chairman Majoras for opening  
12 remarks, I have a number of housekeeping matters I need  
13 to review, so please bear with me for a few minutes  
14 here.

15 First, about security, as you know for those  
16 visitors who came in, you need to go through security  
17 and be screened, and if you leave the building today for  
18 lunch or breaks, you will need to go through security  
19 again, and that's no problem. It's not too onerous, I  
20 hope, but you just need to keep that in mind in terms of  
21 time.

22 Please wear your name tag that they gave you and  
23 security badge at all times and keep it with you and  
24 wear it when you come back from the lunch break or any  
25 other break.

1           For audio-only listeners today, we encourage you  
2           to visit our web site, which is  
3           ftc.gov/mortgageworkshop, and you will find copies of  
4           most of the presentations today and the handouts that  
5           we're using in today's panels.

6           An important note: In case of emergency, please  
7           now locate the exit nearest you. This is my airline  
8           stewardess imitation, fire doors or through the main  
9           doors at the front of the building on New Jersey Avenue,  
10          past the area immediately behind the auditorium.  
11          There's also a G Street corridor exit. If for any  
12          reason there's an emergency that makes it unsafe to go  
13          outside, please listen and security staff will instruct  
14          you.

15          Okay. Here's the important part. Cell phones,  
16          please turn off all now. You can do it with me. Do as  
17          I say and as I do. Actually mine is already off.  
18          Please do not set them to vibrate because this can  
19          interfere with sound and video equipment. If you must  
20          use a cell phone or pager, also please don't use them in  
21          the area right back here or behind us or between here  
22          and the guard's desk. You can use it more in the rest  
23          room area or if you need to outside.

24          Rest rooms, speaking of rest rooms, are located  
25          outside the glass doors where you came in, across the



1 helpful to us in providing feedback on today's workshop.

2 Now, without further delay, I'm honored to  
3 introduce the Chairman of the Federal Trade Commission,  
4 Deborah Platt Majoras, who will give opening remarks.

5 (Applause.)

6 CHAIRMAN MAJORAS: Thank you very much, Peggy,  
7 and good morning, everyone. Welcome to the Federal  
8 Trade Commission's workshop on protecting consumers in  
9 the new mortgage marketplace. I want to thank everyone  
10 for being here and, in particular, our distinguished  
11 panelists for participating in this workshop about  
12 important consumer protection issues in the residential  
13 mortgage marketplace.

14 As many of you may know, at the FTC, when we  
15 have questions about how to protect consumers in new  
16 contexts as there are developments in the commercial  
17 marketplace, our strategy is to reach out and pull in  
18 experts to assist us in understanding new issues. Home  
19 ownership in itself is not a new issue, of course. It  
20 has been, and remains, the American dream. Many  
21 Americans have achieved that dream. Home ownership  
22 today is at record levels.

23 As we all know, however, housing prices have  
24 risen dramatically in recent years and especially in  
25 certain regional markets, and for some that has meant

1 that it is more challenging to achieve the dream of home  
2 ownership. The marketplace has responded, as it often  
3 does, this time with nontraditional or alternative home  
4 mortgage products designed to make homes initially more  
5 affordable for consumer buyers.

6 The key feature of these alternative products is  
7 that they set mortgage payment amounts as low as  
8 possible in the early years of the loan. The prevalence  
9 of these alternative mortgage products has grown  
10 rapidly. While in 2000, they made up less than 1

1 already protecting consumers and learn what consumers  
2 understand about these products.

3           The FTC has broad jurisdiction in this  
4 marketplace over non-bank mortgage lenders, brokers and  
5 loan servicers. Therefore, it's important that we  
6 understand these alternative mortgage products so we can  
7 assess any relevant consumer protection issues.

8           So to guide us today, we're going to have five  
9 panels covering a broad array of consumer protection  
10 issues. The panelists represent a wide cross-section of  
11 experts, drawn from many parts of the mortgage industry,  
12 consumer advocacy groups, academia, and federal and  
13 state regulatory agencies.

14           Initially, our panelists will introduce the  
15 various alternative mortgage products and identify the  
16 major participants in the home mortgage industry. This  
17 should get us all on the same page about what it is  
18 we're talking about.

19           Next, our panelists will explore the benefits  
20 and risks of these mortgages to lenders and consumers  
21 and look at market factors, such as the potential impact  
22 of a housing bubble or a change in interest rates.

23           Then our regulatory representatives will outline  
24 the legal framework in which these loans are made, and  
25 another panel will follow up exchanging views on how



1 best they think we can protect consumers and the  
2 marketplace.

3 We will close the day with a discussion on  
4 consumer literacy and education. Many of you know, I am  
5 a strong proponent of financial literacy among  
6 consumers. Consumers must understand their own  
7 finances, including how their mortgages work and what  
8 mortgage products will work best for them. Members of  
9 this final panel will introduce extrinsic evidence about  
10 how well consumers understand their mortgage loan terms  
11 and consider creative ways to educate consumers.

12 Before I conclude, I would like to thank in  
13 advance all of our moderators and panelists for taking  
14 this time. I know everyone is very, very busy, and we  
15 appreciate the efforts to participate in the workshop.

16 I particularly am pleased that we have senior  
17 officials from the Federal Reserve Board, the Office of  
18 the Comptroller of the Currency, and the Federal Deposit  
19 Insurance Corporation here today to lend their expertise  
20 to us and discuss the proposed guidance issued by the  
21 federal banking agencies, which addresses underwriting  
22 and consumer disclosure standards for certain  
23 nontraditional mortgage products offered by the lenders  
24 that they regulate.

25 I also want to acknowledge the staff of the

1     FTC's Bureau of Consumer Protection, who planned the  
2     workshop: From the Division of Financial Practices,  
3     Peggy Twohig, who is the Associate Director and from  
4     whom you just heard; Assistant Director Reilly Dolan,  
5     and Staff Attorneys Julie Bush and Delores Thompson;  
6     from the Division of Consumer and Business Education,  
7     Erin Malick; from BCP's honors paralegal program, Sarah  
8     Gleich, and from our Bureau of Economics staff,  
9     economist Lynn Gottschalk. We thank all of them.

10           I anticipate that this will be a  
11     thought-provoking and informative workshop, and it  
12     should shed some light on the issues associated with  
13     alternative mortgage loans at a critical time when, as I  
14     said, many consumers are now holding or thinking about  
15     obtaining such loans, and this should assist us in our  
16     mission of protecting consumers and the marketplace.

17           So thank you all for being here this morning.  
18     We appreciate it, and now I will turn the podium back  
19     over to Peggy Twohig, so you can get started with the  
20     workshop. Thank you very much.

21           (Applause.)

22           MS. TWOHIG: Thank you very much, Madam  
23     Chairman. Now, without further ado, we turn to our  
24     first panel, alternative mortgage products and the key  
25     players in today's marketplace. The moderator for this

1 panel is Reilly Dolan, who is one of the Assistant  
2 Directors in the Division of Financial Practices, and  
3 the panelists I guess are taking their seats.

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1 PANEL 1: "Alternative Mortgage Products and the Key  
2 Players in Today's Marketplace."

3

4 PANELISTS:

5 J. REILLY DOLAN, Moderator, FTC

6 AMY CREWS CUTTS, Deputy Chief Economist, Freddie Mac

7 ALLEN FISHBEIN, Director of Housing & Credit Policy,

8 Consumer Federation of America

9 GREG MCBRIDE, Senior Financial Analyst, Bankrate.com

10

11 MR. DOLAN: Thank you, Peggy, and good morning  
12 to everybody. It looks like the crowd is continuing to  
13 grow, which is great.

14 My name is Reilly Dolan. I'm an Assistant  
15 Director in the Division of Financial Practices. As  
16 Peggy mentioned, the panel today is the alternative  
17 mortgage products and key players in today's  
18 marketplace, or as I have coined it, alternative  
19 mortgages 101.

20 Our three panelists, whom I will introduce in  
21 one second, will guide us through the basics about these  
22 products, how they work and who is using them.

23 To my immediate left is Greg McBride, senior  
24 financial analyst at Bankrate.com. Greg provides  
25 analysis and advice on personal finance and has appeared



1 three consumers: Florence, Isaac and Ozzie. Each has  
2 decided to purchase a home for \$437,500. Each will need  
3 a mortgage to finance 80 percent of the purchase price,  
4 which translates to \$350,000, if my math is right. The  
5 remaining 20 percent will be funded through down  
6 payments, piggyback loans or other mechanisms. The  
7 closing costs are the same for each house.

8 Florence has decided to purchase a condo located  
9 in New York City. She chooses a fixed-rate mortgage  
10 with a 30-year loan at an interest rate of 6.5 percent.

11 Isaac has decided to buy a bungalow home near  
12 Los Angeles. He's chosen an interest-only 5/1  
13 adjustable rate mortgage, a 30-year loan with an initial  
14 five-year period where the interest rate is fixed at 6  
15 percent, and payments cover interest-only. After the  
16 initial five-year period, the interest rate adjusts  
17 annually, and the payments must cover principal and  
18 interest.

19 Finally, Ozzie has decided to buy a home located  
20 in Hillside U.S.A., which is a suburb of Washington,  
21 D.C. He has chosen an option adjustable rate mortgage  
22 with an initial five-year period where he may pick the  
23 amount he wishes to pay each month. At the start of the  
24 loan, the interest rate is 6.5, and the minimum monthly  
25 required payment is substantially less than the

1 interest accrued each month. The negative amortization  
2 mortgage cap, which we will explain as we get into the  
3 first panel, is set at 120 percent of the amount  
4 borrowed, i.e., \$420,000.

5 After the initial five-year period, the interest  
6 rate adjusts monthly, and the monthly payments adjust  
7 annually. Also the monthly payments must cover  
8 principal as well as interest after that initial  
9 five-year period, including any negative amortization  
10 accrued during the initial period.

11 One last note, Peggy had referenced questions.  
12 Because of the way this panel is structured and the  
13 presentations that each of our presenters has, I am  
14 going to be taking questions for the panelists at the  
15 end of their presentations, so feel free, as the  
16 question comes to you, to write it on the card, to hand  
17 it to the people who are around to collect them, knowing  
18 that I will be getting to it after everyone has given  
19 their presentations.

20 Now we would like to invite Greg to come to the  
21 podium and to start talking about these particular types  
22 of products. Technology is always one to get ahead of  
23 me. There you go. Thank you, Greg.

24 MR. MCBRIDE: Thank you, Reilly, and thank you  
25 to everyone at the FTC for inviting me to be here today.

1 I've been asked to introduce these alternative mortgage  
2 products, talk about the pros and the cons a little bit,  
3 who they are right for, maybe who they're not for.  
4 After that, we'll talk about risk layering, some of the  
5 additional factors beyond the selection of the mortgage  
6 product that borrowers may be engaging in, and then time  
7 permitting, I'll mention some of the new products that  
8 are in the marketplace.

9           While on the discussion, alternative mortgage  
10 products undoubtedly begins with interest-only loans,  
11 and justifiably so. This is a product that's seen  
12 tremendous growth in recent years, going from less than  
13 2 percent of the market five years ago, now as of 2005,  
14 about 25 percent of the market, and not unexpectedly,  
15 considerably higher in the priciest housing markets.

16           Now, interest-only loans are right for some  
17 people. They're not right for some other people, so  
18 let's talk about who should consider an interest-only  
19 loan. Now, the common theme on a lot of these  
20 alternative mortgage products is the ability to tailor  
21 your monthly payment to your income, so who's best  
22 suited for an interest-only loan?

23           Well, households that have variable income,  
24 commission salespeople, small business owners, for  
25 example. The idea is that you can make a smaller



1 payment in the months when income is lean or larger  
2 payments in months when your income is higher.

3           There's also a school of thought among some  
4 borrowers about, Well, hey, why should I be throwing  
5 money in a mortgage to pay down the balance when it's  
6 really only costing me maybe 4 or 5 percent on an after  
7 tax basis? I can earn higher returns by putting that  
8 money to work elsewhere, and so as a result, you see  
9 many investors, wealthy homeowners that already have  
10 significant real estate holdings, they opt for  
11 interest-only loans because it enables them to minimize  
12 or maximize their cash flow, minimize the amount they're  
13 devoting to their mortgage and maximize the amount of  
14 money that they're putting into other investment  
15 opportunities.

16           Then thirdly, there are the upwardly mobile,  
17 people-17



1           If you also introduce an interest rate increase  
2           at that point in time, if the interest rate goes from 6  
3           percent to 8 percent, then the payment becomes \$2,700 a  
4           month, an increase of \$950 an month.

5           Now, another product that's really gained a lot  
6           of traction, particularly over the last 18 to 24 months,  
7           are what's known as option adjustable rate mortgages or  
8           sometimes called pay option ARMs. Now, as the name  
9           applies, this is a product that gives the borrower  
10          several choices each month in terms of how they want to  
11          make their monthly payment.

12          They can make a payment on the basis of a  
13          traditional 30-year repayment schedule; on an  
14          accelerated 15-year repayment schedule, which would be a  
15          higher payment. They can make an interest-only payment  
16          or they can make what's known as a minimum payment.  
17          Now, again I'll come back to this common theme on the  
18          alternative mortgage products, and that's the ability to  
19          tailor the payments to your monthly income. Well, the  
20          option ARMs really adds enhanced flexibility because of  
21          the presence of that minimum monthly payment.

22          Now, that payment flexibility is the key selling  
23          point on the option ARM product, but if not utilized  
24          correctly, it can also be the biggest pitfall. How?  
25          Well, let's look at the risks.

1           With an interest-only -- I mean, with the option  
2 ARM being -- the interest-only isn't even the riskiest  
3 choice you can make. It's the temptation to make that  
4 minimum payment month after month, so, for example, if  
5 you make that minimum payment month after month, the  
6 unpaid interest, the payment you're making, does not  
7 cover the interest that's due. That unpaid interest  
8 then gets added to the balance, so over time your  
9 balance actually grows. This is known as negative  
10 amortization. In addition, you could be subjected to  
11 rising interest rates and in some cases as soon as the  
12 first month.

13           Now, there are benefits to some borrowers of the  
14 option ARM product. I mentioned the payment flexibility  
15 for households that have widely variable income.  
16 Another avenue is that it enables a buyer to purchase a  
17 larger home sooner, so maybe that's that upwardly mobile  
18 household that we all desire to be. Maybe it's a  
19 household where one spouse is home temporarily maybe  
20 caring for children, but will be rejoining the work  
21 force in a couple of years and expects to make a  
22 significant salary in doing so.

23           The option ARM enables them to get in the home  
24 now with the idea that income is going to increase at a

1 again, before we go down that road, let's look at what  
2 can happen to the payments and decide if this is  
3 something that the household budget is able to handle.

4 I mentioned with the interest-only that when  
5 that loan converts from paying interest-only to interest  
6 and principal, that even if the interest rate stays the  
7 same, the payment goes up. Well, we see the same thing  
8 with the option ARM, only more so. Why?

9 Because not only are you now repaying the  
10 balance over a shorter period of time, but thanks to the  
11 negative amortization, you're repaying a potentially  
12 higher balance over that shorter period of time, so in  
13 this case, the payment at the five-year mark jumps from  
14 the initial minimum of 1,200 to a payment of \$2,600 a  
15 month. If on top of that you introduce an interest rate  
16 increase, if the rate jumps to 8 percent, then all of a  
17 sudden you're looking at a payment that's nearly \$3,000  
18 a month.

19 Now, it's always important when we talk about  
20 alternative mortgage products to explain the risks, and  
21 why is that? Well, some figures from the Federal  
22 Reserve Board indicate that a good chunk of borrowers  
23 really don't have a good handle on the risks of  
24 adjustable rate mortgages or alternative mortgages.  
25 They don't know the maximum rate they can be charged.

1 They don't know the amount that the rate can rise at one  
2 time, and they don't know how often that rate can  
3 change.

4 So at a minimum, if you're going to get one of  
5 these alternative mortgage products, those are the  
6 questions you absolutely have to be able to answer as a  
7 borrower. You have to know the maximum that that rate  
8 can climb to. You have to know how much it can rise at  
9 any one point in time, and you have to know how often  
10 that rate is going to change.

11 Now, in addition, risk layering. So what's risk  
12 layering? Well, we will all agree that crossing the  
13 street without looking is risky. Risk layering is  
14 saying, I'm not only going to cross the street without  
15 looking, I'm going to do it with my eyes closed. It's  
16 adding an additional element of risk to the equation.

17 In an environment where we see those alternative  
18 mortgage products grow, 42 percent of first-time home  
19 buyers bought homes last year without making a down  
20 payment, so we have to kind of consider it in the  
21 context of an environment with people are making smaller  
22 down payments or increasingly making no down payment.

23 Now, that can be a dangerous mix for borrowers  
24 that go that route. That no down payment, coupled with  
25 a loan product where they're not repaying the principal.

1 Another avenue for borrowers that are making low and no  
2 down payments is that they take a piggyback loan  
3 arrangement, where they simultaneously take a first and  
4 a second mortgage combining what might be an  
5 interest-only first loan with a home equity line of  
6 credit on the second loan, in which case they're skating  
7 by the interest-only payments on both products, not  
8 building any equity for principal repayment, but thanks  
9 to rising interest rates, could be seeing higher  
10 interest rates and higher monthly payments on both  
11 products.

12 I'll just real quickly touch on some of the new  
13 products that are in the marketplace right now. There's  
14 now a fixed rate interest-only mortgage product that's  
15 really gained a lot of traction in the last 12 months or  
16 so. Unlike the interest-only product in our  
17 hypothetical, this offers a fixed rate throughout the  
18 term of the loan, so the borrower gets the benefit of  
19 that lower interest-only payment in the initial years,  
20 but they will face an adjustment at a later period, once  
21 the loan converts to repayment of principal as well.

22 The benefit here is that because you're removing  
23 interest rate uncertainty, the borrower can really  
24 manage what that payment increase is going to be at the  
25 10 or 15-year mark, whenever that loan converts.





1 playing in the marketplace. Thanks.

2 MS. CREWS CUTTS: Thank you very much. It's a  
3 pleasure to be here. I'm going to walk you through what  
4 I will hope will be a story as to how did we get here,  
5 because it suddenly seems like these things came out of  
6 thin air, and one of the things I would like to start  
7 off with is the fact that what we today call exotic  
8 mortgage products or new mortgage products or  
9 nontraditional or whatever name we want to give them,  
10 they have been around for a very, very long time. They  
11 just haven't been mainstream, and so now they have  
12 entered into mainstream, and I would like to walk you  
13 through a discussion as to why I think that happened.

14 We have had an extraordinary change in our  
15 mortgage and housing markets over the last 30, 40, 50, a  
16 hundred years. What we have today is a very, very  
17 modern mortgage market and housing market. Starting in  
18 about 1980, we enjoyed 25 years of nearly monotonic  
19 falling interest rates. There were a few times when  
20 they kind of bounced up a little bit, but for the most  
21 part we had 25 years of falling rates.

22 We also, if you look back 25 years, enjoyed a  
23 period where incomes were growing faster than home  
24 prices, and in 1997, as this chart shows, that spread  
25 between house price growth and income growth stopped

1 getting wider, and it kind of turned the corner. Where  
2 we have that little dotted line is where that gap  
3 started to narrow and now in the past year, 2005, we  
4 actually crossed where house prices have grown over a  
5 very long term -- economists like the long-term, don't  
6 look at the short-term, look over the long-term. We  
7 know, looking back to 1975, 30 years have crossed where  
8 over the last 30 years incomes have failed to keep up  
9 with home prices, so this question of affordability  
10 rises to the forefront.

11 This picture shows more recently what's happened  
12 to mortgage interest rates. From the middle of 2000 to  
13 the middle of 2003, 30-year fixed mortgage rates fell 40  
14 percent. The rates, the initial rates on one-year  
15 regular vanilla adjustable rate mortgages fell 50  
16 percent, so we head into a recession. Home ownership  
17 rate hits an all time high, which doesn't make sense,  
18 right? Normally you think recession, the whole thing  
19 falls apart, but in this case, because of the dramatic  
20 fall in mortgage rates and the fact that most of us

1 York, Boston, Miami, California, again falling interest  
2 rates saved borrowers, but now you see that the rates  
3 came together, that 30-year fixed, if you draw a line on  
4 that blue line, the upper line, is almost horizontal.  
5 At the same time the green line, the bottom line, has  
6 come up to meet it.

7 That spells an affordability problem because  
8 house prices continue to grow. 30-year fixed didn't  
9 really go anywhere, but house prices growing, and at the  
10 same time adjustable rate mortgages getting very  
11 expensive in a relative sense.

12 Now, when they got very wide, those two lines  
13 here got very wide, especially 2003-2004, the mortgage

1 interest rate, and that matched people's plans perfectly  
2 with their needs.

3 What we had then was this compression in  
4 interest rates, rising house prices and a burden on  
5 affordability, and the mortgage market response to this,  
6 as we have people trying to get into homes, trying to  
7 buy homes, change homes, change their life styles, was  
8 to offer different mortgage products, variations on  
9 there.

10 Adjustable rate mortgages have been with us for  
11 a very long time. It wasn't until the early '80s that  
12 they became a very mainstream product with changes in  
13 the regulatory structure, allowing most savings and  
14 loans to offer adjustable rate mortgages. Up to then  
15 savings and loans were restricted to a fixed rate.  
16 There were some different charters that's allowed that,  
17 but for the most part, the industry was limited to  
18 fixed, but nonetheless, here the dark blue bars at the  
19 bottom show the adjustable rate share of the total  
20 mortgage market.

21 This is limited here just to the purchase side  
22 of the dark blue bars. The lighter blue bars show the  
23 fixed rate portion of mortgages for home purchase, and  
24 the green bars show then all the refinances, but as you  
25 can see, we've ended up in periods where ARMs were the

1 dominant product. In the last two years they were more  
2 than 50 percent of mortgage originations for home  
3 purchase. Forecast is for that to get a little bit  
4 narrower, that fixed rates will take over, but we've had  
5 periods like this before.

6 It's helpful I think to put into context how big  
7 is the market for adjustable rate mortgages. Now, this  
8 is only on prime mortgages, prime first lien, which is  
9 the dominant part of the market, but sub-prime has  
10 certainly risen quite substantially in recent years.

11 Adjustable rate mortgages are roughly 12  
12 percent of the number of loans outstanding but 20  
13 percent of the dollars outstanding in the prime market,  
14 and that comes from the very high cost markets,  
15 especially jumbo loans, that is, above the conventional  
16 conforming loan limit being predominantly ARMs, okay,  
17 and the interest rate savings are bigger, the bigger the  
18 mortgages are, so for many borrowers, that's their  
19 desire.

20 Looking now at the distribution of interest  
21 rates because it's useful to think about where the  
22 potential risks might be, this is a chart from a study  
23 done by Chris Cagan at First American Real Estate  
24 Solutions using data from Loan Performance, and roughly  
25 20 percent of the market has initial interest rates that

1 he considers "below market."

2 Many of these are option payment ARMs, which  
3 have for the first month an amortizing payment of 1 and  
4 a half or 2 percent; and thereafter become, if you do  
5 the full payment, amortizing but adjustable at a higher  
6 rate, but the minimum payment is non amortizing, in fact  
7 is negative amortization and fixed for a period of time.

8 He calls "at market" those that are within a  
9 short range of today's current rates. At the time that  
10 these loans were taken out, 2004-2005, 4 and a half and  
11 5 percent mortgages were perfectly in the mainstream for  
12 adjustable rate mortgages. Today they're a little bit  
13 higher as interest rates have climbed.

14 What he considers "above market" mortgages here  
15 are both some second lien mortgages, oftentimes our  
16 second lien mortgages fixed and seconds are at higher  
17 rates, and also sub-prime.

18 Already we saw this morning a little discussion  
19 about different payments. Here I've offered more  
20 products and in a side by side comparison for a  
21 hypothetical borrower with a \$150,000 mortgage, so it's  
22 a little bit lower than the balances described in the  
23 hypotheticals, but I wanted to put it maybe in the  
24 context of the affordable or first time home buyer  
25 market.

1           Here you see a regular one year adjustable rate  
2 mortgage, the plain vanilla stuff that we've seen for  
3 the past 25 years, comes with an interest rate payment  
4 shock every year if interest rates are climbing, and I  
5 took here for my example the extreme; that is, it goes  
6 up the maximum amount each year that it could go up, and  
7 over time, it might ultimately get to a 68 percent  
8 increase. In many cases borrowers will refinance after  
9 a year or two either into a different product or again  
10 into a lower initial rate loan.

11           What's considered the one month option payment  
12 mortgage, which was also earlier discussed, comes with  
13 as I discussed a minimum payment that starts off with  
14 this 1 and a half percent amortizing payment the first  
15 month; thereafter, the rate adjusts.

16           You can coast for awhile at this minimum  
17 payments adding to your loan balance, and many of these  
18 products come with a cap of 115 or 120 percent of the  
19 original loan balance, not the home value or net, but of  
20 the loan balance, and once you hit that cap, then they  
21 say, Okay, no more of this freebie stuff, you have to  
22 start paying back the loan, the interest and the  
23 principal, and you can end up with quite a large payment  
24 difference there after four or five years.

25           There are other products here that were also

1 mentioned, this idea of doing a fixed-rate mortgage that  
2 you pay interest-only for a period of time and then  
3 start paying the amortization, has a smaller increase,  
4 and then of course the 30-year fixed-rate mortgage, also  
5 known as the "American mortgages" with no payment shock,  
6 but you still might have property tax increases,  
7 insurance increases, things like that.

8           There is lot of worry in the press and other  
9 places of what will happen when those people hit the end  
10 where they have to do a reset on those mortgages. 500  
11 billion dollars, by our estimates, cobbling together  
12 from the best information we could find, will reset this  
13 year, that is, hit a payment adjustment on their first  
14 lien mortgage. (Sometimes you'll see numbers as high as  
15 1.2 trillion, but that includes home equity lines of  
16 credit which already adjusted on a very regular basis.)  
17 500 billion or roughly 6 percent of all mortgage debt  
18 outstanding.

19           A lot of the news, a lot of the data that we  
20 have is on loans newly originated. It's very hard among  
21 those resets that I told you about to say, Well, how  
22 many of those are regularly vanilla ones, one years and  
23 three years and so on, and how many of them are  
24 nontraditional, and the answer is, we don't know. It's  
25 very hard to get good data on that, but roughly 35





1 characteristics of borrowers who are looking into these  
2 types of loans.

3 MR. FISHBEIN: Good morning, everyone. Thank  
4 you, Reilly, for the introduction, and I want to thank  
5 the FTC for inviting us to participate in this forum and  
6 congratulate them on convening the forum because we  
7 think it's a very important and timely subject.

8 As now several people have said, I'm going to  
9 talk a little bit about what we've learned in our  
10 organization, CFA, about borrower characteristics  
11 regarding some of the nontraditional mortgages in the  
12 marketplace.

13 The starting point for this effort to gather  
14 information was, as many people in the room and others  
15 have pointed out, is that we were mindful of changes in  
16 the market. We realized the rapid increase in  
17 nontraditional mortgages provided additional  
18 opportunities for many borrowers to become homeowners,  
19 but at the same time we are aware that housing  
20 appreciation and the struggle for consumers to afford  
21 homes in that environment were causing some people to

1           So we undertook, the way CFA goes about doing  
2 things, an examination of what we could learn about the  
3 market and what was known about nontraditional  
4 mortgages, and that has culminated in a paper that we're  
5 releasing today called "Exotic or Toxic? An Examination  
6 of the nontraditional Mortgage Market For Consumers and  
7 Lenders." There are copies I believe on the table out  
8 in back. For those of you who don't get it, it will be  
9 on the CFA web site, [consumerfed.org](http://consumerfed.org).

10           And I also want to acknowledge Patrick Woodall,  
11 who is here someplace. Patrick? Yes, Patrick who  
12 coauthored the paper along with myself.

13           Now, in reviewing a lot of material from the  
14 industry and news media and everything we can get our  
15 hands on, one of the things that struck us was that  
16 there was remarkably little information about the  
17 make-up of borrowers who were taking out nontraditional  
18 mortgages, a lot about the products and the rising of  
19 the products and very little about the borrower, and we  
20 noted that lending industry consultants and people in  
21 the mortgage industry were suggesting that borrowers who  
22 were taking out these mortgages had better credit scores  
23 and were wealthier, but that we saw there was little  
24 analysis that really provided information about the full  
25 spectrum of borrowers who were taking out nontraditional

1 mortgages. (Now how do I do this?)

2 So we were able to look at a database of some  
3 hundred thousand mortgage loans that were made in part  
4 of 2005, which included identification of interest-only  
5 and payment option loans that were at least two of the  
6 nontraditional mortgage products out in the marketplace,  
7 and by the way, the results of this is contained in that  
8 paper that we are releasing.

