OPTION ONE
MORTGAGE

Statement
of
Faith Schwartz
Senior Vice President of Enterprise Risk Management & Public Affairs
Option One Mortgage Corporation
at the
Federal Reserve Board's
June 14, 2007 Hearing
on the
Home Equity Lending Market

I am Faith Schwartz, Senior Vice President of Enterprise Risk Management and Public Affairs of Option One Mortgage Corporation (Option One).[1] I also am a current member of the Federal Reserve's Consumer Advisory Committee.[2] I appreciate the invitation to testify at today's hearing on the home equity lending market and the adequacy of existing regulatory and legislative provisions in protecting the interests of consumers that is being held pursuant to the requirements of the Home Ownership and Equity Protection Act of 1994 (HOEPA).[3]

As requested in the Federal Reserve Board's hearing notice, I will focus my testimony primarily on the loan terms and practices identified in the notice,[4] which indicates that the Board is seeking information on how it might use its rulemaking authority under section 129(l)(2) of HOEPA to address concerns about certain potentially abusive mortgage lending practices.[5]

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[1] Option One Mortgage is a nationwide residential nonprime wholesale lending firm that is in the business of purchasing loans from a network of mortgage brokers. As a mortgage banker, we sell loans and securitize loans and service the majority of loans made by our company. We were founded in 1992 and the founding leadership remains at the company today. Option One is a subsidiary of H&R Block, Inc., but an agreement is in place to sell Option One Mortgage to Cerberus Capital Management, L.P., a private investment firm. Option One also is a member of leading industry trade groups, including the Mortgage Bankers Association, the Housing Policy Council and the American Financial Services Association.
[2] I have been in the residential mortgage market for over 20 years. My background spans working for a bank-related mortgage company where I spent my time on capital markets and buying and selling mortgage loans. I then spent a few years as an entrepreneur where I was the COO of two smaller mortgage companies which served a nationwide market. Prior to my position at Option One, I worked at Freddie Mac. I joined the firm to manage their pilot entrance into the subprime segment of the market in order to understand the practices and products that existed in that market segment. While at Freddie, I also managed the firm's efforts to combat predatory lending. This background has given me a global perspective on the market and I, like others, am confident that a proper combination of disclosure, regulations and guidance will assist in maintaining and ensuring health and liquidity in this critically important market segment.
[3] Pub. L. 103-325, 108 Stat. 2160.
[4] 72 Fed. Reg. 30,380 (May 31, 2007).
[5] Section 129(l)(2) of HOEPA grants the Board regulatory authority to prohibits acts or practices:

Specifically, the Board has asked for information regarding whether certain terms or practices are or may be associated with unfairness or deception or otherwise may be abusive and not in consumers' interests and to help the Board evaluate whether it can address issues about predatory lending "in a way that preserves incentives for responsible lenders to provide credit to consumers, particularly subprime consumers."[6]

Option One is concerned that a broad rulemaking under section 129 of HOEPA will unduly limit lenders' underwriting flexibility and threaten credit availability, especially for those who need flexibility because of life events such as illness or job loss. Option One is also concerned that such rigid rules, when applied in the current statutory context where there is little opportunity to correct inadvertent errors, will expose lenders to far more litigation, especially costly class action suits that may involve uncapped damages.[7]

The Board should be cautious in exercising its rulemaking authority under HOEPA section 129. Instead of issuing numerous rigid rules, we urge that the Board address concerns through exercising its authority: (1) pursuant to section 105 of the Truth-In-Lending Act (TILA) to strengthen and simplify disclosures with respect to all four topics the Board has asked for input on; (2) pursuant to section 129(l)(2) of HOEPA to craft targeted rules with regard to truly unfair acts and practices that are abusive; and (3) pursuant to its supervisory authority deal with most concerns by issuing further regulatory guidance, which provides more flexibility than regulations. The effectiveness of guidance has been seen in the rapid, positive transformation of the mortgage market in response to the federal regulatory agencies' nontraditional mortgage guidance and the parallel state guidance adopted in over 30 states. Option One has adopted the policy of following such guidance in all 50 states.

Such a judicious mixture of, targeted formal rules, together with broader application of general principles in regulatory guidance and greater transparency through better disclosures, is our recommended approach. This path should better protect consumers, create a more level playing field for lenders, and promote conditions that help keep mortgage capital widely available in all communities.

- In connection with mortgage loans---if the Board finds the practice to be unfair, deceptive, or designed to evade HOEPA; and
- In connection with refinancing of mortgage loans---if the Board finds that the practice is associated with abusive lending practices or is otherwise not in the interest of the consumer.

[6] 72 Fed. Reg. 30,380, 30382.

[7] While Option One supports Board action along the lines suggested in this testimony, we have long felt that Congress should pass comprehensive new legislation that provides clear requirements and that applies these mandates to all lenders through uniform national mortgage lending standards. Such legislation should replace the myriad of inconsistent state and local laws with a substantially higher overall level of uniform, equal consumer protections. We believe this can be accomplished in a balanced way that keeps mortgage capital available in all communities, to a broad spectrum of consumers, on fair and affordable terms.

