The Washington Post

BUSINESS

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Stocks
Washtech

Wednesday, May 25, 2005

STEVEN PEARLSTEIN

Greenspan Misfires on Fannie, Freddie

We now know that the Bush administration routinely suppresses dissident views, mischaracterizes staff-level analysis and stokes irrational fears to justify predetermined, ideologically driven policy positions.

Unfortunately, this cynical approach seems to have been adopted by Alan Greenspan in his crusade to privatize Fannie Mae and Freddie Mac — a crusade that has now undercut the credibility and the independence of the Federal Reserve.

I have in my hand a report by the Fed professional staff titled, "Concentration of Risk in the OTC Market for U.S. Dollar Interest Rate Options." Until I inquired after it Monday, this report was not going to see the light of day, ostensibly because it is based on confidential information provided by Fannie, Freddie and the major dealers in interest-rate swaps. But it comes to three interesting conclusions, which I'll attempt to paraphrase using the Queen's English:

(1) The risks to the financial system posed by Fannie and Freddie's use of the derivatives market to hedge interest-rate and mortgage-prepayment risks are less than most of us thought.

(2) If either Fannie or Freddie were to fail, these derivatives markets would not melt down.

(3) The availability of these hedging instruments allows Fannie, Freddie and big banks to load up their balance sheets with mortgages and, indirectly, lower mortgage interest rates.

These conclusions posed a political problem for Sir Alan. While they confirmed his long-held belief in the value of an unregulated derivatives market, they also undercut his effort to convince Congress that Fannie and Freddie were ticking financial time bombs that did little to lower the cost of home mortgages.

So what did Greenspan do? In a virtually impenetrable speech delivered by satellite to a Fed banking conference in Chicago earlier this month, Greenspan attempted to summarize the staff study. At times, his talk tracked portions of the report almost line by line, while carefully skipping over other portions that might have given explicit comfort to Fannie, Freddie and their supporters. Then, at a crucial moment, he departed from the staff's conclusions to add one of his own, albeit without attribution:

"Nonetheless, concerns about potential disruptions to swaps market liquidity will remain valid until the vast leveraged portfolios of mortgage assets held by Fannie and Freddie are reduced."

If only Kwame Brown could pivot and fake like that, the Wizards would still be in the NBA playoffs.

When asked yesterday about the staff study concluding that the interest-rate hedges used by Fannie and Freddie might be more effective than previously thought, a Fed spokesman reminded that the mortgage giants could still make misjudgments in using those hedges — a statement as true about Fannie and Freddie as about the major banks that are regulated by the Fed and that are even bigger hedgers of risks of all kinds.

