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M E M O R A N D U M

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To Our Clients and Friends

Re: Interagency Guidance on Nontraditional Mortgage Product Risks

The Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision and National Credit Union Administration (the “Agencies”) have issued guidance to address the risks posed by nontraditional residential mortgage products which permit borrowers to defer payment of principal and, for certain products, interest during an initial period for higher payments during a later amortization period. These products are also often referred to as “alternative” or “exotic” mortgages and include “interest-only” and “payment option” adjustable-rate mortgages. The guidance, which applies to all residential mortgage loan products that allow borrowers to defer repayment of principal or interest except for home equity lines of credit (“HELOCS”), specifies that depository institutions should consider and mitigate potential exposure associated with these loans. Specifically, institutions should:

- Ensure loan terms and underwriting standards are consistent with prudent lending practices and consider a borrower’s repayment capacity
- Implement strong risk-management standards, risk-based capital levels and allow for loan and lease losses that reflect the collectibility of the portfolio
- Ensure when promoting or describing nontraditional mortgage products that consumers have sufficient information to clearly understand loan terms and associated risks

The guidance appears to be effective immediately.

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The Agencies have also amended the *Interagency Credit Risk Management Guidance for Home Equity Lending*, issued in May 2005, to include consumer disclosure recommendations included in this guidance that will apply to HELOCS with interest-only features.

Additionally, the Agencies request comments on proposed illustrations designed to assist institutions in complying with the consumer information recommendations of the guidance. Comments on the proposed illustrations are due 60 days from publication in the Federal Register.

A copy of the Agencies' guidance can be found on our web site at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen, Tom Fox or Heidi Wicker at (202) 776-0700.