Washington Mutual

OPTION ARM FOCUS GROUPS - PHASE II

WAMU OPTION ARM CUSTOMERS

September 17, 2003

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CORPORATE RESEARCH & DEVELOPMENT DIVISION

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Option ARM Focus Groups - Phase II
WAMU Option ARM Customers
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Section 1 Introduction and Objectives

Home Loans & Insurance Services wanted to explore ways to increase sales of Option ARMs, Washington Mutual's most profitable mortgage loan products. To date, Strategic Market Research has completed two phases of this study, with more to follow:

- Phase I of the research involved four focus groups held among Washington Mutual Loan Consultants and external Mortgage Brokers to understand their perceptions of Option ARM sales. The results of Phase I of the research are summarized in a separate report (a video summary of the groups is also available).
- For Phase II of the Option ARM study – which is the focus of this report, Strategic Market Research conducted four focus groups among current Washington Mutual Option ARM customers to better understand how they felt about their loans. The specific purposes of Phase II were to:
  - Determine what makes Option ARMs appealing/unappealing for consumers
  - Understand how Washington Mutual could better position, market, or enhance this product line to increase demand
  - Discover customers' hot buttons for this product line
  - Identify any other issues relevant to the sales and marketing of Option ARM products

The key learnings from Phases I and II will be used to develop concepts and positioning statements to be used in Phase III of this project, which will consist of 8 focus groups to be held among general mortgage borrowers, who may or may not be WaMu customers. The report for Phase III will be available by 9/10.

Methodology

Four focus groups were held August 12th and 13th, 2003. Two groups were held in Schaumburg, IL and two were held in Orange County, CA. There was a total of 31 participants (17 males/14 females), and all groups were moderated by Kevin Jenné from WaMu's Strategic Market Research group. The schedule of groups is shown below.

Date	Participants (# participants)	Place
August 12, 2003	Option ARM customers (8)	Schaumburg, IL
August 12, 2003	Option ARM customers (8)	Schaumburg, IL
August 13, 2003	Option ARM customers (8)	Orange County, CA
August 13, 2003	Option ARM customers (7)	Orange County, CA

Data from qualitative methods such as focus groups are based on small samples, and are descriptive in nature, without attempting to provide a statistical or quantitative assessment of the prevalence of opinions expressed. These data are best used to give a detailed snapshot of *why* people feel the way they do, rather than the *number* of people who feel that way.

- In general, people do not seem to have a good understanding of their mortgage and its terms. What understanding they do have is framed by the context of a 30-year fixed mortgage. Option ARMs are very complicated and need to be explained in simple, easy to understand terms. Prospective borrowers need to be educated about the loan – this is not a product that sells itself.

  Providing salespeople with more training and simple sales tools that help illustrate the important points of the Option ARM will make it easier for them to educate prospective borrowers and sell the loan.

- Customers tend to view their Option ARM as a loan of last resort. Whether explicit or implicit, loan consultants and brokers need to move away from positioning these loans as "the only one you can qualify for."

- Borrowers want peace of mind with respect to their mortgage. Helping prospective borrowers understand payment and interest rate caps may mitigate fears of wild monthly payment swings

  - Similarly, fears about negative amortization, a concept also not very well understood by participants, could be reduced or eliminated by showing how much residential properties in the local market have appreciated over time.

- Many borrowers do not understand that Option ARMs are 30-year mortgages – and names like Flex 3 or Flex 5 do nothing to help foster that understanding. The mindset of Option ARMs as short-term fixed-rate mortgages needs to shift to one of Option ARMs as a long-term financial tool, whose rate will automatically shift downward in falling rate environment and save thousands in refinancing costs over time. Borrowers also do not seem to understand the costs of continually refinancing their existing mortgage to a new 30-year term.

- Self-employed individuals and individuals undergoing a significant life change, such as divorce or retirement, may represent an underserved mortgage niche.

  - For these individuals, low doc and payment flexibility are key selling points

- Having the ability to make payments online may help solidify relationship between the borrower and Washington Mutual

Section 3 Executive Summary of Findings

The following summary lists the main findings from the research.

- Few participants fully understood the Option ARM and its key benefits. A number of them were not familiar with the payment options or how they could be used.

  Additionally, most did not understand how their interest rate was derived, how often their payments would change, and what, if any, were the interest and/or payment caps.

- Participants generally chose an Option ARM because it was recommended to them by their Loan Consultant or Mortgage Broker, rather than actively having actively sought it out. This finding confirms some of the learning from focus groups and underscores the importance of the loan consultant/broker in the process.

