FEDERAL TRADE COMMISSION

PUBLIC WORKSHOP:

PROTECTING CONSUMERS IN THE NEW MORTGAGE MARKETPLACE

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FEDERAL TRADE COMMISSION

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WEDNESDAY, MAY 24, 2006

Federal Trade Commission
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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

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

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

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

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

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

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

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

Rest rooms, speaking of rest rooms, are located outside the glass doors where you came in, across the lobby, kind of back that direction.

Please also find time today, if you haven't already, to check the materials that are out on two tables. There was a lot of information, including much of the Federal Trade Commission's consumer publications and information in the mortgage area, and also literature from other panelists and groups.

If you have any questions throughout the day, there's staff members with staff buttons on them, name tags on them, so for any questions you have, please ask them for assistance.

Okay. Moving along to more substantive housekeeping measures, if you have questions, we are going to ask our moderators for each panel to try to take questions during the panels or at the end of the panels. Each one might be a little different, but please fill out the question card that's in your packet and hand them to staff that will be roaming around. You can send them along your aisle, and they will collect them and provide them to the moderator.

For those listening on call-in lines, you can ask questions by emailing your questions to mortgageworkshop@ftc.gov. That's mortgage workshop, all one word, @ftc.gov. And please fill out the evaluation forms that we have in your materials. That will be very helpful to us in providing feedback on today's workshop.

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

(Applause.)

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

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

As we all know, however, housing prices have risen dramatically in recent years and especially in certain regional markets, and for some that has meant that it is more challenging to achieve the dream of home ownership. The marketplace has responded, as it often does, this time with nontraditional or alternative home mortgage products designed to make homes initially more affordable for consumer buyers.

The key feature of these alternative products is that they set mortgage payment amounts as low as possible in the early years of the loan. The prevalence of these alternative mortgage products has grown rapidly. While in 2000, they made up less than 1 percent of the home mortgage market, by 2005 they accounted for up to 50 percent of all new home loans in some markets, which is pretty astounding. What these new loan products have in common is that they offer flexibility to borrowers, and for some, an entry into the housing market they might not already have. At the same time, however, these new loan products may present some unexpected risks for consumers.

Some lenders may find it challenging to explain the differences among the various loan products in a way that's understandable, which could affect consumer's ability to make informed decisions.

Our primary goal today is to gain a greater understanding of the benefits and risks of these nontraditional mortgage products, discuss how the law is already protecting consumers and learn what consumers understand about these products.

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

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

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

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

Then our regulatory representatives will outline the legal framework in which these loans are made, and another panel will follow up exchanging views on how best they think we can protect consumers and the marketplace.

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

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

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

I also want to acknowledge the staff of the

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

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

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

(Applause.)

MS. TWOHIG: Thank you very much, Madam Chairman. Now, without further ado, we turn to our first panel, alternative mortgage products and the key players in today's marketplace. The moderator for this panel is Reilly Dolan, who is one of the Assistant Directors in the Division of Financial Practices, and the panelists I guess are taking their seats.

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

PANELISTS:
J. REILLY DOLAN, Moderator, FTC
AMY CREWS CUTTS, Deputy Chief Economist, Freddie Mac
ALLEN FISHBEIN, Director of Housing & Credit Policy, Consumer Federation of America
GREG MCBRIDE, Senior Financial Analyst, Bankrate.com

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

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

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

To my immediate left is Greg McBride, senior financial analyst at Bankrate.com. Greg provides analysis and advice on personal finance and has appeared on national television probably more times than he can count to discuss these products. Greg will be talking about the different products out there and how they work.

Next is Ms. Amy Crews Cutts, deputy chief economist at Freddie Mac. Amy is responsible for primary and secondary mortgage market analysis and forecasting. She will be providing us with facts and figures about these products, including the prevalence in the marketplace.

And last, but certainly not least, is Mr. Allen Fishbein, director of housing and credit policy at Consumer Federation of America. Mr. Fishbein has coauthored an article examining nontraditional mortgages, which I believe is out on the table there, and he will be discussing the characteristics of nontraditional or alternative mortgage loan borrowers.

Before turning the podium over to Greg, I want to quickly introduce to you three hypotheticals that are in your packets, and I invite the panelists throughout the day, and actually each one of you in the audience, if you have questions, to refer to these hypotheticals, so that we all have a general sense of the scenarios that you're asking questions about.

Let me see if I can do this right. We have three consumers: Florence, Isaac and Ozzie. Each has decided to purchase a home for $437,500. Each will need a mortgage to finance 80 percent of the purchase price, which translates to $350,000, if my math is right. The remaining 20 percent will be funded through down payments, piggyback loans or other mechanisms. The closing costs are the same for each house.

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

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

Finally, Ozzie has decided to buy a home located in Hillside U.S.A., which is a suburb of Washington, D.C. He has chosen an option adjustable rate mortgage with an initial five-year period where he may pick the amount he wishes to pay each month. At the start of the loan, the interest rate is 6.5, and the minimum monthly required payment is substantially less than the interest accrued each month. The negative amortization mortgage cap, which we will explain as we get into the first panel, is set at 120 percent of the amount borrowed, i.e., $420,000.

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

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

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

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

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

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

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

Well, households that have variable income, commission salespeople, small business owners, for example. The idea is that you can make a smaller payment in the months when income is lean or larger payments in months when your income is higher.

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

Then thirdly, there are the upwardly mobile, people that expect a significant increase in income. I know we all wish we were part of that group, but the idea here is that you can make a smaller payment in the early years with the idea that the income is going to grow at a faster rate than the mortgage payment will increase, so that any future increases are not a burden to the household budget.

Now, the problem that potentially arises is in a period where these products have grown in popularity is that some borrowers may be using interest-only loans as a way to combat affordability concerns.

Why would they do that? Well, let's go to this hypothetical. Let's go to this scenario. We're going to compare the payment that Florence has on that 30-year fixed with what Isaac has on the interest-only loan. For that $350,000 loan, Isaac is going to save more than $450 a month initially by taking that interest-only loan, but before Isaac can really determine if this is the best loan for him, he has to get out the crystal ball and look down the road and see what could potentially happen to those payments.

Now, with an interest-only loan, the initial years you're paying interest, just interest. Your required minimum payment is interest-only. In this scenario we've assumed the rate stays fixed for that first five-year period, but at the end of that five-year period a change occurs. The loan converts from paying interest-only to paying both interest and principal, with that principal now being repaid over a shorter period of time. So holding interest rates steady, that is enough to produce a significant payment increase, so in that case, even if the rate remains at 6 percent, Isaac's payment will go up more than $500 at the five-year mark.

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

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

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

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

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

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

The option ARM enables them to get in the home now with the idea that income is going to increase at a pace that would offset any increase in the payments, but again, before we go down that road, let's look at what can happen to the payments and decide if this is something that the household budget is able to handle.

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

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

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

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

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

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

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

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

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

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

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

40-year fixed mortgages also are appealing to buyers that are concerned about affordability but don't want the risk of either an interest-only loan or facing an adjustable later at some point in time.

The advantage is the payments are locked in stone. The disadvantage is that by stretching that loan out an extra ten years, it's a modest impact on monthly payments, but a more substantial impact in terms of the amount of equity you're going to build through principal repayment, and then lately, of course, now there's the 50-year loan, which again stretches it out even further, the difference being there the product is currently on the marketplace is not a fixed rate product. The fixed rate is only for the first five years.

So that's the conclusion of my remarks. Thank you all very much. I'll hand it back to Reilly.

(Applause.)

MR. DOLAN: Thank you, Greg.

Now I would like to turn the podium over to Amy, who has all sorts of statistics, facts and figures on these products that I think for me, when I saw the charts, I was like, Oh, my God, numbers, but Amy does a great job of actually explaining all this so that it will help put everything in perspective as you're trying to figure out to what extent these products really are playing in the marketplace. Thanks.

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

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

We also, if you look back 25 years, enjoyed a period where incomes were growing faster than home prices, and in 1997, as this chart shows, that spread between house price growth and income growth stopped getting wider, and it kind of turned the corner. Where we have that little dotted line is where that gap started to narrow and now in the past year, 2005, we actually crossed where house prices have grown over a very long term -- economists like the long-term, don't look at the short-term, look over the long-term. We know, looking back to 1975, 30 years have crossed where over the last 30 years incomes have failed to keep up with home prices, so this question of affordability rises to the forefront.

This picture shows more recently what's happened to mortgage interest rates. From the middle of 2000 to the middle of 2003, 30-year fixed mortgage rates fell 40 percent. The rates, the initial rates on one-year regular vanilla adjustable rate mortgages fell 50 percent, so we head into a recession. Home ownership rate hits an all time high, which doesn't make sense, right? Normally you think recession, the whole thing falls apart, but in this case, because of the dramatic fall in mortgage rates and the fact that most of us still had jobs, we ended up in a situation with a rising home ownership rate, and affordability not a question because the rates were falling so fast.

House prices rising very dramatically, especially in high cost areas like Washington, D.C., New

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

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

Now, when they got very wide, those two lines here got very wide, especially 2003-2004, the mortgage markets were offering a wide variety of adjustable rate products in the form of what we call just regular hybrid ARMs. They are fixed for a period of time, and then become adjustable thereafter, but nothing bizarre between them. Regular mortgages just become adjustable.

This was a perfect contract for many borrowers who didn't need 40 years of interest rate insurance. They were going to sell the home in five years when their kids went off to college. Why not take a five-year insurance product? Five years of fixed interest rates that then become adjustable when you're going to sell the house anyway, so you get a lower interest rate, and that matched people's plans perfectly with their needs.

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

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

This is limited here just to the purchase side of the dark blue bars. The lighter blue bars show the fixed rate portion of mortgages for home purchase, and the green bars show then all the refinances, but as you can see, we've ended up in periods where ARMs were the dominant product. In the last two years they were more than 50 percent of mortgage originations for home purchase. Forecast is for that to get a little bit narrower, that fixed rates will take over, but we've had periods like this before.

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

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

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

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

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

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

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

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

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

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

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

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

A lot of the news, a lot of the data that we have is on loans newly originated. It's very hard among those resets that I told you about to say, Well, how many of those are regularly vanilla ones, one years and three years and so on, and how many of them are nontraditional, and the answer is, we don't know. It's very hard to get good data on that, but roughly 35 percent, 32 percent of the loans originated in 2005 that were then packaged into private label mortgage backed securities, adjustable rates, were interest-only or negative amortization. Negative amortization is not only option payment, but there are many different flavors of that as well, but that doesn't tell us anything about the debt outstanding.

Last thing, I'm going to close here with a little view of where are these products popular. Well, they are popular in the very highest cost markets. Along the bottom access, I have the median home price, the state home price, and along the vertical access, I have the share of interest-only and negative amortization loans for home purchase, and the correlation is quite strong. California and Hawaii and D.C., very high cost markets, are where we tend to see these products. Some lower cost markets, but for the most part, it's an affordability question, and in many cases very sophisticated borrowers.

I'm going to end now because Allen has some fabulous slides on who these borrowers are and how we got there.

(Applause.)

MR. DOLAN: Thank you, Amy.

Now Allen is going to be talking about the characteristics of borrowers who are looking into these types of loans.

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

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

The starting point for this effort to gather information was, as many people in the room and others have pointed out, is that we were mindful of changes in the market. We realized the rapid increase in nontraditional mortgages provided additional opportunities for many borrowers to become homeowners, but at the same time we are aware that housing appreciation and the struggle for consumers to afford homes in that environment were causing some people to turn to nontraditional mortgages, not so much as a choice, but really as the only option that they had, and we're concerned about what the impact on consumers would be.

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

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

Now, in reviewing a lot of material from the industry and news media and everything we can get our hands on, one of the things that struck us was that there was remarkably little information about the make-up of borrowers who were taking out nontraditional mortgages, a lot about the products and the rising of the products and very little about the borrower, and we noted that lending industry consultants and people in the mortgage industry were suggesting that borrowers who were taking out these mortgages had better credit scores and were wealthier, but that we saw there was little analysis that really provided information about the full spectrum of borrowers who were taking out nontraditional mortgages. (Now how do I do this?)

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

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

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

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

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

That's 62 percent higher than the national median income $44,389, and probably represents the median income of some of the high priced cities where many of these products are the most popular. However, if you look at this chart, you'll also notice that more than a third of interest-only borrowers have incomes under $70,000, and one-sixth of them had incomes under $48,000. One-third of payment option loan borrowers had incomes under 72,000, and one-eighth of them had incomes under 48,000, quite modest, particularly considering that it's likely that these borrowers were in high cost areas to a certain extent.

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

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

We also looked at the distribution of this database by LTVs. Generally borrowers with nontraditional mortgage products have lower debt loads than borrowers overall. The combined LTV ratio that measures overall debt, including junior liens from second mortgages or piggyback mortgages against the value of the property, we found over one-half of nontraditional borrowers had LTVs below 90 percent compared to over half of other kinds of borrowers who had LTVs higher than 90 percent, so there was a split between the nontraditional and the traditional products as far as we could tell.

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

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

Thank you.

(Applause.)

MR. DOLAN: Thank you. A reminder, if you have any questions, the cards are in your packets, if you could fill them out and when you see somebody who has one of the blue name tag ribbons, hand them off to them, and then they can pass the questions up to me.

As I'm waiting for questions, I actually have a couple of my own. Allen, you had referred to a couple of terms that I just wanted to define for everybody. One was the LTV ratio, if you could quickly define what that is.

MR. FISHBEIN: That's the loan to value ratio Generally in traditional market, LTVs are 80 percent or lower, but increasingly in recent years, particularly as borrowers have been strapped to qualify, they've been putting down less down payments, and we've seen the loan as a relationship to the overall value of the property increasing to 90 or even 100 percent financing.

I think some of the latest research indicates that 43 percent of first time home buyers put no money down last year in order to acquire their home.

MR. DOLAN: So in the hypo that was in the package where we laid out that everyone was -- the $350,000 loan was for the 80 percent, but we also signaled that we weren't identifying how they were coming up with the other 20 percent. That is then what would then play into the loan to value ratio.

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

MR. DOLAN: And the FICO score is?

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

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

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

MR. DOLAN: I noticed that each of you had different numbers regarding the percentage that these product have in the marketplace, and the Chairman herself had a different number, and I believe all of them are based on something that has been read. What accounts for these different numbers that people are using when they're talking about these products?

I will leave it to the whole panel.

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

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

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

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

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

MR. DOLAN: We had discussed what these products were. We discussed the borrowers in a certain amount of detail. Who are the other players in this marketplace on the other side of the transaction, and what incentives do they have when they're entering into these transactions? Again I'll leave it to the panel to decide who wants to jump in with that.

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

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

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

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

MS. CREWS CUTTS: There's another component of this, of the -- mortgage market is very complicated, lots of players in it. There are mortgage insurers that insure the lender against part of the loss. There are secondary market investors like Freddie Mac and Fannie Mae that buy the loans from the banks, so that the banks have more money to lend out to other borrowers, and then we sell those loans onto investors and securities.

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

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

There are brokers we talked about, and of course the newspaper media guiding. The personal finance media has gotten many consumers armed very well, almost to the point where sometimes they dictate the terms of the loans to the people they go into, and that's one of the best things we've done in the last ten years is to arm consumers with great information, so many players, many sides.

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

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

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

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

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

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

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

MR. DOLAN: Greg, you had mentioned the 50-year mortgage at the end of your presentation. What other advantages does it have other than the predictability of the monthly payments?

MR. MCBRIDE: Even that predictability is limited to a five-year horizon because the interest rate becomes adjustable at a five or seven-year period, so I think even in terms of that advantage, I think that's a rather limited advantage. I think the 50-year product -- I think the 50-year product lacks a lot of the advantages that maybe the 40-year might have over the 30-year, and the reason I say that is the 40-year, you at least have the option of a fixed-rate product, and so that there is not that payment or interest rate variability that you have with the 50-year loan.

The other thing is that the longer you stretch out that loan term, it has a smaller and smaller effect in terms of reducing your monthly payments, but a larger and larger effect in terms of retarding the process of balancing your payment, and that equity cushion that you get by chipping away at that loan balance is especially critical in a slowing appreciation market and in a situation where borrowers have more of a shorter time horizon with the idea that, Well, I'm going to move on.

That 50-year loan with the rate fixed for five years, the product or the fixed rate for five years you would argue is best for somebody who is only going to be in the home for five years, but with the 50-year amortization schedule, you're not going to build a whole lot of equity in the course of that five years. That lack of equity cushion could really bite you when it comes to sell.

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

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

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

So there are some advantages of the fixed-rate interest-only loan, but I think one of the advantages is that it really lets you manage how you want to chip away at that balance, whether that's building a sufficient equity cushion whenever you want to sell or just minimizing the payment shock at the 10 or 15-year mark when the loan converts.

