DISTRICT COURT, ARAPAHOE COUNTY, COLORADO 7325 S. Potomac Street Centennial, Colorado 80112 STATE OF COLORADO, ex rel. JOHN W. SUTHERS, ATTORNEY GENERAL, Plaintiff, v. HOME MORTGAGE SOLUTIONS, INC.; TOAN Q. ("JAMES") LE, individually and as president thereof; AN T. NGUYEN, individually and as vice-president thereof; and LEONARD D. SMITH, individually Defendants.	▲ **COURT USE ONLY** ▲
Attorneys for Plaintiff: JOHN W. SUTHERS Attorney General ANDREW P. MCCALLIN, 20909* First Assistant Attorney General OLIVIA C. DEBLASIO, 35867* Assistant Attorney General 1525 Sherman Street Denver, Colorado 80203 (303) 866-5079 (303) 866-4916 Fax *Counsel of Record	Case No.: 08cv1659 Division: 404

ASSURANCE OF VOLUNTARY COMPLIANCE AND DISCONTINUANCE WITH AN NGUYEN

This Assurance of Voluntary Compliance and Discontinuance ("Assurance") is entered into between the State of Colorado, ex rel. John W. Suthers, Attorney General (the "State"), and Defendant An T. Nguyen ("Nguyen"), a mortgage broker licensed by the

Colorado Division of Real Estate, mortgage broker license number LMB100015187. This Assurance is entered into pursuant to the Attorney General's powers under § 6-1-110(2), C.R.S. (2007), and is being agreed to by the parties to resolve this civil action only as against Defendant Nguyen.

I. PARTIES

1. John W. Suthers is the duly elected Attorney General for the State of Colorado and has express jurisdiction to investigate and to prosecute violations of the Colorado Consumer Protection Act ("CCPA"), § 6-1-101, et seq., C.R.S. (2007).

2. Nguyen is a licensed mortgage broker with the state of Colorado and former vice president of Home Mortgage Solutions, Inc. (hereinafter "HMS") which had its principal place of business at 5990 Greenwood Plaza Blvd., #200, Greenwood Village, Colorado 80111. Nguyen had knowledge of and sanctioned the content and distribution of HMS's marketing materials advertising option ARM Loan products. She trained and mentored HMS loan brokers and directed the processing of loans, including option ARM loans. She also originated option ARM loans through HMS to Colorado consumers. Nguyen conceived of and directed the practices and policies of HMS to such a degree as to make her personally liable for the deceptive trade practices described below.

3. Nguyen understands and agrees that this Assurance shall apply to her and any future loan officers she may employ, as well as any principals, officers, directors, agents, employees, representatives, successors, affiliates, subsidiaries, assigns, contractors and any person acting on her behalf.

II. FACTUAL BACKGROUND

4. Colorado Attorney General John W. Suthers has conducted an investigation pursuant to the CCPA into the advertising and business practices of Nguyen and HMS.

5. Nguyen sold "option ARM" and other non-traditional or hybrid loan products between 2003 and 2007. An "option ARM" loan typically allows the borrower to choose from a payment options, including: an amortizing payment of interest and principal, an interest-only payment, or a minimum payment that is calculated using a low teaser rate.

6. The State alleges that Nguyen had knowledge of advertisements in the form of mass-mailed standardized letters printed on HMS letterhead that marketed option ARM loan products. HMS distributed the letters to consumers between 2004 and 2006. The letters would disclose only low introductory rates and the resulting low monthly minimum payments associated with those rates. The letters drew misleading comparisons between a particular consumer's current mortgage payment and the "new monthly payment" based on the "new rate." The letters stated that the advertised loan program would result in a lower interest rate without disclosing the adjustable nature of the loan. The marketing letters were designed to suggest that the consumer could expect to pay the advertised rates throughout the life of the loan.

7. These letters did not disclose any key features of the advertised loans. Specifically, the letters did not disclose that the "new rate" was really the payment rate or introductory rate. The letters further failed to disclose the reference rate and margin on which the "new rate" was based, any potential for negative amortization, the negative amortization life cap and resulting payment shock, and applicable pre-payment penalties.

8. The marketing letters did not comply with the Colorado Uniform Commercial Credit Code ("UCCC") and the Federal Truth in Lending Act ("TILA"). Specifically, HMS' advertisements failed to disclose the Annual Percentage Rate ("APR") and that the APR may increase after consummation of the loan, the terms of repayment, and the rate at which the interest is in fact accruing.

9. Although the letters were supposedly mailed only to borrowers with an "A" credit rating, HMS knew that many of the consumers who may qualify for an option ARM loan should not be in the loan because it is a risky loan and it would not be in those consumers' best interests. HMS was aware that option ARM loan products were intended for investor borrowers who understood how the loan worked and were comfortable with the risk and able to make more than the minimum payment. However, HMS approved the marketing and selling of option ARM loans to a much broader population, including borrowers who might not have been able to make more than the minimum payment.

10. Because of the low introductory rates in its advertisement letters, HMS received numerous calls regarding the advertised loan products. The State alleges that even after receiving complaints from borrowers regarding the misleading way in which HMS was marketing option ARM loans, HMS continued to approve of sending out the advertisement letters. With the exception of lender documents, HMS never required written disclosures to the borrowers at the time of application that would explain material terms of the loan. Such information would have included the fully-indexed interest rate at which interest would accrue, the negative amortization life cap, and prepayment penalties associated with these loans.

11. When consumers would inquire about their interest rate, HMS brokers would again direct consumers to the low introductory payments. HMS passed any responsibility to the lenders who provided information on option ARM loans to borrowers, but only after HMS brokers had already sold the loan to the borrower, collected nonrefundable fees and dismissed any of the borrower's concerns about the loan. Many borrowers did not understand that the introductory rate was not their interest rate until they received their first payment notice from the lender.

12. The State contends that these advertising and sales practices violate the CCPA, including § 6-1-105(1), C.R.S. (2007) and § 38-40-105, C.R.S. (2007).

III. DEFINITIONS

13. "CHARM Booklet" means the Consumer Handbook on Adjustable-Rate Mortgages published by the Federal Reserve Board.

14. "Clear and Conspicuous" or "Clearly and Conspicuously" as used herein shall have the same meaning as these terms are used in the Federal Reserve Board's proposed revisions to the advertising standards found in Regulation Z (12 CFR § 226.24).

15. "Credit score" means a numerical value that ranks a borrower's credit risk based upon a statistical evaluation of the borrower's credit history as determined by the Fair Isaac Corporation.

16. "Loan to value ratio" means the relationship between the loan amount and the value of the property (the lower of the appraised value or sales price), expressed as a percentage of the property's value.

17. "Nontraditional Mortgage" means any residential mortgage loan product that allows the borrower to defer repayment of principal or interest. This includes all interest only

products, payment option ARMs and negative amortization mortgages, with the exception of reverse mortgages and home equity lines of credit, other than a simultaneous second-lien loan.

18. "Reference rate" means an interest rate benchmark upon which an adjustable rate mortgage is based, such as the U.S. Treasury Index or the London Interbank Offered Rate ("LIBOR").

IV. UNDERTAKINGS

19. Nguyen enters this Assurance as a full compromise and settlement of the State's allegations herein and the civil action filed against her. This Assurance shall not be considered an admission of violation for any purpose. Nguyen assures the State that she and any future loan officers she may employ, as well as any principals, officers, directors, agents, employees, representatives, successors, affiliates, subsidiaries, contractors, assigns and any person acting on her behalf shall comply with the CCPA as now constituted or as may hereafter be amended in conducting business in the state of Colorado.

A. Disclosures Provided to Borrowers Applying for Variable Rate or Non-Traditional Loan Products.

20. In discussing any loan product with a consumer, Nguyen shall not represent that the introductory rate is the applicable interest rate for longer than the introductory period. Nguyen shall affirmatively disclose the following:

a) The precise term of any introductory rate;

b) The interest rate the consumer will likely pay after the expiration of that interest rate;

c) The consumer's estimated monthly payment for each payment option upon the expiration of that introductory rate; and

d) The maximum monthly payment the consumer may have to pay under the loan.

Additionally, Nguyen shall not represent the introductory rate as the "interest rate" for purposes of the Good Faith Estimate.

21. Nguyen shall not provide any consumer with a TILA disclosure based solely on the introductory rate without simultaneously providing the consumer with a TILA disclosure based upon the composite of the rate in effect during the introductory period and the rate that is the basis of the loan for the remainder of the term. Copies of both TILA disclosures shall be part of the consumer's loan file.

22. Nguyen shall provide every borrower with whom an ARM loan product is discussed a copy of the ARM Illustration & Loan Comparison Worksheet, which is attached hereto as **Exhibit A.**

23. Nguyen shall provide every borrower with whom an interest-only or an option ARM loan product is discussed a copy of the Nontraditional ARM Illustration & Loan Comparison Worksheet, which is attached hereto as **Exhibit B**.

24. Nguyen must fill in all information accurately in the ARM and/or Nontraditional Mortgage Illustrations & Loan Comparison Worksheets.

25. The ARM or Nontraditional Mortgage Illustrations & Loan Comparison Worksheets must be provided to the borrower before the borrower's loan application is completed and submitted to any lender. A copy of the executed ARM or Nontraditional Mortgage Illustrations & Loan Comparison Worksheets shall be the borrower's to keep.

26. The borrower must keep the ARM and/or Nontraditional Mortgage Illustrations & Loan Comparison Worksheets for 24 hours before the borrower's loan application is filled out and submitted to any lender.

27. The completed and signed ARM and/or Nontraditional Mortgage Illustrations & Loan Comparison Worksheets must be part of the borrower's loan file maintained by Nguyen.

28. Nguyen shall give a copy of a current CHARM Booklet to every borrower to which Nguyen attempts to sell any ARM loan product. A current copy of the CHARM Booklet is attached hereto as **Exhibit C.** Nguyen shall go to www.FederalReserve.Gov to obtain the most current copy of the CHARM Booklet.

29. Nguyen shall provide the CHARM Booklet to the borrower before the borrower's loan application is filled out and submitted to any lender. The CHARM Booklet will be the borrower's to keep. The borrower must keep the CHARM Booklet for at least 24 hours before the borrower's loan application is filled out and submitted to any lender.

30. When the borrower has received the ARM Illustrations, Nontraditional Mortgage Illustrations, and the CHARM booklet and has kept them for at least 24 hours, the borrower and Nguyen shall sign and date a Confirmation of Receipt Form, attached hereto as **Exhibit D**.

