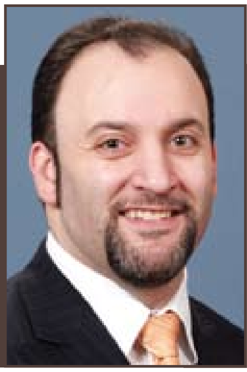


Process Improvement - By Tony Garritano

Warren Isn't Right

The first initiative of the Consumer Finance Protection Bureau is called "Know Before You Owe." It's a good idea, but it has its flaws, too.

The Consumer Finance Protection Bureau was formed under Dodd-Frank to protect the consumer from predatory practices. I was watching "Your Money" on CNN only to see Elizabeth Warren talking about the bureau's first initiative. As you may know, it is called "Know Before You Owe." The idea is that there will be a simple, two-page disclosure that magically makes it easier for the borrower to understand their mortgage.

The bureau describes this initiative this way:

"Right now, anyone who applies for a mortgage gets two disclosures that contain basic information about the mortgage: the Truth in Lending form and the Good Faith Estimate.

The feedback process we're starting today is one of the first steps in combining the Truth in Lending form and the Good Faith Estimate into a single, simpler disclosure form. While you're looking at one of the forms, think about these questions:

<< Would this form help consumers understand the true costs and risks of a mortgage?

<< Could lenders and brokers clearly and easily explain the form to their customers?

<< What would you like to see improved on the form? Is there some way to make things a little bit clearer?

At the heart of our work is the idea that the consumer financial product and services market should work for you. We think we should learn from you what you want to see. One of the best ways to do that is also the simplest: we're asking.

This is the first step in a process that will last months. There will be more opportunities to weigh in as we move forward."

Lenders have to **do more** to learn about who they are lending to and they have to learn more about **the property** getting financed.

Is this good or bad? Creating a shorter, streamlined disclosure is certainly welcome. It's unfortunate that it is taking the government to do this, I think the industry should have done this on its own, but what do I know? The problem that I have with this is that I don't think it's possible to better educate people about their mortgage so they truly know before they owe. Why do I say that? The information in this streamlined disclosure is not new. This information was always there for the borrower to read before they signed off on their mortgage. So, really this is just about consolidating the information and making it easier to consume.

After listening to Ms. Warren I discussed this with my wife. Unfortunately for my wife she has to be my sounding board on these matters. In this case though, she was very heated. My wife is a doctor, so she is very familiar with streamlined disclosures. Needless to say, she is not impressed with these documents.

HIPAA requires that the medical disclosure be written in plain language, include an expiration date, and notify the patient of the right to revoke authorization at any time. The patient must sign and date the disclosure or provide a personal representative to complete the disclosure. In addition to this document patients have to sign a consent form before going into a surgery. The consent form is under a page long.

My wife was not on board with the new mortgage disclosure because she says the streamlined medical disclosures don't work. No matter how short or easy to read a disclosure is, people still say they don't understand their options. So, streamlined disclosures are good in that they will take useless paper out of the process, but I question if a streamlined disclosure will really result in a more informed borrower.

So, what is the answer? Instead of "Know Before You Owe" it should be "Learn Before You Lend." I don't believe that the borrower can be trusted to make the best decision in all cases. Why? Because they want the house even if they can't qualify for it. So, lenders have to make better decisions.

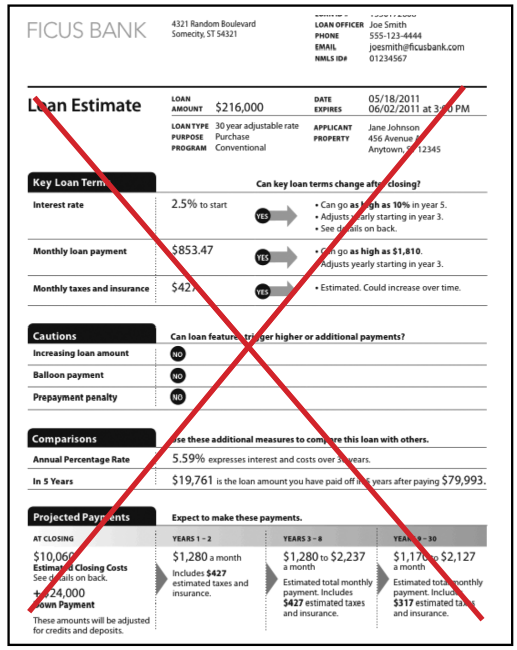
Part of the problem with the mortgage industry is that lenders only look to originate a loan that will sell to an investor instead of really doing all they can to learn about the borrower and the property so they are sure that they are originating a loan that will perform over time. Sure things like illness, divorce, death will happen and can't be predicted, but there are other things that lenders can learn about the borrower and the property that they don't care to ask for because all they are looking to do is create a loan that an investor will buy.

What do I mean? Doug Duncan, chief economist at Fannie Mae, recently pointed out some flaws with the standard appraisal. Generally an appraisal accounts for three local comps. If the three most recent sales came in at $250,000 then this house must be worth $250,000. Doug thought maybe we should go further to look at the credit scores of the three owners of the houses used as comps. Why is that important? If a few of those borrowers have a sharply declining credit score that might be an indication that they are in distress, which might put that property into foreclosure, thus reducing the value of all the houses in that market.

