My name is Steven Krystofiak, President of the Mortgage Brokers Association for Responsible Lending. The MBARL is an advocacy group protecting consumers and the loan industry from outlandish and counter productive loan programs. Currently we see stated income and stated asset loans as the largest problem in the real estate industry.

1. Stated income loans are associated with fraud, and started to become popular in 2002.

A stated income loan is a loan where the income that is put on a home loan application is not verified at all by the banks. The banks simply take your word for it. Home buyers might be unaware of the fraudulent income that is being stated on the loan application because the loan officer, or bank representative have the power to falsify the income on the application.

Stated income loans became popular in 2002, and have since become mainstream. According to one survey it was discovered that 37% of all loans sold in the United States are originated without income being proven. In areas where homes are the least affordable (i.e. California, and Florida) that number grows to over 50%. Some banks doing business nationwide are reporting that close to 80% of loans originated are stated income loans. Fraudulent stated income loans in many cases are the only way for individuals to obtain a home.

Imagine if colleges implemented the same honesty based policies for college admission? That policy would allow perspective students to simply state their GPA and test scores. The policy would be a huge convenience, but there would be a large influx of students applying to Stanford and Ivy League schools. College students stating a higher GPA and test scores would prosper with the covenanted enrollment.

2. Banks originate these loans because they are profitable and then sell them to reduce their risk.

Banks allow such high volumes of risky loans to be originated because days after the loan funds they get pooled together with millions of dollars of other loans and sold to financial institutions, pension companies, life insurance companies, foreign governments and the US federal government on Wall Street on what is called the secondary market. Between 40-50% of all outstanding loans in the United States are owned by the federal government. After the loans get sold, which is very easy to do in the secondary market, the banks earn a nice profit and go out to find more loans to originate. John R Vogt, the Executive Vice President of The Bond Market Association wrote in a letter to federal regulators that, "selling and securitizing loans is one of the most important ways financial institutions manage their risk exposure. "

Banks have convinced themselves that these loans are not risky based on past performance. Since 2002 the United States has seen an enormous appreciation rate on single family homes. During the same period Americans have accumulated millions of dollars of credit card debt, partially due to high unaffordable mortgage payments. Homeowners have been "cashing out" their equity to pay other outstanding debts in alarming numbers in recent years. This cycle is the reason why currently there is a small default rate on stated income loans. Once appreciation goes flat the cycle of "cashing out" will no longer keep default rates low. Stated income loans need to stop now before thousands of new home buyers buy property that they can not afford.

3. Fraud is encouraged by the banks

A large problem as to why these loans have become so prevalent is because the first line of defense against stated income loan fraud are individuals who are commission based; the loan originator, the bank representative, and in many cases the managers for the bank reps have a large portion of their income derived from bonuses based on loan production. Bank employees, i.e. underwriters and bank processors, return applications back to mortgage brokers with

instructions to send back an application with a higher stated income. The mortgage industry has become comfortable with stating incomes higher on loan applications.

Online underwriting systems that are used by Fannie Mae and some banks are being exploited by bank representatives and loan officers wanting to obtain a loan with stated income underwriting standards but with fully documented interest rates. The systems allow mortgage brokers to "play" with different incomes more than 15 times until they get the results they want.

4. Stated income loans help no one. Stated income loans cost consumers hundreds of dollars a year because of higher interest rates.

Stated income loans hurt everyone, the home buyer, the institution who buys the loan on the secondary market, and even the home shopper who does not inflate their income to purchase a home. Because of stated income loans, home prices have gone up so dramatically that homes are now unobtainable for Americans wanting to use loan officers unwilling to commit fraud.

The "convenience" of not wanting to collect personal papers for 5 minuets and mail them can cost consumers thousands of dollars over the life of the loan. To be very conservative banks would increase interest rates by .125% to do a stated income loan, in some cases the interest rate can be more than .5%! On a $300,000 loan this would cause a consumer's yearly interest payments to increase by $375. Over 3 years that would be more than $1100.

5. Exotic loans originated with stated income are now causing foreclosures or forcing homeowners to refinance into negatively amortized loans.

Since 2002 many 1st time homebuyers have taken advantage of no money down loans. Many of these homebuyers also obtained a short term fixed interest rate (2, 3 or only 5 years long) while using a stated income loan to purchase a home that would otherwise have been out of their price range. Interest rates have since risen, and now the consumers can afford their home even LESS than when they purchased it because of higher payments. Home owners are now refinancing into increasingly popular negatively amortized loans, also known as option arms. Over 29% of all loans originated in 2005 in the San Francisco area were option ARM loans. This is directly related to home buyers who were convinced they could afford homes that were too expensive using stated income loans since 2002. Many of these option ARM loans are being offered with stated income. Now highly profitable negatively amortized loans "seem" to be relief and an answer to homeowners, but these loans are driving many consumers even more in debt.

