



# Subprime Mortgages and the Moral Imperative to Help Homeowners

Michael Boylan

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## Introduction

**D**ebate in Congress and among financial regulatory policymakers over how to manage the housing and credit crises have mostly focused on how the interconnected crises have affected the markets—and not on how it has affected the average American. When a large Wall Street investment bank such as Bear Stearns Cos., which was known for its aggressive mortgage lending cum mortgage securitization practices, is allowed to avoid bankruptcy because it's too large to fail, but ordinary folk are told to pay heavily for their mistakes, then something is morally wrong.

When the invisible hand of the marketplace is given a hefty influx of money from the Federal Reserve (with an implicit backing from U.S. taxpayers) to help the credit market, many applaud the action. But what about individual homeowners facing foreclosure? This essay will take the position that one essential perspective in this ménage of high finance is the plight of low- and moderate-income home-owning families living in a house facing foreclosure. What of their lot? Will the invisible hand help them? Or do we instead need a visible helping hand to help responsible family homeowners stay in their homes?

Families need a helping hand from government because the invisible hand imposes high social costs in the face of multiple market failures. The analysis that follows, however, starts from a very different place than would usually be expected—detailing the fundamental philosophical and thus moral imperatives for helping low- and moderate-income homeowners keep a roof they own over their heads. This approach requires the swift exploration of several telling philosophical truisms; terms such as “human claims rights” and “goods of agency” and “human agency.”

Far from being arcane philosophical terms, these fundamental truths (as we shall see) underscore exactly why members of Congress have a moral obligation to help those homeowners who through no fault of their own face foreclosure and financial ruin due to housing and credit crises for which they bear little if any responsibility.

## The Philosophical Argument

The argument for the helping hand approach stems philosophically from the nature of so called human claim rights. The structure of a claim right is:

**X** has a right to **Y** against **Z** in virtue of **M**.<sup>1</sup>

**X** is a person or robust group.

**Y** is a good of human agency, which philosophers define as what people need in order to live their lives through purposive action.

**Z** is the person or group against which the right is asserted.

**M** is the legitimating moral or legal institution, such as government.

Here's a historical case in point: A philosopher could have rightly argued in 1965 during the debate over the Voting Rights Act that "African Americans (X) have a right to vote (Y) that ought to be recognized by the people of the United States (Z) by virtue of the 14th Amendment of the Constitution (M)."

This and all other human claim rights entail a correlative duty of the following structure:

Z has a duty to provide X with Y in virtue of M. In the case above that means "the people of the United States have a duty to provide African Americans the right to vote by virtue of the 14th Amendment of the Constitution." All legitimate rights claims entail this correlative duty.

What is critical in this analysis is the nature of all four constituent elements. But to give further clarity to this, it is instructive to examine the nature of the goods of agency. It is the position of this essay that goods of agency are ethically important as they proximately permit the very possibility of human agency, or the ability of individuals to make choices and then act on those choices in their everyday lives. This model of human agency will be taken to be descriptive of our most essential desires: human nature understood as the desire to act.

How shall people understand their social responsibility to individual human agency? It is the contention of this essay that the answer to this question is one properly posed to people collectively and individually. The trick here is to get people to recognize that the goods they personally want for themselves to promote their personal agency also apply to others. It is not a big leap if we assume that the basis of any of our personal claims

for these goods is grounded in human needs (the needs for any individual to perform action).

Again, let's examine this in light of our philosophical argument about the Voting Rights Act of 1965. Enabling individuals to be able to vote in a democracy (a very important good of moral agency) is more important than many other goods one might claim for oneself. One must

accept, then (upon the pain of logical contradiction), that what one claims for oneself, others can also legitimately claim for themselves. Those goods, including voting, are more primary and important to action than those goods more remote to action, such as luxury goods.