MR. DOLAN: Bringing Amy back into the conversation, are the government sponsored entities purchasing ARMs? If not, why not?

MS. CREWS CUTTS: Alternative mortgage products? Yes, we are. We have been a late arrival to this stage. In the past year we have started to purchase option payment mortgages. Fannie Mae had been purchasing interest-only mortgages for a longer period than Freddie Mac, but then again, both of us were a little late to this party, and we don't offer as full a range of products. There are many more products out there than we are currently purchasing.

MR. DOLAN: Several of you talked about how these nontraditional mortgage products have grown in the high cost markets such as California or D.C. Is there any explanation why they have grown in -- I guess the first question is: Have they grown in non-high cost markets, and if so, is there any explanation why they may be coming more prevalent in those markets as well?

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

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

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

They didn't even think they had the ability, particularly in high cost markets, to be able to afford traditional products, and so regardless of the risk, they were inclined to take out these loans as the only means they have to qualify.

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

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

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

And they are in the process of renegotiating the contracts with the people who supply data to identify interest-only mortgages and option payment mortgages. They already have negative amortization but not option payment specific, so we're maybe two or three years away from having great data on what happened in the past couple of years, but that data will be retrospective once they get those contracts renegotiated.

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

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

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

MR. MCBRIDE: I think that risk is something that lenders decreasingly are bearing themselves, and I think that's why you see some of those standards that have become more lax, because of the presence of the secondary market where lenders can sell these products into the secondary market and essentially off-load the risk. It's then diversified among the range of different investors.

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

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

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

So one of the things we found and we cited is that borrowers were expressing interest in wanting to know what the foreclosure risk was for different loan products. All of the disclosures that are talked about that would be useful to consumer, consumers were saying, Well, we want to know what the chances are on a statistical basis of the loan not being able to be paid, and I thought that was a very interesting idea that reflects this unease and concern that at least some borrowers in the marketplace have with these products.

MS. CREWS CUTTS: I would like to jump in here also with a view a little bit on the other side. Most borrowers who buy a home and have a mortgage on it have the intention of living in the home, living the American dream and want to keep the home.

At the time they take out the mortgage, I think they think that they have the capacity to do this for the long-term, stay in the home and pay this mortgage as agreed, but bad things happen to good people, right? The best of intentions can sometimes go awry.

One of the slides I did not get to in trying to be mindful of the clock, but it's in your packet, it's page 4 here on the bottom, but it's the slide that's numbered 11 in mine. Job loss is the number 1 leading reason why people get very far behind on mortgage. This comes from Freddie Mac's analysis of borrowers that have gone delinquent and get contacted by the servicer, and the first question is: How did you get here, what happened to you?

So job loss, income curtailment which could come from losing over-time perhaps or a cut in pay, maybe like the United Airline pilots who had to renegotiate their contracts or business loss.

The number 2 reason is illness in the family. Now, maybe job loss is related to that illness, if the child was sick enough that you kept skipping work, and finally they said, You know what, we don't need your services. It's hard to know exactly how those come together, but illness being the number 2 reasons. So things can happen to derail that on the way. Best of underwriting may not forestall that.

One other thing I want to close with here is that as interest rates have risen, mortgage lenders have lost a very valuable foreclosure prevention tool called the loan modification. When interest rates were falling, if somebody had an 8 percent interest rate, lost their job but got a new job but couldn't quite make it back and get fully reinstated, the borrower -- the lender had the option to negotiate with the borrower a new loan, a loan modification maybe at 6 percent, a new market rate at 6 percent, which would relieve some of that burden, but with interest rates rising, if you already have a 6 percent mortgage, we can't save you that way because market rates today are 6 and a half, so we've lost a powerful tool simply by interest rate turning the corner.

MR. DOLAN: You actually anticipated a question I was going to ask so thank you.

We have one minute left, and I want to leave with this last question: Are there now products offered by the lender -- I think the question is: Are these products offered by the lenders approved before they are able to be offered to the borrowers? Is there any kind of prescreening for these types of products?

MS. CREWS CUTTS: That's a great question for somebody who is talking to the borrowers directly. I don't now have an answer for that. Do you?

MR. FISHBEIN: I'm not sure.

MR. DOLAN: I suspect one of the next panels with the government regulators might be able to better answer that, but I'll leave it with that.

Thank you very much, all three of you, for your thoughts and expertise.

(Applause.)

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

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

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

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

For those who are listening on the audio-only line, the presentations are now accessible on the FTC's mortgage workshop web site, which is ftc.gov/mortgageworkshop, so with that housekeeping taken care of, your panel is all set? Okay.

So I think we're ready to move on to the next panel, and that is on evaluating consumer benefits and risks, and we'll explore those issues that we began in the first panel more thoroughly, so this panel will talk about the benefits and challenges that these new mortgages may pose for consumers, and I'm now happy to introduce Jesse Leary, who is the assistant director in the FTC's Bureau of Economics, who will moderate the panel.

PANEL 2: "Evaluating Consumer Benefits and Risks."
PANELISTS:
JESSE LEARY, Moderator, FTC
STELLA ADAMS, Executive Director, North Carolina Fair Housing Center
ROBERT BROEKSMIT, Chairman, Mortgage Markets Committee, America's Community Bankers; President, Mortgage Lending, Chevy Chase Bank
DOUG DUNCAN, Senior Vice President and Chief Economist, Mortgage Bankers Association
PATRICIA MCCOY, Professor, University of Connecticut School of Law

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

On this panel we have Doug Duncan, who is the vice president and chief economist with Mortgage Bankers Association; Patricia McCoy, who is a professor of law at the Connecticut School of Law; Bob Broeksmit, who is COO of the B.F. Saul Mortgage Company, Chevy Chase Bank's residential lending subsidiary, and in addition, Bob is the chair of America's Community Banker's Mortgage Markets and Lending Technology Committee, and he is also on the Mortgage Bankers Association's Residential Board of Governors; and we have Stella Adams, who is the director of the North Carolina Fair Housing Commission or --

MS. ADAMS: Housing Center.

MR. LEARY: Sorry, thank you.

The way we're going to try to run this panel is we want to have as much of a as discussion as possible. A couple of the speakers do have presentations. I've asked them to give them as quickly as possible, and I'll again do that now in front of everyone just to repeat that. And so Doug and Patricia both have slight presentations, and Bob and Stella I've also asked to speak for a few minutes about their views on these issues, and then we'll try to really quick move into more discussion, more question answer.

I'll have some questions, and we'll take questions from the audience I guess using the cards that have been handed out and, I encourage the panelists, if they have questions of each other, to ask questions of each other try to make this as free flowing and interesting as possible.

If folks could hold their questions during presentations, and we'll move to question and answer period as quickly as we can, so with that, Doug, could you start?

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

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

I want to start with something that was made, particularly the last point, with regard to financial literacy. You'll find that the mortgage industry is very committed to financial literacy, and when we speak to the public, there are a few basic principles that if they were consistently applied, we would solve about 95 percent of the problems. They are: For the consumer, before they even look for a house, to decide what they need versus what they want, and those are two substantively different things. They probably have different prices.

The second thing is for the consumer to know their own financial profile. It's amazing how many people do not know what they look like to a lender when they walk in the door, puts them in a disadvantageous position in terms of bargaining.

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

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

The third Sunday, he came and preached the same sermon, and the congregation and the elders came and asked him, What's up with that? He said, Well, I'll change the sermon when you change your behavior, so you won't go out of business trying to convince borrowers to educate themselves and bring a solid position to the table.

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

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

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

The key to understanding what's going on in the demand side in the economy is the behavior of consumers and why they're behaving the way they are. Some of this was already covered in the first panel, so I'll take one minute here. First of all, they're looking at a wider variety of affordable products. Second of all, they're matching loan terms to their time in the property, and the third thing is that they're actively managing the balance sheet.

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

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

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

But the answer of the other three was instructive. Two of them said, We work for firms where we have a 401 K that matches dollar for dollar the first 6 percent of our pay that goes into the retirement fund, so we've looked at the returns being 100 percent on every dollar that we put into that retirement fund, whereas if we were paying principal in on our mortgage, we would only get returns at the pace of appreciation of housing. That seemed like a pretty intelligent investment strategy.

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

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

Now, what are consumers doing today? They're definitely shifting to fixed rate products so that when I showed you that ARM application index, that it had started to decline, what's happened is, as the Fed has raised short-term interest rates, consumers have lost the advantages of those adjustable rate products, and the two left -- the bars that go to the left here are both products that have adjustable interest rates to them, and you can see that consumers are shifting away from them.

This is the second half of '05, the first quarter of '06, an even stronger rate to fixed-rate products, so as the market is changing, consumers are changing. Here's some applications from the month of March. What's interesting here on the left side are refinance loans. On the right side are purchase loans. Only 35 percent of the market was for loans to refinance a mortgage, 65 to purchase, but the share of adjustable versus fixed-rate products within each of those categories was the same.

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

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

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

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

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

So you have about 34 percent with no debt, about 48 percent with fixed rate debt. The remainder have adjustable rate debt, so it's somewhere in the 18 percent of households. Now, the other number you will see is people talking about just those who have a mortgage. If you eliminate the people who own a house outright and you go with those that just have a mortgage, it's somewhere in the neighbor of 25 percent have adjustable rate mortgages. Just to give you kind of the big picture of when the interest rates change or payments change, what share of the home owning public or the mortgage public we're talking about.

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

(Applause.)

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

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

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

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

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

So what we find is that today in month one, he pays $1,750 a month just to pay off interest in his loan. In month 61, which is the first time that his loan will rise, his interest rate rises from 6 percent to 8.8 percent. His monthly payment goes up $969, which is slightly over 55 percent, and depending how much disposable income Isaac has, that may be a big shock.

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

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

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

Now, Amy and I both were fascinated by the same chart which is by Christopher Cagan at Loan Performance and its parent company, and what's interesting about this chart is on the far left side, the red bars, adjustable rate mortgages, first mortgages in 2004 and 2005, quite a good number of them, about 17 percent, started out with interest rates of under 2 percent.

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

Now, of these loans with initial interest rates of 1 to 2.5 percent, if you see where I clearly put the little red markers, 21.5 percent of them are loans in which the loan is larger or the same as the value as the home. In other words, the homeowner has no equity left, in one fifth of these homes.

If Isaac eventually has problems repaying his loan, he needs to somehow resolve these problems. Either he may want to sell, but if he does, he's not going to get enough for his house to repay the loan, or he may seek to refinance, but the mortgage bankers have done a wonderful analysis of how easy that may be to do in a rising interest rate environment, and what we see, the loan that has been captioned in red, the average 5-1 I-O is essentially Isaac's loan, and we see that he only has one refinancing option of these various loans, a teaser ARM of 1.5 percent, so he has very few refinancing options left for him.

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

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

So, why do our borrowers get themselves into these crazy situations if you have no equity and a limited ability to make higher payments? There's some concepts from a new field called behavioral economics. It helps us understand this, and one is the concept of loss aversion. That just means that people don't like losses that are certain, and they will maneuver to try to avoid them, so here Isaac may see his choices, as he's thinking about getting this loan, as I'll have to make higher payments now if I get a fixed rate loan, that would be a certain loss because I'll have less money for other things versus let me get lower payments now with my interest-only loan and possible higher future -- higher payments in the future.

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

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

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

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

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

Instead, the law allows a lender to just assume that your mortgage is only $10,000 interest and run out a projection of how high the monthly mortgage payment could go on $10,000, and then you have to do the rest of the math.

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

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

So with that, I conclude, and thank you.

(Applause.)

MR. LEARY: Thanks, Pat. Bob?

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

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

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

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

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

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

So in order to get an option ARM from Chevy Chase Bank or other members of America's Community Bankers, you need to qualify for a fully amortizing principal and interest payment at 7 percent. If you can qualify for that, you can get whatever mortgage you want because fixed rates are at that level or below, 5/1 ARMs, all of the mortgage options out there -- and I'm speaking about the prime world at the moment, all of the other mortgage options out there are at or below that rate, so some of the comments earlier about people taking this mortgage because they had to, it is the only way they could afford the mortgage, that characterization does not apply to lenders who use this qualifying methodology. And most lenders do use that.

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

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

Another topic I wanted to touch on is this notion of payment shock, which is a very real one when you start off with that payment, that very low payment, but again back to qualifying borrowers at this fully indexed rate, if you qualify a borrower at that fully indexed rate with a fully amortizing payment, and our loans recast at 110 percent. You have seen some of the other ones are higher, but we would recast at 110 percent of the original principal balance.

So based on recent figures, that would happen three years into the loan if you made nothing but the minimum payment every month, and we, like most lenders who offer option ARMs, give the option to the borrower every month on a payment statement that says, Here's the minimum payment, interest-only, 30-year amortizing, 15-year amortizing, so every month that borrower has to make an affirmative choice to make the smallest payment available to them.

If they do that every month for the first three years, given current interest rates and the spread interest the introductory rate and the fully indexed rate, they would recast at 110 percent after 36 months, so three years into the loan. At that point their payment would be recast over the remaining 27 years of the loan, and their principal balance would be 10 percent higher, so their payment would increase by 13.5 percent over the payment at which they were qualified.

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

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

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

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

We have also I think again 110 percent ceiling on our negative amortization. We have never had a borrower exceed 103 percent, which suggests that the borrowers who, the 50 to 65 percent who in a given month are making a payment that amortizes negatively, aren't continuously doing that, and I will grant that we've been in a benign interest rate environment in 2004 and -- 2003 and 2004, which made it more difficult to amortize negatively, but so we are seeing more negative amortization with rates' rise, about in that time the negative amortization figure was much lower than this 50 to 65 percent.

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

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

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

This $2 and a half billion pool after the same 20 month interest-only owed 97.6 percent of the original balance, which says that these borrowers were contractually obligated to pay no principal, and they choose to pay principal 2.4 percent of the original loan amount that exceeded the amount of scheduled principal they would have had on a fixed rate product, so I think that says something about the borrowers that are taking this product and how they are qualified to get into the product.

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

Thank you.

(Applause.)

MR. LEARY: Thank you, Bob. Stella?

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

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

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

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

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

If you -- that's like asking for a second opinion from a cancer specialist. If you don't know, unless they tell you it's really bad, you don't have any reason to shop. If they tell you this is the best you can do and you can have your dream, and what we have to understand here on these products is that you're telling -- is that you're telling borrowers they can get more for less. You're saying this fixed rate loan at 30 years where you know your payment is going to be going to be $1,500, but with this option loan, you can have the same house for a thousand, interest-only, maybe 600 with the minimum payment.

It's not like you're offering different things to shop with. It's the same house. It's the same amount of mortgage, but you're giving me the option of payment price.

We tested in 2004 -- we issued a report called the summary of which is called Cash in the Face, and we tested at the upper income level, and I'm so happy, Allen, that you've done this -- he's gone, no, he's not. I'm so happy that you did your study because it confirms my testing study. We tested in five markets initially at the upper income level because we had seen a disturbing trend that upper income African Americans and upper income Latinos were more likely than low income whites to have sub-prime mortgages, and what we wanted to find out was, what percentage of that was based on discrimination, so that was the purpose of the study.

But when we got there, we found some interesting behavior in that market that we hadn't seen before. The African Americans and Latinos were more often offered interest-only products and pay option out products than the white borrower, but what was more damaging and scarier than that, was that none of the borrowers -- none of the borrowers understood the risk associated with each product.

There was one really great lender in Cleveland, Ohio, who explained the risks. This is why I know what the risk is because he explained it to every single borrower. He was perfect. He explained it to the -- every single tester that went into him got the same routine the same way, but he asked the question upfront, How do you consider yourself: Are you a mattress under the bed kind of person, or are you like spending, free wheeling in Las Vegas, or are you somewhere in between?

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

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

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

(Applause.)

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

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

The other extreme, the most extreme would be people who are just being lied to about what they're getting, and for those kinds of situations, we sort of know how to deal with those kind of lenders. That's the FTC goes after those sorts of people when we know about it and when we can.

And then it seems like there's a lot of people who are somewhere between those extremes, people who maybe they get the basic idea, but they're not doing sort of muddling through the problem. They don't have a real sophisticated understanding of what the product is, but they get the point and they can make some judgment of whether it works for them to people who maybe don't exactly have -- sort of a little more towards not really understanding what the situation is, and my first question is, I guess when you don't really have enough of an answer to that, that Allen was getting at initially, that Allen's presentation was getting at this morning is, do we know much about what the mix is of people, kind of how many of these products are going to people who really have a good understanding and how many are going to be people who might not know as well what the situation is or be in a position to make a good judgment about whether the product will work for them, or is it just something we all would like to know more about?

Stella?

