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# Moral Duties in Business and Their Societal Impacts: The Case of the Subprime Lending Mess

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**ABSTRACT**

A worldwide recession of unusual breadth and depth is causing harm to many individuals and businesses. While the causes are complex, the recession got its start with failures in the subprime mortgage market. The process of creating such loans is complex and often includes securitization after loans are approved. The reasons for the subprime lending mess can be at least partly traced to decisions made by individual mortgage brokers and lending officers. These individuals had moral or ethical responsibilities because of their positions. An analysis of the rights and duties approach to ethics shows that some of these individuals failed in their moral duties and that their failure is partly to blame for the resulting harmful consequences.

Foreclosure proceedings were started on about 1.5 million homes in the United States during 2007. This number of foreclosure initiations was 53 percent higher than in 2006.[1] While the number of foreclosures continued to increase dramatically in 2008 and 2009, most economic analysts identify

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the beginning of the long recession as starting with the increase in mortgage failures in 2007.[2] Although subprime mortgages accounted for less than 20 percent of all mortgages outstanding, just over half of these foreclosure initiations were on subprimes. Later in the financial crisis, foreclosures spread to other classes of mortgages, but the problem originated and grew large mainly with subprimes.

Companies involved in the mortgage business have laid off tens of thousands of employees since the fall of 2007 and have taken hundreds of billions of dollars in write-offs on their subprime assets. Millions of people in the United States have lost their homes. The financial instruments such as Collateralized Mortgage Obligations (CMOs) and Collateralized Debt Obligations (CDOs) that were based on securitized mortgages have declined greatly in value, and this decline has substantially contributed to a freezing of credit markets, with the follow-on effects of unemployment and recession.

All of these factors have led to a major decline in stock markets and in the world economy. In the memorable words of a certain comic character, "It's a fine mess you got us into this time!" However, who got us into this mess? The business press has provided numerous stories and commentaries on the subprime lending mess with multiple theories of who or what caused it.[3] Although the effects have spread far beyond the mortgage industry, the problems with subprime mortgages either caused or contributed substantially to these further effects. By asking whether anyone involved had or breached any moral duties in the creation of this mess, we are entering the realm of business ethics.

In the first section of this article, we present some facts about the subprime lending mess and the process involved in subprime lending. These facts provide the basis for subsequent analysis. The next section provides a brief discussion of ethics and how it is involved with decision-making by individuals and organizations. We then proceed to a discussion of one of the principal approaches to ethics, which is that of moral rights and duties. The following two sections discuss predatory lending and careless lending and show what ethical analysis of each of these practices reveals in terms of moral guilt and innocence on the part of individuals involved in these practices. In the final section, we draw conclusions based on the facts and analysis presented.

## FACTS ABOUT THE SUBPRIME LENDING PROCESS

Before proceeding further, it will be helpful to define some terms: first, the subprime mortgage lending mess. A mess is a bit like pornography: hard to define, but we know it when we see it. Elements of the subprime lending mess include individuals defaulting on loans, banks, and other mortgage lenders foreclosing on houses, borrowers being removed from their homes, neighborhoods being blighted by unkempt lawns, and unauthorized squatters in the empty houses that were abandoned by the borrowers and neglected by the lenders. Further elements include a significant tightening of loan requirements for current mortgage applicants, a drop in the market for houses, a tightening of credit by lenders generally, layoffs and bankruptcies at some lending companies, hundreds of billions of dollars of investment losses, sudden unplanned injections of money and reduction of interest rates by the Federal Reserve Bank, hundreds of billions of dollars of loans and payments by the U.S. government, and the aforesaid volatility in the stock market. By almost any definition, this is a mess!

It is, specifically, a subprime mortgage lending mess because many of the defaults with all their attendant unpleasantness were on subprime loans. Investopedia, a Forbes Media Company, defines a subprime loan as "A type of loan that is offered at a rate above prime to individuals who do not qualify for prime rate loans."[4] The U.S. Department of Housing and Urban Development, in defining subprime lending, says that "[t]ypically, subprime loans are for persons with blemished or limited credit histories. The loans carry a higher rate of interest than prime loans to compensate for increased credit risk."[5] One type, but not the only type, of subprime loan is a home mortgage.