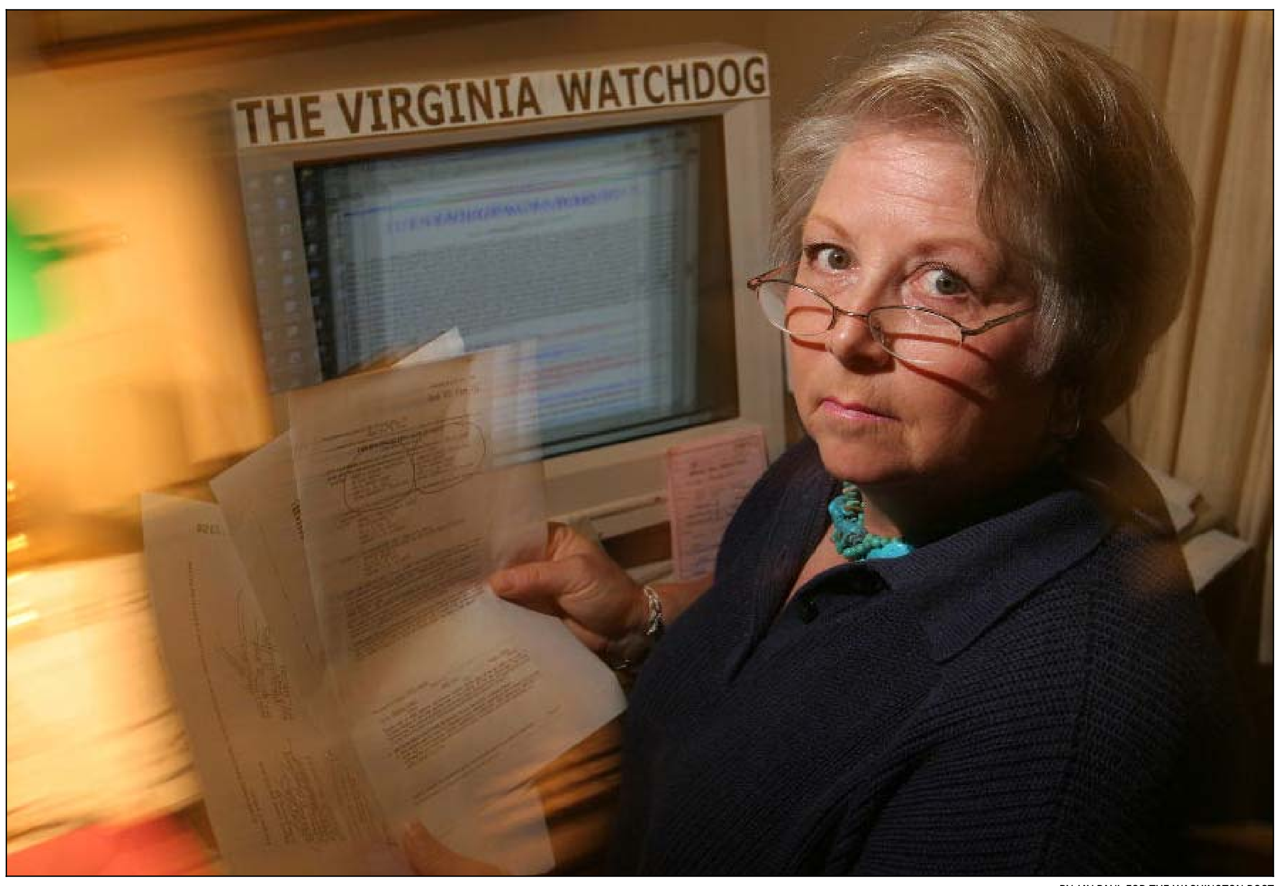
In fact, this is only the latest of the many contradictions underpinning Greenspan's relentless attack on Washington's two largest financial institutions.

He complains that Fan and Fred undermine the efficiency of capital markets by diverting huge sums to housing — then uses all sorts of econometric mumbo-jumbo to show that all this diverted capital really has only a teeny, tiny impact on cost and availability of mortgage money.

He runs around the country warning that the sky is going to fall because Fannie and Freddie are using their implicit government guarantee to borrow cheaply and load their balance sheets up with mortgage debt — but somehow ignores the fact that this "carry trade" is no different from that of the big banks whose water Greenspan has been carrying for the past 18 years. These banks, remember, also get cheap money in the form of government-insured deposits. And in the past few years, they have been buying up so many mortgages that the largest, Bank of America, held more than $400 billion in residential mortgage debt at the end of 2004. That compared with $653 billion on the books of Freddie Mac.

It is also hard to square Greenspan's overriding concern about the risk of financial meltdown posed by Fannie and

See PEARLSTEIN, E2, Col. 4



BY JAY PAUL FOR THE WASHINGTON POST

For Betty Ostergren, the solution to protecting privacy is simple: Keep public records public, but don't put them online.

A Matter Of Public Record

Activist Aims to Scare Officials Into Protecting Personal Data

By Jonathan Krim
Washington Post Staff Writer

Betty (but call her BJ) Ostergren, a feisty 56-year-old from just north of Richmond, is driven to make important people angry. She puts their Social Security numbers on her Web site, or links to where they can be found.

It's not that she wants CIA Director Porter J. Goss, former secretary of state Colin L. Powell, or Florida Gov. Jeb Bush to be victims of identity theft, as were millions of Americans in the past year. Ostergren is on a crusade to scare and shame public officials into doing something about how easy it is to get sensitive personal data.

Data brokers such as ChoicePoint Inc. and LexisNexis Group have been attractive targets for identity thieves because they are giant buyers and sellers of personal data on millions of people.

But as federal and state lawmakers try to keep sensitive information from falling into criminal hands, they face a difficult dilemma: The information typically originates from records gathered and stored by public agencies, available for anyone to see in courthouses and government buildings around the country.

What's more, local governments have in recent years rushed to put these records online.

A wealth of documents — including marriage and divorce records, property deeds, and military discharge papers — containing Social Security numbers, dates of birth and other sensitive information is accessible from any computer anywhere. Many of the online records are images of original documents, which also display people's signatures.

