Angelo Mozilo/Managing Directors/CF/CCI

08/03/2005 08:47:23 AM

To: Dan Tarman/Managing Directors/CF/CCI@Countrywide
cc: "Andy Bielanski Pager" <3815762@Skyreply>@Countrywide
bcc:
Subject: Re: Today's American Banker: Pay Options

You should know that we have made major changes in the Bank this week relative to placing substantial restrictions for pay option loans. For example we will not accept pay option loans for speculators or on second homes. Pay option loans will be offered at the Bank only on owner occupied properties where the borrowers Fico is 660 or above.

You should speak to Carlos Garcia to fully understand all of the major changes that we have made this week. In my opinion there is nothing intrinsically wrong with pay option loans however there is something very wrong as to whom the product is being sold. Third party originators such as mortgage brokers are utilizing the loan to squeeze borrowers into homes without regard to the future consequences to that borrower, and speculators are using it as an arbitrage product. These events could lead to catastrophic consequences which would be exacerbated if real estate values begin to decline. The moves we have made should substantially mitigate any damage to the bank irrespective of future events. More importantly this change in policy is positive for your shareholders as well as to borrowers who, most likely, are being set up for foreclosure.

Dan Tarman/Managing Directors/CF/CCI
08/03/2005 07:59 AM

To: Angelo Mozilo/Managing Directors/CF/CCI@COUNTRYWIDE, Stan Kurland/Managing Directors/CF/CCI@COUNTRYWIDE, Dave Sambol/Managing Directors/CF/CCI@COUNTRYWIDE, Eric Sieracki/Managing Directors/CF/CCI@COUNTRYWIDE, Sandy Samuels/Managing Directors/CF/CCI@COUNTRYWIDE
cc:
bcc:
Subject:

A quick note to bring to your attention a piece in today's American Banker regarding the pay option issue. The article focuses on the emerging trend toward greater transaparency around this issue and references both CFC as well as some of our competitors. I believe we are positioned relatively well in terms of our posture vis a vis disclosure. Three particular things in the piece to note: 1) once again, Herb Sandler is out there reinforcing similar messaging to what we saw from him in the WSJ piece; 2) a reference to some concerns among ratings agencies around this issue; 3) our discussion of this topic during the Q&A on the earnings call is positioned in a relatively positive light in the article.

This article is yet another example of how the media herd is moving on this issue. It also states as fact the notion that pay option products are inherently risky.

Our cross-functional team is developing a recommended strategy, messaging and set of actions that we expect to be able to present to you shortly for your review and consideration.

Dan

Executives Giving More Details on Option ARMs

From: American Banker

Wednesday, August 3, 2005

By Jody Shenn

Swirling questions sparked by the growth in adjustable-rate mortgages that allow for negative amortization met with much more detailed responses from lenders during their second-quarter earnings discussions.

Washington Mutual Inc., Golden West Financial Corp., IndyMac Bancorp Inc., and FirstFed Financial Corp. all volunteered details on aspects of their originations and portfolios of "option" or "MTA" ARMs that they had never before disclosed, previously tucked into securities filings, or revealed only sporadically.

In Wamu's case, last month's disclosures included completely new data on the level of its option ARM activity in the supplementary information with its quarterly earnings press releases.

The Seattle thrift company, not exactly a newcomer to the product, explicitly broke out the exact amount of option ARMs among its mortgage originations (37%) and in its loan portfolio (35%). It had previously only hinted at such details in securities filings, or given them out occasionally during presentation Q&A sessions.

During the second-quarter call chief executive officer Kerry Killinger indicated that concerns about housing prices motivated its sales of about three-quarters of its option ARM originations - another increase in the percentage. Chief financial officer Thomas Casey followed up by talking about its portfolio. He said only 8% of its option ARMs started with loan-to-value ratios above 80%, and he stressed that none were made to subprime borrowers.

For Golden West, IndyMac, and FirstFed, the new level of candidness also included the amount of negative amortization their borrowers are actually using.

Whether the round of disclosures will satisfy calls for more information, or last beyond the quarter, is uncertain. What's clear is that more and tougher questions about option ARMs are being lobbed at lenders, even those on the West Coast that have regularly made the loans as far back as the early 1980s.