- Perhaps the best selling point for the Option ARM loan was being shown how much lower their monthly payment would be by choosing an Option ARM versus a fixed-rate loan.

  The second-most important selling point was payment options. For loan consultants and brokers, discussing payment options is particularly important when speaking with people whose monthly income fluctuates, those who may be less stable financially, or retired people who want to keep their house and need to increase their monthly disposable income. Many participants considered having payment choices a very appealing and important benefit.

  Interestingly, those familiar with the payment options liked having the payment flexibility, even though some always made the full principal and interest payment. Individuals whose incomes fluctuated from time to time seemed to be the ones most likely to take advantage of the various payment options.

- Many participants did not know what happened to their loan at the end of the fixed interest rate period. Most of them assumed they would have to sell or refinance because of a potential balloon payment or a steep jump in their payments. Because of these misperceptions, most participants expect to refinance their loans within the next three to five years.

- Despite their lack of understanding about these loans, participants were almost universally happy with their loan choice as the Option ARM gave them lower payments, more cash in their pockets, and helped some of them keep their homes during periods of financial difficulties.

- The lower interest rate, ability to qualify, and length of time they expected to keep the loan were the primary drivers of the participants' Option ARM purchase decision.

- For some, the Option ARM was a loan of last resort – they were unable to qualify for a fixed-rate purchase or refinance mortgage.

- For almost all of the participants, the fixed-rate mortgage is still the mortgage of choice – the "gold standard" so to speak – for people who are going to stay in their homes.

- Low doc was an attractive aspect of the Option ARM product for a few of the participants, especially those who were self-employed.

- Suggested names for the Option ARM: Several suggestions were made, and most contained the word "flexibility." They felt this word described the loan and its payment options.

- Suggested improvements for the Option ARM: Bi-weekly payments, allowing online payments, and having a skip payment option were all briefly discussed and had moderate appeal.

Section 4 General Analysis

Reasons for Selecting an Option ARM

Option ARMs can be an appealing mortgage alternative for many different types of people with different life situations. During the groups, participants discussed factors that contributed to their decision to obtain an Option ARM. Listed below are some of the life situations that contributed to participants' choice of an Option ARM:

- First-time homebuyers who planned to be in their home for a short time
- Individuals who were not concerned about paying down their principal
- People with significant life changes such as divorce or unemployment
- Commission-based employees whose income fluctuated from month to month
- Older homeowners who wanted to access some of the equity in their home
- Individuals who couldn't qualify for a fixed-rate loan
- People who were aggressively seeking the best rate and payment, and were willing to refinance often to get them
- Multiple property owners who consolidated two mortgages into one with a lower payment
- People who experienced temporary difficulty in meeting their monthly obligations.

"I could either get this loan or sell the house."

- WAMU Option ARM Customer

When participants initially went to talk to a loan consultant or mortgage broker, most knew little, if anything, about Option ARMs. Most of the participants chose an Option ARM based on a recommendation by a loan consultant or broker, after he/she had reviewed their personal financial situation. One of the keys to selling more Option ARMs seems to be having the loan consultant or broker develop a good understanding of the financial needs and objectives of prospective borrowers to determine the best mortgage fit. The bottom line is that most customers choose an Option ARM because someone has taken the time to understand their personal situation and has determined that the Option ARM is the best choice.

"Need to Know" Information for Choosing an Option ARM

The Option ARM is a complex financial product with many facets. Focusing on the right "need to know" information is critical to developing more Option ARM sales. Participants seemed easily overwhelmed by the product details.

"My broker told me it was the best rate out there and to take it since I wasn't planning to be there that long"

- WAMU Option ARM Customer

The three critical pieces of information borrowers understood about their loan seemed to be:

(1) It is an adjustable rate mortgage with a fixed interest rate for some period of time and a pre-payment penalty – however, borrowers did not necessarily understand that it is a 30 year loan

(2) The interest rate and payments are less than those for a fixed-rate mortgage

(3) These loans don't require lot of paperwork if they choose the low doc option

Many participants mentioned that, if they planned to be in a home for a long time, they would prefer a fixed-rate loan. Perhaps then, the most important question to ask a prospective borrower is *"How long do you plan to be in your home?"* In many cases, if the answer to this question is less than five years, the Option ARM may be easier to sell than if the answer is more than five years.

"Fixed is the only way to go if you are not planning on refinancing or moving at any time. You want to lock it in and have a great rate."

