Regulatory Update on Nontraditional Mortgage Products and the Challenges Facing Subprime Mortgage Borrowers

An Informed Discussion of Nontraditional Mortgage Products and Escalating Foreclosures

December 11, 2007

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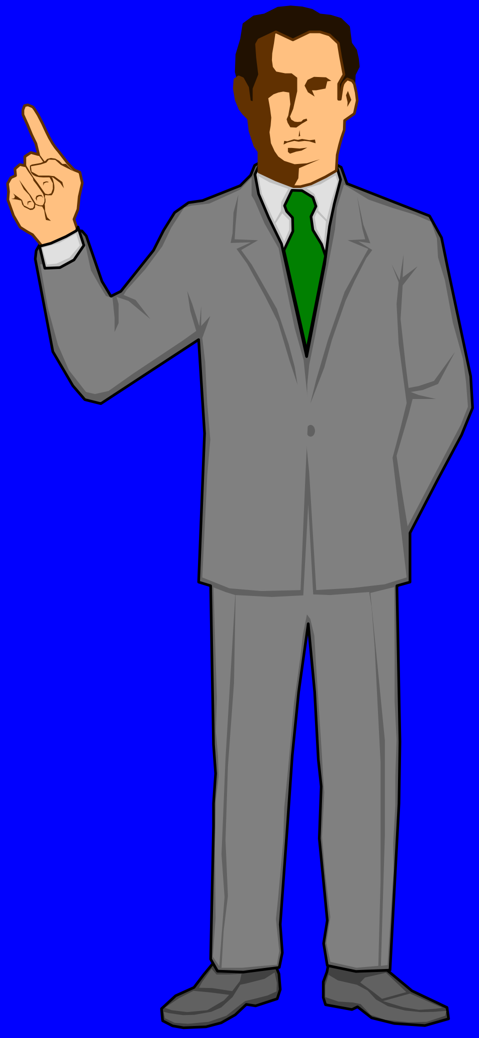
- If you have specific legal questions you should consult an attorney.

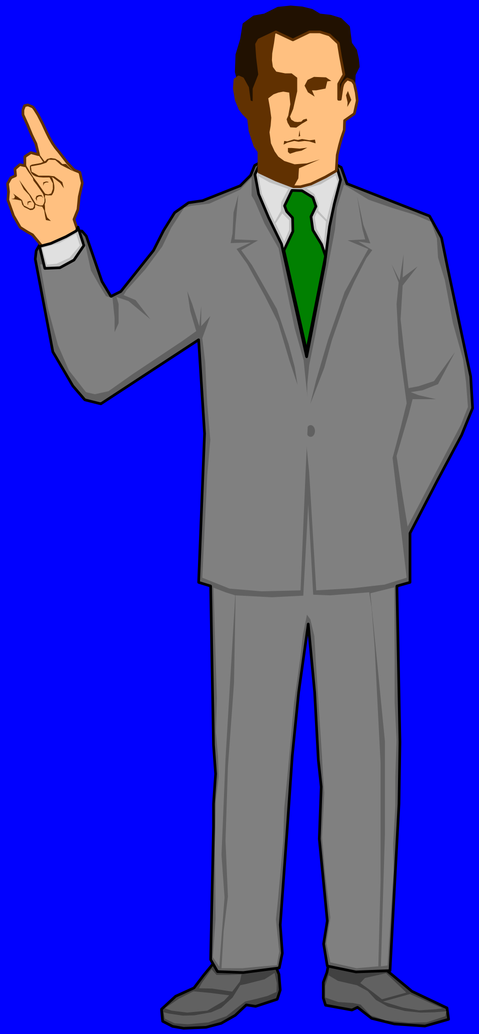
Today's Program

- **Background on the Subprime Mortgage Market**
- **Sources of the Recent Problem**
- **Prospects for Subprime Borrowers**



Today's Program

- **Helping Borrowers and Mitigating Losses**
- **Actions Taken by Banking Supervisory Agencies**
- **Questions?**



Background on the Subprime Mortgage Market

- What are subprime loans?
- Expansion of subprime lending
- Technological advances and financial innovations
- Ongoing growth in the secondary market

Background on the Subprime Mortgage Market

- Subprime loans mean increased risks
- Subprime loans are more likely to default
- For borrowers – this can mean the loss of a home and reduced access to future credit
- For lenders – the originate-to-distribute model can leave lenders with weaker incentives to maintain strong underwriting standards.