See RECORDS, E5, Col. 2

Home Sales Continue at Torrid Pace

No Sign Yet of Market Slowing Down Soon

By Nell Henderson
Washington Post Staff Writer

Sales and prices of existing homes rose to record highs in April, an industry group reported yesterday, four days after Federal Reserve Chairman Alan Greenspan warned in his strongest language yet that housing prices have climbed to "unsustainable" levels in many markets.

Greenspan and other Fed officials have said for a while that home-price appreciation should slow in coming months as interest rates rise, most likely in a gradual manner that will not harm the overall economy. But that process has not even begun.

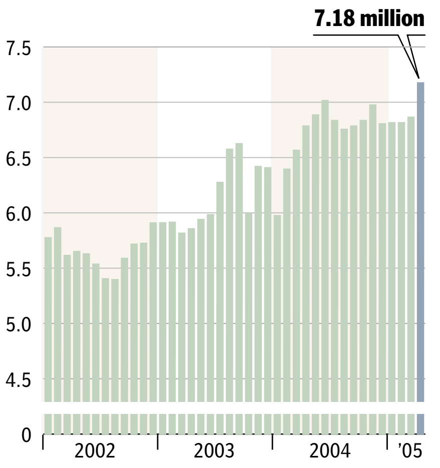
U.S. sales of previously owned homes — including single-family, townhouse, condominium and co-op units — rose 4.5 percent to an annual rate of 7.18 million units last month, after adjusting for seasonal variation, the National Association of Realtors said yesterday.

The national median price for all previ-

See ECONOMY, E3, Col. 3

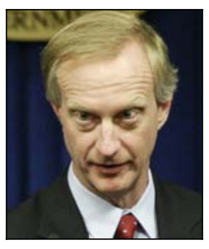
A Record High

Existing-home sales
Seasonally adjusted annual rates, in millions



SOURCE: National Association of Realtors

THE WASHINGTON POST



D.C. Council members Jack Evans, left, and Kwame R. Brown agree that their bill, aimed at Wal-Mart, should be changed.

D.C. Bill Clouds Sales Pitch to Big-Box Stores

By Michael Barbaro
Washington Post Staff Writer

LAS VEGAS, May 24 — In Washington, D.C. Council members Jack Evans and Kwame R. Brown have led the fight against the infiltration of big-box retailers, co-sponsoring a bill that would prohibit national chains such as Wal-Mart Stores Inc., Wegmans Food Markets Inc. and Costco Wholesale Corp. from building their most profitable kinds of stores in the city.

That hasn't stopped them from joining Mayor Anthony A. Williams (D) and other District officials who are here to court some of those retailers at an industry trade show.

"It's a major contradiction," said council member Vincent B. Orange Sr. (D-Ward 5), who opposes the bill and traveled to Las Vegas to meet with representatives of Costco and Target, both of which are planning to open stores in his ward but could be blocked if the proposed legislation were to become law.

The bill would ban stores with more than 80,000 square feet that devote more than 15 percent of their space to nontaxable products such as food. Council members say it is aimed squarely at Wal-Mart, but the legislation would also lock out other major chains that are considering opening stores in the city.

The bill is part of the delicate balancing act District leaders perform as they try to

See RETAILERS, E3, Col. 1

Standards for Mortgage Lending Debated

By Kirstin Downey
Washington Post Staff Writer

Lending industry officials and consumer advocates clashed Tuesday at a congressional hearing over the best ways to rein in abuses in the $600-billion-a-year market for high-cost home mortgages. Both sides agree that bad practices are resulting in people losing their homes to foreclosure because of steep payments and extra fees.

Lenders have endorsed a proposed measure that would establish uniform national lending standards, preempting more-restrictive lending laws that have been passed in more than a dozen states. The measure also would improve consumer literacy outreach aimed at protecting people buying or refinancing their homes from fraud by unscrupulous lenders.

Consumer advocates want to boost home-finance education as well, but they oppose the proposed federal measure because it would strip consumer protections from states that have done more to protect consumers than federal regulators have done. The state laws, modeled after a measure passed in North Carolina in 1999, generally limit hefty fees, prepayment penalties and "loan flipping," in which houses are refinanced frequently, stripping out eq-

See MORTGAGE, E2, Col. 4

INSIDE

BY NEAL ULEVICH — BLOOMBERG NEWS

Qwest Communications International has ended its pursuit of MCI and is now considering other acquisition targets. Story, E5.