More specifically, we believe that the Board should consider adopting regulations and guidance as follows:

<u>More Timely Plain Language Disclosures</u> – **Option One believes that more can and should be done to provide consumers with clearer, more easily understood disclosures regarding key loan terms. Accordingly, we recommend that the Board work with lenders, consumers, consumer advocates, brokers and other interested parties to develop and require by regulation, pursuant to section 105 of TILA, the use of enhanced early, plain-language disclosures in connection with all mortgage loans. We also think that a lender should be deemed to have met Board mandated disclosures if the lender uses disclosure forms issued by the Board.**

In particular, we urge that such disclosures explain: (1) balloon payment terms; (2) cost of stated income loans; (3) the existing interest-only terms; (4) yield spread premiums; (5) prepayment penalty provisions; (6) the option of escrowing of taxes and insurance; and (7) ARM provisions and potential payment shock. [8]

We would also urge the Board to work with interested parties to develop an educational video to help educate borrowers on the mortgage finance process, including in clear, plain language such things as the basic types of mortgages, typical terms, warnings regarding potentially abusive terms or practices, and who the consumer can contact for additional help and information. This video, which might run 10-15 minutes and be available in a number of languages, should made widely available on DVDs and online and should even be required to be shown to all borrowers, or at least to certain categories of borrowers.

Our recommendation here regarding early plain language disclosures is based on our favorable experience in providing such disclosures. As a wholesale mortgage lender Option One seeks to balance the fact that the broker is at the point of sale and we receive a loan package with an application already taken. To provide a safeguard to help clarify the very complex issues involved, Option One has adopted the policy of making direct contact with applicants and providing them with what we believe are clear, plain language disclosures that are written for 8th grade level understanding. Such disclosures are given early in the loan process immediately after we receive the application, and then repeated if there is any material change to a key provision, and, in any case, provided again at closing. We are always improving and adjusting our disclosures or processes. Currently, we are reviewing these forms and others and are likely to make further

[8] Appendix "A" contains copies of such disclosures that Option One sends out directly to borrowers once a loan application is received. These disclosures relate to: (1) balloon payment terms; (2) stated income---this is to minimize fraud and ensure that the borrower indeed did not provide actual documentation that was then altered when submitted to Option One; (3) interest-only provisions versus fully amortizing loan terms; (4) an explanation of a Yield Spread Premium (YSP), the amount of any YSP being paid to a broker and the fact that this payment results in a higher interest rate; Option One also limits the payment of any YSP to a maximum of 2% of the loan amount, and our average YSP is less than 1%; (5) prepayment charges---the existence and nature of a prepayment penalty charge is disclosed; and (6) ARM provisions---when the loan has an adjustable rate feature this is disclosed together with an illustration of how monthly payments may increase after the end of the introductory interest rate.

refinements to improve and simplify the information we provide to our consumers. For example, we are looking to refine our ARM disclosures to better illustrate how "worse-case" scenarios might significantly increase monthly payments.

Option One believes that providing more effective disclosures is the right approach for helping borrowers better understand loan products and terms. We would welcome a more robust regulatory effort to ensure transparency and consistency to assist borrowers with the most complex transaction they may have in their lifetime. Option One believes that every reasonable effort should be made to enhance transparency regarding loan provisions and to educate consumers so they understand how specific provisions might affect them.

<u>Prepayment penalties</u> – **As a policy matter, Option One believes that no borrower should be required to accept a prepayment penalty provision; the consumer should be allowed to make a clear and informed choice of whether to accept a penalty provision; a notice should be provided of its terms; and, the terms should be reasonable and provide the borrower with a benefit. Accordingly, Option One recommends that the Board:**

(1) require a plain-language disclosure pursuant to TILA section 105, be given at or shortly after the time of application and again at closing regarding any prepayment penalty, including clearly describing its terms and a simple explanation of the potential benefits and detriments of accepting the penalty; and

(2) craft a targeted regulation pursuant to HOEPA section 129(l)(2) that includes substantive requirements that:

(a) provide the consumer must be given a choice of not accepting a penalty provision;

(b) limit the term of a penalty to a maximum of three years, or in the case of an adjustable rate loan, to at least 30 days prior to the first rate adjustment date in order to give the consumer additional time to secure refinancing, if desired, without incurring the penalty; and

(c) require that the consumer receive a reasonable benefit, in terms of lower-up front costs or a lower interest rate in exchange for electing the penalty provision, and that the amount of the penalty be reasonable in light of the benefit provided.

A prepayment penalty is a tool that can provide the consumer with a significant benefit in the form of lower-up-front costs or lower interest payments, especially if they know they will not be refinancing before the end of the prepayment period. Option One provides such a benefit for consumers who elect a loan that includes a prepayment option. We are able to offer the benefit because the secondary market will pay a premium for loans that have a penalty provision to help protect the investor from the loss incurred when a loan is paid off earlier than the term on which the price of the loan had been based.

Prepayment penalties can be especially helpful to nonprime consumers who do not anticipate moving or refinancing during the penalty term and who need, for example, a lower interest rate and lower monthly payments to qualify for the loan. If they did not have the choice of electing a penalty provision in exchange for the lower rate benefit, they may not be able to obtain a loan or as large a loan as they need. However, it is not only nonprime consumers who can benefit from having the option of choosing a properly regulated prepayment penalty. Although prepayment penalties are more widely used in the nonprime segment of the mortgage market where the risk of early prepayments is significantly higher, consumers in the prime segment also in many cases choose a prepayment penalty provision in order to lower their rate or closing costs. We believe that it would be appropriate for the Board to apply the recommended prepayment penalty requirements to all consumer mortgage loans, not just nonprime loans.