31. Nguyen shall adhere to the duty of good faith and fair dealing found at § 12-61-904.5, CRS, follow the reasonable inquiry standards set forth at § 12-61-904.5(1)(b), CRS, the reasonable, tangible net benefit standards set forth at § 12-61-904.5(1)(a), CRS and any rules adopted by the Division of Real Estate pertaining to these standards.

B. Advertising of Mortgage Loan Products.

32. When creating any advertisement, marketing or promotional material for any mortgage loan products, Nguyen shall follow the advertising standards set forth in Regulation Z, 12 CFR § 226.24, including the revisions to this Regulation as proposed by the Federal Reserve Board and published in the Federal Register on January 9, 2008. 73 Fed. Reg. at 1722 -1724, attached hereto as **Exhibit E.**

33. Nguyen shall also follow the Official Staff Interpretations for the proposed revisions to Regulation Z's advertising standards (12 CFR § 226.24) found at 73 Fed. Reg. at 1729 – 1731.

34. In the event the Federal Reserve Board adopts provisions to Regulation Z's advertising standards that are different than those proposed, then Nguyen must follow the advertising standards as adopted.

35. Any advertisements Nguyen runs that include an interest rate, including an annual percentage rate shall, in addition to complying with the above requirements as well as TILA and the UCCC, include Clear and Conspicuous disclosures regarding any qualifications a borrower must have to obtain the advertised interest rate, including, but not limited to, credit score, minimum down payment, and loan-to-value ratio and the period during which the advertised interest rate will be in effect (i.e., if advertising an interest rate that is fixed for the first two years of the loan, the advertisement shall state this fact.)

36. Advertisements for loans featuring no closing costs, no payments for a set time period, no document loans or reduced documentation or that income need not be verified shall also contain Clear and Conspicuous disclosures that such features will cause the borrower to finance a greater amount or pay a higher interest rate.

37. Any advertisements that Nguyen runs which offer free or no appraisal fees must Clearly and Conspicuously state the conditions for receiving the free appraisal. For example, if the borrower must pay for the appraisal at the time of appraisal and the Nguyen reimburses or credits the appraisal fee to the borrower at a later time, and only if the loan closes, then the advertisement must state as such.

38. The advertising standards set forth in this subsection IV(B) shall apply to all advertisements, marketing or promotional materials issued by Nguyen, including but not limited to, newspaper and magazine advertisements, direct mail, flyers, brochures, emails, faxes, websites, telemarketing, billboards and banner or pop-up advertising that is disseminated electronically. In this regard proposed subparagraph 12 CFR § 226.24(f)(4) (excluding envelopes, banner advertising and pop-up advertising) shall not apply to exclude this form of advertising from the requirements found in this subsection IV(B).

V. ENFORCEMENT

39. Violation of any of the terms of this Assurance shall constitute a prima facie violation of the CCPA in accordance with § 6-1-110(2), C.R.S. (2007). Upon any violation of this Assurance by Nguyen, the Attorney General shall be entitled to file a civil action under the CCPA in any court of competent jurisdiction and to seek an injunction or other appropriate order from such court to enforce the provisions of this Assurance.

40. In addition to any remedies provided under the CCPA, the Attorney General will also be entitled to apply for and seek from a court of competent jurisdiction an order converting this Assurance into a permanent injunction against Nguyen as if the parties had fully litigated all issues contained herein, upon a showing by the Attorney General of a violation by Nguyen of this Assurance. In such event, Nguyen agrees to waive any and all

defenses and counterclaims she may have had to such an action, except as to claims or defenses related to the alleged violation of this Assurance or as to the need for injunctive relief.

41. This Assurance shall not be construed to affect the rights of any private party to pursue remedies pursuant to § 6-1-113, C.R.S. (2007), or under any other statutes through claims or actions in common law.

42. Nothing in this Assurance shall be construed to release claims held by any other government authority.

43. Pursuant to § 6-1-110(2), C.R.S. (2007), this Assurance shall be a matter of public record.

44. Nguyen acknowledges that she has had a full opportunity to review this Assurance and consult with legal counsel regarding same. Nguyen agrees and represents that she has read and understands this Assurance, that she accepts the legal consequences involved in signing it and that there are no other representations, agreements or understandings between Nguyen and the State that are not stated in writing herein.

45. Nguyen agrees to cooperate with all investigations and other proceedings that the State may bring to enforce the terms of this Assurance or to enforce the CCPA against any other entity. Included within this cooperation agreement is the obligation to:

a) Appear for hearings, deposition or provide testimony in any form (including affidavits). All such testimony shall be truthful;

b) Produce documents, records, electronic records or any other tangible things in response to a subpoena or other written request issued by the State; or

c) Accept a subpoena from the State without the need for service of process.

46. Any notices, complaints or other documents required by this Assurance (including any request or subpoena) shall be sent to the following individuals at the address or email set forth below:

To Defendant An Nguyen:

An T. Nguyen
9630 Sunset Hill Circle
Lone Tree, Colorado 80124
Email: annguyenhms@yahoo.com

To the State at:

Olivia C. DeBlasio
Assistant Attorney General
Consumer Protection Section
1525 Sherman Street
Denver, Colorado 80203
Email: libby.deblasio@state.co.us

Any Party may change the designated persons and address for delivery with respect to itself by giving notice to the other party as specified herein.

VI. MONETARY PROVISIONS

47. Nguyen agrees to pay to the State $35,000.00 in accordance with the payment schedule and subject to the conditions set forth below in order to cover the amount necessary, at the discretion of the Attorney General, to restore to any person any money that may have been acquired by the violations discussed herein and to the Attorney General, which shall be used first for the reimbursement of the State's actual costs and attorney fees and, second, to be held along with any interest thereon, in trust by the Attorney General for future consumer education, consumer fraud or antitrust enforcement efforts. § 6-1-110, C.R.S. (2007).

48. Nguyen shall make monthly payments of no less than $972.22 beginning May 1, 2010 and on the 1st business day of every month thereafter until the entire $35,000 amount is satisfied. In the event Nguyen can pay $30,000 to the State no later than May 1, 2012, she will have satisfied the entire monetary obligation to the State. In the event Nguyen can pay $25,000 to the State no later than May 1, 2011, she will have satisfied the entire monetary obligation to the State.

49. For each of the above payments, a check shall be made payable to the "Colorado Department of Law," reference "State v. Nguyen settlement," and be delivered to:

Olivia C. DeBlasio
Assistant Attorney General
Consumer Protection Section
1525 Sherman Street
Denver, Colorado 80203

50. Nguyen may increase the payment amounts at any time without penalty. If Nguyen fails to make a payment pursuant to this Assurance and fails to demonstrate to the State good cause for her inability to make the payment, the State may accelerate all payments due hereunder and collect the entire amount due. In such event, the State shall be entitled to recover its costs and attorney fees in collecting such amounts.

51. If Nguyen cannot make any scheduled payment required by this Assurance, she agrees to voluntarily provide to the State within 20 days any and all financial information and documents requested by the State, and allows the State to inspect her personal records and inspect the business records of any entity in which Nguyen is a member, shareholder, officer, partner, investor, or owner.

52. Any failure by Nguyen to provide the financial information and documents requested by the State or to allow the State to inspect her personal records and inspect the

business records of any entity in which Nguyen is a member, shareholder, officer, partner, investor, or owner pursuant to paragraph 51 herein shall constitute a material breach of this Assurance.

Dated: 3/3/10

DEFENDANT AN T. NGUYEN

By: ______________________
(Signature)

AN NGUYEN
(Please print name)

STATE OF COLORADO)
) ss.
CITY AND COUNTY OF DENVER)

SUBSCRIBED and sworn to before me this 3rd day of March, 2010 by An T. Nguyen. Witness my hand and official seal.

My commission expires: 05/05/2011

Robin Mason
Notary Public

ROBIN MASON
Notary Public
State of Colorado

Dated: 3/3/10

JOHN W. SUTHERS
Attorney General

____
OLIVIA C. DEBLASIO
Assistant Attorney General
Consumer Protection Section

EXHIBIT A

ARM ILLUSTRATION & LOAN COMPARISON WORKSHEET

Important Facts About Your Adjustable Rate Mortgage

Whether you are buying a house or refinancing your mortgage, this information can help you decide if an adjustable rate mortgage (ARM) is right for you. ARMs can be complicated. If you do not understand how they work, you should not sign any loan contracts, and you might want to consider other loans.

With an ARM, the interest rate on your loan is not fixed. Instead, it changes over time according to a formula, typically a base interest rate (index) plus a certain percent (margin) (for example, the Prime Rate plus 3 percent). So, if the base interest rate increases, your interest rate and monthly payment will also increase.

Important Information:

- **Your broker must check each term that applies to the loan you are considering**
- **After reading each term, please initial the box next to the term**
- **You must have this ARM Illustration and Loan Comparison Worksheet for at least 24 hours before applying for a loan**
- **After you have read and completed both pages, please sign and date it on the last page and return it to your mortgage broker**

Check if this term applies	Your Initials	
☐	_____	**Your loan will have a reduced initial interest rate.** Some ARMs have a reduced interest rate (start rate) for a short period of time, for example, the first two years of the loan. The reduced interest rate is less than the index plus margin rate. This means that your interest rate and monthly payments will be lower than normal for the first two years. However, your interest rate and monthly payment may increase significantly when that period is over – even if market rates stay the same. And your interest rate and monthly payment will increase even more if market rates rise.
Check if this term applies ☐	Your Initials _____	**Your monthly payment will not include an amount to cover taxes and insurance.** In some mortgages, your monthly payment includes both principal and interest and an amount to cover real estate taxes and home insurance and your lender pays your taxes and insurance out of these funds. In other mortgages, your monthly payment covers only principal and interest and you are responsible for paying real estate taxes and insurance premiums when the bills arise. When you are comparing mortgages, or deciding whether you can afford a mortgage, you need to consider whether the monthly payment includes an amount to cover estimated taxes and insurance.
Check if this term applies ☐	Your Initials _____	**You will be required to pay a prepayment penalty if you pay off your loan within _____ months. [Insert term of prepayment period.] The amount of the penalty will be _______________ [Insert amount or formula for calculating prepayment penalty.]** Some ARMs require you to pay a large prepayment penalty if you sell your home or refinance during the first few years of the loan. A prepayment penalty can make it difficult, or very expensive, to sell your home or refinance, which you may need to do if your interest rate, and therefore your payment, is about to increase significantly. Under Colorado law, a mortgage broker cannot recommend or induce a borrower to enter into a mortgage that contains a prepayment penalty that extends past the adjustment date for any type of ARM.
Check if this term applies ☐	Your Initials _____	**Your loan will have a balloon payment.** Most mortgages are set up so that you pay off the loan gradually by the monthly payments that you make over the loan term (for example, 30 years). Some ARMs, however, are set up with "balloon payments" where you make the same monthly payments that you would for a 30-year loan, but after a shorter period of time (for example, 10 years) the entire remaining balance of the loan is due. When the balloon payment is due you will usually need to refinance your loan to pay it, or sell your home if you cannot refinance the loan.
Check if this term applies ☐	Your Initials _____	**Your loan will have a higher price because of reduced documentation.** "Reduced documentation" or "stated income" loans usually have higher interest rates or other costs compared to "full documentation" loans where you document your income, assets, and liabilities. These higher costs can be substantial.