9 The data also included income, loan purpose,  
10 credit scores, LTV ratios and some other borrower  
11 characteristics as well, and the database roughly  
12 included loans in every state. Now, what we found and  
13 as revealed in this pie chart is that one out of ten  
14 loans of these hundred thousand mortgages we looked at  
15 were interest-only or payment option loan features. The  
16 others were other products including traditional  
17 products.

18 We found that generally but not universally  
19 these borrowers did have higher incomes than borrowers  
20 overall in that database, but their credit scores were  
21 not necessarily higher than borrowers overall, and that  
22 many borrowers of the nontraditional products had median  
23 incomes and only moderate scores in contrast to some of  
24 what we read in the media.

25 Part of the database that enabled us to identify

1 the purpose of the mortgages, and not surprisingly, a  
2 majority of the interest-only and payment option loans  
3 in this database were for purchase money purposes, and  
4 you can see the high figure, particularly among  
5 interest-only loans. That's certainly consistent with  
6 the view that nontraditional mortgage products are being  
7 used to address escalating housing prices  
8 and affordability problems rather than instruments in  
9 the refinance market.

10 We looked at the distribution of borrower income  
11 by mortgage type, and interestingly, you can look at the  
12 distribution here, this is on a monthly basis, that the  
13 vast majority of -- over half of interest-only and  
14 payment options loans were taken out by borrowers whose  
15 annual income was over \$70,000.

16 That's 62 percent higher than the national  
17 median income \$44,389, and probably represents the  
18 median income of some of the high priced cities where  
19 many of these products are the most popular. However,  
20 if you look at this chart, you'll also notice that more  
21 than a third of interest-only borrowers have incomes  
22 under \$70,000, and one-sixth of them had incomes under  
23 \$48,000. One-third of payment option loan borrowers had  
24 incomes under 72,000, and one-eighth of them had incomes  
25 under 48,000, quite modest, particularly considering

1 that it's likely that these borrowers were in high cost  
2 areas to a certain extent.

3 We also looked at distribution of borrower FICO  
4 scores by loan type. Lenders offer mortgage products,  
5 and they price products based on credit risk factors  
6 like credit scores and LTVs. Generally payment option  
7 borrowers we found have lower scores than borrowers  
8 overall, but interest-only borrowers have higher credit  
9 scores than borrowers overall, so there was a split  
10 between these two products.

11 It suggests perhaps that interest-only borrowers  
12 are better credit risks than borrowers overall, and  
13 payment option borrowers are the worst credit risk than  
14 borrowers overall, but it may also be possible that  
15 credit scores are not adequately measuring the risk of  
16 the new products, and in fact there have been some  
17 suggestions by the rating agencies, among others, that  
18 FICO may not be predictive of a borrower's ability to  
19 pay, particularly as it relates to option ARM products.

20 We also looked at the distribution of this  
21 database by LTVs. Generally borrowers with  
22 nontraditional mortgage products have lower debt loads  
23 than borrowers overall. The combined LTV ratio that  
24 measures overall debt, including junior liens from  
25 second mortgages or piggyback mortgages against the

1 value of the property, we found over one-half of  
2 nontraditional borrowers had LTVs below 90 percent  
3 compared to over half of other kinds of borrowers who  
4 had LTVs higher than 90 percent, so there was a split  
5 between the nontraditional and the traditional products  
6 as far as we could tell.

7           Although I don't have a slide for you, we found  
8 in the database that African Americans and Latino  
9 borrowers are more likely to receive interest-only and  
10 payment option mortgages than non-minority borrowers, at  
11 all levels of income, credit scores and debt load.

12           Now, a couple more words about this database.  
13 We were given access to look at some of the  
14 characteristics of this database from a source that we  
15 cannot disclose, but we do feel it's a very credible  
16 source and reliable, but at the same time, we're not  
17 representing how representative this data set is of the  
18 overall market. We happen to think it's a national  
19 database that provides some insight about the  
20 distribution and certainly suggests that a significant  
21 number of borrowers with fairly low incomes and lower  
22 credit scores are taking out what are considered to be  
23 riskier mortgage products which should be of concern,  
24 but ultimately what we hope is that this research will  
25 spur others to come forward, particularly lending





1 package where we laid out that everyone was -- the  
2 \$350,000 loan was for the 80 percent, but we also  
3 signaled that we weren't identifying how they were  
4 coming up with the other 20 percent. That is then what  
5 would then play into the loan to value ratio.

6 MR. FISHBEIN: That's right, and that could be  
7 either in the form of a down payment, kind of the  
8 traditional approach to taking out a mortgage, but  
9 increasingly it might be a simultaneous second mortgage  
10 in which the borrower took out a second loan in order to  
11 make up the difference between the amount of the first  
12 mortgage and what they have to pay for the property.

13 MR. DOLAN: And the FICO score is?

14 MR. FISHBEIN: Fair Isaac score that tries to  
15 reflect on the statistical likelihood of a borrower with  
16 particular characteristics to repay their loan, that  
17 runs the gamut from I think 400 to 800, and generally a  
18 score under -- the 620 mark or thereabouts is the  
19 difference between a borrower qualifying for a cheaper  
20 prime loan versus a more expensive sub-prime product.

21 MR. DOLAN: So it's your credit score?

22 MR. FISHBEIN: It's your credit score, yes.

23 MR. DOLAN: I noticed that each of you had  
24 different numbers regarding the percentage that these  
25 product have in the marketplace, and the Chairman

1 herself had a different number, and I believe all of  
2 them are based on something that has been read. What  
3 accounts for these different numbers that people are  
4 using when they're talking about these products?

5 I will leave it to the whole panel.

6 MS. CREWS CUTTS: I'll take the first stab at  
7 that. It's just not these products. It's true across  
8 mortgage data. The survey of mortgage lending activity  
9 was a survey that was conducted by HUD up until 1997.  
10 It was for better or for worse because no survey data is  
11 complete. It doesn't represent the whole population of  
12 data, the last time we had official government numbers  
13 on the size, even of the mortgage market, and since then  
14 we've had even less data with respect to the size of the  
15 mortgage market overall.

16 We have the Homeowner's Disclosure Act which  
17 does not provide information at all on the type of  
18 product. It does now give us information on the  
19 interest rate on those product -- on the loans that are  
20 taken out but not the product itself. We have data,  
21 private data vendors. Loan Performance is one of many.  
22 Bankrate is another one of various types of information  
23 on loans, applications, originations, refinances, the  
24 whole nine yards.

25 And we have mortgage securities data, that is

1 loans that are packaged into mortgage backed securities.  
2 There are disclosure circulars that are given to  
3 investors when they buy into those by Wall Street firms,  
4 and those contain many bits of information, but that's  
5 only on the loans in those in those securities, not on  
6 the ones not in securities. So you piece it together,  
7 it's all parts of a puzzle, and it depends on which  
8 piece you're looking at at the moment as to which view  
9 that you have.

10 MR. DOLAN: Greg, do you have something to add?

11 MR. MCBRIDE: Yes, just one other thing, and Amy  
12 actually alluded to this during her presentation, is  
13 that in addition to sort of the differences depending on  
14 whose database the information is coming from, there's  
15 often a distinction or, for example, you may read  
16 figures one place that are broken out on the basis of  
17 percentage of loans whereas someplace else it might be  
18 on dollar value of loans, so even the same data source  
19 can come up with conflicting numbers there depending  
20 upon whether the particular percentage reflects the  
21 overall percentage of number of loans or by dollar  
22 value.

23 MR. DOLAN: We had discussed what these products  
24 were. We discussed the borrowers in a certain amount of  
25 detail. Who are the other players in this marketplace

1 on the other side of the transaction, and what  
2 incentives do they have when they're entering into these  
3 transactions? Again I'll leave it to the panel to  
4 decide who wants to jump in with that.

5 MR. MCBRIDE: Well, there are a variety of  
6 different parties. It can be whether you're going  
7 through a mortgage broker. It can be the lender that  
8 you're dealing directly with. It could be even your  
9 realtor that perhaps is steering you towards a  
10 particular lender.

11 I think a common theme there is that none of  
12 those can necessarily be considered a consumer advocate.  
13 They may all have a conflict of interest or have their  
14 own interests that are really driving their  
15 recommendation, not necessarily the consumer's best  
16 interest.

17 I think as a consumer that's why you have to be  
18 very -- you have to be informed and so that you can make  
19 the most educated decision possible and not rely on the  
20 advice of somebody who may not necessarily be on your  
21 side.

22 MR. DOLAN: I'm sorry, go ahead.

23 MS. CREWS CUTTS: There's another component of  
24 this, of the -- mortgage market is very complicated,  
25 lots of players in it. There are mortgage insurers that

1 insure the lender against part of the loss. There are  
2 secondary market investors like Freddie Mac and Fannie  
3 Mae that buy the loans from the banks, so that the banks  
4 have more money to lend out to other borrowers, and then  
5 we sell those loans onto investors and securities.

6           There is Wall Street, which either does the  
7 securitization on its own, buying those loans from banks  
8 and securitizing them, or in some cases lending. I  
9 talked earlier about how these products have been around  
10 for many, many years. Some of these products -- and  
11 there are some things that it's even too hard to put  
12 together all the words that they use to describe these  
13 mortgage products, to the very highest end clients of  
14 these brokerage firms. If you have many millions of  
15 dollars invested with them, they have a mortgage product  
16 for you, to maximize your portfolio value and make the  
17 most on return for you. That's how these products got  
18 started was through that.

19           We have the lenders themselves originating these  
20 mortgages and holding that risk of the borrowers  
21 defaulting. You have realtors who are guiding their  
22 clients into homes and trying to do the best by them to  
23 get them the nicest home in the nicest area.

24           There are brokers we talked about, and of course  
25 the newspaper media guiding. The personal finance media

1 has gotten many consumers armed very well, almost to the  
2 point where sometimes they dictate the terms of the  
3 loans to the people they go into, and that's one of the  
4 best things we've done in the last ten years is to arm  
5 consumers with great information, so many players, many  
6 sides.

7 MR. DOLAN: Thank you. Turning to some  
8 questions that have been turned in. Allen, do you have  
9 the percentage difference regarding Latino customers  
10 getting more interest-only or payment option ARMs?

11 MR. FISHBEIN: Yes, I do. And again this  
12 information is contained in our -- the "Exotic or Toxic"  
13 CFA study. Latinos were near twice as likely in this  
14 database as non Latinos to receive payment option  
15 mortgages. About one in 50 non-Latino borrowers  
16 received payment options compared to 4 percent who  
17 received non-payment option mortgages, and African  
18 Americans were 30.4 percent more likely than non-African  
19 to receive payment option mortgages, and they were more  
20 likely than non-African Americans to receive  
21 interest-only loans.

22 MR. DOLAN: Do you have any data on fixed income  
23 borrowers in particular?

24 MR. FISHBEIN: No. Unfortunately, that would be  
25 a valuable piece of information to disclose to us.

1           MR. DOLAN: There seems to have been some  
2 interest in your data. The next question says: "You  
3 cannot reveal the database but encourage more lenders to  
4 contribute the data. Where would they contribute this  
5 data to so that it would be able to be used by people  
6 such as you?"

7           MR. FISHBEIN: Well, as I said, it's a little  
8 unusual for us because we couldn't reveal the source,  
9 but we did share the results of this analysis with other  
10 lenders to see whether it reflected their own book of  
11 business, and generally the reaction we got was that  
12 nothing we had in there seemed out of line with the  
13 experiences of other lenders, and I'm not -- I'll let  
14 lenders come forward and speak for themselves, but it  
15 seemed to us that more research in this area would be  
16 particularly valuable, particularly as we look at the  
17 need for consumer protection.

18           I think we need to know what kind of borrowers  
19 are taking out the mortgages, what their capacity is to  
20 repay the loans, and whether it be through the means of  
21 a federal agency or by the industry, I think more  
22 information on this subject would be helpful and further  
23 the discussion.

24           MR. DOLAN: Greg, you had mentioned the 50-year  
25 mortgage at the end of your presentation. What other





1 in the home for five years, but with the 50-year  
2 amortization schedule, you're not going to build a whole  
3 lot of equity in the course of that five years. That  
4 lack of equity cushion could really bite you when it  
5 comes to sell.

6 MR. DOLAN: That may be a good lead into another  
7 question: Are fixed-rate interest-only loans attractive  
8 for a person who is planning to live in a home for less  
9 than five years?

10 MR. MCBRIDE: Well, in certain cases I think it  
11 can be. Again, the risk there is that you succumb to  
12 the temptation of just making an interest-only payment,  
13 and particularly if you've purchased a home with a  
14 minimal down payment, you're not going about the  
15 processing of building an equity cushion that's  
16 sufficient to cover your transaction costs at the other  
17 end.

18 Now, that might be fine and dandy for somebody  
19 who -- this is the third or fourth home they've  
20 purchased. They have a large equity cushion. They  
21 probably have other real estate holdings or investments  
22 to cushion that, but for the typical household where the  
23 savings rate is negative and people don't have those  
24 liquid assets to cushion those transaction costs, that



1 may be coming more prevalent in those markets as well?

2 MS. CREWS CUTTS: The answer is absolutely.  
3 They have grown across the country, but every time you  
4 aggregate data, you lose sight of the distribution of  
5 things. You're always looking at a point in that  
6 distribution, and there are high cost homes even in  
7 lower cost markets, and there are reasons sophisticated  
8 borrowers all over who may be looking at some of the  
9 things that Greg talked about, maximizing their total  
10 portfolio package of how to increase their wealth over  
11 time.

12 And so they are attractive to borrowers across  
13 the nation, but for many borrowers who look at the risks  
14 and the rewards, they opt for the fixed rate mortgage,  
15 the plain vanilla types of things in places where costs  
16 are on not so high simply because the risks don't seem  
17 worth it.

18 MR. FISHBEIN: What struck us in some of the  
19 data that we looked at was the differential by income,  
20 and we talk about it in the paper, that a wealthier  
21 borrower views these different products as financial  
22 options for them that may satisfy certain objectives,  
23 whereas the middle and lower income borrowers taking out  
24 these mortgages were doing it from lack of choice.

25 They didn't even think they had the ability,

1 particularly in high cost markets, to be able to afford  
2 traditional products, and so regardless of the risk,  
3 they were inclined to take out these loans as the only  
4 means they have to qualify.

5 MR. DOLAN: For the panel, has there been any  
6 analysis for default rates for nontraditional products?

7 MS. CREWS CUTTS: I'm sure that we will get  
8 there. This again comes down to a data question of,  
9 Where are we going to get the data to do this? Loan  
10 Performance has I think the best ability to do that, but  
11 these are such new products that the contracts they  
12 negotiated -- let me explain how Loan Performance works.

13 They get data from mortgage servicers as well as  
14 from mortgage backed securities that are in the  
15 marketplace and package them into data sets so that  
16 people can do total market analyses on that data. You  
17 don't get the loan data. If you were to purchase their  
18 data, you wouldn't get loan data, but you could do what  
19 are called pivot tables, so you could do cuts, like by  
20 FICO score ranges and by values and so forth.

21 And they are in the process of renegotiating the  
22 contracts with the people who supply data to identify  
23 interest-only mortgages and option payment mortgages.  
24 They already have negative amortization but not option  
25 payment specific, so we're maybe two or three years away

1 from having great data on what happened in the past  
2 couple of years, but that data will be retrospective  
3 once they get those contracts renegotiated.

4 MR. DOLAN: Then, Amy, you had said \$500 billion  
5 of first lien adjustable rate mortgages reset in 2006.  
6 What percentage of that for all first liens, not of all  
7 mortgage debt, if I'm reading this question properly?

8 MS. CREWS CUTTS: Right. Boy, that's one cut I  
9 didn't do. Total mortgage debt is \$9 trillion. Roughly  
10 1 trillion of that is second liens, so out of \$8  
11 trillion, the rest of it would be first liens, so 500  
12 billion out of 8 trillion is what we're looking at.

13 MR. DOLAN: Another question came in: The  
14 notion or concept of qualifying for a mortgage seems to  
15 have disappeared. What are the ramifications of the  
16 marketplace in which everyone can qualify for a  
17 mortgage? I suspect that the next panel may get into  
18 this in more detail, but if you have any kind of  
19 preliminary thoughts on the question?

20 MR. MCBRIDE: I think that risk is something  
21 that lenders decreasingly are bearing themselves, and I  
22 think that's why you see some of those standards that  
23 have become more lax, because of the presence of the  
24 secondary market where lenders can sell these products  
25 into the secondary market and essentially off-load the

1 risk. It's then diversified among the range of  
2 different investors.

3 The difference is, it's all the parties on the  
4 lending side of the table and the secondary market side  
5 of the table that are able to diversify the risk. Who  
6 is the one party in the transaction that's not able to  
7 diversify the risk? The borrower. They're the ones  
8 that are ultimately on the hook for the payments.

9 MR. FISHBEIN: I want to underscore that because  
10 one of the things that we see emerging in our  
11 discussions and it's reflected in the paper is this  
12 divergence of what is an acceptable level of risk, and  
13 it's almost gone full circle for those of us who were  
14 around 20 to 30 years who were encouraging increases in  
15 mortgage credit availability, that the industry seems to  
16 accept a higher level of default and foreclosure than  
17 borrowers are in a position to accept.

18 They can't price for that additional risk the  
19 way the industry can, and in fact, that should be a  
20 cause for concern because of course, if loans go bad and  
21 borrowers lose their home, it also has implications for  
22 the surrounding neighborhoods, so there's societal costs  
23 as a result of homes that possibly could become  
24 foreclosed upon and vacant for some period of time,  
25 dragging down property values and affecting overall









1           MR. DOLAN: And now we would like to turn it  
2 back over to Peggy Twohig to introduce the next panel.

3           MS. TWOHIG: Thank you, Reilly, and thank you to  
4 our panelists for such insightful presentations. I know  
5 that this is complicated stuff, at least it is to me.  
6 I'll speak for myself, and I really appreciate such a  
7 clear explanation of what some of these products are and  
8 what some of the marketplace factors are.

9           I know there's a lot of data to absorb, but for  
10 better or worse, I think some of that data and the facts  
11 and figures are very important in understanding some of  
12 the issues here, so I also appreciate that.

13           One housekeeping matter while people are getting  
14 situated, there are some handouts I believe associated  
15 with the next panel that are just being distributed so  
16 we'll give everybody a second to get those.

17           For those who are listening on the audio-only  
18 line, the presentations are now accessible on the FTC's  
19 mortgage workshop web site, which is  
20 [ftc.gov/mortgageworkshop](http://ftc.gov/mortgageworkshop), so with that housekeeping  
21 taken care of, your panel is all set? Okay.

22           So I think we're ready to move on to the next  
23 panel, and that is on evaluating consumer benefits and  
24 risks, and we'll explore those issues that we began in  
25 the first panel more thoroughly, so this panel will talk

1 about the benefits and challenges that these new  
2 mortgages may pose for consumers, and I'm now happy to  
3 introduce Jesse Leary, who is the assistant director in  
4 the FTC's Bureau of Economics, who will moderate the  
5 panel.

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

FTddddd

1 PANEL 2: "Evaluating Consumer Benefits and Risks."

2 PANELISTS:

3 JESSE LEARY, Moderator, FTC

4 STELLA ADAMS, Executive Director, North Carolina Fair  
5 Housing Center

6 ROBERT BROEKSMIT, Chairman, Mortgage Markets Committee,  
7 America's Community Bankers; President, Mortgage  
8 Lending, Chevy Chase Bank

9 DOUG DUNCAN, Senior Vice President and Chief Economist,  
10 Mortgage Bankers Association

11 PATRICIA MCCOY, Professor, University of Connecticut  
12 School of Law

13

14 MR. LEARY: Thank you, Peggy. Today we have  
15 with us to discuss the benefits and risks of these new,  
16 I don't want to say new because they've been around a  
17 long, but the alternative mortgage products.

18 On this panel we have Doug Duncan, who is the  
19 vice president and chief economist with Mortgage Bankers  
20 Association; Patricia McCoy, who is a professor of law  
21 at the Connecticut School of Law; Bob Broeksmit, who is  
22 COO of the B.F. Saul Mortgage Company, Chevy Chase  
23 Bank's residential lending subsidiary, and in addition,  
24 Bob is the chair of America's Community Banker's  
25 Mortgage Markets and Lending Technology Committee, and

1 he is also on the Mortgage Bankers Association's  
2 Residential Board of Governors; and we have Stella  
3 Adams, who is the director of the North Carolina Fair  
4 Housing Commission or --

5 MS. ADAMS: Housing Center.

6 MR. LEARY: Sorry, thank you.

7 The way we're going to try to run this panel is  
8 we want to have as much of a as discussion as possible.  
9 A couple of the speakers do have presentations. I've  
10 asked them to give them as quickly as possible, and I'll  
11 again do that now in front of everyone just to repeat  
12 that. And so Doug and Patricia both have slohhusing Commission o

1     you start?

2                   MR. DUNCAN:  We'll test the power of the  
3     situation here.  I will not go through all the slides.  
4     I do need to highlight a couple of things.

5                   First, I do want to thank the FTC for having  
6     this event.  Our view is the more information that  
7     consumers have on the mortgage business and products,  
8     the more likely they're able to stay in their home, and  
9     lenders are in the business of high financing people  
10    buying homes, so the incentives seem to be aligned so I  
11    think this is a good thing.

12                   I want to start with something that was made,  
13    particularly the last point, with regard to financial  
14    literacy.  You'll find that the mortgage industry is

1 they walk in the door, puts them in a disadvantageous  
2 position in terms of bargaining.

3 The third thing is shop. The fourth thing is  
4 shop. The fifth thing is shop. There are 8,800 lenders  
5 out there competing for your business. You can't get  
6 the benefits of competition if you don't activate it,  
7 and I practice what I preach. There are several  
8 mortgages that I have had. I've never talked to less  
9 than three lenders. I've never had a worse deal at the  
10 end than what I was offered at the beginning. Those  
11 principles are rock solid.

12 The final one is don't sign anything you don't  
13 understand. If you don't understand it, don't sign it.  
14 If you just apply those principles, 95 percent of the  
15 problems in the market would go away, but there's a  
16 story about an old country church that brought in a new  
17 preacher, and the first Sunday, he preached the fire and  
18 brimstones sermon about repenting and changing your  
19 behavior. The second Sunday he came and preached  
20 exactly the same sermon, and the crowd kind of looked  
21 around.

22 The third Sunday, he came and preached the same  
23 sermon, and the congregation and the elders came and  
24 asked him, What's up with that? He said, Well, I'll  
25 change the sermon when you change your behavior, so you

1 won't go out of business trying to convince borrowers to  
2 educate themselves and bring a solid position to the  
3 table.

4 I wanted to piggyback on a chart that Amy showed  
5 in terms of the volume of adjustable rate mortgages in  
6 the marketplace. This chart is the weekly percentage --  
7 it's a survey of applications for mortgages on a weekly  
8 basis since the late 1980s, showing the share of  
9 applications that was in the marketplace for adjustable  
10 rate mortgage products.

11 As you can see, this is not new. The current  
12 environment is not new. We've had two other previous  
13 periods of substantial consumer demand for alternative  
14 mortgage rate products, and it's how they manage the  
15 changes in the interest rate environment.

16 What's different about the current one is that  
17 it's been extended over a couple of years time period by  
18 the innovation of product offerings, and that's why  
19 we're having the conversation today, but it's not new.

20 The key to understanding what's going on in the  
21 demand side in the economy is the behavior of consumers  
22 and why they're behaving the way they are. Some of this  
23 was already covered in the first panel, so I'll take one  
24 minute here. First of all, they're looking at a wider  
25 variety of affordable products. Second of all, they're



1 matching loan terms to their time in the property, and  
2 the third thing is that they're actively managing the  
3 balance sheet.

4 Now, you heard elements of that in the earlier  
5 comments. I'm going to give you one anecdote from a  
6 recent experience I had in a restaurant here in  
7 Washington, D.C. There were five people in their early  
8 to mid 30s sitting at a table. One of them recognized  
9 me so they involved me in the conversation.

10 Four of them had just bought homes within the  
11 past 18 months; three of them with adjustable rate  
12 mortgage -- I'm sorry, with interest-only mortgages, and  
13 one of them with a fixed-rate mortgage, and one of them  
14 didn't buy. The one that didn't buy thought prices were  
15 too high and they were going to come down.

16 The one that bought a fixed-rate, took a  
17 fixed-rate mortgage, was telling the other two -- other  
18 three with interest-only mortgages loans they were nuts  
19 because they were faced with payment adjustments.

20 But the answer of the other three was  
21 instructive. Two of them said, We work for firms where  
22 we have a 401 K that matches dollar for dollar the first  
23 6 percent of our pay that goes into the retirement fund,  
24 so we've looked at the returns being 100 percent on  
25 every dollar that we put into that retirement fund,

1       whereas if we were paying principal in on our mortgage,  
2       we would only get returns at the pace of appreciation of  
3       housing. That seemed like a pretty intelligent  
4       investment strategy.

5               The third one that had an interest-only product  
6       planned to move in about four or five years because they  
7       were thinking they would get married or that kind of  
8       thing.

9               The point is that households now recognize that  
10       the multiplicity of the products offers for them lots of  
11       option to structure their mortgage debt, their real  
12       estate finance debt according to how they plan to live  
13       their life.

14              Now, what are consumers doing today? They're  
15       definitely shifting to fixed rate products so that when  
16       I showed you that ARM application index, that it had  
17       started to decline, what's happened is, as the Fed has  
18       raised short-term interest rates, consumers have lost  
19       the advantages of those adjustable rate products, and  
20       the two left -- the bars that go to the left here are

1 products, so as the market is changing, consumers are  
2 changing. Here's some applications from the month of  
3 March. What's interesting here on the left side are  
4 refinance loans. On the right side are purchase loans.  
5 Only 35 percent of the market was for loans to refinance  
6 a mortgage, 65 to purchase, but the share of adjustable  
7 versus fixed-rate products within each of those  
8 categories was the same.

9           So whether people were refinancing or whether  
10 they were purchasing a home, they were looking at  
11 adjustable versus fixed-rate products similarly.

12           In addition, if you look at the average time to  
13 reset on those loans, you'll see it's pushed out toward  
14 the time people expected to be in the house, so the  
15 average household stays in their house seven to nine  
16 years. They're pushing it out toward the seven-year  
17 time frame where there would be some sort of an  
18 adjustment in their mortgage product.

19           With regard to delinquencies, we survey loan  
20 delinquencies on a quarterly basis. We've been saying  
21 for the last year that these four factors were going to  
22 start to ease delinquency rates up, and they started  
23 moving up in the fourth quarter of last year. We expect  
24 that will happen for the next couple years, modest  
25 increases and largely because the loan portfolio is

1 aging.

2 Loans tend to peak, and their probability of  
3 delinquency rate in years -- between years three and  
4 five of their life. As Amy was pointing out in her  
5 mortgage volumes chart, most of the loans that are out  
6 there are less than three years old, so as they move  
7 into that period of the peak probability, we'll see  
8 delinquencies rise.

9 One last thing, and then I'll step down. I  
10 always call it the take a deep breath moment. If you  
11 look at all the people who own a house in the United  
12 States, about 34 percent of them have no debt secured by  
13 that house, so about 34 percent of the households own  
14 their home outright. You can look at the American  
15 Housing Survey, and you have to update it because it's a  
16 couple years old but that's the source of the data. If  
17 you look at people who own a house and have -- who own a  
18 house, 50 percent or about 48 percent of them have fixed  
19 rate loans only against that house.

20 So you have about 34 percent with no debt, about  
21 48 percent with fixed rate debt. The remainder have  
22 adjustable rate debt, so it's somewhere in the 18  
23 percent of households. Now, the other number you will  
24 see is people talking about just those who have a  
25 mortgage. If you eliminate the people who own a house

1 outright and you go with those that just have a  
2 mortgage, it's somewhere in the neighbor of 25 percent  
3 have adjustable rate mortgages. Just to give you kind  
4 of the big picture of when the interest rates change or  
5 payments change, what share of the home owning public or  
6 the mortgage public we're talking about.

7           And of those who have adjustable rate mortgages,  
8 you've seen some data on income distributions showing  
9 that upper income, upper households, upper wealth  
10 households tend to have ARM products. They're probably  
11 not nearly at risk the way that some of the other  
12 households are. That's just kind of a big picture look  
13 at the marketplace, and then we'll move on.

14           (Applause.)

15           MR. LEARY: Thanks, Doug. Now we have Pat  
16 McCoy. I'm not a big PowerPoint person here. If I can  
17 get some help from staff.

18           MS. MCCOY: All right. I would like to address  
19 everybody at the FTC who invited me here. It's a very  
20 important conference, and exactly the people whom I  
21 consider the experts in the field are speaking today.  
22 It's just a very distinguished group of speakers.

23           As I think is now obvious, both interest-only  
24 ARMs and option ARMs trade lower monthly payments on the  
25 front end for higher and often much higher monthly

1 payments on the back end.