Housing Oversight Bill

The Bush administration says it won't derail legislation establishing a new Fannie Mae and Freddie Mac regulator.
E2

Finance Chief Steps Down

BearingPoint lets its chief financial officer, Joseph Corbett, go after just four months on the job.
E5

Scrushy Trial Jury Requests Judge's Guidance

By Carrie Johnson
Washington Post Staff Writer

BIRMINGHAM, May 24 — Jurors deliberating in the conspiracy and fraud trial of former HealthSouth Corp. leader Richard M. Scrushy expressed confusion about conflicting language in the jury instructions and sought an explanation from the judge.

In the first of two notes sent Tuesday afternoon, jurors wrote that "we can not unanimously agree on a verdict" and that they needed help "in layman's terms." U.S. District Judge Karon O. Bowdre appeared to interpret the note as a request for more information rather than a sign that the jury, which has been deliberating for four days, was hopelessly deadlocked.

Later jurors wrote a second missive, telling the judge that her instructions and a 37-page verdict form appeared to be inconsistent. The judge met with prosecutors and defense lawyers late into the afternoon and is expected to respond when jurors return Wednesday morning.

The Scrushy case has attracted widespread national attention in part because he is the first chief executive to be accused of violating the 2002 Sarbanes-Oxley Act,

See HEALTHSOUTH, E5, Col. 2

DOW 10,503.68
DOWN 19.88, 0.2%

NASDAQ 2061.62
UP 4.97, 0.2%

STANDARD & POOR'S 500
1194.07, UP 0.21, 0.02%

WASH. POST-BLOOMBERG REGIONAL
259.19, DOWN 0.01, 0.004%

10-YEAR TREASURY NOTE
UP $2.81 PER $1,000, 4.03% YIELD

CURRENCIES
107.60 YEN=$1, EURO=$1.2585

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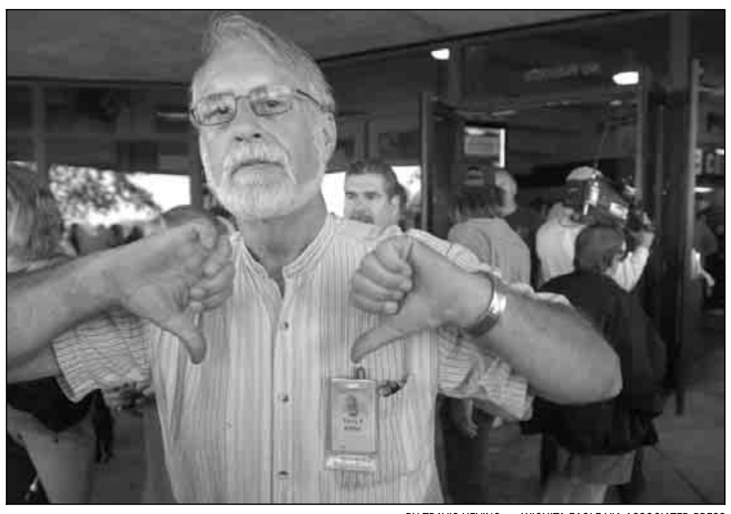
Inquiry Sought in SEC Shortfall

The chairman of the House Appropriations subcommittee that funds the Securities and Exchange Commission said he is requesting an inquiry into a $48 million budget shortfall at the agency. Rep. Frank R. Wolf (R-Va.) said he plans to ask the Government Accountability Office to conduct the review. "It is particularly unfortunate, to use a mild word, for the SEC, which is looking at other people's books, to find out that they had this problem."

Nextel to Pay Motorola $50 Million

Nextel Communications agreed to pay Motorola, its fifth-largest shareholder, a $50 million consent fee to support its merger with Sprint. Motorola manufactures Nextel's "push-to-talk" devices and owns 36.5 million Nextel shares. Sprint is paying $35 billion in stock and cash to buy its wireless phone competitor.



BY TRAVIS HEYING — WICHITA EAGLE VIA ASSOCIATED PRESS

Members of the largest union at Boeing's commercial aircraft division in Wichita yesterday rejected a labor agreement that the plant's proposed buyer, Onex Corp., had called vital to the acquisition. Here, Boeing machinist Terry Ables shows how he voted on the proposal as he walks out of the Kansas Coliseum. The union represents 5,300 workers.