LOAN COMPARISON WORKSHEET
READ CAREFULLY

How to compare loan terms: The Loan Amount, Loan Type, Rate, and Note Payment should be compared to the Note you sign at closing. You should scrutinize the costs on the Good Faith Estimate in light of this disclosure, or a revised version of this disclosure, and compare with the HUD Settlement Statement at closing. **You are not obligated to take this loan. Consider your options carefully.**

Comparing Monthly Payments for Refinances: If you are refinancing your existing loan your monthly payments will change as follows by taking out a Loan Amount of $________: [Circle or Insert term of ARM]:

1
3

Current Loan Type: ☐ Fixed ☐ ARM | Proposed Loan Type: ☐ Fixed ☐ 5 yr ARM
Current principal and interest: $ ______________ | Proposed principal and interest: $ ______________
Current monthly reserves: ______________ | Proposed monthly reserves: ______________
Current total: $ ______________ | Proposed total: $ ______________

Qualifying Monthly Income: The loan being offered to you is based on your gross monthly income of $ ________. The starting payment on this loan, including taxes, insurance and other items will be ____% of your gross monthly income.

Monthly Payments and Amortization (loan balance reduction): Your loan does ☐ does not ☐ contain payment features or options that may result in no reduction in your principal balance owed over time or possibly an increase in the amount you must repay over time. In certain cases the payment choice you make early in the life of the loan may result in an effect known as "payment shock." Payment shock results when you choose to make a payment that is insufficient to retire or "amortize" the loan balance over the life of the loan. In such situations, the loan will "reprice" or "recast" to a new payment amount, which may be substantially higher than you are accustomed to paying. This effect is also referred to as "negative amortization" or "deferred interest". Your loan representative should explain these features to you, including realistic examples of how the choices you make can affect the amount of money you owe.

Prepayment Penalty: Applicable to your loan ☐ Not applicable to your loan ☐
A prepayment penalty means that if you attempt to pay off or refinance the loan early, you will pay a penalty in **ADDITION** to the interest and principal due under the loan.

If you refinance or sell your house prior to ____________ you will pay a prepayment penalty of $____________, or _______% of the principal loan balance.

The adjustment date for your ARM is ______________________, 20____.
The prepayment penalty does ☐ does not ☐ extend past the adjustment date for your ARM.

Balloon Payment: Applicable to your loan ☐ Not applicable to your loan ☐
A balloon payment is a final lump sum payment due at the end of your loan. If you do not have the funds to pay off the balloon payment when due, you may have to obtain a new loan to make the balloon payment. If you do not have the money to make the balloon payment, you may lose your property and all of your equity in your home through foreclosure. Before deciding to take this loan, consider your ability to pay the balloon payment. The balloon payment on this loan is due______years from the date your loan begins. The final balloon payment due is $______.

Demand Payment: Applicable to your loan ☐ Not applicable to your loan ☐
A demand payment provision means that the holder of your loan can demand payment in full if certain conditions are met. Before deciding on this loan, ask your broker or lender what circumstances allow the holder of the loan to demand payment in full.

Reduced Documentation: Applicable to your loan ☐ Not applicable to your loan ☐
Your loan is being underwritten and approved without full documentation of your employment, income, or financial situation. Regardless, all statements made by you or your loan representative must be accurate and true. Inaccurate or untruthful statements are a serious violation of law and may result in criminal penalties. Your loan representative should explain to you any additional cost associated with a reduced documentation loan.

To be completed by Borrower:

I have received the foregoing ARM Illustration and Loan Comparison Worksheet and have had it for at least 24 hours before applying for an ARM. I have read the ARM Illustration and have completed the Loan Comparison Worksheet and understand them. I have received a filled out copy of this Illustration and Loan Comparison Worksheet to keep.

Dated: ________________

______________________________ ______________________________

Borrower's signature Borrower name (please print)

To be completed by Toan ("James") Le

I hereby certify that I provided the above ARM Illustration and Loan Comparison Worksheet, filled them out as accurately as possible, and provided them to the borrower at the time and date indicated below:

Delivered to borrower on:

________________________ (date)

at ________________________ (time)

and, Borrower returned a signed copy of the same to me at least 24 hours after having had them and the CHARM Booklet on the following date and at the following time:

Received from borrower:

________________________ (date)

at ________________________ (time)

Signed on behalf of Toan ("James") Le

______________________________ Date: ______________________

Representative of Toan ("James") Le

____

Title

EXHIBIT B

NONTRADITIONAL ARM ILLUSTRATION & LOAN COMPARISON WORKSHEET

Important Facts About Interest Only and Payment Option ARM Mortgages

Whether you are buying a house or refinancing your mortgage, this information can help you decide if an interest-only mortgage or a payment option mortgage is right for you. These mortgages can be complicated. If you do not understand how they work, you should not sign any loan contracts, and you might want to consider other types of loans.

Important Information:

- Your broker must check each term that applies to the loan you are considering
- After reading each term, please initial the box next to the term
- You must have this ARM Illustration and Loan Comparison Worksheet for at least 24 hours before applying for a loan
- After you have read and completed all pages, please sign and date it on the last page and return it to your mortgage broker

Check if this term applies	Your Initials	
☐	______	**Interest-Only Mortgages** allow you to pay only the interest on the money you borrowed for the first few years of the mortgage (the "interest-only period"). **If you pay only the amount due, then at the end of the interest-only period:** • You will still owe the original amount you borrowed. • Your monthly payment will increase because you must pay back the principal as well as interest. Your payment could increase even more if you have an adjustable rate mortgage ("ARM") and interest rates increase.
☐	______	**Payment Option Mortgages** allow you to choose among several payment options each month during the first few years of the loan (the "option period"). The option period will end earlier than scheduled if the amount you owe grows beyond a set limit—for example, 110% or 125% of your original mortgage amount. **During the option period, the payment options usually include:** • A payment of principal and interest, which reduces the amount you owe over time. • An interest-only payment, which does not reduce the amount you owe. • A minimum payment, which may be less than the interest due that month. *If you choose this option, any unpaid interest will increase the amount you owe.* **At the end of the option period, depending on what payment options you chose:** • You could owe substantially more than the original amount you borrowed. • Your monthly payment could increase significantly because: ➢ You may have to start paying back principal, as well as interest. ➢ Unpaid interest may have increased the amount you owe. ➢ Interest rates may have increased (if you have an ARM).
☐	______	**You will be required to pay a prepayment penalty if you pay off your loan within _____ months. [Insert term of prepayment period.] The amount of the penalty will be _________________ [Insert amount or formula for calculating prepayment penalty.]** Some ARMs require you to pay a large prepayment penalty if you sell your home or refinance during the first few years of the loan. A prepayment penalty can make it difficult, or very expensive, to sell your home or refinance, which you may need to do if your interest rate, and therefore your payment, is about to increase significantly. Under Colorado law, a mortgage broker cannot recommend or induce a borrower to enter into a mortgage that contains a prepayment penalty that extends past the adjustment date for any type of ARM.
☐	______	**Your loan will have a higher price because of reduced documentation.** "Reduced documentation" or "stated income" loans usually have higher interest rates or other costs compared to "full documentation" loans where you document your income, assets, and liabilities. These higher costs can be substantial.

Additional Information

- **Home Equity** – If you make interest-only payments, your payments are not building home equity. And if you make only the minimum payment on an Option ARM mortgage, you may be losing home equity. This may make it harder to refinance your mortgage or to obtain funds from selling or refinancing your home.
- **Yield Spread Premium** – Yield Spread Premium ("YSP") refers to a fee paid by the lender to your broker because the loan carries a higher interest rate. In some cases, the YSP may offset other costs. You should inquire about this offset.

LOAN COMPARISON WORKSHEET
READ CAREFULLY

How to compare loan terms: The Loan Amount, Loan Type, Rate, and Note Payment should be compared to the Note you sign at closing. You should scrutinize the costs on the Good Faith Estimate in light of this disclosure, or a revised version of this disclosure, and compare with the HUD Settlement Statement at closing. **You are not obligated to take this loan. Consider your options carefully.**

Comparing Monthly Payments for Refinances: If you are refinancing your existing loan your monthly payments will change as follows by taking out a Loan Amount of $________: [Circle or Insert term of ARM]: 1 3

Current Loan Type: ☐ Fixed ☐ ARM		Proposed Loan Type: ☐ Fixed ☐ 5 yr ARM	
Current principal and interest:	$ ________	Proposed principal and interest:	$________
Current monthly reserves:	________	Proposed monthly reserves:	________
Current total:	$ ________	Proposed total:	$ ________

BELOW ARE 5 THINGS YOU SHOULD KNOW ABOUT AN OPTION ARM LOAN. PLEASE REVIEW AND INITIAL THESE POINTS BEFORE APPLYING FOR THIS TYPE OF LOAN:

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1. THERE ARE TWO RATES ASSOCIATED WITH AN OPTION ARM LOAN: A PAYMENT RATE AND A FULLY-INDEXED INTEREST RATE There are two rates that apply to an Option ARM loan. The first rate is the initial low "payment" rate, and the second is the fully-indexed rate. The initial low rate of an Option ARM loan is the interest rate for **only the first month of your loan**, and then it becomes the payment rate. The fully-indexed rate is calculated using a reference rate that can change monthly or annually, such as the London Interbank Offered Rate, or "LIBOR", plus a margin, which is a fixed number of percentage points, usually 2% or more. Be sure to ask your broker about which reference rate your option ARM will use, when that rate changes (monthly or annually), and how it has performed in the past (i.e., what it has been over the course of the last ten years, and whether it has increased or decreased over time). _____ Borrower's Initials	**(This column to be filled in with information about the specific Option ARM loan discussed)** Payment rate (interest rate for ________ month(s)):__________ Fully-indexed rate (interest rate for remainder of the loan): Margin________ + Index_________* = __________ *Changes _________ [Insert time period when index changes]
2. AN OPTION ARM GIVES YOU SEVERAL PAYMENT OPTIONS. An Option ARM allows you to make a monthly "minimum payment," an interest only payment, or a payment of principal and interest that results in paying off your loan. Borrower's Initials	Loan amount: ____________________ Minimum monthly payment: ______________ Monthly interest-only payment (assumes current fully-indexed rate): ______________ Monthly principal and interest payment (assumes current fully-indexed rate and pay-off in __ years):