Many of the traditional players find the new interest somewhat perplexing, but some have clearly decided they cannot ignore it.

"It seems to us if everybody is talking about something, you ought to be giving them the information they need," said Herb Sandler, the co-chief executive at Golden West, an option ARM pioneer that began to disclose the negative amortization in its portfolio only this year.

A main reason for the attention to such loans is the danger posed by the combination of growing loan balances and frothy home prices in some markets, as well as what is widely seen as generally looser mortgage underwriting. Another reason is the increased recent use of the negative amortization feature by borrowers.

Still another reason has to do with the increased pessimism by Standard & Poor's Corp. and Fitch Inc., which has cut into the profitability of securitizations. There is also competitive pressure, which until recently was not impacting the loans' sales margins as much as those for other loan types.

On their conference calls, executives at both IndyMac and Wamu talked about the product in their prepared statements. Even so, they then spent a good deal of time answering questions about it.

"No closing remarks - I'm worn out here," Michael W. Perry, IndyMac's chairman and CEO, said at the end of his call, after he had discussed its option-ARM origination metrics, insurance and underwriting policies, and borrowers' payment choices, among other things.

"As you can see, we are trying our very best to be fully transparent and address the key issues," he said. "We came a long way toward addressing people's concerns, so they can understand this option ARM product a little better."

In their quarterly releases, Golden West and FirstFed included information on what some analysts call one of the loans' key data points: the amount of deferred interest created by borrowers' use of negative amortization. This number shows both how much of a lender's interest income was noncash and how much of its loan growth came from partial payments, not new loans.

FirstFed, of Santa Monica, Calif., previously offered the information in its annual reports, but not in other releases or filings. Golden West, the Oakland parent of World Savings Bank, began disclosing the figure in the 10-K it filed in March for last year. In an interview, Mr. Sandler said it was responding to questions stemming from what he agrees is the lax underwriting of some new entrants, and their extremely low teaser rates.

IndyMac also provided a glimpse into the issue by describing the deferred interest on the loans it services. (A spokeswoman said its own loan portfolio has behaved similarly. Considering the level of questioning, it expects to break out extra details on the ARMs "for a while," she said.)

Wamu, on the other hand, offered no details on its deferred interest during the quarter, though Mr. Casey did say only 4 basis points of its option ARM balances was above the principal amount of the loans when they were made.

Responding to a question, he defended the decision not to disclose deferred interest. Wamu would "continue to look at that and see if it's relevant, but we think the more appropriate assessment of the risk is the amount above the original loan value," he said.

A spokesman said last week that it received no follow-up questions and presented a "fair and meaningful picture" of its book.

Paul Miller, an analyst with Friedman, Billings, Ramsey & Co., said he cares less about seeing the amount of negative amortization than he does about making sure the loans' underwriting is sound, and that they can be sold. Where such disclosures are lacking, "we'll just keep on asking," he said.

The earnings call for Countrywide Financial Corp. of Calabasas, Calif., whose entry into the market a few years ago helped make the option ARM a standard product, was a case in point. Countrywide, the nation's top home lender, again disclosed no specific information on the loans in its release or any other prepared remarks, but executives were peppered with questions, and they were obviously ready with quantitative answers.

Among other things, they talked about the amount of the loans it holds in its bank, the use of negative amortization, and how much of the demand for the loans came from California. Angelo Mozilo, Countrywide's CEO, volunteered that the average FICO score of its option ARM borrowers was above 700. Stanford Kurland, its president, said the delinquency rate on the option ARMs in its portfolio was just over 1%.

For years Downey Financial Corp. of Newport Beach, Calif., has provided more details in its filings than others: the amount of its ARMs with the negative amortization option, the percentage of loans that cap negative amortization at 110% or 125% of the original principal, and the net amount of deferred interest.

Thomas E. Prince, its chief operating officer and CFO, said he is definitely getting more questions about the loans, which he attributed to a widespread lack of understanding of them - in particular among analysts and investors based on the East Coast.
Downey may or may not say anything more in future quarters, Mr. Prince said in an interview. "We haven't hidden it or anything, but whether we do it in the earnings release remains to be seen."