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

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

That's a responsible use of income. There are things that are going on. The only thing you can lock down for 20, 30 -- 15, 30 years is your payment on your mortgage. Everything else is influx, and I don't think that people, when they're being sold these loan payments, are really -- I know, we tested 24 banks, one bank explained it. We tested in seven cities, and it's, not being explained to borrowers, and these are upper income. These are the borrowers for whom these products are appropriate and who should be sophisticated, but they were not explained to them at all, not one bit. Didn't happen, except one bank.

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

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

MR. BROEKSMIT: I don't want to turn this into a point, counter point, but I do want to reply to Stella that if we qualify you at the fully amortizing, fully indexed payment, your ratio is 40 percent or less, meaning you still have 60 percent of your income to pay for the higher fuel costs, so that's a portion of the analysis that, of course, I'm not trying to impugn people from paying their heating bills.

The question here is how are they explained, and one thing that we are diligent about is understanding that mortgage brokers, most studies would say do about two-thirds of the mortgages in this country, and there are thousands of them, and how do we as a lender know not being in the room when the product was explained to the consumer, know that the mortgage broker did a good job of this?

So what we do is, in addition to requiring evidence that the mortgage broker provided the appropriate disclosures to the consumer within three days of application, when we get the file into underwriting, we redisclose and we redisclose directly to the consumer, not through the broker, so if the broker glossed over some of the points of the mortgage or had incorrect disclosures, we make sure that, well in advance of the closing, they get the right ones from us as well.

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

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

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

MR. DUNCAN: Let me just pull together the previous question on the data that's available and the issue of disclosure because we're within the association -- I think our incoming chairman wants to have a task force to look at the efficacy of disclosures to make sure that consumers are indeed getting upfront, as you suggest, the kind of information that helps them be good decision makers, plus there's been an effort underway for a number of years to try to reform the Real Estate Settlement Procedures Act to make things more clear for consumers to shop.

In the absence of those things today, with regard to data, Amy did a nice job of describing how you have to kind of compile pieces together from various sources to get a reasonable composite of the local -- or of the total marketplace, but there is a mechanism in place in the markets which enforces a certain level of discipline with regard to the loan terms that are being offered and that is that a significant portion of loans are ultimately bought by investors as collateral to mortgage backed securities.

And the investors get a great deal of information revealed to them in the prospectuses for the mortgage backed securities about the characteristics of the borrowers who have those loans, which are the collateral for the security, and to the extent that they don't perform as expected in terms of the yield to the investor, the pricing changes, for example, if Bob's company were to sell that collateral and it didn't perform as promised and the pricing is going to be altered and that will be a form of punishment to Bob's company for not performing according to expectations, so if he underwrites the loans in a way that leads to a misrepresentation of what the investor is going to get, ultimately it hurts him economically.

And the way that the broker is disciplined is companies like Bob's will run a score card on the performance of the loans that's brought to the table by the broker, and if it doesn't comply with the characteristics that are required for that collateralization process, either the broker gets punished in pricing or are thrown out of the system by the lender, so there is a mechanism there in the absence of perfection of information to discipline the bad actors.

MR. LEARY: Thank you. I'm going to move into the questions from the audience, and they've given us another five minutes, so hopefully we can get through a few of these. Does anyone on the panel have legislative or regulatory recommendations to deal with the problems that you see, to the extent that you see problems in this market?

MS. MCCOY: Let me just make two broad recommendations. One is I do think we need to rethink disclosures, and that's not only for these types of products but also just generally in the sub-prime market. They worked in the old fixed mortgage days pretty well for the Truth In Lending Act, but they don't work very well for these newer mortgages.

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

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

We would be in favor of standardizing that across the nation so that there isn't an imposition of multiplicity of costs of having to meet multiple state regulations, which ultimately comes back to the consumer in terms of the cost of giving credit to them, so we would certainly be in support of a nationwide standard.

MS. ADAMS: I think it's important, one, make it easy so I can understand it. If you add -- instead of $10,000, if you just add zeroes behind each of those numbers, that might scare enough people just by itself, and two, I think it's imperative, this is the most -- this is the biggest investment that most Americans ever make. When you're a big time -- if you're investing on Wall Street, you've got to be a sophisticated investor. The products have to be suitable to you to be offered to you, and there's a suitability standard for when you buy something, investment on Wall Street, but there's no suitability standard that is attached to making sure that the loan is suitable to the borrower.

In the past, underwriting served that purpose, but when we have a diverse market where we don't have the controlled market that we had in the past, where the lender kept it in his books or he sold it to the government, and those were the options, that was regulatory coverage. Now that you can find somebody who will buy anything, as long as he can make a profit and make it quick and they can price it for risk, we don't have the market discipline in place, and so now we need a suitability standard in place because the person who bears the risk, who all the risk falls on is the borrower.

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

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

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

MS. ADAMS: Bob, when you discount, if you're talking about market rate ARMs, where we're really rolling the dice, and I have a chance to get a lower rate and you have a chance to get a higher rate, that's okay, but when we've discounted down to 1 percent, there is no way in the world that I am ever going to get that.

MR. BROEKSMIT: I qualified you at 7.

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

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

MR. BROEKSMIT: Maybe it's semantics.

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

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

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

MR. LEARY: I think I'll ask one more question here. Are there data on borrower behaviors in terms of paying down principal in the sub-prime market? Bob had some data on prime borrowers. I think we expect the data to be quite different, but do we have information on that?

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

MR. FISHBEIN: That's right.

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

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

MR. LEARY: Okay.

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

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

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

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

(Applause.)

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

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

(A brief recess was taken.)

PANEL 3: "Protecting Consumers: Current Regulatory and Law Enforcement Issues."

PANELISTS:

PEGGY TWOHIG, Moderator, FTC

DAVID BLEICKEN, Director of the Bureau of Licensing, Investigation and Consumer Services at the PA Department of Banking

SANDRA BRAUNSTEIN, Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System

APRIL BRESLAW, Acting Associate Director, Division of Supervision and Consumer Protection, Federal Deposit Insurance Corporation

MICHAEL BYSLMA, Director, Division of Community and Consumer Law, Office of the Comptroller of the Treasury

IVY JACKSON, Director, Office Of Real Estate Settlement Procedures Act, U.S. Department of Housing and Urban Development

GEORGE KINSEL, President, American Association of Residential Mortgage Regulators; Director, Non-Depository Examination, Consumer Credit Union, Maryland Commissioner of Financial Regulation

MS. TWOHIG: Welcome back, everyone. We're running a little late, so we should get started. Okay. We're ready to go with our next panel, which will be focusing on protecting consumers: The current regulatory and law enforcement issues. I'm going to be moderating the panel. I'll introduce the panelists all at once from here, and then I'll sit down, and we'll mostly have our discussion from the table.

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

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

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

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

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

If you have questions for the panelists, just send them along to those that are picking up the questions, and about halfway through this panel, we will break and ask some questions, and then I'll take some questions at the end, if we have time.

So moving along to our panelists. First, we have Sandra Braunstein who is Director of the Division of Consumer and Community Affairs of the Board of Governors of the Federal Reserve System.

We also have April Breslaw, who is Acting Associate Director of the Division of Supervision and Consumer Protection at the FDIC.

We have Michael Bylsma, who is Director of the Division of Community and Consumer Law at the Office of the Comptroller of the Currency.

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

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

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

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

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

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

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

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

Truth In Lending is a little context for this. One of the things we need to remember is that when Truth In Lending originally came about, both the statute and when we originally wrote Truth In Lending regulations, adjustable rate mortgages were a very, very tiny percent of the marketplace, and in fact Truth In Lending originally didn't deal with adjustable rate mortgages. It was written for fixed-rate mortgages, but as these things grew in importance over the years, we added requirements for disclosures for ARMs.

Now, we're always trying to gather information in order to improve disclosures, and we get information all the time from lenders, from consumer groups, from consumers themselves about how these disclosures work, and one of the things that we're planning to do, because we do know that we are overdue for a major review of fixed credit and of mortgage disclosures. It is something that is on our agenda, and one of the things that we're going to be doing this summer, you may have seen, we've already announced them, is we're doing a bunch of hearings on home equity lending over the next month and a half.

We're doing hearings in four different locations around the country, and part of the agenda for those hearings is to gather some more information on these nontraditional products and to see and hear specifically about the disclosures that are given and the adequacy of those disclosures, and eventually we will be kicking off a review of closed end credit, of mortgage disclosures, and we will be looking at this.

The other thing that we do is that we now have made it a mandatory part of rule makings like this to do consumer testing, and I just wanted to mention that you may know that we currently have a rulemaking going on on open end regs and credit or Truth In Lending, and which really deals with credit cards, and we are working on consumer testing.

We've hired a firm. We're doing focus groups. We're going to be looking at new disclosures in that line of business. We plan to do the same kind of rigorous work when it comes time to do the disclosures for closed end mortgages.

An overview of the disclosures: I'm going to walk you through, as Peggy asked me to, just a sample disclosure, and I just wanted to set the context that disclosures required by Reg Z are given to a consumer three times: First of all, when a consumer gets an application for an ARM; when or before the applicant closes on the ARM; and then during the loan term when the payment and interest rate changes.

When somebody gets an application form for an ARM, one of the things that is required by us is that they receive a booklet about ARMs, as we call it,the "CHARM" booklet, and I have an example of this, a sample of it, and basically that is the consumer handbook on adjustable rate mortgages, hence "CHARM", and actually before this started, Mike Bylsma was saying that too he helped write this when he was at the Fed. He's really proud of this.

MR. BYLSMA: I love the $10,000 example.

MS. BRAUNSTEIN: The CHARM booklet that's given to all consumers explains in general how ARMs work, and educates the consumers about the risks of payment shock and negative amortization. However, it does not discuss, currently discuss the heightened risks of these nontraditional mortgage products, and it's something we're looking at in terms of updating this booklet.

Now, in addition to the booklet, a program description is also given, and that is one of the disclosures. And they must get a detailed description of the ARM program for which they are applying, or programs, if they've expressed interest any others, and let me go to the first slide. Okay.

This I want to say is I don't expect anybody to read these slides. They're very dense. That's the nature of the beast, so in fact one of the things I'm most disappointed about was, that I was looking forward to is that I have this laser pointer so that I could show you things, but the way the room is set up, it's not going to be very practical to use, but I'm just going to give you some ideas of the kinds of information that is included in these disclosures.

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

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

Now, this raises a lot of issues looking at the first page of this disclosure, and some of the issues that this raises for us is whether or not consumers, one, can read and understand this information or if they find it useful. Possibly -- you have to keep in mind that this is given, but also at the same time there is a lot of discussion that goes on between the borrower and the lending officer, so this is not just given in a vacuum. They're also getting the CHARM booklet.

They're getting other information besides this, so you don't know how much more they're being given by the lenders that might help explain some of this, and so we need to get answers to some of these questions. Is this something they can use to shop further, to look at other program descriptions from other lenders? Is this too dense for people to read, and should it be boiled down to one or two major points? So these are the kinds of things that we're going to be looking at through consumer testing when we do our review.

Page 2 of the disclosure, once again I know this is also dense. Basically the highlights of this, how your payment can change. That's the heading at the top in the black bar. The second page of this program description is really devoted to how the payment is determined on the option ARM. The consumer is told in here that their payment can increase substantially as a general matter. They're also told that -- there's a warning that the loan amount could increase because of negative amortization, and that's down in the largest box in there.

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

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

Also the regulation currently does not really contain any format requirements other than the information be conspicuous, and you'll see that the part -- I think you can see that on the slide at the bottom of that really big box, that last sentence is bolded a bit, and that's the sentence that refers to the negative amortization, and that was this lender's I think attempt to make that more conspicuous and bring it to the attention of the borrower, but we need to consider whether we should impose or at least model some additional format requirements that highlight the key risks of these products and to help make comparison shopping easier.

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

First of all, does the consumer get through those first two pages even to get to this third page to see this example of what can happen, and do consumers ignore worst case scenarios anyway because people a lot of times never think worst case things are going to happen to them? But the big issue raised by this, I know in my mind and I think for everybody, is: Do consumers do the math and can they do the math in some cases and do they understand that, that you have a $10,000 example here, and they have to somehow translate that into a much larger mortgage? So again these are issues that we are looking at, and we will be looking at when we do our rulemaking.

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

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

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

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

MS. TWOHIG: Thank you, Sandy, but don't sit down yet. Sandy has one more topic I want her to comment on, but I really appreciate that very helpful explanation of current disclosure requirements. I know it wasn't a fun assignment, Sandy, but I think it's critical information for us all to understand what the baseline is, where are we now in terms of disclosure requirements before we can move on to have a full discussion of where do we go from here.

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

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

Basically we felt that there was a need for guidance obviously because we needed to address more than what's currently in the Reg Z disclosures. We wanted to cover not just the written communications that are given, but the guidance actually talks about even the oral communications and the explanations that are given to borrowers. We also wanted to focus on the heightened risks that are connected with these nontraditional mortgage products, the payment shock, the negative amortization and other kinds of risks to consumers.

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

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

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

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

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

(Applause.)

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

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

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

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

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

The banking agencies enforce the FTC Act with respect to the institutions under our supervision, so when we get into questions about whether advertisements are misleading or deceptive, that's the tool we would use to evaluate a situation. We do note in the guidance that state law may be applicable, and we are certainly aware of that and are looking forward to hearing about some of those state laws a little bit later on in the presentation.

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

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

With respect to that, our concern with how consumers get information is really paramount. I think somebody said in one of the earlier panels, and we absolutely agree with this, that consumers should receive information at decision points, at the point when they're shopping for loans, at the point later on where they're making decisions each month about how much to pay, so that's really a critical aspect of the guidance, which is that we encourage lenders to provide information at those points in time.

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

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

With respect to payment shock, we think that institutions should disclose potential increases in payment obligations in both dollar and percentage amounts. They should describe when structural changes will occur. With negative amortization, they have to tell people that if you make the minimum payments, your principal balance is going to increase, and that will also likely decrease the equity that you have in your home.

With respect to prepayment penalties, we would encourage people to explain their existence and the amount. Also we have seen or heard of some situations where people are encouraged to get involved with these products and told them, You know, what you can refinance your way out of in X years down the line. Well, that may be a possibility, that may be true, but if there are prepayment penalties, they also need to be told that because that would obviously be a cost of doing a refinance transaction later on.

With respect to reduced documentation loans, which I think Mike is going to talk a bit about what we would call the safety and soundness concerns that we have, but we are seeing kind of a trend where these products are offered as low doc or no doc products. That's legal. You can do that, but if there's an increased cost because you're offering a low doc product, then they also need to explain that to consumers, particularly where they offer other types of products.

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

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

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

So that's the consumer side I guess in a nutshell, and with that I guess, I'll let Peggy do the next section.

MS. TWOHIG: Thank you, April.

(Applause.)

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

MR. BYLSMA: The other aspects sounds ominous.

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

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

Well, these market pressures also are affecting underwriting practices, as you've heard earlier today. Nontraditional mortgages used to be made available primarily to high income, high asset customers, but given the competition in the market and the demand for affordability products, lenders have loosened their underwriting standards to qualify a broader range of consumers than ever before, even sub-prime borrowers to enable them to qualify for loans that they could not otherwise qualify for using traditional loan terms and traditional underwriting standards.

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

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

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

So the borrower that makes minimum payments will face negative amortization, and with negative amortization you not only don't make any progress in paying down your loan, you also get deeper into debt.

Now, when either of these two loan types carries a teaser introductory interest rate, underwriting the loan based on the borrower's ability to make the payments at that temporary low interest rate level, and they should be considering instead the borrower's ability to make the payment at the fully indexed rate level.

And there's some other underwriting practices that we have expressed concern with in the guidance, in particular when lenders add on or layer additional risk factors onto a nontraditional loan product. This risk layering includes, for example, when a lender doesn't verify or document income, assets or liabilities of the borrower or when the lender lets the borrower take out a simultaneous second mortgage to finance a down payment.

This raises the home equity that's put at risk, and it raises the loan to value ratio, or when a lender loosens its debt to income ratio standards to qualify borrowers, and finally when lenders loosen other underwriting standards just so they can qualify borrowers with weak credit profiles.

People may disagree about the extent to which nontraditional mortgages and nontraditional underwriting practices may pose risks to the safety and soundness of lenders, but in my opinion there shouldn't be any disagreement about the fact that changing economic conditions and a housing price decline will put more stress on portfolios of these loans and more stress on borrowers, and that's why the proposed Interagency Guidance that April mentioned devotes a significant amount of attention to underwriting, the need for banks to follow prudent underwriting procedures in connection with nontraditional mortgages.

It also addresses other issues like the need for banks to use strong risk management controls and appropriate capital and loan loss reserves when they offer these products. I'm going to focus right now on the underwriting guidelines that we propose, because they have the most direct relationship to consumer protection issues that are the focus of the workshop today.

