

NY Times

Many Incorrect Charges Found On

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Adjustable-Rate Mortgages

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As many as one of every four Americans who bought homes with adjustable-rate mortgages may be paying either too much or too little each month because of bank errors in calculating interest rates, according to a report by the General Accounting Office. The miscalculations were discovered in routine audits of mortgages issued by failed savings and loan associations that have been taken over by Federal regulators. But bankers concede that some adjustable loans, which have complex terms, are also being incorrectly adjusted by solvent institutions.

Overcharges Put at \$8 Billion

The extent of the problem is disputed. John Geddes, a former Federal mortgage banking auditor who has been the chief whistle-blower on the errors, estimates that 30 to 35 percent of the country's 12 million outstanding adjustable-rate mortgages, which include home equity loans, are billed incorrectly, with half the borrowers charged too much and the rest too little.

He says the net overcharges are about \$8 billion, but says he has not estimated the undercharges. It is also unknown how many of these loans have already been paid off. Mr. Geddes's estimate is based on his review of 7,000 adjustable mortgages taken over by the Government in the savings bailout.

Experts cited in an October report of the accounting office, the investigative arm of Congress, put the error rate at 20 to 25 percent of these mortgages, but some banking industry officials contend that the rate is considerably less than that. Chase, for instance, audited its adjustable mortgages last year and found almost no errors.

The size of the errors varies, with most considered to be small. But Shirley and Gordon Wynn of Miami received a \$1,463.99 refund from the Coral Gables Federal Savings and Loan in September after pointing out to the bank that charges on their adjustable home mortgage since 1987 had been based on an interest rate of 10.875 percent instead of the correct rate of 10.375 percent. The Wynns' monthly mortgage payment is now \$797.75, instead of \$812.34.

It is unclear whether financial institutions are liable for making refunds to overcharged borrowers, although the first lawsuits challenging lenders on the issue are now being

brought by borrowers.

But a big concern to members of Congress who are beginning to look into the problem is the additional cost of the Federal savings and loan bailout if such refunds have to be made.

The Federal regulators' role in the problem is also expected to be discussed at Congressional hearings to be held on the miscalculations. Documents from the Federal Savings and Loan Insurance Corporation, which took over thousands of mortgages from failed savings banks whose deposits it insured, show that the corporation knew as early as the summer of 1988 that many mortgages in its portfolio were being billed incorrectly. People working for the agency say they were told not to notify overcharged borrowers, and to keep billing at the wrong interest rates. "I don't believe that most of the errors were

intentional," Mr. Geddes said, "but what I did find is that once the errors were found, a lot of savings and loans, and the F.S.L.I.C. for certain, would do nothing to fix them."

Federal regulators overseeing the portfolio would not comment on that practice, arguing that they would first like to finish a formal audit of these mortgages.

The miscalculations came to light in the summer of 1989, when Mr. Geddes alerted Senator Richard G. Lugar of Indiana to the large percentage of errors in the mortgages taken over by the F.S.L.I.C., where he was employed. Lugar Sought Review

Late last year, the Senator asked several Government banking agencies to review reports of a growing mortgage bookkeeping problem, and was told there was none.

"They all wrote back, 'We don't see any problems,' " said Steven Fischer, the Senator's aide for banking issues.

Still, after the release of the G.A.O. report, which was requested by Senator Lugar, the F.D.I.C. began an audit of its Chicago office mortgage portfolio, where Mr. Geddes and others who confirm his story worked.

Arthur Lorentzen, an assistant director in the F.D.I.C.'s Division of Liquidation, originally said the review of a sample of the Chicago portfolio would be finished by the second week in December. But on Thursday he said his office would review the audit and postpone an announcement of the results indefinitely.

"Because of the publicity about all this we've decided to go back and refigure them," he said in an interview. "There's a lot more to it than meets the eye," he said of the audit process.

Human Mistakes

In most cases, Mr. Geddes and others familiar with the process said, the errors have resulted from human mistakes at failed savings institutions, many of which were small operations, unfamiliar with the complexity of adjustable-rate mortgages. Often, they computed adjustable mortgages by hand. The G.A.O. report suggest that the problem may be greatest in the Middle West, where banks are smaller and adjustable-rate mortgages are less common than on the coasts.

Unlike fixed-rate mortgages, whose rates are fixed for the duration of the mortgage, adjustable-rate mortgages have interest rates that rise and fall with a designated index of prevailing interest rates. The rates are usually low for the first year, and are then adjusted every six months or every year after that.

The rate consists of an index like the interest rate on Treasury bills plus a fixed margin of two or three percentage points. Changes are usually “capped,” and the rate may not rise more than two percentage points in any adjustment period and six percentage points over the life of the loan.

