Countrywide Case

1. Without making specific reference to the practices of CFC, describe what you believe to be an ethical lending policy. Be specific about the practices you would require and those you would prohibit as well as the ethical theories underlying your decision.

2. Were the business practices of CFC ethical? Describe the policies you find to be particularly ethical, if any, and the practices you find to be particularly unethical, if any. Justify your classification of a practice as ethical or unethical by reference to the theories enumerated in your answer to #1.

3. Identify an alternative set of business practices that CFC might have adopted to improve its ethical position. Be specific about the ethical improvement that would result, as well as any ethical tradeoffs that need to be considered.
An ethical lending policy is a policy where a firm uses non-discriminatory and fair practice procedures that promote homeownership. These practices must be in the best interest of homeowners, secondary mortgage market investors, and the lending firm’s long-term financial interests. The lending policy must include strict guidelines and rules as to how an investor can qualify for a loan. The strict guidelines for a prime investor, a future homeowner who has a good credit score and a positive financial history, must be different than the rules and guidelines for a subprime investor, one who has a poor credit score and high debt to income ratio. While subprime loans are risky investments, it would be unethical to deny all possible investors the chance to own their own home because their credit score is just below the prime credit score rating. The rules and guidelines for handling both prime and subprime mortgages must allow for open communication between lender and investor. In order to achieve an ethical lending policy, the trust between lender and investor must be established first in order to promote a healthy financial relationship. This can be achieved by first making the investor disclose financial information such as credit score, employment history, and financial history. Next, the lending firm must disclose all information regarding the loan or mortgage in order to educate the investor on the terms and interest rates of the loan. The lending firm must then analyze the financial information of the investor and determine if they can afford the loan for the full duration of the loan. If there is any doubt that the investor may not be able to make payments, then this information needs to be communicated back to the investor. If new terms cannot be negotiated then the deal must be terminated in order to prevent unethical lending practices. Ethical lending practices would prohibit the misrepresentation of any information regarding the loan’s rates. The change in interest
rates and payment amounts must be communicated to the investor in order to better determine whether the loan is a good investment for both the lending firm and investor. Each loan must also follow the strict rules and guidelines of the lending firm and local laws for writing a loan and must receive the approval of an upper management lender in order to be finalized and signed. The approval of loans with no down payment is also prohibited. An ethical lending policy would require the investor to put a down payment on the loan based on a certain percentage of the home’s cost in order to ensure the loan is in the best interest of both lending firm and the investor. An ethical lending policy would also prohibit incentive compensation for just creating loans. Incentive programs can work to the lending firm’s advantage, but must be based on how successful the loan’s performance is. These lending practices are ethical because they do not seek to manipulate numbers and misrepresent loan and investor information in order to profit from investor loss. The main school of thought that underlies these practices is ethical universalism, which promotes trust, honesty, and the avoidance of any harm to employee or customer. (Khan, 2011) This means that what is considered ethical and unethical, holds true across all nations. Corporate social responsibility is another underlying theory that influenced these lending practices. (Khan, 2011) By exercising corporate social responsibility, the lending firm can assure its employees and customers that they are practicing ethical lending policies by conducting business in a purely honest manner. (Khan, 2011) Deontological ethics is another theory these lending practices are influenced by because ethical behavior based on this theory states that benefiting from others harm is not ethical. (Khan, 2011)
2. Most of the business practices of Countrywide Financial Corporation were unethical in nature. The only lending practice that was ethical were the mortgages CFC approved for investors that were qualified and were appropriate investments based on honest financial data. This is considered ethical because based on the school of ethical universalism; honesty is the basis for this lending practice. Countrywide mainly practiced unethical lending practices by placing borrowers in loans they clearly could not afford. (Eastburn, 2011) Other unethical practices by CFC were not following company and industry underwriting standards, providing mortgage underwriters incentive bonuses based on number of mortgages approved, and misrepresenting financing rates. (Eastburn, 2011) The unethical practices of misrepresenting financing rates also included misrepresenting adjustable rates as fixed rates, misrepresenting how payments would increase after initial fixed rate period ended, and misrepresenting teaser rate’s expiration dates, thus making the investor have to take on larger payments beyond their financial means. (Eastburn, 2011) All of these unethical practices are considered unethical based on the school of ethical universalism because each one is dishonest in nature. Deontological ethics also supports these lending practices as unethical because it states that firms cannot use other people for the benefit of the firm. In this case, Countrywide is being dishonest in how it lends to investors because it wants to create as many loans as possible in order to generate more profit.

3. An alternative set of business practices that Countrywide would have adopted to improve its ethical position would be to first change all lending rules and guidelines that were dishonest to honest. The main ethical issue with CFC was the dishonesty in how they lend to investors. By adopting an “honesty” policy, CFC would abolish the
misrepresenting practices of “tricking” investors into loans that they are unable to handle. CFC would need to use hard financial data to back their lending approval decisions. By communicating the full details to investors about the loan and its terms, CFC would be engaging in ethical lending practices because they are based on honesty. This honesty would result in an increase in successful loans and mortgages that would ultimately lead to more successful long term homeownership. Also changing the incentive compensation program to loan underwriters based on volume is needed. By changing the basis of this incentive program from volume to successful loan performance, this would result in less defaults and foreclosures and more satisfied customers.

Works Cited


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