First of all, the guidance that we proposed emphasizes the cardinal safety and soundness rule for lending, which is banks should properly assess a borrower's ability to repay the loan. The principal is critical in connection with nontraditional mortgage mortgages because of their potential for interest rate increases, payment shock and negative amortization.

It's no small problem either for the bank or for the borrower when loan underwriting is so defective that the borrower's only options are to refinance the loan or sell his home because he can't make the payments when the loan starts to amortize, so to address these concerns, the proposed guidance says that a bank should evaluate a borrower's ability to repay the loan as if the borrower will be required to make fully amortizing payments at the fully indexed rate beginning with the first payment.

For loans that permit negative amortization, the guidance advises lenders to qualify borrowers based on their ability to repay, to make the payments that would fully amortize a loan balance. That would be the total amount that the borrower might end up owing. In other words, the loan should be underwritten based not only on the borrower's ability to make the payments on the face amount of the loan but the face amount of the loan plus any potential negative amortization. That's what we propose.

We also said lenders should prevent over reliance on credit scores in qualifying buyers in lieu of or as a substitution for documenting income. We didn't say that no doc and low doc programs are inappropriate, but they do pose risks, and so the guidance says that reduced documentation programs and stated income procedures generally should be used only in conjunction with risk mitigating factors like a lower loan to value ratio.

Finally, we touched on sub-prime lending in this guidance, and Stella talked about this earlier. We advise lenders to carefully consider circumstances when, if ever, they would offer nontraditional mortgage products to sub-prime borrowers, and we advise banks to follow existing Interagency Guidance on lending to sub-prime borrowers to avoid predatory practices. This should help them limit the risk to the bank and limit the risk to the borrower.

That was an overview of the safety and soundness guidelines in the interagency proposal. I wanted to highlight one other aspect of the guidance, and April touched on it, because it was a focus of substantial adverse comment by lenders, and it concerns oversight of arrangements with third parties like mortgage brokers.

Banks increasingly rely on third-party originators to make mortgages, and this can help them originate more loans with greater efficiency, but it can also pose several risks, litigation risks, reputation risks and credit risks, and the risks are of particular concern when banks deal with third parties like mortgage brokers that may not be subject to effective regulatory oversight and enforcement at the state level.

So the proposed guidance recommends that banks develop strong internal control systems to ensure that actual lending practices conform to these guidelines, both in underwriting and consumer protection for loans that the bank originates directly or through brokers and for loans that it purchases.

And the two specific recommendations in the guidance I wanted to mention are that lenders need to monitor the type of information that is given to borrowers by third-party originators in marketing, and they need to review their compensation systems, as April mentioned, to make sure that there is not inappropriate steering of borrowers to particular loan products.

The last thing I want to cover is to give you all sort of an executive summary of the public comments that we received on this proposed guidance. We got a fair number of comments, and I can say generally speaking, lenders and lender trade organizations thought the guidance was overly prescriptive, to use their term, in several respects.

As I just mentioned, for example, they were very critical of some of our recommendations about oversight of third-party originators, and they brought up practical problems in the feasibility of actually monitoring transactions with thousands and thousands of brokers, particularly when a bank buys loans in bulk or a portfolio in a wholesale transaction.

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

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

Some industry comment letters urged us to either delete entirely or substantially pare down the consumer protection section of the guidance. Most of these commenters suggested that if new disclosures are needed, they should be required through changes to Regulation Z because those rules apply to all lenders, not just the lenders who are subject to oversight by the federal banking agencies.

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

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

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

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

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

(Applause.)

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

So let me start out by asking one that was asked this morning, that is a little off topic, but I think it reveals just how important it is to lay the ground work for everyone to understand how the marketplace works.

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

MS. BRAUNSTEIN: That's actually pretty easy. No, not unless -- unless they're doing something that is illegal, which then you would go through enforcement, but, no. That's how the market develops as people develop new products all the time, and it's not just mortgages. It's other kinds of loans. It's deposit products. The industry develops some product.

MS. TWOHIG: Thank you, Sandy, for that, and so that was an easy one. The questions might get harder.

MS. BRAUNSTEIN: I took that one. They can take the rest of them.

MS. TWOHIG: One again perhaps for Sandy, but anyone can address this, is: Should disclosures about nontraditional mortgage products be layered so that the key facts with respect to payment shock, negative amortization and those kinds of things be explained in bold language in a short form?

This question was probably asked by someone who is very familiar with the debate over privacy notices and layered notices and how that's playing out. Anyone want to comment on that?

MS. BRAUNSTEIN: Well, I think that that's the kind of issue that I indicated we will look at when we get to that rulemaking, those kinds of things, and we do plan to use consumer testing to find out exactly that kind of information, how do consumers best get and absorb and how would they best utilize the information that's given to them, and that may be one of the things that comes out of it, but I think we look at a whole range of options for how to present the information.

MS. TWOHIG: Turning to some questions on the Interagency Guidance: First, in terms of the bigger picture, in terms of how the consumer protection recommendations and in particular the information that you are recommending that consumers get about some of these products, in your view, does that go beyond existing disclosure requirements or how do you see that related.

In other words, Sandy explained this morning that there are some disclosures in the CHARM booklet and in the particular program description and in the specific transaction disclosures about payment increases and about negative amortization, so how do you see the guidance interrelating to that?

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

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

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

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

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

MS. BRESLAW: The one thing that led up to that is obviously if you qualify people based only on their ability to make those interest payments, then what you've done is you've required them to sell the house or refinance at the end of whatever the period is when the interest-only payments stop, so you are probably boxing people in more by underwriting that way.

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

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

MR. BYLSMA: Let me just add to that. At the same time we do hope to effect changes in the market with this guidance, and that's why we issued it, and it's our supervisory recommendation essentially to the institutions that we examine, so we would hope to see -- there are certain aspects of the guidance that criticizes practices. An examiner would criticize that practice in the course of their supervision. The examiner would not say, You have violated the guidance by not adopting this one thing, but we would hope that there would be general conformity with the broad outline in the guidelines.

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

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

We also do studies from time to time, and in fact our Bureau of Economics is conducting a study on mortgage disclosure issues and have done studies in the past. The one that's ongoing at present has to do with how consumers search for and choose mortgages, how they use and understand mortgage disclosures and information and whether improved disclosures might enhance consumer understanding, mortgage shopping and the ability to avoid deception, so that's one activity that is ongoing right now by our economists.

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

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

Well, I think you all have guessed the punch line. These marketing materials we allege were deceptive because they were really offering a type of payment option ARM. The interest rate was not 3.5 percent. Even in the first year it was higher. That was what they called a payment rate. You paid as if you had 3.5 percent, but the interest rate was actually higher, and interest accrued at a higher rate, and therefore it was a negative amortization if you paid at that rate, and nothing at all about the loan was fixed, even at that payment rate would increase after the first year.

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

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

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

Departments. Mostly mortgage regulators are under the State Bank Departments, but in some states the agency that regulates the brokers and the agency that regulates the lenders are two different agencies.

There are other regulator associations, other than AARMR, that were involved in the federal guidelines, the Conference of State Bank Supervisors and the National Association of Consumer Credit Administrators both offered their comments on the proposed guidelines.

The State Financial Regulatory Round Table, which is a conglomerate of these associations, distributed the federal guidelines to the State Mortgage Regulators with a recommendation that they be implemented for the non-depository mortgage lenders.

There were several comments made earlier, one was about 60 percent of the loan originations are made by brokers. It's probably a little bit higher. In our state, I think it's closer to 80 percent. We had one that we're going to take to task for their advertising, no advertising, "1 percent mortgage solution," but it's not a 1 percent mortgage. It's just a 1 percent solution.

And then I've got another one that I brought to David's attention since they're based in his state. I pulled this information off their web site, and it's only part of the information that's available on their web site. They have five different ARM products and four different payment options, and it's ten pages that the consumer has to read through, but the thing that caught my -- there were two things that caught my eye: The features and benefit, the real upside and downside, and then in real bold print, the truth.

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

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

Also in the state regulatory scheme, we have the state mortgage regulator who enforces the state mortgage laws, and I can tell you that at least in our state, when the laws were enacted, these loans were not contemplated. The 30-year fixed was probably in effect at that time, and I can tell you that some of our statutes have been around for 37 years or plus, and adjustable rates were not in existence at that time.

We also have, in most states, the Consumer Protection Division of the Attorney General's office, and they enforce the Unfair and Deceptive Trade Practices Acts, much broader authority than the State Mortgage Regulators have and covers any type of advertisement, whether it's print, oral or whatever.

So we're taking action against one company. We have to look at this company in cooperation with our colleagues in Pennsylvania to make sure that the consumer is not being misled on their liens. David?

MR. BLEICKEN: Thank you, George. Good afternoon. My name is David Bleicken with the Pennsylvania Department of Banking, and I'll tell you what I'll do. I'll give you a sense for the debate that we sort of hear internally. George gave you a great overview of sort of the patch work system. We have a great relationship, like George does, with our AG's office. Dave Saunders is here from their office, and we work together on these kind of things because we really care about them.

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

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

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

Pennsylvania, in the last few years, we've been focused on mortgage foreclosures because we've had several hot spots, and we've been on the wrong side of some statistics in recent years. Is this -- our question is, will these add to that? That is, are we going to see more hot spots with these kind of alternative products?

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

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

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

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

So we have lots of questions right now, and we're working through them. We're also working on some answers in Pennsylvania. We're drafting some regulations. We're drafting what we called the guidance -- you have guidance here. In our system we call it a statement of policy that will deal with some of these issues, not necessarily all of them, and let me close -- because I want you to get to Ms. Jackson's comments, but let me close by saying two things: One, the public debate on this, if you're reading in the papers like my wife does, Mary Ann brings these things to me, if you look at the public debate, it's not good.

USA Today had an article a couple weeks ago or whenever it was, it was -- it just talked about the next S&L crisis. Last Sunday, Mary Ann brought me the Sunday Parade, and in the middle -- in the column of these nontraditional mortgage products, it says loans to avoid. That's where the public debate at least is going from what the consumer is seeing.

Number 2, let me give you a historical perspective window into my twisted mind and how it works and forgive me for this, but I like history, so think of it this way. Mankind has struggled for millennia with how to deal with lending problems, right? We have ancient religious texts that say the paradigm from that is neither a borrower nor a lender be. We got rid of that one. So then we have these statutes in England and Pennsylvania too in the earlier years, 200 or 300 years ago, interest rates bouncing from 8 to 15 to 16, and that didn't work.

Then you had the rise of the administrative state, the end of the 19th Century, early to mid and continuing into the 20th Century. Then we have the disclosure idea. Tell you what, let's disclose to folks, give them a choice and they can figure it out.

So my question to all of you, and I will leave you with this, and this is rhetorical, and I do not have an answer to it so don't ask the question, but the question is this: Are we at the threshold of the next change? People are using the "S" word, suitability. Some folks -- it's what lenders fear. It's what some folks want. What does it mean? How would it work? Is the broker responsible? Is the lender responsible?

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

Thank you.

MS. TWOHIG: Thank you, David.

(Applause.)

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

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

Anecdotally, we have had borrowers complaining about not understanding the loan products that they were getting and complaining that the disclosures would appear to be for fixed rate types of products, and then when they actually got the loan at the closing table, and of course did not read the documents at the closing table, that they ended up with a loan product that they were not expecting.

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

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

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

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

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

We had a consumer that filed a complaint with us, and she thought she was starting off with a loan that her payments would be about $1,700, and after the closing of her mortgage, she found out that after the first year, her payments were going to be about $3,000.

Now, we were able to contact the lender, and this was on a refi, and the lender reversed it, so she got out of that transaction, but we can't really always under our -- the penalty provisions and everything under RESPA don't really allow us to necessarily always get some type of compensation for the borrower. Sometimes they'll just call them up and, my staff can be pretty aggressive, and sometimes once somebody says, This is HUD calling, then we're able to work out a solution.

But this kind of leads into another complaint that I hope we're not just seeing the tip of an iceberg here, is that the consumer had an option loan, and it adjusted monthly. The interest rate adjusted monthly, and after a couple months, the consumer was looking at the loan statement, and I don't know how many of you -- I don't look at my loan statement each month on the balance, maybe I should, but they happened to look at the loan statement and noticed that even though they were making not the only minimum interest payment, but in order not to get amortization -- negative am, they were actually making an additional interest payment on the loan, the balance on the loan was going up.

So when they called the servicer to try to determine what was happening here, the servicer said, Oh, well, you know we're really not set up to service these types of loans, and after checking into it, they found out that the additional interest payment was going of course into a suspension account and sitting there, but the consumer was able to get that straightened out, but that may be something that consumers need to do is to check their -- if they get a monthly statement is to check those statements.

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

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

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

(Applause.)

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

We've been focusing earlier this morning mostly on the point in time when the consumer is deciding to take out the loan, but clearly there is a whole other stage to the transaction as perhaps the initial period is fixed and/or the payments under a payment option ARM might be changing, and Ivy addressed this generally, but we got a specific question, and maybe we could all take a crack at this.

How are monthly statements under current law regulated, and in particular for option ARMs? Can the lender present one payment as the default payment?

Anyone want to try that one?

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

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

MS. BRESLAW: The one thing I would add is, listening to Ivy's story, really the problem was not with the monthly statement. That's actually what alerted the consumer to the problem. The problem was that the mortgage servicer wasn't doing its job right, and I think that gets back to the points that are made in the guidance about in our perspective monitoring third parties that our institutions are doing business with, and this is exactly what we want to avoid, and we would expect our institutions to ensure that the servicer does have the capacity to handle the type of transactions that are involved.

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

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

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

MS. TWOHIG: Moving to a question that perhaps our state representatives might want to address is: Isn't one way to protect mortgage consumers mandatory licensing and licensure education and criminal and credit background checks for mortgage loan officers?

MR. KINSEL: We're doing that.

MS. TWOHIG: So do you want to talk about that?

MR. KINSEL: As of January 1 of '07, loan originators -- and the lenders got to the legislature. It only applies to loan originators who work for brokers or net branch lenders, but under our statute, if you have more than one loan a year, you become a broker, so pretty much all the loan originators will need to be licensed. If you have less than three years experience, you will have to take a 40 hour classroom instruction with a test to achieve a passing grade of 70, and there is a criminal background check required.

In talking with regulators in other states that have implemented licensing for loan originators, loan officers, loan solicitors, whatever you call them, there is a pretty high license application denial rate that comes about because of the criminal background check primarily. Either they have a conviction that precludes them from working in the mortgage business: Identity theft, bad checks, fraud, something of that nature, or on the application, it says, Have you ever been convicted and they put no, and then you pull up their sheet and it's this long (indicating.)

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

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

MS. TWOHIG: David, anything to add?

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

MS. TWOHIG: How do you see that related to the particular issues we've been talking about with nontraditional mortgage products?

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

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

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

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

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

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

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

And then it's how do you have trusted providers because let's face it, the people who are out there trying to rip off consumers, the predatory lenders, so to speak, easily can set up their own counseling services. If you meet this requirement, the next thing you know, they're like, Yeah, you need counseling, and I've got just the guy, call this guy and he'll take care of it, so it's just a much more complex issue than it would seem on the face.

On the face it seems like kind of a "duh", but when you start looking at quality control, provider control, all the other kinds of issues, it's more complex than that. In an ideal world, yes.

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

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

(Applause.)

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

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

After lunch, just remember you're going to have to go back through security when you come back in the building, and so we'll see you at 1:55 for what is sure to be a lively afternoon. Thank you.

(Whereupon, at 12:40 p.m., a lunch recess was taken.)

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.

(Pause.) She is here.

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

I'm going to ask the panelists to each introduce themselves quickly, tell us who you are, who you work for, and where you're from originally. Let's just get some interesting information that's not on the agenda, okay? So, Michael, would you explain yourself.

MR. WILLIAMS: How much time do we have?

MS. HARRINGTON: No. This is quick.

MR. WILLIAMS: Mike Williams with The Bond Market Association. We're a trade association representing broker dealers who purchase and securitize loans in the secondary market. I am originally from the Bronx, New York.

MS. HARRINGTON: Okay.

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

MS. HARRINGTON: Thanks.

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

MS. HARRINGTON: Good. Jamie?

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

MS. HARRINGTON: Harry?

MR. DINHAM: I'm Harry Dinham, and I'm with the National Association of Mortgage Brokers, president-elect. We represent over 25,000 mortgage brokers, and I'm originally from -- I was born in Washington, D.C., but I was raised in Mobile, Alabama.

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

MS. HARRINGTON: Okay. And I'm Eileen Harrington. I am the Deputy Director for the Bureau of Consumer Protection here at the FTC. I began my FTC career in the division that is sponsoring this workshop today, so I have a long standing interest in these issues, and I'm from Madison, Wisconsin. We have no one from the West Coast on this panel, so we're out of balance already. Yes? Oh, are you from Vancouver?