Some facts about subprime mortgage lending will help to delineate the scope of the problem. Subprime mortgage originations increased from $120 billion in 2001 to $625 billion in 2005.[6] As of 2005, only 16 percent of subprime mortgages were used for home purchases.[7] The rest were used for either second mortgages or home refinancing. More than two-thirds of subprime mortgage originations in 2006 were adjustable rate mortgages (ARMs).[8] These are mortgages with an initial rate that changes (often upward) after a specified period of time, resulting in higher

monthly payments for the borrower. According to Ben Bernanke, the Chairman of the Federal Reserve Bank,

> Mortgage delinquencies began to rise in mid-2005 after several years at remarkably low levels. The worst payment problems have been among subprime adjustable-rate mortgages (subprime ARMS); more than one-fifth of the 3.6 million loans outstanding were seriously delinquent at the end of 2007.[9]

In the summer and fall of 2007, heightened awareness of problems in the subprime mortgage area led to a general tightening of credit. An article in *Business Week* summarized the situation nicely.

> Lenders know there are billions of dollars of weak assets out there, such as securities backed by foolish or fraudulent mortgages. What they don't know is who holds those weak assets. So when borrowers come to them offering suspect securities as collateral for a loan, the safest thing to say is no. When everyone says no at once, the result is a credit crunch that, if unabated, could cause a recession.[10]

The reference to securities as collateral for a loan introduces the last piece of the current picture. Once again, we turn to the Federal Reserve Chairman:

> Although [subprime mortgages] emerged on the financial landscape more than two decades ago, they did not begin to expand significantly until the mid-1990s. . . .[R]egulatory changes and the ongoing growth of the secondary mortgage market increased the ability of lenders, who once typically held mortgages on their books until the loans were repaid, to sell many mortgages to various intermediaries, or "securitizers." The securitizers in turn pooled large numbers of mortgages and sold the rights to the resulting cash flows to investors, often as components of structured securities. This "originate-to-distribute" model gave lenders (and, thus, mortgage borrowers) greater access to capital markets, lowered transaction costs, and allowed risk to be shared more widely.[11]

Later in the same testimony, Bernanke draws out some of the implications of the whole structure described here, and its difference from the older model of the originator holding the loans until repayment was complete:

> The originate-to-distribute model seems to have contributed to the loosening of underwriting standards in 2005 and 2006. When an originator sells a mortgage and its servicing rights, depending on the terms of the sale, much or all of the risks are passed on to the loan purchaser. Thus, originators who sell loans may have less incentive to undertake careful underwriting than if they kept the loans. Moreover, for some originators, fees tied to loan volume made loan sales a higher priority than loan quality.[12]

A number of other authors have also discussed the originate-to-distribute model and the ways that it contributed to lower underwriting standards on the part of mortgage brokers and lenders.[13]

So who is responsible for this mess? Possible culprits include the following:

1. Borrowers, who may or may not have lied to lenders in their applications;
2. Mortgage brokers and lenders, who may or may not have asked the right questions or enough of the right questions or checked on the answers to these questions to justify the loans that they made;
3. Securitizers (institutions, including commercial banks and investment banks) that combine individual mortgage loans into bundles, divide the bundles into tranches, and sell the resulting collateralized mortgage obligations to investors;
4. Rating agencies that somehow managed to turn subprime mortgages into prime investments by giving a much higher rating to the collateralized mortgage obligation than the individual mortgages might achieve; and
5. Investors who purchased these instruments without really knowing what they were buying.

With all of these participants in the creation of the subprime mortgage lending mess, it is tempting to say that things went bad because of bad luck or forces of nature or the complex interactions of multiple forces or the unintended consequences of well-intentioned actions. What we will explore in the remainder of this article is the possibility or likelihood that things went bad, with the whole resulting mess, at least partly because individuals at the front end of the process made decisions that were ethically or morally wrong (I will use these two terms interchangeably). In

other words, individuals bear at least some of the blame for the many negative consequences of this particular mess because they failed to do what they were morally obliged to do. There were undoubtedly moral failures in the later stages of the process as well, notably on the part of securitizers and rating agencies, but this article will confine its analysis to mortgage brokers and lenders.