2 There clearly are some people who are  
3 appropriate customers for both types of loans. I've  
4 listed some here, and what's important is that these  
5 people tend to be financially sophisticated and either  
6 are affluent now or will be very, very soon, so the law  
7 student may not be affluent at the moment, but in six  
8 months may very well be, but my question is: How about  
9 less affluent or less sophisticated borrowers? Are

23 10s \$1,750 a day in irias go, h'tf 20 in to 2lone, h've done is take  
10 these products good bets for them?

11 What I've done is taken Isaac's interest-only  
12 loan and asked, Well, today in this market, how far  
13 might it jump up, and there's an interesting report by  
14 Fitch Ratings that looked at how high sub-prime  
15 interest-only loans from 2005 would jump up, and without  
16 going over these numbers, these numbers give us some  
17 parameters about how high they would go, and so I  
18 plugged them into Isaac's loan, and assumed that the  
19 interest rate today -- thank you, and assumed that the  
20 interest rate today would be the same in month 61 when  
21 his monthly payments are going to go up.

22 So what we find is that today in month one, h've done is t

1 to 8.8 percent. His monthly payment goes up \$969, which  
2 is slightly over 55 percent, and depending how much  
3 disposable income Isaac has, that may be a big shock.

4 Under his loan, if we used these fixed  
5 assumptions, the maximum monthly payment he could have  
6 after the fifth year is \$3,400 and change, and that  
7 would be almost twice the initial payment, so that's  
8 quite a bit of payment shock if you don't have large  
9 amounts of disposable income.

10 Now, this projection of what might happen with  
11 Isaac's loan actually is probably too low because it  
12 assumes that interest rates will not rise over the next  
13 five years, which is unlikely.

14 If we then move on to Ozzie's loan with an  
15 option ARM, if he has any negative amortization, if he  
16 just makes the minimum payments, his monthly payments  
17 eventually will reset to a much higher level, and then  
18 finally the Fitch assumptions that I'm using are based  
19 on averages, so that the initial interest rate in the  
20 loan, the so-called teaser rate, could go lower than I  
21 assumed and often does in option ARMs.

22 Now, Amy and I both were fascinated by the same  
23 chart which is by Christopher Cagan at Loan Performance  
24 and its parent company, and what's interesting about  
25 this chart is on the far left side, the red bars,

1 adjustable rate mortgages, first mortgages in 2004 and  
2 2005, quite a good number of them, about 17 percent,  
3 started out with interest rates of under 2 percent.

4 Now, because these interest rates are  
5 artificially low, they will definitely go up in the  
6 initial period and when the loan resets.

7 Now, of these loans with initial interest rates  
8 of 1 to 2.5 percent, if you see where I clearly put the  
9 little red markers, 21.5 percent of them are loans in



1     happening with underwriting which is that most lenders  
2     will qualify an applicant for a interest-only loan at  
3     the small initial interest-only payment. They will not  
4     consider in the underwriting the effect of the monthly  
5     payments going up, and this quote from Fitch says "as a  
6     as a result, if there's an inability to make the higher  
7     payments later, the interest-only borrower could become  
8     financially strapped."

9             Now, Mr. Cagan at Loan Performance and its  
10     parent company did a projection of what he called the  
11     red loans, which we just saw before, the ones on the far  
12     left. Remember a fifth of those on the far left have no  
13     equity left in the house, and his projection was a  
14     conservative one in which he assumes that 90 percent of  
15     the loans with no equity left in the house would go in  
16     to default, so if I can just be clear. Of the loans in  
17     red, 90 percent of one-fifth of those loans, so that's  
18     approximately 3 percent of those loans have a 90 percent  
19     default risk.

20             So, why do our borrowers get themselves into  
21     these crazy situations if you have no equity and a  
22     limited ability to make higher payments? There's some  
23     concepts from a new field called behavioral economics.  
24     It helps us understand this, and one is the concept of  
25     loss aversion. That just means that people don't like

1 losses that are certain, and they will maneuver to try  
2 to avoid them, so here Isaac may see his choices, as  
3 he's thinking about getting this loan, as I'll have to  
4 make higher payments now if I get a fixed rate loan,  
5 that would be a certain loss because I'll have less  
6 money for other things versus let me get lower payments  
7 now with my interest-only loan and possible higher  
8 future -- higher payments in the future.

9           So he sees the interest-only loan as a gain now  
10 with some future risk, and he's willing to take that  
11 risk to avoid the certain loss. There's another concept  
12 with a really scary name called hyperbolic discounting,  
13 but it's basically the idea from Popeye and Wimpy, that  
14 people put a higher value on gains today than on  
15 avoiding losses in the future, so here Wimpy sees  
16 getting a hamburger today as a gain and the loss in the  
17 future as having to pay for it, and that's what he  
18 wants. So he says, I'll gladly pay you Tuesday for a  
19 hamburger today.

20           A final concept is the idea of framing which is  
21 that borrower's choices may depend on how the choices  
22 are framed, so if a choice is framed as a loss, then  
23 they avoid it, but if it's framed as a gain, they may go  
24 for it.

25           And so let's just take a look at this web page.

1 This is what I believe is a mortgage broker's web page  
2 for negative amortization loans, some of which involve  
3 option ARMs, but there are other types of negatives --  
4 negative amortization loans as well, so this presents  
5 negative amortization loans as gains, not as losses.  
6 How can I save you thousands of dollars by lowering your  
7 interest rate to 1.25 percent, that really low teaser  
8 rate, and it runs through some numbers comparing fixed  
9 rate loans, the typical loan, to a negative amortization  
10 loan and says, If you take the negative amortization  
11 loan, you will get 20,000 of savings a year. Well,  
12 that's exactly the behavioral pitch that would get  
13 people to go for these loans.

14 Now, my last question is: Do people really  
15 understand these products? Some of them do. Some of  
16 them don't. My concern is that our current scheme of  
17 federal disclosures is hard to understand. It's hard to  
18 sort through these, so you don't have to read this text,  
19 but this is the disclosure for a one-month payment  
20 option ARM, and just note, it's three pages long. Just  
21 to understand the terms, it's three pages long, and if  
22 you want to try to understand how high your monthly  
23 payments may eventually go, you can't give that exact  
24 number.

25 Instead, the law allows a lender to just assume

1 that your mortgage is only \$10,000 interest and run out  
2 a projection of how high the monthly mortgage payment  
3 could go on \$10,000, and then you have to do the rest of  
4 the math.

5 Well, a lot of us in the room can do it but a  
6 lot of my law students can't, okay? Final slide.  
7 Policy implications, problems with disclosure. Do  
8 consumers get the information they need to evaluate  
9 these loans in a readable and digestible fashion?

10 Second, counseling and education, are these  
11 products too complex and risky at least for  
12 unsophisticated and financially stretched borrowers?  
13 Are these cognitive biases too deep-seated to make  
14 counseling effective? Is society willing to pay for  
15 effective and independent counseling? I think we have a  
16 big resource question. Last policy implication: Has  
17 underwriting become too lax, and if so, as a society  
18 what should we do about it?

19 So with that, I conclude, and thank you.

20 (Applause.)

21 MR. LEARY: Thanks, Pat. Bob?

22 MR. BROEKSMIT: Thank you, Jesse, and thank you  
23 to the FTC for inviting me here today. I wanted to  
24 embellish a little bit on what Jesse said to introduce  
25 me, while it's true that I'm the chairman of the

1 Mortgage Bankers Association's Residential Board of  
2 Governors, I'm here today representing America's  
3 Community Bankers. I'm the chair of its mortgage  
4 markets and lending technology committee as well, so my  
5 remarks will be tailored a little bit to depositories  
6 who make mortgages.

7           And some of the statements made earlier about  
8 lenders making loans and the risk being laid off in the  
9 secondary market doesn't apply as much to the group I  
10 represent today or to Chevy Chase Bank for that matter,  
11 since we are balance sheet lenders and most of our  
12 members do keep the risk on the balance sheet.

13           It struck me, listening to Pat and the Popeye  
14 and Wimpy comparison, that there was a full page ad in  
15 The Washington Post yesterday from Pepco offering its  
16 Maryland electrical consumers a burger today and pay for  
17 it on Tuesday, phasing in the rate increases, and I  
18 called the 800 number to inquire if this were an  
19 interest free loan or there would be a finance charge  
20 assessed on the amount that you were able to defer, and  
21 the answer was there would be no charge, so that's a  
22 free loan, I'll take it, and the operator resisted that  
23 characterization, but I think it was pretty accurate, so  
24 I think that behavior is pretty rampant in this area as  
25 well.

1           I just want to open my remarks by commenting on  
2           how we at Chevy Chase Bank, and I dare say all members  
3           of America's Community Bankers, qualified borrowers for  
4           option ARMs, and interest-only loans are also prevalent,  
5           but I want to speak specifically about option ARMs.

6           This matter is also addressed by the proposed  
7           guidance from the federal regulators where they suggest  
8           that qualifying a borrower at the fully indexed rate,  
9           with a fully amortizing payment is a sensible policy,  
10          and for option ARMs, that's exactly what we do, and what  
11          that means is that if, for instance, you have a 1  
12          percent start rate, meaning that your initial payment is  
13          principal and interest based on a 1 percent interest  
14          rate, but in the second month your interest rate goes to  
15          the fully indexed rate, which is an index, let's call it  
16          MTA or LIBOR or a treasury based or a LIBOR Index, which  
17          let's say is 4 percent and a half. Treasury rate is a  
18          little lower than, a LIBOR is a little lower, so let's  
19          say 4 and a half percent, and let's say a margin over  
20          that of 2 and a half, so you have a 7 percent fully  
21          indexed rate.

22          So in order to get an option ARM from Chevy  
23          Chase Bank or other members of America's Community  
24          Bankers, you need to qualify for a fully amortizing  
25          principal and interest payment at 7 percent. If you can

1     qualify for that, you can get whatever mortgage you want  
2     because fixed rates are at that level or below, 5/1  
3     ARMs, all of the mortgage options out there -- and I'm  
4     speaking about the prime world at the moment, all of the  
5     other mortgage options out there are at or below that  
6     rate, so some of the comments earlier about people  
7     taking this mortgage because they had to, it is the only  
8     way they could afford the mortgage, that  
9     characterization does not apply to lenders who use this  
10    qualifying methodology. And most lenders do use that.

11           We do compete against at least one notable  
12    competitor, top-20 mortgage lender, real estate  
13    investment trust, not as tightly regulated by the  
14    federal regulators, that qualifies at 4 and a quarter,  
15    which I consider irresponsible, so there are lenders out  
16    there doing this in a less responsible way, but the vast  
17    bulk of lenders qualified a fully amortizing payment at  
18    the full index rate, and that's something that ACB in  
19    its comment letter to this proposed guidance has  
20    supported.

21           So Doug said that a lot of the problems  
22    disappear if you shop, shop, shop which I believe is  
23    correct, and I would posit that a lot of problems  
24    disappear if you qualify borrowers in a responsible  
25    manner for these products.

1

Another topic I wanted to touch on is this



1 percent higher, so their payment would increase by 13.5  
2 percent over the payment at which they were qualified.

3 Now, you've seen slides with much higher payment  
4 increases, and that's correct over the minimum payment,  
5 that the payment increase is substantially greater, but  
6 over the rate -- over the payment at which they were  
7 qualified it's only a 14. -- sorry, 13.5 percent  
8 increase, and that's after three years. So if their  
9 income had increased by 4.3 percent per year compounded,  
10 their income would have kept pace with the increase in  
11 the payment from where they were qualified.

12 Now, are people getting comfortable making the  
13 minimum payment and not responsibly spending the rest?  
14 Right, because the idea is that if you're going to make  
15 a minimum payment and you're qualified to make a much  
16 greater payment, that you would responsibly be using the  
17 difference. You could be investing it. You could be  
18 paying off higher rate debt. Back to Doug's examples of  
19 putting it into the 401K, and clearly some buyers will  
20 not use it responsibly, but the fact remains that when  
21 that payment increase occurs, absent a drop in income  
22 from when they were qualified, they have the wherewithal  
23 to make that payment, they might have to choose to not  
24 spend on things they had gotten used to spending on in  
25 the three years in the interim, but it is not a large

1 increase over where they were qualified.

2 Another thing I wanted to point out is that in  
3 our experience, we've been offering these products since  
4 1999, they really were started in the early '80s in  
5 California, really designed for all borrowers, not just  
6 affluent borrowers, and one of the largest lenders in  
7 this space, Golden West, which is World Savings, I think  
8 they've had a lot of press recently because of their  
9 takeover by Wachovia, and I believe their average loan  
10 size is in the low 200s, so this is really a product  
11 that's been available for borrowers from up and down the  
12 income spectrum.

13 But our experience has been that the percentage  
14 of borrowers who in a given month choose a payment that  
15 does not require any principal, so it's either the  
16 minimum payment or it's some amount between the minimum  
17 payment and the interest-only payment, right, so that  
18 the principal balance increases month over month, has  
19 ranged from 50 to 65 percent, and that about 20 percent  
20 of the borrowers choose an interest-only payment, and  
21 the remaining 20 to 30 percent of the borrowers make a  
22 payment that amortizes some amount of principal.

23 We have also I think again 110 percent ceiling  
24 on our negative amortization. We have never had a  
25 borrower exceed 103 percent, which suggests that the

1 borrowers who, the 50 to 65 percent who in a given month  
2 are making a payment that amortizes negatively, aren't  
3 continuously doing that, and I will grant that we've  
4 been in a benign interest rate environment in 2004 and  
5 -- 2003 and 2004, which made it more difficult to  
6 amortize negatively, but so we are seeing more negative  
7 amortization with rates' rise, about in that time the  
8 negative amortization figure was much lower than this 50  
9 to 65 percent.

10           And the other point is historically, if there's  
11 any slope to the yield curve, meaning that it's cheaper  
12 to borrow one month money than 30-year money, which is  
13 typically true, it's not very true at the moment, but  
14 the curve is very flat to even invert it at some points  
15 -- but typically it's cheaper to borrow on the short-end  
16 of the yield curve than on the long end, and these  
17 monthly adjustables are indexed to short term indices,  
18 whether it's a one-month LIBOR or a one-year treasury,  
19 and that with a reasonable margin on top of it, that is  
20 generally cheaper over time than a fixed-rate mortgage,  
21 and it also -- one of the hidden costs of financing with  
22 Fixed-Rate Mortgages 5/1 ARMs is when rates come down,  
23 in order to take advantage of them you must refinance.

24           The transaction costs in the refinance are  
25 substantial, and the amortization starts over again

1 which is highly overlooked by borrowers. They just fold  
2 in their closing costs and nothing comes out of their  
3 pocket and they go merrily along their way, but it's the  
4 only way to take advantage of lower rates, if you are in  
5 say a 5/1 ARM or a 30-year fixed, where if you're in a  
6 monthly adjustable, the bad news is when rates go up,  
7 your interest rate goes up as well, but the good news is  
8 when they come down, you get the advantage of that  
9 without starting over again.

10 The final point I will make is that on the  
11 interest-only side, we looked at a portfolio of about \$2  
12 and a half billion of interest-only option loans, so  
13 these are loans where the interest rate adjusts monthly,  
14 and there was no neg am available but the minimum  
15 payment was the interest-only payment. These loans have  
16 been seasoned for about 20 months, and the amortization  
17 that would have occurred on a comparable loan, which I  
18 think I used a 6 percent 30-year fixed rate loan, after  
19 20 months, that would have amortized by 2.1 percent, so  
20 that you would have owed 97.9 percent of what you  
21 borrowed.

22 This \$2 and a half billion pool after the same  
23 20 month interest-only owed 97.6 percent of the original  
24 balance, which says that these borrowers were  
25 contractually obligated to pay no principal, and they

1 choose to pay principal 2.4 percent of the original loan  
2 amount that exceeded the amount of scheduled principal  
3 they would have had on a fixed rate product, so I think  
4 that says something about the borrowers that are taking  
5 this product and how they are qualified to get into the  
6 product.

7           So, in other words, you cannot get an option ARM  
8 if you need that payment to qualify if the lender is  
9 qualifying at the fully indexed rate, so again I'm sure  
10 there will be discussion later in the day about the  
11 proposed guidance from the regulators. We believe that  
12 qualifying borrowers at that level is prudent and we  
13 would encourage lenders who aren't to change their  
14 practices, and I'm sure there is a whole separate  
15 conversation in the sub-prime space which I know very  
16 little about which might be of interest to the group  
17 late every in the day.

18           Thank you.

19           (Applause.)

20           MR. LEARY: Thank you, Bob. Stella?

21           MS. ADAMS: Thank you. I'm going to do  
22 something that people in this room who know me know is  
23 really hard, and first I'm going to keep this under  
24 seven minutes so we actually have time to do the  
25 free-roaming discussion that I thought we were going to

1 do.

2 First I'm going to respond to Robert and say  
3 about sub-prime, the answer is it's not appropriate. If  
4 you can't manage your money to stay in prime, you can't  
5 manage your money with an option ARM or an adjustable  
6 rate mortgage. It's not appropriate for the sub-prime  
7 market. Particularly the option ARM is absolutely not  
8 appropriate because it requires a level of discipline  
9 you have not shown that you can do.

10 I'm going to be quick though. You set out four  
11 or five points, and I'm going to rebut them. Decide  
12 what they need, not what they want. Home ownership is a  
13 dream. It is a want to start with. People have  
14 anticipation of it. They have desire. They have  
15 dreams, and it is a dream, and so it is very difficult  
16 when you have realtors and mortgage brokers telling you  
17 you can have a bigger bite of that dream, a bigger piece  
18 of that dream than you thought you could afford.

19 Know your own financial profile. Most borrowers  
20 have no idea of their financial profile and what's good  
21 and healthy and what's not, as you and I have about what  
22 our health condition is. We go to a professional who  
23 gives us a clean bill of health. We go to a doctor, and  
24 we ask, Doctor, am I okay, and we may feel okay and look  
25 okay, and he may finding something in that says no.

1           When we walk into a mortgage lenders's office,  
2 we expect that mortgage lender to tell us, Can I -- am I  
3 financially healthy enough to afford my dream or how  
4 much of my dream am I healthy enough to afford, and  
5 we're looking to that mortgage lending professional to  
6 give us a diagnosis of how much we can afford. Shop,  
7 shop, shop.

8           If you -- that's like asking for a second





1 the bed kind of person, or are you like spending, free  
2 wheeling in Las Vegas, or are you somewhere in between?

3 And then he explained that the fixed rate was  
4 sort of like that mattress product, and that the option  
5 ARM was like gambling in Las Vegas, and that the  
6 different types of ARM products kind of put you in  
7 between, and he really kind of explained each product  
8 based on where you said you fell sort of in that thing,  
9 and that -- he was the only person who explained the  
10 risk to the borrowers, and once he figured out their  
11 aversion to risk, he then gave them options within that  
12 framework, but that is not what other lenders did. They  
13 say -- they said to the Latino and African American  
14 borrower, We can get you a lower monthly payment with  
15 this, this will give you a low monthly payment. Okay.  
16 But you can afford it.

17 A lot of the African American and Latino  
18 borrowers who are going in are first generational  
19 homeowners, so they don't have any kind of past to even  
20 relate to. They are the hopes and dreams of their  
21 families. They built -- their families worked to put  
22 them into college, to pay for those professional degrees  
23 to give them the opportunity to buy that home.

24 One of the young women I know, we told her that  
25 she could afford, and she's in one of these high priced

1 markets, \$171,000 home based on our calculations, on  
2 what her fully amortized, fully indexed rate would be on  
3 a fixed rate. She came to us and she said, Well, my  
4 mortgage broker told me I could afford a 250,000 home,  
5 and I was like, I don't know what math he's using but  
6 you can't, but what happened was he had put her in this  
7 one-month interest, 1 percent, one-month interest  
8 adjustable option, and she could get that bigger house.  
9 But she had us to tell her, No. Most borrowers depend  
10 upon the professional. There needs to be a suitability  
11 standard. I'm going to stick with this because I want  
12 to hear talk.

13 (Applause.)

14 MR. LEARY: Thank you, Stella. I'm going to  
15 sort of use my position here and ask a couple questions  
16 first. Do we have a mike option for questions or do we  
17 need to use cards? We need to use cards.

18 The first question I have is: There's sort of  
19 two extremes here of how we might look at what's going  
20 on. One extreme are people who are very sophisticated  
21 about what they're doing, they understand exactly what  
22 they're doing, and we can use kind of the high finance  
23 model for the decision making, use the traditional  
24 finance model for how they're allocating their assets  
25 and what kind of credit product to have and what kind of

1 other financial products to have.

2           The other extreme, the most extreme would be  
3 people who are just being lied to about what they're  
4 getting, and for those kinds of situations, we sort of

1 or is it just something we all would like to know more  
2 about?

3 Stella?

4 MS. ADAMS: I'll try to talk about that. I  
5 don't think we have good data. I think Allen's data is  
6 the first real cut of looking at how long -- how they're  
7 adjusting to these products, but there was a statement  
8 estimate that Robert used about people who have these  
9 loans, who get the pay option, they're fully amortized,  
10 they're fully indexed, and they make the choice to make  
11 the minimum payment, and then they maybe don't  
12 responsibly use the difference and really it's only 4.3  
13 percent a year, and then they need to cut back on some  
14 the stuff they're doing.

15 Well, when heating prices go up 73 percent,  
16 that's a responsible use of your money. You got to say  
17 warm, but it's certainly not something you calculated  
18 was going to happen when you were doing this. When gas  
19 prices go up, and they've gone up in this time period,  
20 they have gone from about 1.50 a gallon to about \$3 a  
21 gallon, so that's doubled your costs of transportation.

22 That's a responsible use of income. There are  
23 things that are going on. The only thing you can lock  
24 down for 20, 30 -- 15, 30 years is your payment on your  
25 mortgage. Everything else is influx, and I don't think

1 that people, when they're being sold these loan  
2 payments, are really -- I know, we tested 24 banks, one  
3 bank explained it. We tested in seven cities, and it's,  
4 not being explained to borrowers, and these are upper  
5 income. These are the borrowers for whom these products  
6 are appropriate and who should be sophisticated, but  
7 they were not explained to them at all, not one bit.  
8 Didn't happen, except one bank.

9 MR. LEARY: So my next question was that  
10 question: How are these loans -- given that they're  
11 complicated and given that they are -- given that  
12 they're complicated and it's probably very important how  
13 they are communicated to potential borrowers, either  
14 through advertising or through how realtors portray them  
15 or how mortgage brokers portray them, and we had the  
16 example in the past presentation, and, Stella, your  
17 organization has obviously experience with lenders on  
18 this issue.

19 Would other folks like to comment on whether  
20 that's -- well, on how they should be portrayed and  
21 whether you have any information about whether that is  
22 typical? Are these ways being portrayed typical or are  
23 they -- Bob?

24 MR. BROEKSMIT: I don't want to turn this into a  
25 point, counter point, but I do want to reply to Stella

1     that if we qualify you at the fully amortizing, fully  
2     indexed payment, your ratio is 40 percent or less,  
3     meaning you still have 60 percent of your income to pay  
4     for the higher fuel costs, so that's a portion of the  
5     analysis that, of course, I'm not trying to impugn  
6     people from paying their heating bills.

7             The question here is how are they explained, and  
8     one thing that we are diligent about is understanding  
9     that mortgage brokers, most studies would say do about

1 plain English say four paragraph piece of paper that  
2 says, If you think you're getting a fixed rate loan or  
3 you're not, head for the hills, this thing adjusts  
4 monthly, just so people we know, and we require them to  
5 sign that as well.

6 MS. MCCOY: There are a couple questions, one is  
7 at the time of application how understandable is the  
8 disclosure, and the three page thing that I put on the  
9 board is an example of a mandatory disclosure. What I  
10 walk away from that with is the convention that it would  
11 be very helpful to have a disclosure that lists how high  
12 the maximum principal and interest payment could go  
13 after adjustment for that loan with that amount of  
14 principal, and these days you can program the computer  
15 to generate that very simply. It's not difficult to do.

16 Let's not fool around with the idea that people  
17 are getting \$10,000 first mortgages. They're not.  
18 Let's get real, and the other question is timing. Do we  
19 actually want to make disclosures akin to this before  
20 application, so at the shopping stage, people can  
21 understand the payment shock issue.

22 MR. DUNCAN: Let me just pull together the  
23 previous question on the data that's available and the  
24 issue of disclosure because we're within the association  
25 -- I think our incoming chairman wants is an examerymyn6.001000 0.

1 force to look at the efficacy of disclosures to make  
2 sure that consumers are indeed getting upfront, as you  
3 suggest, the kind of information that helps them be good  
4 decision makers, plus there's been an effort underway  
5 for a number of years to try to reform the Real Estate  
6 Settlement Procedures Act to make things more clear for  
7 consumers to shop.

8           In the absence of those things today, with  
9 regard to data, Amy did a nice job of describing how you  
10 have to kind of compile pieces together from various  
11 sources to get a reasonable composite of the local -- or  
12 of the total marketplace, but there is a mechanism in  
13 place in the markets which enforces a certain level of





1 disclosures, and that's not only for these types of  
2 products but also just generally in the sub-prime  
3 market. They worked in the old fixed mortgage days  
4 pretty well for the Truth In Lending Act, but they don't  
5 work very well for these newer mortgages.

6           The other thing, I'm very cheered to hear Bob's  
7 description of the underwriting for Chevy Chase and for  
8 certain other lenders. That is a responsible practice.  
9 It, however, is not uniform against the industry, and so  
10 one of the things that the proposed alternative mortgage  
11 product guideline would do is create some additional  
12 regulatory incentives for there to be responsible  
13 underwriting across the industry, and I think that's  
14 really important.

15           MR. DUNCAN: I think each of us, our  
16 associations which weighed in on the OCC guidelines to  
17 suggest to them different aspects of it that would be  
18 useful for the marketplace. In addition, with regard to  
19 the separation between sub-prime lending and predatory  
20 lending, as you know, there are a variety of legislative  
21 proposals out there that would address that issue, many  
22 of them at the state level.



1 a suitability standard in place because the person who  
2 bears the risk, who all the risk falls on is the  
3 borrower.

4 That's the person whose dream is denied, whose  
5 hopes are dashed, and when we're talking about first  
6 generational first time home buyers, we have taken  
7 away -- and I'm going to tell you, these 50-year  
8 mortgages, that's rent. There's no opportunity. We  
9 already have put these children in debt with student  
10 loans, and now we're going to pile on. We got to help  
11 them the way we were helped by giving them an  
12 opportunity to build wealth.

13 MR. LEARY: Does anyone want to address the  
14 suitability? Bob?

15 MR. BROEKSMIT: There's a whole other hour on  
16 that topic I think, but what's the difference between  
17 eligibility and suitability, and who am I to tell you  
18 that you're eligible for a monthly ARM but it's not  
19 suitable to you? And am I right, if rates drop  
20 consecutively for two years and then you come back to me  
21 and say, That would have been a better deal for me  
22 because rates dropped, but I didn't offer it to you,  
23 even though you're eligible for it?

24 MS. ADAMS: Bob, when you discount, if you're  
25 talking about market rate ARMs, where we're really

1 rolling the dice, and I have a chance to get a lower  
2 rate and you have a chance to get a higher rate, that's  
3 okay, but when we've discounted down to 1 percent, there  
4 is no way in the world that I am ever going to get that.

5 MR. BROEKSMIT: I qualified you at 7.

6 MS. ADAMS: I want to get that rate back.

7 MS. MCCOY: Bob, I think because you qualified  
8 the loan at 7, that you actually did do the suitability  
9 analysis.

10 MR. BROEKSMIT: Maybe it's semantics.

11 MS. MCCOY: See the question is whether the  
12 eligibility standards -- are they underwriting at 1  
13 percent or 7. 1 percent is not suitable.

14 MR. BROEKSMIT: Right, agreed. It's 4 and a  
15 quarter.

16 MR. DUNCAN: Under the whole discussion of  
17 suitability will be the issue of access to credit, and I  
18 think we all agree that people should have access to  
19 credit markets, but not everyone is qualified for a loan  
20 at a particular point in time, and there are some people  
21 who are not prepared for credit at different points in  
22 time.

23 MR. LEARY: I think I'll ask one more question  
24 here. Are there data on borrower behaviors in terms of  
25 paying down principal in the sub-prime market? Bob had

1 some data on prime borrowers. I think we expect the  
2 data to be quite different, but do we have information  
3 on that?

4 MR. BROEKSMIT: Allen, didn't you say -- I don't  
5 want to fumble around for your slide, but didn't you say  
6 that the high LTV, low FICO was pretty unusual in the  
7 option ARM, that the LTVs were not generally over 90?  
8 And I guess what I'm saying is I don't think there's a  
9 whole lot of data on sub-prime option ARMs because there  
10 aren't that many.