My point is that lenders have to do more to learn about who they are lending to and they have to learn more about the property getting financed. I'm not convinced that a streamlined disclosure is the answer. Unfortunately I think lenders have to step things up and really become lending detectives. It's a sad statement to make, but I don't think there's any way around it.

To lenders I say: Learn Before You Lend. ❖

This Is Not The Answer:



FICUS BANK

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Somecity, ST 54321

LOAN OFFICER Joe Smith
PHONE 555-123-4444
EMAIL joesmith@ficusbank.com
NMLS ID# 01234567

Loan Estimate

LOAN AMOUNT $216,000
LOAN TYPE 30 year adjustable rate
PURPOSE Purchase
PROGRAM Conventional

DATE 05/18/2011
EXPIRES 06/02/2011 at 3:00 PM
APPLICANT Jane Johnson
PROPERTY 456 Avenue A
Anytown, ST 12345

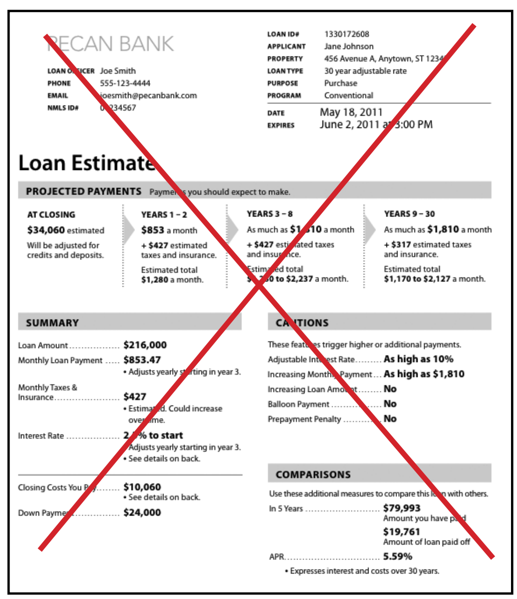
Key Loan Terms		Can key loan terms change after closing?	
Interest rate	2.5% to start	YES	• Can go **as high as 10%** in year 5. • Adjusts yearly starting in year 3. • See details on back.
Monthly loan payment	$853.47	YES	• Can go **as high as $1,810**. • Adjusts yearly starting in year 3.
Monthly taxes and insurance	$427	YES	• Estimated. Could increase over time.

Cautions	Can loan features trigger higher or additional payments?
Increasing loan amount	NO
Balloon payment	NO
Prepayment penalty	NO

Comparisons	Use these additional measures to compare this loan with others.
Annual Percentage Rate	5.59% expresses interest and costs over 30 years.
In 5 Years	$19,761 is the loan amount you have paid off in 5 years after paying $79,993.

Projected Payments Expect to make these payments.

AT CLOSING	YEARS 1 – 2	YEARS 3 – 8	YEARS 9 – 30
$10,060 **Estimated Closing Costs** See details on back. + $24,000 **Down Payment** These amounts will be adjusted for credits and deposits.	$1,280 a month Includes **$427** estimated taxes and insurance.	$1,280 to $2,237 a month Estimated total monthly payment. Includes **$427** estimated taxes and insurance.	$1,170 to $2,127 a month Estimated total monthly payment. Includes **$317** estimated taxes and insurance.



PECAN BANK

LOAN OFFICER Joe Smith
PHONE 555-123-4444
EMAIL joesmith@pecanbank.com
NMLS ID# 01234567

LOAN ID# 1330172608
APPLICANT Jane Johnson
PROPERTY 456 Avenue A, Anytown, ST 12345
LOAN TYPE 30 year adjustable rate
PURPOSE Purchase
PROGRAM Conventional

DATE May 18, 2011
EXPIRES June 2, 2011 at 3:00 PM

Loan Estimate

PROJECTED PAYMENTS Payments you should expect to make.

AT CLOSING	YEARS 1 – 2	YEARS 3 – 8	YEARS 9 – 30
$34,060 estimated Will be adjusted for credits and deposits.	**$853** a month + **$427** estimated taxes and insurance. Estimated total **$1,280** a month.	As much as **$1,810** a month + **$427** estimated taxes and insurance. Estimated total **$1,280 to $2,237** a month.	As much as **$1,810** a month + **$317** estimated taxes and insurance. Estimated total **$1,170 to $2,127** a month.

SUMMARY

Loan Amount **$216,000**
Monthly Loan Payment **$853.47**
• Adjusts yearly starting in year 3.
Monthly Taxes & Insurance **$427**
• Estimated. Could increase over time.
Interest Rate .... **2.5% to start**
• Adjusts yearly starting in year 3.
• See details on back.

Closing Costs You Pay **$10,060**
• See details on back.
Down Payment **$24,000**

CAUTIONS

These features trigger higher or additional payments.
Adjustable Interest Rate .... **As high as 10%**
Increasing Monthly Payment ... **As high as $1,810**
Increasing Loan Amount .... **No**
Balloon Payment .... **No**
Prepayment Penalty .... **No**

COMPARISONS

Use these additional measures to compare this loan with others.
In 5 Years **$79,993**
Amount you have paid
$19,761
Amount of loan paid off
APR............................... **5.59%**
• Expresses interest and costs over 30 years.

Tony Garritano is Chairman and Founder of PROGRESS in Lending. As a speaker Tony has worked hard to inform executives about how technology should be a tool used to further business objectives. For over 10 years he has worked as a journalist, researcher and speaker. He can be reached via e-mail at tony@progressinlending.com.