Sources of the Recent Problem

- Two-thirds of subprime borrowers have variable-rate mortgages
- More than 17% of these mortgages are in serious delinquency
- Near-prime loans are showing a rise in serious delinquencies as well

Serious Delinquencies

- Serious delinquencies – single family mortgage that is 90 days or more past due, or a multi-family mortgage that is two months past due
- Foreclosure proceeding averaged 320,000 mortgage loans per quarter during the first half of 2007
- Foreclosures averaged 240,000 mortgage loans per quarter during 2006 and 2005.

Factors Contributing to Delinquencies and Foreclosures

- Unemployment rate
- Slowing of house prices
  - Dampening the growth of home equity
  - “Under water” mortgages
  - Property purchased for investment purposes

Factors Contributing to Delinquencies and Foreclosures

Loosening of underwriting standards
- Investors did not demand information
- Many subprime originators engaged in risk-layering
  - Piggyback loans
  - Lack of full documentation
  - Failure to escrow taxes and insurance

Factors Contributing to Delinquencies and Foreclosures

Substantial payment increase at the first interest rate reset.

- Most common type of subprime variable-rate loan is the “2/28 loan”
- Typical first reset had the rate increase from 7% to 9 ½ %
- $350 per month increase for the average subprime variable-rate mortgage

Factors Contributing to Delinquencies and Foreclosures

What about refinancing as the answer to interest rate resets?

- In 2003 and 2004, about two thirds of subprime 2/28s were terminated by refinancing or home sale before reset.
- Prepayments on subprime variable-rate loans originated in late 2005 and 2006 have slowed.

Prospects for Subprime Borrowers

Conditions for subprime borrowers have the potential to get worse

- Housing activity continues to weaken
- Bulk of resets is pending
  - Quarterly until the end of 2008, monthly payments for more than 400,000 subprime mortgages will reset
  - This is up from 200,000 per quarter during the first half of 2007

Prospects for Subprime Borrowers

- Borrowers with solid payment records and enough home equity should be able to refinance
- Others will face challenges from tighter credit conditions:
  - Recent surveys of senior loan officers show significant tightening of standards on subprime loans.
  - Many lenders have gone out of business
  - Issuance of new securitized pools has dwindled
  - The supply of funds for subprime loans is likely to remain low

Helping Borrowers and Mitigating Losses

- We need to pay close attention to communities that may face more challenges than others, such as African-American families
  - According to HMDA data, African-American families account for a disproportionate share of higher-price (and more likely, subprime) loans
  - Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner (2007), “The 2006 HMDA Data,” *Federal Reserve Bulletin*, vol. 93.

Actions Taken by Banking Supervisory Agencies

- Statements issued urging lenders and servicers to work with borrowers
  - Board of Governors of the Federal Reserve System (2007), "Working with Mortgage Borrowers," Division of Banking Supervision and Regulation, Supervision and Regulation Letter SR 07-6 (April 17).
  - "Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages," Supervision and Regulation Letter SR 07-16 (September 5).

Lenders and Services Generally Want to Work with Borrowers

- Foreclosures can lead to a loss of 40% to 50% of the unpaid mortgage balance
- Loss mitigation techniques are typically less costly, especially before default
- Borrowers who have been current should work with their creditor to make the loan payments manageable.