3. **BECAUSE YOUR INTEREST RATE BECOMES ADJUSTABLE AFTER ____ [Insert time period] AND WILL BE HIGHER THAN YOUR PAYMENT RATE, MAKING THE MINIMUM PAYMENT WILL RESULT IN YOU OWING MORE MONEY.** If you continue to make a minimum payment after the first month of your Option ARM loan, you will not be paying all the monthly interest that you owe, and the unpaid interest will be added to your owed principal. This is called "negative amortization" or "deferred interest" and will result in you owing more money than you originally borrowed. In addition to adding unpaid interest to your principal, your monthly interest will be calculated based upon the higher principal amount, causing you to owe more in interest each month. _____ Borrower's Initials	Loan amount:________________ Interest-only payment (assumes current fully-indexed rate):______________________ Minimum payment:__________________ Monthly deferred interest (if only monthly payment minimum payment is made, calcualated at the current fully indexed rate): ____________________ New total amount owed:_____________________________ New interest-only payment (assumes current fully-indexed rate): _____________________________
4. **EVEN THOUGH THE OPTION ARM ALLOWS YOU TO MAKE THE MINIMUM PAYMENT FOR A SET PERIOD OF TIME, YOUR LOAN MAY "RECAST' BEFORE THEN AND REQUIRE YOU TO START MAKING MUCH HIGHER FULLY-AMORTIZED PAYMENTS.** Most Option ARM loans have a period of one to five years during which you may make the minimum payment. However, these loans usually have provisions that require the loan to "recast" when your owed principal reaches 110%-125% of your original principal, which can happen quickly with negative amortization or deferred interest. When a loan recasts, your option to make the minimum monthly payment is eliminated, and you are required to make a fully-amortized principal and interest payment each month based upon the fully-indexed rate, which adjusts monthly or annually. _____ Borrower's Initials	Loan amount:________________________ Loan recasts at _____% of loan amount, or _______________ Monthly deferred interest if making minimum payment (assumes current fully-indexed rate): _____________________ Months it will take for loan to recast:______* Required monthly payment after recasting (assumes current fully-indexed rate):________________ *This calculation does not take into account the fact that deferred interest will increase monthly because the principal will increase monthly, so time to recasting likely will be even less than this number.

5. OPTION ARM LOANS TYPICALLY INCLUDE A PRE-PAYMENT PENALTY. Most Option ARM loans include a pre-payment penalty that penalizes you for re-financing your loan and/or selling your house within the first three years. The pre-payment penalty is included as an addendum to your adjustable rate note. Typically the pre-payment penalty states that if you pay off more than 20% of your original principal in the first three years, you must pay a pre-payment penalty amounting to six months interest on the remaining principal. Therefore, if you decide that you do not want to be in your Option ARM loan in the first three years, you must pay a significant amount of money to be re-financed into a different loan. Under Colorado law, a mortgage broker cannot recommend or induce a borrower to enter into a mortgage that contains a prepayment penalty that extends past the adjustment date for any type of ARM. _____ Borrower's Initials	If you refinance or sell your house prior to ________________ you will pay a prepayment penalty of $_____________, or ________% of the principal loan balance. The adjustment date for your ARM is ________________________, 20____. The prepayment penalty does ☐ does not ☐ extend past the adjustment date for your ARM.

To be completed by Borrower:

I have received the foregoing Nontraditional ARM Illustration and Loan Comparison Worksheet and have had it for at least 24 hours before applying for an ARM. I have read the Nontraditional ARM Illustration and have completed the Loan Comparison Worksheet and understand them. I have received a filled out copy of this Illustration and Loan Comparison Worksheet to keep.

Dated: ________________

______________________________ ______________________________

Borrower's signature Borrower name (please print)

To be completed by Toan ("James") Le

I hereby certify that I provided the above Nontraditional ARM Illustration and Loan Comparison Worksheet, filled them out as accurately as possible, and provided them to the borrower at the time and date indicated below:

Delivered to borrower on:

______________________ (date)

at ______________________ (time)

and, Borrower returned a signed copy of the same to me at least 24 hours after having had them and the CHARM Booklet on the following date and at the following time:

Received from borrower:

______________________ (date)

at ______________________ (time)

Signed on behalf of Toan ("James") Le

______________________________ Date: ______________________________

Representative of Toan ("James") Le

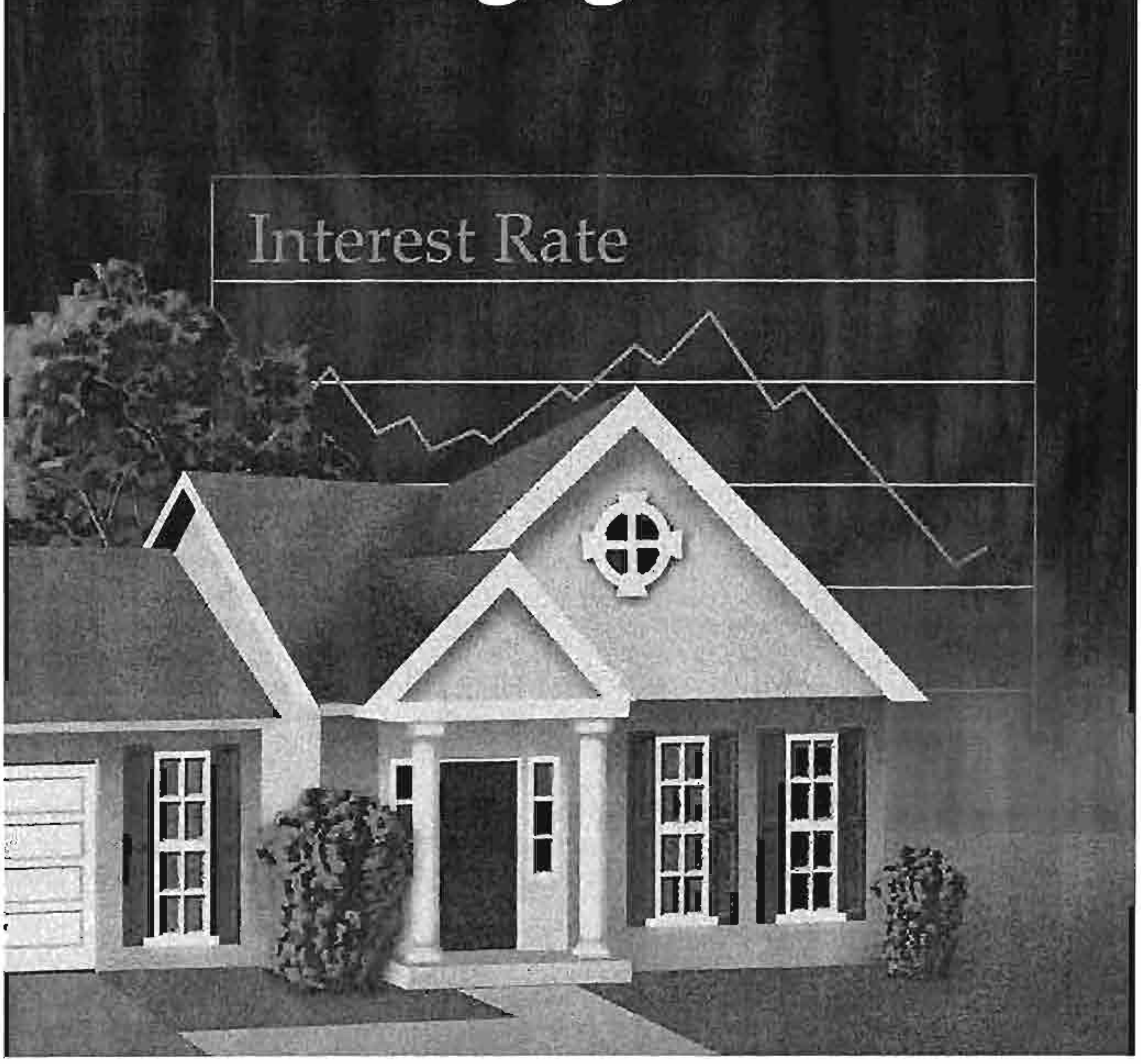
____

Title

EXHIBIT C

The Federal Reserve Board

Consumer Handbook on Adjustable-Rate Mortgages



Adjustable-rate mortgages (ARMs) are loans with interest rates that change. ARMs may start with lower monthly payments than fixed-rate mortgages, but keep the following in mind:

- Your monthly payments could change. They could go up—sometimes by a lot—even if interest rates don't go up. See page 20.
- Your payments may not go down much, or at all—even if interest rates go down. See page 11.
- You could end up owing more money than you borrowed—even if you make all your payments on time. See page 22.
- If you want to pay off your ARM early to avoid higher payments, you might have to pay a penalty. See page 24.

You need to compare features of ARMs to find the one that best fits your needs. See the Mortgage Shopping Worksheet on page 2.

This handbook explains how ARMs work and discusses some of the issues that borrowers may face. It includes ways to reduce the risks and gives some pointers about advertising and other ways you can get information from lenders and other trusted advisers. Important ARM terms are defined in a glossary. And the Mortgage Shopping Worksheet can help you ask the right questions and figure out whether an ARM is right for you. Ask lenders to help you fill out the worksheet so you can get the information you need to compare mortgages.

Mortgage Shopping Worksheet

Ask your lender or broker to help you fill out this worksheet.