## ETHICS AND DECISION MAKING

"An organization does not make decisions; its function is to provide a framework, based upon established criteria, within which decisions can be fashioned in an orderly manner. Individuals make the decisions and take responsibility for them."[14] These words were written over 40 years ago by Alfred Sloan, the legendary chief executive officer of General Motors. If we think about their meaning, we can take the first step toward establishing who is to blame for the subprime lending mess. Mortgage loans are made by an institution, not by an individual. However, the authority to decide whether or not to make a loan is vested not in the institution as a whole but in a credit or loan officer or committee. Even if the authority is vested in a committee, the vote of the committee is the sum of the votes of the individuals on that committee. The money is the institution's, but the decision is the individual's. Some mortgage lenders automated the process to the degree that approval to grant an individual loan was computerized. If all the criteria set by the lender were met, human review was not required, and computer approval followed. However, some individual person or committee of individuals set the criteria.

### *Ethics Differs From Law*

All of ethics is based on the foundation of free choice. If a person can not choose freely, he or she cannot be ethical or unethical in her choice. However, if a person can and does choose freely, ethics is about the interpersonal values exhibited by those choices when dealing with others. Ethics deals with many of the same topics as law, but it is not the same as law.[15] Many executives charged with serious wrongdoing have said something like "I did not do

anything wrong: ask my lawyer!" Laws are made by legislators—senators and congressmen; state legislators, county commissioners, and men and women serving on city councils. When asked whether they would be satisfied to have legislators make their moral code, most people would probably answer strongly in the negative. Ethics is often defined as the study of right conduct, but conduct can be right or wrong in ways that have nothing to do with ethics. For instance, an act is legally right if it complies with existing laws, is professionally right if it complies with generally accepted professional standards, and is practically right if it achieves the intended end. It is right to drive screws with a screwdriver; it is wrong to pound screws with a hammer. Neither choice involves ethics.

Ethics deals with many of the same issues and comes to many of the same conclusions as law because both are founded on values that relate to dealings with other people. The fact that a person does not have a legal obligation to refrain from making certain loans does not, however, preclude that person from having an ethical obligation to refrain from doing so. Professional lenders tend to be aware of the fact that not everyone who wishes to borrow money has the means to pay it back.

Mortgage brokers often assist and qualify borrowers in finding a mortgage loan. They advise borrowers and do much of the preliminary screening of information on behalf of lenders. Loan officers or loan committees for the institution that actually funds the loan make the final decision on whether to grant a particular loan to a particular borrower. As noted earlier, this may be performed by human review of each individual loan application or by computers applying quantifiable standards or thresholds set by loan officers or executives. When a mortgage broker presents a client as qualified for a loan, that broker could also choose not to do so. When a credit or loan officer or member of a loan committee chooses to lend money, the assumption is that they could also choose, in a given case, not to lend money. That is to say, the free choice, which underlies any discussion of ethics, is present in the individual loan approval situation.

Do individuals who loan money on behalf of others have any ethical or moral obligations in performing this task? One way to answer this question is to discuss rights and duties.[16] Legal duties are imposed by laws, and legal rights are protected by

laws. Legal duties can be positive in form, such as the duty to pay taxes or to serve on juries. They can also be negative in form, such as the duty not to steal or not to assault people. If there is a question about the existence of a legal right or duty, the usual way to resolve it is to consult an attorney, one trained in the law. The attorney then consults codified laws and regulations and court decisions interpreting these laws and regulations. However, how do we determine whether an individual has an ethical or moral right or duty?

### *Ethics Described*

Ethics can be defined as a system of rules or standards governing the conduct of a person or group. While companies sometimes have codes of ethics (Enron's was 64 pages long), there is no generally agreed upon body of ethical rules and interpretations as there is for law. Some possible rules or standards that would apply in business settings include the following: treat others fairly; observe the rights of others and the duties they impose; do not hurt others, directly or indirectly; follow the law; treat others as you would wish to be treated; treat others as you have been treated; be merciful; and be just.

While all of these rules and the values they imply might be considered by some to be ethical, and their opposites to be unethical, further understanding of a person's or a company's ethics can be found when some of these rules conflict. Treating others as you wish to be treated (the golden rule) is often incompatible with treating others as they have treated you (an eye for an eye). Mercy and justice are often in conflict.

However a person or company prioritizes these and other rules, the result can be said to embody that person's or company's ethics. Both ethical and unethical behavior results from observing value-driven rules; a key question is which rules are given priority. An even more important question is why one rule is given priority over another. This is why ethics is sometimes defined as a system of rules or standards. One of the fundamental issues in ethics is whether it is more important to respect individual rights in one's actions or to create the greatest good for the greatest number, even if this means the rights of some individuals must be denied.