Escrows for Taxes and Insurance on Nonprime Loans – With respect to escrows, Option One recommends that the Board:

(1) Issue guidance for nonprime loans that:
   (a) Lenders should include tax and insurance obligations in their calculations when considering whether a consumer qualifies for a loan.
   (b) Consumers should be strongly encouraged to have their lender / servicer establish an escrow for the payment of taxes and insurance. An escrow account should be automatically established and maintained unless the consumer affirmatively opts out of having the escrow.[9]

(2) Use its authority pursuant to TILA section 105 to require that nonprime consumers be given an early, plain-language disclosure at or immediately after application explaining the benefits of having such an escrow account, estimating the consumer's likely tax and iusurance costs and illustrating how including such costs would affect their monthly loan payment. The escrow disclosure should be updated and include more precise numbers and be provided again at closing.

Most borrowers in the prime mortgage market have escrows for the payment of insurance and taxes. Option One has found that in general nonprime loans that have such escrows perform better than those that do not. Some consumers find it difficult to have or save enough money on their own to be able to make their periodic tax or insurance payments, which typically arise on an annual or semi-annual basis. Accordingly, we strongly encourage our borrowers to establish escrows. In addition, as a major nonprime loan server, we work diligently with the consumers whose loans we service to establish such escrows.[10] In that regard, the National Fair Housing Alliance has helped us design better procedures to encourage consumers to set up escrows in the loan servicing process.

[9] The Board might consider imposing restrictions in some cases on a consumer's ability to opt-out of having an escrow (e.g., first-time home buyers or consumers with certain high debt-to-income or loan-to-value ratios might be prohibited from opting-out for some other minimum time period).

[10] Attached as Appendix "B" is an excerpt from Option One's Servicing Best Practices that illustrates how we encourage consumers to establish escrows which we provide at no cost.

"Stated Income" or "Low Documentation" Loans – Option One recommends that the Board:

(1) Require pursuant to its TILA section 105 authority that when stated income or low doc loans are made the consumer should be given an early, plain-language disclosure of key facts such as noting that the stated-income procedure is being used; that the loan rate will be higher than a fully-documented loan; that the consumer may choose to fully document income and receive a lower rate; and that intentionally misstating one's income could involve fraud and make it more likely that the consumer would lose the home by not being able to repay the loan. The consumer should receive another such disclosure at closing.

(2) Issue guidance that would allow the origination of stated income or low doc loans when:

(a) Excessive risk-layering factors are not present;

(b) The loan is refinancing another loan with the lender and the consumer's payment history is favorable; and

(c) The consumer is self-employed or paid in cash or with respect to income from tips or other special circumstances---

Provided the lender uses enough other controls to have a reasonable basis for concluding that the consumer does have the claimed income. [11]

As the Board knows, the use of "stated income" or "low doc" loans, when the lender generally does not obtain explicit verification of a consumer's claimed or stated income from signed tax returns or independent third-parties, has become widely used in the nonprime mortgage market as it has in the prime and Alt-A sectors. This growth in stated income has been significant in the last few years when rates have been relatively low and non-traditional products have escalated far beyond the standard fixed-rate 30-year, full doc, fully amortizing loan. Stated income loans have been helpful for consumers who have a difficult time documenting or providing proof of income. For example, these loans offer a less cumbersome process for people who are self-employed, or work a side job in addition to their regular job, receive tip income or are paid in cash.

Some people have the impression that lenders who offer stated income or low documentation loans simply accept the amount of income claimed and fail to make any further inquiry. In fact, Option One and other responsible lenders apply a number of controls or safeguards to make a determination if the claim is reasonable and to limit the higher risk posed by such loans. For example, Option One does not offer state income loans to borrowers whose income is based on their social security benefits. We also apply various controls such as making an independent verification of the business the consumer claims to work for, obtaining a verification of employment, reviewing credit report and usage data, business licenses, assets and corporate documents, and confirming that the claimed income is reasonable for the consumer's position and time employed. If

[11] For example, review of credit records, especially prior mortgage payment history, confirmation of employment, etc.

our controls raise concerns or discrepancies, we require that the consumer shift to a fully-documented loan.

Although some lenders have found such loans in their portfolios to be very problematic, quite frankly we have found that, for the most part, our stated income loans where considerable risk-layering has not existed have basically performed well and very similarly to our broader full documentation loans. The stated income loans that have tended to have significantly more problems have been those where other layered-risk factors, such as second-liens or lower FICO scores, have existed, and we, like other market participants, have accordingly tightened our requirements.

Concerns have been raised that consumers often are not aware of the additional cost of such loans and that they could get a lower rate loan by fully documenting their income. In addition, such loans may involve a higher risk of fraud due to the consumer's income being falsely inflated. Moreover, as I mentioned, loans have greater risks when this stated income approach is used with other risk-layering features such a simultaneous second-lien loans that provide most or all of the consumer's down payment. We believe these concerns can be addressed through better disclosures and guidance as suggested herein.