11 MR. FISHBEIN: That's right.

12 MR. BROEKSMIT: I and the group I represent  
13 don't make them to sub-prime borrowers so I don't have  
14 any data.

15 MR. DUNCAN: It's not the normal product in the  
16 sub-prime arena.

17 MR. LEARY: Okay.

18 MS. ADAMS: But it is out there. They will  
19 write them to -- they will write an option ARM with 500  
20 FICO score, and they'll write it to a 100 LTV.

21 MR. BROEKSMIT: Who is they? I think we ought  
22 to turn them in.

23 MS. ADAMS: I'm saving that for my comments.

24 MR. LEARY: Okay. Thank you very much. I wish  
25 we had more time to go into more of this.

1 (Applause.)

2 MS. TWOHIG: Thank you, Jesse, and thank you,  
3 panelists, for your enlightening comments and for that  
4 discussion. That was very interesting. There's now  
5 going to be a 15-minute break. We're running a little  
6 bit over but not too bad, so if you could make sure  
7 you're back at 11:05.

8 Rest rooms are that direction. Remember, if you  
9 go outside the building, you're going to need to come  
10 back in through security. If you need more question  
11 cards, we've had a lot of questions submitted, they're  
12 out there on the registration table, and there's coffee  
13 and all kinds of materials to pick up so we'll see you  
14 back at 11:05. Thanks.

15 (A brief recess was taken.)

16

17

18

19

20

21

22

23

24

25





1 focusing on protecting consumers: The current  
2 regulatory and law enforcement issues. I'm going to be  
3 moderating the panel. I'll introduce the panelists all  
4 at once from here, and then I'll sit down, and we'll  
5 mostly have our discussion from the table.

6 First, I would like to note that we have a  
7 distinguished panel of federal and state regulators here  
8 today, and we have a lot to cover. This panel will lay  
9 the ground work for the later discussion that we will  
10 have today, and actually will provide some ground work  
11 for some discussion that we have already had by  
12 reviewing what information currently must be provided to  
13 consumers about nontraditional mortgage products under  
14 current law.

15 In other words, what do consumers learn now from  
16 the disclosures that they're required to receive about  
17 one of the key issues that we've discussed this morning,  
18 possible increases in payments, and when do they learn  
19 it?

20 Next, our panel is going to be discussing the  
21 Interagency Guidance on nontraditional mortgage products  
22 that has been proposed by five federal bank regulatory  
23 agencies. The five agencies that have proposed the  
24 guidance are: The Federal Reserve Board, the Federal  
25 Deposit Insurance Corporation, the Office of the

1 Comptroller of the Currency, the Office of the Thrift  
2 Supervision, and the National Credit Union  
3 Administration. We have several representatives from  
4 some of those agencies to discuss the Interagency  
5 Guidance here today.

6 Finally, we will discuss the role of the Federal  
7 Trade Commission, the Department of Housing and Urban  
8 Development, state regulators, and law enforcers with  
9 respect to nontraditional mortgage products and the  
10 issues that are arising in connection with these  
11 products.

12 If youcm0.rg(dtcaI frorthe Dpanelstr, ajus)TjET1.00000 0.0

1 the Comptroller of the Currency.

2 We have Ivy Jackson, who is Director of the  
3 Office of the Real Estate Settlement Procedures Act of  
4 the Department of Housing and Urban Development.

5 We also have George Kinsel, who is current  
6 president of the American Association of Residential  
7 Mortgage Regulators, and he's also the director of  
8 non-depository examinations of the Consumer Credit Unit  
9 with the Maryland Commissioner of Financial Regulation.  
10 Boy that's a lot to say about you, George.

11 And finally we have David Bleicken, who is  
12 Director of the Bureau of Licensing, Investigation and  
13 Consumer Services at the Pennsylvania Department of  
14 Banking.

15 I appreciate the participation of all our  
16 panelists, but I particularly want to thank David, who  
17 we asked only Monday to participate when I learned that  
18 he would be speaking on this topic at another conference  
19 in town yesterday, and I cajoled him into staying and  
20 providing some information about his perspective from  
21 the Pennsylvania perspective here today. For that  
22 reason, he's not listed on the official printed agenda,  
23 but his bio should be in your packet.

24 So let's get started, first with Sandy  
25 Braunstein. Sandy?

1 MS. BRAUNSTEIN: Thank you, Peggy. I'm glad to  
2 be here today, and one of the things that Peggy had  
3 asked me to do in order to set up our discussion of  
4 where we're going with these nontraditional products, is  
5 first it would be helpful to look at where we are now in  
6 terms of what is required with disclosures for consumers  
7 and what kinds of information are consumers actually  
8 required to get, so that's what I'm going to do first is  
9 talk a little bit about our required disclosures under  
10 the current TILA provisions. Of course technical  
11 glitches. Okay. Great.

12 It's hard to do this without some slides to  
13 illustrate, and I understand I think that Pat McCoy  
14 showed some disclosures this morning, so hopefully this  
15 won't be too redundant.

16 One of the things that I want to focus on are  
17 the disclosures that are given with these loans, and  
18 especially the sample I'm going to give actually is an  
19 ARM because the vast majority of those loans, even the  
20 interest-only loans, are also ARMs.

21 Truth In Lending is a little context for this.  
22 One of the things we need to remember is that when Truth  
23 In Lending originally came about, both the statute and  
24 when we originally wrote Truth In Lending regulations,  
25 adjustable rate mortgages were a very, very tiny percent







1 going to give you some ideas of the kinds of information  
2 that is included in these disclosures.

3 And this is a real life disclosure. We  
4 certainly edited out anything that would cause privacy  
5 concerns, as well as what company it came from, but this  
6 is a real life disclosure. I also need to make the  
7 caveat that I am not putting this forward as a model  
8 disclosure. This is not a best practice or model. It's  
9 just a real life disclosure. It also is from last year,  
10 from 2005, so it may be a bit dated in some ways.

11 Of course there's a lot of detail on this slide,  
12 but I just want to direct your attention to the heading  
13 and basically the disclosure that I have up on the  
14 screen, the basic purpose of it is to tell you how your  
15 interest rate and payment are determined, and there is a  
16 lot of information there that talks about, here's the  
17 index we use to determine your rate, asks us for the  
18 current interest rate margin, and basically it does tell  
19 you that your rate can never go higher than 9.95  
20 percent.

21 Now, this raises a lot of issues looking at the  
22 first page of this disclosure, and some of the issues  
23 that this raises for us is whether or not consumers,  
24 one, can read and understand this information or if they  
25 find it useful. Possibly -- you have to keep in mind



1 that this is given, but also at the same time there is a  
2 lot of discussion that goes on between the borrower and  
3 the lending officer, so this is not just given in a  
4 vacuum. They're also getting the CHARM booklet.

5           They're getting other information besides this,  
6 so you don't know how much more they're being given by  
7 the lenders that might help explain some of this, and so  
8 we need to get answers to some of these questions. Is  
9 this something they can use to shop further, to look at

1           It talks about what happens if you only make the  
2           minimum payment and that your loan amount could  
3           potentially increase because of negative am, and that  
4           also your payment could jump up sooner than the  
5           five-year because of negative am if it reaches a certain  
6           limit, that you can't exceed your loan -- unpaid  
7           principal can never exceed 115 percent of the original  
8           amount borrowed or your payment could jump up, so it  
9           does give you that information.

10           Okay. This also raises significant issues. For  
11           instance, the regulation currently contains model  
12           language, things like negative amortization, and one of  
13           the things we need to test with consumers is do they  
14           understand what that means really because it's not just  
15           using the words but really to understand the concept and  
16           to understand that that's reducing wealth and reducing  
17           equity.

18           Also the regulation currently does not really  
19           contain any format requirements other than the  
20           information be conspicuous, and you'll see that the  
21           part -- I think you can see that on the slide at the  
22           bottom of that really big box, that last sentence is  
23           bolded a bit, and that's the sentence that refers to the  
24           negative amortization, and that was this lender's I  
25           think attempt to make that more conspicuous and bring it

1 to the attention of the borrower, but we need to  
2 consider whether we should impose or at least model some  
3 additional format requirements that highlight the key  
4 risks of these products and to help make comparison  
5 shopping easier.

6 Page 3, and this is something that -- I guess  
7 this might be the thing that Pat showed. Okay. This  
8 page, which is the end of the program description I'm  
9 going to show you, the consumer gets to some more  
10 concrete information about payment risk, and on this one  
11 you're going to see the maximum interest rates and the  
12 corresponding initial and maximum payments, but this is  
13 the one that's given for the hypothetical \$10,000 loan  
14 because that's what's currently required, and there is  
15 an instruction with the note at the bottom that tells  
16 consumers how to figure out their loan amount, and they  
17 give a hypothetical example of a \$60,000 loan, which

1 know in my mind and I think for everybody, is: Do  
2 consumers do the math and can they do the math in some  
3 cases and do they understand that, that you have a  
4 \$10,000 example here, and they have to somehow translate  
5 that into a much larger mortgage? So again these are  
6 issues that we are looking at, and we will be looking at  
7 when we do our rulemaking.

8           So then let's say they go ahead and get the ARM.  
9 This is the last page. Now, this is the time where they  
10 will get a transaction specific disclosure. You'll get  
11 estimates three days after applying if you're buying or  
12 building a house that are based on actual, or if you're  
13 not, it could be that you get this at the closing table.

14           And this one actually tells you the amount of  
15 the loan, the amount being financed, the APR, the amount  
16 of your finance charge, and this does list -- now, this  
17 is a very abbreviated disclosure on this, but this  
18 actually lists the payments, and this is in a place  
19 where you can actually see specific information about  
20 payment shock, if you look in the chart at the first  
21 five years where the bottom of the fifth year is a  
22 \$1,087, you will see that the next one bumps up to  
23 \$1,800, which is a huge increase, and that reflects the  
24 minimum payment and negative amortization that would  
25 kick in the next sixth year.

1           And the other thing about these transaction  
2           specifics is that these do keep the interest rate  
3           constant. They assume that the interest rates are not  
4           going up, so it's not a worst case scenario. It's just  
5           an actual based on the interest rate on the day the  
6           person closes.

7           So this raises obvious questions. Should  
8           consumers receive, at least on request, information  
9           about APRs and payments on your loans under different  
10          interest rate scenarios? Should the key risks of the  
11          ARM be once again highlighted on this disclosure? The  
12          consumer is reminded, you will see a check box at the  
13          very bottom that this loan has a variable rate feature,  
14          which should tell them that the interest rate can kick  
15          up, but is it realistic to think they're going to relate  
16          that back to a separate set of disclosures that they may  
17          have gotten a month or two earlier, especially if at  
18          that point you get this at the settlement table and  
19          you're trying to move and you sold your own house and  
20          you're moving into a new house? So those again are  
21          things that we're going to have to look at, and that's  
22          it.

23                 MS. TWOHIG: Thank you, Sandy, but don't sit  
24                 down yet. Sandy has one more topic I want her to  
25                 comment on, but I really appreciate that very helpful

1 explanation of current disclosure requirements. I know  
2 it wasn't a fun assignment, Sandy, but I think it's  
3 critical information for us all to understand what the  
4 baseline is, where are we now in terms of disclosure  
5 requirements before we can move on to have a full  
6 discussion of where do we go from here.

7 But before Sandy sits down, I want her to help  
8 start the discussion on the next topic that we are going  
9 to turn to, and that's the proposed Interagency Guidance  
10 on nontraditional mortgage products, and Sandy is going  
11 to start off the discussion by explaining why the  
12 agencies proposed the guidance on this topic.

13 MS. BRAUNSTEIN: Thanks, Peggy. This will be  
14 quick. I just wanted to make a couple comments, because  
15 one of the things that we'll talk about more is people  
16 ask, Why are you doing this guidance, why don't you just  
17 fix Reg Z? So why are we -- why are we doing guidance?

18 Basically we felt that there was a need for  
19 guidance obviously because we needed to address more  
20 than what's currently in the Reg Z disclosures. We  
21 wanted to cover not just the written communications that  
22 are given, but the guidance actually talks about even  
23 the oral communications and the explanations that are  
24 given to borrowers. We also wanted to focus on the  
25 heightened risks that are connected with these

1 nontraditional mortgage products, the payment shock, the  
2 negative amortization and other kinds of risks to  
3 consumers.

4 A few points about the connection. You know,  
5 guidance, one of the things guidance allows us to do is  
6 allows to us respond much more quickly to the  
7 marketplace than does an amendment to a regulation. We  
8 can put guidance out within a few months or maybe not a  
9 few, maybe a little more than a few, but it's certainly  
10 a much faster process.

11 When we do a rulemaking, as I'm sure you all  
12 probably know from seeing it, is we've got to do an AMPR  
13 usually, especially if it's a major rulemaking, and get  
14 a lot of input into what issues we should be doing.  
15 Then if we're lucky, we can go from there to a proposed  
16 rule, and then we have a comment period, and then we  
17 have to go through the comments, and then if we're lucky  
18 and can get to a final rule from there, sometimes we  
19 have to have multiple comment periods, depending on what  
20 direction we take, and then there needs to be a very  
21 long lead time to make it effective because the  
22 industry, rightly so, needs time to adjust their systems  
23 and get new computers and forms up and running, so with  
24 a rulemaking, you're talking about I would say at least  
25 a three-year lead time as opposed to guidance that can

1       come out much more quickly.

2               The other thing is that with guidance, it allows  
3       us more flexibility, and we feel that flexibility  
4       benefits lenders as well as consumers. Guidance tends  
5       not to be as prescriptive as a regulation. It sets  
6       general expectations, and in many ways leaves it to the  
7       private sector to try to figure out how to meet these  
8       expectations, and this can be helpful to us because it  
9       also is an experimentation in some sense.

10              You're piloting some things that may later show  
11       up in regulation, but we can work through things in  
12       guidance, and guidance can be amended much more easily  
13       than a regulation, and actually having guidance first  
14       can ultimately result in better regulations in the  
15       future.

16              MS. TWOHIG: Thank you Sandy. Thank you again  
17       actually for starting off the discussion for this panel.

18              (Applause.)

19              MS. TWOHIG: Next we will hear from April  
20       Breslaw, who is going to describe the consumer  
21       protection issues that are addressed in the proposed  
22       interagency guidelines.

23              MS. BRESLAW: See I have to start wherever I  
24       speak by pulling the microphone down, shorter than  
25       everyone else.



1           Fundamentally, our consumer protection concern  
2 when we were developing the guidance was the marketing,  
3 and it's easy to sort of slip into discussions about  
4 disclosures, and obviously that's an important aspect of  
5 how I guess we all do business, but in this context, the  
6 marketing has really been the big issue.

7           We've heard some things this morning, and I  
8 think we had already realized that there is a tendency,  
9 at least in some cases, to focus on the short-term  
10 benefits of these products and downplay the long-term  
11 risks, and when you have that temptation out there, you  
12 really do begin to wonder if consumers understand what  
13 they're getting into, and of course things like payment  
14 shock and negative amortization are complicated concepts  
15 so that makes the risk of misunderstanding I think even  
16 greater.

17           On the consumer side, what the guidance does is  
18 really two things. We have a section in there where we  
19 summarize some of the laws that apply in this context.  
20 One of them is certainly TILA and implementing  
21 regulation, Reg Z. RESPA is another one, but an equally  
22 important one from our perspective is the Federal Trade  
23 Commission Act, and as I'm sure many of you are aware,

1 respect to the institutions under our supervision, so  
2 when we get into questions about whether advertisements  
3 are misleading or deceptive, that's the tool we would  
4 use to evaluate a situation. We do note in the guidance  
5 that state law may be applicable, and we are certainly  
6 aware of that and are looking forward to hearing about  
7 some of those state laws a little bit later on in the  
8 presentation.

9 We also made a point of noting for the readers  
10 that the sale or the securitization of these products  
11 will probably not take them off the hook for bad  
12 marketing; in other words, if your marketing is found to  
13 be deceptive, the fact that you sell that loan to  
14 somebody else is not going to alleviate your liability.

15 Now, the second thing that the guidance did,  
16 just summarizing the laws and rules that apply, is we  
17 included a list of recommended practices, and I do have  
18 to emphasize these are recommendations. These are not  
19 rules, but we hope that people will take them seriously  
20 because we do believe that if you follow these  
21 practices, your risk of violating the various laws that  
22 are in place will go way down.

23 With respect to that, our concern with how  
24 consumers get information is really paramount. I think  
25 somebody said in one of the earlier panels, and we

1 absolutely agree with this, that consumers should  
2 receive information at decision points, at the point  
3 when they're shopping for loans, at the point later on  
4 where they're making decisions each month about how much  
5 to pay, so that's really a critical aspect of the  
6 guidance, which is that we encourage lenders to provide  
7 information at those points in time.

8           Of course, we want people to provide clear  
9 information and that's formatted in a way that people  
10 can notice it and will understand it, won't overlook it;  
11 to the extent possible, to try to use plain language.  
12 There is really a tendency to drift into pretty  
13 technical terminology, and it goes over a lot of  
14 people's heads, and just the sheer volume of it makes it  
15 difficult to absorb.

16           With respect to advertising, we really did  
17 emphasize, and we very much endorse the idea of  
18 providing balanced information, not just focusing on the  
19 short-term benefits, but also giving consumers a fair  
20 understanding of what that long-term risk will be, and  
21 that would certainly be with respect to the verbal  
22 communications as well as the written communications.

23           With respect to payment shock, we think that  
24 institutions should disclose potential increases in  
25 payment obligations in both dollar and percentage

1 amounts. They should describe when structural changes

1 products.

2           With respect to the monthly payments,  
3 particularly with the option ARM products, we really  
4 want to encourage people to or encourage institutions to  
5 encourage consumers to make responsible payment choices.  
6 That includes information about the consequences of  
7 selecting a particular payment each month, and I do want  
8 to say that we have found banks that are already doing  
9 this, so we know it can be done, and we think it's not  
10 really too burdensome to do that.

11           We really also would encourage institutions not  
12 to steer customers toward that minimum payment every  
13 month, and I guess last we have a section in the  
14 guidance that talks about control systems. From the  
15 institution's perspective, this is what it's all about.  
16 You have to train your staff to make sure they  
17 understand what these products are and they can explain  
18 them appropriately.

19           You have to address consumer complaints when  
20 they come in, and lastly, you have to set up your  
21 compensation program in a way that doesn't provide any  
22 kind of inappropriate incentive to cause originators to  
23 direct borrowers to certain kinds of products.

24           So that's the consumer side I guess in a  
25 nutshell, and with that I guess, I'll let Peggy do the

1 next section.

2 MS. TWOHIG: Thank you, April.

3 (Applause.)

4 MS. TWOHIG: Now, Mike Bylsma will discuss some  
5 of the other aspects of the proposed Interagency  
6 Guidance.

7 MR. BYLSMA: The other aspects sounds ominous.

8 MS. TWOHIG: You know what I mean, Mike.

9 MR. BYLSMA: All the hidden agenda items. We've  
10 been hearing a lot about the group of nontraditional  
11 mortgage products and about the intense competition for  
12 borrowers in the market today, and as April mentioned,  
13 the federal banking agencies are concerned, that  
14 aggressive marketing of these products as payment  
15 affordability products may be misleading consumers by  
16 not alerting them to the risk of payment shock and  
17 negative amortization.

18 Well, these market pressures also are affecting  
19 underwriting practices, as you've heard earlier today.  
20 Nontraditional mortgages used to be made available  
21 primarily to high income, high asset customers, but  
22 given the competition in the market and the demand for  
23 affordability products, lenders have loosened their  
24 underwriting standards to qualify a broader range of  
25 consumers than ever before, even sub-prime borrowers to

1 enable them to qualify for loans that they could not  
2 otherwise qualify for using traditional loan terms and  
3 traditional underwriting standards.

4 And so the federal banking agencies have become  
5 concerned with some of these changes as well, and what I  
6 would like to do is to begin by describing the types of  
7 underwriting practices we've seen that are causing this  
8 concern.

9 For example, some lenders are underwriting  
10 interest-only loans based on the borrower's ability to  
11 repay the interest-only payment during the initial  
12 period when principal payments are deferred.

13 Our concern arises because they're not taking  
14 into account the borrower's ability to handle the  
15 interest and principal payments that will be required  
16 when the interest-only period ends. Some lenders are  
17 qualifying borrowers for payment option ARMs based on  
18 the borrower's ability to repay only the minimum payment  
19 that's required, and the problem here is that the  
20 minimum payment in a payment option ARM usually isn't  
21 enough to cover the full amount of interest that's due  
22 every month, much less any principal.

23 So the borrower that makes minimum payments will  
24 face negative amortization, and with negative  
25 amortization you not only don't make any progress in





1 lenders, but in my opinion there shouldn't be any  
2 disagreement about the fact that changing economic  
3 conditions and a housing price decline will put more  
4 stress on portfolios of these loans and more stress on  
5 borrowers, and that's why the proposed Interagency  
6 Guidance that April mentioned devotes a significant  
7 amount of attention to underwriting, the need for banks  
8 to follow prudent underwriting procedures in connection  
9 with nontraditional mortgages.

10           It also addresses other issues like the need for  
1 will put more

1 the borrower when loan underwriting is so defective that  
2 the borrower's only options are to refinance the loan or  
3 sell his home because he can't make the payments when  
4 the loan starts to amortize, so to address these  
5 concerns, the proposed guidance says that a bank should  
6 evaluate a borrower's ability to repay the loan as if  
7 the borrower will be required to make fully amortizing  
8 payments at the fully indexed rate beginning with the  
9 first payment.

10 For loans that permit negative amortization, the  
11 guidance advises lenders to qualify borrowers based on  
12 their ability to repay, to make the payments that would

1     stated income procedures generally should be used only  
2     in conjunction with risk mitigating factors like a lower  
3     loan to value ratio.

4             Finally, we touched on sub-prime lending in this  
5     guidance, and Stella talked about this earlier. We



1 monitoring transactions with thousands and thousands of  
2 brokers, particularly when a bank buys loans in bulk or  
3 a portfolio in a wholesale transaction.

4 We also got a number of comments about the  
5 underwriting guidelines, and lenders were particularly  
6 opposed to our recommendations about payment option  
7 ARMs, that they need to be underwritten assuming that  
8 the borrower makes only the minimum payment and that the  
9 balance would be increased due to negative amortization.

10 And we got a lot of comments about the scope of  
11 the guidance. Again lenders thought -- they urged us  
12 not to cast our net so widely, and they encouraged us to  
13 exclude certain loan types from the final guidance, like  
14 home equity loans and loans without negative  
15 amortization features, and there was a theme among some  
16 of the commenters that a recommendation to exclude  
17 fixed-rate, interest-only loans with long initial  
18 periods like ten years, this is becoming a popular  
19 product now, because of statistics that suggests that  
20 borrowers typically or at least on average pay off their  
21 loans in seven years, and so a borrower in this type of  
22 loan wouldn't face payment shock.

23 Some industry comment letters urged us to either  
24 delete entirely or substantially pare down the consumer  
25 protection section of the guidance. Most of these

1 commenters suggested that if new disclosures are needed,  
2 they should be required through changes to Regulation Z  
3 because those rules apply to all lenders, not just the  
4 lenders who are subject to oversight by the federal  
5 banking agencies.

6 Now, consumer organizations, on the other hand,  
7 were much more supportive of the guidance generally,  
8 including the recommendations for enhanced disclosures.  
9 They argued that we needed to adopt more hard and fast  
10 rules for these products.

11 Finally, a big picture concern that I wanted to  
12 tee up, now that we have two representatives of state  
13 agencies on our panel. We heard this concern repeated  
14 in the comment letters by the industry and by consumer  
15 organizations, that the guidance does not apply as  
16 proposed to lenders and loan brokers that are not  
17 subject to federal regulatory oversight.

18 Their concern about this unlevel regulatory  
19 playing field is that lenders, some lenders would be  
20 held to much lower standards than others, and this would  
21 give them an unfair competitive advantage, and it would  
22 also put consumers of their services at risk, so we were  
23 very pleased to receive comment letters from the  
24 Conference of State Bank Supervisors and from the State  
25 Financial Regulators Round Table.

1           Among other things, they said that they were  
2 committed to working with state regulatory agencies to  
3 distribute the final guidance issued by the federal  
4 banking agencies to state regulated non-bank lenders and  
5 brokers. This should be very helpful in addressing some  
6 of the comments I just described about the benefits of  
7 uniform standards for all lenders who offer  
8 nontraditional mortgages, not just for federally  
9 regulated lenders.

10           Next steps: We've reviewed all the comment  
11 letters, and the interagency working group has begun to  
12 discuss changes, if any, that we might recommend our  
13 agencies make before we finally propose this guidance.  
14 My guess is that the approval process will take the next  
15 few weeks. Thank you.

16           (Applause.)

17           MS. TWOHIG: Thank you, Mike. The questions are  
18 pouring in, and so I'm going to take a few on the  
19 subjects we've discussed so far before we move onto the  
20 rest of the panel. Unfortunately, we can't go through  
21 them all or we would be here probably the rest of the  
22 day talking about these questions that have come in.

23           So let me start out by asking one that was asked  
24 this morning, that is a little off topic, but I think it  
25 reveals just how important it is to lay the ground work

1 for everyone to understand how the marketplace works.

2 One question that the first panel got I believe  
3 that no one wanted to take a crack at, so I'm going to  
4 ask you guys to try to answer, is: Are these new loan  
5 products offered by lenders approved by anyone? In  
6 other words, does anyone have to approve loan products  
7 before they're offered by lenders?

8 MS. BRAUNSTEIN: That's actually pretty easy.  
9 No, not unless -- unless they're doing something that is  
10 illegal, which then you would go through enforcement,  
11 but, no. That's how the market develops as people





1 guidance interrelating to that?

2 MS. BRESLAW: I think as I said when I started,  
3 we've been focused fairly heavy on the marketing. It  
4 gets to a question of timing. It gets to a question of  
5 when consumers get information, so the disclosures are  
6 there at the points in time that Sandy mentioned, but I  
7 believe the first one is the point in time when a  
8 consumer turns in an application.

9 So that's at a point in time when the consumer  
10 has already been looking for a house, probably has  
11 already decided on the house they want to buy, and is at  
12 the point of putting in an application for credit, so we  
13 all know that's several steps down the road, so I think  
14 kind of the big focus from our perspective is getting  
15 information to consumers earlier, so that they can take  
16 that into consideration when they're deciding, can they  
17 afford that 170,000 or can they afford that 250,000  
18 house.

19 MR. BYLSMA: I'll just add on the other end, the  
20 recommendations on payment option ARMs and monthly  
21 statements is filling in sort of another regulatory gap.  
22 There are no requirements, other than when an adjustable  
23 rate mortgage changes for an annual disclosure for --  
24 affecting monthly statements, closed-end mortgages, and  
25 so we feel like that's filling in another gap both at

1 the beginning and at the end of the process.

2 MS. TWOHIG: Thanks. A question that's perhaps  
3 more related to the underwriting side of the guidance:  
4 If a lender is required to qualify a potential borrower  
5 seeking an interest-only loan product on the basis of  
6 the borrower's ability to make future payments of  
7 principal and interest, wouldn't that effectively  
8 eliminate the availability of these products for  
9 borrowers who intend to sell before the end of this  
10 period?

11 MR. BYLSMA: Well, that assumes that these  
12 borrowers are being underwritten, not -- without being  
13 able to make the principal payments. There are plenty  
14 of borrowers. The representative from B.F. Saul  
15 discussed there are plenty of borrowers that can be  
16 qualified for both principal and interest payments, and  
17 it may, as Stella Adams said, affect the total house you  
18 can buy, but I don't think so. I think that there can  
19 be plenty of borrowers who can be qualified who can  
20 still move out before the principal amortization begins.

21 MS. BRESLAW: The one thing that led up to that  
22 is obviously if you qualify people based only on their  
23 ability to make those interest payments, then what  
24 you've done is you've required them to sell the house or  
25 refinance at the end of whatever the period is when the

1 interest-only payments stop, so you are probably boxing  
2 people in more by underwriting that way.

3 MS. TWOHIG: Thank you, and one more question,  
4 and then I think we're going to have to move on. Anyone  
5 want to address, once it is finalized, how the guidance  
6 fits into the overall picture of bank supervision?

7 MS. BRESLAW: It is guidance, and as I  
8 mentioned, we did point leaders towards the laws and  
9 rules that are enforceable themselves. It's really not  
10 a question of us enforcing the guidance per se, but as I  
11 mentioned, we have recommended practices, and we do  
12 believe that if institutions follow those practices,  
13 that their risk of violating the laws and rules that do  
14 exist will go way down, so in that sense it's intended  
15 to be a way for institutions to reduce their risk of  
16 violating the laws that are enforceable.