If this is true, then among various rights claims those that describe claims to goods more embedded to action will trump

<b>THE TABLE OF EMBEDDEDNESS</b>	
<i>The hierarchy of goods involved in human claim rights</i>	
<b>BASIC GOODS</b>	
<b>Level One: <i>Most Deeply Embedded, or that which is absolutely necessary for human action:</i></b>	
<ul style="list-style-type: none"> <li>• Food</li> <li>• Clothing</li> <li>• Shelter</li> <li>• Protection from unwarranted bodily harm</li> </ul>	
<b>Level Two: <i>Deeply Embedded, or that which is necessary for effective basic action within any given society:</i></b>	
<ul style="list-style-type: none"> <li>• Literacy in the language of the country</li> <li>• Basic mathematical skills</li> <li>• Other fundamental skills necessary to be an effective agent in that country, e.g., in the United States some computer literacy is necessary</li> <li>• Some familiarity with the culture and history of the country in which one lives</li> <li>• The assurance that those you interact with are not lying to promote their own interests</li> <li>• The assurance that those you interact with will recognize your human dignity (as per above) and not exploit you as a means only</li> <li>• Basic human rights such as those listed in the U.S. Bill of Rights and the United Nations Universal Declaration of Human Rights</li> </ul>	
<b>SECONDARY GOODS</b>	
<b>Level One: <i>Life Enhancing—Medium to High-Medium on Embeddedness</i></b>	
<ul style="list-style-type: none"> <li>• Basic societal respect</li> <li>• Equal opportunity to compete for the prudential goods of society</li> <li>• Ability to pursue a life plan according to the Personal Worldview Imperative</li> <li>• Ability to participate equally as an agent in the Shared Community Worldview Imperative</li> </ul>	
<b>Level Two: <i>Useful—Medium to low-Medium Embeddedness</i></b>	
<ul style="list-style-type: none"> <li>• Ability to utilize one's real and portable property in the manner one chooses</li> <li>• Ability to gain from and exploit the consequences of one's labor regardless of starting point</li> <li>• Ability to pursue goods that are generally owned by most citizens; in the United States today a telephone, television, and automobile would fit into this class</li> </ul>	
<b>Level Three: <i>Luxurious—Low Embeddedness</i></b>	
<ul style="list-style-type: none"> <li>• Ability to pursue goods that are pleasant even though they are far removed from action and from the expectations of most citizens within a given country; in the United States today a European vacation would fit into this class</li> <li>• Ability to exert one's will so that she might extract a disproportionate share of society's resources for her own use</li> </ul>	

those more remote. For instance, claims to luxury goods are weaker than claims to food to keep one alive. Thus, in a contest, bread trumps a diamond, which is why society should treat claims to the latter good first. To make this more concrete, the table below depicts the hierarchy of goods that may be involved in right claims.

If this table is roughly correct vis-à-vis the goods needed to provide the possibility of action, and if it is accepted that all people

count as one with an equal claim first upon the most fundamental, then there is a correlative duty (subject to the ability to provide these goods—often called the ‘ought implies can’ caveat) for all people in the United States first to provide level-one basic goods to everyone in their society. Only then is action needed to provide level-two basic goods, and finally level-one secondary goods. The other two levels of secondary goods can be divided according to a competitive marketplace.

## Theory of Embeddedness and the Housing and Credit Crises

So how does this theory relate to the secondary mortgage crisis? There are two levels of response. First, in many cases borrowers were denied the level-two basic good that those you interact with will recognize your human dignity and not exploit you as a means only. And second, in many cases borrowers were denied basic societal respect and the equal opportunity to compete for the prudential goods of society. These will be examined respectively.

### A Borrower's Right of Non-Exploitation

First, the non-exploitation good of agency was in many cases denied to borrowers by offering them a mortgage that was unfair to begin with. In the absence of mortgage brokers' fiduciary duties to the borrower, many subprime borrowers were offered inappropriate and high-priced loans. Brokers were paid an incentive fee known as a yield spread premium based on the interest rate on each loan they closed.

