

AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Lawrence Baxter

Bass Connections

Duke University

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## PREFACE

The following Oral History is the result of a recorded interview with Lawrence Baxter conducted by Andrew Carlins on March 26, 2020. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

Readers are asked to bear in mind that they are reading a transcript of spoken word, rather than written prose. The transcript has been reviewed and approved by the interviewee.

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Interviewee: Lawrence Baxter  
Interviewer: Andrew Carlins

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Andrew Carlins: I'm Andrew Carlins, an undergraduate studying economics and history at Duke University and a member of the Bass Connections team, American Predatory Lending and the Global Financial Crisis. Today is March 26, 2020. I am conducting an oral history interview with professor Lawrence Baxter, former Chief eCommerce Officer at Wachovia. Thank you for joining me today.

Lawrence Baxter: You're very welcome.

Andrew Carlins: I'd like to start by establishing a bit of your background. I believe that you went to the University of Natal where you received an LLB, BComm and PhD in law and government regulation, and you've also received a diploma in legal studies and a LLM at the University of Cambridge.

Lawrence Baxter: Yes

Andrew Carlins: .... When you first arrived at Wachovia, what were some of your responsibilities?

Lawrence Baxter: I went there actually on a sabbatical from Duke Law School to help Wachovia with strategic adjustments to their corporate positioning in the wake of legislation called the Riegle-Neal Act of 1994, which made it possible for them to consolidate their different bank subsidiaries that spread across state lines. And at that time, it was North Carolina, Georgia and South Carolina and a Delaware company that issued the credit cards. I had been involved before then in some of the drafting of some of the earlier legislation, so I had an interest in seeing how it all worked in practice and they did not have anybody with that expertise.

They asked me to come and spend my sabbatical there and I was working for the Chief Financial Officer, not in the legal division, but the contact was through the legal division. So I went in and prepared a study for them on how much they would save in eliminating duplicate regulation and compliance if they were to consolidate the three major banks into one based in North Carolina, which was then allowed under that 1994 legislation. And that was the bulk of my work. When I first went for the first few months of what was then a six-month sabbatical, I produced a report and the savings were so substantial that the company then adopted the recommendations and went about doing the legal work necessary to consolidate the three major subsidiaries under Wachovia corporation into one bank.

While I was there, they seemed pretty pleased with the work. So they asked me if I'd stay on and I was finding it very exciting. And so we talked about a role that I might have, now that that work had been done. I didn't want to go into the

legal division because I had a great job as a lawyer at Duke Law School and I wanted to do something that was different. It was agreed that I should start an emerging businesses group, which I did. The first business emerging was insurance, which was also another thing that had become possible for banks like Wachovia as a result of judicial and regulatory interpretations. National banks were before that, very heavily restricted as far as insurance is concerned. And because although I never had a clue about the insurance business and I became head of it and, that was the first emerging business, I was not overly excited about being involved in insurance because it just wasn't something I had a whole lot of expertise in. So, we brought that business to a level of operational maturity and then I transferred it to the head of what we called "personal financial management" at the time. It's known as "wealth management" nowadays. It was a kind of business that very neatly complimented the financial planning for wealthier individuals. And we had also cleaned up the credit insurance side, which, I think it was a bit exploitative, but that's a complicated subject.

So, the question then was, what was the next emerging business? And I'd been very fortunate in having been at Duke beforehand. I had become familiar with what was then still a very new concept: the internet. And I wasn't much of a technologist, but I was a user of graphical interface computing, starting with Windows (Microsoft Windows), and then with browsers, as that browser technology came out and the very first versions of it, which ultimately matured to Netscape and Explorer, and then finally into the situation we have now with Safari and Chrome and Firefox and so on.