17 MR. BYLSMA: Let me just add to that. At the  
18 same time we do hope to effect changes in the market  
19 with this guidance, and that's why we issued it, and  
20 it's our supervisory recommendation essentially to the  
21 institutions that we examine, so we would hope to see --  
22 there are certain aspects of the guidance that  
23 criticizes practices. An examiner would criticize that  
24 practice in the course of their supervision. The  
25 examiner would not say, You have violated the guidance

1 by not adopting this one thing, but we would hope that  
2 there would be general conformity with the broad outline  
3 in the guidelines.

4 MS. TWOHIG: Thank you very much. Now we're  
5 going to try to pay attention to this end of the table  
6 that has been neglected. We're going to turn to the  
7 role of other federal and state regulators in this  
8 mortgage market, and in particular to -- I'm going to  
9 say a few words about the role of the Federal Trade  
10 Commission, and we're also going to talk about HUD and  
11 then generally about the roles of states in general, and  
12 perhaps Maryland and Pennsylvania in particular.

13 I just thought it's important, even though I'm  
14 moderator, to explain to everyone and say a few words  
15 about the Federal Trade Commission and our role. One  
16 role of course is illustrated by this workshop that  
17 we're having here today of gathering information about

1 and whether improved disclosures might enhance consumer  
2 understanding, mortgage shopping and the ability to  
3 avoid deception, so that's one activity that is ongoing  
4 right now by our economists.

5 The rest of our mission includes consumer and  
6 business education, a very, very important part of our  
7 function, and of course law enforcement. Our law  
8 enforcement role centers on enforcing the Federal Trade  
9 Commission Act which has already been mentioned by  
10 April, that the bank regulatory agencies also enforce,  
11 and that prohibits unfair and deceptive acts and  
12 practices.

13 And indeed we have enforced the FTC Act in one  
14 case that did involve a nontraditional mortgage product.  
15 The FTC has sued a California mortgage broker called  
16 Chase Financial Funding, no relation to The Chase, in  
17 alleging deceptive marketing of the type of a payment  
18 option loan, and just to give you a flavor of that case,  
19 in that case the broker sent out spam and direct mail  
20 pieces that advertised -- there were variations on the  
21 theme, but they advertised, for example, a 3.5 percent  
22 fixed payment for 30 years.

23 Well, I think you all have guessed the punch  
24 line. These marketing materials we allege were  
25 deceptive because they were really offering a type of

1 payment option ARM. The interest rate was not 3.5  
2 percent. Even in the first year it was higher. That  
3 was what they called a payment rate. You paid as if you  
4 had 3.5 percent, but the interest rate was actually  
5 higher, and interest accrued at a higher rate, and  
6 therefore it was a negative amortization if you paid at  
7 that rate, and nothing at all about the loan was fixed,  
8 even at that payment rate would increase after the first  
9 year.

10 There was also another aspect of the case that  
11 the FTC is challenging is deceptive, the case is still  
12 in litigation, claims made about annual savings that the  
13 consumer would make. The marketing materials compared  
14 basically apples and oranges, a current amortizing loan  
15 to basically the negative option, minimum negative  
16 amortization rate.

17 So I just wanted to mention that about the  
18 Federal Trade Commission, and we're going to next turn  
19 to our state regulators who are here today, who will  
20 explain their role and their perspective on these  
21 issues. First we will here from George Kinsel from  
22 Maryland.

23 MR. KINSEL: Thank you. The State regulatory  
24 system is a hodgepodge is the best way to describe it.  
25 We have 48 mortgage regulators, 50 State Bank





1 pulled this information off their web site, and it's  
2 only part of the information that's available on their  
3 web site. They have five different ARM products and  
4 four different payment options, and it's ten pages that  
5 the consumer has to read through, but the thing that  
6 caught my -- there were two things that caught my eye:  
7 The features and benefit, the real upside and downside,  
8 and then in real bold print, the truth.

9 I saw the upside and the features and benefits.  
10 I didn't see any downside. Our experience with brokers  
11 is they're pushing these loans with the thought to  
12 consumers that they're going to save money on the  
13 mortgage, and that's the case here.

14 The other thing that they're pushing, and this  
15 company is no exception, is easy qualifications. Many  
16 of these loans allow homeowners with good credit to  
17 apply without documenting their income, assets or down  
18 payment, and then in bold print, we even have one lender  
19 that will not ask for employment information, which is  
20 perfect for self-employed people who have not been in  
21 business for two years. We call them "liar loans." You  
22 just make it up.

23 Also in the state regulatory scheme, we have the  
24 state mortgage regulator who enforces the state mortgage  
25 laws, and I can tell you that at least in our state,

1     when the laws were enacted, these loans were not  
2     contemplated.  The 30-year fixed was probably in effect  
3     at that time, and I can tell you that some of our

1           Also it's my understanding that the effort by  
2           SFRR that George mentioned is well underway, and we're  
3           still addressing the implementation, working on getting  
4           that guidance out to our folks, but we do regulate a lot  
5           of people: Mortgage bankers, mortgage brokers, who  
6           would not necessarily be subject to the proposed federal  
7           guidance, and a lot of the states, including  
8           Pennsylvania, are trying to figure out what to do about  
9           it.

10           We're talking about the various guidance, and  
11           it's very well crafted. It's an artful piece of  
12           drafting, but our Secretary of Banking, Bill Schenck, a  
13           very consumer protection oriented gentleman, is very  
14           interested in the idea that, is the loan doomed from the  
15           beginning, and with these kinds of new products, how do  
16           you know? What are the issues with all that?

17           So right now we have lots of questions, so let  
18           me sort of just give you a sense of what we're hearing  
19           both inside and outside of our agency. Are these  
20           ticking time bombs just waiting to go off?

21           Pennsylvania, in the last few years, we've been  
22           focused on mortgage foreclosures because we've had  
23           several hot spots, and we've been on the wrong side of  
24           some statistics in recent years. Is this -- our  
25           question is, will these add to that? That is, are we

1 going to see more hot spots with these kind of  
2 alternative products?

3 Can consumers really handle them? Do they know  
4 what they're getting? Is it all consumers or some and  
5 how would we know? Do disclosures work?

6 Some people say privately, Look the current  
7 system of disclosures really isn't getting the job done.  
8 We don't know. Is there a place -- this is interesting.  
9 Is there a place in today's modern world for disclosures  
10 other than paper disclosures? Is there a place for an  
11 audio or a video or a graph or something so you can type  
12 something into the computer and you get an image because  
13 people in today's world learn off of TV, and you got the  
14 Game Boy going, so we learn differently than we did  
15 maybe even 30 years ago.

16 Is there a place for that in this world? Would  
17 it be effective? Would it be binding? How would you  
18 prove it? What is the relationship? Like folks have  
19 said, mortgage brokers, we regulate them. Other state  
20 agencies regulate the appraisers. All the mortgage  
21 issues -- it's not just with the lender, of course.  
22 It's a system, and it's regulated by different pieces.  
23 We work with our AG. We work with our Department of  
24 State on the appraisers some times. We have the brokers  
25 and lenders.

1           What is everyone's responsibility in that  
2 transaction? Can one rule for a broker be applied to a  
3 lender? Don't know. Given all that, we want to be  
4 sensitive to the needs of industry. We don't want  
5 necessarily -- we're very concerned anyway about the  
6 comparative -- the competition equity problem. Can one  
7 group get away with something when another group  
8 doesn't? That's a serious concern.

9           So we have lots of questions right now, and  
10 we're working through them. We're also working on some  
11 answers in Pennsylvania. We're drafting some  
12 regulations. We're drafting what we called the  
13 guidance -- you have guidance here. In our system we  
14 call it a statement of policy that will deal with some



1 the broker responsible? Is the lender responsible?

2 We've seen tangible net benefit in North  
3 Carolina. We've seen the tangible net benefit issue  
4 that was tweaked afterwards in New Jersey, and we see in  
5 the Ameriquest settlement, it's not tangible benefit,  
6 it's net benefit, right? So the issue is: Is that  
7 where we're all going? Don't know.

8 Thank you.

9 MS. TWOHIG: Thank you, David.

10 (Applause.)

11 MS. TWOHIG: Last, but certainly not least,  
12 we'll turn back to the federal perspective and hear from  
13 Ivy Jackson to here about HUD's perspective on some of  
14 these issues.

15 MS. JACKSON: I guess the sort of good news on  
16 the HUD perspective is that we regulate everybody, so we  
17 have the state banks, the national banks, the brokers,  
18 the appraisers, everyone who is involved in these types  
19 of transactions, but I guess the bad news is that  
20 basically we see the -- or are getting the complaints at  
21 the end of the transaction when it's questionable  
22 whether it's something that we can do about -- do  
23 anything about or not.

24 Anecdotally, we have had borrowers complaining  
25 about not understanding the loan products that they were

1 getting and complaining that the disclosures would  
2 appear to be for fixed rate types of products, and then  
3 when they actually got the loan at the closing table,  
4 and of course did not read the documents at the closing  
5 table, that they ended up with a loan product that they  
6 were not expecting.

7           And that's not only for the -- I realize we're  
8 talking more about the interest-only and the option ARM  
9 loans today, but I think a lot of borrowers start out  
10 thinking that they are going to get a fixed rate loan,  
11 and somewhere along the process they get switched to an  
12 adjustable loan, and to make matters worse, oftentimes  
13 there is a prepayment penalty on these loans.

14           So after they found out what kind of loan rider  
15 they got and it's not what they thought it was, then  
16 there may be a requirement that there's a three-year  
17 prepayment penalty that kind of locks them into this  
18 product.

19           We've had, for example, an interest, a consumer  
20 was told -- she was told that the loan could have  
21 negative amortization, but she didn't really understand  
22 it, and so she started out with a 1.95 percent fixed  
23 rate ARM for a certain period of time, but in reality,  
24 it started increasing the next month, and the cap on  
25 that loan is 19 percent, so I think that borrower may be



1 in for a bit of a problem.

2 We had another one that complained that the  
3 mortgage broker misrepresented the terms of the loan,  
4 imagine that, but the consumer started out being  
5 promised a 30-year fixed rate and probably had not had  
6 the best credit because she was being promised it at 8.3  
7 percent. However, after settlement she found out that  
8 it was an interest-only type product that was adjusting,  
9 and there was a prepayment penalty. We were able to  
10 contact the lender in that example, and they did switch  
11 her back to the fixed rate loan she wanted, and she got  
12 an \$11,000 credit toward her loan.

13 We had another consumer that basically  
14 complained that -- the HUD of course requires certain  
15 disclosures, such as the good faith estimate on the HUD  
16 I, and although we don't require that the interest rate  
17 currently be -- and the loan program be on the good  
18 faith estimate, many lenders do disclose it.  
19 Unfortunately, according to some consumers, it's not  
20 disclosed or what is disclosed is not what they actually  
21 get.

22 We had a consumer that filed a complaint with  
23 us, and she thought she was starting off with a loan  
24 that her payments would be about \$1,700, and after the  
25 closing of her mortgage, she found out that after the



1 Oh, well, you know we're really not set up to service  
2 these types of loans, and after checking into it, they  
3 found out that the additional interest payment was going  
4 of course into a suspension account and sitting there,  
5 but the consumer was able to get that straightened out,  
6 but that may be something that consumers need to do is  
7 to check their -- if they get a monthly statement is to  
8 check those statements.

9 Now, under RESPA, like I said, we kind of get  
10 these complaints at the back end, and there are -- there  
11 is a little bit of consumer protection here in that the  
12 borrower can file a qualified written request with the  
13 lender, and then the lender must respond to the borrower  
14 within 20 business days that they've received the  
15 complaint and within 60 business days try to either  
16 resolve the complaint or send something back to the  
17 borrower in writing as to why the lender thinks that the  
18 borrower's complaint is not valid or what the facts of  
19 the matter are from their perspective.

20 And there are provisions under RESPA for the  
21 borrower to file an action in court and receive damages,  
22 and then of course there is a provision or a class  
23 action suit with damages. In addition, HUD has the  
24 ability for three years to go out into a case and seek  
25 an injunction.

1           We have worked with the Federal Trade Commission  
2 a year or so ago on a Fairbanks case when there was some  
3 servicing issues, but I would say this is really the  
4 only protection that RESPA offers is the possibly  
5 basically for the borrower is to take an action in  
6 court. So thank you.

7           (Applause.)

8           MS. TWOHIG: Thank you, Ivy. Unfortunately, we  
9 have many questions and not much time. We're going to  
10 go about five minutes over here to talk about some of  
11 these -- to try to address some of these questions. I'm  
12 glad Ivy was able to talk about an important issue that  
13 I think we do need to consider, what the issues are at  
14 the servicing end of these loans.

15           We've been focusing earlier this morning mostly

1     Anyone want to try that one?

2             MR. BYLSMA: Well, I think I touched on it  
3     earlier at least in the context of Truth In Lending.  
4     There aren't any requirements for monthly statements for  
5     closed end loans. There is a requirement for a  
6     statement when an adjustable rate mortgage adjusts, and  
7     then you get the new rate, the old rate, the index  
8     values, the impact, the effect of the rate change on the  
9     payment and on the balance.

10            But this is an issue that -- I guess in general  
11     also they're regulated loosely in the context of, if  
12     there is something deceptive about them under the FTC  
13     Act, that would apply to monthly statements just as it  
14     would to advertising, and that's the area where the  
15     proposed guidance is trying to get to improve practices  
16     beyond the initial shopping stage, but actually with  
17     payment options ARMs, monthly statements we're saying in  
18     the proposed guidance should not just say, Pay this  
19     amount, forcing the consumer into negative amortization.  
20     It should fully explain all the payment options,  
21     including the fully amortizing payment and what the  
22     impact of paying those would be.

23            MS. BRESLAW: The one thing I would add is,  
24     listening to Ivy's story, really the problem was not  
25     with the monthly statement. That's actually what

1 alerted the consumer to the problem. The problem was  
2 that the mortgage servicer wasn't doing its job right,  
3 and I think that gets back to the points that are made  
4 in the guidance about in our perspective monitoring  
5 third parties that our institutions are doing business  
6 with, and this is exactly what we want to avoid, and we  
7 would expect our institutions to ensure that the  
8 servicer does have the capacity to handle the type of  
9 transactions that are involved.

10 MS. JACKSON: That's correct, and in that  
11 example, it was a good thing that they were getting  
12 monthly statements, because often time you get a book of  
13 coupons and you don't get the statement until the end of  
14 the year, and then you have to go back and subtract all  
15 the principal payments to see if you came up with the  
16 right number.

17 MS. TWOHIG: And, Ivy, is that where a qualified  
18 written request to a lender would come where a borrower  
19 would ask for or challenge what they are being told?

20 MS. JACKSON: Yes, it would. And we would hope  
21 the borrower would first write the lender, and if the  
22 lender was non responsive or the borrower thinks the  
23 lender was incorrect, then we would become involved at  
24 that time.

25 MS. TWOHIG: Moving to a question that perhaps

- 1 our state representatives might want to address is:
- 2 Isn't one way to protect mortgage consumers mandatory

1 convicted and they put no, and then you pull up their  
2 sheet and it's this long (indicating.)

3 But increasingly states are moving to licensing  
4 loan originators. I don't know how many states are  
5 going to the criminal background check, but that's  
6 normally keeping them most of them out.

7 One additional comment I have for the state or  
8 federal regulator that regulates somebody doing mortgage  
9 loans is to look and see if there's another entity  
10 associated with that lender. I do know a case of a  
11 lender who operates in North Dakota, who operates an  
12 investment firm, and they're pushing these alternative  
13 mortgage products, pushing the reduced payment and then  
14 steering the company over to their investment company,  
15 and the consumers investing their money with the  
16 investment company, so it's something to look out for.

17 MS. TWOHIG: David, anything to add?

18 MR. BLEICKEN: Yes, we're trying to introduce  
19 legislation to license individual loan officers, and my  
20 other comment is Armor and CRSBS are working on a  
21 project for an initial line database, where it would be  
22 a repository for uniformed license applications, and  
23 that would also provide a platform to follow people from  
24 state to state.

25 MS. TWOHIG: How do you see that related to the



1 particular issues we've been talking about with  
2 nontraditional mortgage products?

3 MR. BLEICKEN: Well, it was my answer to your  
4 question about the licensing bit, but in terms of  
5 nontraditional mortgage products, I don't know if it has  
6 a direct applicability to -- other than the licensing  
7 requirements and following people around. I don't know  
8 if -- I think the real issue is the nontraditional  
9 products would be more along the lines of the rules you  
10 implement.

11 MS. TWOHIG: Thanks. We're running out of time  
12 here, we're already over time, but I would ask one more  
13 question for anyone: Should housing counseling or home  
14 buyer's education be a requirement for mortgage products  
15 that are ARMs, that are negative amortization or  
16 interest-only loans?

17 MS. BRAUNSTEIN: You know, that on the face of  
18 it seems like, Well, yeah, why not. We've looked at  
19 that question in regards to a lot of things, including  
20 when we were doing more HOEPA rules some years ago in  
21 terms of high cost loans, and ideally, in an ideal  
22 world, that's true.

23 The concern always is if you do mandate it, do  
24 you also mandate standards for the counseling? Because  
25 as all of us know, and especially those, I don't know if

1 Stella is still here, in the business, there's home  
2 ownership counseling, and there's home ownership  
3 counseling and there's the --

4 MS. TWOHIG: We at the Federal Trade Commission  
5 know that.

6 MS. BRAUNSTEIN: So there's the people who talk  
7 to someone on the phone for an hour and say they've been  
8 counseled and then have they really, and then there's  
9 classes that you go to for weeks at a time where you  
10 really delve into budgeting and how to handle household  
11 expenses that are much better, so how do you control for  
12 quality?

13 And then it's how do you have trusted providers  
14 because let's face it, the people who are out there  
15 trying to rip off consumers, the predatory lenders, so

1           MS. TWOHIG: Thank you, Sandy. With that, I  
2 think we're going to need to end. We've got so many  
3 questions and so many important issues to discuss, but  
4 unfortunately, there are time limits.

5           Before we break for lunch, just a couple  
6 housekeeping matters, and first thank you all to this  
7 panel for your presentations.

8           (Applause.)

9           MS. TWOHIG: We're going to have one hour and 15  
10 minutes for lunch, so someone help me do the math, how  
11 much time? So five to two, please be back, and we will  
12 get going. We have a lot of interesting information to  
13 still come this afternoon, and an interesting dialogue  
14 should occur in both panels after lunch.

15           There's a list of lunch suggestions in your  
16 folder. There's a Sun Spot Cafe that's right here in  
17 the building. There's Georgetown University cafeteria  
18 across the street. The entrance is behind the building.  
19 You have to sign in, but it's pretty quick.

20           After lunch, just remember you're going to have

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10
- 11
- 12
- 13
- 14
- 15
- 16
- 17
- 18
- 19
- 20
- 21
- 22
- 23
- 24
- 25

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

AFTERNOON SESSION

(1:55 p.m.)

PANEL 4: "Protecting Consumers: Beyond the Existing  
Regulatory Framework."

PANELISTS:

EILEEN HARRINGTON, Moderator, FTC

ALYS COHEN, Staff Attorney, National Consumer Law Center

HARRY DINHAM, President-Elect, National Association of  
Mortgage Brokers

JAMIE Z. GOODSON, Policy Counsel, Center for Responsible  
Lending

PETER MACDONALD, General Counsel and Vice President,  
LendingTree Loans

ROBERT MCKEW, General Counsel and Vice President,  
American Financial Services Association

MICHAEL WILLIAMS, Vice President for Legislative  
Affairs, The Bond Market Association

MS. HARRINGTON: Could you please find your  
seats and then sit in them. Yes, that's the next task.  
Can you find them? Can you sit down?

We need Jamie Goodson. Has anyone seen Jamie  
Goodson?

MS. COHEN: I know Jamie, and I don't see her.

MS. HARRINGTON: We are missing a panelist.

1 (Pause.) She is here.

2 Good afternoon. I hope that you all had a  
3 wonderful lunch break, and we're very much looking  
4 forward to the afternoon panels. This panel, protecting  
5 consumers beyond the existing regulatory framework, I  
6 think will be lively and interesting, and then as we  
7 always do at the Federal Trade Commission, we save the  
8 best for last, at least on the staff side, because my  
9 colleague, Lesley Fair, who is absolutely the smartest,  
10 most clever lawyer at the Federal Trade Commission, will  
11 be moderating the last panel, so I think you'll enjoy  
12 the afternoon.

13 I'm going to ask ~~the panelists to help each other~~ ~~to introduce~~ ~~themselves~~ ~~quickly~~, tell us who you are, who you work  
14 for, and ~~wwwffctfooooo1 fo~~ ~~wsmartest~~,

1           MR. MCKEW: Well, I'm Bob McKew, and I'm general  
2           counsel of the American Financial Services Association,  
3           and we represent many different types of entities,  
4           including auto finance, sales companies, credit card  
5           issuers, private label card issuers, national finance  
6           companies, mortgage companies, the whole range of  
7           consumer credit. And I grew up in a military family,  
8           but I was born in Portland, Maine.

9           MS. HARRINGTON: Thanks.

10          MR. MACDONALD: I'm Peter McDonald. I'm general  
11          counsel and vice president of LendingTree Loans, a  
12          wholly owned subsidiary of LendingTree, and I'm a  
13          Canadian. I'm from Toronto, Canada.

14          MS. HARRINGTON: Good. Jamie?

15          MS. GOODSON: I'm Jamie Goodson. I'm with the  
16          Center for Responsible Lending, where I'm a policy  
17          counsel. The Center for Responsible Lending is a  
18          nonprofit, nonpartisan research and policy organization  
19          that promotes access to fair terms of credit for low  
20          wealth families. And I am also originally from the  
21          Bronx, New York.

22          MS. HARRINGTON: Harry?

23          MR. DINHAM: I'm Harry Dinham, and I'm with the  
24          National Association of Mortgage Brokers,  
25          president-elect. We represent over 25,000 mortgage

1       brokers, and I'm originally from -- I was born in  
2       Washington, D.C., but I was raised in Mobile, Alabama.

3               MS. COHEN: I'm Alys Cohen from the National  
4       Consumer Law Center. NCLC is a support center for legal  
5       services and private attorneys representing low income  
6       consumers on financial services and other consumer  
7       credit issues. I was born at Mount Sinai Hospital in  
8       New York City.

9               MS. HARRINGTON: Okay. And I'm Eileen  
10       Harrington. I am the Deputy Director for the Bureau of  
11       Consumer Protection here at the FTC. I began my FTC  
12       career in the division that is sponsoring this workshop  
13       today, so I have a long standing interest in these





1 loans, including nontraditional mortgage products, but  
2 the consumers and the lawyers for the consumers who I  
3 hear from every week are not.

4           They don't get the information they need. They  
5 don't get the responsible underwriting they need, and  
6 what they lose is their house. They lose their home and  
7 they lose the greatest amount of wealth that they have  
8 because it's in their home. There was just an article  
9 in the Peoria Journal Star the other day about a HUD  
10 Section 8 home ownership plan where people were in a  
11 home buying program, and they ended up with  
12 interest-only loans.

13           HUD was subsidizing those mortgages. I don't  
14 think that's a huge problem at HUD, but it's an  
15 indication, among many, many indications, that these are  
16 ending up creating high risk problems for people who  
17 shouldn't end up in this market, so that's the risk.

18           The legal question is: Is the state of contract  
19 law today really what we need? I recommend to you an  
20 article by Allen White, and I'm going to look up the  
21 name so I get it right later, but it's an article about  
22 literacy and contract, and it's in the Stanford Law and  
23 Policy Review. It's called Literacy and Contracts, and  
24 it basically talks about what all of the risk legally in  
25 the context of a contract should be and whether that's

1 really a fair assumption in light of what the market  
2 looks like today.

3 I have some specific suggestions for how to  
4 change the protections, which I can talk about now or  
5 later.

6 MS. HARRINGTON: Let's get to that in a minute,  
7 but, Peter, what do you think about that? Do you think  
8 that borrowers are bearing all of the risk here?

9 MR. MACDONALD: I believe that this should be a  
10 partnership. The partnership is between industry,  
11 regulators, and the consumer. Each one of those three  
12 groups brings to the transaction an obligation to either  
13 obtain as much information as possible, provide as much  
14 information as possible, or provide as much guidance as  
15 possible, and it's only through the partnership of those  
16 three areas where the goal of a consumer obtaining the  
17 appropriate and best loan be achieved in my opinion.

18 It is incumbent upon the lender to provide  
19 information. It's incumbent upon the consumer to fully  
20 understand the information so they understand the  
21 transaction, and it's incumbent upon regulators to  
22 provide guidance in a clear and concise form so that we  
23 can all ensure we hit the mark of protecting consumers.

24 MS. HARRINGTON: What about risk?

25 MR. MACDONALD: Alys was correct, that the

1 borrower does bear the risk of foreclosure. That can't  
2 be minimized. That's a significant financial and  
3 emotional impact to a consumer. I would also suggest  
4 though that lenders definitely bear financial risk in  
5 this area and reputational risk and regulatory risk.

6 The regulators bear the risk that in the form if  
7 they are not engaged with their licensees, then they --  
8 the regulations may be misunderstood or misapplied, so  
9 each area does bear some risk. The most tangible is  
10 probably to the consumer based upon the foreclosure  
11 aspect but it is not the sole risk.

12 MS. HARRINGTON: Do you think that the current  
13 regulatory framework is adequate?

14 MR. MACDONALD: Whether it's adequate or not I  
15 don't believe is the question. Maybe I'm skirting your  
16 question, but it's that partnership that I want to come  
17 back to, and I would rather focus on ensuring the  
18 partnership between the three areas is joined and is  
19 fully engaged rather than address a new law or a change  
20 in law.

21 The lenders, in my opinion, the majority of  
22 them, the good ones, will not only comply with the  
23 spirit of the law and the written letter of the law but  
24 will try to do what's best for the consumer as well  
25 because an educated consumer is not only good business,

1 but it's good for business, and this is an area where  
2 all three groups have aligned incentives to make sure  
3 that there is consumer protection. This is not a  
4 trade-off, one for the other. All three groups can  
5 obtain what they desire out of proper regulatory

1 variance on it, so you couldn't have exceeded the 10  
2 percent variance without redisclosure.

3 I really believe that this is something we have  
4 to fix. It's been a problem for a long time, and it's  
5 something that we -- it's only addressed on a minimal  
6 side at that point, and the reason is because when we  
7 talk about the redisclosure aspect of doing this, the  
8 industry gets upset about the time loss at that point,  
9 but I think it's more important that the consumer be  
10 well informed at the time they go to the closing table  
11 so there aren't any surprises.

12 MS. HARRINGTON: And you're saying that there's  
13 some need to tighten up on the law to ensure that  
14 disclosure?

15 MR. DINHAM: What I'm saying is that there's no  
16 basis today that the good faith estimate has to look  
17 anything like the HUD I does at this point, and we need  
18 to get to a situation where the consumer knows at the  
19 time he's given his initial good faith estimate, that  
20 this is what it's going to be when he gets to the  
21 closing or it's going to be -- or either somebody is  
22 going to redisclose to him prior to the closing at that  
23 point, so it does not continue to be a surprise when he  
24 gets there.

25 MS. HARRINGTON: Bob, what do you think about

1 that, about Harry's last point?

2 MR. MCKEW: I was relating to your question.

3 MS. HARRINGTON: Well, that was related to my  
4 question, but we'll get back to the question, but what  
5 do you think about what Harry just suggested?

1           MR. DINHAM: Today they have 24 hours. They get  
2 to look at their HUD I, and they have 24 hours to make  
3 up their mind whether they're going to do that or not,  
4 and so I'm saying we need to find a way to better inform  
5 them of exactly what the costs are going to be at the  
6 time of closing.

7           MS. HARRINGTON: If I'm going out to shop in the  
8 mortgage market, that's a little far down the road it  
9 seems to me.

10           MR. DINHAM: No, because the more you do in the  
11 beginning, the closer you are to the costs, the less







1 requirements, it would be great, and it would cover the  
2 entire industry if some of those rules were promulgated  
3 as unfair and deceptive acts and practices, regulations  
4 and not just issues and guidance.

5 I think that there are some extremes that most  
6 responsible lenders would agree they don't underwrite at  
7 a 1 percent loan, at a 1 percent rate where it's going  
8 to remain for six months. Most responsible lenders  
9 don't do that, so it should be acceptable for the  
10 Federal Reserve Board, the NCUA, OTS and the FTC to get  
11 together and use that authority under the FTC Act, which  
12 has not been used in quite some time.

13 MS. HARRINGTON: Okay. I'm going to sort of  
14 drill down a little bit more on this question. Don't  
15 worry, I haven't forgotten about you, but I don't have a  
16 question for the secondary market just yet.

17 MR. WILLIAMS: I have an answer for you though.

18 MS. HARRINGTON: Would you like to say  
19 something before we drill a little bit more? Go ahead.

20 MR. WILLIAMS: Oh, sure. Getting back to your  
21 question, you can always make it better, right? You can  
22 make anything better, but to sort of sum up what I think  
23 at least I heard Jamie say is from my perspective, if  
24 there is something that you don't like, make it illegal  
25 or make it non-permissible, and you solve the problem,

1 but is that really what we want to do? Do we really

1 yes or no for starters right down the panel. You start,  
2 yes or no, is Truth In Lending adequate for these  
3 products?