We can probably obtain general agreement that ethical individuals and companies do not break the law. In other words, very high, if not absolute, priority should be given to the rule "follow the law." Assuming that the law is clear, and recognizing that this is not always the case, we can then judge a wide variety of actions as ethical or unethical depending on whether they comply with this one rule. The scope of this rule in determining whether actions are ethical is so broad that it is worth considering this point more closely.

It makes no sense to say that it is ethical to break laws as a general rule and unethical to follow them. We can take the position that it is ethical to follow the law and unethical to break it. The only other available position, logically, is to say that sometimes it is ethical to follow the law, and sometimes it is unethical. If we take this position, then someone or some group must decide in which cases it is ethical to follow the law and in which cases it is not. If we assign this task to legal experts, say judges or lawyers, then we are asking them to judge actions in respect to applicable law and their consequences not on legal terms, in which they are trained and skilled, but in ethical terms, in which they are usually not specially trained or skilled. If we assign the task to companies or individual actors, then any violation of any law can be justified not on legal grounds but on the basis of idiosyncratic ethical judgments. Clearly, this is not workable. If we assign the task to philosophers or wise men and women or ethical specialists, then this group basically can reverse or negate any judgment of any part of the legal system. Logically, there does not appear to be any viable position except to say that it is ethical to follow the law and unethical to violate it.

This argument cannot reasonably be extended to the point of saying that all laws always and everywhere have been and will be based on ethical values and result in ethical actions as long as they are followed. Laws that prohibit one group, such as American blacks in the Southern United States, from exercising basic economic or civic rights can not be automatically considered ethical. If we accept the logical conclusion that the default position is that the ethical action is to follow the law rather than to disobey it or to treat it as a suggestion, there needs to be some way to examine individual laws from an ethical perspective. Perhaps the clearest and most eloquent statement on this topic is Martin Luther King

Jr.'s Letter from Birmingham Jail.[17] In this letter, he discusses just and unjust laws and the duty to disobey unjust laws and accept the consequences.

The legal system, including police officers, courts, and jails, cannot be ignored because a law is viewed as unethical. King was willing to accept the legal consequences of his actions. However, wise men and women can argue that a law is unethical and that it should be changed. While it is the law, the legal system enforces it, and protestors willing to violate it are subject to its consequences. However, ethical arguments both theoretical in the marketplace of ideas and practical in the real world of actions and consequences can and should be made.

Executives or other employees who violate a law in their corporate role involve not only themselves but also their companies in the violation and the consequences. Ethical priorities in terms of choosing values that include breaking laws are very difficult, but not impossible, to justify. We can then conclude as a default position that it is moral to follow the law and immoral to break laws. This means that for a wide variety of actions and decisions of managers, the first question in ethical analysis will be "is it legal?"

As we said earlier, legal responsibility and moral responsibility are not always the same. In many cases, the law is silent, and in other cases, it is not clear whether a given law or regulation applies precisely to a given set of circumstances. In the issue under consideration, making a mortgage loan to an applicant unlikely to repay it may be an instance of poor business judgment, or even of plain stupidity, but it is not by itself an illegal act. If we can agree that illegal actions are also unethical, what can be said of actions that embody poor business judgment? Is it immoral to make and act on dumb decisions?

### *Policy-Making and Policy-Implementing Decisions*

As was stated earlier in this analysis, organizations do not make decisions; people do. One useful way to characterize the decisions that people make in organizations is to divide them into policy-making decisions and policy-implementing decisions. An example of a policy-making decision is to offer a certain kind of ARM as a product to a mortgage lender's clients. A policy-implementing

decision is to offer this specific client, with this specific set of assets, income, credit history, etc., an ARM of a certain type and amount on a specific home. Policy-making decisions are usually made by managers of an organization, and the more breadth or scope the policy has, the higher the level of manager involved in making the decision. Policy-implementing decisions can be made by individuals at any level, but they are often made by workers below the level of manager. Policy-implementing decisions are more constrained by the fact that the policy has already been determined, and the decision at hand is intended to implement a specific case of the general policy.

There have been many studies of ethical decision making. Several models of such decision making have been presented, and each has been tested by examining specific decisions of specific individuals.[18] While details vary, there is general agreement that the first step in ethical decision making is the recognition that an issue of ethics is involved. Policy-making decisions might or might not involve issues of ethics. For instance, the decision that the workday for a group of individuals will start at 8:00 am rather than 8:30 am or 9:00 am does not present any obvious ethical issues. Yet, this decision does involve policy-making. The decision to offer ARMs to applicants who can barely qualify at the initial rate, and who will probably be unable to meet their obligations if the rate increases in the future, does present an ethical issue. If the policy will result in individual decisions that put a substantial amount of money at risk in situations where preventable losses are likely, ethical values may well be violated by the decision.

