

Subprime Mortgage Lending - Expanded Guidance

Even in the late 1990s, subprime lending was becoming more and more of a problem. The 2001 Expanded Guidance was an expansion of earlier statements about this issue. The agencies' focus was the responsible use of subprime lending to assist subprime consumers to win back their credit ratings. Regaining lost credit would enable these people to enhance their financial situations. At the same time, the agencies stressed that lenders who assume a greater risk by lending to subprime individuals must also show evidence of ability to maintain their duty of upholding the public's trust in financial matters. It is the lender's responsibility to assess most carefully whether or not the borrower is likely to be able to repay the debt incurred. Painstaking effort is required to create strict rules of underwriting to assist in such assessment. Only when controls like this exist will both borrower and lender enjoy minimized risk of loss.

This Expanded Guidance clearly defined for the first time the criteria used to decide whether a potential borrower will be classified as "prime" or "subprime." It states that at least one of these issues will characterize a borrower as subprime when the person applies for a loan:

- Low credit score
- Bad credit history, including
 - collection accounts
 - repossessions
 - late payments of invoices
 - bankruptcy
 - debts that have been written off as uncollectable, called "charge-offs"
- high ratio of debt to income
- decreased ability to pay off the loan.

Further, the document describes these attributes of the subprime borrower:

- has a Fair Isaac Corporation (FICO) credit score of less than 660;
- has collection activity, liens, charge-offs, or judgments within the past two years;
- within the past year, has had two late payments;
- within the past two years, has made a payment that was more than 60 days late;
- has a ratio of debt to income of at least 50%;
- has declared bankruptcy in the past five years;
- has been assigned a score by another credit rating service that would equate to a FICO score of 660.

All lenders use these standards to identify subprime borrowers. Bear in mind that even if you have a FICO score that is better than 660, you will still be considered a subprime borrower if you possess a single one of the attributes listed above.

Expanded Guidance offers a clear definition of lending practices to be considered "predatory." The agencies in no way insinuate that predatory lending practices characterize all subprime lenders. In fact, it is their belief that benefits for both the borrower and the lender come from using subprime loans that are administered properly. Nonetheless, the public should be made aware that predatory lending practices do exist, and that borrowing at subprime may leave them vulnerable to such practices. In predatory lending, the exchange between borrower and lender is very unequal: the lender

gets the borrower's money and the borrower gets not much of anything!

Most predatory lending practices fall into three categories.

- Many car loans and housing mortgages are made based on assets pledged by the borrower as collateral, rather than on the borrower's actual ability to fulfill the debt.
- "Loan flipping" occurs when a lender coerces or talks a borrower into refinancing a mortgage, at no advantage to the homeowner, but at great advantage to the lender, who may collect sizeable fees for the transaction.
- Failing to reveal to the borrower all the hidden fees and costs of a loan, and concealing information or providing fraudulent information to the borrower.
- Very often, these practices are perpetrated on vulnerable borrowers, like the elderly, minority homeowners, or low-income families. In many cases, these people would actually have qualified for a mortgage at prime rates; but they are at a disadvantage because of their lack of knowledge.

If you are thinking of borrowing at subprime for a mortgage, you should familiarize yourself with the 2001 Expanded Guidance for Subprime Lending. It is available on the Internet, and is definitely worthwhile reading. It laid a fine foundation for further definition of the responsibilities of subprime lenders and the needs and rights of subprime borrowers.

About the Author

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