Likewise, as mortgage originators knew they would sell the rights to future mortgage payments to Wall Street investment banks almost immediately—to be repackaged into mortgage-backed securities and sold to institutional investors worldwide—the opportunity for fast, easy payouts left little incentive within the system to engage in serious due diligence. While some subprime loans began with unrealistically low introductory interest rates that would reset to a much higher level, most subprime adjustable rate mortgages had initial rates that were already at or above market; when these ARMs reset, borrowers often faced interest rates into the double digits.

Borrowers who legitimately questioned their ability to sustain these loans after resets were often assured by the originator or broker that they could always refinance to keep their payments down. When real world conditions set in—often two or three years after the loan was closed, but in some of the highest cost loans, as soon as a few months after closing—there was a scenario of probable failure written all over these loan conditions. It was almost as if the loans were meant to go into default so that the house might be sold again and new closing costs might be earned by the lending institution all over again.

Such loan behavior is best described as predatory lending. We have seen how payday loans (another variety of predatory lending) have been used to ill effect upon low-income individuals—and even upon the brave men and women in our armed forces. Predatory lending is unfair and is structured to stack the odds against borrowers. Because predatory lending creates an unfair contract with borrowers, it treats them as

means only and violates their right to a level-two basic good.

On this alone, we should structure a public response to help rectify this unjustified taking of an embedded good of agency. The need for a strong public response is highlighted by the fact that most of the workouts offered by mortgage servicers participating in the Bush administration's voluntary Hope Now alliance are repayment plans that allow servicers to recoup their fees without offering borrowers in distress any serious modifications that would allow the mortgages to be sustainable over the long term.

## A Borrower's Right to Compete for the Prudential Goods of Society

Why is it that so many people signed on the dotted line for houses that they could not afford? Homeownership lies at the core of the American dream. Nothing less than societal respect and equal opportunity to compete for the prudential goods of society are at stake. Both of these are considered level-one secondary goods.

One very plausible suggestion is that these individuals were so taken with achieving their shot at the American Dream that they entered the transaction in a diminished capacity. Their desire to own a home and thus confer upon their family full status as Americans created what philosophers call an opaque context.<sup>2</sup>

Opaque contexts work like this: When someone has a primary interest or desire that is intense, it is often the case that other events will be interpreted in light of that interest. This dynamic will skew the agent's capacity to view events realistically for all their upsides and downsides. The event is seen either overly optimisti-

cally or overly pessimistically (depending upon whether the primary interest or desire coincides or is contrary to the proposed event at hand).

The result is not the rational consumer of economic textbooks, but a real person whose desire to achieve the American Dream has diminished their capacity for dispassionate judgment. Often it was the case that subprime mortgage sales people fanned these primary desires. What they should have done was to scrupulously point out the dangers in these sorts of loans. They should have kept engagement with the potential borrowers until they obtained fully informed consent.

Unless this was the case, borrowers were denied a realistic shot at the level-one secondary good they sought. As such, most borrowers did not receive this full measure of care that informed consent—especially in opaque contexts—demands, but rather faced salespeople who increased the opaque context for their own personal advantage. Thus, under this line of analysis we should structure a public response to help rectify this unjustified taking of an embedded good of agency.<sup>3</sup>

Under both levels of response, then, the lenders have culpability in the creation of the subprime mortgage. Because of this, the borrowers have a claim right to redress for the good of agency lost. Since all agents in the United States have a claim right to these goods, the public has a correlative duty to provide them to all.

In the case of subprime borrowers, this amounts to a fair public response to help these individuals stay in their homes and to retain these goods. Evidence suggests that when offered appropriate financing, borrowers with similar risk profiles are able to sustain mortgages. The next section will detail one such policy option.

## A Modest Proposal

This section will sketch out the need for policy options that are intended to help those families that are suffering the ill effects of the predatory lending practices outlined above. These policy options will be based upon the theoretical framework set out in part two of this essay, along with the general policy goals of the Center for American Progress' Task Force on Poverty.<sup>4</sup>

There are several potential goods of agency at stake. Let's look to the table of embeddedness and examine each within the context of the Center's poverty report. First, there is the first-level basic good to housing. It would seem that kicking people out of their homes in a foreclosure proceeding would violate this most deeply embedded right.