4 MR. WILLIAMS: No.

5 MR. MCKEW: Yes.

6 MR. MACDONALD: Yes in law but maybe no in  
7 applicability.

8 MS. GOODSON: No.

9 MR. DINHAM: Yes.

10 MS. COHEN: No.

11 MS. HARRINGTON: Okay. There we have it. Now  
12 we're going to hear from a yes person. Why? Bob, tell  
13 me, a consumer interested in one of these products, what  
14 I'm going to learn from Regulation Z and Truth In  
15 Lending about this product, these products?

16 MR. MCKEW: I studied under the great Professor  
17 Ralph Rohner, who is probably the foremost expert in  
18 Truth In Lending up at Catholic University Law School,  
19 and we spent a lot of time talking about, Has anybody  
20 come up with a better way? It's almost like talking  
21 about democracy.

22 MS. HARRINGTON: But he had been retired by the



1 a ringing endorsement.

2 MR. MCKEW: I'm not saying it's perfect. As a  
3 matter of fact, there is a lot of over-disclosure.  
4 There's a lot of things that we thought at another time  
5 -- a lot of important information in mortgage packages  
6 now probably is in there, and if the consumer could find  
7 it, it would be great. It would be great. But the  
8 problem is there's just so much of it, and that's  
9 another issue. That's another issue.

10 MS. HARRINGTON: Let's see if we can get -- if  
11 there's anyone on the panel who would like to deliver a  
12 more enthusiastic endorsement for the consumer benefit  
13 that derives from the existing Truth In Lending regime  
14 on these products? Anyone with a more enthusiastic  
15 endorsement? Anyone in the audience who would like to  
16 stand up and tell us why the current regulatory  
17 environment is providing -- okay.

18 Well, let's go back to the no's for a moment.  
19 Who wants to take a crack at no? Why am I not  
20 surprised? Alys?

21 MS. COHEN: One thing I want to say upfront is  
22 this doesn't mean we want to get rid of Truth In  
23 Lending. Truth In Lending has really important  
24 remedies. It has some really important disclosures. We  
25 think those are essential, so the question isn't:





1 behind TILA was to be able to shop with that  
2 information. That isn't happening.

3 The CHARM booklet, I'm glad that people wrote it  
4 and that people like it. I have legal services lawyers  
5 who tell me that none of their clients get them, and  
6 those are clients who should be getting them. If you  
7 don't have a private cause of action to enforce your  
8 right, often it's not happening. People don't get GFEs.  
9 There's no private cause of action under RESPA for that.  
10 There is a private cause of action for qualified written  
11 requests, and so people use those, so private causes of  
12 action matter.

13 Under TILA, people need the maximum payment, and  
14 that's not the maximum payment based on the interest  
15 today. It's the maximum payment including neg am, and  
16 including the fact that LIBOR has risen every month for  
17 the last two years, and it's going to continue to do  
18 that. People need that information. They might need  
19 other information to help them balance that, but they  
20 need that information.

21 The analysis of repayment ability that we heard  
22 this morning from our friend Bob at Chevy Chase was very  
23 helpful, but it's still true that residual income is  
24 not considered in repayment ability, and if you have a  
25 low income, median African American is \$42,000, it

1 doesn't matter if your ratios are right if you don't  
2 have money to pay the bills, and so residual income  
3 needs to be part of that repayment ability.

4 Purchase money loans: All of the hypos and the  
5 FTC hypos for the mortgage workshop today are purchase  
6 money loans. Huge abuses are in the refinance market,  
7 but if you've got a purchase money loan, you have no  
8 rescision under the Truth In Lending Act so people need  
9 that.

10 People need a private cause of action around the  
11 country for unfair deceptive acts or practices. You  
12 have one in Maryland. In Virginia the UDAP law is  
13 useless in mortgage cases so people need that, and there  
14 need to be duties of good faith and fair dealing that  
15 are clear for appraisals, for servicing, for repayment  
16 ability. A lot of these I-O loans in the sub-prime  
17 market are associated with over-appraisals with false  
18 income on the applications and a lot of other problems.

19 Those abuses need to be addressed together and  
20 clearly.

21 MS. HARRINGTON: Those are fairly comprehensive  
22 calls for additional law and regulation. Michael?

23 MR. WILLIAMS: Well, three things I want to  
24 address. The private right of action and rescision, I  
25 just don't see. That's an after the effect, right? How

1 do you -- why not slow down and get back to your  
2 question? I know my answer was a no, but that is on the  
3 practical implications of it, and the reason why I said  
4 no is because I wanted to be a little bit controversial.  
5 Coming from the industry, everyone is looking at me  
6 like, Whoa, why did you say that? Because all of those  
7 things that Alys just ticked off, they would be  
8 fantastic --

9 MS. COHEN: Great. We'll sign up at our next  
10 conference.

11 MR. WILLIAMS: -- if in fact the consumer gave a  
12 whit about any of it before the fact. When they were  
13 going to look at that loan, I'm not generalizing here,  
14 this is just my opinion: How much am I going to pay,  
15 how long am I going to pay it for, and can I afford this  
16 on a monthly basis?

17 They're not talking about rescision. They're not  
18 thinking about private rights of action. That's for  
19 later when they go to see Alys, and they're not thinking  
20 about the fraud and the over-appraisal, and they should,  
21 and that's exactly what that is. That is fraud, and you  
22 can call it whatever you want to, but it is fraud, and  
23 if they're going in and they're falsifying income, that  
24 is also fraud, and that should be prosecuted under all  
25 of the various state fraud statutes.

1           Make a law that says you can't do that, but at  
2           the end of the day, we're talking about the  
3           effectiveness of TILA and whether or not consumers have  
4           the information they need. I think the information that  
5           consumers need is a full understanding of the mortgage  
6           process, not just how do I get my loan and what -- it  
7           should be what happens to my loan afterwards, where are  
8           the pitfalls? Who is going to call me? What's a  
9           servicer? You're finding that out when you're facing a  
10          balloon payment, which in some states are illegal, but  
11          that's the kind of thing that would be helpful.

12           MS. HARRINGTON: Well, and is that a matter for  
13          law or is that a matter for the kind of partnership that  
14          Peter is talking about?

15           MR. WILLIAMS: I think the partnership is  
16          important. It's the partnership between all the  
17          industry participants, but also on the state and federal  
18          government level, because you can't keep people, and we  
19          go through this with a number of different laws, the  
20          speed limit, the drinking age, all kinds of things. You  
21          can't keep people from doing things that are not  
22          necessarily good for them.

23           What you can do is inform them of the  
24          consequences of those items. Now, that in and of  
25          itself, not enough, all right? If there are specific

1 problems out there, over-appraisals or anything like  
2 that, fraudulent activity taking place, or if there's a  
3 loan feature that someone may take question with because  
4 it opens the door for fraud, then that needs to be  
5 addressed very specifically, right, on the federal level  
6 or state level. We prefer federal.

7           However, it has to be that kind of partnership,  
8 so it's not one or the other. It's all taken as a  
9 whole.

10           MS. HARRINGTON: Okay. Bob, did you want to say  
11 something?

12           MR. MCKEW: I did, and mainly I think this  
13 follows on what Michael was saying, and to recognize  
14 that government regulation isn't the be all and end all,  
15 and I was hoping to get in early. Kind of maybe this  
16 statement can be challenged, but I think as we sit here  
17 today, that the mortgage industry, the mortgage lending  
18 markets are probably in the best shape insofar as the  
19 government regulators, the industry participants,  
20 including the secondary market, and consumers basically  
21 all have their interests in alignment.

22           Nobody wants a loan to fail, not even one, but  
23 we do have a -- we do have an environment, and I was  
24 happy to hear some of the panels this morning where  
25 there was talk on this Interagency Guidance, that one of

1 the motivations for that guidance was not to go right  
2 out with that rulemaking but was to provide flexibility  
3 and to actually use it kind of as an experimentation to  
4 see what was going to work, and I think that's a good  
5 way to handle it.

6 We have a good situation. We tend to focus on  
7 things that don't work right, but we should be looking  
8 at what is working right, and there is a lot of things  
9 that are working right, and a lot of it has to go to  
10 what Michael was talking about in the industry that he  
11 comes from.

12 The emergence of the secondary market over the  
13 past 10, 15, 20 years is actually probably a more real  
14 time implicit regulator of the industry as far as making  
15 sure that the right things are happening. If loans are  
16 being designed that are going to have -- that are  
17 inevitably going to fail or obviously are not going to  
18 have a good survivability rate, there will be no buyers  
19 for those loans in the secondary market. The secondary  
20 market acts as an effective regulator in addition to  
21 government regulation.

22 And I think those kinds of things should be  
23 recognized. This is a different environment than we had  
24 in the '70s, and we have so many more people that now  
25 have access to credit that didn't have access to it

1 before, and I don't know -- I don't hear very much, and  
2 I hope I don't, that jeez, I wish we could go back to  
3 the good old days because I don't remember when those  
4 good old days were frankly.

5 MS. HARRINGTON: Okay. We have a question  
6 specifically for you, Michael, from someone in the  
7 audience who says: "Michael, you said that consumers  
8 only care about what the loan will cost them and for how  
9 long. Doesn't that mean that consumers should be told  
10 of all of the potential costs of alternative mortgages  
11 including after the teaser period?"

12 MR. MCKEW: Absolutely.

13 MS. HARRINGTON: That was easy. Here's another  
14 one from the audience, for all of you: While consumers  
15 might believe that mortgage brokers and lenders have  
16 their best interests in mind, the truth is, according to  
17 this questioner, that their interests often conflict  
18 with consumers. Should these brokers and lenders have a  
19 fiduciary duty to consumers? Do they? Should they?

20 Michael, I'll start with you.

21 MR. WILLIAMS: I would say a fundamental error  
22 is to think when you go into a process like this, that  
23 somebody that's lending you money is your friend or they  
24 have your best interests in mind. It's a business, and  
25 I mean, it sounds cold and calculated, and I don't know

1 if anybody else on the panel will say it, but I will. I  
2 can tell you our guys are --

3 MS. COHEN: It's not in the commercials that  
4 way. Come in and see what we can do for you.

5 MR. WILLIAMS: My member firms are as altruistic  
6 as the next. Everybody has their philanthropic  
7 foundations and they give away money, but at the end of  
8 the day, they're there to make money, and that's what it  
9 is.

10 It's a business transaction and it should be  
11 viewed that way. It should be sold that way, I agree,  
12 and if you have folks who are misleading in making  
13 people feel good, you have that in the insurance  
14 industry. You have that everywhere. It's called  
15 marketing, but again at the end of the day, consumers  
16 have to go into this in a cold calculating way to say,  
17 I'm going to get a loan for hundreds of thousands of  
18 dollars to purchase a home that I have to pay back at  
19 interest, and there are rules that are applied to it,  
20 and if I don't pay it back then there will be penalties  
21 and consequences to that, and this person is not my  
22 friend nowhere along the way.

23 MS. HARRINGTON: Okay. On this matter of



1 audience that there is an alignment of interest among  
2 lenders, consumers and secondary market. Do brokers  
3 share that interest? Are they aligned as well or are  
4 brokers primarily interested in originations where they  
5 generate their fees? Harry, I bet you have something to  
6 say about that?

7 MR. DINHAM: Well, the brokers are mainly in the  
8 production side of the business. They don't actually  
9 service any loans. We're mainly interested in the  
10 production side, and we think of ourselves as mortgage  
11 stores where we carry products from several lenders, and  
12 because of our contracts with those lenders, it makes it  
13 very hard to consider being a fiduciary to somebody  
14 other than the lenders that are providing money in the  
15 long run at that point, so in our mind, it would create  
16 a conflict for us to be considered a fiduciary of the  
17 borrower at that point.

18 So as Michael said, I have to -- when they come  
19 in to borrow money, they have to understand that we have  
20 to have the best interest of the lender at heart at that  
21 point, so that's where we are on that issue.

22 MS. HARRINGTON: Michael?

23 MR. WILLIAMS: I would like to add just to sort  
24 of play out my statement here, just because they're  
25 looking at it as a business relationship, there

1 shouldn't be any implication that somehow they are  
2 trying to be underhanded. The two don't go hand in  
3 hand, even though some try to make it go hand and hand,  
4 but because someone is being practical and business  
5 like, that somehow they're underhanded, and it's not the  
6 case.

7           So when you go in and if the person, the lender,  
8 the broker, the secondary market participant, the  
9 investor, they're not your friend, you shouldn't look at  
10 them as your friend, but they're not necessarily trying  
11 to defraud you either, and .000sr-Ms16odsariluit

1 their broker and not have any law enforcement to go to  
2 afterwards.

3 For those of you who don't know, borrowers who  
4 go to brokers may, in many instances, pay a higher  
5 interest rate, and the lender pays a fee to the broker  
6 that makes up for that interest rate and then the  
7 borrower essentially pays that back later. The lender  
8 is paying the broker to upcharge the borrower, and the  
9 borrower pays for that through the interest rate, and  
10 that's how the lender makes its money back.

11 Our proposal to HUD, which is public in the  
12 context of the RESPA reform, among other things, is to  
13 have a contract between the borrower and the broker, so  
14 the borrower understands what the broker fee is. The  
15 YSP is part of the broker fee, but people don't know  
16 they're paying it, and they think that the broker fee  
17 line on their HUD I is the only broker fee that they're  
18 paying. They need more information so that they  
19 understand where the obligations of the broker really  
20 lie.

21 And to be clear, I love my broker, but that's  
22 not relevant to this discussion.

23 MR. MCKEW: Alys, actually this was discussed  
24 quite extensively a number of years ago in the  
25 negotiated rulemaking.

1           MS. COHEN: I was there. Thank you.

2           MR. MCKEW: And actually I think we were pretty  
3 close to coming to a solution on this agreement between  
4 the broker and the customer, and I thought that the  
5 mortgage industry was pretty lined up on that, but there  
6 is an issue with the parity in the channels going  
7 through the lenders, and that has to do with -- I guess

1 kinds of -- the specific products we're talking about,  
2 and let's go to the hypos and the Ozzie option. In the  
3 current regulatory framework, is Ozzie getting enough  
4 information and protection upfront? Ozzie, you'll  
5 recall, has chosen the option on -- the third hypo.  
6 Does the current regulatory environment give Ozzie  
7 enough information? And let me ask more specifically  
8 whether in the proposed guidance, the consumer  
9 protection provisions there would give Ozzie additional  
10 information or better protection?

11 MS. COHEN: Can you ask the last sentence of  
12 your question again? I was reading.

13 MS. HARRINGTON: Yes. In the Interagency  
14 Guidance, there are some specific questions about some  
15 consumer protection measures, about communicating  
16 clearly with consumers about loan terms and payment  
17 structures and so forth, alerting consumers to  
18 associated benefits and risks, including the risk of  
19 payment shock and negative amortization, and of course  
20 the guidance also calls for compliance with all  
21 applicable consumer protection laws, da-da-da-da.

22 Would Ozzie's situation improve under the terms  
23 of that proposed guidance?

24 MR. MCKEW: Yes.

25 MS. HARRINGTON: And how?

1           MR. MCKEW: I think the proposed guidance has  
2 succeeded in focusing the industry on new products, new  
3 innovative products, and I have to believe that these  
4 are not going to be the last new, innovative products in  
5 the mortgage industry, but I think the agencies have  
6 done a good job of identifying some of the factors that  
7 could be problematic for some consumers going down the  
8 line.

9           We submitted the comments on the Interagency  
10 Guidance, and we didn't go in and say, You shouldn't be  
11 doing this. We actually made constructive comments on  
12 how the writing could be a little bit more flexible in  
13 terms of allowing more flexibility with the products and  
14 not basically giving a road map to class action lawyers  
15 and so forth and state AGs to basically take these  
16 so-called guidance and then basically turn them into  
17 UDAP type of actions.

18           But I think there's enough information that's  
19 being provided there, and that the guidance is serving a  
20 good function and highlighting to the industry and to  
21 everybody that these are things that we -- everybody  
22 needs to take a serious look at and make sure that the  
23 appropriate information is getting to everybody.

24           MS. HARRINGTON: Jamie?

25           MS. GOODSON: I agreed with the beginning of

1     what Robert said, until we got to the point where he  
2     indicated that the guidance was okay as long as there  
3     was really no recourse for somebody if the guidance was  
4     not followed, if the AGs didn't go after people who  
5     violated the guidance, and if borrowers didn't have the  
6     opportunity to receive recourse.

7             That's not a standard that's meaningful. That's  
8     on paper, and it's useless, so what I also -- I'm  
9     pleased to hear that people are excited about the  
10    guidance, and I wanted to get a little bit away from  
11    disclosures.

12            Disclosure has its place and it can always be  
13    fiddled around with, and we'll talk about that, but one  
14    thing I liked about the guidance was its focus on  
15    underwriting, which I think is very much a lender  
16    process. Lenders talk -- when we talk about what can be  
17    disclosed under the Homeowner's Disclosure Act about  
18    different products to give the public more information,  
19    one reply is, Oh, no, we can't give out all our  
20    underwriting secrets, that's proprietary, or when you  
21    want to compare one lender to another, Oh, we're using  
22    different systems, you can't compare apples to oranges.

23            So if those statements are true, then it's also  
24    true that the consumers can't be expected to know what's  
25    in that black box that lenders don't want other lenders

1 to know.

2 I liked Stella Adams' analogy earlier when she  
3 spoke about coming to a doctor, and I think that's how  
4 people do evaluate mortgage professionals. They think  
5 they're going to professionals, and the idea that you  
6 would have to engage in mortal combat to expect anything  
7 fair is unreasonable, especially when we talk about an  
8 application. I guess the analogy -- I don't have a good  
9 medical analogy, but I was thinking about college  
10 admissions. You go and submit your application. The  
11 professional looks at your application, your  
12 qualifications, judges it as compared to other people,  
13 sees, Will you work with this class or should you really  
14 be at a liberal arts college or should you really be  
15 going to some other kind of school.

16 And do you take -- you're stuck with what they  
17 say but they do tell you no; if this is not right for  
18 you, no, and you also don't expect for them to be trying  
19 to undermine you in different ways with either fiddling  
20 around with your documents and those types of things. I  
21 don't want to run the analogy into the ground, but I  
22 think it's much -- I think everyone involved should want  
23 people to feel comfortable coming to them, trusting them  
24 as professionals, just like you trust your doctor, just  
25 as you trust other people who have studied and who



1     should know more than you know, and any loan officer or  
2     broker who doesn't know more than the customers in front  
3     of them should be ashamed.

4             So given that trust and that experience, I think  
5     that the underwriting -- at the very least, underwriting  
6     standards should be on the shoulder of the lenders to

1 he may not have any recourse anyway.

2 One other point that I would liked to make is  
3 Robert said before that the sort of confluence of all  
4 the parties and it is in the best shape ever and the  
5 mortgage industry is doing great, I just want to share  
6 two statistics. In a recent Wall Street Journal  
7 article, there was an industry study that was published  
8 that said one in eight households with ARMs originated  
9 in 2004-2005 will default on those loans, and another  
10 statistic from the Center For Responsible Lending, Jamie  
11 won't tell you, but they have a lot of good research on  
12 their web site, is that over 20 percent of the sub-prime  
13 refinances that were originated in 1999 were in  
14 foreclosure in 2003.

15 MR. MCKEW: Can I have a quick retort to that?

16 MS. COHEN: Yes.

17 MR. MCKEW: The retort is I do believe that most  
18 of the industry and consumers and secondary market and  
19 industry participants are in alignment as to their  
20 interest. The one thing that isn't in alignment is  
21 interest rates. Interest rates are going up. It's  
22 really not a coincidence, I don't think, that these  
23 kinds of issues are coming up, this summer, this  
24 hearing.

25 What's started to happen is interest rates are

1 going up, and we are not kidding ourselves where we  
2 stand that we probably are going to hear some stories  
3 that some indicators of defaults, delinquencies probably  
4 are going to start to rise. If I knew what the stock  
5 market was going to do tomorrow, I would probably do  
6 something about it right now, but I think that as the  
7 interest rate trend continues upward, it is going to  
8 presented a more challenging environment for the

1 MS. HARRINGTON: I'm going to call on someone in  
2 the audience, my old friend Allen Fishbein. If you were  
3 sitting here, what question would you want to ask?

4 MR. FISHBEIN: We haven't heard for at least 10  
5 or 15 minutes any discussion about the applicability of  
6 the suitability doctrine to mortgage lending. Clearly I  
7 think you could question, as some of the panelists have,  
8 that disclosures under any circumstances --

9 MS. HARRINGTON: I can hear you. For people who  
10 are listening only, they are going to miss this. Allen  
11 is asking about the suitability doctrine and points out  
12 that we haven't heard any mention of it.

13 MR. FISHBEIN: I was going to make the point  
14 that it seems that there's some agreement that  
15 disclosures have their limitation, and we're still faced  
16 with the situation of borrowers, even if better  
17 information was provided to them, might still not be in  
18 a position to consider all the risk factors and put  
19 themselves in potentially vulnerable positions.

20 And we know that many of those people might be  
21 the people that a lot of efforts to improve home  
22 ownership levels have been targeted at in recent years,  
23 so what's to be done?

24 One suggestion has been to at least have some  
25 obligation on the part of lenders, mortgage brokers and

1 the industry to consider the suitability of the products  
2 they're offering. In other words, whether there's a  
3 reasonable prospect for the borrower to be able to repay  
4 issues like residual income and the like being taken  
5 into consideration in determining whether to offer a  
6 particular plan?

7 MS. HARRINGTON: I'm going to summarize in two  
8 sentences. Allen's question is about some additional --  
9 or Allen points out that disclosures only go so far.  
10 Should there be some additional requirement for lenders  
11 to assess suitability, some legal requirement on them to  
12 do that? Let's hear from the panel on that question.  
13 Thank you, Allen.

14 MR. MACDONALD: I think suitability is  
15 ultimately a decision for the consumer. However, the  
16 lender plays an absolute pivotal role in ensuring that  
17 the borrower is equipped with the proper information,  
18 proper traction, proper engagement in the process to  
19 make that decision. The lender has to partner with the  
20 consumer to identify the pros and cons of whatever  
21 financial product they're given because I think  
22 ultimately suitability is about financial literacy, and  
23 the financial literacy cannot just be within the  
24 industry. It's got to make it's way down to the  
25 consumer.

1           As products get more sophisticated, and as more  
2 sophisticated products are being utilized by the  
3 American public, the American public can and will rise  
4 to the challenge of figuring out how these things work.  
5 That financial literacy aspect is not just an industry  
6 wide initiative. It has to be a industry, regulatory,  
7 and consumer wide initiative.

8           Therefore, whereas the lender and the industry  
9 participants have to be engaged in the suitability  
10 aspects, the suitability decision is made by the  
11 consumer based upon their current financial plan, their  
12 current financial goals, and the products available to  
13 them at that time.

14           MS. HARRINGTON: Rob?

15           MR. MCKEW: I agree with everything that Peter  
16 said. There were two things that came up this morning,  
17 and I believe that Robert from -- or the gentleman from  
18 Chevy Chase actually hit that question square on, and  
19 that is you turn to the person next to you, and say, Do  
20 you want me to be making the determination for you as to  
21 whether you're suitable for a particular loan?

22           I just don't think that that's -- if you have  
23 the information that you have. I may be actually -- if  
24 I had a suitability requirement by actually knocking you  
25 out of a loan that you may be perfectly qualified and

1 may be perfectly appropriate for you, and let's take a  
2 collection of 50 loans, and maybe one or two people, if  
3 a suitability test could be actually developed -- and I  
4 think that's a completely elusive endeavor -- that if it  
5 could identify the two people who are going to have  
6 problems in advance, in advance, those loans wouldn't be  
7 made.

8 But I don't think there's a system that exists  
9 right now to identify those two people in advance, so if  
10 we had a suitability standard that knocked out all 50  
11 people, 48 people that are not having access to a  
12 product that may be perfectly suitable and appropriate  
13 for them, and that's wrong.

14 MS. HARRINGTON: There's another question from  
15 the audience then about requiring legally some form of  
16 borrower education for certain loan products before the  
17 loan can close. There's a question from the audience  
18 saying: Should there be -- if, as you're saying, the  
19 determination of suitability rests on the consumer, then  
20 should there be, for certain products, some kind of  
21 mandatory identical process before the loan can close?

22 That's an audience question. Anyone on that on  
23 the panel? Yes, Michael? Your answer is yes?

24 MR. WILLIAMS: No.

25 MS. HARRINGTON: Yes, your answer is no, or no,





1 MS. COHEN: You know, the credit counseling  
2 provisions in the bankruptcy bill are a good lens for  
3 thinking about this question. I get calls from  
4 bankruptcy attorneys who are trying to figure out those  
5 provisions. You can do it on the Internet in an hour  
6 and that counts, which some people argue is good because  
7 they don't think that provision is useful.

8 In the context of these loans which is different  
9 from credit counseling, the issue is, even if you have  
10 credit counseling, even if they're HUD certified, even  
11 if it's extensive analysis of the loan, are those papers  
12 binding? If you have counseling, but the papers don't  
13 reflect the loan that the person is actually going to  
14 get, then it's not going to be helpful, and so it might  
15 be that for some higher risk category of loans, and I  
16 would never say as high as HOEPA but some middle  
17 category, it would be useful if we could figure out a  
18 way to do it, but it wouldn't be relevant if the  
19 information that the person was evaluating for the  
20 consumer wasn't binding.

21 I want to go back to the context question, which  
22 is why are we putting it all on the borrower? The  
23 citation for the Literacy and Contract article is  
24 Stanford Law and Policy Review, Volume 13.2 from 2002.  
25 You can email me if you didn't write it down, but the

1 bottom line is: Why are we putting the burden on the  
2 consumer?

3 Mike said earlier a recision and things like  
4 that, those are back end solutions. They are front end  
5 solutions because lenders change their behavior because  
6 they don't want to deal with those kinds of risks. If  
7 we want to change behavior in the marketplace, the  
8 behavior has to change because the lenders will know  
9 that they face money damages, recision, and other  
10 liabilities, and that includes the investors for making  
11 certain kinds of loans, and until we can change the  
12 market, nothing is going to change because people are  
13 not able to adequately protect themselves.

14 MR. WILLIAMS: Well, I had a conversation today,  
15 and not to betray any confidences here, Jamie.

16 MS. HARRINGTON: G Tr0.0000 0.0000 cm01de, Jamie.

1 to get to a point where they go out and they maintain,  
2 they get an attorney, right, or they find an advocate.

3 MS. COHEN: That's what you said, it's  
4 deterrence. We don't want people to get to that point.  
5 They don't need to get to that point, Mike.

6 MS. HARRINGTON: Hang on.

7 MR. WILLIAMS: The point is that very few of  
8 them are going to get there if you have a rescision  
9 standard. Your argument over whether or not a rescision  
10 standard in the context of assignee liability would be  
11 appropriate, right? This is on anti-predatory lending,  
12 and my argument was, no, and he says, Well, why are you  
13 guys worried about it, you're never going to have --  
14 you're not going to have the flood of people who are  
15 going to file these cases where you're going to have to  
16 worry about rescision.

17 The point is: Is the borrower really going to  
18 care about, well, I'm going to sue somebody, I want to  
19 know that I have the right to sue somebody after the  
20 fact, after I get screwed? If that person knows that  
21 they're getting a bad deal before they sign the  
22 paperwork and they're able to decipher, you don't --  
23 nothing is going to be perfect, right?

24 And you're going to have people out there who  
25 are going to try intentionally to defraud borrowers.

1 You're going to have them, and you're not going to  
2 create the perfect law that's going to get rid of them,  
3 but to the extent that you can have an educated  
4 borrower, that's not putting an unreasonable burden on  
5 the consumer to say you need to be educated.

6 You don't have to be a lawyer, and you don't  
7 have to have experience in real estate or in high  
8 finance. You just have to be able to know when  
9 something is not right, that you have other options, and  
10 other venues, other avenues in which you can go and  
11 check that information. That information is not  
12 available.

13 Now, if you say to the borrower, Well, you have  
14 to go to a mandatory counselor to get that information,  
15 suppose that counselor is no good? What are you going  
16 to do, sign a contract with that counselor and that  
17 counselor gives bad information and then that person is  
18 going to get sued?

19 Ultimately you cannot just push. It's a closed  
20 balloon. You can't push the air on one side and expect  
21 that the balloon is not going to over-inflate.

22 MS. HARRINGTON: Let's look at this from a  
23 slightly different --

24 MS. GOODSON: Eileen?

25 MS. HARRINGTON: Jamie, quickly, and then I have

1 another question.