<u>Unaffordable Loans</u> – **Option One recommends that the Board:**

(1) Require, pursuant to its authority under TILA section 105, that hybrid-ARM borrowers be given an early, plain-language disclosure regarding such things as illustrating how the loan's monthly payment may increase over the next few years due to periodic rate resets and how the ARM compares to fixed rate products.
(2) Issue guidance that would:
- **(a) Provide that lenders originating hybrid-ARMs use start rates and periodic and overall rate adjustment caps that do not raise significant "payment shock" concerns for a reasonable period of time (e.g., at least 4 years),[12] and use greater than a start rate underwriting standard (e.g., 2% over the start rate) but not necessarily underwriting at the fully-indexed rate.[13]**
- **(b) Have less restrictive requirements for current hybrid-ARM consumers who may be unable to find a satisfactory refinance loan if rigid restrictions are now applied.**
- **(c) Not have a presumption of the lack of repayment ability apply merely because some specified debt-to-income ratio (e.g., 50%) is exceeded.**

The Board should be cautious about being too restrictive with respect to repayment ability requirements. If restrictions are too rigid many nonprime consumers, including

[12] The Board should keep in mind how long loans actually exist (e.g., the typical nonprime loan is refinanced in 2 to 3 years).
[13] We urge the Board to be creative and to allow flexibility in this area, perhaps by developing some type of "payment shock" test or safe harbors where the loan has a lower loan-to-value (e.g., 75%) or the loan meets criteria for purchase by Freddie Mac or Fannie Mae. We also would note that hybrid-ARMs underwritten to the introductory rate, or at least below the fully-indexed rate, performed very well for a number of years and benefited many consumers.

potentially disproportionate numbers of economically disadvantaged minorities and recent immigrants, may be unable to qualify for a loan. Recent problems involving hybrid-ARMs underwritten at an introductory rate that adjusts upward have been due in large part to major changes in the yield curve. In the future, it is quite likely that circumstances may change again so that it would be in many consumers' interests to have more flexibly underwritten hybrid-ARM products available.

Option One and other lenders have every incentive to not offer consumers loans that they cannot afford. We make money by originating loans which consumers can repay, and we lose money when loans fail and end up being foreclosed upon. Admittedly, however, although lenders seek to confirm repayment ability, underwriting practices have not always adequately accounted for unanticipated shifts in market circumstances and for significant risk layering. For example, Option One and many other nonprime lenders experienced many more early payment defaults on loans than expected in the 2006 vintage when significant market shifts occurred, with high home appreciation ending in most areas and sometimes even depreciating values, rising interest rates and market competition resulting in more relaxed underwriting requirements and greater risk-layering. However, the market has reacted strongly the nonprime segment already has changed significantly as a result of market dynamics and of lenders, including state regulated companies, moving to comply with federal guidance proposals. Credit and underwriting standards have shifted to be significantly more conservative to help ensure repayment ability on future loans.

Moreover, we must not forget that the market is dynamic and underwriting standards for repayment ability therefore should not be put forth in a rigid manner. If the 28 / 36 debt ratios that were the general rule only 10-15 years ago had been set forth as a regulatory mandate, the market would never have developed so that there now millions of nonprime borrowers can obtain affordable loans. Moreover, hybrid-ARMs clearly have served as a valuable transition or bridge product that allows the consumer to subsequently move in 2 or 3 years to a better loan, often at significantly lower prime rates.

* * * *

Thank you for this opportunity to present Option One's views on these important issues. I would be happy to respond to any questions that you may have.

Appendix "A"

Loan Number: Servicing Number: Date:

Important Disclosure - Please Read

PREPAYMENT CHARGE DISCLOSURE

A Prepayment Charge is a charge for paying off or refinancing a loan within a certain time period after loan closing. For example, if your mortgage loan includes a Prepayment Charge period of year(s), and you pay off or refinance the loan within the first year(s) after closing, you may be assessed a Prepayment Charge. On the other hand, if you retain your loan longer than the year period, no Prepayment Charge is assessed upon payoff or refinance. A Prepayment Charge is typically included on a mortgage loan in exchange for a reduction in interest rate or other loan fees. Loans with Prepayment Charges may be favorable to borrowers who plan to remain in their home and retain their mortgage loan for a time period exceeding the Prepayment Charge period.

To see an illustration of how a Prepayment Charge may be assessed, please see the example below:

Note: The following example does not represent the terms of your loan. It is provided solely for the purpose of illustrating the potentially significant Prepayment Charge you may be charged if your loan is paid off or refinanced during the Prepayment Charge period.

Loan Type: 30 years/fixed
Loan Amount: $200,000
Interest Rate: 8.00%
Year Prepayment Charge

A Prepayment Charge may be as much as $6400.00 if the loan is paid off or refinanced within the first year(s) after closing.

As illustrated above, your Prepayment Charge may be significant. Prior to signing any documents, please make sure you fully understand the Prepayment Charge provisions outlined in your loan agreement. If you do not wish to obtain a loan with a Prepayment Charge, please check with your as you may be eligible for other loans without Prepayment Charges.

Your signature acknowledges that you have been advised that your loan contains a Prepayment Charge.

Borrower	Date	Borrower	Date
Borrower	Date	Borrower	Date
Borrower	Date	Borrower	Date

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Loan Number: Servicing Number: Date:

Important Disclosure - Please Read

STATEMENT OF UNDERSTANDING

Stated Income Loan

You have applied for a mortgage loan using Stated Income documentation. A Stated Income loan is designed for borrowers who qualify for a mortgage loan yet may have difficulty documenting their income. The lender determines what loans or loan amounts for which a borrower may qualify based on their representation of Stated Income. With a Stated Income loan, it is very important that the borrower accurately represents their income to ensure they can afford the loan. A Stated Income loan typically carries a higher interest rate than a Non-Stated Income loan. As a result, Stated Income loans are not suitable for fixed income borrowers as they should be able to document their income and thus qualify for lower interest rate.