MR. MACDONALD: I live in California now, but I'm from Toronto, Canada.

MS. HARRINGTON: There we go. Good job organizers. You have it covered.

Well, we want to begin with a general question, and also invite those of you here to send in your questions, and we'll use the card approach, and if it seems that that doesn't promote the liveliest discussion in the room, we might even start just talking back and forth, but let's open with a really general broad question, and that is whether our panelists think that the current legal and regulatory framework adequately protects consumers -- and whether also the protection of consumers in this marketplace ought to rest primarily on something other than law?

So does the current legal regulatory framework provide adequate protection for consumers in this new mortgage marketplace? Should consumer protection rest primarily on something beyond law or in addition to law or other than law?

Alys, do you want to kick this off because you used to work here?

MS. COHEN: I just want to say it's really nice to be back among family. I want to start by answering the question by putting forward a couple of lenses for thinking about the question because it seems like we have an economic issue. We've got a legal issue.

To me the economic question is: Is the system we have properly apportioning risk? And what Stella was saying this morning is something that I see every day, which is that the people originating these loans, the people investing in these loans, the people brokering these loans, are to a great extent able to protect themselves from the risks associated with high risk loans, including nontraditional mortgage products, but the consumers and the lawyers for the consumers who I hear from every week are not.

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

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

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

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

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

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

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

MS. HARRINGTON: What about risk?

MR. MACDONALD: Alys was correct, that the borrower does bear the risk of foreclosure. That can't be minimized. That's a significant financial and emotional impact to a consumer. I would also suggest though that lenders definitely bear financial risk in this area and reputational risk and regulatory risk.

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

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

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

The lenders, in my opinion, the majority of them, the good ones, will not only comply with the spirit of the law and the written letter of the law but will try to do what's best for the consumer as well because an educated consumer is not only good business, but it's good for business, and this is an area where all three groups have aligned incentives to make sure that there is consumer protection. This is not a trade-off, one for the other. All three groups can obtain what they desire out of proper regulatory structure combining education with financial products.

MS. HARRINGTON: Okay, Harry, you're up.

MR. DINHAM: I'm up? Well, we tie it specifically to those products because I see one of the biggest problems we have from a regulatory standpoint is the difference or the variations between the good faith estimate and the HUD I closing statement at that point. We need to do something to -- this has been part of RESPA. We need to push forward on it. It's the biggest problem that we have.

And I'll just say in the state of Texas the Office of Consumer Credit Commissioner states that the biggest problem they have is consumers calling in saying that the terms aren't the same as what they were when they actually applied for the loan, so we need to do something, I feel, to press forward on fixing that problem, the way we have some kind of variances or I think -- in fact AMB had put forward to HUD on the RESPA issue a copy of a new good faith estimate that looked similar to the HUD I, which would have had a 10 percent variance on it, so you couldn't have exceeded the 10 percent variance without redisclosure.

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

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

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

MS. HARRINGTON: Bob, what do you think about that, about Harry's last point?

MR. MCKEW: I was relating to your question.

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

MR. MCKEW: What did he say? I was focusing on your question.

MS. HARRINGTON: Harry, do you want to repeat that, that there is not necessarily a unity between -- go ahead.

MR. DINHAM: What I'm saying is there's a disconnect between the good faith and the HUD I. We need to do something to be sure that the good faith that we're giving to the consumer is pretty close to what we do at the time of closing, and what I was saying is we, in the RESPA process, had put forward a good faith that had a 10 percent variance on any fees so that if you exceeded that, that you would have to redisclose back to the consumer at least -- I think it was ten days, but I think what we prescribed was ten days before the closing.

MS. HARRINGTON: Is that in time though? If those disclosures were in sync and are accurate, does that still give consumers enough of an opportunity to consider --

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

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

MR. DINHAM: No, because the more you do in the beginning, the closer you are to the costs, the less problems you have at the closing table. We've got to find a way to better inform them at the time of closing so that they are informed when they get to the closing, and there aren't any surprises. That's why a lot of us attend our closings to be sure that there's no problem at the closing table.

MS. HARRINGTON: Bob?

MR. MCKEW: I did listen that time, thank you. Eileen, I think Harry is absolutely right. In my 20 years in Washington, this RESPA issue is just an issue that just will not go away. We have tried various and innovative things like negotiated rulemakings and other types of -- almost every HUD Secretary has made RESPA reform a priority, and to try to reconcile Truth In

Lending which is interpreted by the Federal Reserve Board, and the Real Estate Settlement Procedures Act, and what we have are two separate sets of disclosures coming out at different times that say different things, and it really is incomprehensible, and it's a situation that's existed for an amazingly long time, and it's really quite astounding that it hasn't been fixed yet.

MS. HARRINGTON: Okay. Jamie, you're up, the broad question and the specific.

MS. GOODSON: I was going to piggyback or follow-up on something Peter said.

MS. HARRINGTON: That's fine.

MS. GOODSON: It was interesting when he spoke of working as partners because I think that's what most consumers feel they're entering into when they walk into a lender's office or when they respond to a solicitation from a mortgage broker, and I'm sure that there are lots of lenders and brokers who respect that -- who understand the responsibility and the expectations that have been placed on them.

But unfortunately we're here to talk about those who don't, and if we talk about a partnership, that's all great until something goes wrong, and I forget who mentioned contract law when everybody becomes adversary. Mortgage brokers like to disclaim liability, disclaim fiduciary duties and to argue, We are brokers in between the borrower and the lender. That's not what -- that's not the warm fuzzy feeling that that borrower had when they went to you to look for the lowest rate.

The lender is the person who's there to help you and guide you, but when you look at the responses to the guidance, the proposed guidance, you see lot of lenders wrote in and said, How can we be held responsible for the action of the third parties with whom we interact? They're the ones who spoke to the person, and we cannot be responsible for that.

So I think what we need to try to figure out is how to make all of that partnership a reality because when push comes to shove, it's going to be the consumer who is not going to have any leverage.

MS. HARRINGTON: Well, in making that a reality, do you see a need for some change in law or how do you go about doing that, Jamie, in your mind?

MS. GOODSON: I think the guidance is a good first step, and I'm very pleased to hear that it sounds like it's moving ahead. When I saw the often negative reaction to it from a lot of industry groups, I was afraid we would be at a standstill. I thought the standards there were eminently reasonable, and I thought that in particular with respect to underwriting requirements, it would be great, and it would cover the entire industry if some of those rules were promulgated as unfair and deceptive acts and practices, regulations and not just issues and guidance.

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

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

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

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

MR. WILLIAMS: Oh, sure. Getting back to your question, you can always make it better, right? You can make anything better, but to sort of sum up what I think at least I heard Jamie say is from my perspective, if there is something that you don't like, make it illegal or make it non-permissible, and you solve the problem, but is that really what we want to do? Do we really want to put constraints on borrowers, right, or do we want to identify specific problems?

Do we want to go out there and say, Well, this loan presents the following because it is susceptible to fraud and therefore we're going to make it illegal, or are we going to regulate it better? As opposed to a very general statement which is, yeah, bad things are happening. People are defaulting on their homes, but people default on credit cards. They default on car loans. They default on a lot of things.

MS. GOODSON: I don't think I said that.

MR. WILLIAMS: No, no. I got off you. I'm a rambler, but I'm just talking about the general question now, which is how do you address it, and is it to a current regulator construction work?

MS. HARRINGTON: Let me be more specific on that. We're talking about a certain subset of products here at this workshop. Does the current regulatory environment adequately, number 1, inform? Do the regulations provide adequate information to consumers who are interested in these products?

I think we're talking primarily about Truth In Lending. Are the current -- is the current disclosure regime adequate to protect consumers? Let's just say yes or no for starters right down the panel. You start, yes or no, is Truth In Lending adequate for these products?

MR. WILLIAMS: No.

MR. MCKEW: Yes.

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

MS. GOODSON: No.

MR. DINHAM: Yes.

MS. COHEN: No.

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

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

MS. HARRINGTON: But he had been retired by the time these products hit the marketplace, so that doesn't work. Does Truth In Lending work?

MR. MCKEW: Ralph is still working. Ralph is still working, and they are essential disclosures. They are well established in the marketplace. They are well known in the industry. The training given to employees has been established. The secondary market understands what they have to look for when they are checking to -- as to the accuracy of the disclosures.

So even if you see, for example, secondary market, and maybe Michael can speak to this, that some broker product or some lender is making kind of fairly fundamental mistakes in Truth In Lending disclosures, that's kind of a red flag that we may have a problem with that lender, but as far as providing the information, it does provide information. Whether it provides all the information, I don't know.

MS. HARRINGTON: Well, what I am hearing you say, Bob, just to go back, is Truth In Lending works real well for the lawyers who prepare the documents and the companies that make the loans. So my question it: Does the current regime work for the consumer who is the prospective borrower?

MR. MCKEW: The Truth In Lending mechanism we have now is the best we have, and I have yet to see a model disclosure regime that is better than what we have. I'm not saying it's perfect.

MS. HARRINGTON: I have to tell you, that's not a ringing endorsement.

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

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

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

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

Should we replace Truth In Lending whole hog with something else? The question is does the current regime under Truth In Lending, as I understand the question, solve our problems in the context of these products?

So there's two parts to that. One is there are a lot of things outside of Truth In Lending, which I'll get into in a second. Within the context of Truth In Lending, as you heard this morning, Sandy Braunstein put the disclosure on the screen and she said, I don't expect you to read this now. I don't know if Sandy is still here.

The problem is that people can't read them when they need to, and even if they try to, they don't understand them, and there's no layering of information. To the extent we're going to get people information, we need to get them information upfront, I would say when they're shopping, but a lot of people don't shop. They get called and offered these loans, but if they are shopping or if they are offered them, they need the information upfront, and it needs to be binding.

If it's not binding, the information is somewhat irrelevant because they show up at closing, and the information is different, and for reasons we all understand, many people don't walk away. The legislative history of TILA is very clear that the idea behind TILA was to be able to shop with that information. That isn't happening.

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

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

The analysis of repayment ability that we heard this morning from our friend Bob at Chevy Chase was very helpful, but it's still true that residual income is not considered in repayment ability, and if you have a low income, median African American is $42,000, it doesn't matter if your ratios are right if you don't have money to pay the bills, and so residual income needs to be part of that repayment ability.

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

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

Those abuses need to be addressed together and clearly.

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

MR. WILLIAMS: Well, three things I want to address. The private right of action and recision, I just don't see. That's an after the effect, right? How do you -- why not slow down and get back to your question? I know my answer was a no, but that is on the practical implications of it, and the reason why I said no is because I wanted to be a little bit controversial. Coming from the industry, everyone is looking at me like, Whoa, why did you say that? Because all of those things that Alys just ticked off, they would be fantastic --

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

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

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

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

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

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

What you can do is inform them of the consequences of those items. Now, that in and of itself, not enough, all right? If there are specific problems out there, over-appraisals or anything like that, fraudulent activity taking place, or if there's a loan feature that someone may take question with because it opens the door for fraud, then that needs to be addressed very specifically, right, on the federal level or state level. We prefer federal.

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

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

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

Nobody wants a loan to fail, not even one, but we do have a -- we do have an environment, and I was happy to hear some of the panels this morning where there was talk on this Interagency Guidance, that one of the motivations for that guidance was not to go right out with that rulemaking but was to provide flexibility and to actually use it kind of as an experimentation to see what was going to work, and I think that's a good way to handle it.

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

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

And I think those kinds of things should be recognized. This is a different environment than we had in the '70s, and we have so many more people that now have access to credit that didn't have access to it before, and I don't know -- I don't hear very much, and I hope I don't, that jeez, I wish we could go back to the good old days because I don't remember when those good old days were frankly.

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

MR. MCKEW: Absolutely.

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

Michael, I'll start with you.

MR. WILLIAMS: I would say a fundamental error is to think when you go into a process like this, that somebody that's lending you money is your friend or they have your best interests in mind. It's a business, and I mean, it sounds cold and calculated, and I don't know if anybody else on the panel will say it, but I will. I can tell you our guys are --

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

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

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

MS. HARRINGTON: Okay. On this matter of alignment of interests, separation of interests follow up, actually regarding Bob's comment, this is from the audience that there is an alignment of interest among lenders, consumers and secondary market. Do brokers share that interest? Are they aligned as well or are brokers primarily interested in originations where they generate their fees? Harry, I bet you have something to say about that?

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

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

MS. HARRINGTON: Michael?

MR. WILLIAMS: I would like to add just to sort of play out my statement here, just because they're looking at it as a business relationship, there shouldn't be any implication that somehow they are trying to be underhanded. The two don't go hand in hand, even though some try to make it go hand and hand, but because someone is being practical and business like, that somehow they're underhanded, and it's not the case.

So when you go in and if the person, the lender, the broker, the secondary market participant, the investor, they're not your friend, you shouldn't look at them as your friend, but they're not necessarily trying to defraud you either, and the vast majority are not.

MS. HARRINGTON: Pete, did you want to say something?

MR. MACDONALD: I'm okay.

MS. HARRINGTON: Jamie, we haven't heard from you for a minute. I'm just checking.

MS. GOODSON: I don't know who to follow.

MS. HARRINGTON: That's fine. Alys, we'll go to you.

MS. COHEN: I'm glad that Mike was so clear about the alignment of interests, and that Harry was clear about where they see their duty. That's exactly why we need more laws. It's exactly because the responsibility can't be on the part of the borrower who is paying for a YSP through their interest rate to trust their broker and not have any law enforcement to go to afterwards.

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

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

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

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

MS. COHEN: I was there. Thank you.

MR. MCKEW: And actually I think we were pretty close to coming to a solution on this agreement between the broker and the customer, and I thought that the mortgage industry was pretty lined up on that, but there is an issue with the parity in the channels going through the lenders, and that has to do with -- I guess Harry can explain that better, but it has to do with employees of mortgage entities and the broker channels and the parity in what may appear on the kind of disclosures that would discourage broker type of arrangements when in fact there really is no effective difference. Is that right? Am I describing that correctly?

MR. DINHAM: I would say that you are. I think the main problem we have in our discussion about YSP is the fact that if you have two 8 percent loans, and the mortgage broker discloses his YSP and another lender does not disclose his YSP, it's confusing to the consumer.

MS. HARRINGTON: I'm going to jump in because YSP is really not necessarily what we're discussing.

MR. DINHAM: He start ed it.

MS. HARRINGTON: I know, but I'm going to divert this conversation. I'm going to divert this back to the kinds of -- the specific products we're talking about, and let's go to the hypos and the Ozzie option. In the current regulatory framework, is Ozzie getting enough information and protection upfront? Ozzie, you'll recall, has chosen the option on -- the third hypo. Does the current regulatory environment give Ozzie enough information? And let me ask more specifically whether in the proposed guidance, the consumer protection provisions there would give Ozzie additional information or better protection?

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

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

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

MR. MCKEW: Yes.

MS. HARRINGTON: And how?

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

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

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

MS. HARRINGTON: Jamie?

MS. GOODSON: I agreed with the beginning of what Robert said, until we got to the point where he indicated that the guidance was okay as long as there was really no recourse for somebody if the guidance was not followed, if the AGs didn't go after people who violated the guidance, and if borrowers didn't have the opportunity to receive recourse.

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

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

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

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

And do you take -- you're stuck with what they say but they do tell you no; if this is not right for you, no, and you also don't expect for them to be trying to undermine you in different ways with either fiddling around with your documents and those types of things. I don't want to run the analogy into the ground, but I think it's much -- I think everyone involved should want people to feel comfortable coming to them, trusting them as professionals, just like you trust your doctor, just as you trust other people who have studied and who should know more than you know, and any loan officer or broker who doesn't know more than the customers in front of them should be ashamed.

So given that trust and that experience, I think that the underwriting -- at the very least, underwriting standards should be on the shoulder of the lenders to meet standards that they know are reasonable for making the loans that are safe, sound and fair to consumers.

MS. HARRINGTON: Alys?

MS. COHEN: I just wanted to answer the question which was asked before and add to what Jamie was saying. I appreciate all the steps that the guidance has taken, and I think it really is a vote from the regulators for underwriting which is essential, and underwriting goes by -- explained how I wanted to go further, but I think it has gone farther in the guidance, and that's helpful.

The ways in which Ozzie might fall short, even if his repayment ability is analyzed, might be because his residual income isn't considered. We don't know what his income is in this hypothetical. Also we don't know which lender he's going to, and if he doesn't go to a lender that's regulated by one of the federal banking regulators, then the guidance is somewhat irrelevant. It's also true that if there's no private cause of action and he does go to one of the regulated lenders, he may not have any recourse anyway.

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

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

MS. COHEN: Yes.