2 MS. GOODSON: I just wanted to jump in on  
3 Allen's suitability question, and I noticed that it may  
4 have been earlier panels or it may have been this panel  
5 when it was mentioned that borrowers should get  
6 information about the worst case scenario, how bad  
7 things could be. Part of the argument was, they will be  
8 scared and they won't do it.

9 Then when we talk about it from the other side,  
10 we'll say they did it, so disclosure is either good or  
11 -- I wanted to point out that you don't want to give  
12 people the worst case scenario if it means they're going  
13 to change their behavior, but then if they behave in  
14 accordance with what you've told them, it's on them.

15 And on the suitability standard, I think you can  
16 probably tell from my earlier comments, that I think  
17 it's perfectly reasonable to expect professionals to be  
18 able to provide better advice to consumers, but I think  
19 it was Michael who talked about class action risk, and I  
20 wanted to point out that a suitability question is  
21 inherently an individualized analysis, and so when you  
22 talk about worst case scenarios, I don't want us to  
23 think that suitabilities, that everybody whoever gets a  
24 loan is going to come and argue it's unsuitable, that is  
25 impractical and it won't happen.

1           An unsuitability standard, where it's the worst  
2 of the worst, even when you look at that, and you know  
3 in the beginning that this person could not have paid  
4 this. This person is on Social Security. How are they  
5 going to have something when -- how are they going to be  
6 able to pay when this ARM adjusts, or this person didn't  
7 get any net tangible benefit from this refinance. Most  
8 of the benefit went to the lender or the broker.

9           I think it's a little bit of a red herring to  
10 say suitability, Oh, it will never work because in  
11 reality, we're trying to deal with the worst of the  
12 worst, and I don't think anybody here is trying to give  
13 the entire mortgage, everyone who gets a mortgage, extra  
14 bites at the apple, and I think we can all agree that  
15 some things are unsuitable, and if we can reach that  
16 standard and find ways to enforce restrictions against  
17 unsuitable loans, then we'll be in a place where we can  
18 agree.

19           MS. HARRINGTON: I have a different question.  
20 What about the, I'll call it sort of the unsuitable  
21 lender or broker, who has focused only on minimum  
22 payment, in the competitive marketplace who just pitches  
23 the minimum payment and hooks a consumer in there on one  
24 of these products? Is there a need for additional law  
25 or regulation to address that problem? It happens.

1 Jamie?

2 MS. GOODSON: To be a little bit -- this is kind  
3 of a subset of what you're saying, but we focus on the  
4 sub-prime market, and in the prime market, most lenders  
5 provide for an escrow for taxes and insurance payments.  
6 What happens in the sub-prime market is that many  
7 lenders do sell on just the principal and interest  
8 without dealing with the taxes and insurance.

9 That sets up a perfect storm for a refinance  
10 when taxes come due and they don't have the money to  
11 pay, and they say, Okay, you can refinance, and there's  
12 more equity stripping, so I do think -- and one of the  
13 things that was stated in our comment letter was that  
14 steps should be taken to either encourage or require  
15 that sub-prime lenders provide for taxes and insurance  
16 to be counted in the monthly payments that are sold.

17 MS. HARRINGTON: Bob?

18 MR. MCKEW: I would say, yes. I think the trend  
19 towards more broker licensing is good, and that -- and  
20 more education for brokers. If you take the financial  
21 planning industry, which also was a kind of wild west at  
22 one time, and I think they've done a pretty good job of  
23 moving up the certification of some of the outliers in  
24 that industry, but, yes, I do think that there should be  
25 consequences for somebody who is --

1 MS. HARRINGTON: Under what law? Under what  
2 regulation?

3 MR. MCKEW: State licenses and disciplinary  
4 mechanism.

5 MS. HARRINGTON: Do you think brokers ought to  
6 be licensed?

7 MR. MCKEW: Yes. I would go further and say a  
8 federal license. We have 50 states with 50 different  
9 licensing schemes going down as far as loan officers or  
10 registration, continuing legal education, and we have a  
11 variety of differences in the schemes presented. I  
12 think a federal licensing structure would benefit  
13 consumers industry and regulators.

14 MS. HARRINGTON: I want to move to a different  
15 area of the guidance, and that goes to the underwriting  
16 part and the discussion and suggestion that there might  
17 be a legal requirement that these products be  
18 underwritten at a fully indexed rate. What do you think  
19 about that?

20 MR. MCKEW: That they be underwritten?

21 MS. HARRINGTON: Yes, that the consumers have to  
22 be able to pay -- that they be indexed, that they be  
23 underwritten at the fully indexed rate.

24 MR. MCKEW: I don't know whether that should be  
25 a government regulation frankly.



1 MS. HARRINGTON: Why not?

2 MR. MCKEW: Because I think it's something that  
3 the market is probably better able to deal with than the  
4 government frankly, and I think maybe Michael can talk  
5 about it. I have a feeling the secondary market will  
6 pick up on thing likes that a lot quicker than the  
7 government can. Sorry about that.

8 MR. WILLIAMS: That's fine. I was going to  
9 answer your question anyway. When you say fully  
10 indexed, I mean fully indexed to what?

11 MS. HARRINGTON: I'm going to ask the person who  
12 passed me the question. When the interest rates rise,  
13 after the teaser rate has expired.

1 market catches on to who the unnamed parties are.

2 I wanted to -- if we're talking about a teaser  
3 rate that's 1 percent, and it lasts for six months and  
4 then the rate, the index plus the margin is going to be  
5 8 percent, why should the lender not see if the borrower  
6 is able to pay the 8 percent. You know it's coming in  
7 six months. That's the question, and there are some  
8 things that both the government and the market can do.  
9 Hopefully they would reach the same conclusion because I  
10 haven't heard an objection to underwriting on the rate  
11 that the person will clearly have to pay unless they  
12 refinance within the six months.

13 MR. WILLIAMS: Yes, I mean, I don't know.

14 MS. GOODSON: That's what's in the guidance.

15 It's in the guidance that's coming out so this is

16 saying, Ctq b1t MS. GOODSOrx5.x mon out 000 0.00000 0.000

1 monthly payment, and then you have to figure in if  
2 there's some neg am period, and you saw that in most  
3 states it goes up to 115 percent.

4 So you saw Pat McCoy's analysis I think it was  
5 of Isaac's loan and what it would look like over time,  
6 and it seems like, A, it should be underwritten for that  
7 scenario and for the things I just described, and B,  
8 that he should be able to get that information.

9 I just have to go back to something which I  
10 think Robert said. It might have been someone else  
11 which is the American public can and will rise to the  
12 occasion and figure out how these things work. These  
13 things are complicated. We're all trying to talk about  
14 the terms, and we don't all understand them all of the  
15 time. We can't put the burden just on the people to do  
16 that. The market is not fixing these problems.

17 Another statistic, sub-prime ARMs have a 49  
18 percent greater chance of entering foreclosure than  
19 sub-prime fixed-rate mortgages. People aren't shopping.  
20 They're getting loans they can't afford, and the system  
21 has to be fixed.

22 MS. HARRINGTON: Bob?

23 MR. MCKEW: Well, the only thing I have to come  
24 back to is that as I referred to today, Michael once  
25 again might be the better person to speak to this. We

1 have really this other regulator out there, and it's  
2 called the market that's purchasing these mortgages and  
3 that is providing funding to this industry, and I know  
4 they have very sophisticated models to assess all kinds  
5 of contingencies and economic scenarios and everything  
6 under the sun.

7 I just believe that that -- that level of  
8 sophistication wasn't around 10, 15, 20 years ago, and  
9 possibly we could say, Well, let's not wait until the  
10 market fixes this. I think that the market is fixing  
11 things quicker now than they were even just a couple of  
12 years ago. This industry is moving fast.

13 MS. HARRINGTON: We are running out of time. I  
14 want to ask each panelist to take a minute to think and  
15 then answer this question. If there's no change at all  
16 in any applicable law governing these products, no  
17 change at all, the status quo remains, five years from

1 time?

2 MS. HARRINGTON: No. Five years from now,  
3 what's the headline? It has to be spiffy. You're a  
4 headline writer. They didn't tell you that this was  
5 entailed on being on this panel.

6 MR. WILLIAMS: I have a headline.

7 MS. HARRINGTON: Michael, what's your headline?

8 MR. WILLIAMS: It may be politically incorrect,  
9 but here we go. United States Invades Iran, and the  
10 reason I say it is because -- and the reason that I  
11 didn't mention anything about mortgages is because it's  
12 a market, and markets evolve, and there may be problems  
13 with it, but there have been problems in the past and --

14 MS. HARRINGTON: Got it. We're not going to  
15 have time. Headlines without explanations.

16 MR. WILLIAMS: I'm sorry. I didn't know.

17 MS. HARRINGTON: Harry?

18 MR. DINHAM: I don't have one.

19 MS. HARRINGTON: That's fine. That saves some  
20 time. Jamie, headline?

21 MS. GOODSON: I would put Wealth Gap Grows, but  
22 I need more time.

23 MS. HARRINGTON: Wealth gap?

24 MS. GOODSON: Wealth Gap Grows. That's the home  
25 ownership is a step up in wealth.

1 MS. HARRINGTON: Okay. Peter?

2 MR. MACDONALD: Mortgage Products Continue to  
3 Evolve to Suit Needs of Consumers.

4 MS. HARRINGTON: Headline, Bob?

5 MR. MCKEW: I like Peter's too, but I'll go with  
6 -- first of all, it won't be a headline. It will be on  
7 page A -- C 14, and it will talk about specific regions,  
8 probably southern California, and that may be a little  
9 bit of an additional problem with these kind of products  
10 actually because I understand that's where a lot of them  
11 are.

12 MS. HARRINGTON: Okay. That wasn't a headline.  
13 Alys?

14 MS. COHEN: High Foreclosures Gut Neighborhoods  
15 and Feed Crime All Under Wall Street's Watch.

16 MS. HARRINGTON: Oy, oy, oy. Okay. Who's got a  
17 headline? Yes.

18 UNIDENTIFIED SPEAKER: Federal Government Steps  
19 in to Prevent Mass Foreclosures.

20 MS. HARRINGTON: Federal Government Steps in to  
21 Prevent Mass Foreclosures. Wendy?

22 UNIDENTIFIED SPEAKER: ARMs Reach Out to  
23 Strangle Consumers.

24 MS. HARRINGTON: ARMs Reach Out to Strangle  
25 Consumers, yikes. Do we have a rosier scenario out

1 there in the headline writing world? Yes, John?

2 UNIDENTIFIED SPEAKER: Mortgage Brokers Enjoy  
3 Record Year As Interest Rates Hit 10 Percent and  
4 Refinancings Skyrocket.

5 MS. HARRINGTON: Mortgage Brokers Enjoy Record  
6 Year As Interest Rates Hit 10 Percent and Refinancings  
7 Skyrocket, something like that. Okay. That was you.  
8 What's your headline? Your hand was up. You were just  
9 scratching your head. Just headlines.

10 UNIDENTIFIED SPEAKER: Mortgage Market Beat  
11 Chicken Little.

12 MS. HARRINGTON: Mortgage Market Beat Chicken  
13 Little. Other headlines? Yes, right here.

14 MS. MCCOY: Secondary Market Slices and Dices  
15 Risks So Fine That It Continues to Finance Bad I-O and  
16 Option ARMs.

17 MS. HARRINGTON: Secondary Market Slices and  
18 Dices Risks So Fine That It Continues to Finance Bad I-O  
19 and Option ARMs.

20 MR. MCKEW: I have another one.

21 MS. HARRINGTON: You know what? There has to be  
22 a headline this time, Bob, not the story. We need the  
23 headline.

24 MR. MCKEW: Company Develops Products to Deal  
25 With People That Have Had Problems With I-O and Option

1 Arms Products.



1 PANEL 5: "Consumer Literacy and Education in the  
2 Mortgage Marketplace."

3 PANELISTS:

4 LESLEY FAIR, MODERATOR, FTC

5 MICHAELA ALBON, Legal Committee Member, Mortgage Bankers  
6 Association; Senior Vice President, Senior Counsel, and  
7 team Leader, Washington Mutual Bank

8 JANIS BOWDLER, Housing Policy Analyst, National Council  
9 of La Raza

10 BRIAN BUCKS, Economist, Division of Research and  
11 Statistics, Board of Governors of the Federal Reserve  
12 System

13 ALLEN FISHBEIN, Director of Housing and Credit Policy,  
14 Consumer Federation of America

15 JACK GUTTENTAG, a.k.a, "The Mortgage Professor,"  
16 syndicated columnist and Professor Emeritus of Finance,  
17 the Wharton school of the University of Pennsylvania

18 JOHN VENERIS, Chairman, Conventional Finance and Lending  
19 Committee, National Association of Realtors;  
20 Owner/Broker, Realty Executives Pro/Team

21

22 MS. TWOHIG: Boy, this is a well behaved crowd.  
23 I didn't even say anything and people are sitting down,  
24 quieting down. Thank you very much, and thank you for  
25 sticking with us so long. I don't think you're going to



1 those of you who are listening off site, this is your  
2 opportunity, since it seems to me really everything that  
3 we've talked about today focuses in on it seems to be  
4 this last panel talking about consumer literacy and  
5 education in the new mortgage marketplace.

6 I am going to ask each panelist to briefly -- I  
7 will not ask where you were born, Social Security  
8 numbers, no personal information. I will, however, ask  
9 your employment, your affiliation and also just in 25  
10 words or less your organization's interest in the topic  
11 at hand today.

12 Let met start off with you, Brian Bucks.

13 MR. BUCKS: Thank you, Lesley. My name is Brian  
14 Bucks. I'm an economist at the Federal Reserve Board.  
15 I work at the Board primarily on the survey of consumer  
16 finances, which I'll be talking a bit about, in  
17 producing it, analyzing it and making it available to  
18 users.

19 MS. FAIR: I will mention about Brian. I  
20 thought as an attorney at the FTC named Fair I had a  
21 very suitable last name, but an economist from the Fed  
22 named Bucks, you got me beat entirely.

23 So, Michaela?

24 MS. ALBON: My name is Michaela oF

1 vice president and senior counsel for Washington Mutual  
2 Bank, which is based in Seattle, Washington, and I'm  
3 also here speaking in part on behalf of the MBA as well,  
4 and as you may know, Washington Mutual is one of the

1           MS. FAIR: Janis has written extensively on this  
2 topic, so I think a quick look at the La Raza web site  
3 is a font of information about what she and her  
4 organization have done.

5           Next we have table tentless Allen Fishbein, who  
6 I am sure needs no introduction, but he can introduce  
7 himself anyway.

8           MR. FISHBEIN: No table tent, but it's okay.

1           MS. FAIR: Please check out his web site, a very  
2 interesting one and, Jack, if you wouldn't mind speaking  
3 directly into the mike, I wouldn't want to miss a word.

4           MR. GUTTENTAG: mtgprofessor.com.

5           MS. FAIR: I can assure you it is a colorful and  
6 thought provoking site for everyone to take a look at.

7           John, could you introduce yourself?

8           MR. VENERIS: My name is John Veneris. And  
9 actually I'm wearing two hats today. One hat, I serve  
10 as the chair of the Conventional Finance and  
11 Lending Committee for the National Association of  
12 Realtors. The other hat I wear is the fact that I own a  
13 small real estate company in Illinois, and I actively  
14 list and sell on a daily basis, and so I felt I'm glad  
15 to see I'm the only realtor that served on the panel  
16 today, and hopefully will have some good input,  
17 especially with regard to some of the educational  
18 discussion.

19           We did have some brochures that we had set out  
20 in the back that were developed by the National  
21 Association of Realtors, and Lesley is holding those up  
22 for you, and I just checked before I came in, and they  
23 were all gone, so I guess they were well received, and  
24 we'll talk about that I'm sure a little bit down the  
25 line here.

1 MS. FAIR: Thank you very much. I was also on  
2 your web site just this morning, John, and noticed that  
3 you have a ranch with full basement listed, so if anyone  
4 is looking for what looks to be a darling place in west  
5 Chicago and its suburbs, it's certainly a place to take  
6 a look at.

7 I would like to think that speaking  
8 presumptuously I guess for the federal and state and  
9 local regulatory law enforcement agencies here, as well  
10 as for the Simm's department store chain, that our motto  
11 is, "an educated consumer is our best customer," so it  
12 seems to me that that's what we have put together this  
13 esteemed panel together to talk about today.

14 Certainly there may be issues we've heard today  
15 where there is respectful but vigorous disagreement, but  
16 I hope we can all agree at the end of the day on just a  
17 couple things: That consumers should enter into the  
18 biggest purchase decision of their lives with their eyes  
19 wide open and armed with accurate information about the  
20 benefits and risks of whatever mortgage product they're  
21 thinking about buying.

22 So I think to keep up my McLaughlin Group  
23 metaphor here, issue one: What we know and don't know  
24 about what consumers know and don't know about their  
25 mortgages. Most of our conversation here is going to be

1 interactive discussion, but I would like to start off  
2 with Brian Bucks giving us a little bit of information  
3 about some findings in a relatively recent study.

4 MR. BUCKS: Well, first of all, thank you very  
5 much, Lesley. I'll be glad to start off this panel, and  
6 I look forward to our subsequent discussion. I  
7 appreciate in particular the opportunity to discuss some  
8 fairly recent research that I've done with my colleague,  
9 Karen Pence, who is also at the Board of Governors.  
10 This work I think sheds some lights on which mortgage  
11 terms borrowers seem more or less likely to understand,  
12 and also suggests some groups of borrowers for whom lack  
13 of knowledge of these details may be of particular  
14 concern.

15 Of course my comments and conclusions today are  
16 mine alone and not necessarily those of the Board of  
17 Governors or its staff. Of course we've heard a lot so  
18 far today about the growth of alternative mortgage  
19 products in recent year, but to be clear, the work I'm  
20 going to discuss today draws on the 2001 survey of  
21 consumer finances and two other data sources from that  
22 year.

23 So we examined the stock of existing mortgages  
24 as of 2001. Nonetheless, I think our findings and in  
25 particular the many borrowers with adjustable rate



1 mortgages appear to either underestimate or not know the  
2 details of how their interest rate adjusts or to  
3 underestimate how much their rates can adjust. That's  
4 still quite relevant for today's discussion, and we take  
5 a two pronged approach in the paper, assessing just how  
6 well homeowners are able to report the details of their  
7 mortgages.

8           First, we compare how closely distributions of  
9 data drawn from a number of reported sources align with  
10 those same data from borrower reported sources, so, for  
11 instance, we look at the distribution of amortization  
12 rates in the Survey of Consumer Finances or SCF and  
13 compare those to -- those are reported of borrowers in  
14 the Survey of Consumer Finances, and we compare those  
15 back to lender report of data sources, namely the 2001  
16 Residential Finance Survey, and data from Loan  
17 Performance Corporation.

18           The limitation of this approach though is  
19 because we're only comparing distributions, we can't  
20 tell whether individual borrowers overall know their  
21 loan terms. So in a second approach, we look very  
22 specifically at the fraction of borrowers in the Survey  
23 of Consumer Finances who say they don't know the answers  
24 to questions regarding their mortgages.

25           There are, of course, numerous caveats and

1 qualifications to all this research, and those are laid  
2 out in the paper, but overall we find that at least in  
3 the aggregate, borrowers appear to be fairly accurate in  
4 their knowledge of basic features of their mortgages;  
5 more specifically, the distributions of responses given  
6 by borrowers are quite similar to the distributions  
7 given from lender data.

8 As you can see from the top two rows of the  
9 table, all three data sets agree, for example, that  
10 about 85 percent of mortgages in 2001 were fixed rate  
11 loans. There's also a close correspondence in the  
12 distribution of annual mortgage payments, in the SCF and  
13 RFS, with a median payment amount of about \$8,500 in  
14 both data sets; the distributions of interest rates,  
15 amortization periods, and to a lesser extent the loan  
16 origination are also quite similar across data sets.

17 However, there are some exceptions, one of which  
18 I have listed on the bottom rows showing the final rows  
19 in the table. 23 percent of SCF borrowers reported  
20 their mortgage was insured by the FHA compared to 11  
21 percent in the RFS and 11 percent according to Loan  
22 Performance.

23 In contrast, we generally find that ARM  
24 borrowers tend to underestimate the amount by which  
25 their interest rate can rise in any adjustment period or

1 over the life of the loan. The first row of tables show  
2 for example that 43 percent of ARM borrowers in the SCF  
3 report a pre period cap on rate changes of less than 2  
4 percentage points, compared to 7 percent in the RFS.  
5 Similarly shown on the bottom half of the table, 57  
6 percent of SCF borrowers report a lifetime cap of less  
7 than 5 percentage points, whereas lenders shows 6  
8 percent. At the other end of the spectrum though, one  
9 quarter of ARMs in the RFS had lifetime limits of 12 or  
10 more percentage points versus 2 percent or less of SCF  
11 respondents.

12 Very similar conclusions about borrowers'  
13 knowledge of their mortgage terms and mortgage when  
14 considering the share of SFC respondents who said,



1 ARMs and ARM borrowers in 2001, and in addition the  
2 samples used in the simulation are fairly small so the  
3 results should be interpreted with caution.

4 That said, this slide summarizes the results of  
5 the simulation. Specifically, the rows show the shares  
6 of the borrowers in both the RFS and the SCF whose  
7 mortgage payments would rise by less than 5 percent of  
8 income, 5 to 10 percent of income, or more than 10  
9 percent of income under this scenario so it rose to 100  
10 percent. Both the RFS and SCF indicate that mortgage  
11 payments would rise by less than 5 percent of 2001  
12 income by majority of ARM borrowers in this simulation.

13 The RFS data indicates that the mortgage payment  
14 of 68 percent of ARM borrowers would rise by this  
15 magnitude. At the same time, 79 percent of SCF  
16 respondents would expect a payment increase of less than  
17 5 percent of income.

18 Put differently, under this interpretation, 11  
19 percent of SCF ARM borrowers would fail to anticipate  
20 that the change within their mortgage payment under this  
21 scenario would exceed 5 percent of income.

22 Finally we consider how these differences in  
23 payment changes are distributed across income groups.  
24 This table is similar to the prior slide with rows again  
25 summing to 100 percent. In addition, we divided

1 households by annual income.

2 Looking at the top two rows, both data sets  
3 indicate lower income ARM borrowers, those with less  
4 than \$50,000 of annual income, would be more likely than  
5 higher income families to experience relatively large  
6 payment increases. Payments would rise by more than 10  
7 percent of income, for 12 percent of low income  
8 borrowers in the SCF and 16 percent of those in the RFS.  
9 In contrast, only a few borrowers in the middle and  
10 upper income groups would experience payment changes  
11 this large.

12 In short, our analysis suggests that borrowers  
13 are generally aware of their basic mortgage terms such  
14 as the type, maturity and monthly payment, but they  
15 appear less certain about the details of adjustable rate  
16 mortgages. In particular, ARM borrowers appear to  
17 underestimate the amount by which their interest rate  
18 could potentially change.

19 Finally, lower income borrowers are more likely  
20 to know the terms of their adjustable rate mortgage, and  
21 in the event of a sustained rise in interest rates, the  
22 simulation suggests they would also be more likely to  
23 experience relatively large payment changes in mortgage  
24 payments.

25 However, some of these households may be only



1 what were classified as younger consumers.

2 In that, half the people who could calculate it  
3 underestimated what the increase would mean in terms of  
4 payment by as much as 50 percent, so I don't know if it  
5 raises a question about the mathematics that kids are  
6 being taught in school, but it definitely suggests  
7 findings that are very consistent to what Brian was  
8 saying.

9 MR. GUTTENTAG: Let me indicate how it relates  
10 to the findings of what might be called my survey, very  
11 informal and impressionistic, but I probably have  
12 corresponded with 1,500 borrowers who have taken out  
13 ARMs in the last couple years, and the results of the  
14 survey and your findings on them are certainly  
15 consistent with what I have learned.





1           Now, this has a problem, too, and the problem is  
2           that it's beyond the capacity of a large proportion of  
3           borrowers. That's unfortunately true. We've done our  
4           best to make the calculators consumer friendly, but it's  
5           still hard for many, but this is the kind of information  
6           they shouldn't have to go to my web site to try and  
7           figure out. They should get it with their loan, and  
8           they should get it early in their loan, and there's no  
9           reason, no real technical barrier to providing it. This  
10          was a point that was made by one of the panelists  
11          earlier, I think Pat McCoy.

12           MS. FAIR: Jack, let me take a step back. Jack,  
13          I think you were the one who mentioned that regard to  
14          Flo, Isaac and Ozzie in the hypos, and let me  
15          congratulate my colleagues because I finally figured  
16          out, F for fixed, I for interest-only, and O for option  
17          ARM, thank you. Let's take us back.

18           When you said we discussed that, Jack, I mean,  
19          that kind of assumes they already made their decision.  
20          Let's start from the very beginning. If any of you were  
21          approached by a friend, a colleague, your kids' school  
22          teacher, something like that, that says I'm thinking of  
23          buying a house, where do I go for information; I don't  
24          understand all the acronyms; I'm not great in math; what  
25          should my first steps be? What would you counsel?

1           MR. VENERIS: Actually I would like to comment  
2 on that. When someone comes to a realtor, the very  
3 first thing we do when we sit down with them is we want  
4 to go through the buying process, and the buying process  
5 beings with the financing.

6           We as realtors are not experts in financing, so  
7 what we will do is we will recommend them to contact a  
8 lender. We refer them to a lender, and we rely on that  
9 lender to explain the different types of loan products  
10 that are available. I can tell you that in my  
11 experience in working with buyers, the more complicated  
12 the loan product, the less understanding there is with  
13 the buyer.

14          MS. FAIR: How can you tell that, John, just in  
15 your one-on-one experience? What makes that true?

16          MR. VENERIS: Based on the number of questions  
17 that they'll either come back to me with after they  
18 talked to the lender, and they may come to me and say,  
19 Which product do you think best suits me. Really, I can  
20 sit there and try to analyze what their needs are and  
21 what their goals are that they're trying to achieve, but  
22 I also understand at the same time that they still have  
23 questions.

24          The home buying process, we try to make it as  
25 simple as possible, and probably the most complicated

1 step in the process is the financing process. We feel  
2 that the educational portion is probably critical. One  
3 of the things that I talked about earlier was what the  
4 National Association of Realtors has done in developing  
5 educational brochures that are very easy to comprehend.  
6 This is the key.

7           The buyers don't understand all the acronyms and  
8 abbreviations and all the terms. They just want to  
9 know, What's my worst case scenario if I take this  
10 option ARM loan, well, what am I up against, and so with  
11 the brochures that the National Association of Realtors  
12 has come up with, we spell it out very simply using  
13 realistic terms, using realistic dollar figures where  
14 you give an example of a \$300,000 mortgage, so a buyer  
15 can sit down and determine what their options are, where  
16 they stand in a worse case scenario situation.

17           MR. GUTTENTAG: But that doesn't give them that  
18 information for their particular loan, and that's really  
19 what's needed here. That's the problem.

20           MS. BOWDLER: I would agree with that. It's an  
21 interesting question because I just had this scenario  
22 personally where I had a friend come to me, a single  
23 woman looking to buy a condo in D.C., and she wanted to  
24 know if I could help her out, and I said -- she said,  
25 You do this stuff all the time, and I do, but I also

1 know how much I don't know, and so I was like, Oh, man,  
2 I don't know if I'm going to be able to give you all the  
3 information.

4 Well, when I started talking to her, I realized  
5 how much my friend, who is a 30-year old single female  
6 with a master's degree, didn't understand about how  
7 mortgages worked. She's a perfectly capable, smart  
8 woman, and I ended up referring her to one of our local  
9 housing counseling providers, because the only way she  
10 was going to be able to decide what the right mortgage  
11 products were for her was to have somebody who was going  
12 to go through and look at her situation and help her  
13 figure out.

14 And that person has to be independent from  
15 anybody who has a financial stake in the loan process  
16 because otherwise, just to continue the medical analogy  
17 that we're going on earlier, it's kind of like going  
18 straight to the pharmaceutical company and expecting  
19 them to diagnosis all of your problems. Well, I  
20 probably have lots of problems if I go talk to a  
21 pharmaceutical rep, but you need somebody who doesn't  
22 have an interest.

23 Her mortgage broker insisted that the only  
24 product for her was an interest-only loan, and she felt  
25 pressure, and I said, Let's stop. I sent her to my

1 friend, and she managed -- he pre qualified her for a  
2 30-year fixed product with no problem, but she had to go  
3 to somebody that was independent. They gave her  
4 one-on-one counseling in order for her to arrive at that  
5 answer.

6 MS. FAIR: I know La Raza has done a lot dealing  
7 with counseling, and I want to get to that in just a  
8 minute. Michaela, I wanted to toss this off to you.  
9 Now my guess is you get asked this question a lot.

