

## Does it pay to play by the rules?

By [Jay MacDonald](#) • Bankrate.com - December 19, 2008  
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Everywhere you look these days, someone is being rewarded for bad behavior. Wall Street bankers, hedge fund managers, mortgage lenders, even homeowners who knowingly bought homes they couldn't afford -- all have abandoned the moral high ground and are now heading down to bailout town, where the fat cats dine. With bailouts seemingly blowing in the wind, it's hard not to feel like a chump for being fiscally responsible.

Does it still pay to play by the rules?

Peter Schiff, president and chief global strategist of Connecticut-based brokerage firm Euro Pacific Capital, believes government policies are undermining people who behave well, while rewarding those who are irresponsible.

The government is sending out the wrong message by letting everyone involved in this financial folly -- lenders and borrowers alike -- escape the consequences of their actions, says Schiff.

"People say, 'Oh, this isn't fair that people have to suffer,'" he says. "Well, yes it is; they made their bed, now they have to lie in it."

*"What the government is saying with the bailout is, 'be irresponsible, be reckless, and you'll get rewarded.'"*

No price to pay

Schiff is author of the 2007 book "Crash Proof: How to Profit From the Coming Economic Collapse." He was among a handful of pundits and economists who correctly forecast the current financial meltdown.

To illustrate his argument for how the government rewards bad behavior, Schiff cites the example of the [Streamlined Modification Program](#), or SMP. The SMP is a recently implemented joint effort on the part of the private sector and the federal government to bring mortgage payments for some delinquent homeowners to below 38 percent of monthly household income.

Under the SMP, struggling homeowners who are 90 days or more late on their mortgage payments -- and whose loans are owned by Freddie Mac, Fannie Mae or participating lenders and servicers -- are eligible to have their loan restructured to reduce their monthly mortgage payments. Restructuring could include lowering a homeowner's mortgage rate and increasing the length of the loan term to up to 40 years.

"If by *not* paying your mortgage for three months you could qualify for a mortgage modification that would lower your mortgage payment for the next 30 or 40 years, wouldn't you at least be tempted?" Schiff asks.

Life's rules say that if you earn and save, one day you'll be able to buy a house. But Schiff notes that under the SMP's goal of reducing mortgage payments below 38 percent of gross income, the *less* you earn, the lower your mortgage payment will go.

"What does that say?" he asks. "It says that if I'm earning \$100,000 a year right now and can cut my income to \$50,000 a year, my mortgage payment is going to be half as much. Over a 30- or 40-year mortgage, that could be a \$500,000 to a \$1 million handout."

It is important to note that as part of SMP, homeowners whose mortgage rates are cut especially sharply early in the program could see their rates increased somewhat after a set period of time.

Proponents of the SMP also argue it has provisions to discourage opportunists. Homeowners must provide proof of having suffered a hardship, such as a job loss. Those who participate in the program also must sign a form stating that they didn't deliberately default on their mortgage simply to qualify for the benefit.

"But you're talking about people who already lied on their mortgages in the first place by exaggerating their income," Schiff says. "So why wouldn't they lie here?"

Usually, a failure to pay your mortgage lowers your credit score. But with a loan modification, Schiff says, "you'll probably have a higher credit score because now your debt-to-income ratio when you start repaying is going to be a lot better.

"If your mortgage gets cut in half, you're a much better risk than an idiot who is struggling to make his mortgage payment."

Schiff is convinced that angry homeowners will queue up right behind the victims of predatory lending in hopes of landing their own mortgage modifications. He's especially frustrated by the thought that the program could benefit unscrupulous lenders who created the subprime mortgage mess in the first place.

"You're going to have all these mortgage bankers who have nothing to do cold-calling the country, trying to encourage people to qualify," he says. "Instead of encouraging people to exaggerate their income, now they're going to lie to minimize their income."

#### Faulty assumption

However, Charles Geisst is not so sure people will exploit the government's good intentions.

"That was the same assumption used to revise the bankruptcy laws a few years ago, that people were taking advantage of bankruptcy and using it as a tool. I don't think so," says Geisst, professor of finance at Manhattan College in Riverdale, N.Y., and author of "Undue Influence: How the Wall Street Elite Puts the Financial System at Risk."

"I'm sure some did (take advantage), but I think it was just a matter of people being in over their heads and not realizing it," he says.

Kathleen Day, spokeswoman for the Center for Responsible Lending in Durham, N.C., believes it's wrong to point the finger of blame at borrowers who have fallen into a pit of trouble and are now looking for help to climb out.

She says no one in their right mind would join in the subprime debacle voluntarily.

"If anyone thinks that they're an idiot for acting responsibly, just look at the mess we have," she says.

In fact, she says, the majority of people who took out subprime loans actually have played by the rules and acted responsibly, despite a widespread perception to the contrary.

"Were there some outliers? Sure," she says. "But just looking at the mortgage market, 90 percent of the people who got subprime loans live in their homes, and six out of 10 who got a subprime loan in 2006 had a credit score that would have qualified them for a traditional, lower-cost loan."

If anyone has failed to play by the rules, it's the lenders, she says.

"It's not the people who took out this debt, it's the people who gave it to them who weren't playing by the rules through irresponsible underwriting."

#### Do the right thing

Even if bad behavior *is* being rewarded, there are compelling reasons to play by the rules, according to Bruce Weinstein.

"The reason to do the right thing is simply because it is the right thing to do," says Weinstein, author of "Life Principles: Feeling Good by Doing Good."

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Weinstein -- a professional ethicist known by the moniker "The Ethics Guy" -- says individuals should not adjust their moral principles simply for financial gain.

"If it is wrong, for example, to run up a huge personal debt without having the means for paying it off, then it's still wrong even if 100 or 100,000 other people are doing it," he says.

As our parents tirelessly explained, moral rules exist for a reason.

"Imagine what our society would become if we created moral rules not on the basis of their inherent rightness or wrongness but by how a lot of people actually behave," he says. "By this line of reasoning, we would have to say that lying, cheating and stealing are ethically permissible or even laudable. This, of course, is ridiculous."

For her part, Day argues that bailouts don't reward irresponsible behavior as much as people think. A mortgage modification is nothing to covet, even for profit, she says.

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"It is no picnic to get in line to seek a loan modification," she says.

Day insists that homeowners who receive a loan modification are "not being bailed out." Instead, they are receiving a new mortgage rate they can afford.

"They're not even going to be given the rate they should have been given; they're just going to be given rates they can afford, which may or may not still be more expensive than they should be," she says.

In addition, a mortgage modification comes with a heavy price for borrowers in that it is likely to hurt their credit, she says.

"You don't want to ruin your credit rating and then be subject to real loan sharks," Day says. "That is not a bargain."

However, Schiff insists the advent of Bailout Nation increases "moral hazard," the concept that ignoring -- or worse, bailing out -- bad behavior only serves to encourage it in the future.

That sends a dangerous signal to people who have played by the rules in the past, Schiff says.

"What the government is saying with the bailout is, 'be irresponsible, be reckless, and you'll get rewarded; be responsible, and you get punished because you'll have to pay for all the irresponsibility of everyone else,'" he says.

"You can't have a society like that. It won't work."