In some cases, the problems are caused by computer glitches, as indicated by an audit of a sample of 96 adjustable-rate mortgages from a failed savings institution, the Victor Federal Savings and Loan of Muskogee, Okla., The audit, conducted for the F.S.L.I.C. by the Bennington Group, a San Diego consulting firm, found that the bank’s computer system contained logic errors. The bank, among other things, rounded rates upward instead of downward and “pulled” the index on the wrong date.

Victor ended up undercharging borrowers by \$130,000, said Bernard Lomax, an executive at the consulting firm.

Poor Record-Keeping

Mr. Geddes and other former F.S.L.I.C. workers say errors also resulted from the poor recordkeeping at failed savings and loans. Federal bank receivers had unusual or hard-to-locate

interest indexes, or were missing documentation, or did not match the agency’s computer programs.

Some mortgages in the F.S.L.I.C portfolio, have never been adjusted, according to Betty Skatchke, a former loan officer who was in charge of adjustable loans and the corporation’s Chicago office. For mortgages taken out in a time of rising interest rates, this would result in serious undercharges. A Subtraction Mistake

She also recalled a large commercial loan in which a four percentage point interest margin was subtracted instead of added to the index rate, leaving the business paying at an interest rate of a little more than 3 percent instead of more than 10 percent.

“We were told that if there were errors we were not to touch them,” Ms. Skatchke said.

“The bottom line statement was, ‘We must be consistent in our errors.’ ”

Indeed, agency documents show that the Chicago office of the F.S.L.I.C. sought the first of 13 legal opinions about the Federal Government’s potential liability for overcharges by failed banks in August 1988.

Checking the Rate

Homeowners can check their own mortgages by finding the index and the margin for their loans in their loan agreement. The agreement should specify the date on which the mortgage rate changes. The bank bases the new interest rate on the rate at which the index was trading 45 days before that change date. That index rate is published in newspapers. To arrive at the new interest rate, add the margin to the index rate and then check that the mortgage cap was not exceeded.

Mortgage consulting services will also provide audits, for a \$40 or \$50 fee, for consumers who want to check whether lenders are charging them correctly. These firms also sell mortgage-checking kits for \$3 to \$15 that contain tables on interest rates over several years and on several indexes.

Mr. Lorentzen said the F.D.I.C. would probably credit any overcharges it finds to the

borrower's principal balance. Some interpretations of the Federal Truth in Lending Act maintain that the borrower may be entitled to cash, but the G.A.O. report noted that the issue probably would be left to the courts to decide.

Delays Cited

Still, some mortgage holders have found the Government unresponsive to their requests for refunds or their inquiries. Evelyn McGuire, a Paducah, Ky., apartment landlord and real estate agent, is still waiting for Federal regulators to untangle three adjustable-rate mortgages they took over from the First Federal Savings and Loan of Paducah, which failed in 1988.

The \$120,000 mortgages started out in 1986 with identical payments and balances, Mrs. McGuire said, but they have since wandered off in different directions. Now, she is waiting for the F.D.I.C. to explain why she has three different monthly payments, three different loan balances and two different payment schedules. On top of that, Mrs. McGuire added, the F.D.I.C. got the index wrong at the change date last September. "I'm in the real estate business and I know how to check the numbers," Mrs. McGuire said in an interview. "So I wrote and asked them to document how they got that number, but they have never answered, they do not return my phone calls. So I pay it every month, but I tell them I'm paying under protest."

And not all homeowners received refunds from their banks as easily as the Wynns. Class action suits charging violations of the Truth in Lending Act, enacted to protect borrowers against such things as interest-rate fluctuations, were brought in September against four small Indiana savings and loans, with Mr. Geddes acting as a researcher for Henry Price, the lead attorney for the plaintiffs. Mr. Price, of Indianapolis, is seeking refunds of the overcharges plus undetermined damages under the Federal law.

It is unclear how the courts would treat any of these cases. The G.A.O. report cites the opinion of Federal regulators that the Truth in Lending Law "probably does not" require lenders to repay overcharges in any form, but legal opinions sought by the Federal Savings and Loan Insurance Corporation held the opposite view. Borrowers who were undercharged, however, are not believed to be liable for making up the difference.

Photo: Gordon Wynn of Miami, who received a \$1,463.99 refund from Coral Gables Federal Savings and Loan after pointing out that charges on his adjustable home mortgage were incorrect. (Susan Greenwood for The New York Times) Graph: 'Adjustable Loans' gives percentage of new mortgages that have adjustable rates from '85

to '90 (Source: Federal Housing Finance Board) (pg. D4)