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

What's started to happen is interest rates are going up, and we are not kidding ourselves where we stand that we probably are going to hear some stories that some indicators of defaults, delinquencies probably are going to start to rise. If I knew what the stock market was going to do tomorrow, I would probably do something about it right now, but I think that as the interest rate trend continues upward, it is going to presented a more challenging environment for the industry and for consumers.

MS. HARRINGTON: What will be the challenges for the industry? We know what the challenge for consumers is, but what's the industry challenge?

MR. MCKEW: Well, maybe somebody else can better answer that, but I guess I would just throw out one, and that is some of the providers -- I understand that 25 of the -- 25 mortgage lenders provide all -- 55 percent of all mortgages in the U.S., 25. These are public companies, and so obviously there's going to be some pressure for them to communicate with their shareholders and to convey some realistic expectations as to the environment that's ahead, that we think may be ahead, and because this may become a mortgage difficult environment given how interest rates are trending.

That's one thing I can think of. Maybe someone has got something else?

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

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

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

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

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

One suggestion has been to at least have some obligation on the part of lenders, mortgage brokers and the industry to consider the suitability of the products they're offering. In other words, whether there's a reasonable prospect for the borrower to be able to repay issues like residual income and the like being taken into consideration in determining whether to offer a particular plan?

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

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

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

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

MS. HARRINGTON: Rob?

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

I just don't think that that's -- if you have the information that you have. I may be actually -- if I had a suitability requirement by actually knocking you out of a loan that you may be perfectly qualified and may be perfectly appropriate for you, and let's take a collection of 50 loans, and maybe one or two people, if a suitability test could be actually developed -- and I think that's a completely elusive endeavor -- that if it could identify the two people who are going to have problems in advance, in advance, those loans wouldn't be made.

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

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

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

MR. WILLIAMS: No.

MS. HARRINGTON: Yes, your answer is no, or no, your answer is yes?

MR. WILLIAMS: That's a concept that works in theory, right, to have mandatory education. What do you do when the borrower doesn't want education? They don't want to listen to what you have. They don't want counselment. They just want the loan, right? And even if it were that you could get everybody to agree to it on a wholesale level, what's to say, unless you set up standards, minimum standards on what needs to happen, that has to be done by the government, right, and you have to set up what standards are going to be there and keep up to speed as to what the products are.

There you have to give the consumer the most accurate information. You have to know when there's innovation going on in the market. It's a great conceptual idea, but in practice, it does fall short, and you look at examples of that throughout the country where people have mandated education before they get the loan, and consumers either don't want the education or they go to somebody else who doesn't have that or they just say, I don't want that product or there's not enough funding to provide adequate counselment, and to keep that real time information flow that's necessary.

MS. HARRINGTON: Is there a different view? Thank you. Alys?

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

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

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

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

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

MS. HARRINGTON: Go ahead.

MR. WILLIAMS: But I had some conversations with you.

MS. GOODSON: It wasn't with me.

MR. WILLIAMS: No, it wasn't with you, but one of your colleagues, and we were talking about recision, and I was making just the case you made, Alys. And you know what they said? They said, Well, there are very few people who actually even get to that point. That's what the studies show, that very few borrowers are going to get to a point where they go out and they maintain, they get an attorney, right, or they find an advocate.

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

MS. HARRINGTON: Hang on.

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

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

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

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

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

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

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

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

MS. GOODSON: Eileen?

MS. HARRINGTON: Jamie, quickly, and then I have another question.

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

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

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

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

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

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

Jamie?

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

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

MS. HARRINGTON: Bob?

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

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

MR. MCKEW: State licenses and disciplinary mechanism.

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

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

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

MR. MCKEW: That they be underwritten?

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

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

MS. HARRINGTON: Why not?

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

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

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

(Discussion off the record.)

MR. WILLIAMS: I'm trying to think.

MS. HARRINGTON: Index plus margin?

MR. WILLIAMS: I'm trying to figure out why that's something that the -- I'm trying to figure out the negative answer, why it's something that the market wouldn't be able to handle because if it became unwieldy, then no one would purchase those loans.

MS. GOODSON: We've heard people say earlier, even though their practice is to underwrite at the full index rate, that others didn't, and if that's going on, then clearly I don't think we should wait until the market catches on to who the unnamed parties are.

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

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

MS. GOODSON: That's what's in the guidance. It's in the guidance that's coming out so this is saying, Can everyone live with that.

MR. WILLIAMS: I would say sure.

MS. HARRINGTON: Any other panelists on this issue? Alys, did you want to say something?

MS. COHEN: Well, I just wanted to point out that the fully indexed rate at the time of the closing of the loan doesn't mean that the person would receive the maximum amount they would pay under the loan. There's another contract term in the contract which is the maximum rate that would essentially be applied for a monthly payment, and then you have to figure in if there's some neg am period, and you saw that in most states it goes up to 115 percent.

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

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

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

MS. HARRINGTON: Bob?

MR. MCKEW: Well, the only thing I have to come back to is that as I referred to today, Michael once again might be the better person to speak to this. We have really this other regulator out there, and it's called the market that's purchasing these mortgages and that is providing funding to this industry, and I know they have very sophisticated models to assess all kinds of contingencies and economic scenarios and everything under the sun.

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

MS. HARRINGTON: We are running out of time. I want to ask each panelist to take a minute to think and then answer this question. If there's no change at all in any applicable law governing these products, no change at all, the status quo remains, five years from now, what will the headline be about these alternative mortgage products? What's the headline in five years if there's no change in the law? And people in the audience, I want you to take a minute, because I'm going to call you on randomly to hear your headlines as well.

MR. MCKEW: Can you give us --

MS. HARRINGTON: That's all you get.

MR. MCKEW: -- what the interest rate is at that time?

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

MR. WILLIAMS: I have a headline.

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

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

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

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

MS. HARRINGTON: Harry?

MR. DINHAM: I don't have one.

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

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

MS. HARRINGTON: Wealth gap?

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

MS. HARRINGTON: Okay. Peter?

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

MS. HARRINGTON: Headline, Bob?

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

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

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

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

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

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

UNIDENTIFIED SPEAKER: ARMs Reach Out to Strangle Consumers.

MS. HARRINGTON: ARMs Reach Out to Strangle Consumers, yikes. Do we have a rosier scenario out there in the headline writing world? Yes, John?

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

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

UNIDENTIFIED SPEAKER: Mortgage Market Beat Chicken Little.

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

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

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

MR. MCKEW: I have another one.

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

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

Arms Products.

MS. HARRINGTON: So the market responds to the market's disaster. That's a joke. Feds Still Working on RESPA Reform?

Well, here's Peggy with the hook for this panel.

MS. TWOHIG: I hate to cut off the fun. Thank you, Eileen, for that very interesting and provocative discussion, and thank you all to the panelists.

We're now going to take a 15 minute break. Again you're welcome to leave the building, but if you do, of course as you know by now, you'll have to go through security again. Rest rooms that way. There should be water out there. See you back in 15 minutes.

(Whereupon, a brief recess was taken.)

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

PANELISTS:

LESLEY FAIR, MODERATOR, FTC

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

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

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

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

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

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

MS. TWOHIG: Boy, this is a well behaved crowd. I didn't even say anything and people are sitting down, quieting down. Thank you very much, and thank you for sticking with us so long. I don't think you're going to be disappointed. I think this is going to be a very interesting panel, and so without further ado, we will move on to our final panel, which focuses on consumer education and understanding of alternative mortgage products, including a look of industry's best practices to create well informed borrowers.

Once again cell phones off if you have them on, and it's my pleasure to the introduce the moderator for this panel, Senior Staff Attorney Lesley Fair.

MS. FAIR: Thank you very much, Peggy. I am with the Division of Consumer and Business Education in the FTC's Bureau of Consumer Protection. I have promised my esteemed panelists today in explaining how this would proceed -- I described it as a McLaughlin group style panel with a less annoying moderator. In the interest, since I spent 20 years prosecuting false advertising cases here at the FTC, I'll have to modify that.

I can promise them a McLaughlin group style discussion with a moderator who is annoying in new and creative ways, so we'll have to start a little differently.

Let me also remind you that this panel is really the last call for questions, and so, please, when you see the FTC staffers brandishing the question cards, those of you who are listening off site, this is your opportunity, since it seems to me really everything that we've talked about today focuses in on it seems to be this last panel talking about consumer literacy and education in the new mortgage marketplace.

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

Let met start off with you, Brian Bucks.

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

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

So, Michaela?

MS. ALBON: My name is Michaela Albon. I guess I'm sort of here in two capacities today. I'm a senior vice president and senior counsel for Washington Mutual Bank, which is based in Seattle, Washington, and I'm also here speaking in part on behalf of the MBA as well, and as you may know, Washington Mutual is one of the largest originators of option ARMs and interest-only ARMs, so this is a subject that is very near and dear to our hearts.

We're happy to share some of the steps we've taken and plan to take, and then also to give you a flavor of the industry's position on the proposed guidance and related issues.

MS. FAIR: I think, Michaela, based in Seattle, were we offering a "we appreciate it that you travelled the longest award," it would go to you, so thank you very much.

Janis?

MS. BOWDLER: Hi. My name is Janis Bowdler. I'm from the National Council of La Raza, which is the nation's largest Hispanic civil rights organization, so I will be representing some of the things that are unique about the Latino community in this space, and in addition, we have a network of 40 organizations across the country that provide pre purchase and post purchase housing counseling services, so we have a unique perspective on the issue.

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

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

MR. FISHBEIN: No table tent, but it's okay. Allen Fishbein. I'm director of housing and credit policy for Consumer Federation of America. We have a strong interest in promoting education, particularly for the underserved, as a means for building wealth and assets.

By the way, the report that I made reference to earlier this morning, we had additional copies out on the back table if you didn't get one.

MS. FAIR: I would suggest everybody get a copy. It makes for very interesting reading.

The Mortgage Professor, Jack, tell us about yourself.

MR. GUTTENTAG: Jack Guttentag, Emeritus Professor from University of Pennsylvania. I write a weekly column on home mortgages, maintain a web site that tries to educate borrowers, and also fields a lot of questions from borrowers, many of which educate me.

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

MR. GUTTENTAG: mtgprofessor.com.

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

John, could you introduce yourself?

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

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

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

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

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

So I think to keep up my McLaughlin Group metaphor here, issue one: What we know and don't know about what consumers know and don't know about their mortgages. Most of our conversation here is going to be interactive discussion, but I would like to start off with Brian Bucks giving us a little bit of information about some findings in a relatively recent study.

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

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

So we examined the stock of existing mortgages as of 2001. Nonetheless, I think our findings and in particular the many borrowers with adjustable rate mortgages appear to either underestimate or not know the details of how their interest rate adjusts or to underestimate how much their rates can adjust. That's still quite relevant for today's discussion, and we take a two pronged approach in the paper, assessing just how well homeowners are able to report the details of their mortgages.

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

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

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

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

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

In contrast, we generally find that ARM borrowers tend to underestimate the amount by which their interest rate can rise in any adjustment period or over the life of the loan. The first row of tables show for example that 43 percent of ARM borrowers in the SCF report a pre period cap on rate changes of less than 2 percentage points, compared to 7 percent in the RFS. Similarly shown on the bottom half of the table, 57 percent of SCF borrowers report a lifetime cap of less than 5 percentage points, whereas lenders shows 6 percent. At the other end of the spectrum though, one quarter of ARMs in the RFS had lifetime limits of 12 or more percentage points versus 2 percent or less of SCF respondents.

Very similar conclusions about borrowers' knowledge of their mortgage terms and mortgage when considering the share of SFC respondents who said, "don't know" about questions as to their mortgages. As the first column shows, nearly all homeowners with mortgages gave answers to the questions on their mortgage type, maturity, amortization period and payment. 90 percent reported the current interest rate.

In contrast, looking at the right hand column there, 35 percent of ARM borrowers said they did not know the per period cap on interest changes, and 41 percent said "don't know" when asked the lifetime cap. The high "don't know" rates for these questions provides further evidence that borrowers have difficulty recalling their interest rate caps accurately, at least in the context of this survey interview.

There are notable differences across demographic groups in this share who apparently did not know those details, with higher "don't know" rates among less educated borrowers, racial and ethnic minorities and lower income households. For example, about 40 percent of those with annual income of less than $50,000 said they didn't know the per period cap compared to 13 percent for borrowers with more than $150,000 of income. Similarly, higher income borrowers were 32 percentage points more likely to know that -- more likely than lower income borrowers to know their lifetime cap.

To understand a little better the potential implications of our findings, we conduct a simple simulation for both the SCF and RFS. We calculate how household's mortgage payments would change if interest rates rose 2 percentage points for two consecutive years for a total of 4 percentage points.

Differences in the implied payment changes across the two data sets might be taken as a measure of the difference between borrowers' perceived changes as measured by the SCF and the actual payment change that what would occur according to the RFS. Again, it's worth noting that the stimulation is for the stock of

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

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

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

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

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

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

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

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

However, some of these households may be only temporarily low income, and in addition, even among some of the lower income households, some of these households could draw on home equity or other forms of wealth in the event of a large payment change. For example, about half of the lower income borrowers with projected payment increases in our simulation that exceeded 5 percent of income actually have current loan to value ratios below 80 percent.

So with that, again I look forward to our discussion.

MS. FAIR: Thank you very much, Brian. Based on the other information that the panelists have seen, are the findings of what Brian has just mentioned consistent or inconsistent with what you have seen in focus groups, other kinds of studies? How is it looking to you?

MR. FISHBEIN: Well, I'll start off. I think this data is very important, very useful, and it's very consistent with other data that exists on this subject. For example, two years ago CFA did a survey of consumers which reached very similar findings, and in particular we found that one-third of all consumers surveyed were unable to calculate what 2 percent increase in the interest rate would mean for their mortgage payment, and that figure rose to 50 percent of all consumers surveyed who were lower income, had limited formal education, and what were classified as younger consumers.

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

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

But I think that what we ought to be thinking about here is not how we can educate borrowers to understand how these mortgages work because I don't think that that's where we ought to be going. I think the first thing we have to be doing is asking the question: What is it that borrowers really want to know about ARMs?

And aside from a relatively small group, estimated general sort of at 10 percent of the total, most borrowers have no interest in learning how ARMs work. What they want to know is: What will or might happen to the ARM in the future, and even if they can read and understand the current disclosure statements and the current till, they will not get that information.

So I, a long time ago, gave up trying to explain the disclosure documents for borrowers. What I have done is used my own disclosure system. I have a form on my web site, and the form lists and defines very carefully each ARM characteristic that you need to know in order to project the future interest rate and the future mortgage payment over the entire future life of the loan.

Now, this list is a little bit longer for ARMs that allow negative amortization, so it has four more items on it or five more items, but the instruction is to take this list to the loan officer and have him fill it out and then take it to one of three calculators on my web site, which will then generate interest rates and monthly payments on a no change scenario, meaning that the index used does not change from its initial value, a worst case scenario, meaning that the index jumps to its maximum value in the second month or any other scenario that the borrower wishes to define. The first two were built in. The third has to be defined by the borrower.

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

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

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

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

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

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

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

The home buying process, we try to make it as simple as possible, and probably the most complicated step in the process is the financing process. We feel that the educational portion is probably critical. One of the things that I talked about earlier was what the National Association of Realtors has done in developing educational brochures that are very easy to comprehend. This is the key.

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

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

MS. BOWDLER: I would agree with that. It's an interesting question because I just had this scenario personally where I had a friend come to me, a single woman looking to buy a condo in D.C., and she wanted to know if I could help her out, and I said -- she said, You do this stuff all the time, and I do, but I also know how much I don't know, and so I was like, Oh, man, I don't know if I'm going to be able to give you all the information.

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

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

Her mortgage broker insisted that the only product for her was an interest-only loan, and she felt pressure, and I said, Let's stop. I sent her to my friend, and she managed -- he pre qualified her for a 30-year fixed product with no problem, but she had to go to somebody that was independent. They gave her one-on-one counseling in order for her to arrive at that answer.

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

MS. ALBON: Actually I do. I've had a couple of friends come to me and say, Hey, I'm thinking of refinancing or buying a new home and my realtor mentioned this option ARM thing or the broker mentioned an option ARM, what do you think of it, and basically what I counsel them to do is to get a copy of our brochure, which we've come up with which we think explains the product in fairly simple terms.

I advise them to look very carefully about the potential interest rate adjustments and make sure that they're comfortable with the fact that there will be some inherent interest rate risk to the product, and from there they go off and make that decision, but I want to make it clear, neither Washington Mutual nor the MBA objects to the idea of additional disclosures in this area.

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

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

I think the computer idea is an interesting one, but then what do we do about the consumers that don't have ready access to computers? How do we deal with that? How do we deal with the fact that a lot of the shopping for mortgage loans today is done by phone rather than actually getting in a car and driving around and going from lender to lender and picking up something like this?