Name of lender or broker and contact information	
Mortgage amount	
Loan term (e.g., 15 years, 30 years)	
Loan description (e.g., fixed rate, 3/1 ARM, payment-option ARM, interest-only ARM)	
Basic Features for Comparison	
Fixed-rate mortgage interest rate and annual percentage rate (APR) (For graduated-payment or stepped-rate mortgages, use the ARM columns.)	
ARM initial interest rate and APR How long does the initial rate apply?	
What will the interest rate be after the initial period?	
ARM features How often can the interest rate adjust?	
What is the index and what is the current rate? (See chart on page 8.)	
What is the margin for this loan?	
Interest-rate caps What is the periodic interest-rate cap?	
What is the lifetime interest-rate cap? How high could the rate go?	
How low could the interest rate go on this loan?	
What is the payment cap?	
Can this loan have negative amortization (that is, increase in size)?	
What is the limit to how much the balance can grow before the loan will be recalculated?	
Is there a prepayment penalty if I pay off this mortgage early?	
How long does that penalty last? How much is it?	
Is there a balloon payment on this mortgage? If so, what is the estimated amount and when would it be due?	
What are the estimated origination fees and charges for this loan?	
Monthly Payment Amounts	
What will the monthly payments be for the first year of the loan?	
Does this include taxes and insurance? Condo or homeowner's association fees? If not, what are the estimates for these amounts?	
What will my monthly payment be after 12 months if the index rate… …stays the same?	
…goes up 2%?	
…goes down 2%?	
What is the most my minimum monthly payment could be after 1 year?	
What is the most my minimum monthly payment could be after 3 years?	
What is the most my minimum monthly payment could be after 5 years?	

	Fixed-Rate Mortgage	ARM 1	ARM 2	ARM 3

What Is an ARM?

An adjustable-rate mortgage differs from a fixed-rate mortgage in many ways. With a fixed-rate mortgage, the interest rate stays the same during the life of the loan. With an ARM, the interest rate changes periodically, usually in relation to an index, and payments may go up or down accordingly.

Shopping for a mortgage is not as simple as it used to be. To compare two ARMs with each other or to compare an ARM with a fixed-rate mortgage, you need to know about indexes, margins, discounts, caps on rates and payments, negative amortization, payment options, and recasting (recalculating) your loan. You need to consider the maximum amount your monthly payment could increase. Most important, you need to know what might happen to your monthly mortgage payment in relation to your future ability to afford higher payments.

Lenders generally charge lower initial interest rates for ARMs than for fixed-rate mortgages. At first, this makes the ARM easier on your pocketbook than a fixed-rate mortgage for the same loan amount. Moreover, your ARM could be less expensive over a long period than a fixed-rate mortgage—for example, if interest rates remain steady or move lower.

Against these advantages, you have to weigh the risk that an increase in interest rates would lead to higher monthly payments in the future. It's a trade-off—you get a lower initial rate with an ARM in exchange for assuming more risk over the long run. Here are some questions you need to consider:

- Is my income enough—or likely to rise enough—to cover higher mortgage payments if interest rates go up?
- Will I be taking on other sizable debts, such as a loan for a car or school tuition, in the near future?
- How long do I plan to own this home? (If you plan to sell soon, rising interest rates may not pose the problem they do if you plan to own the house for a long time.)
- Do I plan to make any additional payments or pay the loan off early?

Lenders and Brokers

Mortgage loans are offered by many kinds of lenders—such as banks, mortgage companies, and credit unions. You can also get a loan through a mortgage broker. Brokers "arrange" loans; in other words, they find a lender for you. Brokers generally take your application and contact several lenders, but keep in mind that brokers are not required to find the best deal for you unless they have contracted with you to act as your agent.

How ARMs Work: The Basic Features

Initial rate and payment

The initial rate and payment amount on an ARM will remain in effect for a limited period of time—ranging from just 1 month to 5 years or more. For some ARMs, the initial rate and payment can vary greatly from the rates and payments later in the loan term. Even if interest rates are stable, your rates and payments could change a lot. If lenders or brokers quote the initial rate and payment on a loan, ask them for the annual percentage rate (APR). If the APR is significantly higher than the initial rate, then it is likely that your rate and payments will be a lot higher when the loan adjusts, even if general interest rates remain the same.

The adjustment period

With most ARMs, the interest rate and monthly payment change every month, quarter, year, 3 years, or 5 years. The period between rate changes is called the *adjustment period*. For example, a loan with an adjustment period of 1 year is called a 1-year ARM, and the interest rate and payment can change once every year; a loan with a 3-year adjustment period is called a 3-year ARM.

Loan Descriptions

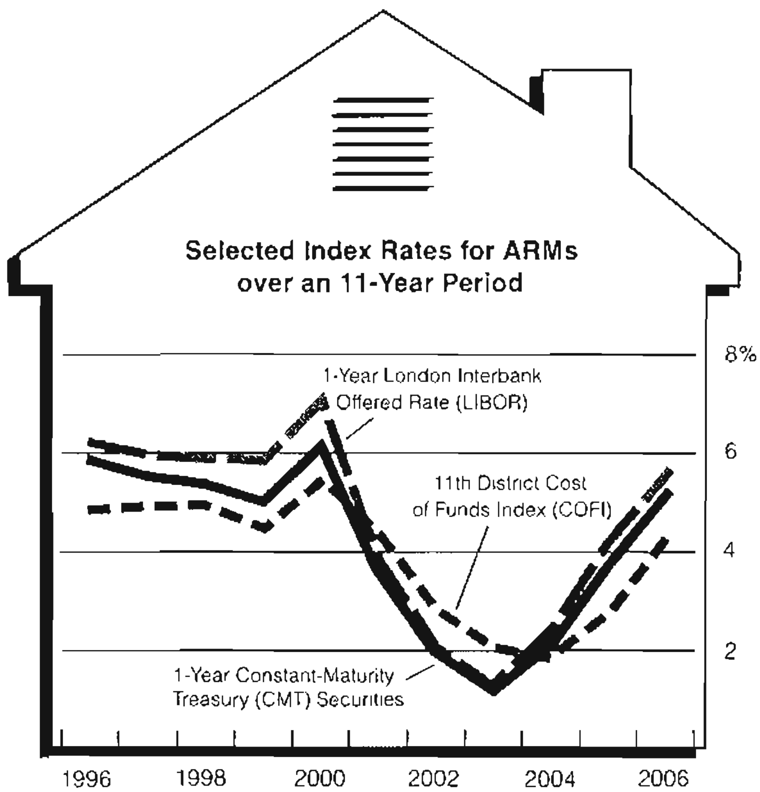
Lenders must give you written information on each type of ARM loan you are interested in. The information must include the terms and conditions for each loan, including information about the index and margin, how your rate will be calculated, how often your rate can change, limits on changes (or *caps*), an example of how high your monthly payment might go, and other ARM features such as negative amortization.

The index

The interest rate on an ARM is made up of two parts: the index and the margin. The index is a measure of interest rates generally, and the margin is an extra amount that the lender adds. Your payments will be affected by any caps, or limits, on how high or low your rate can go. If the index rate moves up, so does your interest rate in most circumstances, and you will probably have to make higher monthly payments. On the other hand, if the index rate goes down, your monthly payment could go down. Not all ARMs adjust downward, however—be sure to read the information for the loan you are considering.

Lenders base ARM rates on a variety of indexes. Among the most common indexes are the rates on 1-year constant-maturity Treasury (CMT) securities, the Cost of Funds Index (COFI), and the London Interbank Offered Rate (LIBOR). A few lenders use their own cost of funds as an index, rather than using other indexes. You should ask what index will be used, how it has fluctuated in the past, and where it is published—you can find a lot of this information in major newspapers and on the Internet.

To help you get an idea of how to compare different indexes, the following chart shows a few common indexes over an 11-year period (1996–2006). As you can see, some index rates tend to be higher than others, and some change more often. But if a lender bases interest-rate adjustments on the average value of an index over time, your interest rate would not change as dramatically.



The margin

To determine the interest rate on an ARM, lenders add a few percentage points to the index rate, called the *margin*. The amount of the margin may differ from one lender to another, but it is usually constant over the life of the loan. The *fully indexed rate* is equal to the margin plus the index. If the initial rate on the loan is less than the fully indexed rate, it is called a *discounted index rate*. For example, if the lender uses an index that currently is 4% and adds a 3% margin, the fully indexed rate would be

Index	4%
+ Margin	3%
Fully indexed rate	7%

If the index on this loan rose to 5%, the fully indexed rate would be 8% (5% + 3%). If the index fell to 2%, the fully indexed rate would be 5% (2% + 3%).

Some lenders base the amount of the margin on your credit record—the better your credit, the lower the margin they add—and the lower the interest you will have to pay on your mortgage. In comparing ARMs, look at both the index and margin for each program.

No-Doc/Low-Doc Loans

When you apply for a loan, lenders usually require documents to prove that your income is high enough to repay the loan. For example, a lender might ask to see copies of your most recent pay stubs, income tax filings, and bank account statements. In a no-doc or low-doc loan, the lender doesn't require you to bring proof of your income, but you will usually have to pay a higher interest rate or extra fees to get the loan. Lenders generally charge more for no-doc/low-doc loans.

Interest-rate caps

An interest-rate cap places a limit on the amount your interest rate can increase. Interest caps come in two versions:

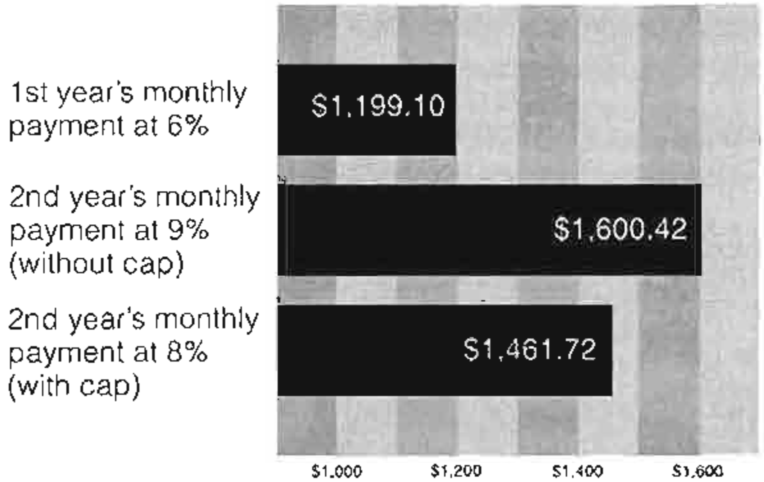
- *periodic adjustment caps*, which limit the amount the interest rate can adjust up or down from one adjustment period to the next after the first adjustment, and
- *lifetime caps*, which limit the interest-rate increase over the life of the loan. By law, virtually all ARMs must have a lifetime cap.

Periodic adjustment caps

Let's suppose you have an ARM with a periodic adjustment interest-rate cap of 2%. However, at the first adjustment, the index rate has risen 3%. The following example shows what happens.