- WAMU Option ARM Customer

Because of its appeal among self-employed individuals and others whose income is subject to fluctuation, a key follow-up question might be *"Are your income and expenses fairly stable or does they fluctuate from month-to-month?*

Participants lacked clarity on what happens to their loan after the fixed period ends. After this period, nearly everyone had the perception they would either have to refinance their loan, make a balloon payment, or sell their house. Some participants thought that their interest rate would increase significantly at the end of the fixed period. Others thought the whole loan had to be paid off in five years. In particular, participants who had a Flex 5 considered their loan to be a 5-year fixed-rate loan. Many had no idea they would simply have an ARM after 5 years. Regardless of their perceptions, however, nearly all participants planned to pay off this loan by sometime within the next two to five years – either by selling or refinancing.

"It's really scary to me what's going to happen in 5 years."

- WAMU Option ARM Customer

"Something terrible happens in 3 years."

- WAMU Option ARM Customer

Beyond understanding the loan was good for short-term needs, understanding the rate and payment was very important to these individuals. In particular, understanding how the initial low interest rate afforded by the Option ARM saved them money vis-à-vis those for a fixed-rate loan, was a critical selling point for these loans.

Many participants also seemed to appreciate the flexibility and safety the payment options afforded them. Interestingly, even though they had different payment choices each month, many chose to consistently make the same payment. Some chose to always make the 30 year payment; others added a few hundred dollars to the interest only payment. Most mentioned that they felt good being able to pay a portion of the principal each month because it seemed to be the right thing to do. The following paragraphs describe how the Option ARM and payment options were explained and sold to some of the participants.

- Among those who planned to be in their home for only a year or two, choosing a Flex 3 or Flex 5 was almost a "no brainer" once it was explained to them, although none of them knew these product names. Most considered these to be short-term fixed-rate loans, and currently the interest rates for these loans are significantly less than 30 year fixed-rate loans.
- People who weren't planning to pay off their loan liked the interest-only payment option as this was considerably less than the full principal and interest payment for a 30-year fixed-rate loan. This option gave them more cash in their pockets each month and allowed them to pay off bills or use the extra cash for other things. They also liked having the ability to choose to pay some of the principal if they wanted, but it was not required.
- Participants whose monthly income fluctuated or who were not in a stable financial situation liked the payment flexibility. If something catastrophic happened (lost their job, etc.), they could make the minimum or interest only payment and not have to worry about losing their home. They understood that reducing payments when times were tough was not an option with 30-year fixed-rate loans and the penalties for doing so are high.

Participants also stressed the importance of explaining things in easy-to-understand terms. This point was also made by the Mortgage Brokers and Loan Consultants during Phase I of the research.

"Try and make it understandable in layman's terms"

- WAMU Option ARM Customer

Secondary Loan Details – Not Part of the Purchase Decision

While all participants felt that they understood the rate and payment terms, they were less diligent about understanding some of the other aspects of their Option ARM loan. Some of the specific terms and conditions that these customers had little or no awareness of included rate/payment caps, the index from which their interest rates are derived, and negative amortization.

How much information the mortgage brokers and loan consultants provided to these customers cannot be objectively determined but enough was given so that the borrowers were able to reach an acceptable comfort level for the Option ARM loan. After discussing these topics, many participants seemed to realize how little they really knew about these loans and wanted more education about less the familiar aspects and terms.

"I'm a little nervous about it. I have this feeling of impending doom...it's almost too good to be true."

- WAMU Option ARM Customer

Rate/Payment Caps: Many participants knew there was a lifetime interest rate cap on their loan but most could only guess as to how much. Some thought it was around 8% and others thought it was about 12%. Several people mentioned an annual rate cap, but once again, most really didn't know how much this was. Most guessed that it was one or two percent.

Nobody in the groups mentioned annual payment caps. When they were asked directly about this, a few said the payment increase was limited by the amount the rate can go up. No one seemed to understand that the payment cap and the interest rate cap are different. For some consumers, understanding the payment cap may be an important way to mitigate some of the concerns and misperceptions about the periodic adjusts in payments.

In general, the participants seemed relieved to know they were somehow protected from potentially skyrocketing interest rates, even if they weren't sure exactly how high the rates could go, or how their protection worked.

Additionally, most participants did not seem to be aware that their payments were only adjusted annually – not when the interest changed. This lack of awareness about payment changes also indicated that they probably did not know that an increase in interest rates could also result in some negative amortization.

Index: Only a couple of people had any idea how the interest rate on their loan was determined. Most either had no idea, or simply speculated as to how they thought it was calculated – one woman was convinced her mortgage interest rate was tied to the Nikkei index. But for the most part, there were a lot of blank looks from participants when this topic was introduced. When the moderator described how the rate was calculated, they were able to understand that it was based on a moving average, which made the rate less volatile.