6. Stated income loans are why home prices have skyrocketed. They have caused a large demand in the US housing supply.

Many economists are currently unaware of how prevalent stated income loans are. They attribute high home prices to low interest rates, low to zero percent down payments, speculative purchasing, and interest only loans. What economist fail to realize is that popular stated income loans are what have led have home prices to skyrocket in recent years. Traditionally banks told consumers how much money their maximum monthly payment could be, based on their income and outstanding debts. With stated income loans the consumer is in the driver's seat to tell the bank how much they want to spend every month on their home payments. This is dangerous and unproven over time and is the reason have doubled while the median incomes in the respective areas have remained relatively flat since 2001. Loose under writing guidelines caused by stated income loans have allowed individuals to speculate on 3, 4, and in some cases over 5 homes at once.

Homes have a unique situation where demand is directly related to whether or not someone can receive a loan from a bank or lender. With banks loosening their guidelines for the home buying process we have experienced a huge surge in demand for homes over the past few years. These surges have not come all at once. First we saw low down payments become popular. Then interest only loans lowered monthly payments, and now negatively amortized

loans do that even more. All of these loan enhancements have been "logs to the fire" of home appreciation. Unfortunately there are no more logs, to throw onto the fire, which will cause appreciation to go flat.

7. Banks have sold their loans and have already made their profit. Investors will soon realize stated income loans are too risky and stop purchasing them.

Banks have already made the profit on the loans by selling them on the secondary market. Eventually investors will see loans that were done as stated income as being much more risky than once perceived. In the future investors might refuse to buy these loans. Demand will go down, along with home prices. If this happens 1 or 2 years from now, regulators will have allowed 1-2 years worth of home buyers to overpay for homes.

8. Almost anyone can get a stated income loan for $950,000.

Consumers have access to loans where a home can be purchased with 0% of a down payment, stated income AND stated assets. This same loan will allow a very low credit score of 620 (680 is average). Lastly this loan program will allow someone to borrow up to $950,000 dollars.

9. Stated income loans allow tax cheats to purchase homes easier.

Banks argue that stated income loans allow borrowers to include income from side jobs that do not show up on their tax returns. It is unimaginable that banks are making the American dream of homeownership easier for tax cheats. Though technically these borrowers are not lying about their income and committing mortgage fraud, they are in fact committing tax fraud, and banks should join in a joint effort with the IRS to cross reference the incomes stated on tax returns and mortgage applications.

10. Stated income loans are not always faster than fully documented loans.

Stated income loans are not faster in many cases for self employed borrowers. Extra proof is needed in the form of a letter from their tax preparer or CPA stating the amount of years the CPA has been prepared their taxes. Nowhere in the letter is there any mention as to the income that the person makes. These letters can take days to obtain, and during tax season they can take over a week. There are cases where unscrupulous people with a tax preparer ID have gone to mortgage brokers offering their services for fraudulent stated income letters for a fee.

11. Appraised values are often inflated. Underwriters are basing their decision on inflated home values, inflated incomes and inflated assets. The only "real" number is the FICO (credit) score. This is why underwriters have become focused on FICO scores.

Loan officers have a lot of pressure to find a "liberal" appraiser so the home can be bought. This pressure to find a "liberal" appraiser is often coming from both the home buyer and the real estate agent. This pressure is then applied to the appraisers who are often forced into coming up with a predetermined value for a homes in order for the "deal to go through." Don Kelly from the Appraisal Institute stated in a letter to federal regulators, "For years- and more so recently- our members have reported the loss of appraiser independence, when they are directed to provide predetermined opinions of value to help facilitate transactions. Failure to adhere to such requests from loan officers, mortgage brokers, and others has resulted in honest and ethical appraisers being placed on exclusionary or "do-not-use" list."

12. Rules are not enough, they must be enforced.

The FBI has acknowledged that mortgage fraud is a problem that is a growing epidemic. Reports of suspicious activity has rose from 3,088 in 1999 to 21,994 in 2005. After 9/11 the FBI has made mortgage fraud a low priority. Within the FBI mortgage fraud is in a section for white collar crime that is ranked number seven, (1 through 6 is related to terrorist) and within that mortgage fraud is a smaller subsection which is only priority number four.

13. Stated income loans must stop now

Stated income loans might be more convenient for a small portion of the home buying population, but it is a sleeping plague on the financial integrity for the rest of us. Federal regulators must end stated income loans now. Greed by mortgage brokers, banks, and real estate developers must not be encouraged by keeping this issue unaddressed and silent. Stated income loans are being used fraudulently in alarmingly high rates and are hurting consumers. If federal regulators don't act on this now, they will be dealing with the consequences of their lack of actions later.

Data Collected by the Mortgage Brokers Association for Responsible Lending

1. A recent sample of 100 stated income loans which were compared to IRS records (which is allowed through IRS forms 4506, but hardly done) found that 90% of the income was exaggerated by 5% or more. MORE DISTURBINGLY, ALMOST 60% OF THE STATED AMOUNTS WERE EXAGGERATED BY MORE THAN 50%. These results suggest that the stated income loans deserves the nickname used by many in the industry, the "liar's loan."[i]

2. 37.2% of non-agency mortgage backed securities were no document loans in 2005[ii].