People, however, can have housing without owning the property in which they reside. It is true that the financial trauma of foreclosure may put some families on the street. The answer to this may not be to put them into a dwelling that they own, but merely into warm, secure quarters.

This can be accomplished in a number of ways, including the proposed "opportunity" housing vouchers that are designed to promote equitable development around the central cities. This is the foundation for our policy suggestions: Equal opportunity to compete for the prudential goods of society, a level-one secondary good.

Certainly there are various preconditions that would make this possible, such as the restructuring of so called Euclidean<sup>5</sup> or exclusionary zoning, which allows municipalities to zone out more affordable housing by implementing minimum lot sizes and prohibiting multifamily development. These discriminatory social policies create pressure on low- and moderate-income families to make a leap for homeownership because it is the price of entry to schools, parks, and other locally provided (and excludable) goods.

More important, however, may be the fact that homeownership is touted as the cornerstone of "the ownership society." Are there programs or policies out there that would provide similar "ownership" opportunities without the high risk that comes with an undiversified portfolio? A single piece of real estate as the overwhelming preponderance of a household's wealth certainly would qualify as undiversified.

Thus, it would be a mistake not to consider possible competing policy goals, such as living the American Dream of owning a home versus building diversified wealth. It

is clearly possible that striving for homeownership in the hope that it will be the most effective savings and investment vehicle is mistaken.

There are two ways to protect homeowners' wealth. We can insure against the risk of equity loss or we can seek to diversify their real estate portfolio. We must also begin a transformative dialog around wealth creation, ownership, and clarifying means versus carefully specified ends. In most ways, homeownership is means rather than an end, but our policies seem to treat it as an end.

Once homeownership is achieved, an individual or family is assumed to have "made it," with only a small number of programs designed to assist people in meeting the ongoing costs of ownership. Housing in the economic literature, however, is considered both a consumption good and an investment good. As a consumption good, housing provides shelter, a most deeply embedded basic good. As an investment good, it potentially provides a luxurious secondary good, the ability to pursue goods that are pleasant even though they are far removed from action.

It is possible that one could construe the "fact" of home ownership as possibly a level-two secondary good. This would put it into the class of "keeping up with the Jones's." If this were the case, then our duties to members of our society would be lower. "Equal opportunity to compete for the prudential goods of our society" is aimed at wealth accumulation. Since we have said that being able to rent a place to live is consistent with the level-one basic good of "housing," then what is left is a rather more remote good: owning one's own house.

With this in mind, we can begin to disentangle the complex good that is housing. Instead, we can consider other ways to provide the same ends via separate means, ideally in a way that respects the level-two basic good necessary for effective basic action within society versus having what one's peer group possesses (keeping up with the Jones's—a level-two secondary good).

If we split off shelter from homeownership, we return to a household that rents. But in returning to renting, we must also provide alternate means of attaining full participation in an ownership society. This could include ownership of corporations, through a reasonably diversified portfolio of stocks and bonds. If we consider that in most places over most times, real estate paces inflation, it may be far more prudent for most families simply to invest in U.S. Treasury bonds than in their homes.

For many Americans, homeownership is a wise and solid investment, but we must use the ongoing problem of abusive mortgage lending and rising foreclosures to broaden the discussion about alternative means of wealth building. (With that in mind, this is the first in a series of papers called "Homeownership Done Right.") For borrowers currently facing a rate reset and, absent any intervention or mitigation, foreclosure, we must find a way to protect these homeowners.

The reason for this is that the predatory lending practices outlined above illustrate a denial of a level-two basic good: the right not to be treated as a means only. Predatory lending does just that. It treats clients as means only. Thus, these subprime mortgage holders have a solid claim for redress.

Given this analysis, what sort of redress is in order? It is not the lavish help that the federal government has given to the financiers of predatory mortgages who are responsible for the problem either at the loan origination phase or at the mortgage bundling phase of securitization. Instead, we need recognition of strong moral claim rights that entail correlative duties.