Showing prospective borrowers how the index has historically performed, and its stability, may be an important key to raising the acceptance of this type of ARM and reassuring them that the interest rate is not historically volatile and does not change quickly.

Pre-Payment Penalties: Many of the participants had one-year pre-payment penalties on their loans and seemed to have little concern about it. Those borrowers who had three-year penalties were a little nervous about the penalty should they need to sell or refinance sooner than expected.

Negative Amortization: Several participants mentioned negative amortization during the groups, but most were not very clear on what it was. One or two called it "reverse amortization." Some thought that if they made interest-only payments, the balance of their loan would go up. They often referred to this as "tacking it on at the end." They generally thought that negative amortization was a moderately or very bad concept. The idea of making minimum or interest only payments made many people a bit nervous and they didn't like the feeling of "falling behind." Most felt that "falling behind" was something to avoid. No one mentioned that price appreciation would likely overcome any negative amortization – particularly in Southern California where real estate prices have increased substantially over the past several years.

Drawbacks To The Loan

Participants were almost universally happy with their loan choice as the Option ARM gave them lower payments, more cash in their pockets, and in two cases let divorced women save their homes. When asked about drawbacks to the Option ARM, few were mentioned. Most concerns centered around the possibility of interest rate increases and subsequent increases in their monthly payment. A few mentioned that the interest rate could go higher than fixed-rates; some didn't like that payments could increase after five years. And for others, a misperception that the payment could change every month was unnerving. Some participants stated outright that the loan was not good for the long-term.

Suggestions for Improving the Option ARM

Biweekly Payments: Some borrowers thought we currently offer this option and they weren't necessarily clear on whether a fee is charged for this payment structure. They understood the benefits once they were explained by other participants, but someone pointed out in each group that if fees are charged, they would be better off just paying that additional amount directly themselves.

Online Payments: At least one person in each group indicated they'd like to be able to make their payments online each month. Because Option ARM customers can choose their payment amount each month, having an automatic recurring withdrawal doesn't necessarily work well for them. They contrasted Washington Mutual with their utilities and other companies, with whom they can pay bills directly. This proposal had moderate appeal. To some, it sounded like something Washington Mutual should simply offer, as everyone else already does. They viewed this not a competitive advantage, but just keeping up with the times.

Skip Payment Option: Initially, participants were very skeptical about this feature. After a good deal of discussion and drawing on life illustrations such as their experience with credit cards, they began to understand where they might benefit from such a skip option, but they would be very cautious about using it. Again, they talked about money being "tacked on at the end," and thought this option would really cost them in the long run. Having an option like this could potentially be "nice to have" but no one was really clamoring for it, and many had considerable misgivings about this option. It could be a tie-breaker between two identical loans, but isn't likely to serve as a major selling point.

Other Suggestions: A few other suggestions were voiced but not discussed much due to time constraints. One suggestion was to have the option to convert the loan to a fixed-rate loan after three years. Another idea was to have a referral program for customers where they get money for referring friends who get loans. Finally, the last suggestion was to offer a discount on loans for being a return customer.

Suggested Names for the Option ARM

At the conclusion of each group, participants were asked to brainstorm for new names for the Option ARM loan. For the most part, relatively few ideas emerged, but the one word that consistently surfaced during the discussion was "flexible." Many people liked the idea of this word being part of the name because they felt it accurately described the loan and its payment options. Several of the suggestions incorporated this word or a variation of this word into the name. The suggestions mentioned (listed in alphabetical order) were:

- Chinese Menu Loan (because you can choose what you want)
- Easy Flexible Adjustable
- Flex ARM
- Flex-ability
- Flexipay
- Flex Plan
- Less Stress Loan (based on being able to choose to make a lower payment if a difficult financial situation came up)
- Variable Option Loan

One clever participant came up with a potential slogan for the loan:

"We at Washington Mutual flex our ARMs for you."

- Washington Mutual Option ARM Customer

Washington Mutual

Option ARM Focus Groups - Phase I
WAMU Loan Consultants and Mortgage Brokers

August 14, 2003

Research prepared by:
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OPTION ARM FOCUS GROUPS - PHASE I
WAMU LOAN CONSULTANTS AND MORTGAGE BROKERS
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Section 1 Introduction and Objectives

Strategic Market Research conducted four focus groups to explore what Washington Mutual could do to increase sales of Option ARMs, our most profitable mortgage loan. All participants had sold Washington Mutual Option ARMs, and were either Washington Mutual Loan Consultants, or external Mortgage Brokers. These groups will be followed by customer focus groups (Phase II), and supplemented with more research as needed. The specific purposes of Phase I of the research were to:

- Determine ways Washington Mutual could increase sales of Option ARMs
- Understand what types of people are most likely to get these types of loans
- Discover how successful salespeople position these loans
- Identify obstacles to selling these types of loans

Methodology

Four focus groups were held July 22nd and 23rd, 2003 in the Los Angeles area. Two groups were among Washington Mutual loan consultants and two were among external Mortgage Brokers. There were a total of 19 participants (15 males/4 females), and all groups were moderated by Kevin Jenné. The schedule of groups is shown below.