MORE NEWS

Morningstar, a research company that rates mutual funds, said a unit received a subpoena from the Department of Labor that seeks information on its consulting services. It was asked to provide information on services for retirement plan providers and sponsors, the company said. New York Attorney General Eliot L. Spitzer in December requested information about services offered to retirement plan providers, including the funds Morningstar recommended. In March, the Securities and Exchange Commission requested similar information.

General Motors' debt rating was cut to non-investment grade by Fitch Ratings, three weeks after Standard & Poor's also cut the company's bond rating to junk status. Fitch cited sales declines at the top U.S. automaker and price competition in the industry as a whole. "Clearly GM has many challenges in North America, but the company is moving aggressively to address the challenges," GM spokeswoman Gina Proia said.

L. Dennis Kozlowski, Tyco International's former chief executive, thought he was acting lawfully when he accepted millions of dollars he is accused of stealing, his lawyer told jurors in New York. Austin Campriello said in closing arguments that without proof of criminal intent, Kozlowski should not be convicted.

Hedge funds added a net $24.6 billion in the first quarter, Tremont Capital Management reported. Event-driven funds — which bet on companies going through a merger, management shake-up or other corporate changes — attracted $8.2 billion, the most by a fund category. Multi-strategy funds, which invest in a variety of securities, ranked second at $6.5 billion. Convertible bond funds lost $1.8 billion, the only category of 10 with net withdrawals.

Boeing is going ahead with the launch of a cargo version of its long-range, twin-engine 777 after Air France ordered five of the airplanes with options for three more. Air Canada last month ordered two. Deliveries are scheduled to begin in the fourth quarter of 2008, Boeing said.

CVS said it will sever ties with pharmaceutical suppliers that do not buy all their medications directly from manufacturers in an effort to limit entry points for counterfeit drugs. The New York attorney general and various state legislatures have opened investigations into this so-called secondary market, in which drugs are resold by companies or hospitals with excess inventory. The sources of the products are sometimes obscure, providing an opportunity for fake drugs to sneak into the supply chain.

May and Federated department stores scheduled shareholder meetings for June to solicit endorsement of a planned $11 billion merger. It would create a retailing colossus of nearly 1,000 department stores and $30 billion in annual sales to compete against Wal-Mart and upscale merchants, and requires approval by the Federal Trade Commission.

Nordstrom said its board approved a two-for-one stock split, which will increase the number of issued shares to 1 billion. Nordstrom said it would issue the additional shares June 30 to shareholders of record as of June 13.

PalmOne is buying full rights to the brand name Palm from PalmSource for $30 million and plans to start using the label on a broader range of products. PalmOne, which makes hardware and currently puts the brand only on devices containing PalmSource systems, will return to using the name Palm Inc., the company said.

Warren E. Buffett's utility company agreed to buy PacifiCorp from Scottish Power for $5.1 billion in cash. PacifiCorp supplies power to California, at least partly from hydroelectric generators. The Berkshire Hathaway utility company, MidAmerican Energy Holdings, already owns a pipeline that carries natural gas to the state.

The Public Company Accounting Oversight Board revoked the registration of Goldstein & Morris, its first disciplinary action since it was established in 2003. The audit board is a centerpiece of the 2002 Sarbanes-Oxley corporate governance law.

College students are carrying fewer credit cards and using them less, college lender Nellie Mae found in a study, which showed that 76 percent of undergraduates carried credit cards in 2004, down from 83 percent in 2001. They carried an average of four cards and their outstanding balances averaged $2,169, down from $2,327 in 2001.

Genentech released data showing that its treatment for age-related blindness stabilized or improved vision in 95 percent of patients, compared with 62 percent taking a placebo. Rival Eyetech Pharmaceuticals shares hit a new 52-week low on the news and as two investment firms downgraded the stock.

Boeing said it would consider for its chief executive job candidates who have no experience in the aerospace industry. Candidates must have experience in manufacturing and working with government agencies in Washington. They won't come from companies significantly smaller than Boeing, board Chairman Lewis Platt said.

A publishing study estimates that a record 195,000 works came out in 2004, a 14 percent jump over the previous year and 72 percent higher than in 1995. The R.R. Bowker report follows a survey last week from the Book Industry Study Group that estimated that the number of books sold in 2004 dropped by 40 million from the previous year.