BORROWER ACKNOWLEDGMENTS:

- You provided the recorded monthly gross income in "Section V - Monthly Income and Combined Monthly Housing Expense" of the Uniform Residential Loan Application (1003).
- You have carefully reviewed the Uniform Residential Loan application (1003) to confirm that it accurately states your income, your assets, and your obligations.
- You understand that you have the option to apply for a loan using Full Income Documentation, which may result in a lower interest rate.
- You understand that your qualification for a loan is based, in part, on Stated Income Documentation.
- You understand a Stated Income loan is NOT designed to allow for declaring inflated monthly gross income for the purpose of qualifying for a loan.
- If you have stated an income higher than you actually receive, you may encounter difficulty making your mortgage payments.

Borrower Date Borrower Date

Borrower Date Borrower Date

Borrower Date Borrower Date

Loan Number: Servicing Number: Date:

BROKER COMPENSATION (YSP) AND THE FEES IN YOUR TRANSACTION

In your loan transaction, you will have to pay fees to your broker, lender, and third parties (such as the appraiser, title company, closing agent, etc.). Some of these fees may be paid out of your pocket, others may be paid from the loan proceeds, and yet others may be paid by another party on your behalf (for instance, perhaps the seller of your property agreed to pay some of your costs). You should discuss with your broker the type of fees you will have to pay in your loan transaction, and the best way for you to handle the payment of those fees.

One of the ways that you can pay your broker is through something called a Yield Spread Premium, usually referred to as a YSP. When some or all of the broker's fee is paid by a YSP, it means that the lender is paying the broker on your behalf. The upside is you will be reducing the amount you have to pay out of pocket for the loan fees, or less money will be added on your loan balance to pay these fees. The benefit of a YSP is it leaves more money in your pocket. But in return for this benefit to you, you agree to pay a higher interest rate on the loan, allowing the lender to recoup the money it paid for you on this transaction.

THE YSP CHOICE IS YOURS TO MAKE

In your transaction, you are agreeing to pay a higher interest rate of __________%. Your broker will directly receive compensation from Option One Mortgage Corporation ("OOMC") in the amount of $ ___________ _______. You understand that this compensation will appear as "broker compensation" or "yield spread premium" on certain disclosures (i.e. Good Faith Estimate of Closing Costs and HUD-1 Settlement Statement).

Borrower's Acknowledgment:

I acknowledge that I have a choice regarding loan terms. I have voluntarily agreed to the inclusion of the Yield Spread Premium in my loan terms.

Borrower	Date	Borrower	Date
Borrower	Date	Borrower	Date
Borrower	Date	Borrower	Date

Loan Number: Servicing Number: Date:

Important Disclosure - Please Read

Interest-Only Loan Disclosure

You have applied for a mortgage loan with an Interest-Only feature. With an Interest-Only loan, you pay only the interest on the mortgage in monthly payments for a fixed term (typically 5 or 10 years). You are not required (though you can elect) to make principal payments during the Interest-Only term. After the end of the Interest-Only term, your monthly payment will most likely feature a significant increase because it changes to include both principal and interest.

To see an illustration of how your payment may change after the Interest-Only period lapses please see the example below.

Note: The following example does not represent the terms of your loan. It is provided solely for the purpose of illustrating the potentially significant increase in loan payment once the Interest-Only period ends.

Loan Type: 30 year fixed rate with 5 year Interest-Only term
Loan Amount: $200,000
Interest Rate: 8.00%
Interest-Only payment: $1333.33 for months 1 through 60

Fully amortized payment (principal and interest) after Interest-Only period ends (61st month): $1543.63.

Note: Adjustable rate mortgage loans may feature an even larger payment increase once the Interest-Only period ends.

An Interest-Only loan might be a good fit for:

- Someone one whose income is mostly in the form of infrequent commissions or bonuses.
- Someone who expects to earn a lot more in a few years.
- Someone who intends to move or refinance within a few years.
- Business owners with unpredictable incomes.

If an Interest-Only loan does not make sense for you, please check with your
as you may be eligible for other loan programs.

It is important to understand that with an Interest-Only loan, if you make only the minimum payment during the Interest-Only period, your principal balance will not be reduced.

Your signature acknowledges that you have been advised that your loan contains an Interest-Only term.

Borrower Date Borrower Date

Borrower Date Borrower Date

Borrower Date Borrower Date

Loan Number: Servicing Number: Date:

Important Disclosure - Please Read

Adjustable Rate 2/28 Loan Disclosure

You have applied for a mortgage loan with a 2/28 Adjustable Rate feature. With a 2/28 Adjustable Rate mortgage loan, your interest rate is fixed for the first 2 years of your mortgage loan - usually at a lower introductory interest rate than offered by a 30-year fixed mortgage loan. This means your monthly payment amount, which is based on the lower introductory interest rate, is fixed for the first 2 years of your mortgage loan. In exchange for the lower 2-year introductory interest rate and payment amount, the remaining 28 years of your mortgage loan becomes subject to interest rate changes. This means your monthly payment may significantly increase after any interest rate change. A significant increase in your monthly payment is especially likely after the lower introductory 2-year fixed interest rate period ends.