Date	Participants (# participants)	Place
July 22, 2003	WAMU Loan Consultants (6)	Los Angeles
July 22, 2003	Mortgage Brokers (4)	Los Angeles
July 23, 2003	WAMU Loan Consultants (6)	Los Angeles
July 23, 2003	Mortgage Brokers (3)	Los Angeles

Data from qualitative methods such as focus groups are based on small samples, and are descriptive in nature, without attempting to provide a statistical or quantitative assessment of the prevalence of opinions expressed. These data are best used to give a detailed snapshot of *why* people feel the way they do, rather than the *number* of people who feel that way.

Section 2 — Executive Summary

The following summary lists the main findings from the research.

- Option ARMs are **sold** to customers and few walk through the door and ask for them. People selling these types of loans must be able to:
  (1) Understand the features and benefits of Option ARM loans
  (2) Identify people who can benefit from the flexibility offered by the product features
  (3) Have the desire to sell the product
  (4) Be able to effectively communicate how the Option ARM can benefit customers, given each customer's unique financial situation
- If salespeople don't understand Option ARMs, they won't sell them. Many felt that more training would be needed to better educate salespeople about this type of loan, and to change the mindset of current Loan Consultants. Some felt there were many within Washington Mutual who simply felt these loans were "bad" for customers, probably from a lack of understanding the product and how it could benefit customers
- It is critical that salespeople fully understand a customer's financial situation and motivation for the loan. By taking into account these factors, they can recommend the loan that will best fit their customers' needs. Given today's low interest rate environment, it can be challenging to get salespeople do take the time to do this. Currently, it is easier for them to give customers what they ask for (a 30 year fixed loan) than to sell them an Option ARM. They can take 20 minutes and sell a 30 year fixed-rate loan, of spend an hour trying to sell an Option ARM.
- Commission caps make it unappealing for Mortgage Brokers to sell Washington Mutual Option ARMs. Most would not sell loans to customers with prepayment penalties, and given the low commission rate for selling them without the prepayment penalty, many simply go to another company or product where they can make more money.
- Slow ARM processing times (up to 90 days) can cause Mortgage Brokers to take business elsewhere. They would rather not expose their customers to the risk of missing a closing date, especially since a lot of their customers provide them with repeat business.
- Improving collateral would help salespeople better explain Option ARMs to customers and take away some of the mystery. This could be in the form of Excel worksheets which show how ARMs and fixed-rate loans compare. They also would like improved brochures which talk to the customer in simple, easy to understand terms about features and benefits. They liked the current sample statements they are provided.

Section 3 General Analysis

How to Successfully Sell Option ARMs

Most participants felt that Option ARMs are **sold** to customers and that very few people simply walk through the door and ask for them. Customers typically choose an Option ARM because the mortgage broker or loan consultant takes the time to understand their financial situation, understands the products they sell, then communicates to the customer how an Option ARM might be a good choice for them. This being said, it is important for people selling these types of loans to be able do the following things:

(1) Understand the features and benefits of Option ARM loans

(2) Identify people who can benefit from the flexibility offered by the product features

(3) Have the desire to sell the product

(4) Be able to effectively communicate how the Option ARM can benefit customers, given each customer's unique financial situation

Training Issues

All of the focus group participants demonstrated success selling Option ARM loans. It was apparent as the groups progressed that these people understood the complex facets of the loans, and understood how to identify customers who could best make use of them, particularly Loan Consultants who came from Home Savings. Universally, everyone felt that if salespeople didn't understand Option ARMs, they wouldn't sell them.

Many participants said they knew co-workers who didn't believe in Option ARM loans, and who wouldn't sell this type of product because they deemed it to be "bad" for customers. Their co-workers just couldn't understand why someone would ever want to purchase a loan which could yield negative amortization. Simply put, these people don't understand the benefits of this type of loan, and don't understand how this could be a good thing for a customer. Improving training for Washington Mutual Loan Consultants is a must to increase sales of the product through this channel. Training for external brokers could also be improved, however, compensation seemed to be a larger issue with this group (compensation for brokers is discussed later in this report).