10 MS. ALBON: Actually I do. I've had a couple of  
11 friends come to me and say, Hey, I'm thinking of  
12 refinancing or buying a new home and my realtor

1           I think it's a matter of best practices. Many  
2 responsible lenders have already started doing some of  
3 that, and we would be very happy to work with our  
4 counterparts in the agencies, with the realtors, with  
5 the consumer groups to help come up with that.

6           Unfortunately, I don't think that the data that  
7 Brian described surprises me terribly. I would comment  
8 though that was five years ago, and the sky hasn't  
9 fallen yet, but we do recognize that there are some  
10 additional risks associated with these products.  
11 Obviously we're all going to be more nervous about them  
12 in a rising rate environment, and I think the real  
13 challenge here is: What can we do to feasibly put  
14 better information, which I think is not the same thing  
15 as saying more information as some of the panelists  
16 pointed out this morning, in the hands of the consumers  
17 so that they're better equipped to make their own  
18 choices with respect to these products and feel more  
19 comfortable going into the products that they've chosen  
20 and feel like they understand what they've chosen  
21 better?

22           I think the computer idea is an interesting one,  
23 but then what do we do about the consumers that don't  
24 have ready access to computers? How do we deal with  
25 that? How do we deal with the fact that a lot of the

1 shopping for mortgage loans today is done by phone  
2 rather than ~~than~~ ~~at~~ ~~361802~~ ~~get~~ ~~www.fn~~ ~~prcan~~ ~~and~~ ~~080010921r0u5t~~.  
3 and going from lender to lender and picking up something  
4 like this?

5           You can get it on our web site if you have  
6 access to a computer and you're looking at our web site,  
7 but that's a challenge I think we need to think about.  
8 I don't think you would find that there's much  
9 disagreement in the industry even that the current  
10 disclosure scheme is probably not sufficient, especially  
11 with respect to the nontraditional mortgage products,  
12 and therefore we support in principle what the agencies  
13 are trying to do. We just have the concern about what's  
14 the best way to go ~~about~~ ~~the~~ ~~background~~ ~~in~~ ~~cat~~.

15           MS. FAIR: Other comments about the current  
16 disclosure scheme from --b7 0.0000 0.0000 cm0.00 0.00 0.00 rgBT36.



1 they were 25 years ago. The difference is the amount of  
2 products that are available today compared to the past  
3 or when that CHARM booklet was originally written, and  
4 what it suggests is there's going to have to be a series  
5 of steps to try to improve that, several aimed at  
6 improving consumer awareness and information, several  
7 aimed at giving them better tools for those who want to  
8 go about actually doing the calculations and figuring  
9 out what to do.

10 But ultimately there needs to be some better  
11 means for turning to trusted advisors, turning to people  
12 who could help narrow the choices for them. Pat McCoy  
13 earlier this morning talked about behavioral economics.  
14 And a book I have become enamored with is Barry  
15 Schwartz' book, The Paradox of Choice, in which he  
16 suggests that more may be less, that by providing more  
17 choices to people, providing choice overload while  
18 actually making them more susceptible to being  
19 manipulated and more difficult for them to make the  
20 right decision.

21 So finding ways of narrowing choices through  
22 trusted advisors that many of us in the room could  
23 probably turn to, people who have friends like Janis,  
24 who, if she can't answer the question, can steer them to  
25 the right people to talk to, and that's as much what

1 some segment of the population is looking for than just  
2 getting brochures or information or calculations that  
3 ultimately they're still not going to be able to make  
4 comparisons and perhaps not make the right choices.

5 MS. FAIR: Let me ask this: Other than Janis,  
6 who we've not qualified as a trusted advisor in this,  
7 who do all of you recommend? Who should folks go to get  
8 to this kind of information? Jack, what do you have in  
9 mind?

10 MR. GUTTENTAG: Let me tell you who I don't have  
11 in mind first. Janis made the point that you have to go  
12 to someone who is independent. The set of those are too  
13 small. That's a cancel of defeat I think if you take  
14 that position. Someone earlier suggested that an  
15 educated consumer was a lenders's best customer. I  
16 don't believe that for a moment.

17 I don't think that we should ever expect lenders  
18 to act as trusted advisors to borrowers, but I want to  
19 go back to that group in between the customer and the  
20 lender, the mortgage broker, because mortgage brokers do  
21 have the capacity to act in a fiduciary capacity with  
22 the borrower. Remember that mortgage brokers don't lend  
23 money. They are not merchants.

24 They generally tend to think of themselves as  
25 independent contractors, as merchants because they can

1 make more money that way, but fundamentally they are  
2 providing a service. They provide a service the way an  
3 architect or a lawyer provides a service, and they  
4 should be compensated for that service, and the price  
5 for that service should be stipulated in advance with a  
6 customer, and then they can give their full time and  
7 talent and attention to getting the best possible deal  
8 for the borrower.

9           It's very difficult for borrowers to shop this  
10 market. Mortgage brokers are experts at shopping this  
11 market. That's what they do every day of the week.  
12 They do it for every client -- or I could say they do it  
13 in connection with every client, but mostly they do it  
14 for themselves. They want to get the best price,  
15 because the better the price they get, the larger the  
16 mark up they will make.

17           Now most mortgage brokers act as independent  
18 contractors, meaning what they make on the deal is none  
19 of the borrower's business. They're independent  
20 businessmen, and they do it that way generally because  
21 they can make more money. However, one of the reasons  
22 or a second reason they act that way is because  
23 borrowers allow them to.

24           Borrowers allow them to act in that capacity,  
25 but if a borrower goes to a mortgage broker and says,

1     Look, I want you to act for me, I want to pay you a fee  
2     and we'll talk about the fee, and I want you to advise  
3     me, give me your best advice about the mortgage I need  
4     and find the best deal in the market you can find, nine  
5     times out of ten at least the broker will say, yes,  
6     because the cuhe broBd,

1           MR. VENERIS: That seems, for all intents and  
2 purposes, that that really is a practice not exactly in  
3 the way you explained it, Jack, but it just seems that  
4 when the consumers -- they don't know who to turn to,  
5 they're going to be talking to mortgage brokers for the  
6 simple reason is there are thousands of them out there.

7           MR. GUTTENTAG: They are the natural people for  
8 them to turn to. There are many of them there. There  
9 are about 35,000 mortgage brokers. They know the  
10 business. They have the expertise, not all the  
11 ~~expertise. MR. GUTTENTAG: They are the natural people for~~

1 of legislation. Without that, it will be a slow  
2 process. It's underway but it's going to be slow.

3 MR. VENERIS: I think though that that kind of  
4 legislation would be quite a daunting task to pass. The  
5 mortgage bankers have quite a strong lobby. I'm not  
6 sure where they would weigh in on that, but I think -- I  
7 don't know if the mortgage brokers association would be  
8 in favor of that or not.

9 MR. GUTTENTAG: I can tell you they would not.

10 MR. VENERIS: That's right.

11 MS. FAIR: Let's ask the question we just got:  
12 If consumers want a clear, honest explanation of the

1 what he should demand when he goes into the marketplace.

2 MS. BOWDLER: I'm going to agree with Jack,  
3 backing up just a little bit, in saying the world of  
4 independent counselors is much too small, and there were  
5 questions about mandating counseling earlier, and you  
6 would never be able to do that because the  
7 infrastructure just isn't there.

8 As much as I love counselors and I fund  
9 counselors, we just wouldn't be able to do that, and  
10 it's not only that the mortgage broker should act as the

1 and how we might be able to similarly protect our low  
2 income investors who are investing in their homes, and  
3 currently relying on those brokers as if they had  
4 fiduciary responsibility.

5 MS. FAIR: What has La Raza's experience been  
6 with regard to counseling?

7 MS. BOWDLER: Well, we have now been in business  
8 supporting housing counselors for almost ten years. In  
9 that time, we've counseled over 25,000 families, and I'm  
10 not going to try to remember the number of homeowners  
11 because I'll get it wrong and I'll have to hear about it  
12 later, but lots and lots of homeowners, and I think one  
13 of the things that I've heard missing from the debate  
14 and one of the biggest struggles that counselors have is  
15 a counselor has the responsibility to tell a family,  
16 Home ownership is not for you, and that's one of the  
17 biggest differences between a counselor and say somebody  
18 from the industry who is faced with, let's face it,  
19 market pressure to produce a loan.

20 And so my experience with counseling is that  
21 that is part of the job of saying counseling -- sorry,  
22 that home ownership is not for you, but if you give me a  
23 year of fixing whatever is wrong with your credit or  
24 saving or sometimes longer, counselors work with people  
25 for up to two years, in that time then you may be able



1 to be ready to buy a home.

2 A counselor's problem is that there's always  
3 somebody out there who is willing to make a loan to that  
4 family regardless and in their current situation, so the  
5 counselors have a fair amount of competition, but I'll  
6 just add to that that, since nobody else jumped in in  
7 that space, that there's -- we haven't seen a large  
8 amount of investment in this strategy. We have from  
9 some, and we do have industry partners, Washington  
10 Mutual is one of them, but so that the operation is  
11 still very small.

12 And while I would say that it is the most  
13 effective way to make sure that a family understands all  
14 of their options, there's no way that you're going to be  
15 able to counsel every single home buyer out there, so it  
16 is a method. It's not the only method.

17 MR. VENERIS: I think the situation is as you  
18 said earlier, that there are so few counselors as  
19 opposed to mortgage brokers, we have to try to within  
20 the system we have and try to make that system better,  
21 and I think we are recognizing the importance of the  
22 education and the component of education is going to  
23 have to come from those mortgage brokers because we just  
24 don't have the counselors to offer that good advice.

25 I agree with you in what you're saying where if



1           So first, let's talk about the paper, but I want  
2 to broaden the discussion to beyond paper. Right now,  
3 what do you see as the most effective ways, and let's  
4 again talk within the eight and a half by 11 context  
5 before we jump into what else is available -- what are  
6 the most effective ways for getting the message, getting  
7 that education in consumer's hands?

8           MR. VENERIS: If we can back up a second, you  
9 talked briefly about disclosure requirements and how  
10 helpful are they in the process? And quite frankly I  
11 think the disclosure requirements are part of the  
12 problems in the process. When you read the disclosure,  
13 and in fact, we saw several disclosures on the screen  
14 today, and for instance I was reading one of them, and  
15 I'm thinking to myself, okay, I've been doing this for  
16 28 years, how do I expect a buyer to understand what  
17 they're seeing on the disclosure?

18           And when they see the disclosure, they see it in  
19 a couple different times I think. One is when they  
20 actually applied for their mortgage. That's when the  
21 lender tries to explain it to them, and probably the  
22 only other time they're going to see any similar type of  
23 disclosure would be at the time they're signing the  
24 mortgage documents, when it's one piece of paper out of  
25 a half inch stack of pieces of paper, and that's not the

1 time for them to try to understand that disclosure.

2 So I think that's another avenue that has to be  
3 tackled. I think that we have to have disclosures that  
4 have more words that are not four syllables, and again I  
5 think this is a situation where less is more. I think  
6 that if you have a disclosure that gives half the  
7 information that the consumer needs to understand in an  
8 easier context, they may actually read it, and they may  
9 actually get a grasp of it.

10 We have to remember, the consumers don't know  
11 what they don't know, and so they're relying on us,  
12 they're relying on the mortgage brokers. They're  
13 relying on the educational materials that we're giving  
14 them to try to educate them to get a mortgage. What's  
15 their number 1 goal? It's not to get the mortgage.  
16 It's to buy the house.

17 MS. ALBON: I agree with that, and this is our  
18 program disclosure for the option ARMs, and it's similar  
19 versions. Almost all of this is required by the fed and  
20 you can see how long it is. I too worry about whether  
21 borrowers really get through the whole thing, so what we  
22 did is we kind of put in bold at the beginning the  
23 highlights of the product, the highlights of the risks  
24 of the product and advantages of the product in hope  
25 that while if they don't read the whole thing, maybe



1 being literal, but I was pretty impressed with this.  
2 This is a variable interest rate mortgage, if that's not  
3 what you want head for the hills, unquote. Let's not  
4 worry here yet about mode, but let's talk about wording.

5 I mean, what kind of language -- is part of the  
6 problem here what a lot of people have called a post  
7 literate society? What do we need to do to just explain  
8 what I think we all agree can be a complicated bit of  
9 information? How do we explain that? What can we do to  
10 explain that in a clearer fashion?

11 MR. GUTTENTAG: Lesley, it's not words that are  
12 needed. It's numbers. They don't care about how the  
13 mortgage works. They care about what might happen, so  
14 let's show them the numbers instead of one move  
15 generating these very complex and long textual  
16 explanations of how the mortgage works. Let them  
17 provide some expositions of what will happen to the  
18 payment and their rate in this clearly defined set of  
19 assumptions.

20 MS. FAIR: What should those assumptions be in  
21 your opinion, Jack?

22 MR. GUTTENTAG: Well, one of them would be no  
23 change, because that's critically important, and it's  
24 also an assumption up underlying the APR. On an option  
25 ARM, because they use relatively stable indexes, worst

1 case is an extreme and very unlikely kind of scenario,  
2 so I think I would opt for something in between.

3 In various expositions that I have done, I've  
4 used a 1 percent increase in the index for each of the  
5 first five years as a reasonable rising rate scenario.  
6 Obviously it's arbitrary. Why 1 percent? Why not 1 and  
7 a half or 3 quarters? It is arbitrary but they're all  
8 arbitrary. It does give the borrower a sense of what  
9 can happen and 1 percent a year for five years is not  
10 historically unprecedented. It's not as bad as a few  
11 cases that we have actually had. It's not as bad as  
12 1981 or 1987 for example.

13 MS. ALBON: To be fair can it show what can  
14 happen in a declining rate environment as well?

15 MR. GUTTENTAG: I don't know what fair means,  
16 but I think it's redundant. The borrower isn't  
17 concerned about declining rates and declining payments.  
18 He's concerned about the bad things of what might  
19 happen. It's the same reason why on Truth In Lending  
20 that it does make sense to tell a borrower that there's  
21 a prepayment penalty on the loan but it doesn't make any  
22 sense to tell them whether or not the lender is going to  
23 give him a refund of this finance charge which the  
24 current statement does because borrowers don't have to  
25 be warned about the benevolence of lenders, and they

1 don't have to be warned against good things happening in  
2 the environment.

3 MS. ALBON: Well, but there are advantages to  
4 these products as well, and that is you can actually  
5 save money with them. Wouldn't it be more fair and  
6 appropriate to share various types of interest rates  
7 environments, both climbing and declining, so that they  
8 can better weigh the cost, the risks and the benefits of  
9 the product?

10 MR. GUTTENTAG: Michaela, if I were making the  
11 rules, I would allow you to add whatever scenarios you  
12 as a lender thought were reasonable.

13 MS. FAIR: Other comments on what Jack has  
14 proposed?

15 MS. BOWDLER: I would agree it's not just about  
16 the words. It's about the numbers, but it's also about  
17 timing. I mean, this kind -- I think your comment  
18 earlier, Michaela, was exactly right because this kind  
19 of paper assumes that people shop for their mortgages,  
20 but they don't. It's kind of a myth now. People don't  
21 shop for their mortgages.

22 At best, some of your more sophisticated  
23 borrowers or your moderately sophisticated borrowers





1 to provide that, and that's online.

2 MS. FAIR: You said online.

3 MR. GUTTENTAG: Online.

4 MS. FAIR: What about consumers who aren't  
5 online? What do you do for them?

6 MR. GUTTENTAG: They go to a trusted advisor.

7 MR. FISHBEIN: But I think what Michaela's posed  
8 is one of the dilemmas here. In part the lender is  
9 trying to sell the product, at the same time provide  
10 certain information, and those two things conflict with  
11 each other, so when you talk about providing risk  
12 information, that might scare some borrowers away in the  
13 context of -- remember we're talking about particular  
14 mortgage products that the regulators themselves have  
15 defined as riskier products than typical products, that  
16 that could get in the way of the ability of institutions  
17 that want to sell those products, to make the attractive  
18 case that they're beneficial.

19 And that seems to be an ongoing dilemma here on  
20 how you balance proper information to consumers, but  
21 what we know will also be the case which is lenders' and  
22 brokers' efforts to sell products and to get compensated  
23 for them.

24 I mean, one of the things that hasn't been  
25 touched on I think very much up until now in the

1 conference is compensation-related. As I understand it,  
2 I've had lenders tell me brokers were getting extra  
3 compensation for placing people in riskier loans,  
4 nontraditional mortgage loans, and that is a reality at  
5 least of some of the marketplace.

6 So in one hand you have every economic incentive  
7 to put people into loans because people are helping to  
8 mediate that process, are going to be compensated at a  
9 higher level. At the same time you're saying here, hand  
10 these disclosures at an early process so the consumers  
11 can be potentially scared away because they realize they  
12 don't have the risk appetite that these products entail.

13 MR. GUTTENTAG: Markups tend to be higher on  
14 these loans because brokers can get them is the major  
15 reason, especially if they're dealing with disadvantaged  
16 borrowers.

17 MS. FAIR: I think which raises a critical area,  
18 and I was wondering, Janis, if you could address that.  
19 Are there particular areas that need to be handled  
20 differently when we're dealing especially with the  
21 Hispanic population which La Raza represents?

22 MS. BOWDLER: Wow, I could actually opine on  
23 that for quite some time.

24 MS. FAIR: How about a couple minutes?

25 MS. BOWDLER: In a couple minutes, I would

1 actually like to talk just a little bit about some of  
2 the things maybe people don't know and how the Latino  
3 community is a little bit different. I mean, I think  
4 your example I would like to come back to, Michaela, is

1           It's a community, somebody else mentioned  
2 earlier, that is largely not just first time home buyers  
3 but first generation home buyers, so that makes that  
4 position of trusted advisor, which we keep hearing so  
5 much about, all the more important because the community  
6 infrastructure and knowledge that maybe they're in  
7 middle class white communities is not necessarily there  
8 in Latino communities so it's very important.

9           But I just want to stress that while we may not  
10 ever be able to grow the independent sector large enough  
11 to handle all of the needs, I don't think that you could  
12 rely on mortgage brokers as your trusted advisor until  
13 they have some sort of suitability or fiduciary  
14 responsibility because without that, they have a clear  
15 conflict of interest in helping the client, and what  
16 we're seeing in the Latino community unfortunately is a  
17 lot of what we not so fondly like to call brown on brown  
18 crime, where you have bilingual, bicultural folks who  
19 take advantage of their own.

20           And I have story after story of this of families  
21 who are approached by bilingual, bicultural brokers,  
22 sold option ARMs. They never went out and sought them,  
23 interest-only loans, stated income loans, all of these  
24 bad products, and there's not a lot of remedy out there  
25 for them.



1 on and on. You can make up your own slogans but that's  
2 the message that ought to go out.

3 MS. FAIR: Other perspectives on that point,  
4 about responding to advertising?

5 MR. VENERIS: One of the things we're seeing  
6 more and more in the industry is the effectiveness of  
7 the advertising of the different lenders. I can tell

1           So, I mean, if we're going to talk about how we  
2 combat billions of dollars of advertising, we have to  
3 think of what kind of investment are we prepared to make  
4 to inform consumers.



1 that's designed to be viewed by high school aged  
 2 students, and we're in the process right now of going to  
 3 high schools throughout the state to see if they will be  
 1 willing to develop a curriculum that will tie in with  
 116 BMS, ALBON: BYeah, Iphiskthat's dight, and TjET1.00000 0.  
 22 Iinformayonstoverload so wi itstefect ves  
 5 the web site.

6 But the importance of this web site is that it  
 7 drives home the point of the importance of how decisions  
 8 that you make today can affect your credit and your  
 23 B Ad ha Iphisktha res danoha rtchalleng ,TjET1.00000 0  
 9 ability to buy a home 10 or 15 years from now, so what  
 10 we're doing in Illinois is we're trying to tap into that  
 11 Intens.etmakrketmnto ta gougpof hpeoplethat wie kow oar  
 12 wagan Iphisktha tchalleng is , Wat itstha tight TjET1.00000 0.00

1 may not be as experienced in home ownership and may not  
2 be as experienced in finances, but actually as Bob  
3 pointed out this morning, a large percentage of this  
4 market are very savvy borrowers, who see real advantage  
5 of these products, and presumably wouldn't require as  
6 much consumer education as well.

7           And one of the things I think lenders always  
8 struggle with is, Well, how do you deal with that given  
9 that you have different segments of the market and so  
10 that we don't run into fair lending problems either, so  
11 we look like we're treating others differently -- the  
12 borrowers differently.

13           So those are always challenges as a practical  
14 matter we're faced with on a daily basis.

15           MS. FAIR: Allen, you have that "I have  
16 something to say" look.

17           MR. FISHBEIN: Well, I thought I did, but I'm  
18 not so sure. No. I think we still come back to the  
19 fact -- and you touched on this, that there are a lot of  
20 different consumers in the marketplace, and CFA is very  
21 committed to consumer education in a lot of ways. We've  
22 been promoting knowledge of credit scores as a way of  
23 managing certain household finances, and we have other  
24 programs underway, but we also recognize ultimately the  
25 limitations.



1 MS. BOWDLER: I would say that post purchase and  
2 early delinquency counseling is one of the hardest kinds  
3 of counseling out there. I mean, unfortunately if  
4 people can anticipate, they got notice they're going to  
5 lose their job in six weeks, they go into crisis mode,  
6 and they are not -- they are going to start avoiding  
7 phone calls from their lenders. This is one of the  
8 hardest areas for the industry, and I think they need to  
9 figure out how to deal with this.

10 But to answer this question and a little bit on  
11 the last question, one of the best practices that I've  
12 seen out there and could be a potential tool for this  
13 kind of thing was actually in Chicago where they pulled  
14 together a coalition of bankers and realtors and brokers  
15 and the counselors and all the advocates.

16 They set up a 1-800 number and did a massive  
17 social marketing campaign so that people knew if they  
18 suspected something was wrong with their loan before  
19 they signed on their loan, before they were late on a  
20 payment, they could call this 1-800 number that was  
21 backed by the city, and the city then staffed it and  
22 routed their call either to a counselor or to somebody  
23 appropriate to answer their question.

24 The benefit to that kind of model is that the  
25 message is very simple and does not have to be



1 on home price appreciation, interest rate movements, but  
2 the reality is we're facing a staggering number of  
3 potential default situations.

4           What we encourage borrowers to do, or at least  
5 through the media we encourage them to do, is to pull  
6 out their mortgage documents and begin to try to  
7 understand them, even if they didn't at the time they  
8 made or took out the loan, to understand what the  
9 features are and what the prospects for higher monthly  
10 payments are because they are a lot better off trying to  
11 deal with them before they fall behind on mortgage  
12 payments than once they have, but the reality is that

1 so be thinking.

2 Let me finish up with these last few questions,  
3 however, one for Michaela. A few large lenders  
4 originate the majority of option ARMs. Do these lenders  
5 go beyond minimum requirements to educate and inform  
6 potential borrowers?

7 MS. ALBON: I think most of the responsible  
8 lenders do. I think, as I said, we've created a special  
9 brochure for it. We've added bold disclosures to our  
10 ARM program disclosure, and this kind of goes to the  
11 point that was just raised. We've now created a letter  
12 that will be going out to all of our customers who are  
13 in the neg am situation or near the neg am situation  
14 advising them of where they are, and reminding them,  
15 projecting for them what they would look like at the end  
16 of a 12-month period if they continued to make only the  
17 minimum monthly payment.

18 I do agree that that's the best defense to equip  
19 them with information. It really does not behoove us,  
20 believe me, to get into situations where our borrowers  
21 default on loans. That's not the way we make money I  
22 can assure you.

23 So, yeah, I think we are. I think the larger

1 Lending today. I know in our ads, even though it is not  
2 technically required, we do disclose the possibility of  
3 negative amortization, for example, on our option ARM  
4 and payment shock.

5 I know IndyMac's do. I believe Countrywide's  
6 do, and although I haven't seen any directly, I  
7 know that National City's compliance officer told me two  
8 weeks ago that theirs did, and I'm inclined to agree.

9 So I think that the larger, more respo186.00000 1.0s0 1.00



1       However --

2               MS. FAIR:   There's a however?

3               MR. GUTTENTAG:   Can I do a however?   I have one  
4       broker, call him a broker.   He's really what's called a  
5       correspondent lender meaning he actually closes loans,  
6       and he has a web site, a very good web site which  
7       borrowers can see the whole range of prices on every  
8       instrument, all the loan combinations and so forth, and  
9       I've made a deal with this lender that I think might  
10      interest you.

11              The deal was that I would refer clients to him  
12      if he rejiggered his site according to my  
13      specifications, and among my specifications were the  
14      following:   Number 1, and the most important, he reveals  
15      his wholesale price, and his markup and his wholesale  
16      price and markup depend only on the loan size on nothing  
17      else, and so it doesn't vary with credit score or LTV or  
18      anything else.

19              And the second thing that he agreed on, and I  
20      think this might interest you, is that if a borrower  
21      doesn't qualify for the loan he selects on the screen  
22      and has to fall into the sub-prime category, his markup  
23      will remain the same.   So a borrower with shaky  
24      credentials who is not quite sure whether he'll qualify  
25      for prime maybe Alt A, A minus, various degradations

1     that are above sub-prime, if he's not sure about that,  
2     he's safe to go to this site because even if he drops to  
3     sub-prime, this lender is committed to the same markup  
4     on that loan, even though the loan will be more costly  
5     to originate than other loans.

1 the -- I do want to point out that while it is true that  
2 option ARMs and interest-only loans have an incremental  
3 risk over and above what we've seen previously, it's  
4 also true that a lot of the risks that we talk about  
5 today apply to ARMs generally as well, and I think we  
6 shouldn't lose sight of that.

7 MS. FAIR: Janis, one thing you would like to  
8 see done immediately.

9 MS. BOWDLER: I would layer an investment in  
10 broad access to information through, obviously since I'm  
11 a czarina, independent housing counselors, but also  
12 layer that with a protection, a right of consumers to a  
13 suitability standard and assume that their mortgage  
14 broker is working on their behalf.

15 MS. FAIR: Allen?

16 MR. FISHBEIN: I would say the same thing,  
17 fiduciary responsibility for the mortgage brokers to the  
18 borrower.

19 MR. GUTTENTAG: I'll go for that.

20 MS. FAIR: I'm sorry, Jack.

21 MR. GUTTENTAG: I agree with that. I would also  
22 like to see the fed revise its Truth In Lending on this  
23 to get rid of the junky disclosure they have now and  
24 require the provision of useful information about what  
25 might happen on the specific transaction to payments and

1 rates.

2 MS. FAIR: John?

3 MR. VENERIS: If I were a czar, I would have to  
4 meet with the education czar in the country to have him  
5 develop a course called understanding the mortgage loan  
6 and require that every high school student take it upon  
7 graduation.

8 MS. FAIR: I will take the prerogative too, if I  
9 was a czarina, I would ask each of you to fill out the  
10 evaluation form that you have in your materials.

11 I would also ask each of you to do what you can  
12 to publicize the FTC's 877-FTC-HELP number or the place  
13 on our web page where consumers, businesses, attorneys,  
14 anyone can file complaints. If there are practices,  
15 advertising especially, things in the marketplace that  
16 strike you as deceptive, we want to know about it,  
17 certainly if it's an entity over which the FTC has  
18 jurisdiction. If it isn't, it will be put on our  
19 special hotline to our brothers and sisters at the  
20 agencies that do, but again at ftc.gov or by calling  
21 877-FTC-HELP.

22 Thank you, panelists, very much. That's the  
23 last word.

24 (Applause.)

25 MS. TWOHIG: Thank you, Lesley, and thank you,



1           Therefore, it's important that borrowers are  
2           adequately informed as they decide whether  
3           nontraditional mortgage loans are right for them. If we  
4           can achieve that goal, we'll have gone a very long way  
5           towards protecting consumers.

6           I would like to thank all of our panelists, who  
7           represent federal and state regulators, consumer  
8           advocacy groups, industry, and other market experts. I  
9           also want to thank everyone here for your participation,  
10          and I actually saw the little cards being filled out and  
11          coming up to the panelists, so I know that the folks  
12          here really were active participants in the day and you  
13          made it a better day with your involvement.

14          Lastly, I would like to thank the staff that  
15          made this possible and worked very hard to put on a  
16          great workshop, and particularly Julie Bush, Delores  
17          Thompson, and Sarah Gleich, so thank you all, and enjoy  
18          the rest of your day.

19          (Whereupon, at 4:55 p.m., the workshop was  
20          concluded.)

21

22

23

24

25

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24

CERTIFICATE OF REPORTER

DOCKET/FILE NUMBER: P064812  
CASE TITLE: PROTECTING CONSUMERS IN THE NEW MORTGAGE  
MARKETPLACE WORKSHOP  
DATE: MAY 24, 2006

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the steno notes transcribed by me on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED: JUNE 8, 2006

---

DEBRA L. MAHEUX

CERTIFICATION OF PROOFREADER

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

---