"Toxic Mortgages" under HR 3915:

Virtual Immunity

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FACTS ABOUT "TOXIC MORTGAGES"—PAYMENT OPTION ARMS

Payment Option Adjustable Rate Mortgages (POARMs)combine the threat of steep "payment shock" when it resets to fully amortizing loan with the possibility – in fact, with minimum monthly payments, the *certainty* – of negative amortization. They have also been called by one analyst "the most complicated mortgage product ever marketed to consumers,"[1] which makes it very difficult for the average consumer to understand.

POARMs typically have very low teaser rates of 1-2% that are in effect for a very short time—as little as just one day, or the day the **first** payment is due. The low teaser rate and low initial payments make them ideally suited for misrepresentations and "low-balling" to sell them.

Although the interest rates begin to adjust at the first or second month of the loan and typically *adjust monthly*, there are caps on payments, typically for five years. At that time the payments start reflecting full amortization. Because of negative amortization, the principal is higher and the borrower has five fewer years to pay it, so there is a steep payment increase.

POARMs also have a trigger that can make the payment reset even sooner than the typical five years. When the balance grows through negative amortization to, for example, 110% or 125% of the original loan amount, the payment caps are removed, and the payment shock will hit sooner.

Moody's estimates that monthly payments on $220 billion of POARMs will convert to fully amortizing payments between 2009 and 2011.[2]

Because of the probability of negative amortization, fully indexed rates on these loans are lower than the typical 2/28. The majority of these loans are "prime" or "Alt-A" loans, not subprime loans. Under H.R. 3915, many POARMs would be "qualified mortgages." We estimate that **over 70%** of current POARMs would fall into that safe harbor category.[3]

Legal services and elder law attorneys are increasingly seeing POARMs sold to elderly homeowners based on the low payments, when a fully amortizing payment would take up or exceed their entire monthly income. These products are being encouraged as the industry makes "stated income – retired" products available.

Even for POARMS that are not "qualified mortgages," there is no deterrent for assignees to buy such loans. In the small fraction of cases where the consumer has access to counsel, the assignee simply has to cure that consumer's loan, with no incentive to fix the problem for other similarly situated homeowners.

There is virtual immunity for these loans, and no remedies for these homeowners.

H.R. 3915 presumes that prime loans are affordable and provide a net benefit. *It makes this presumption irrebuttable as to both creditors and assignees.* (Section 203.) That means that a consumer who received an unaffordable loan cannot bring evidence of that before a court.

H.R. 3915 preempts all state laws that could be used to challenge a loan made to an elderly homeowner as described above, including fraud, misrepresentation, fraud in the inducement, unconscionability, or unfair and deceptive acts as practices. (Section 208).

Because of the irrebuttable presumption, this immunity would appear to protect creditors as well as assignees, and it would mean that the fact that the loan was unaffordable and provided no net benefit could not be raised even as a defense to a foreclosure. (Section 205)

The Solution: Do not preempt existing state law claims that can now be used to challenge these loans. The preemption in Section 208 replaces *something* with *nothing* by way of relief for these homeowners or accountability for these loans.

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[1] *See* Marketplace Money, *The Straight Story* (October 20, 2006), *available at* http://www.marketplacemoney.publicradio.org/display/web/2006/10/20/straight_story_trickle_down.

[2] Ruth Simon and James R. Hagerty, *Countrywide's New Scare – "Option ARM' Delinquencies Bleed Into Profitable Prime Mortgages*, (Wall Street Journal, October 24, 2007).

[3] CRL examined a data base that included nearly 668,000 option ARM loans **to owner occupants**, with negative amortization permitted, and estimated that only about 28% would be above the “qualified mortgage” safe harbor. (We used the loan margin, and a commonly used index, the 12-month moving average of 1-year treasuries.)