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**THE WALL STREET JOURNAL**

WSJ.com

MARKETS | JUNE 9, 2007

## Did Greenspan Add to Subprime Woes?

*Gramlich Says Ex-Colleague Blocked Crackdown On Predatory Lenders Despite Growing Concerns*

By GREG IP

Alan Greenspan was arguably the country's most powerful financial cop in his 18 years as chairman of the Federal Reserve. But Mr. Greenspan's regulatory record has received far less scrutiny than his management of the economy.

That may be changing. A former colleague says Mr. Greenspan blocked a proposal to increase scrutiny of subprime lenders under the Fed's broad authority. That added scrutiny might have helped curtail questionable lending practices now blamed for soaring defaults by mostly low-income borrowers. Democrats in Congress are now turning up the heat on regulators, especially the Fed, for failing to do more to stamp out those practices, and the Fed appears increasingly likely to overhaul its approach.



**Alan Greenspan**

Edward Gramlich, who was Fed governor from 1997 to 2005, said he proposed to Mr. Greenspan in or around 2000, when predatory lending was a growing concern, that the Fed use its discretionary authority to send examiners into the offices of consumer-finance lenders that were units of Fed-regulated bank holding companies.

"I would have liked the Fed to be a leader" in cracking down on predatory lending, Mr. Gramlich, now a scholar at the Urban Institute, said in an interview this past week. Knowing it would be controversial with Mr. Greenspan, whose deregulatory philosophy is well known, Mr. Gramlich broached it to him personally rather than take it to the full board.

"He was opposed to it, so I didn't really pursue it," says Mr. Gramlich, a Democrat who was one of seven Fed governors.

### *Greenspan's Response*

Mr. Greenspan, in an interview, says he doesn't recall a specific discussion of the idea but confirmed his opposition to it.

There is "a very large number of small institutions, some on the margin of scrupulousness and very hard to detect when they are doing something wrong," says Mr. Greenspan, who retired in February last year. "For us to go in and audit how they act on their mortgage applications would have been a huge effort, and it's not clear to me we would have found anything that would have been worthwhile without undermining the desired availability of subprime credits."

Mr. Greenspan adds that borrowers might get a false sense of security from a lender that advertised itself as Fed-inspected.

Ben Bernanke, Mr. Greenspan's successor, told Congress in March that he has asked his staff for "a complete review of our powers and practices" in examining holding-company units. A Fed spokesman this past week said "that review is under way." The Fed Thursday will conduct a public meeting on steps it could take to strengthen laws governing subprime lending.

On June 29, the Urban Institute will release a book by Mr. Gramlich, "Subprime Mortgages: America's Latest Boom and

Bust." It argues, among other points, that all lenders affiliated with banks and thrifts could "be brought under the same supervisory conventions as their parents seemingly without major culture shock." It wouldn't be a huge undertaking by policy makers, and it would lead to more uniform, stringent practices.



**Edward Gramlich**

Mr. Gramlich, who is being treated for cancer, says, "There are certain things that unsupervised lenders do that a Fed supervisor would not let you get away with," such as not escrowing taxes and insurance, not verifying an applicant's stated income, or assessing the borrower's ability to repay based on an introductory "teaser" rate. But he said the proposal's reach would have been limited by the fact that many lenders would still have no federal supervision.

At the time President Clinton appointed Mr. Gramlich to the Federal Reserve Board, he was a University of Michigan academic who had served on commissions studying Major League Baseball and Social Security. Mr. Greenspan put him in charge of the board's community and consumer affairs committee.

Mr. Gramlich often pushed the Fed to expand fair-lending and consumer-protection rules, winning the admiration of consumer groups that often accuse the Fed of being too supportive of the financial industry. Despite their differing philosophies, Mr. Gramlich says he got along well with Mr. Greenspan, who supported him on most initiatives, especially those involving increased disclosure.

Nonetheless, his remarks represent a rare insider's criticism of Mr. Greenspan's regulatory record. Mr. Greenspan says he didn't get heavily involved in regulatory matters in part because his laissez-faire philosophy was often at odds with the goals of the laws Congress had tasked the Fed with enforcing.

"I basically listened to the staff and tried as best I could to support the staff's recommendation," he says. He notes that with one exception, on a highly technical issue, he always voted with the board majority.

Still, Mr. Greenspan's views did color the regulatory environment, facilitating growing concentration in banking and a hands-off approach to derivatives and hedge funds. That approach, broadly shared by both the Clinton and Bush administrations, is coming under increased scrutiny.

### *Heat on the Fed*

The Fed has taken heat recently for not more vigorously using its power to write consumer-protection rules for the entire industry, not just the lenders it oversees directly. Before it proposed new standards last month, the Fed hadn't conducted a broad review of its credit-card disclosure requirements since 1981 -- six years before Greenspan took office.

In 2005, 52% of subprime mortgages were originated by companies with no federal supervision, primarily mortgage brokers and stand-alone finance companies; 23% by banks and thrifts; and 25% by finance companies affiliated with banks and thrifts, including units of bank holding companies.

According to Inside Mortgage Finance, an industry publication, in 2006 three of the eight largest subprime mortgage lenders were units of bank holding companies. The Fed is one of four federal regulators that supervises deposit-taking banks and thrifts. It also has oversight over bank holding companies, with the discretion to delegate authority over their operating units to other agencies.

Thus the Fed generally leaves regulation of nationally chartered banks to the Office of the Comptroller of the Currency; of securities-dealer units to the Securities and Exchange Commission; and of consumer-finance companies to the states.

However, state regulation is generally considered inconsistent and usually less rigorous than federal oversight. Moreover, 18 states offer some form of exemption from state regulation to bank holding company units, according to the Conference of State Banking Supervisors.

The Fed periodically examines the finance-company units to ensure that they pose no threat to the "safety and soundness" of their deposit-taking affiliates and to assess their controls for things like money laundering. In special situations, it does scrutinize their practices for compliance with consumer-protection laws. In 2004, it fined Citigroup \$70 million for alleged abuses by its CitiFinancial unit.



Bloomberg News/Landov

Edward Gramlich was a Clinton appointee from the University of Michigan.

But Mr. Gramlich fretted that extending those standards to holding-company units would create an unlevel playing field unless stand-alone lenders were subjected to the same thing.

Jim Strother, general counsel for Wells Fargo & Co., said oversight of bank holding company units isn't "where the need is," noting the Fed does examine Wells Fargo Financial, a major subprime mortgage lender. "The gap is for companies that aren't in the banking system at all."

—Damian Paletta contributed to this article.

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Printed in The Wall Street Journal, page B1

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