

Non-Traditional Mortgage Products

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Non Traditional Mortgage Products Generally

- The final and proposed guidance address:
 - ◆ Loan terms and underwriting practices
 - ◆ Portfolio and risk management practices
 - ◆ Consumer information

Non Traditional Mortgage Products Coverage

Nontraditional Loans - where interest and principal may be deferred

- IOs and Option ARMs
- Not HELOCs and Reverse Mortgages

Federally Regulated Institutions

- Trickle down effect
- States Pending



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Underwriting Standards

Guidance requires:

- Appropriate borrower repayment analysis
 - ◆ Credible analysis of borrowers capacity to repay the full amount of credit considering principal and interest
 - ◆ Qualify at “fully indexed rate assuming a fully amortizing payment including potential negative amortization amounts
- Collateral dependent loans – generally considered unsafe and unsound
- Risk layering - when for example, I O with low doc or simultaneous second– mitigating factors, e.g., lower ltv, credit score, liquid assets, mi or other credit enhancements
- Reduced doc – use with caution
- Below market introductory rates - minimize payment shock
- Lending to subprime borrowers – follow earlier guidance
- Non-owner occupied properties- underwrite to service debt



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Risk Management Practices

Guidance requires risk management keep pace with portfolio growth and changing risks of nontraditional loans:

- Policies – set acceptable levels of risk in operating practices, accounting procedures and policy exception tolerances – limit risk layering include risk management tools, growth and volume limits
- Concentrations – well developed monitoring systems and risk management for nontraditional concentrations
- Controls – Q C, compliance, auditing for nontraditional
- Third party originations –monitor to reflect institution's standards
- Secondary market activities –manage risks, buybacks
- Management information and reporting
- Stress testing
- Capital – Maintain appropriate levels for portfolio, ALLL



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Consumer Protection

- Guidance requires that institutions provide clear and balanced information to consumers
- Advertisements and monthly statements for products should
 - ◆ Describe risks and benefits of products and payments
 - ◆ Clearly describe
 - Payment shock
 - Negative Am
 - Prepayment Penalties
 - Cost of reduced documentation loans
 - Effects of payment options
- Institutions should
 - ◆ Comply with TILA, RESPA and Sec. 5 of FTC Act
 - ◆ Avoid practices that obscure risks
 - ◆ Develop strong controls, training, consumer complaint procedures, third party controls
 - ◆ Avoid bad compensation schemes



As Expected

- Guidance revised slightly
- Includes all three components, underwriting, risk management and consumer information
- No suitability standard
- Generic disclosures
- CSBS and AAMR will move quickly with similar guidance

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Industry Comments

- Industry supports sound underwriting, risk management and consumer information. Nonetheless:
 - Underwriting requirements should permit flexibility
 - Risk management requirements should recognize long experience of industry with these products
 - Also, concern about control over third party channels and other issues
- Consumer protection section should be done through comprehensive approach affecting all loans and all borrowers
 - Question wisdom of all new disclosure regime directed to institutions only favoring Federal overhaul instead



Non Traditional Mortgage Products Consumer Response

- Consumer protection section should be strengthened
- Suitability Standard

Challenges of Suitability

- Definition - Approaches
- Application
- Effect on Fair Housing
- Other consumer protection approaches deserve effort

Next Steps

- Debate continues – Suitability etc.
- Consider inquiries for clarification
- Respond to disclosure proposals
- Address state actions - advocate ceiling not floor

Connecting the Dots

- Homeownership in America is at or near record highs
- Innovation in the marketplace has expanded access to credit & increased homeownership
- While sound underwriting and risk management are essential, overly tight regulation will threaten innovation
- HMDA and CRA seek investment
- Financial literacy and greater transparency can foster borrower understanding, innovation and competition
- Non-traditional experience will feed the movement for national standards and overhaul of consumer disclosures