And it always seemed to me that once you could put a technology platform in front of a customer, things were going to change, because the customer is going to be able to see things they couldn't see before without going into a banking office and sitting down with somebody who has an internal computer view of the general ledger in front of them. So I agitated for a while that we should begin what was first called "eBusiness," and ultimately came to be called eCommerce, that I thought at that time, really was going to take over the business environment.

But, I had met a lot of skepticism. The technology people were all mainframe people. They were all trained in the IBM mainframe tradition and they had a very deep disdain for the internet, which they thought was flaky, IP technology. And so, in frustration, the head of the general bank said to me, just go and start it and I'll fund it, which he did. I was like, the dog that had caught the car, I wasn't quite sure what to do with it because I wasn't a technologist, but I knew enough to have made friends with some of the very few people in the technology side of the company who did have an interest in the internet. And I assembled a group of them, who could help with designing browser technology, browser presentations, the middle architecture and so on. And we started to develop internet online banking. That sounds commonplace now, but in fact, there were only two other companies in the country that were trying it. One was First Union, which was in Charlotte and the other was Wells Fargo in San

Francisco, and they were (like my group and I were) amateurs at it, we were dabbling.

So between the three companies, we were able to learn a lot from each other, and, start to build it. We were a little bit behind the Dutch bank, ING, and the South African banks, which had moved out even a little earlier. But, we were early enough in the United States to essentially establish the framework for internet-based banking. There had been telephone dial-up banking and computer-based dial-up banking before, but none of it was successful at all. It failed for many different reasons. Well, I was lucky enough that I had not only the support of the head of the general bank, but also the CEO, who, although he hated technology himself, had the good sense to know that it was going to transform financial services. He protected me from the political, shall we say, rivalry, of the traditional bank channels, who were not at all happy with the idea that a lot of their services would be executed online without a middleman and woman and therefore without a very big role for them.

The CEO protected me all the way through to the point where we were growing very rapidly in 2000, when we announced a merger with First Union. So, this was by chance, it had nothing to do with the fact that they were also on the internet. But, that led to a combination which I inherited and I moved from Winston-Salem to Charlotte and was then running what was probably the biggest e-commerce division in financial services in the country. And I had a very well-funded, highly energized group of people who were just terrific. So, that developed and it also started to absorb lots of different products. And, one of which actually that started earlier with the Winston-Salem based bank was the Charlotte company, LendingTree, perhaps the first online mortgage brokerage. We partnered with them very early on and literally rewrote their software to develop them into a viable platform, which as you know nowadays, is a major lending platform.

We also rewrote the online banking software that we had acquired from Atlanta, based on a small online bank called Security First and made it industrial strength. And, we built then a couple of major online platforms over the next few years that had huge resiliency and could handle a lot of volume and reliability. We partnered with Accenture (formerly Anderson Consulting) in that process, and to a lesser degree with IBM, which was quickly adjusting itself from a mainframe oriented technology to internet oriented technology. One thing led to another until by 2003, we became the busiest sales and service channel in the company. By that, I mean the volume of dollars and transactions were bigger going through the internet than anywhere else in the company. We'd also pioneered mobile banking with the wholesale side of the company, the cash management side.

One thing led to another to the point where in 2005, I started to realize that the internet had become so pervasive that what we were doing as a centralized organization was no longer productive because the rest of the company just simply needed to absorb and apply the internet. So, we embarked on a strategic

review, which led to a big chunk of my division being farmed out to the business units. That was about 2005. And, that reduced what I was going to be doing in that capacity as Chief eCommerce Officer quite substantially. At that point, I thought, well it was probably time to go try new things. So I retired from Wachovia in 2006 to go and dabble with startups. And it's important to note that date because of course the crisis blew up in 2008, so I was tangentially involved, not directly involved in that period, but I was still interacting with a lot of the people at the bank and hearing and being familiar with some of the changes that were happening. The ultimate irony was that Wells Fargo bought the then-combined First Union and Wachovia, so all three of the pioneers of online internet banking were all consolidated together into Wells Fargo, which I think remains one of the leading online eCommerce platforms in financial services.