Examples in This Handbook

All examples in this handbook are based on a $200,000 loan amount and a 30-year term. Payment amounts in the examples do not include taxes, insurance, condominium or home-owner association fees, or similar items. These amounts can be a significant part of your monthly payment.



Difference in 2nd year between payment with cap and payment without = $138.70 per month

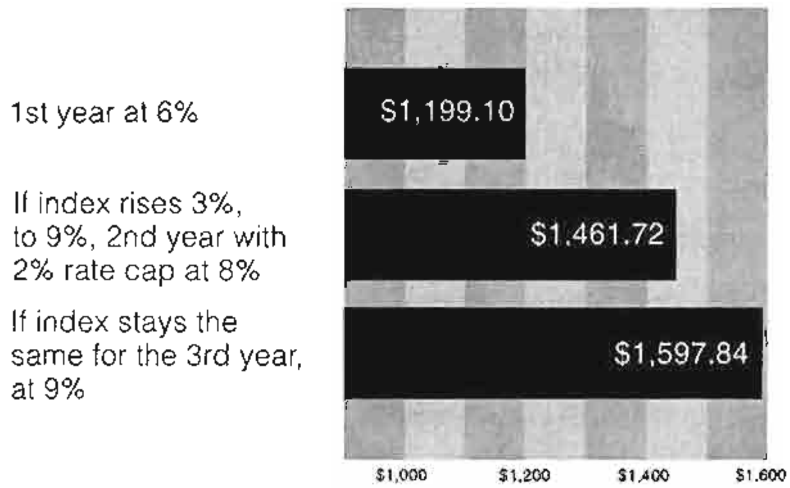
In this example, because of the cap on your loan, your monthly payment in year 2 is $138.70 per month lower than it would be without the cap, saving you $1,664.40 over the year.

Some ARMs allow a larger rate change at the first adjustment and then apply a periodic adjustment cap to all future adjustments.

A drop in interest rates does not always lead to a drop in your monthly payments. With some ARMs that have interest-rate caps, the cap may hold your rate and payment below what it would have been if the change in the index rate had been fully applied. The increase in the interest that was not imposed because of the rate cap might carry over to future rate adjustments. This is called *carryover*. So at the next adjustment date, your payment might increase even though the index rate has stayed the same or declined.

The following example shows how carryovers work. Suppose the index on your ARM increased 3% during the first year.

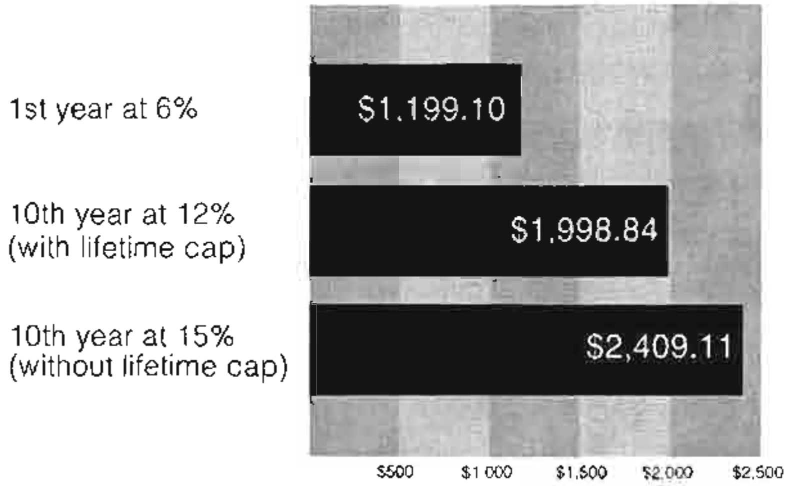
Because this ARM limits rate increases to 2% at any one time, the rate is adjusted by only 2%, to 8% for the second year. However, the remaining 1% increase in the index carries over to the next time the lender can adjust rates. So when the lender adjusts the interest rate for the third year, the rate increases by 1%, to 9%, even if there is no change in the index during the second year.



In general, the rate on your loan can go up at any scheduled adjustment date when the lender's standard ARM rate (the index plus the margin) is higher than the rate you are paying before that adjustment.

Lifetime caps

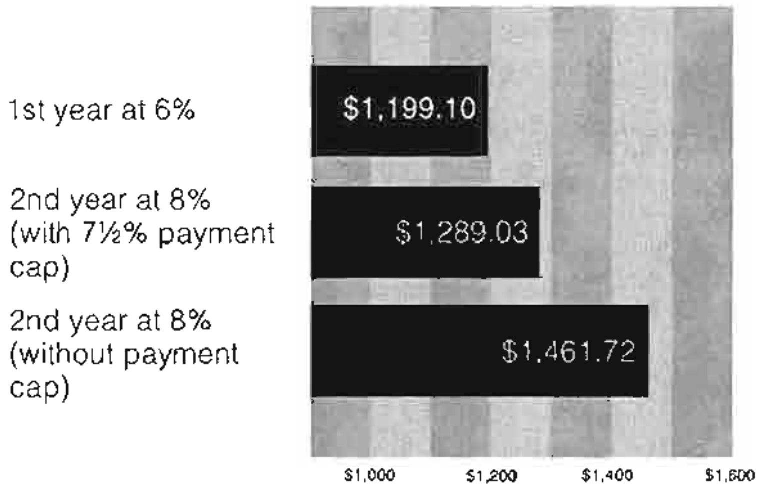
The next example shows how a lifetime rate cap would affect your loan. Let's say that your ARM starts out with a 6% rate and the loan has a 6% lifetime cap—that is, the rate can never exceed 12%. Suppose the index rate increases 1% in each of the next 9 years. With a 6% overall cap, your payment would never exceed $1,998.84—compared with the $2,409.11 that it would have reached in the tenth year without a cap.



Payment caps

In addition to interest-rate caps, many ARMs—including payment-option ARMs—limit, or cap, the amount your monthly payment may increase at the time of each adjustment. For example, if your loan has a payment cap of 7½%, your monthly payment won't increase more than 7½% over your previous payment, even if interest rates rise more. For example, if your monthly payment in year 1 of your mortgage was $1,000, it could only go up to $1,075 in year 2 (7½% of $1,000 is an additional $75). Any interest you don't pay because of the payment cap will be added to the balance of your loan. A payment cap can limit the increase to your monthly payments but also can add to the amount you owe on the loan. (This is called *negative amortization*, a term that is explained on page 22.)

Let's assume that your rate changes in the first year by 2 percentage points but your payments can increase no more than 7½% in any one year. The following graph shows what your monthly payments would look like.



Difference in monthly payment = $172.69

While your monthly payment will be only $1,289.03 for the second year, the difference of $172.69 each month will be added to the balance of your loan and will lead to negative amortization.

Some ARMs with payment caps do not have periodic interest-rate caps. In addition, as explained below, most payment-option ARMs have a built-in recalculation period, usually every 5 years. At that point, your payment will be recalculated (lenders use the term *recast*) based on the remaining term of the loan. If you have a 30-year loan and you are at the end of year 5, your payment will be recalculated for the remaining 25 years. The payment cap does not apply to this adjustment. If your loan balance has increased, or if interest rates have risen faster than your payments, your payments could go up a lot.

Types of ARMs

Hybrid ARMs

Hybrid ARMs often are advertised as 3/1 or 5/1 ARMs—you might also see ads for 7/1 or 10/1 ARMs. These loans are a mix—or a hybrid—of a fixed-rate period and an adjustable-rate period. The interest rate is fixed for the first few years of these loans—for example, for 5 years in a 5/1 ARM. After that, the rate may adjust annually (the 1 in the 5/1 example), until the loan is paid off. In the case of 3/1 or 5/1 ARMs

- the first number tells you how long the fixed interest-rate period will be and
- the second number tells you how often the rate will adjust after the initial period.

You may also see ads for 2/28 or 3/27 ARMs—the first number tells you how long the fixed interest-rate period will be, and the second number tells you the number of years the rates on the loan will be adjustable. Some 2/28 and 3/27 mortgages adjust every 6 months, not annually.

Interest-only ARMs

An interest-only (I-O) ARM payment plan allows you to pay only the interest for a specified number of years, typically between 3 and 10 years. This allows you to have smaller monthly payments for a period of time. After that, your monthly payment will increase—even if interest rates stay the same—because you must start paying back the principal as well as the interest each month. For some I-O loans, the interest rate adjusts during the I-O period as well.

For example, if you take out a 30-year mortgage loan with a 5-year I-O payment period, you can pay only interest for 5 years and then you must pay both the principal and interest over the next 25 years. Because you begin to pay back the principal, your payments increase after year 5, even if the rate stays the same. Keep in mind that the longer the I-O period, the higher your monthly payments will be after the I-O period ends.

Payment-option ARMs

A payment-option ARM is an adjustable-rate mortgage that allows you to choose among several payment options each month. The options typically include the following:

- *a traditional payment of principal and interest*, which reduces the amount you owe on your mortgage. These payments are based on a set loan term, such as a 15-, 30-, or 40-year payment schedule.

- *an interest-only payment*, which pays the interest but does not reduce the amount you owe on your mortgage as you make your payments.
- *a minimum (or limited) payment* that may be less than the amount of interest due that month and may not reduce the amount you owe on your mortgage. If you choose this option, the amount of any interest you do not pay will be added to the principal of the loan, **increasing the amount you owe and your future monthly payments**, and increasing the amount of interest you will pay over the life of the loan. In addition, if you pay only the minimum payment in the last few years of the loan, you may owe a larger payment at the end of the loan term, called a *balloon payment*.

The interest rate on a payment-option ARM is typically very low for the first few months (for example, 2% for the first 1 to 3 months). After that, the interest rate usually rises to a rate closer to that of other mortgage loans. Your payments during the first year are based on the initial low rate, meaning that if you only make the minimum payment each month, it will not reduce the amount you owe and it may not cover the interest due. The unpaid interest is added to the amount you owe on the mortgage, and your loan balance increases. This is called *negative amortization*. This means that even after making many payments, you could owe more than you did at the beginning of the loan. Also, as interest rates go up, your payments are likely to go up.

Payment-option ARMs have a built-in recalculation period, usually every 5 years. At this point, your payment will be recalculated (lenders use the term *recast*) based on the remaining term of the loan. If you have a 30-year loan and you are at the end of year 5, your payment will be recalculated for the remaining 25 years. If your loan balance has increased because you have made only minimum payments, or if interest rates have risen faster than your payments, your payments will increase each time your loan is recast. At each recast, your new minimum payment will be a fully amortizing payment and any payment cap will not apply. This means that your monthly payment can increase a lot at each recast.