Since there was little oversight of this process—regulators consistently failed to use their existing authority under several statutes to act in a timely fashion, or at all, in certain respects—this governmental negligence creates an even stronger standard to assist the segment of the population that are generally invisible in much of this policy discussion: the low- and moderate-income homeowners who have had their dreams shattered by those keen on collecting fees on the front end while their clients trot out the back door after the real nature of their transaction becomes clear to them.

We do not want to reward housing speculators and those who knowingly took risks that they understood. Instead, in this essay we are talking about fashioning policies that both help people stay in their own homes while creating a “cost” for alleviating the problem.

One sort of policy solution would be shared equity. In this way people can stay in their houses at rates they can afford by transferring a proportional equity in their house to the entity offering them hope.

This policy approach satisfies the moral risk factor because the homeowner does lose a little in return for the capacity to stay in his or her house.

Whether we choose this sort of solution or another is not the primary rationale for this essay.

Instead, it is all about making the plight of individual low- and middle-income homeowners visible within the subprime crisis. The wealthy investment bankers have their channels of influence, but who will speak for the individually dispossessed?

We desperately need policies to help those who have been treated unfairly in this process. Ethically minded citizens concerned with fairness and the claim right for appropriate goods of agency should desperately search for solutions for low- and middle-income Americans affected by the subprime crisis. These may include shared equity models and other solutions. The point is to make the plight of these citizens visible to the body politic.

We need policies that will give these victims of the unregulated subprime mortgage origination and securitization bulldozer of the past seven years their best chance to achieve the goal of home ownership. These Americans are the ones who are struggling to achieve the social dream of home ownership. The homeowners have a moral right to fair treatment. And we have a duty to give it to them.

## Endnotes

- 1 Wesley N. Hohfeld, *Fundamental Legal Conceptions* (New Haven, CT: Yale University Press, 1919).
- 2 Much of the modern work on opaque contexts follows W.V.O. Quine, *Word and Object* (Cambridge, MA: MIT Press, 1960): sections 31-35.
- 3 It is also possible that some of the aggressive selling of these loans were targeted to African- American and Latino communities.
- 4 Center for American Progress, "From Poverty to Prosperity: A National strategy to Cut Poverty in Half" (Washington, D.C.: Center for American Progress, April, 2007).
- 5 Euclidean or exclusionary zoning comes from a traditional zoning system thought to have been originated in Euclid, Ohio. By establishing uniform codes according to land- use categories it became very popular. However, it is very rigid and not amenable to dynamic urban planning as evidenced by performance or incentive- based planning models.

## About the Author

Michael Boylan, a Fellow at the Center for American Progress, received his Ph.D. from the University of Chicago and is professor of philosophy and chair at Marymount University. His most recent book, *The Extinction of Desire* (April, 2007), is a bold experiment in narrative philosophy. *A Just Society* (2004) is his manifesto on ethics and social/political philosophy. It is the most complete depiction of his normative worldview theory and is the subject of a forthcoming book of exploratory essays by scholars from six countries.

Boylan is also the author of “Basic Ethics” (2000), an essay on normative and applied ethics, *Genetic Engineering: Science and Ethics on the New Frontier* (2002, with Kevin E. Brown), *Ethics Across the Curriculum: A Practice-Based Approach* (2003, with James A. Donahue), and *Public Health Policy and Ethics*, (ed. 2004) along with 13 other books in philosophy and literature and over 90 articles. He is also the general editor of a series of trade books on public philosophy with Basil Blackwell Publishers and another series of books with Prentice Hall, as well as the ethics editor for the *Internet Encyclopedia of Philosophy*.

Presently, Boylan is working on an extension of his worldview theory to some of the major problems in philosophy entitled, *The Good, The True, and The Beautiful*, which is under contract and scheduled for publication in June, 2008 (U.K.) and September, 2008 (U.S.).

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