Andrew Carlins: I'm wondering if you could go into a little more detail about how online banking and digitization changed the world of financial services.

Lawrence Baxter: Yes. I think first and foremost, it switched the orientation of the design of financial services. So, in the older model, financial services and products would be pushed out to the public in a pre-designed form. You would have loan officers designing their products and you would have deposit takers designing things like certificates of deposit and so on, and a customer would see a range of options and they would have to choose from there. But the design didn't matter much because it was being, or at least the complexity of the design didn't matter a lot, because the products and services were being intermediated by banking staff. They could explain it to their clients and so on. With the internet, it gave a direct view into the company from the desktop of the customer. And that changed everything. It seemed there was a lot of skepticism because at first I remember people saying to me, "Well, you might get young people who are interested in experimenting with the internet who would have an interest, but the fact that they don't have much by way of savings or other financial products. They're not really important."

I remember repeatedly being told that you couldn't make money out of young people. I was always very skeptical about that in two directions. One is I thought they hadn't looked carefully at the fact that young people will pay for financial services as well, but also that it was a very short term view because young people do get stuff after a while and they start to actually become very valuable customers. And it seemed to me to make sense to recruit them all the way from college. In fact, college financial services were part of my emerging businesses group. So, that's one thing. The second thing is that having a customer or client perspective as opposed to a producer perspective means that the presentation has to be understandable, if it starts to become a self-service thing and the browser enabled a customer to quickly compare with other products and other institutions, and unless they were presented in a very understandable way, one would simply lose that customer.

We used to run all kinds of metrics and they still do now (much more sophisticated by now, I am sure). One of these metrics was, how long a customer would be willing to wait after clicking on a link. And it was shockingly short. Remember we were dealing with very narrow-band internet at the time, so the delivery was slow, but after eight seconds of waiting a customer would click somewhere else. This changed the company mindset a lot. It made technology a key performance driver. It made design *user* oriented. In fact, we had a special lab called User Centered Design, in which specialists would run experiments with customers and other analysts would sit behind a one-way mirror and watch how the customers behaved. These specialists would make recommendations about redesigning the products that weren't actually being completely understood by customers.

The move to internet financial services also meant that we were subject to much more competition because the customer could see what interest rate Wachovia was offering on a particular product, and they could immediately see what interest rates Bank of America (or NationsBank as it was then called) was offering. And that made it a lot tougher for bankers. They could no longer assume the relationship between their customer and the bank itself was a very secure one. You had to have visually appealing browsing presentations. You had to have very deep reliability with your technology. You also had to have a huge escalation and network security because, as we see nowadays with cyber security, eventually the bad guys will find a way in. And, it changed the whole orientation of the company in terms of investment.

Salaries used to be the overwhelming driver and they still are a big driver of the operating costs of banks. But technology just skyrocketed in its operating and especially capital expense, and it was hard to actually get the investment for it because of the short term views of the financial division, which would always have to be looking at whatever Wall Street and shareholders wanted over the next quarter, not the next twenty-four or more months, which is what a lot of these projects would take to do. In fact, some of the technology projects took much longer and you really had to be able to sell inside the company very hard to get the buy-in, to get the capital investment necessary to build the platforms. The other side of it is new reputation risk, becoming very much more important and more fragile. So we started to become aware that if there was an outage, for example, for even a few minutes, certainly a few hours, that would quickly end up in the media in addition to inflicting financial losses on the company.

We started to realize, as we had earlier with credit cards, that even a breakdown on the network of a few seconds during the holiday times could involve large dollar losses. This escalated the demand for skilled IT people and it required businesspeople inside the company to be much more effective at engaging with the IT people, who were mostly engineers. And that then meant that I, among others, had to hire people who had the special skill of being kind of “bilingual” between business and technology. They didn't have to be technologists, but they had better understand how technologists thought, and the technologists needed to understand what business people really wanted.