To see an illustration of how your payment may change after the introductory 2-year fixed interest rate period lapses please see the example below.

Note: The following example does not represent the terms of your loan. It is provided solely for the purpose of illustrating the potentially significant increase in loan payment once the introductory 2-year fixed interest rate period ends.

Loan Type:2/28 Adjustable Rate Mortgage Loan
Loan Amount:$200,000.00
Introductory Interest Rate for the first 2 years: 8.000%
Introductory Monthly Payment: $1,467.53 for months 1 through 24

Payment based on index and margin: $1,944.52
Total increase in monthly payment: $476.99

A 2/28 Adjustable Rate Mortgage Loan might be a good fit for:

- •Someone who expects to earn a lot more in a few years;
- •Someone who intends to move or refinance within a few years;
- •Someone whose monthly non-mortgage expenses will likely significantly decrease in a few years.

If a 2/28 Adjustable Rate Mortgage Loan does not make sense to you , please check with your
as you may be eligible for other loan programs.

Your signature acknowledges that you have been advised that your loan contains a 2/28 Adjustable Rate feature.

Borrower	Date	Borrower	Date
Borrower	Date	Borrower	Date
Borrower	Date	Borrower	Date

Loan Number: Servicing Number: Date:

Important Disclosure - Please Read

Adjustable Rate 3/27 Loan Disclosure

You have applied for a mortgage loan with a 3/27 Adjustable Rate feature. With a 3/27 Adjustable Rate mortgage loan, your interest rate is fixed for the first 3 years of your mortgage loan - usually at a lower introductory interest rate than offered by a 30-year fixed mortgage loan. This means your monthly payment amount, which is based on the lower introductory interest rate, is fixed for the first 3 years of your mortgage loan. In exchange for the lower 3-year introductory interest rate and payment amount, the remaining 27 years of your mortgage loan becomes subject to interest rate changes. This means your monthly payment may significantly increase after any interest rate change. A significant increase in your monthly payment is especially likely after the lower introductory 3-year fixed interest rate period ends.

To see an illustration of how your payment may change after the introductory 3-year fixed interest rate period lapses please see the example below.

Note: The following example does not represent the terms of your loan. It is provided solely for the purpose of illustrating the potentially significant increase in loan payment once the introductory 3-year fixed interest rate period ends.

Loan Type:3/27 Adjustable Rate Mortgage Loan
Loan Amount:$200,000.00
Introductory Interest Rate for the first 3 years: 8.000%
Introductory Monthly Payment: $1,467.53 for months 1 through 36

Payment based on index and margin: $1,935.30
Total increase in monthly payment: $467.77

A 3/27 Adjustable Rate Mortgage Loan might be a good fit for:

- •Someone who expects to earn a lot more in a few years;
- •Someone who intends to move or refinance within a few years;
- •Someone whose monthly non-mortgage expenses will likely significantly decrease in a few years.

If a 3/27 Adjustable Rate Mortgage Loan does not make sense to you , please check with your as you may be eligible for other loan programs.

Your signature acknowledges that you have been advised that your loan contains a 3/27 Adjustable Rate feature.

Borrower	Date	Borrower	Date
Borrower	Date	Borrower	Date
Borrower	Date	Borrower	Date

Loan Number: Servicing Number: Date:

Important Disclosure - Please Read

BALLOON LOAN DISCLOSURE

You have applied for a 30 year mortgage loan with a Balloon term. Unlike a typical 30 year loan, a 30 year Balloon Loan calculates your monthly payments using a year amortization instead of a 30 year amortization. This means your Balloon Loan monthly payment will be lower than the monthly payment on a typical 30 year loan. In exchange for lower monthly payments, you will be charged a "Balloon Payment" at the end (final payment) of the loan. The Balloon Payment is generally much larger than the preceding monthly payments.

A Balloon Loan may be beneficial to you if you plan to sell you home or refinance your loan before the balloon payment becomes due. On the other hand, if you don't plan to sell your home or refinance your loan, a Balloon Loan may not be desirable.

IT IS IMPORTANT TO UNDERSTAND THAT WITH A BALLOON LOAN, YOU WILL BE RESPONSIBLE FOR A FINAL BALLOON PAYMENT UPON THE MATURITY DATE OF YOUR LOAN. THE BALLOON PAYMENT WILL BE SIGNIFICANTLY LARGER THAN YOUR PRECEDING MONTHLY PAYMENTS.

Your signature acknowledges that you have been advised that your loan contains a Balloon Payment.

Borrower Date Borrower Date

Borrower Date Borrower Date

Borrower Date Borrower Date

Appendix "B"

Excerpts Regarding Escrows from Option One's Servicing Best Practices, available online at:

https://spice.oomc.com/servicing/bestpract_servicing_payment.asp

Escrow Accounts

Option One believes escrow accounts benefit borrowers. Escrow accounts provide a means to put money aside monthly to pay real estate taxes and homeowners insurance. These monthly payments can help you avoid large, lump-sum payments when bills are due. We provide these time saving and convenient escrow accounts free of charge. There are no set-up or deletion fees for an escrow account. If your loan does not already have this feature, we will ask you if you'd like to establish an escrow account when we make your welcome call. Our Customer Contact Center associates are also trained to explain the benefit to borrowers and ask them if they'd like to start an account. Click here to learn more about escrow accounts or to access an online escrow account application form, please click here.