3. 49.3% of ARMS with interest only features originated in 2004 lacked full documentation. [iii]

4. As of September 2005, Adjustable rate Mortgages (ARMs) accounted for roughly 70% of the prime mortgage products originated and securitized and 80% of the subprime sector.[iv]

5. In 2006 97.5% of borrowers are likely to face a payment shock of at least 25% and 75% of borrowers could face a shock of 50% or more.[v] These changes neglect additional shocks that would result from the repayment of principal because of current interest only payments!

6. Payments will increase on 41% of the outstanding subprime loans in 2006 alone. [vi]

7. As of March 22, 2006 53.1% of interest only ARMS had a prepayment penalty. [vii]

8. 70% of borrowers with Option ARMs (Arms that allow negative amortization) are currently making minimum payments.[viii]

9. In 2004 $600 BILLION of consumers' spending power was from borrowing against home values. That is double the value of President Bush's tax cuts, as estimated by Brooking Institution scholar Peter Orzag. [ix]

10. 2nd homes accounted for 14% of new mortgages in 2004; in 2000 it was only 7%. Mr. Greenspan said that the fact that someone can sell a 2nd home without moving, "suggests that speculative activity may have had a greater role in generating the recent increases than it customarily has had in the past." [x]

11. Residential housing now makes up 16 percent, or $1.9 trillion, of the gross domestic product and is the economy's largest single sector, slightly bigger than the industries and services that supply health care. [xi]

12. In 2005 the FBI convicted only 170 people nationally for mortgage fraud. In 2004 that number was 172 people. According to the FBI the hot spots for Mortgage Fraud activity in 2004 (per capita) were: California, Nevada, Utah, Arizona, Colorado, Missouri, Illinois, Maryland, Georgia, and Florida.[xii]

13. In the San Francisco Bay Area alone, almost 75% of mortgage loans taken out last year (2005) allowed borrowers to delay the payment of principle. Negatively amortized loans jumped to 29% of the Bay Area mortgage market from less than 10% in 2004. [xiii]

14. Employment in housing and related industries accounted for about 43% of the increase in private sector payrolls since the economic recovery began in November 2001. The number of job losses could be significant given the role the hosuing sector has played in the current recovery[xiv].

15. The following chart shows the percentage of Bay Area loans that were interest only or Option ARMs (know as negative amortization). [xv]

Year	Interest Only	Option Arm
2005	42.6%	29.1%
2004	43.7%	9.6%
2003	20.3%	0.8%
2002	12.0%	1.7%
2001	2.9%	1.6%

15.

[i] http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf, page 15 of adobe document, July 17th, 2006.

[ii] *What else is new? ARMs Dominate Subprime Mix*, INSIDE B&C LENDING (Bethesda, MD), Jan. 20, 2006, at 4.

[iii] Observed by The Center for Responsible Lending.

[iv] *2006 Global Structured Finance Outlook: Economic and Sector-by-Sector Analysis*, FITICH RATINGS CREDIT POLICY (New York, N.Y), Jan. 17, 2006 at 12.

[v] http://www.federalreserve.gov/SECRS/2006/May/20060516/OP-1246/OP-1246_37_1.pdf, page 10, June 15th, 2006.

[vi] http://www.federalreserve.gov/SECRS/2006/May/20060516/OP-1246/OP-1246_37_1.pdf, page 10, June 15th, 2006.

[vii] Study through The Center for Responsible Lending (CRL), which analyzed Loan performance data on March 22, 2006

[viii] Ruth Simon, *A trendy mortgage falls from favor – Demand for option ARMs, which helped fuel boom, wanes amid rising rates, growing risk*, THE WALL STREET JOURNAL, November 29, 2005, at D1.

[ix] Greg Ip, *Greenspan warns of reliance on housing loans*, THE WALL STREET JOURNAL, September 27, 2005, at A1.

[x] Greg Ip, *Greenspan warns of reliance on housing loans*, THE WALL STREET JOURNAL, September 27, 2005, at A1.

[xi] David Leonhardt, *Boom in Jobs, Not Just Houses, as Real Estate Drives Economy*, THE NEW YORK TIMES, July 9, 2005

[xii] http://www.fbi.gov/pressrel/pressrel05/quickflip121405.htm, June 26th, 2006.

[xiii] Kathleen Pender, *Mortgage options explode*, SAN FRANCISCO CHRONICLE, April 13, 2006

[xiv] Asha Bangalore, *Housing Market – Another Information Tidbit,* The Northern Trust Company, May 23, 2005 http://www.northerntrust.com/library/econ_research/daily/us/dd052305.pdf

[xv] Kathleen Pender, *Mortgage options explode*, SAN FRANCISCO CHRONICLE, April 13, 2006