Among the ethical values suggested earlier were "do no harm" and "treat others as you would wish to be treated." Setting a policy that is likely to result in defaults on mortgage loans will probably do harm to the borrowers and quite possibly, to the lenders. However, such a policy might benefit the mortgage broker who is paid when the loan is funded or the bank that is paid when the loan is sold to a securitizer. These are foreseeable, predictable results of the stated policy. Individuals who actually did set such policies were involved in ethical issues, whether they recognized them or not, and do bear some responsibility for the consequences. Similar arguments could be made for individuals who set the policy to loan money to home buyers without verifying their income or to make loans equal to or in excess of the value

of the home that constituted the collateral for the loan. This, then, provides a partial answer to the question whether individuals were morally responsible for the subprime lending mess.

It is not always immoral to make dumb decisions. If it were, purchasers of lottery tickets and fans of certain chronically losing sports teams would be ethically suspect. However, when the dumb decisions come in areas where an individual is acting on behalf of a company and has certain responsibilities by his or her position and is putting other people's money (or health or life) at risk, then dumb decisions often are immoral. Put differently, individuals who assume positions of authority and responsibility in organizations take on some moral obligations by position. They are dealing, in at least some of their decisions, with ethical issues, and ignorance of this fact on their part can itself be a moral failing.

There were many levels of participants in the subprime mortgage lending mess. Among these were loan applicants, mortgage brokers, lenders, packagers of individual mortgages, rating agencies, investment brokers and advisers, and purchasers of the collateralized mortgage obligations that finally emerged from all the layers of processing. The individual applicants or borrowers were generally not acting in an organizational setting but were seeking mortgage loans on their own. The other participants were acting within organizational settings, which means that their actions were sometimes policy-making and sometimes policy-implementing, but they were performed from a given formal position within an organization.

## MORAL RIGHTS AND DUTIES

One of the basic approaches to ethics involves the topics of rights and duties. All humans have moral or ethical rights to life, to dignity, and to some other basic features of what it means to be human.[19] These rights are recognized by all major religious and legal systems. Similarly, some individuals have rights and duties by virtue of their positions. These rights and duties are not shared by all humans and do not exist for the individuals before assuming or after leaving a given position. Police officers have the right to detain, question, and arrest individuals based on probable

cause. Surgeons have the right to operate and attorneys to represent clients in court. Along with these rights come duties to take proper care of their patients and clients.

One class of rights is known as privileges or liberties. The individual who has such a right has no duty not to do something. Examples include choosing the color to paint one's room or taking an empty seat on a bus.[20] Many rights fall into the class denoted as claims. For these rights, one or more individuals must have a corresponding duty. If I have a right to be paid for my work, someone has a duty to pay me.

Managers also have rights and duties by their positions. Most employees are not authorized or allowed to determine what kinds of loans a bank will offer or what criteria will be used to judge the creditworthiness of potential borrowers. These are policy-making decisions and are made by those whom an organization has designated or to whom the organization has given the right to make these decisions. Along with the right to make such policy decisions comes the duty to take proper care of the interests of the organization and also of the customers. A narrow view of the purpose of business would maintain that the manager's only duty is to maximize the wealth of the stockholders, but the wider view that recognizes the rights of at least some other stakeholders such as employees and customers is now commonly recognized as valid.[21]

## PREDATORY LENDING

Policy-makers who decide that their institutions will make loans to customers who present substantial risk of default may justify their decisions on the basis of adequate collateral and higher interest. However, the harmful consequences of defaults are real and affect both the lending institution and the defaulting borrower. If the policy-makers' decisions hurt their company, then they have failed in their positional duty to act in the company's interest. However, do policy-makers have any responsibility for the effects on their customers of the policies they make? In financial services, it may appear that they do not. After all, no one forced prospective borrowers to apply for mortgage loans, and the government-required disclosures explain in excruciating detail the terms and conditions of any contract that will govern a mortgage loan.