INTERNATIONAL

Three British bankers can be extradited to the United States on Enron-related fraud charges, the British Home Office said. The U.S. government wants to prosecute David Bermingham, Gary Mulgrew and Giles Darby in Texas on charges they defrauded their former employer, a unit of Royal Bank of Scotland Group, of $7.3 million by using an Enron off-the-books partnership.

EARNINGS

GameStop, the largest U.S. video game retailer, said first-quarter profit climbed 55 percent, to $10.3 million, from the corresponding period a year earlier. Strong sales of Sony's PlayStation Portable helped the company to its biggest profit gain in nine quarters. Revenue for the period ended April 30 rose 28 percent, to $474.7 million.

Computer Sciences said fourth-quarter profit more than doubled, to $411.8 million, on the sale of a division. Revenue for the period ended April 1 rose 7.9 percent, to $3.88 billion.

Medtronic's fourth-quarter profit fell 66 percent, to $194.4 million, on costs to settle a patent-infringement dispute. Revenue for the period ended April 29 rose 4 percent, to $2.78 billion.

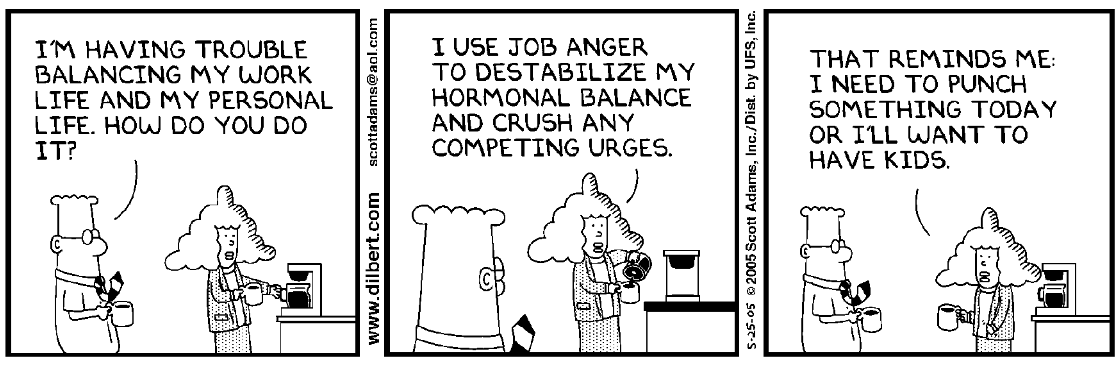
Network Appliance said fourth-quarter profit rose 74 percent, to $63.4 million. Revenue for the period ended April 30 increased 34 percent, to $451.8 million.

Dillard's, a department store chain with most of its stores in the South, said first-quarter profit fell 29 percent, to $38 million, on markdowns and falling sales. Revenue for the 13 weeks ended April 30 fell 4 percent, to $1.84 billion.

Williams-Sonoma's first-quarter profit rose 22 percent, to $26.2 million, helped by an upswing in business at its Pottery Barn chains. Earnings for the quarter ended May 1 rose 12 percent, $720.7 million.

Compiled from reports by the Associated Press, Bloomberg News, Dow Jones News Service and Washington Post staff writers.

DILBERT *By Scott Adams*



House Takes Up Bill On Fannie Oversight

Proposal at Odds With White House

By Annys Shin
Washington Post Staff Writer

The Bush administration is at odds with key provisions of legislation that would create a new regulator for housing finance companies Fannie Mae and Freddie Mac, but the administration will not attempt to derail the bill as it begins moving through the House today.

Last week, the administration recommended that Congress adopt legislation that would force the two companies to shrink their $1.5 trillion investment portfolios by sharply curtailing the kinds of assets they can hold. Critics of Fannie and Freddie, including Federal Reserve Chairman Alan Greenspan, have long argued that by having such large investment portfolios, which are vulnerable to changes in interest rates, the two companies put the financial system and taxpayers at risk.

But the legislation proposed by House Financial Services Committee Chairman Michael G. Oxley (R-Ohio) and scheduled to be debated in committee today does not force the companies to reduce their portfolios. Instead, it gives a new regulator the authority to require that Fannie and Freddie buy or sell portfolio holdings if it's judged to be important to the financial soundness of the companies, according to a copy of the legislation Oxley released yesterday.