"A lot of (Loan) Consultants don't believe in it (Option ARMs) and don't think its good for the customer. You're going to have to change the mindset for a lot of the consultants that are on board."

- WAMU Loan Consultant

When asked how they would like to receive training regarding Option ARMs, Loan Consultants mentioned they would like to have a trainer come visit their Home Loan Center from time-to-time to give half-day seminars. They also mentioned that this type of training might work well for all types of things. They felt that ongoing training in the HLC would be more convenient than if they had to travel to a central location for training. They also liked this idea because it would allow them to spend the other half of their day in the office tending to their business. Besides the improved convenience for them, they felt this could be more cost-effective for the company.

Specifically regarding Option ARMs, many felt that during training, not only should the features and benefits of the products be talked about, but they want the trainer to provide real-world examples of reasons people would want to get an Option ARM. They indicated that too many times, trainers simply tell them about product features, without giving them additional real-world examples that can help them "sell" the product. One Loan Consultant suggested that to identify employees who could use more training on Option ARMs, they could be given a test which asked questions such as the following:

> *"An elderly lady with a low, fixed income needs to choose a mortgage loan that will best meet her needs. She could get a fixed-rate loan with a monthly payment of $1,400, or an adjustable rate loan with a payment of $1,100. Which loan should you sell her?"*

While this is a simplistic example, a similar approach could be used to identify employees that could use training on a particular topic.

Another separate but related issue mentioned was that some of the loan consultants don't know when or where training is taking place. Several wanted to know how to find out what training Washington Mutual offered, and where it was located. This topic was not discussed in depth. A few also mentioned that while they were aware of computer-based training that was available, only a couple had used it and they thought it was too long.

Identifying Potential Option ARM Customers

Loan Consultants stated that Option ARMs are not for everyone. Specifically, they mentioned that ARMs are not necessarily the best choice for people who are planning to be in their home for a long time. For these people, being subjected to interest rate fluctuations for a long time can prove to be risky. That being said, identifying potential customers who could benefit from Option ARMs is critical to sales success.

From a customer's point of view, the two primary benefits they can realize by choosing an Option ARM are: (1) the multiple monthly payment options allow for minimum and interest-only payments, and (2) they are able to qualify for a larger loan than if they used a fixed-rate mortgage. Participants indicated that slightly more of their customers tend to choose an Option ARM because of the payment options, rather than to qualify for the loan.

In order to successfully sell Option ARMs, it is critical that a Loan Consultant understands a customers financial situation and motivation for the loan. They said that understanding the following types of things will help them make good product recommendations:

- Does their monthly income fluctuate?
- Age
- Monthly bills
- Outstanding debt
- Is the loan for rental or investment property?
- Do they have a business?
- Will they qualify for a fixed-rate loan for the amount they need?
- Are they concerned with paying off their loan?
- How long are they going to be in their home?

"If the Loan Consultant doesn't ask the right questions, you'll never know what that person (the customer) is willing to do."

- WAMU Loan Consultant

During the groups, many examples of reasons customers choose an Option ARM were mentioned. While not all inclusive, the following is a list of the most commonly given examples:

- People who have monthly income fluctuations such as seasonal workers or those who are paid on commission can make minimum or interest-only payments in the months where they have less income. Then they can make larger payments in months where they have higher income. This payment flexibility can be a real benefit, whereas with fixed-rate loans they would have to make the same monthly payment regardless of their income, causing serious cash flow problems.

- If someone is buying investment property and knows they will resell it within a few years, being able to make minimum or interest-only payments can be a real advantage. Using the Option ARM for this purpose means they will not have to pay down the principal which would be required using a fixed rate loan. To the buyer this gives two benefits: (1) they can keep more money in their pocket each month while the property appreciates, and (2) since the loan is only for a few years, they will have a lower interest rate compared to a fixed-rate loan which will save them money.

- If someone is buying rental property, having the option to make minimum or interest-only payments can be beneficial as vacancy rates fluctuate. In months where vacancies may be higher, they can choose to make minimum or interest-only payments. Then when vacancy rates decline, they have the option to additionally make principal payments.

- Option ARMs can be good choices for elderly people who want to have more money to live on each month. Many people past retirement age have a fixed income. By refinancing with an Option ARM and making minimum or interest-only payments, they can have more money available to live on, because they are not having to make principal payments as they would have to do with a fixed-rate loan. The net result is that while they are not paying down the principal on their residence, they have more money to live on. Since these homes have generally appreciated over the years and have partially paid-down loan balances, older homeowners can still leave substantial value to their heirs.