Could the makers of lead-painted toys excuse themselves from all moral responsibility for their customers if they disclosed on the package that lead paint may cause serious health problems for children who ingest even small amounts? Those applying for mortgage loans are not children, but sometimes, their level of financial understanding and ability to grasp the complexity of the loan terms is quite low, and their need for a loan is quite urgent. In testimony before a congressional committee, one finance industry employee stated the following:

> Finance companies try to do business with blue collar workers, people who have not gone to college, older people who are on fixed incomes, non English-speaking people, and people who have significant equity in their homes. In fact, my perfect customer would be an uneducated widow who is on a fixed income—hopefully from her deceased husband's pension and social security—who has her house paid off, is living off of credit cards, but having a difficult time keeping up her payments, and who must make a car payment in addition to her credit payments.[22]

In testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs, another borrower told how her mortgage was flipped (refinanced) seven times between May 1995 and August 1996. Over two years, her home equity loan increased from $11,921 to over $64,000. She received less than $100.00 in cash from these transactions, while fees came to $52,000. She summarized her experience as follows: "I now understand that these lenders pushed me into loans I couldn't pay. Adding all of these fees and costs each time caused me to lose my home, a home that I owned free and clear shortly after my husband died."[23] A *Newsweek* article published in June 2008 describes a mortgage broker in Cleveland who was the broker of record for 71 mortgage loans in one neighborhood between 2003 and 2006. *All* of these loans went into foreclosure within a year or two. The neighborhood is now suffering several forms of blight and crime, and remaining properties have lost much of their value.[24]

While such cases are admittedly extreme, the practice of predatory lending accounts for some portion of the total subprime lending mess.[25] A widely used textbook on Real Estate Law defines predatory lending as "[l]ending practices that take advantage of

borrowers who lack sufficient sophistication and knowledge to protect themselves from illegal and unethical lending practices."[26] Ethically, predatory lending is straightforward: it is wrong. For a mortgage broker or lender to persuade unsophisticated clients to enter contracts that are clearly and unarguably not in their (the client's) best interest and will in fact cause them considerable financial harm is morally indefensible. To argue otherwise would be to maintain that clients are fair game (to continue the metaphor of predatory lending) and that brokers and lenders have no moral duty to refrain from taking advantage of them in any way that has not been outlawed.

To argue that predatory lending is ethical, one would have to take the position that encouraging others to hurt themselves, and profiting by such encouragement, embodies values that can legitimately be called ethical. The study of ethics in the Western tradition extends back almost 2,500 years to Plato and Aristotle. Within that entire tradition, no significant school of thought has called such values ethical. Therefore, we can conclude that individuals who did pursue such predatory lending practices, while they may have performed nothing illegal, were unethical in their choices and actions and bear some moral blame for the consequences of their actions.

Predatory lending, by definition, implies positive action on the part of individuals who encouraged borrowers to enter contracts that were harmful to them. Since many of these borrowers defaulted on their loans and had their homes foreclosed, the harm was not limited to the borrowers. As we saw earlier, many individuals and institutions are harmed by foreclosures. To the extent that foreclosures can be causally traced to predatory loans, the broader consequences can also be traced, at least in part, to the predatory lenders.

## CARELESS LENDING

Between predatory lending and careful, fully responsible lending there is a middle ground of loans that do not fit either description. One of the benefits of subprime mortgage lending is that it makes home ownership possible for some people who can not qualify for prime mortgage loans but who are reasonably good credit risks

and have a high likelihood of repaying their loans.[27] There are many benefits to society of increasing home ownership as long as the financing mechanisms are appropriate. Home owners build equity, take better care of their homes, and participate more in their communities. However, as we noted earlier in this article, fewer than 20 percent of subprime mortgages are used to purchase homes. The large majority of subprime mortgages are used either as second mortgages or to refinance existing home loans.

In the large space between clearly predatory lending and careful, responsible lending, there are many loans that might represent sound financial transactions and might not. For instance, there is a category of mortgage loans referred to as Alt-A. These loans are not quite sufficiently solid to rate as prime, but the borrowers have near-prime characteristics. Such loans might be thought of as the most sound of the subprimes. On the other hand, during the height of the subprime boom, there was a category of mortgage loans known as "stated income." For these loans, the applicant stated their income (a key component in judging credit risk), and the lender did not verify that the applicant did indeed have the income stated. Many of these loans were classified as Alt-A as long as the borrower had a reasonably high FICO (credit) score. This practice, while not predatory by definition, certainly encourages applicants to lie about their income in order to qualify for a loan. If the applicant could obtain a loan honestly by stating their true income, then there is no reason not to verify, except to omit a very minor administrative cost and delay.