This was a major shift. I remember once, one of my direct reports saying to me about the challenge of the website alone. He said, "Lawrence, if you think about it, there's only two places that the entire company shows up at once. The first is the annual report, which is a glossy, 150-page production. And the second is the website." The customer can see everything on the website and it better look coherent and not disorganized and the presentation and navigation better work because they won't stick with you if it doesn't.

So that whole mindset shifted everything. It changed things. And I had an unwitting advantage in that I saw things as a consumer, not as a technologist. So whereas the engineers would always be thinking about the engineering structure of the software and hardware, I didn't understand enough of that, but I would say, this doesn't work or I can't make any sense of that presentation, blah, blah, blah.

I had a very wonderful experience once. Microsoft used to fly me and a couple of other people out there often because they were trying to break into industrial scale technology platforms. There was a lot of skepticism because IBM had successfully convinced everybody that Microsoft was just a small retail platform provider. But Microsoft's ambition was that Windows NT, which was their industrial version of Windows, was to become a platform for big companies. And the place where you would really test it would be banks because the transactions, scalability and platform resilience mattered. It was all about money. So they would fly us out there. My IT partner and I would take a group in the company plane.

I remember at one time I was out there, one of the Microsoft people was very excited. He said, "You've got to come down and see what we're doing in this other lab." So I went with him and he introduced me to a young man who was clearly a technology wizard of some kind. He very excitedly showed me a very big computer screen, something we all now take for granted, but in those days was technology I'd never seen before in my life. It was like a 27-inch computer screen and there was actually a row of them. So, he said, "Let me show you what we're doing for mobile phones." And he showed me the browser that was called Windows CE, which way predated the iPhone. I looked at it and said, "that looks very cool." And he said, "look how fast it is." And I was amazed at how it would pull up information. Then I said, "So this is coming out on some kind of broadband?" And he said, "Oh yeah." And he gave me the statistics. I can't remember what they were, but the delivery was very fast for those days. I mean, it's nothing now. We've all got faster in our houses. And I said, "What's the size of this phone?" He showed me a fairly small phone. It looked like something that, I don't know if you ever remember, was called the Apple Newton, a little bit smaller than an iPhone. And he said, "that's what it's going to be." So I said, "you're designing this on a 27-inch screen. What's going to be the speed of the phones?" And he gave me some statistic, very low bandwidth. And I said, "But shouldn't you be designing this on the phone with the customers you are going to be using?" There was a sort of silence and people said, "Oh." Well, that was where my ignorance of technology helped and where

his expertise in technology didn't help because he imagined a world in which he and his fellow engineers were all operating the same way on very advanced technology, but of course the customer wasn't going to be using such technology at all.

So we learned an awful lot through all of that. The other thing that was very formative was that on 9/11, I was running a business meeting up on the 21st floor of what was then called One Wachovia, and all of a sudden one of the people in the room got up and walked out. He had gotten a message from his New York team on his Blackberry. I was a bit irritated cause I didn't like people just walking out of my meetings, but he came back and he came up to me and said, "Can I interrupt you?" And I said, "No, we'll get this meeting finished first." He said, "No, I have to interrupt you." He had gotten a message from our people in the World Trade Center, One World Trade Center, to say that they'd just been hit by what seemed to be a plane.

And he said, come out here and look on the TV. And we went out and we saw the two towers going down. It was a horrifying experience. The thing that kept the company going was the internet, because we all had to get out of the building because there was the fourth plane. The third one was run into the Pentagon and then the fourth plane was up in the air and they didn't know where it was. It ultimately crashed in Pennsylvania, but they were worried that because Charlotte was the second biggest financial center, that that's where the plane could have been heading. So security got us out of that building and we (the eCommerce Division) set up a command center with the internet. The whole company, or at least all the executives in the company operated through that command center. This essentially legitimized the internet as the technology of the modern era. And, it changed everybody's thinking. So all of us use technology now in a way we take for granted. If somebody is shopping for a mortgage, they will use something like LendingTree. That wasn't taken for granted at all as recently as 20 years ago. It was considered almost fantasy.