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

MS. FAIR: Other comments about the current disclosure scheme from --

MR. FISHBEIN: Lesley, could I answer that first? I think what a number of these comments underlie is the question that there's no panacea for improving consumer awareness and ability to select the right mortgage for them. Consumers are a very broad group. Their level of awareness and their level of interest are going to vary.

I don't know that consumers are any less aware or less able to do these interest rate calculations than they were 25 years ago. The difference is the amount of products that are available today compared to the past or when that CHARM booklet was originally written, and what it suggests is there's going to have to be a series of steps to try to improve that, several aimed at improving consumer awareness and information, several aimed at giving them better tools for those who want to go about actually doing the calculations and figuring out what to do.

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

So finding ways of narrowing choices through trusted advisors that many of us in the room could probably turn to, people who have friends like Janis, who, if she can't answer the question, can steer them to the right people to talk to, and that's as much what some segment of the population is looking for than just getting brochures or information or calculations that ultimately they're still not going to be able to make comparisons and perhaps not make the right choices.

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

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

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

They generally tend to think of themselves as independent contractors, as merchants because they can make more money that way, but fundamentally they are providing a service. They provide a service the way an architect or a lawyer provides a service, and they should be compensated for that service, and the price for that service should be stipulated in advance with a customer, and then they can give their full time and talent and attention to getting the best possible deal for the borrower.

It's very difficult for borrowers to shop this market. Mortgage brokers are experts at shopping this market. That's what they do every day of the week. They do it for every client -- or I could say they do it in connection with every client, but mostly they do it for themselves. They want to get the best price, because the better the price they get, the larger the mark up they will make.

Now most mortgage brokers act as independent contractors, meaning what they make on the deal is none of the borrower's business. They're independent businessmen, and they do it that way generally because they can make more money. However, one of the reasons or a second reason they act that way is because borrowers allow them to.

Borrowers allow them to act in that capacity, but if a borrower goes to a mortgage broker and says, Look, I want you to act for me, I want to pay you a fee and we'll talk about the fee, and I want you to advise me, give me your best advice about the mortgage I need and find the best deal in the market you can find, nine times out of ten at least the broker will say, yes, because the customer is the client, and the client dictates the terms of the engagement.

Now, there are already a group of mortgage brokers who act in this way as a matter of course. They're called upfront mortgage brokers. There are about 150 of them and they're listed on my web site, and it's something I started a couple years ago.

So this is not a pie in the sky idea. There are already many brokers out there who act in this capacity, and if borrowers insisted that that's the kind of relationship that they wanted, that's the way the industry would act.

MR. FISHBEIN: Jack, are you going so far as to recommend fiduciary responsibilities as a matter of law?

MR. GUTTENTAG: Absolutely, I am.

MS. ALBON: So you're suggesting basically that the mortgage broker should be the one that assists the borrower in determining whether or not that loan is suitable for them?

MR. GUTTENTAG: That's correct.

MR. VENERIS: That seems, for all intents and purposes, that that really is a practice not exactly in the way you explained it, Jack, but it just seems that when the consumers -- they don't know who to turn to, they're going to be talking to mortgage brokers for the simple reason is there are thousands of them out there.

MR. GUTTENTAG: They are the natural people for them to turn to. There are many of them there. There are about 35,000 mortgage brokers. They know the business. They have the expertise, not all the expertise. As far as counselors are concerned, some are good, some are fair, some are bad, some are excellent. But in time ways will be found to rate mortgage brokers on the kind of service they give, that is something that I'm working on right now, so that that problem will start to be addressed as well.

MS. ALBON: How did we get there then? I mean, as we say there's 150 on your web site, but there are thousands of thousands of mortgage brokers out there. How do we get to that result? Is that by regulation?

MR. GUTTENTAG: Well, I think that I would be in favor of legislation that would require that brokers assume an agency responsibility toward clients.

MS. ALBON: At the federal level?

MR. GUTTENTAG: I think I would favor that kind of legislation. Without that, it will be a slow process. It's underway but it's going to be slow.

MR. VENERIS: I think though that that kind of legislation would be quite a daunting task to pass. The mortgage bankers have quite a strong lobby. I'm not sure where they would weigh in on that, but I think -- I don't know if the mortgage brokers association would be in favor of that or not.

MR. GUTTENTAG: I can tell you they would not.

MR. VENERIS: That's right.

MS. FAIR: Let's ask the question we just got: If consumers want a clear, honest explanation of the different options --

MR. GUTTENTAG: Remember what we're talking about here. We're talking about education, so why don't we educate borrowers as to where they go to a trusted advisor and what they do when they find him, what kind of deal they propose to these brokers?

MS. FAIR: If consumers do want a clear, honest explanation of the different offers, why doesn't the market force brokers and lenders to provide this?

MR. GUTTENTAG: When you say the market force, the market force is the borrower. The borrower is not educated so we can't force anything. That's the whole thrust of this. The borrower has to be educated to know what he should demand when he goes into the marketplace.

MS. BOWDLER: I'm going to agree with Jack, backing up just a little bit, in saying the world of independent counselors is much too small, and there were questions about mandating counseling earlier, and you would never be able to do that because the infrastructure just isn't there.

As much as I love counselors and I fund counselors, we just wouldn't be able to do that, and it's not only that the mortgage broker should act as the trusted advisor, they do currently act as the trusted advisor in the mortgage place now, except for that they don't have the fiduciary responsibility.

So they have all the advantage of having the trust and the terms of endearment from the client, but they don't necessarily have the responsibility. And I'm not really sure why this is such a huge leap of logic for everybody since there's models out there for this.

If you are an affluent person who wants to invest your money the same way a low income person wants to invest their money in a house, you go to a securities broker who has a responsibility to find you the best securities product that he can, and so I think there's some parallels there of how the security industries are regulated, and they regulate their individual brokers and how we might be able to similarly protect our low income investors who are investing in their homes, and currently relying on those brokers as if they had fiduciary responsibility.

MS. FAIR: What has La Raza's experience been with regard to counseling?

MS. BOWDLER: Well, we have now been in business supporting housing counselors for almost ten years. In that time, we've counseled over 25,000 families, and I'm not going to try to remember the number of homeowners because I'll get it wrong and I'll have to hear about it later, but lots and lots of homeowners, and I think one of the things that I've heard missing from the debate and one of the biggest struggles that counselors have is a counselor has the responsibility to tell a family, Home ownership is not for you, and that's one of the biggest differences between a counselor and say somebody from the industry who is faced with, let's face it, market pressure to produce a loan.

And so my experience with counseling is that that is part of the job of saying counseling -- sorry, that home ownership is not for you, but if you give me a year of fixing whatever is wrong with your credit or saving or sometimes longer, counselors work with people for up to two years, in that time then you may be able to be ready to buy a home.

A counselor's problem is that there's always somebody out there who is willing to make a loan to that family regardless and in their current situation, so the counselors have a fair amount of competition, but I'll just add to that that, since nobody else jumped in in that space, that there's -- we haven't seen a large amount of investment in this strategy. We have from some, and we do have industry partners, Washington Mutual is one of them, but so that the operation is still very small.

And while I would say that it is the most effective way to make sure that a family understands all of their options, there's no way that you're going to be able to counsel every single home buyer out there, so it is a method. It's not the only method.

MR. VENERIS: I think the situation is as you said earlier, that there are so few counselors as opposed to mortgage brokers, we have to try to within the system we have and try to make that system better, and I think we are recognizing the importance of the education and the component of education is going to have to come from those mortgage brokers because we just don't have the counselors to offer that good advice.

I agree with you in what you're saying where if they go to a counselor and they shouldn't be buying a house, they're going to hear that, where if they go to a mortgage broker, perhaps they're not, and that's the problem we heard earlier. It just seems like anyone who wants a mortgage can get a mortgage, but I think we have to work within the system that we've got, and we can do that using an educational component, working with the mortgage brokers I would think, and getting them to distribute the educational types of literature that we're talking about today, so they can pass that on to the consumers.

They can also work hand in hand with the realtors. The realtors could be using this same type of information to pass it on to the consumers at their very first initial meeting, so I think what we have to do is we have to focus on getting pieces of paper in their hand that they'll read and that they'll understand at more than one juncture.

MS. FAIR: Let me stop you right there, John. I think you raise an interesting issue. I had mentioned to you before we started that one of the things that impressed me very much about the National Association of Realtors' brochure, and I think the same holds true for this one, in the realtors' brochure, there are only two four syllable order words: Traditional and adjustable.

So first, let's talk about the paper, but I want to broaden the discussion to beyond paper. Right now, what do you see as the most effective ways, and let's again talk within the eight and a half by 11 context before we jump into what else is available -- what are the most effective ways for getting the message, getting that education in consumer's hands?

MR. VENERIS: If we can back up a second, you talked briefly about disclosure requirements and how helpful are they in the process? And quite frankly I think the disclosure requirements are part of the problems in the process. When you read the disclosure, and in fact, we saw several disclosures on the screen today, and for instance I was reading one of them, and I'm thinking to myself, okay, I've been doing this for 28 years, how do I expect a buyer to understand what they're seeing on the disclosure?

And when they see the disclosure, they see it in a couple different times I think. One is when they actually applied for their mortgage. That's when the lender tries to explain it to them, and probably the only other time they're going to see any similar type of disclosure would be at the time they're signing the mortgage documents, when it's one piece of paper out of a half inch stack of pieces of paper, and that's not the time for them to try to understand that disclosure.

So I think that's another avenue that has to be tackled. I think that we have to have disclosures that have more words that are not four syllables, and again I think this is a situation where less is more. I think that if you have a disclosure that gives half the information that the consumer needs to understand in an easier context, they may actually read it, and they may actually get a grasp of it.

We have to remember, the consumers don't know what they don't know, and so they're relying on us, they're relying on the mortgage brokers. They're relying on the educational materials that we're giving them to try to educate them to get a mortgage. What's their number 1 goal? It's not to get the mortgage. It's to buy the house.

MS. ALBON: I agree with that, and this is our program disclosure for the option ARMs, and it's similar versions. Almost all of this is required by the fed and you can see how long it is. I too worry about whether borrowers really get through the whole thing, so what we did is we kind of put in bold at the beginning the highlights of the product, the highlights of the risks of the product and advantages of the product in hope that while if they don't read the whole thing, maybe they'll at least read that.

We had a lot of conversation today about the worst case example, and I fully understand where some of the folks are coming from, but I also worry about whether the worst case example to most consumers today is such an unlikely proposition, that they would be inclined to dismiss it, and I think along the lines of what you were suggesting, perhaps we disclose various different potential interest rate possibilities.

Maybe we put back the, what is it, the 15-year historical example that the fed removed from their requirements. Maybe that would be a more realistic way to present what could happen in the way of interest rate increases, but I definitely agree that the last thing we probably want to do is bury them in more paper.

The last time I refinanced, it was with Washington Mutual, within three business days they mailed me the package, and when the thing came, it was this big, and I liked to believe that if I wasn't as familiar with what was therein, I would have read it, but it's intimidating to consumers, and it's very costly for us to support that disclosure apparatus which then in turn adds to the cost of the credit for the consumers.

MS. FAIR: Bob Broeksmit, I don't think he was being literal, but I was pretty impressed with this. This is a variable interest rate mortgage, if that's not what you want head for the hills, unquote. Let's not worry here yet about mode, but let's talk about wording.

I mean, what kind of language -- is part of the problem here what a lot of people have called a post literate society? What do we need to do to just explain what I think we all agree can be a complicated bit of information? How do we explain that? What can we do to explain that in a clearer fashion?

MR. GUTTENTAG: Lesley, it's not words that are needed. It's numbers. They don't care about how the mortgage works. They care about what might happen, so let's show them the numbers instead of one move generating these very complex and long textual explanations of how the mortgage works. Let them provide some expositions of what will happen to the payment and their rate in this clearly defined set of assumptions.

MS. FAIR: What should those assumptions be in your opinion, Jack?

MR. GUTTENTAG: Well, one of them would be no change, because that's critically important, and it's also an assumption up underlying the APR. On an option ARM, because they use relatively stable indexes, worst case is an extreme and very unlikely kind of scenario, so I think I would opt for something in between.

In various expositions that I have done, I've used a 1 percent increase in the index for each of the first five years as a reasonable rising rate scenario. Obviously it's arbitrary. Why 1 percent? Why not 1 and a half or 3 quarters? It is arbitrary but they're all arbitrary. It does give the borrower a sense of what can happen and 1 percent a year for five years is not historically unprecedented. It's not as bad as a few cases that we have actually had. It's not as bad as 1981 or 1987 for example.

MS. ALBON: To be fair can it show what can happen in a declining rate environment as well?

MR. GUTTENTAG: I don't know what fair means, but I think it's redundant. The borrower isn't concerned about declining rates and declining payments. He's concerned about the bad things of what might happen. It's the same reason why on Truth In Lending that it does make sense to tell a borrower that there's a prepayment penalty on the loan but it doesn't make any sense to tell them whether or not the lender is going to give him a refund of this finance charge which the current statement does because borrowers don't have to be warned about the benevolence of lenders, and they don't have to be warned against good things happening in the environment.

MS. ALBON: Well, but there are advantages to these products as well, and that is you can actually save money with them. Wouldn't it be more fair and appropriate to share various types of interest rates environments, both climbing and declining, so that they can better weigh the cost, the risks and the benefits of the product?

MR. GUTTENTAG: Michaela, if I were making the rules, I would allow you to add whatever scenarios you as a lender thought were reasonable.

MS. FAIR: Other comments on what Jack has proposed?

MS. BOWDLER: I would agree it's not just about the words. It's about the numbers, but it's also about timing. I mean, this kind -- I think your comment earlier, Michaela, was exactly right because this kind of paper assumes that people shop for their mortgages, but they don't. It's kind of a myth now. People don't shop for their mortgages.

At best, some of your more sophisticated borrowers or your moderately sophisticated borrowers that would benefit from pieces of paper like this probably go online and check out some stuff, and then they either go to the lender where they bank or they go to a mortgage broker.

I would estimate, and from what my counselors tell me, almost nobody goes to more than two stores to check out, and I think you would be hard pressed to find people that go to three or four or more different kinds of sources: Brokers, lenders, different kinds of lenders to shop around and see what their options are.

So if you assume that borrowers are only going to go to one, no more than two places, it's not just about giving them the numbers. It's about getting them the information as early enough in the process that they can make a decision.

MS. FAIR: I think that's a critical point. I can just speak from my own. By the time I went to closing, I had already in my mind picked out the wallpaper. I was not about to -- even had I found something surprising, sort of say stop the music at a point like that.

Where -- or I guess more than one place, where in the transaction should certain kinds of information be given to consumers?

MR. GUTTENTAG: There's only one way to provide this detailed complicated transaction specific information about a loan early on. There's only one way to provide that, and that's online.

MS. FAIR: You said online.

MR. GUTTENTAG: Online.

MS. FAIR: What about consumers who aren't online? What do you do for them?

MR. GUTTENTAG: They go to a trusted advisor.

MR. FISHBEIN: But I think what Michaela's posed is one of the dilemmas here. In part the lender is trying to sell the product, at the same time provide certain information, and those two things conflict with each other, so when you talk about providing risk information, that might scare some borrowers away in the context of -- remember we're talking about particular mortgage products that the regulators themselves have defined as riskier products than typical products, that that could get in the way of the ability of institutions that want to sell those products, to make the attractive case that they're beneficial.

And that seems to be an ongoing dilemma here on how you balance proper information to consumers, but what we know will also be the case which is lenders' and brokers' efforts to sell products and to get compensated for them.

I mean, one of the things that hasn't been touched on I think very much up until now in the conference is compensation-related. As I understand it, I've had lenders tell me brokers were getting extra compensation for placing people in riskier loans, nontraditional mortgage loans, and that is a reality at least of some of the marketplace.

So in one hand you have every economic incentive to put people into loans because people are helping to mediate that process, are going to be compensated at a higher level. At the same time you're saying here, hand these disclosures at an early process so the consumers can be potentially scared away because they realize they don't have the risk appetite that these products entail.

MR. GUTTENTAG: Markups tend to be higher on these loans because brokers can get them is the major reason, especially if they're dealing with disadvantaged borrowers.

MS. FAIR: I think which raises a critical area, and I was wondering, Janis, if you could address that. Are there particular areas that need to be handled differently when we're dealing especially with the Hispanic population which La Raza represents?

MS. BOWDLER: Wow, I could actually opine on that for quite some time.

MS. FAIR: How about a couple minutes?

MS. BOWDLER: In a couple minutes, I would actually like to talk just a little bit about some of the things maybe people don't know and how the Latino community is a little bit different. I mean, I think your example I would like to come back to, Michaela, is you wanted to know is what can we do if the interest rate goes back down.