Escrow Accounts

1. What is an escrow account?

   Answer:
   An escrow account (also known as an impound account) is an account established with Option One to help borrowers pay taxes and insurance premiums for your mortgaged property. Deposits are made to the escrow account through monthly payments made along with the principal and interest amounts due. Note that payments of supplemental tax bills are not paid from your escrow account. Please pay any supplemental tax bills directly to the taxing authority.

   Please note:an escrow account is not automatically established unless it becomes necessary to add insurance to your property or there is a past due tax bill on your property. In these cases, Option One will notify you of these changes and advise you of the new required payment amount.

2. How do I set up an escrow account on my mortgage?

   Answer:
   You may contact Customer Service for detailed instructions on how to set up an escrow account by calling 800.648.9605. Escrow accounts can be set up at the loan closing or any time after that.

3. What is the current escrow balance?

   Answer:
   This is the amount of money in your escrow account available to pay taxes or

insurance for your property. The escrow balance can be found on your monthly billing statement or by viewing your Current Loan Information page or the Escrow Information page in the My Account section of this Web site.

4. What part of my payment is being applied to my escrow account?

Answer:
The amount of escrow applied to your escrow account is determined by the amount needed to pay your taxes and or insurance on a yearly basis. This amount will change only when the amount needed to pay these items either increases or decreases, or the scheduled payment for the last year has not been met. You can find the amount of your escrow payment listed on your monthly billing statement or by visiting the Escrow Information page in the My Account section of this Web site.

5. Am I required to set up an escrow account with Option One to pay my taxes and insurance?

Answer:
While, in most instances, your loan documents specify that you must make monthly contributions to an escrow account for payment of your taxes and insurance, Option One does not require that you set up an escrow account as a prerequisite when approving your loan. Option One's policy is generally to set up an escrow account only upon the request of the borrower but Option One reserves the right to impose an escrow account under certain circumstances.

6. Why should I set up an escrow account to pay my taxes and insurance?

Answer:
With an escrow account, you do not have to worry about paying a large tax or insurance bill when it comes due. Option One will always ensure that your taxes and insurance are paid when they become due. You do not have to worry about budgeting for these items.

7. How does an escrow account work?

Answer:
An escrow account acts like a savings account maintained by the lender. Monthly deposits, which are built into your mortgage payments, are made to your escrow account for future disbursements of your property taxes and/or insurance premiums. Option One will use the funds deposited to pay your property taxes and insurance premiums as they become due.

Please note: Escrow accounts provide only for property taxes on parcels secured by your mortgage and/or insurance that is required by your mortgage. Example: If your property were not in a flood zone, flood insurance would not be required on your property, but if you choose to carry flood insurance, funds collected in your escrow account would not pay for this type of insurance.

8. How much would my payment go up if I establish an escrow account?

Answer:
Your monthly payments will increase depending on the amount of your taxes and/or insurance premiums.

To estimate how much your monthly mortgage payment would increase after establishing an escrow account, first gather the following figures and use the formula below:

1) Total Annual Property Taxes for all collecting agencies =

____

+
2) Total Annual Insurance Premium for all required policies =

____

Total of lines 1 and 2 divided by 12
Equals estimated total monthly escrow collection = __________________________

10. How can I keep track of payments made to my escrow account?

Answer:
In the activity section of your billing statement you will see what was paid, how much and when it was paid. Please note, payments made will only be reflected on the billing statement sent the month following the payment. Also you will receive a very detailed annual escrow analysis that will show, among other items, moneys collected, disbursements made, and anticipated disbursements for the coming year.

11. What if you have to pay my taxes or insurance premium and there are not enough funds in my escrow account to pay the full amount?

Answer:
Option One will pay the full amount due for your taxes and/or insurance premiums even if you are short in your escrow account, then we will simply collect the shortage back from you in small, additional monthly installments.

12. Is an initial deposit required to establish an escrow account?

Answer:
There is no fee required to establish an escrow account with Option One, however a deposit for the purpose of creating an initial balance in your escrow account is needed. Over the first twelve months your escrow account is active, Option One will collect this deposit in 12 equal payments. This amount is in addition to that which is collected to pay all installments of taxes and/or insurance premiums that will be paid from your escrow account.

13. I have taxes and/or insurance due now; will I still be able to set up an escrow account?

Answer:
All taxes and insurance premiums must be paid in full and current prior to establishing an escrow account. If you have a tax or insurance premium due within one (1) month of our receipt of your escrow setup request, you must first pay those items as they come due. In addition you may need to provide Option One with proof of payment when submitting your request.

14. What is acceptable proof of payment?

Answer:
A copy of both sides of your canceled check or a paid receipt from your tax agency or insurance company is acceptable.

15. How will I know if you have received my request and have completed the escrow setup?

Answer:
We will respond to you in writing once we have completed your escrow setup. You will receive a letter from us with the details of your escrow account, as well as what your new payment amount is and when that payment becomes effective.

In addition, you will receive an initial Annual Escrow Account Disclosure Statement shortly thereafter. This statement will give you your escrow projection for the next 12 months.