Lenders may recalculate your loan payments before the recast period if the amount of principal you owe grows beyond a set limit, say 110% or 125% of your original mortgage amount. For example, suppose you made only minimum payments on your $200,000 mortgage and had any unpaid interest added to your balance. If the balance grew to $250,000 (125% of $200,000), your lender would recalculate your payments so that you would pay off the loan over the remaining term. It is likely that your payments would go up substantially.

More information on interest-only and payment-option ARMs is available in the Federal Reserve Board's brochure titled *Interest-Only Mortgage Payments and Payment-Option ARMs—Are They for You?*

Consumer Cautions

Discounted interest rates

Many lenders offer more than one type of ARM. Some lenders offer an ARM with an initial rate that is lower than their fully indexed ARM rate (that is, lower than the sum of the index plus the margin). Such rates—called discounted rates, start rates, or teaser rates—are often combined with large initial loan fees, sometimes called *points*, and with higher rates after the initial discounted rate expires.

Your lender or broker may offer you a choice of loans that may include "discount points" or a "discount fee." You may choose to pay these points or fees in return for a lower interest rate. But keep in mind that the lower interest rate may only last until the first adjustment.

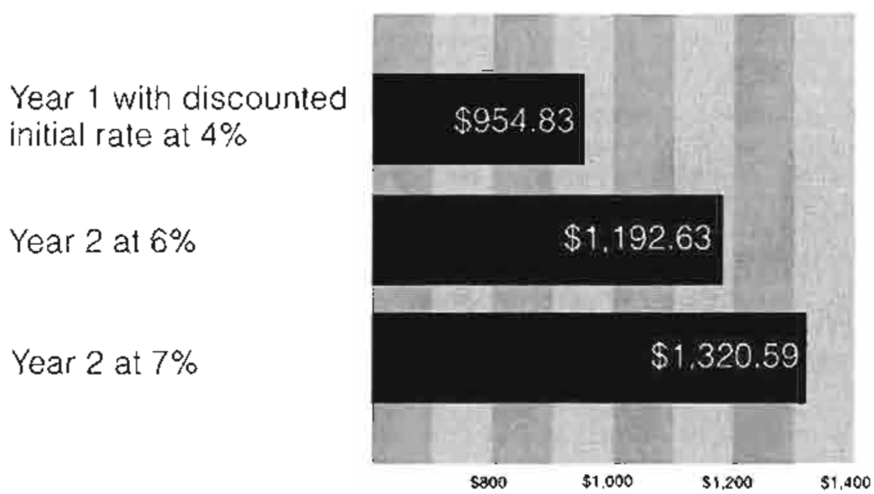
If a lender offers you a loan with a discount rate, don't assume that means that the loan is a good one for you. You should carefully consider whether you will be able to afford higher payments in later years when the discount expires and the rate is adjusted.

Here is an example of how a discounted initial rate might work. Let's assume that the lender's fully indexed one-year ARM rate (index rate plus margin) is currently 6%; the monthly payment for the first year would be $1,199.10. But your lender is offering an ARM with a discounted initial rate of 4% for the first year. With the 4% rate, your first-year's monthly payment would be $954.83.

With a discounted ARM, your initial payment will probably remain at $954.83 for only a limited time—and any savings during the discount period may be offset by higher payments over the remaining life of the mortgage. If you are considering a discount ARM, be sure to compare future payments with those for a fully indexed ARM. In fact, if you buy a home or refinance using a deeply discounted initial rate, you run the risk of payment shock, negative amortization, or prepayment penalties or conversion fees.

Payment shock

Payment shock may occur if your mortgage payment rises sharply at a rate adjustment. Let's see what would happen in the second year if the rate on your discounted 4% ARM were to rise to the 6% fully indexed rate.



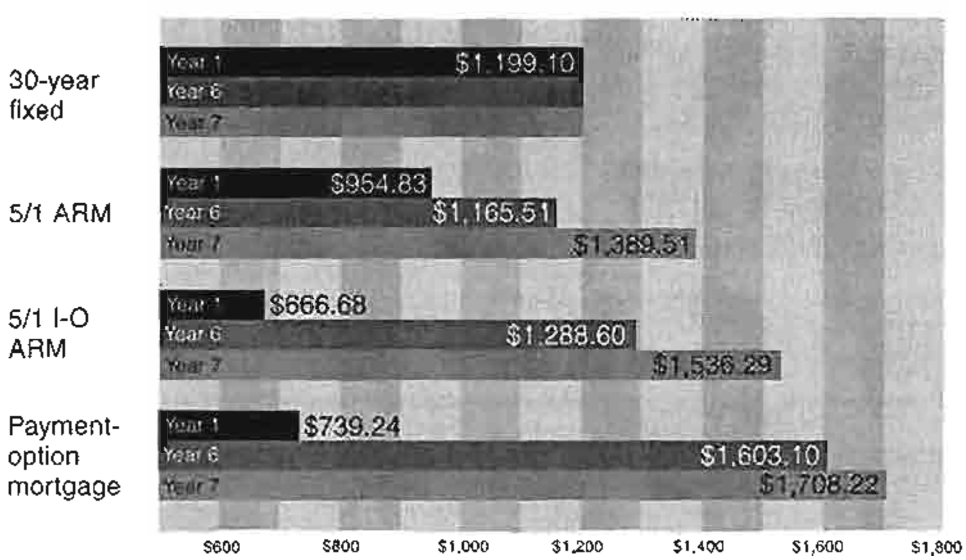
As the example shows, even if the index rate were to stay the same, your monthly payment would go up from $954.83 to $1,192.63 in the second year.

Suppose that the index rate increases 1% in one year and the ARM rate rises to 7%. Your payment in the second year would be $1,320.59.

That's an increase of $365.76 in your monthly payment. You can see what might happen if you choose an ARM because of a low initial rate without considering whether you will be able to afford future payments.

If you have an interest-only ARM, payment shock can also occur when the interest-only period ends. Or, if you have a payment-option ARM, payment shock can happen when the loan is recast.

The following example compares several different loans over the first 7 years of their terms; the payments shown are for years 1, 6, and 7 of the mortgage, assuming you make interest-only payments or minimum payments. The main point is that, depending on the terms and conditions of your mortgage and changes in interest rates, ARM payments can change quite a bit over the life of the loan—so while you could save money in the first few years of an ARM, you could also face much higher payments in the future.



Negative amortization—When you owe more money than you borrowed

Negative amortization means that the amount you owe increases even when you make all your required payments on time. It occurs whenever your monthly mortgage payments are not large enough to pay all of the interest due on your mortgage—the unpaid interest is added to the principal on your mortgage, and you will owe more than you originally borrowed. This can happen because you are making only minimum payments on a payment-option mortgage or because your loan has a payment cap.

For example, suppose you have a $200,000, 30-year payment-option ARM with a 2% rate for the first 3 months and a 6% rate for the remaining 9 months of the year. Your minimum payment for the year is $739.24, as shown in the previous graph. However, once the 6% rate is applied to your loan balance, you are no longer covering the interest costs. If you continue to make minimum payments on this loan, your loan balance at the end of the first year of your mortgage would be $201,118—or $1,118 more than you originally borrowed.

Because payment caps limit only the amount of payment increases, and not interest-rate increases, payments sometimes do not cover all the interest due on your loan. This means that the unpaid interest is automatically added to your debt, and interest may be charged on that amount. You might owe the lender more later in the loan term than you did at the beginning.

A payment cap limits the increase in your monthly payment by deferring some of the interest. Eventually, you would have to repay the higher remaining loan balance at the interest rate then in effect. When this happens, there may be a substantial increase in your monthly payment.

Some mortgages include a cap on negative amortization. The cap typically limits the total amount you can owe to 110% to 125% of the original loan amount. When you reach that point, the lender will set the monthly payment amounts to fully repay the loan over the remaining term. Your payment cap will not apply, and your payments could be substantially higher. You may limit negative amortization by voluntarily increasing your monthly payment.

Be sure you know whether the ARM you are considering can have negative amortization.

Home Prices, Home Equity, and ARMs

Sometimes home prices rise rapidly, allowing people to quickly build equity in their homes. This can make some people think that even if the rate and payments on their ARM get too high, they can avoid those higher payments by refinancing their loan or, in the worst case, selling their home. It's important to remember that home prices do not always go up quickly—they may increase a little or remain the same, and sometimes they fall. If housing prices fall, your home may not be worth as much as you owe on the mortgage. Also, you may find it difficult to refinance your loan to get a lower monthly payment or rate. Even if home prices stay the same, if your loan lets you make minimum payments (see *payment-option ARMs* on page 33), you may owe your lender more on your mortgage than you could get from selling your home.

Prepayment penalties and conversion

If you get an ARM, you may decide later that you don't want to risk any increases in the interest rate and payment amount. When you are considering an ARM, ask for information about any extra fees you would have to pay if you pay off the loan early by refinancing or selling your home, and whether you would be able to convert your ARM to a fixed-rate mortgage.

Prepayment penalties

Some ARMs, including interest-only and payment-option ARMs, may require you to pay special fees or penalties if you refinance or pay off the ARM early (usually within the first 3 to 5 years of the loan). Some loans have *hard prepayment penalties*, meaning that you will pay an extra fee or penalty if you pay off the loan during the penalty period for any reason (because you refinance or sell your home, for example). Other loans have *soft prepayment penalties*, meaning that you will pay an extra fee or penalty only if you refinance the loan, but you will not pay a penalty if you sell your home. Also, some loans may have prepayment penalties even if you make only a partial prepayment.

Prepayment penalties can be several thousand dollars. For example, suppose you have a 3/1 ARM with an initial rate of 6%. At the end of year 2 you decide to refinance and pay off your original loan. At the time of refinancing, your balance is $194,936. If your loan has a prepayment penalty of 6 months' interest on the remaining balance, you would owe about $5,850.

Sometimes there is a trade-off between having a prepayment penalty and having lower origination fees or lower interest rates.

The lender may be willing to reduce or eliminate a prepayment penalty based on the amount you pay in loan fees or on the interest rate in the loan contract.

If you have a hybrid ARM—such as a 2/28 or 3/27 ARM—be sure to compare the prepayment penalty period with the ARM's first adjustment period. For example, if you have a 2/28 ARM that has a rate and payment adjustment after the second year, but the prepayment penalty is in effect for the first 5 years of the loan, it may be costly to refinance when the first adjustment is made.

