Furloughed Federal Workers Getting Special Treatment from Lenders

October 11, 2013 - Over the last several years, millions of Americans lost jobs, homes and have had to suffer through an economic malaise involved a reduced standard of living for many. One thing those people didn't receive was a lot a help and understanding from lenders when they couldn't pay their bills. They may not have gotten much help even if they were able to pay their bills on time. Just ask anyone who has managed to hold onto their home and tried to refinance it at a lower rate while under or unemployed. Yes, a lower interest rate might help them financially and make it easier for them to meet their payment obligations but the fact that their incomes had been reduced or eliminated made them unworthy of new credit. But that apparently isn't the case for government employees unfortunate enough to have been furloughed in the current government shutdown. The federal government is now issuing "guidance" to lenders urging them to ignore safe lending standards without fear of reprisal from regulators.

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The government shutdown has put a lot of government workers on the sidelines and left many without a paycheck. Private sector employees in this position have almost no chance of being granted credit. Any lender deciding to ignore the lack of a pay check for a private sector worker and grant a large line of credit to them anyway would likely face the wrath of federal regulators. So you might think the same rules would apply to furloughed federal employees. Well, they don't.

Five federal agencies (the FED, the CFPB, the FDIC, the NCUA and the Comptroller of the Currency) have issued guidance to lenders to be understanding. The guidance includes the following statement: "The agencies encourage financial institutions to consider prudent workout arrangements that increase the potential for creditworthy borrowers to meet their obligations. The agencies realize that the effects of the federal government shutdown on individuals should be transitory, and prudent efforts to modify terms on existing loans should not be subject to examiner criticism." (Emphasis added)

While the guidance may make some senseâ€¦ the furloughs are expected to be temporaryâ€¦ it comes from agencies that are directly responsible for regulating lenders. Those lenders could very well read the statement as a threat; If you're a lender that takes a hard line with federal employees who get behind on their payments, then you can plan on some extra regulatory supervision once the government shutdown is over.

As bad as the guidance appears to be, the five agencies named above arenâ€™t the only government organizations making exceptions for their own people. Freddie Mac (which is privately incorporated but government run/owned) has issued a bulletin to mortgage lenders who may be considering home loans to federal employees. During the shutdown, lenders don't need to bother verifying the employment information for people claiming to be federal employees. Additionally,

lenders are to operate under the assumption that borrower will still have a job after the shutdown ends and that paychecks will resume. Mortgages issued under these conditions will meet Freddie Mac lending standards and can be federally guaranteedâ€¦ meaning that tax dollars are at risk.

And since the federal government isn't providing employment verification, and the IRS isn't providing tax transcripts during the shutdown, lenders can accept copies of tax returns provided by borrowers as proof of government employment and verification of income. In our estimation, this significantly increases the possibility of mortgage fraud schemes designed to defraud taxpayers on federally insured mortgages.

There is absolutely no doubt that anyone lacking a job could use some financial assistance. But the rules for private sector employees and federal employees shouldn't differ. Relaxing lending standards to a point that they encourage fraud is in nobody's long term interest. But that appears to be exactly what is happening as a result of the federal shutdown.
byJim Malmberg
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