



Consumer Federation of America

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Jeanne. M. Hogarth
Consumer Education & Research
Consumer & Community Affairs
Federal Reserve Board
20th & C Streets, NW
Washington, DC 20551

February 14, 2006

RE: Draft Federal Reserve Consumer Publication on Interest Only and Payment Option Mortgage Products

Dear Ms. Hogarth:

Consumer Federation of America (CFA)¹ is concerned that the proliferation of new mortgage products including interest only and payment option mortgages are confusing to consumers and may not be appropriate for many borrowers who receive them. Over the long term these mortgages could threaten homeownership sustainability for unwary, unsophisticated or financially vulnerable homeowners. CFA commends the Federal Reserve for developing publications to help consumers understand their mortgage options but believes that the brochure should more clearly delineate the payment shock risks and the impact of these risks to homeownership sustainability. The brochure should be targeted to the consumers who are most likely to seek advice from a publication of this nature and the consumers that are most at risk of being unable to financially bear the payment shock these mortgage products contain.

CFA understands that for some borrowers the flexibility and choice of these non-traditional mortgage products may have benefits for some, but more risks than benefits for many other consumers. For those borrowers that are taking out these interest only and payment option mortgages to leverage their purchasing power beyond what is affordable over the long term, these notes may not only be inappropriate but they may be a financial ticking time bomb for families that cannot face the payment shock.

First, consumers now face a dizzying array of mortgage products that are marketed and promoted under a range of product names. Over the past few years, the number of loan products available to homebuyers has exploded, but there is little understanding by many borrowers about how to compare or even understand the

¹ Consumer Federation of America is a pro-consumer association of about three hundred non-profit organizations formed in 1968 to advance consumer interests through research, advocacy and education.

differences between these loan products. The language the lenders use has contributed to this confusion, since the multiplying number of loan products are described by a multiplying number of labels or names. For example, option ARMs are marketed under that name as well as minimum payment, payment option, negative amortization, neg-am and pick-a-payment mortgages. The Federal Reserve brochure should include a sidebar that describes interest only and payment option mortgages in simple and clear language and provides a list of promotional synonyms.

Second, the title of the brochure should express the risks as well as the benefits of interest only and payment option mortgages. The proposed title “Interest Only Mortgage Payments and Option ARMs – Are They for You?” inadequately conveys the complexity of these mortgage products for the average consumer that seeks guidance from educational materials. CFA recommends that the title more accurately reflect the content of the publication, which presents the potential risks and benefits of these mortgage products for consumers in different economic conditions. For example, the title could be “Interest Only Payments and Option ARMs – Are They Too Risky for You?”

Third, when the publication first describes the two primary risks of these mortgage products, consumers can clearly understand “payment shock” but “negative amortization” may not resonate with many consumers. Perhaps a clearer title for negative amortization at the first reference would be “increased mortgage debt” or “loan balance size.” Consumers understand increased debt more easily than negative amortization. Additionally, the negative amortization bullet should more clearly explain that borrowers who make only the minimum payment are increasing the size of their mortgage obligation and in effect borrowing additional money which will have to be repaid.

Fourth, the second paragraph in the interest only mortgage payment section should more clearly explain and delineate that borrowers will have to pay more each month and in effect have deferred payment on a shorter term note. This payment shock is larger for interest only loans with longer interest only payments and the publication should reflect that tradeoff for borrowers.

Fifth, in the section on when these mortgages might not make sense for consumers, the Federal Reserve should much more clearly express the risks to borrowers. CFA believes that it should state that consumers who borrow mortgage products based entirely on their capacity to make initial payments without considering the long-term costs of the mortgage could face significant financial hardship. The publication should clearly state that if the primary incentive for taking an interest only or option ARM mortgage is that the initial monthly payment burden is at the limit of the household budget, consumers should beware and understand that although the mortgage payments are initially affordable, they will be much higher when the mortgage recasts.

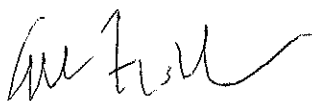
Sixth, the publication should explain the impact of payment shocks on homeowners. Mortgage brokers and real estate agents are over-simplistically pushing these mortgage products as painless to borrowers and even if consumers cannot afford the

higher monthly payments after the initial period they can refinance or sell their home. Borrowers who utilize these mortgages to stretch their payment dollars ultimately have three options when their payment abruptly rises: cover the monthly increases which can be significant; refinance their loan into a fixed rate that still may have higher payments than their initial non-traditional mortgage payments, or sell their homes. None of these options are very attractive and all involve some costs to consumers. If interest rates continue to rise, refinancing may not even be possible for all homeowners, especially if the real estate market stalls or contracts. Under these circumstances, borrowers who have negatively amortizing mortgages will face great difficulty refinancing or selling their home. Interest only borrowers may face similar difficulties in stagnant or declining real estate markets. The brochure should clearly state that borrowers who cannot meet their mortgage obligations when the initial period terminate could face loan default, foreclosure and significant damage to their credit scores.

Last, Consumer Federation of America believes that the Federal Reserve website should have a mortgage payment calculator that shows the monthly payments for fixed and adjustable rate mortgages and interest only and payment option mortgages. It should allow prospective borrowers to enter the cost of their selected home, the down payment, the points and then would describe the change in monthly payments over time for the most common types of mortgages. It should also have a variety of interest rate projections. This would be very helpful to consumers and could assist them in realistically planning for their mortgage costs over the long term.

Educational material for consumers is helpful, but many consumers lack the sophistication to understand the options put before them by mortgage brokers and real estate agents. Although the Federal Reserve's draft publication on non-traditional mortgages presents some of the issues to consumers well, the tone is overly balanced and does not elucidate the potential financial impact these mortgages could have to families who are unprepared to make monthly payments when the notes are recast. The reality is that consumers who are taking out these mortgages to more effectively manage their investment assets are unlikely to need a Federal Reserve publication to make sense out of today's mortgage market. The brochure should be aimed at those consumers who are most likely to need the assistance, which necessarily means that the publication should approach these products with legitimate skepticism.

Sincerely,



Allen Fishbein
Director
Housing and Credit Policy
Consumer Federation of America



Patrick Woodall
Senior Researcher
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