



State of Washington

DEPARTMENT OF FINANCIAL INSTITUTIONS

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November 30, 2006

To: Consumer Loan Licensees, Mortgage Broker Licensees, and Exempt Mortgage Brokers Subject to the Authority of RCW 19.146

From: Scott Jarvis, Director

Re: Regulatory Guidance on Nontraditional Mortgage Products

On October 4, 2006, the federal financial regulators published final guidance on nontraditional mortgage product¹ risks in the *Federal Register* (Volume 71, Number 192, Page 58609-58618). The federal interagency guidance applies only to insured financial institutions and their affiliates. The majority of mortgage originations, however, are now made by state regulated mortgage brokers and companies.

Therefore, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) have developed parallel guidance that applies to state regulated mortgage brokers and companies ([link](#)). The CSBS/AARMR guidance substantially mirrors the interagency guidance, except for the deletion of sections not applicable to non-depository institutions. Specifically, the CSBS/AARMR guidance does not adopt the provisions on portfolio management or safety and soundness that are found in the interagency guidance. Instead, the CSBS/AARMR guidance focuses on consumer protection, proper underwriting standards, and risk management practices. With regard to risk management practices, the guidance is intended to address risk management broadly, to include compliance risk, reputation risk, and litigation risk.

The Department of Financial Institutions has adopted the CSBS/AARMR guidance as an additional tool in determining whether a lender or mortgage broker is in compliance with

¹ Mortgage products that allow borrowers to defer payment of principal and, sometimes, interest. These products, referred to variously as “nontraditional,” “alternative,” or “exotic” mortgage loans include “interest-only” mortgages and “payment option” adjustable-rate mortgages. These products allow borrowers to exchange lower payments during an initial period for higher payments during a later amortization period.

prohibited practices under Washington law.² The guidance is intended to promote consistent regulation in the mortgage market and to clarify how residential mortgage providers can offer nontraditional mortgage products in a way that clearly discloses the risks borrowers may assume. Licensees can expect Department examiners and investigators to employ the guidance when reviewing a lender or mortgage broker's loans for compliance with state law and regulation.

These guidelines are designed to level the playing field in the mortgage market in order to protect consumers from taking on high-risk mortgages without having a full understanding of the terms of such loans. You are strongly encouraged to consider the guidance as a minimum standard or benchmark for compliance with Washington's prohibited practices sections when soliciting, originating or making nontraditional mortgage products.

For questions on this advisory or the guidance, please contact Acting Consumer Services Division Director Deborah Bortner at (360) 902-0511.

² See RCW 31.04.027(1), (2), (3), (6) and RCW 19.146.0201(1), (2), (3), (7).