Washington Mutual

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President,
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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
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Re: Docket No. OP-1253 (71 Fed. Reg. 26513)

Dear Madam:

Washington Mutual[1] ("WaMu") appreciates the opportunity to provide comments on the Federal Reserve Board's 2006 review of the home equity lending market. The Home Ownership and Equity Protection Act ("HOEPA") requires the Federal Reserve Board (the "Board") to conduct periodic hearings that "examine the home equity loan market and the adequacy of existing regulatory and legislative provisions and the provisions of [HOEPA] in protecting the interests of consumers, and low-income consumers in particular."[2] Given the continued concern regarding the reported predatory lending practices of certain lenders and brokers, we believe the Board's 2006 review is timely.

Of particular interest to WaMu is the Board's request for comments on the efficacy of current disclosure requirements and advertising restrictions with regard to "nontraditional mortgage products," such as interest-only loans or payment option adjustable rate mortgages.[3] We appreciate the Board's statement that these mortgage products "can enable a broader segment of consumers to achieve home ownership or access to home equity."[4] That has been the experience for WaMu and other responsible lending institutions that have successfully offered payment option mortgages for more than 20 years to thousands of satisfied consumers. We have found that these mortgage products have provided substantial economic benefits to consumers in allowing borrowers to manage their cash flow by using funds that might otherwise go to their mortgage payment to pay down other debt or for other beneficial purposes. Prudently underwritten alternative mortgage products have also allowed some borrowers who might otherwise have been precluded from participating in the housing market to purchase homes.

In its notice, the Board requests public comment on whether consumers have sufficient information to understand the risks of alternative mortgages, such as payment increases and possible negative amortization; whether the current disclosures required for these

[1] Washington Mutual Inc. , through its bank subsidiaries, is one of the nation's leading consumer and small business banks. At June 30, 2006, Washington Mutual and its subsidiaries had assets of $350.7 billion. The company has a history dating back to 1889 and its subsidiary banks currently operate more than 2,600 consumer and small business banking stores throughout the nation.
[2] 15 U.S.C. 1601 nt.
[3] Hereinafter in this letter, these products are referred to as "alternative mortgages," the term that Congress used in encouraging institutions to offer these kinds of loans when it enacted the Alternative Mortgage Transaction Parity Act of 1982.
[4] 71 Fed Reg. 26513, 26515.

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mortgages under Regulation Z are effective; and whether disclosures should be provided earlier in the mortgage shopping and application process.

We believe that it is important that consumers understand the terms and features of the mortgages that they are considering. We also believe that consumers may find it beneficial to have such information early in their search for the appropriate mortgage loan.

As noted by the Board, alternative mortgage loans are already subject to disclosure requirements under Regulation Z. We and other lenders also have developed disclosures for specific types of alternative mortgage products beyond the disclosures required by law. For example, we have developed a special brochure for our payment option adjustable rate mortgage product, or "Option ARM," that explains the payment options in greater detail as well as the benefits and risks of each option, which include the potential for negative amortization and for payment shocks when the loan is recast. We have provided a copy of this brochure to the Board and the Federal Trade Commission attorneys who are currently evaluating the need for additional disclosures. We are pleased to note that their feedback has been very positive. We have also added additional disclosures to our Option ARM program and provide our alternative mortgage customers a monthly statement, in addition to a yearly statement, of the principal balance and interest deferred. To guard against deferrals that endanger the borrowers' equity in their home, we also limit the maximum amount of possible deferral and, thus, negative amortization. We also have adopted a set of Responsible Mortgage Lending Principles, which apply to all our residential mortgage loans products. Included in these principles is the commitment to only extend credit to borrowers who have demonstrated to us the ability to repay the loan. Moreover, we do not make Option ARMs to subprime borrowers.

With regard to the efficacy of existing disclosure requirements and whether new ones should be prescribed, we would note that new mandated disclosures do not always increase consumer awareness of the terms of a loan. Current mandatory written disclosures are so voluminous and so confusing that some loan applicants simply trust their loan origination representatives to tell them their rates and terms, thus creating an environment in which unscrupulous loan originators can easily mislead borrowers, as the public hearings have revealed. Therefore, in this review and the Board's overall review of Regulation Z, we would urge the Board to rationalize and make simpler the current disclosures mandated with regard to home equity lending. We also respectfully suggest that the Board continue to seek statutory amendments to the TILA and Real Estate Settlement Procedures Act to allow for simple, clear, and streamlined mortgage loan disclosures in the mortgage lending process.