Most mortgages let you make additional principal payments with your monthly payment. In most cases, this is *not* considered prepayment, and there usually is no penalty for these extra amounts. Check with your lender to make sure there is no penalty if you think you might want to make this type of additional principal prepayment.

Conversion fees

Your agreement with the lender may include a clause that lets you convert the ARM to a fixed-rate mortgage at designated times. When you convert, the new rate is generally set using a formula given in your loan documents.

The interest rate or up-front fees may be somewhat higher for a convertible ARM. Also, a convertible ARM may require a fee at the time of conversion.

Graduated-payment or stepped-rate loans

Some fixed-rate loans start with one rate for one or two years and then change to another rate for the remaining term of the loan. While these are not ARMs, your payment will go up according to the terms of your contract. Talk with your lender or broker and read the information provided to you to make sure you understand when and by how much the payment will change.

Where to Get Information

Disclosures from lenders

You should receive information in writing about each ARM program you are interested in before you have paid a nonrefundable fee. It is important that you read this information and ask the lender or broker about anything you don't understand—index rates, margins, caps, and other ARM features such as negative amortization. After you have applied for a loan, you will get more information from the lender about your loan, including the APR, a payment schedule, and whether the loan has a prepayment penalty.

The APR is the cost of your credit as a yearly rate. It takes into account interest, points paid on the loan, any fees paid to the lender for making the loan, and any mortgage insurance premiums you may have to pay. You can compare APRs on similar ARMs (for example, compare APRs on a 5/1 and a 3/1 ARM) to determine which loan will cost you less in the long term, but you should keep in mind that because the interest rate for an ARM can change, APRs on ARMs cannot be compared directly to APRs for fixed-rate mortgages.

You may want to talk with financial advisers, housing counselors, and other trusted advisers. Contact a local housing counseling agency, call the U.S. Department of Housing and Urban Development toll-free at 800-569-4287, or visit www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm to find a center near you.

Newspapers and the Internet

When buying a home or refinancing your existing mortgage, remember to shop around. Compare costs and terms, and negotiate for the best deal. Your local newspaper and the Internet are good places to start shopping for a loan. You can usually find information on interest rates and points for several lenders. Since rates and points can change daily, you'll want to check information sources often when shopping for a home loan.

The Mortgage Shopping Worksheet may also help you. Take it with you when you speak to each lender or broker and write down the information you obtain. Don't be afraid to make lenders and brokers compete with each other for your business by letting them know that you are shopping for the best deal.

Advertisements

Any initial information you receive about mortgages probably will come from advertisements or mail solicitations from builders, real estate brokers, mortgage brokers, and lenders. Although this information can be helpful, keep in mind that these are marketing materials—the ads and mailings are designed to make the mortgage look as attractive as possible. These ads may play up low initial interest rates and monthly payments, without emphasizing that those rates and payments could increase substantially later. So, get all the facts.

Any ad for an ARM that shows an initial interest rate should also show how long the rate is in effect and the APR on the loan. If the APR is much higher than the initial rate, your payments may increase a lot after the introductory period, even if interest rates stay the same.

Choosing a mortgage may be the most important financial decision you will make. You are entitled to have all the information you need to make the right decision. Don't hesitate to ask questions about ARM features when you talk to lenders, mortgage brokers, real estate agents, sellers, and your attorney, and keep asking until you get clear and complete answers.

Glossary

Adjustable-rate mortgage (ARM)

A mortgage that does not have a fixed interest rate. The rate changes during the life of the loan based on movements in an index rate, such as the rate for Treasury securities or the Cost of Funds Index.

Annual percentage rate (APR)

A measure of the cost of credit, expressed as a yearly rate. It includes interest as well as points, broker fees, and certain other credit charges that you are required to pay. Because all lenders follow the same rules when calculating the APR, it provides you with a good basis for comparing the cost of loans, including mortgages, over the term of the loan.

Balloon payment

A lump-sum payment that may be required when a mortgage loan ends. This can happen when the lender allows you to make smaller payments until the very end of the loan. A balloon payment will be a much larger payment compared with the other monthly payments you made.

Buydown

With a buydown, the seller pays an amount to the lender so that the lender can give you a lower rate and lower payments, usually for an initial period in an ARM. The seller may increase the sales price to cover the cost of the buydown. Buydowns can occur in all types of mortgages, not just ARMs.

Cap, interest rate

A limit on the amount your interest rate can increase. Interest caps come in two versions:

- *periodic adjustment caps*, which limit the interest-rate increase from one adjustment period to the next, and
- *lifetime caps*, which limit the interest-rate increase over the life of the loan. By law, virtually all ARMs must have an overall cap.

Cap, payment

A limit on how much the monthly payment may change, either each time the payment changes or during the life of the mortgage. Payment caps may lead to negative amortization because they do not limit the amount of interest the lender is earning.

Conversion clause

A provision in some ARMs that allows you to change the ARM to a fixed-rate loan at some point during the term. Conversion is usually allowed at the end of the first adjustment period. At the time of the conversion, the new fixed rate is generally set at one of the rates then prevailing for fixed-rate mortgages. The conversion feature may be available at extra cost.

Discounted initial rate (also known as a start rate or teaser rate)

In an ARM with a discounted initial rate, the lender offers you a lower rate and lower payments for part of the mortgage term (usually for 1, 3, or 5 years). After the discount period, the ARM rate will probably go up depending on the index rate. Discounts can occur in all types of mortgages, not just ARMs.

Equity
The difference between the fair market value of the home and the outstanding balance on your mortgage plus any outstanding home equity loans.

Hybrid ARM
These ARMs are a mix—or a hybrid—of a fixed-rate period and an adjustable-rate period. The interest rate is fixed for the first several years of the loan; after that, the rate could adjust annually. For example, hybrid ARMs can be advertised as 3/1 or 5/1—the first number tells you how long the fixed interest-rate period will be and the second number tells you how often the rate will adjust after the initial period.

Index
The economic indicator used to calculate interest-rate adjustments for adjustable-rate mortgages. No one can be sure when an index rate will go up or down. See the chart in the text for examples of how some common indexes have changed in the past.

Interest
The price paid for borrowing money, usually given in percentages and as an annual rate.

Interest-only payment ARM
An I-O payment ARM plan allows you to pay only the interest for a specified number of years. After that, you must repay both the principal and the interest over the remaining term of the loan.

Margin

The number of percentage points the lender adds to the index rate to calculate the ARM interest rate at each adjustment.

Negative amortization

Occurs when the monthly payments do not cover all the interest owed. The interest that is not paid in the monthly payment is added to the loan balance. This means that even after making many payments, you could owe more than you did at the beginning of the loan. Negative amortization can occur when an ARM has a payment cap that results in monthly payments that are not high enough to cover the interest due or when the minimum payments are set at an amount lower than the amount you owe in interest.

Payment-option ARM

An ARM that allows you to choose among several payment options each month. The options typically include (1) a traditional amortizing payment of principal and interest, (2) an interest-only payment, or (3) a minimum (or limited) payment that may be less than the amount of interest due that month. If you choose the minimum-payment option, the amount of any interest you do not pay will be added to the principal of your loan (see *negative amortization*).

Points (may be called discount points)

One point is equal to 1 percent of the principal amount of your mortgage. For example, if the mortgage is for $200,000, one point equals $2,000. Lenders frequently charge points in both fixed-rate and adjustable-rate mortgages in order to cover loan origination costs or to provide additional compensation to the lender or broker. These points usually are collected at closing and may be paid by the borrower or the home seller, or may be split between them. Discount points (sometimes called *discount fees*) are points that you voluntarily choose to pay in return for a lower interest rate.

Prepayment penalty

Extra fees that may be due if you pay off the loan early by refinancing your loan or selling your home, usually limited to the first 3 to 5 years of the loan's term. If your loan includes a prepayment penalty, be aware of the penalty you would have to pay. Compare the length of the prepayment penalty period with the first adjustment period of the ARM to see if refinancing is cost-effective before the loan first adjusts. Some loans may have prepayment penalties even if you make only a partial prepayment.

Principal

The amount of money borrowed or the amount still owed on a loan.

For More Information

Looking for the Best Mortgage—Shop, Compare, Negotiate
(at www.federalreserve.gov/pubs/mortgage/mortb_1.htm)

Interest-Only Mortgage Payments and Payment-Option ARMs—Are They for You?
(at www.federalreserve.gov/pubs/mortgage_interestonly/)

A Consumer's Guide to Mortgage Lock-Ins
(at www.federalreserve.gov/pubs/lockins/default.htm)

A Consumer's Guide to Mortgage Settlement Costs
(at www.federalreserve.gov/pubs/settlement/default.htm)

Know Before You Go . . .To Get a Mortgage: A Guide to Mortgage Products and a Glossary of Lending Terms
(at www.bos.frb.org/consumer/knowbeforeyougo/mortgage/mortgage.pdf)

Partners Online Mortgage Calculator
(at www.frbatlanta.org/partnerssoftwareonline/dsp_main.cfm)

This information was prepared by the Board of Governors of the Federal Reserve System and the Office of Thrift Supervision in consultation with the following organizations:

AARP
American Association of Residential Mortgage Regulators
America's Community Bankers
Center for Responsible Lending
Conference of State Bank Supervisors
Consumer Federation of America
Consumer Mortgage Coalition
Consumers Union
Credit Union National Association
Federal Deposit Insurance Corporation
Federal Reserve Board's Consumer Advisory Council
Federal Trade Commission
Financial Services Roundtable
Independent Community Bankers Association
Mortgage Bankers Association
Mortgage Insurance Companies of America
National Association of Federal Credit Unions
National Association of Home Builders
National Association of Mortgage Brokers
National Association of Realtors
National Community Reinvestment Coalition
National Consumer Law Center
National Credit Union Administration

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EXHIBIT D

EXHIBIT D

CERTIFICATION OF PROVIDING CHARM BOOKLET

To be completed by Borrower:

I have received the CHARM Booklet, which I may keep, and have had it for at least 24 hours before applying for an ARM. I have read the CHARM Booklet and understand it.

Dated: ____________________

____ ________________________________
Borrower's signature Borrower name (please print)

To be completed by An Nguyen

I hereby certify that I provided the CHARM Booklet to the borrower at the time and date indicated below:

Delivered to borrower on:

______________________________ (date)

at ______________________________ (time)

Signed on behalf of An Nguyen

____

Representative of An Nguyen

____
Title

Date: __________________________________

EXHIBIT E