One of the things that a lot of people don't know about their adjustable rate mortgages is there are plenty out there that don't come back down, and they don't understand that, and the assumption is that an adjustable rate mortgage will fluctuate up and down, but there are plenty of 2/28 products, the interest-only products and the options ARMs, that don't ever come back down and customers or clients aren't aware of that.

I think when you're dealing with the Hispanic community, one of the things that is very clear that the Latino consumer prefers the one-on-one approach. That's why we have success with counseling. That's why mortgage brokers are successful, and that's why realtors are successful, because a mortgage broker lives in your community, maybe goes to your church, will come to your house at night, is at your kid's birthday party, and sets himself up as that person or -- her, she sets herself up as that person that can be trusted and that's very important in the community.

It's a community, somebody else mentioned earlier, that is largely not just first time home buyers but first generation home buyers, so that makes that position of trusted advisor, which we keep hearing so much about, all the more important because the community infrastructure and knowledge that maybe they're in middle class white communities is not necessarily there in Latino communities so it's very important.

But I just want to stress that while we may not ever be able to grow the independent sector large enough to handle all of the needs, I don't think that you could rely on mortgage brokers as your trusted advisor until they have some sort of suitability or fiduciary responsibility because without that, they have a clear conflict of interest in helping the client, and what we're seeing in the Latino community unfortunately is a lot of what we not so fondly like to call brown on brown crime, where you have bilingual, bicultural folks who take advantage of their own.

And I have story after story of this of families who are approached by bilingual, bicultural brokers, sold option ARMs. They never went out and sought them, interest-only loans, stated income loans, all of these bad products, and there's not a lot of remedy out there for them.

MS. FAIR: What can you do to educate consumers about having an appropriate critical facility when looking at advertising that offers negative number kind of interest rates or offers very impressive sort of the headlines? What can we do to encourage effective critical skills in evaluating those advertisements?

MR. GUTTENTAG: It's seems to me that you need to get a message out, a very simple message. I don't know who the proponent would be, who the disseminator would be, but it's a message that I try to convey to people I correspond with every day, and that is, don't respond to solicitations, especially deal based solicitations because all deal based solicitations are fakes. Nobody can make a valid offer to someone who they don't know, whose credit they haven't looked at, et cetera, et cetera, et cetera. That is real.

So that should be part of the message that is combined with who do you go to; that is, it can't just be negative. We can't just say, You don't go with these people because it immediately raises the question of, Well, who do I go to, so you have to combine those two, but what you don't do, the negative message is you don't respond to solicitations, and the more attractive a solicitation, the more sure you can be that that's funny. If it's too good to be true, it isn't true, and on and on. You can make up your own slogans but that's the message that ought to go out.

MS. FAIR: Other perspectives on that point, about responding to advertising?

MR. VENERIS: One of the things we're seeing more and more in the industry is the effectiveness of the advertising of the different lenders. I can tell you more and more consumers come to us and they say, We already have our lender, we've already talked to someone, and they have talked to someone in many cases that has a very effective advertising campaign.

Jack, I understand exactly what you're saying. Unfortunately, sometimes it's too late, but it's something we have to do.

MS. BOWDLER: I would add to that too that we really, we being as a country or as an industry, have not made a real investment in trying to inform consumers broadly speaking, that that effort is pretty much nonexistent. I mean, you have community based organizations who quite frankly the flyers that they post are just nothing compared to Ameriquest sponsoring the Superbowl, and a couple articles, somebody mentioned reputation risk earlier, just pales in comparison with the amount of money that's spent on all the different forms of advertising.

So, I mean, if we're going to talk about how we combat billions of dollars of advertising, we have to think of what kind of investment are we prepared to make to inform consumers.

MS. FAIR: Let me ask you this about that. Certainly the mode of communication can often be just as important as the message that's being conveyed. I mean, this is not an applicable sort of analogy here, but when the Federal Trade Commission wants to let people know about National Do Not Call, we've got fans to give out at state fairs. We have postcards to give out to college coffee houses.

Now, this is not a substitute obviously for the information that has to go into this, but when we want to talk to college kids about credit, it's a brochure, so cool even I don't understand it or I should say so cool especially I don't understand it.

Are there effective strategies or what should we ought to try in again a post eight and a half by 11? What about Internet? What about video? What about other methods of educating people?

MR. VENERIS: I can only give you an example of what we're doing in my home state of Illinois. We have developed a web site at the Illinois Association of Realtors called credit/power.org, and this is a web site that's designed to be viewed by high school aged students, and we're in the process right now of going to high schools throughout the state to see if they will be willing to develop a curriculum that will tie in with the web site.

But the importance of this web site is that it drives home the point of the importance of how decisions that you make today can affect your credit and your ability to buy a home 10 or 15 years from now, so what we're doing in Illinois is we're trying to tap into that Internet market into a group of people that we know are playing on the net.

MS. FAIR: Michaela, are the things that are getting done in the industry online or elsewhere kind of through industry coalitions to educate consumers?

MS. ALBON: Yeah, I think that's right, and certainly Fannie Mae is trying to do obviously quite a bit, and I'm not sure if we felt -- if there's any statistics on what the impact of that has been, but again I think the challenge is, What is the right information to get in their hands so that we don't have information overload, so it is effective.

And then I think there's another challenge, we've been focusing a lot and understandably so, on the risks of the products as they are offered to people who may not be as experienced in home ownership and may not be as experienced in finances, but actually as Bob pointed out this morning, a large percentage of this market are very savvy borrowers, who see real advantage of these products, and presumably wouldn't require as much consumer education as well.

And one of the things I think lenders always struggle with is, Well, how do you deal with that given that you have different segments of the market and so that we don't run into fair lending problems either, so we look like we're treating others differently -- the borrowers differently.

So those are always challenges as a practical matter we're faced with on a daily basis.

MS. FAIR: Allen, you have that "I have something to say" look.

MR. FISHBEIN: Well, I thought I did, but I'm not so sure. No. I think we still come back to the fact -- and you touched on this, that there are a lot of different consumers in the marketplace, and CFA is very committed to consumer education in a lot of ways. We've been promoting knowledge of credit scores as a way of managing certain household finances, and we have other programs underway, but we also recognize ultimately the limitations.

And when you have a transaction like a mortgage transaction in which a consumer may be involved in only a limited number of times over the course of their lifetime, and each time that they're involved, the market's changed so dramatically that whatever they learned before, they can almost forget about because they have to relearn.

There's always going to be these tremendous information asymmetries out there, which are going to work to the advantage of the professionals, and without clear-cut duties and transparency, a certain group of consumer are always going to be particularly vulnerable to be taken advantage of, and we know with home ownership, you can say this about other aspects of society -- but home ownership, the stakes are so great because this is the anchor for a lot of financial stability and wealth building for so many Americans, that we just have to set a different bar.

MS. FAIR: What about the problem, we've talked so far primarily about people shopping for mortgages, but there are thousands of people with mortgages in hand right now that I can't predict, but let's face it, the word payment shock has been used a lot today. What do we need to do now to assist those consumers that we know are going to experience that payment shock very soon?

MS. BOWDLER: I would say that post purchase and early delinquency counseling is one of the hardest kinds of counseling out there. I mean, unfortunately if people can anticipate, they got notice they're going to lose their job in six weeks, they go into crisis mode, and they are not -- they are going to start avoiding phone calls from their lenders. This is one of the hardest areas for the industry, and I think they need to figure out how to deal with this.

But to answer this question and a little bit on the last question, one of the best practices that I've seen out there and could be a potential tool for this kind of thing was actually in Chicago where they pulled together a coalition of bankers and realtors and brokers and the counselors and all the advocates.

They set up a 1-800 number and did a massive social marketing campaign so that people knew if they suspected something was wrong with their loan before they signed on their loan, before they were late on a payment, they could call this 1-800 number that was backed by the city, and the city then staffed it and routed their call either to a counselor or to somebody appropriate to answer their question.

The benefit to that kind of model is that the message is very simple and does not have to be complicated, and you just get -- you're just trying to get people to come to you because the problem that we're going to face when people hit payment shock is that they're going to go into the woodwork and you're not going to be able to find them until it's too late.

MS. FAIR: Other suggestions in addition to what strikes me as a very creative forum that Janis has mentioned?

MR. FISHBEIN: We get called a lot about this, mostly from reporters I must say.

MS. FAIR: They have mortgages too. I have a friend who has a problem.

MR. FISHBEIN: They're asking what should consumers do, and I think one of the limitations of the proposed Interagency Guidance was that it failed to recognize about many of the loans that have been written already and advise the lenders on what efforts they should be undertaking to try to restructure loans and get into mortgage situations where their borrowers might be able to handle.

It was said earlier, this is a staggering number, and we keep dismissing it. One out of seven of the mortgages, over a million mortgages outstanding that were written in the last two years are due to reset and may go into default and foreclosure. This will depend on home price appreciation, interest rate movements, but the reality is we're facing a staggering number of potential default situations.

What we encourage borrowers to do, or at least through the media we encourage them to do, is to pull out their mortgage documents and begin to try to understand them, even if they didn't at the time they made or took out the loan, to understand what the features are and what the prospects for higher monthly payments are because they are a lot better off trying to deal with them before they fall behind on mortgage payments than once they have, but the reality is that most consumers in that situation will probably not follow that course.

MS. FAIR: In the next few minutes, I want to finish up with these last couple questions, but I do want to give you something to think about for our last word. Eileen Harrington just made you a headline writer. I'm going to do you one better. I'm going to make you the czar or czarina of the regulatory lending industry, real estate and consumer marketplace, and I'm going to ask you if you had the power in the snap of a finger to do anything right now to improve consumer's understandings of the benefits and risks of non nontraditional mortgages, what is it that you would do, so be thinking.

Let me finish up with these last few questions, however, one for Michaela. A few large lenders originate the majority of option ARMs. Do these lenders go beyond minimum requirements to educate and inform potential borrowers?

MS. ALBON: I think most of the responsible lenders do. I think, as I said, we've created a special brochure for it. We've added bold disclosures to our ARM program disclosure, and this kind of goes to the point that was just raised. We've now created a letter that will be going out to all of our customers who are in the neg am situation or near the neg am situation advising them of where they are, and reminding them, projecting for them what they would look like at the end of a 12-month period if they continued to make only the minimum monthly payment.

I do agree that that's the best defense to equip them with information. It really does not behoove us, believe me, to get into situations where our borrowers default on loans. That's not the way we make money I can assure you.

So, yeah, I think we are. I think the larger lenders are today doing more in the way of advertising disclosure than is technically required under Truth In

Lending today. I know in our ads, even though it is not technically required, we do disclose the possibility of negative amortization, for example, on our option ARM and payment shock.

I know IndyMac's do. I believe Countrywide's do, and although I haven't seen any directly, I know that National City's compliance officer told me two weeks ago that theirs did, and I'm inclined to agree.

So I think that the larger, more responsible lenders who have had more experience with the product -- and I do want to emphasize, and it's been talked about today, these aren't new. The option ARMs have been around for over 20 years now. It's just new in a lot of areas of the country -- that I think the responsible lenders are.

And also I think in closing I would just say that I can't emphasize enough that this all really goes hand in hand with responsible underwriting as well, but I think the larger lenders are, but again it's more than the regulations technically require us to do.

MS. FAIR: Question for Jack, which this one doesn't surprise me: Do brokers get referrals from your web sites and pay you a fee for such referrals?

MR. GUTTENTAG: Yes, they get a lot of referrals from my web site. No, they do not pay me a fee.

However --

MS. FAIR: There's a however?

MR. GUTTENTAG: Can I do a however? I have one broker, call him a broker. He's really what's called a correspondent lender meaning he actually closes loans, and he has a web site, a very good web site which borrowers can see the whole range of prices on every instrument, all the loan combinations and so forth, and I've made a deal with this lender that I think might interest you.

The deal was that I would refer clients to him if he rejiggered his site according to my specifications, and among my specifications were the following: Number 1, and the most important, he reveals his wholesale price, and his markup and his wholesale price and markup depend only on the loan size on nothing else, and so it doesn't vary with credit score or LTV or anything else.

And the second thing that he agreed on, and I think this might interest you, is that if a borrower doesn't qualify for the loan he selects on the screen and has to fall into the sub-prime category, his markup will remain the same. So a borrower with shaky credentials who is not quite sure whether he'll qualify for prime maybe Alt A, A minus, various degradations that are above sub-prime, if he's not sure about that, he's safe to go to this site because even if he drops to sub-prime, this lender is committed to the same markup on that loan, even though the loan will be more costly to originate than other loans.

MS. FAIR: That's very interesting, but now it's coronation time. Czar Brian Bucks, let me get just one brief suggestion from every member of our panel. What would you do immediately to facilitate or improve consumer understanding of the risks and benefits of the nontraditional mortgages?

MR. BUCKS: I will actually put that question to the true czars.

MS. FAIR: The question now goes to Michaela.

MS. ALBON: I would encourage the feds, I think that's something we can do quickly, to complete their version of the CHARM booklet that they're creating for distribution that covers interest-only and option ARM mortgages. We've been working on that with them, and I think that will be a beneficial tool.

I hope that -- I think somebody mentioned this morning it would take three years or so to amend Reg Z. That was kind of disappointing. I would like to see us all work together to try to move more quickly on amendments to Reg Z. I think quite frankly a lot of the -- I do want to point out that while it is true that option ARMs and interest-only loans have an incremental risk over and above what we've seen previously, it's also true that a lot of the risks that we talk about today apply to ARMs generally as well, and I think we shouldn't lose sight of that.

MS. FAIR: Janis, one thing you would like to see done immediately.

MS. BOWDLER: I would layer an investment in broad access to information through, obviously since I'm a czarina, independent housing counselors, but also layer that with a protection, a right of consumers to a suitability standard and assume that their mortgage broker is working on their behalf.

MS. FAIR: Allen?

MR. FISHBEIN: I would say the same thing, fiduciary responsibility for the mortgage brokers to the borrower.

MR. GUTTENTAG: I'll go for that.

MS. FAIR: I'm sorry, Jack.

MR. GUTTENTAG: I agree with that. I would also like to see the fed revise its Truth In Lending on this to get rid of the junky disclosure they have now and require the provision of useful information about what might happen on the specific transaction to payments and rates.

MS. FAIR: John?

MR. VENERIS: If I were a czar, I would have to meet with the education czar in the country to have him develop a course called understanding the mortgage loan and require that every high school student take it upon graduation.

MS. FAIR: I will take the prerogative too, if I was a czarina, I would ask each of you to fill out the evaluation form that you have in your materials.

I would also ask each of you to do what you can to publicize the FTC's 877-FTC-HELP number or the place on our web page where consumers, businesses, attorneys, anyone can file complaints. If there are practices, advertising especially, things in the marketplace that strike you as deceptive, we want to know about it, certainly if it's an entity over which the FTC has jurisdiction. If it isn't, it will be put on our special hotline to our brothers and sisters at the agencies that do, but again at ftc.gov or by calling 877-FTC-HELP.

Thank you, panelists, very much. That's the last word.

(Applause.)

MS. TWOHIG: Thank you, Lesley, and thank you, panelists, for your insights, and thank you all for staying to listen to the discussion.

Next, to conclude today's workshop, it's my sincere pleasure to introduce Lydia Parnes of the FTC's bureau of -- Director of Bureau of Consumer Protection. It's been a long day.

MS. PARNES: Peggy, and thank you, and it's obviously been a good day also, and it's still a beautiful day outside, and those of you who are in here haven't seen much of the sun, so I'm going to keep my remarks really short.

One of the most important tasks that we have is to understand market changes so that we can continue to protect consumers no matter what happens in the market, and today we've learned a great deal about the new mortgage marketplace.

Our very distinguished panelists shared their expertise, their perspectives, discussed the challenges and the benefits of nontraditional mortgage products, and exchanged thoughts on how to best protect consumers while encouraging innovation. People may disagree with one another about the best ways to protect consumers, but consumer advocates and industry groups alike seem to agree that consumers and lenders are all better off when consumers get clear and timely information.

Therefore, it's important that borrowers are adequately informed as they decide whether nontraditional mortgage loans are right for them. If we can achieve that goal, we'll have gone a very long way towards protecting consumers.

I would like to thank all of our panelists, who represent federal and state regulators, consumer advocacy groups, industry, and other market experts. I also want to thank everyone here for your participation, and I actually saw the little cards being filled out and coming up to the panelists, so I know that the folks here really were active participants in the day and you made it a better day with your involvement.

Lastly, I would like to thank the staff that made this possible and worked very hard to put on a great workshop, and particularly Julie Bush, Delores Thompson, and Sarah Gleich, so thank you all, and enjoy the rest of your day.

(Whereupon, at 4:55 p.m., the workshop was concluded.)

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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.

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I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

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