- People who have a large amount of debt (such as credit card debt) can benefit from Option ARM loans as they can choose to make minimum or interest-only payments, which also can allow them to pay down their other debt at the same time. If they were using a fixed-rate loan, they would not be as able to do this because they would be required to make principal payments each month. Washington Mutual also has more flexibility on underwriting standards for these portfolio loans than they would on fixed-rate loans, which are sold on the secondary market.

- By using an Option ARM, borrowers can qualify for a larger amount than they could using a fixed-rate mortgage. This allows people to "buy more house" than they could using a fixed-rate loan, and also can benefit people with credit challenges. Also of note, it was mentioned that credit requirements are less stringent on Option ARMs compared to fixed-rate loans, because they are retained in portfolio.

- For people who are not concerned with paying off their loan, Option ARMs can be a good choice. Many participants mentioned that making minimum or interest-only payments is appealing for those who know they will refinance, or who will only be in a house for a few years. Even if they are making full principal & interest payments, their interest rate will be considerably better than a comparable fixed-rate mortgage.

Salespeople Must Have the Desire to Sell Option ARMs

The third requirement for selling Option ARMs is that salespeople must have the desire to sell the product. This is a multi-faceted issue that includes compensation, getting salespeople to "sell" loans rather than just take orders, turnaround time on loan processing is slow, and salesperson training (which has already been discussed).

Mortgage Broker Compensation

Mortgage brokers indicated they would sell products that met their customers' needs, and that would maximize their personal income. Most would not sell products to customers with prepayment penalties because they were concerned about their own image, and because they get so much repeat business that they will not see the customer again during the prepayment penalty timeframe. A few mentioned they get repeat business as often as once or twice each year from the same customer. Of note, prepayment penalties seemed to be of lesser concern among Loan Consultants.

Considering that the mortgage brokers said they were reluctant to sell loans with prepayment penalties, they also complained that when they sell WAMU Option ARMs without a prepayment penalty, there is a commission cap of 50 basis points. If they sell the loan with a prepayment penalty, their commission rate would be higher, but nearly everyone indicated they were not willing to do this. The net result of this is that (1) given the low commission rate for selling without the prepayment penalty, and (2) their unwillingness to sell the product with a prepayment penalty, many brokers simply go to another company to get a loan where they can make more money.

Loan Consultant Compensation

Loan Consultants indicated they were paid the same amount whether they sold a fixed-rate loan or an ARM. When asked if we should compensate them more for selling Option ARMs than 30 year fixed-rate loans, there was some concern that this could cause salespeople to "steer" customers into whichever product they were best compensated for. The current compensation model, coupled with the low interest rate environment and the relative ease of selling a customer a 30 year fixed-rate loan (discussed below) adds to the challenges of selling Option ARMs.

Sell Loans, Don't Just Take Orders

"You're not selling like you used to. You are an order-taker."

- WAMU Loan Consultant

It is easier to give customers what they ask for (a 30 year fixed loan) than to sell them an Option ARM. Many participants noted that given today's low rates on fixed-rate loans, when customers walk in the door and want a 30 year fixed-rate loan, they can spend 20 minutes with them and give them what they want, or spend an hour with them trying to sell them an Option ARM. Since Loan Consultant compensation is the same for both loans, and they have more business than they can handle, it is easier for them to simply sell the customer what they ask for.

"Our position is to educate the borrowers... so many people just give the customer what they ask for."

- WAMU Loan Consultant

Improving Turn-Around Time for Loan Processing

Mortgage brokers in particular were unhappy with Washington Mutual's turn-around time for processing ARMs. While this was secondary in importance to the compensation issue, they indicated that turn-around did contribute to their decision to send business elsewhere. While not just limited to Washington Mutual, they said that because of the lock-in period for rates on fixed-rate loans, these were processed before adjustable-rate mortgages. This caused processing for ARMs to lag and take up to 90 days at WAMU.

The result of slow processing was that they were less likely to take a chance using Washington Mutual for ARMs because they felt we may not be able to meet some closing dates. They also mentioned that this was typically more of a problem for new purchases than for refinances. They would rather take the business elsewhere and not expose their customer to the risk of missing the closing date. Their amount of repeat business also contributed to their concerns regarding this issue.

Image Concerns

Mortgage brokers voiced slight concerns that when selling ARMs, if they recommend one to customers and interest rates increase significantly, this could reflect poorly on them and they would probably lose future business from that customer. While this topic was not discussed much, it could be something to think about when producing training programs or collateral materials. Providing training regarding this may help them address this issue, ensuring that customers understand the choices they are making, so they don't lose face with the customer who feels they were guided into something they didn't understand.