Loan Workouts and Modifications have been Limited

- Borrowers are not seeking help or advice from their lenders
- Borrowers believe lenders cannot or will not help
- Greatest barrier is making contact
- Lenders can make contact through trusted community advocates and partnerships between community groups and lenders

More Needs to Be Done to Deal with Significant Challenges Ahead

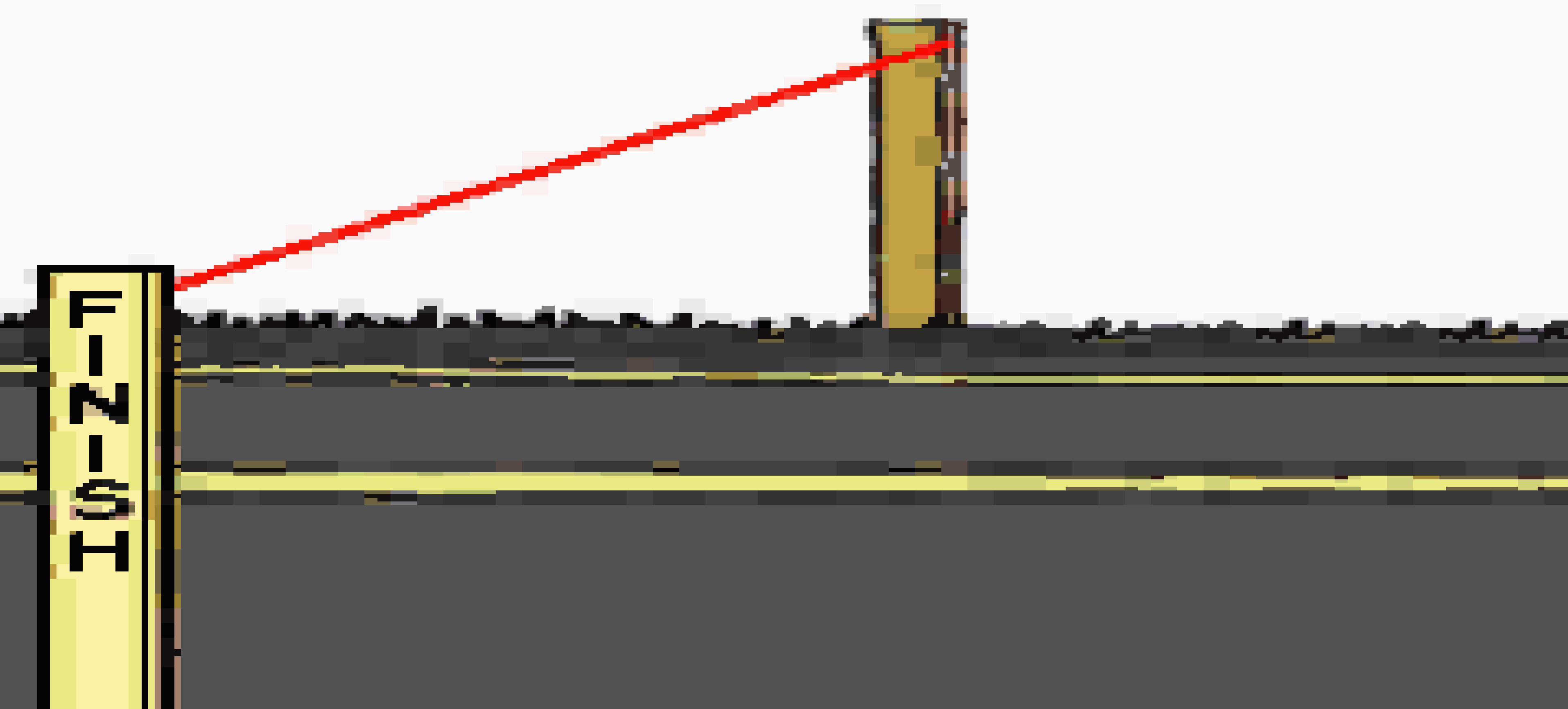
- The industry needs to join together to develop prudent loan modifications systemically.
- Regulation Z, which implements the Truth in Lending Act, will be amended.
  - Ban several deceptive advertising practices
  - Require important consumer disclsoures earlier in the mortgage process

More Needs to Be Done to Deal with Significant Challenges Ahead

- The Board will issue proposed regulations under the Home Ownership and Equity Protection Act to address unfair and deceptive mortgage lending practices.
  - Prepayment penalties
  - Failure to offer escrow accounts for taxes and insurance
  - Stated-income and low-doc lending
  - Failure to give adequate consideration to a borrower’s ability to repay

That's our finish!

Questions?



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