Some lenders allowed applicants to obtain mortgage loans up to, or occasionally exceeding, the appraised value of the home. Such loans make financial sense only if housing prices can not decline, which in light of present trends is obviously not the case. Again, these loans do not quite meet the definition of predatory lending, unless the lender encouraged the borrower to take such loans in spite of other credit weaknesses such as high nonmortgage debt or adjustable rates. Nonetheless, such loans cannot be described as financially prudent, responsible lending.

What kind of loans to make available to borrowers is a policy-making decision. As such, senior executives will normally be the

decision makers, and individual lending officers or members of loan committees will be constrained from offering loans to individual applicants who do not fit the current policy of their organization. Most mortgage lenders have a variety of loan types (prime, Alt-A, subprime adjustable, etc.) available for borrowers so individual loan officers and members of loan committees still have decision-making power and discretion.

At the end of the middle ground that is nearest to predatory lending, the same kind of ethical analysis applies that is relevant to predatory loans. If a loan is likely to be inappropriate for a borrower to the extent that failure to pay and subsequent default and foreclosure are likely, then the lender is acting unethically in approving the loan. Again, "the lender" is not an abstract corporate entity but one or more individuals with the authority to approve the loan. We might call this type of lending careless lending. The individual or individuals approving the loan do not show care either for the borrower or for others who will be harmed if the loan ends in default.

Legally, the duties of mortgage brokers and lenders to borrowers are weak.[28] In most cases, they do not rise to the level of legal fiduciary duties. Morally, there is some duty not to approve loans that will likely cause harm to borrowers and to others. One factor that comes into play in many cases is the fact that the mortgage broker and the lender themselves will not suffer negative consequences in many cases if the loan goes bad because the loan as issued will promptly be sold to a securitizer and then in turn, will be packaged and sold to other investors. The broker and lender will receive their compensation and will have no further financial involvement with the loan or the borrower, whatever the final results are.

This freedom from final consequences does not remove all moral obligations on the part of the broker and lender to take care in their dealings with the borrower. We saw in the case of predatory lending that it is immoral to profit by harming borrowers and others. What we are calling careless lending is only a bit further up the scale from plainly wrong behavior to careful, responsible lending. Moral obligation does not disappear because a loan does not qualify as predatory. Loans likely to end badly, in default and foreclosure, hold out much the same prospect of harm to the borrower and others as do predatory loans. Thus, responsibility

for the likely harm can not be ignored in evaluating moral obligations in the case of such loans.

The fact that securitizers may assemble packages of loans that are less attractive than they are made to appear, or that rating agencies may give these packages higher ratings than they objectively deserve, or that investors may blindly purchase parts of such packages without taking reasonable care, does not absolve the broker or lender from all moral responsibility. The moral obligation to take some care for the consequences of actions remains in force even though others in the chain of transactions may also have significant roles to play in affecting final results.

As we move further from the realm of predatory lending and closer to the realm of responsible lending, it may be impossible to identify the precise point on the scale where brokers and lenders act with sufficient care and responsibility to be considered moral rather than immoral in their actions. The inability to identify the turning point does not negate the fact that in some cases, unethical decisions and actions have occurred, and harmful results have followed.

## CONCLUSION

Can we then say that the subprime mortgage mess described at the beginning of this article, with all of its attendant harms and negative consequences, has been caused by the unethical or immoral actions of some individuals? At least in part, yes. Otherwise, we have to maintain that foreseeable harms resulting from the decisions or actions of individuals are somehow disconnected from those decisions or actions. It may well be that no single broker, or loan officer, or member of a loan committee, or executive who approved inappropriate product lines, thought that he or she was going to cause anything like the mess that has resulted, and in fact, no single individual did cause the subprime lending mess. However, the aggregated decisions and actions of many individuals did cause the mess. It did not simply fall from the sky or magically appear at the confluence of several streams of actions.

Adam Smith, in his famous book *The Wealth of Nations*, told us long ago that self-interested business people would help society.[29]

Less well-known is the fact that Adam Smith's job for many years was professor of moral philosophy. In another book, *The Theory of Moral Sentiments*, he says that "[t]here can be no proper motive for hurting our neighbour, there can be no incitement to do evil to another which mankind will go along with, except just indignation for evil which that other has done to us."[30] An individual who takes part in predatory or careless lending is hurting others. Mankind may understandably have trouble going along.

## NOTES

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