16. Do I need to do anything with the Annual Escrow Analysis Statement?

Answer:
Your escrow analysis statement will show you what is projected to be paid out of your escrow account over the following 12 months to ensure that your property taxes and related insurance premiums are kept current. You should review this document to make sure that Option One is planning to pay your taxes and/or insurance premiums at the correct time and for the correct amount. Discrepancies should be reported to Option One immediately.

17. How often will I get an Escrow Account Disclosure Statement?

Answer:
Option One will analyze your escrow account at least once every 12 months to ensure there are sufficient funds being collected to make all scheduled payments as needed. The analysis determines if any adjustments need to be made to your escrow payments based on projected escrow disbursements for the coming year. Each time you receive an analysis statement you should review it for accuracy and contact Option One if you have any questions regarding your tax and/or insurance premium disbursement(s). (A sample disclosure is included)

18. What if I want to change insurance carrier(s)?

Answer:

You are free to change insurance carriers any time you wish. Having an escrow account does not mean you cannot make changes to your insurance. For a smooth transition, please ensure your new insurance company is aware that your insurance is escrowed and provide them with the following mailing address so Option One can ensure your monthly premium is paid on time.

Option One Mortgage Corporation
Attn: Insurance Department
PO Box 949 Orange, Ca 92856

In addition, you can update your insurance information on our Web site at www.updatemyinsurance.com/01

19. What if I want to make changes to my current insurance policy?

Answer:
You are free to make policy changes as long as they comply with the insurance requirements set forth by your mortgage. Your insurance agent should be familiar with these requirements and, in most cases, will let you know if your changes will be acceptable.

20. What should I do with the tax bills that I may continue to receive?

Answer:
If you are escrowed for taxes and you receive a tax bill you can call Option One's Customer Service Department at 800.648.9605 or mail a copy of your tax bill (please keep the original for your records) to:

Option One Mortgage
Attn: Tax Department
P.O. Box 5155
Pasadena, CA 91107-0515
Fax: 626-345-2046

21. What if I am receiving 'supplemental' or 'added assessment' tax bills?

Answer:
If you have received this type of tax bill, this would indicate that your property is a new purchase and/or new construction. Supplemental or added assessment tax bills are collected due to changes in the assessed value of the property associated with change of ownership or substantial property improvements. We suggest that you wait until you begin receiving fully assessed tax bills prior to setting up an escrow account. Option One is not able to pay your supplemental or added assessment tax bills.

22. What if my taxes were escrowed when my loan was originated and I get a supplemental or added assessment tax bill?

Answer:
At the time your loan was originated, your tax amounts should have been computed based on the fully assessed value of your property at the time of purchase. Therefore, your escrow deposits will be collected at the higher tax amount even though Option One will only be able to pay the secured tax bill that may not yet include the additional amounts. However, Option One may be able to offer some assistance if you are having problems paying the supplemental or added assessment tax bills. Please contact Option One's Customer Service Department at 800.648.9650 so they can discuss your options with you.

23. Who should I call if I have questions about my escrow account?

Answer:
If you have questions about your escrow account, please contact Option One immediately. Our Customer Service Department can be reached at 800.648.9605 to answer any of your questions.

24. What if my monthly mortgage payment is automatically drafted from my checking account?

Answer:
Setting up an escrow account will not affect your automatic payment drafting. Once Option One sets up your new payment, it will draft from your bank account at the new payment amount. It will be your responsibility to ensure that there are sufficient funds in your account on your scheduled payment drafting date.

Thank you for your interest in establishing an Escrow Account on your loan with Option One Mortgage Corporation. Prior to sending in your request to setup an Escrow Account, please verify that your loan meets the following criteria:

- The loan payment must be due for the current month.
- The loan cannot be in foreclosure or bankruptcy.
- If the loan already has a negative Escrow Balance, that balance must be less than $250.
- The loan cannot have any delinquent property taxes.
- There must be no tax and/or insurance payments due for the current month or the next month. *For example, if the current month is January, there can be nothing due for January or February.*
- The insurance must be a voluntary policy.

If your loan meets **ALL** of the above criteria, please complete the form on the following page and send it to the below address:

Option One Mortgage Corporation
Attn: Customer Resolution
6591 Irvine Center Drive
Irvine, CA 62918-4425

You may also fax the completed form to **(949)790-8505**.

OPTION ONE®
MORTGAGE CORPORATION

Escrow Authorization Form

____ I (We), the undersigned authorize Option One Mortgage Corporation to collect monthly, in addition to principal and interest prescribed by the terms of the Note, a monthly amount sufficient to pay for the **PROPERTY TAXES ONLY**.

____ I (We), the undersigned authorize Option One Mortgage Corporation to collect monthly, in addition to principal and interest prescribed by the terms of the Note, a monthly amount sufficient to pay for the **HAZARD INSURANCE ONLY**.

____ I (We), the undersigned authorize Option One Mortgage Corporation to collect monthly, in addition to principal and interest prescribed by the terms of the Note, a monthly amount sufficient to pay for the **PROPERTY TAXES, HAZARD INSURANCE AND FLOOD INSURANCE AS APPLICABLE**. If one of these items does not qualify, Option One may setup the Escrow Account for the remaining item.

The Borrower is responsible for payment of any supplemental/special tax assessments that are billed to the Borrower, and the Lender will not disburse funds from the Escrow Account for payment of such assessments.

____
Loan Number

____
Printed Name

____
Signed Name

____
Date