Effective Communication With Potential Customers

An important facet to selling Option ARMs is to effectively communicate to the customer why an Option ARM would be a good loan choice for them, and to overcome objections they may have to this type of loan. This can be done through training and the use of collateral materials.

"The mind set of individuals that come in to see you is...My parents had a fixed rate loan, I have to have a fixed rate loan, and that's it, no further discussion."

- WAMU Loan Consultant

Overcoming Objections to Option ARMs

Participants mentioned many objections customers have to getting adjustable-rate mortgages. However, based upon their success selling the product, they obviously have found ways to overcome many of these. The first objection they typically encounter is that most people walk through the door and say they want a 30 year fixed-rate mortgage because that's what their parents had, and that's what they want. Many mentioned that some customers are simply not willing to discuss an adjustable-rate mortgage in today's rate environment. Others just have the perception that ARMs in general are "bad." This is most likely a result of not understanding the product, how the loan works, and when it can benefit them.

"Everybody comes in and says, What if interest rates go to 12% tomorrow and I lose my house? Everybody has these extreme unrealistic scenarios that they think can happen... There is a lot of paranoia out there."

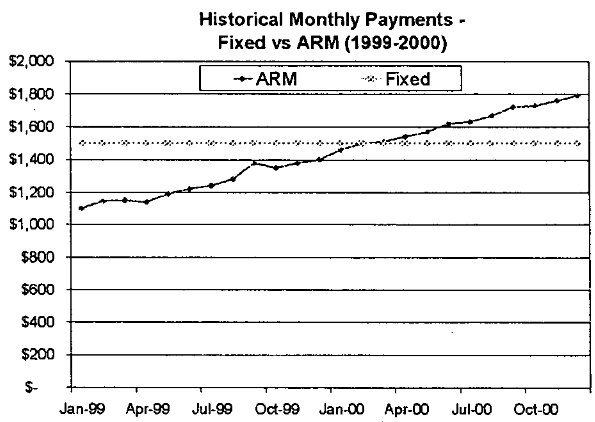
– WAMU Loan Consultant

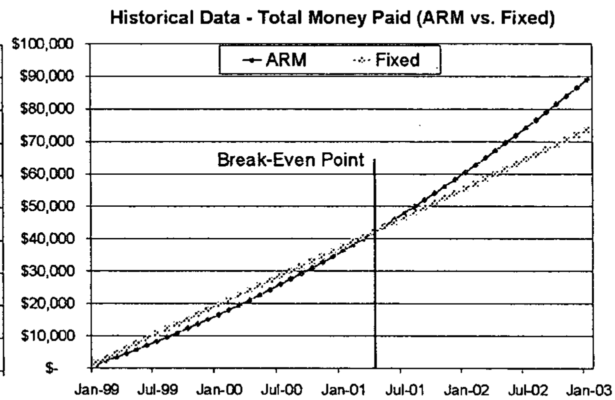
Some Loan Consultants mentioned that helping salespeople overcome customers' objections and fears can be addressed through training. They can learn how to work with customers to make them feel more comfortable with this type of product, and effectively communicate the product benefits. They also mentioned that advertising could help consumers understand the benefits of adjustable-rate mortgages, as well as providing salespeople with tools (Excel worksheets and brochures) that customers can easily understand (sales tools are discussed in the following section).

Helping Customers Understand the Product Will Make Them More Likely to Consider It

The complexity of the Option ARM is a big obstacle to overcome. It is hard to get people to purchase a mortgage, the biggest loan they will ever have, if they don't understand it. Increasing customers' understanding of the product through employee training and providing collateral which explains things will help alleviate some of these objections.

Regarding collateral, there were a few things mentioned they would like to have which could help them better explain Option ARMs. First, some liked the idea of Excel spreadsheets where they could show how fixed-rate loans would compare to Option ARMs over time. They felt that showing customers how adjustable-rate versus fixed-rate payments compared over time would help alleviate some of their objections, and might give customers a better understanding of what they could expect with ARMs. The graphs below are basic examples of what some of these tools could look like. Another example, created by Washington Mutual Loan Consultant Charles Miller is included in Appendix A.





Participants also mentioned that some of the current collateral material is too complicated for customers and that simplifying some if it would be helpful. Other things salespeople felt were difficult to explain included the life cap and the index. They felt that that having brochures with bulleted lists and high-level information would be good, as opposed to providing too much detail where customers can get bogged down and confused. Perhaps the most helpful piece of collateral they currently have are sample statements. This helped them show customers how the various payment options worked and compared with each other, and led to conversations about how they could use the payment flexibility to their advantage.

"It would be nice if Marketing put something together in plain English."

*– **WAMU Loan Consultant***