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Insurers Urge Action On Risky Mortgages;
Firms Want More Loan Restrictions

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Despite regulators' warnings that some popular types of mortgages are risky, lenders are still making them, and mortgage insurance companies have begun pleading with federal banking agencies to act quickly to restrict them.

The loans under scrutiny include interest-only mortgages and "option" mortgages, in which borrowers decide each month how much to repay. Because monthly payments are lower than with traditional fixed-rate mortgages, borrowers can buy more expensive houses. In the past five years, millions of Americans have bought or refinanced homes using these loans. The risk comes because eventually these loans "reset," meaning the payment is adjusted upward -- sometimes as much as doubling -- to repay the full interest and principal owed.

"We are deeply concerned about the potential contagion effect from poorly underwritten or unsuitable mortgages and home equity loans," Suzanne C. Hutchinson, executive vice president of the Mortgage Insurance Companies of America, wrote in a recent letter to regulators. ". . . The most recent market trends show alarming signs of undue risk-taking that puts both lenders and consumers at risk."

Many borrowers are paying as little as possible. About 70 percent of the people who take out an option adjustable-rate mortgage, which lets the buyer avoid paying even the full interest on the loan, end up paying the lowest permissible amount each month, according to the Federal Deposit Insurance Corp., which regulates banks. The amount unpaid is added to the mortgage balance, so borrowers end up owing more than when they started. Having no equity in a home increases the risk of foreclosure, especially when housing values fall and houses are hard to sell.

Late last year, regulators began telling the industry that some of the new loan types put some buyers in jeopardy and lenders at risk of loan losses. But lenders continued making the loans at a fast clip.

In 2000, just 1 percent of American homeowners who got new loans had these types of loans, but by May 2005, about a third of all borrowers did -- about the same percentage as in May 2006, according to new data from First American LoanPerformance, which tracks the statistics. These loans are even more common in the expensive Washington area,

where about half of home borrowers used them in May 2006.

Regulators also told lenders last year that they were considering an advisory called a "guidance," setting new rules on these nontraditional loans. Lenders would be expected to require borrowers to have higher down payments and better credit, to verify borrowers' income, and to make sure borrowers could withstand a payment increase. Lenders would also be required to explain the loans more carefully. Regulators say the final version of the rules will be announced within a few months.

The rule change has few supporters in the lending industry, and much opposition.

In written comments to regulators, the Mortgage Bankers Association called the proposed ruling "overly prescriptive" and said heavier regulation might stifle product innovation. Guaranty Bank said new rules might have "an adverse effect on the availability of credit to homeowners."

J.P. Morgan Chase & Co. said that it was unfair that restrictions would apply to only banks and thrifts under federal oversight, giving more loosely regulated lenders a competitive advantage.

Wells Fargo said that although it "applauds" the regulators' efforts, the agencies should distinguish between mortgages that are really **risky**, such as those with **mortgage** balances owed that can rise rather than fall or with introductory teaser rates likely to increase, and interest-only loans, which the bank said were less risky.

But the mortgage insurers, which cover the losses when loans go bad, see big problems. Their trade group, in a plea to regulators delivered in a comment letter last month, alluded to its fear of widespread foreclosures if some of these new borrowers default on their loans. An increase in such problem properties could weaken the real estate market and drive down home values even for those who bought conservatively and diligently paid their mortgages.

Hutchinson urged faster action and accused mortgage lenders of disregarding the regulators' warnings.

"Although the non-traditional guidance is now only in draft form, one would have expected a far slower growth in industry reliance on non-traditional products in anticipation of final standards with far-reaching market impact," Hutchinson wrote. She added that the final regulation should require "consistent enforcement" and "clear penalties for those who disregard it."

Not all lenders agree with the big banks and industry trade groups. David Dowling, a loan officer with First Trust Mortgage in Tampa, asked regulators to "ignore the lobbying efforts of those in my industry about keeping lax lending standards."

He said he has had a string of elderly clients come to him for help after lenders placed them in adjustable-rate, interest-only or option loans. Accustomed to "traditional underwriting standards," he said, these borrowers did not understand that they had placed themselves at risk of losing their homes. Dowling said he has met people who had owned their homes free and clear and who lost them to foreclosure after taking out these loans.

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