Introduction: Credit Everywhere, but Not a Drop to Drink

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Credit, credit everywhere, nary a drop to drink." If Coleridge's ancient mariner could time-travel to the United States today, he would empathize. Low-income Americans live in a society lavish with houses, cars, and stuff lining the shelves in retail malls. The problem is money. Most low-wage workers do not have enough to buy what they need, much less what their heart desires.

And credit is scarce, at least for them. Worse, that scarce credit is becoming tighter.

This world of tight credit is not new, but many have forgotten that it ever existed. Until three years ago, we all were awash in credit and had been for some time. Many lenders were eager to extend largesse, regardless of where you worked, and were quick to pay scant attention to what you earned. Credit scoring let lenders, at least in theory, calibrate rates to risk. But since very few lenders said no, borrowers lived in a rarefied world of optimism, where tomorrow would inevitably be better.

In 2007 the cascade started: the subprime market fell, then the prime one; foreclosures followed. Median household income, rising for the past three decades, dipped. In March 2009 median income for households of all ages was $49,882, compared to $52,378 in 2001. For low-income Americans (many moderate-income ones too), "tomorrow" turned grim. Rising unemployment led to more foreclosures, which depressed the revenues coming to cities and towns, which

forced cuts in services, which exacerbated the plight of residents. As for the lenders, many tottered.

Uncle Sam came to the bailout rescue, with the Troubled Asset Relief Program, Cash for Clunkers, and the Federal Housing Tax Credit.

Loose credit, particularly subprime loans, emerged as the bogey. The solution: shut off those spigots, particularly to the workers with minimal collateral and shaky credit histories. Taking a page from Coleridge, America's financial gurus saw the subprime market as an albatross, and they wanted to slay it. At least for now, the gurus have stifled the market.

The secondary consequences of this excision have been grim. Low-wage workers desperately need credit to survive, if not to prosper. Try getting to a job without a car; try buying a car—even a rickety second-hand one—without credit. Try renting an apartment without a security deposit or buying a major appliance without a credit card. For many renters, homeownership is still a strategically sound investment, just as it was for generations past. But the would-be buyer needs a mortgage.

Closing the spigots to easy credit "solved" the problem of cascading delinquencies: no credit eventually led to slowing defaults. Yet that strategy has left millions of Americans without any way to leverage their incomes. Just as crucially, the economy depends on consumers—not just wealthy ones—having access to credit. In the past year retail outlets, car manufacturers, and home builders have watched their earnings plummet, their unsold inventories mount.

In February 2010 the Joint Center for Housing Studies of Harvard University convened a national symposium, "Moving Forward: The Future of Consumer Credit and Mortgage Finance." Experts from both the public and private sectors came to ponder ways to open up those spigots responsibly and fairly.

Eugene Ludwig ("Comments: Seven Steps to a Rational Credit Policy"), reflecting on the history of consumer and mortgage credit, offered seven steps that could be taken to ensure decent access to credit for low- and moderate-income people, while protecting consumers and the economy. Most of these suggestions focused on ways to strengthen regulation and macroeconomic policy, but Ludwig also called for placing renewed emphasis on jobs and small businesses in the national conversation on credit, as well as for studying and learning from successes with microcredit in other nations.

Eric Belsky and Nela Richardson ("Rebuilding the Housing Finance System after the Boom and Bust in Nonprime Mortgage Lending") traced the regulatory and lender actions that led up to the fall and proposed measures to maintain a market for low-income borrowers, including greater regulation of the "shadow" banking system, a retooled role for government in guaranteeing debt, and stronger risk-based pricing models.

Rachel Schneider and Melissa Koide ("How Should We Serve the Short-Term Credit Needs of Low-Income Consumers?") zeroed in on short-term credit. Low-

income borrowers who need to replace a broken appliance, repair a car, or make up for lost income seek out not just banks and credit unions, but payday lenders, rent-to-own centers, pawnshops, refund anticipation lenders, and family members. The authors decried an "insufficient supply of products that are profitable for the provider yet affordable and responsibly structured." They examined several potential solutions, including credit unions that make small-dollar loans, installment lenders, account advance products (available to borrowers with direct deposit accounts), and workplace loans, often repaid through payroll deductions.

Marsha J. Courchane and Peter Zorn ("A Changing Credit Environment and Its Impact on Low-Income and Minority Borrowers and Communities") focused on the "price of credit risk"—that is, the price that lenders must pay investors to hold additional risk. With risk-based pricing, higher-risk borrowers pay higher rates.

As credit spreads widen and credit tightens, there is greater movement toward risk-based pricing. The reverse holds when credit spreads narrow. Ironically, just as greater risks were being taken at the peak of home prices, there was too little room in spreads to cover the greater risks. The authors explored the impact on low-income and minority borrowers of the flattening of risk-based pricing in 2004–07 and the tightening of credit in 2008.