Nevertheless, White House spokesman Trent Duffy said that while the administration remained committed to its view that Fannie and Freddie's investments should be restricted, it was "pleased there is movement on the Hill" toward changing how the two companies are governed.

The administration's position is a marked contrast to the hard-line stance it took two years ago, when it denounced a similar bill Oxley introduced as too weak, forcing him to cancel the bill's markup. Unlike in 2003, however, the Senate is now also considering legislation to tighten oversight of Fannie and Freddie, giving the administration another opportunity to weigh in.

Last night, lawmakers were still negotiating some provisions of Oxley's bill that would allow the new regulator to define which kinds of business the two companies could participate in. While Fannie and Freddie's charters prohibit them from originating loans, the companies' competitors have complained that they have strayed beyond their mission of keeping home loans plentiful and tried to break into new lines of business, such as mortgage insurance.

Under Oxley's bill, Fannie and Freddie would have to obtain approval from the new regulator before launching a new program.

Brian Faith, a spokesman for Fannie Mae, and Sharon McHale, a spokeswoman for Freddie Mac, both declined to comment on Oxley's bill.

The legislation is likely to garner Democratic support thanks to a compromise Oxley forged with ranking Democratic member Barney Frank (Mass.) on affordable housing. Oxley proposed putting 5 percent of Fannie and Freddie's after-tax profits into an affordable-housing fund controlled by the two companies. Fannie and Freddie would dole out grants — potentially hundreds of millions of dollars annually — to promote homeownership among first-time home buyers and to preserve or rehabilitate rental housing for low-income Americans.

Oxley's proposal would also allow the companies to buy more expensive mortgages in areas where housing prices are high — allowing them to buy loans of more than half a million dollars in some cases. Under current rules, the companies cannot buy mortgages of more than around $360,000 for a single-family home.

Frank said Oxley's proposal addressed concerns that Fannie and Freddie's chief regulator, the Office of Federal Housing Enterprise Oversight, didn't have enough power to ensure the companies were financially healthy, and that not enough of the profits of the two companies benefited home buyers.

Frank characterized the remaining critics of Oxley's proposal as "competitors who want to knock them out of the box and the ideological critics."

Fannie and Freddie are government-chartered, shareholder-owned companies set up to promote homeownership. They borrow money to buy mortgages from banks and other lenders, freeing up the banks to offer more mortgages. Fannie and Freddie repackage the loans as mortgage-backed securities to sell to investors, and they guarantee the repayment of the loans.

Fannie and Freddie make money off the spread between their borrowing costs and the return on assets they buy, which include $57 billion in non-mortgage assets, such as airplane-lease securities and car loans.

In recent years, the companies have been holding more mortgages in a long-term portfolio. Officials at both companies have said the investment portfolio supports their mission of promoting home ownership because it helps them attract foreign investment, allows them to act as a lender of last resort during financial crises and helps them encourage lending to low-income home buyers.

To protect themselves from shifts in interest rates, the companies invest in derivatives, complex financial instruments that can be used to speculate or hedge against movements in rates.

Last year, OFHEO found that Fannie Mae did not account properly for losses from those derivatives, allowing the company to still hit earnings targets that qualified top executives for millions of dollars in bonuses. Similar practices had been discovered earlier at Freddie Mac by a law firm the company hired to review its books.

The findings forced both companies to oust their senior managers and to restate billions of dollars in previously reported earnings.

STEVEN PEARLSTEIN

Market Needs Mortgage Finance Giants

PEARLSTEIN, *From E1*

Freddie with his opposition to any regulation of hedge funds that now account for a huge share of the trading of activity on Wall Street and a disproportionate share of the loans on the books of big banks. Bloomberg News reported this week that Morgan Stanley and Goldman Sachs are now paying higher interest rates on their own debt because of lenders' concern about the recent losses at several large hedge funds. With more than $1 trillion now under their management, the hedge funds' lack of transparency surely dwarfs any concerns a reasonable person might have about housing finance companies that already make extensive, if sometimes flawed, filings with the Treasury, the Department of Housing and Urban Development and the Securities and Exchange Commission.

But what's most disingenuous about Greenspan's personal and institutional assault on Fannie and Freddie is its willful disregard of history.

During the financial crisis of 1998 — when Greenspan, Bob Rubin and Larry Summers were getting credit for "saving" the global economy from meltdown — the big Wall Street banks were furiously dumping their mortgages and fleeing to the "safety" of government bonds and notes. And there were Fannie and Freddie buying up many of those mortgages — an extra $190 billion that year — paying for them by issuing those bonds that the banks were all too eager to buy.