In addition to simpler disclosures, we support efforts by the Board and others to better educate consumers about the home lending process. In that regard, we support the Board's update of its *Consumer Handbook of Adjustable Rate Mortgages* ("CHARM") booklet to include a discussion of alternative mortgage products. The CHARM booklet is provided to the consumer at the time the consumer begins shopping for a mortgage loan. A revised CHARM booklet would provide some consistency in the description of the advantages and risks of alternative mortgage products that would help the consumer shop for a mortgage loan. It would also provide information about these loans earlier in the shopping and application process.

Despite our concerns regarding the efficacy of requiring yet more disclosures, we believe these hearings and notice for written comments are the appropriate forums for reviewing the need to mandate new disclosures for home equity lending, including alternative mortgage products. In enacting the TILA and its amendments, such as the HOEPA, Congress clearly provided the Board the authority to implement the regulatory scheme for protecting home equity borrowers. We believe regulatory improvements to Regulation Z are preferable to the piece-meal approach now being taken by many states in their enactment of state anti-predatory lending laws (which are also a subject of the Board's 2006 review) and by the federal banking agencies in their regulatory efforts to provide new consumer protections for home equity borrowers. We are especially concerned with how the guidance on alternative mortgages recently proposed by the federal banking agencies (hereinafter referred to as the "proposed guidance")[5] could impose unworkable and excessive disclosure requirements and responsibilities on the federal banking agencies' regulated entities that responsibly offer these products.

Our support for a more holistic approach to advance consumer protections in the mortgage marketplace is based on a number of factors. First, the proposed guidance only applies to alternative mortgage products. The home equity lending abuses noted at the Board's hearings, most of which involve unscrupulous loan originators, are not specific to alternative mortgage products. We would hope the Board in this review and the other regulators in their consideration of the proposed guidance not require specific disclosures or restrictions on alternative mortgages to address problems that also arise with other mortgage products.

Second, the proposed guidance only covers federally regulated entities and their affiliates. Consumer finance companies, mortgage banks, and other state-regulated lenders and brokers not affiliated with federally regulated entities, many of which are new to offering alternative mortgages, would not be subject to the proposed guidance. Regulation Z applies to virtually all home lenders, including these entities. In that regard, we would note that the evidence presented so far indicates that federally regulated entities have not posed the predatory lending concerns that unlicensed or state regulated lenders and brokers have.

Third, different disclosure standards at the state level and by the federal banking agencies under the proposed guidance may very well cause more consumer confusion at the time

[5] "Interagency Guidance on Nontraditional Mortgage Products," 70 Fed. Reg. 77249 (December 29, 2005).

of loan application rather than less.[6] Having different disclosure regimes certainly does not advance the ability of consumers to shop among various lenders for home loans. Therefore, we believe that any new disclosure requirements should be addressed within the Regulation Z framework so that consumers receive consistent disclosures from as many types of lenders as possible. To that end, we also support legislation to amend the TILA so as to provide uniform national mortgage lending disclosures.

In closing, we reiterate our support for the Board's timely review of the home equity marketplace. This review provides an opportunity to reassess the adequacy of the current disclosure requirements for home equity lending. We are pleased to participate with the Board and other interested parties in this reassessment. In its consideration of reforms, though, we would hope that the Board not impose new disclosures or restrictions that would deter responsible lenders from offering a wide array of mortgage products, including alternative mortgages. Unscrupulous loan originators are already breaking the law. Imposing additional restrictions or disclosures is unlikely to deter them from their predatory practices, but it may deter responsible lenders from offering beneficial mortgage products to consumers.

Sincerely,

David C. Schneider
President
Home Loans

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[6] We would also note that because the proposed guidance is vague, and in some cases contradictory, federally regulated entities will interpret and implement it differently, leading to different disclosures being provided to alternative mortgage customers even among these entities.