Before 2008, the U.S. housing finance industry was the envy of the world; post 2008, the system has been marked by foreclosures and defaults. Michael Lea ("Alternative Forms of Mortgage Finance: What Can We Learn from Other Countries?") discussed the Danish model, the European covered bond model, the Australian and U.K. depository model, and the Canadian and Japanese guarantee model. He cautioned, "All models have strengths and weaknesses" and suggested helpful features of each.

Allen Fishbein and Ren Essene ("The Home Mortgage Disclosure Act at Thirty-Five: Past History, Current Issues") spotlighted the Home Mortgage Disclosure Act, enacted in 1975. Initially, the act, with a focus on redlining in inner cities, prompted the compilation of summary statistics on loans in census tracts. In an expansionary period, the act as amended in 1989 shifted to mortgage discrimination at the loan level, adding data on the race and income of mortgage applicants and whether or not their applications were accepted. Now the act has shifted its focus to reverse redlining. Revised in 2001, Regulation C requires lenders to collect pricing information for high-cost loans. The authors discussed the possibilities for expanding reporting under the act.

Howell E. Jackson ("Loan-Level Disclosure in Securitization Transactions: A Problem with Three Dimensions") pointed to the initial problem of disclosure: the tranches of initial securities were merged with the tranches from other offerings into collateralized debt obligations and other complex creations. With no uniform loan-level information, analysts could not distinguish good from bad loans

or evaluate the collateralized debt obligations. One call today is for new reporting requirements for securitized loans, including public disclosure.

To date, the U.S. system of consumer finance regulation has been "idiosyncratically fragmented" compared to the systems in other developed countries. John Campbell, Howell E. Jackson, Brigitte Madrian, and Peter Tufano ("The Regulation of Consumer Financial Products: An Introductory Essay with a Case Study on Payday Lending") discussed the administration's proposed Consumer Financial Protection Bureau, including the limits to regulation, the role of measurement, and the types of future research needed.

Before the fall, credit was too loose, the disclosure of risk was minimal, and oversight was fragmented. Over the past three years, analysts have looked back, laboriously probing the agents of "blame."

These panelists looked forward. They recognized the crucial niche of credit in the lives of working Americans. Their challenge was to envision a system that would extend credit to low-income borrowers, while keeping all parties—borrowers, lenders, and investors—solvent. Gone, they hoped, will be today's complex fine-print financial product explanations that baffle even graduates of the finest business schools. (Try reading the terms of conditions for a credit card, which can run as long as eight pages.) The explanations, as well as the products, will be clear and easy to understand.

Financial education will go hand-in-hand with borrowing. Drivers do not need to understand carburetors to buy cars, but they do need some basic financial understanding to borrow for those cars. "Borrower emptor" has been not just cruel to the borrower, but also disastrous to the financial system.

Lenders will profit not from the origination of the loans, but from their performance, giving lenders a genuine incentive to lend to people with a reasonable chance of paying. Again, defaults have wreaked havoc not just on individual borrowers, but also on lenders and investors.

The government will move off the sidelines, no longer trusting "the market" to even out the cyclical dips and rises. The 2008 dip was too deep for the government simply to step aside, with anodyne bromides about short- and long-term cycles working themselves out. The government moved to bail out a collapsed system; from now on, it will remain involved more actively in overseeing that system.

Transparency will be the watchword not just for borrowers, but also for investors. In the past, toxic mortgages infected the financial products, but those mortgages were buried deep in complex securities. No longer will securities obfuscate the toxic loan components.

There will be a more unified regulatory structure for financial institutions. Consumer financial oversight will no longer be an appendage to a bevy of diverse regulators, but it will be centralized in a single authority.

Steps in these directions are already being taken. Revisions to the Truth in Lending Act, the Home Owners Equity Protection Act, and the Real Estate Settlement Procedures Act have been made. The financial reform bill that passed Congress in the summer of 2010 has improved the loan-level disclosures for investors and the disclosures of credit histories in the Home Mortgage Disclosure Act, promised to strengthen consumer protection through creation of a unified bureau within the Federal Reserve, imposed more stringent requirements on underwriting loans that do not meet a narrow "qualified" definition, placed limits on the ways that brokers can be compensated, and improved the disclosure of this compensation. While these steps will bring greater transparency and reduce risk taking, their impacts on access to credit remain to be seen.

Let us return to the ancient mariner: he repented; the albatross lived. So too the nation must reopen the spigots of credit to low- and moderate-income Americans, but those spigots should work more efficiently and fairly for borrowers, lenders, investors, and the nation as a whole.