Providing that kind of backstop to the mortgage market is precisely why Congress created Fannie and Freddie — and why banks, by the way, are willing to buy so many mortgages in the first place. Don't for a minute think that the banks wouldn't dump their mortgages again if they thought they could earn an extra 20 basis points by rushing into convertible preferreds or Finnish sovereign bonds or whatever is the next hot product to catch their fancy.

It is also short-sighted to argue, as Greenspan does, that now that Fannie and Freddie helped to create the deepest, most efficient and most innovative mortgage finance markets in the world, the private sector can take over. Surely there will be other innovations in the mortgage market that will require the scale and subsidy of a Fannie or Freddie to get them started. And surely Fannie and Freddie will be less likely to do that if they are forced to work under an onerous regulatory regime that would deny them the normal rewards for innovation and risk-taking.

Congress today will begin the process of defining what that regulatory regime will be. There is no reason why strong, new regulators cannot minimize the systemic risks posed by Fannie and Freddie using the same tools, and the same wide discretion, that the Fed and Treasury use to regulate the complex and risky activities of Citigroup and J.P. Morgan Chase.

There are plenty of ways to prevent Fannie and Freddie from abusing their government sponsorship without setting hard-and-fast limits on what they can do, how much they earn or how much they can grow.

Steven Pearlstein can be reached at pearlsteins@washpost.com.

Consumer Safeguards Examined

MORTGAGE, *From E1*

uity.

The public hearing before the House Financial Services Committee highlighted a measure co-sponsored by Reps. Robert W. Ney (R-Ohio) and Paul E. Kanjorski (D-Pa.) that would preempt state legislation. Also in the spotlight was a competing measure sponsored by Reps. Brad Miller and Melvin L. Watt, both North Carolina Democrats, that would establish the North Carolina law as the national model.

"North Carolina has made excellent strides, but we need to be practical," Kanjorski said at the hearing, adding that his bill could be amended to make it more acceptable to consumer advocates. "The North Carolina standard has very little chance of becoming national."

At issue is what is known as "subprime lending," in which lenders charge higher interest rates and require additional fees from home buyers or homeowners who are thought to pose a higher credit risk than people who have good credit. Critics have long charged that some lenders are profiting by exploiting unsophisticated consumers by charging them interest rates and fees in excess of the credit risk they may pose. Then, when homeowners default on their loans, the lenders can take possession of their homes, a lucrative ploy in the current housing boom.

At the hearing, industry leaders acknowledged that there is a serious problem. So-called predatory lending is a "stain on the industry," said Regina M. Lowrie, president of Gateway Funding Diversified Mortgage Services LP in Horsham, Pa., the incoming chairwoman of the Mortgage Bankers Association. But she warned that the proliferation of restrictive state laws passed in reaction to the problems could curtail subprime lending or cause lenders to increase the rates they charge to other homeowners. She said the nation's homeownership rate has reached a record of nearly 70 percent because new kinds of loan programs have been developed, making homeownership available to poorer people.

Similarly, Micah S. Green, president of the Bond Market Association, called predatory lending a "blight on the industry," but he also supports preempting state laws restricting it.

Joseph A. Smith Jr., North Carolina's commissioner of banks, testified that North Carolina's more restrictive laws have not constricted the supply of mortgage money available to consumers or boosted interest rates, and that such reports circulated by lenders' groups are inaccurate.

"I have never heard a single example of a single person . . . who was denied mortgage credit because of our laws," Smith said. "I have yet to meet a flesh-and-blood example."

Lowrie said she knew of a blind man denied a mortgage in New Jersey after that state passed a predatory lending law.

The key question facing Congress is whether, or how much, the federal government should protect consumers from financial predators.

Rep. Barbara T. Lee (D-Calif.) said that what the "loan sharks" are doing is "downright criminal," and that she feared the proposed preemptive legislation would "actually make matters worse."

Rep. Jeb Hensarling (R-Tex.) countered: "I'd offer the opinion the consumer is the best judge of what is in the consumer's best interest."

The legislation is expected to move ahead this summer. Last month, Rep. Michael G. Oxley (R-Ohio) chairman of the Financial Services Committee, signed on to the Ney-Kanjorski bill as a co-sponsor.