Andrew Carlins: I'm wondering if you could even go into more detail, considering that our project is concerned with the residential mortgage market, on how the rise of online banking specifically influenced the mortgage origination and underwriting process, either at Wachovia, or the banking industry more broadly?

Lawrence Baxter: Yeah. Well, keep in mind one caveat. I was never a lender in a bank, so I was observing this from the side and from the point of view of engaging our loan officers in the internet side of things, especially once we signed up LendingTree. (We had been the actual pioneer bank for LendingTree.)

I think a couple of psychological changes took place. The first was the much greater awareness of competition because as you might know, when you apply for a loan via LendingTree, what they will do is present different, competitive bids by banks or other lending institutions, and that meant a keener edge to

getting the loans made. In other words, loan officers could not be as complacent as they used to be before.

So whereas a loan officer before that could rely on a longstanding relationship with the customer, that was no longer guaranteed, because the customer would easily be able to compare what they were offered there with something else. So that was definitely one thing, there was pressure to be competitive. As to underwriting standards, I can't say that they definitely weakened because of that, but there was certainly an eagerness to be competitive. And so I suspect that that had the effect of putting pressure on underwriters to possibly be, I don't want to say lax, but a little more willing to consider varieties of credit worthiness that might not have existed before. The other thing that was happening was that the credit scoring system itself which had been developed for the credit card industry was being rapidly developed for the residential mortgage industry.

And it was a shift as well because of the combination of data analysis and the channel, the internet. It was a shift from the very "broadband" of a loan officer knowing the borrower. In small towns or even in big cities, you might make a loan to Jimmy because you know where he lives, you know who his parents were and you know his reputation. When you go to larger volume and you go into the credit scoring world, you're looking at numbers, you're not looking at people. And of course those numbers are meant to represent how people have conducted themselves with a credit history, but they are aggregate numbers and they are also assumed to generate a volume of lending that permits a failure rate that was probably not acceptable with face to face lendings.

So, I think it engaged a subtle shift into a greater anonymity and a greater reliance on statistical performance as opposed to actual individual performance. Now, I can't say that it meant that this relaxed lending standards. Maybe it didn't on aggregate, but it changed the mindset somewhat. That's what I observed happening. Between that and the competition that was intensifying because of the competitive bid process that LendingTree and others had instituted; all made possible by the internet platform. I think the whole nature of lending changed dramatically. It was also encouraged because at the time, this is after 9/11, after we had recovered from that shock, the economy began to boom and residential real estate prices were rising all the time and everybody felt like their house was their safest asset. Furthermore, one thing you were not going to default on was your home payment.

And, whereas defaulting on credit card borrowing was not considered as, shall we say, risky on the part of the borrower. You just default on your credit card and you might be able to get another one, but at least you carry on living perhaps without a credit card if it gets taken away from you. Your home was your absolute "castle" asset. And, things seemed to be going fantastically. New forms of finance were taking place. The Ginnie Mae (Government National Mortgage Association) and well not Ginnie Mae, Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage

Corporation), were essentially underwriting and Ginnie Mae was insuring loans with much lower deposits than before and they were aggressively expanding their business. And so lending was sort of a party. It seemed to be the place where you would want to be building the business albeit with narrower or reducing margins.

And, it felt fairly safe because the collateral was the residential mortgage, I mean was the real estate itself. I can't point to any one moment, but I do remember, sort of now thinking back, especially that even at the time, feeling the nature of lending was changing. The mindset was becoming much more statistically oriented, much more aggressive growth oriented, because the margins were reducing and safe because residential housing was growing and going up in leaps and bounds, not just in California and Florida, but everywhere. Everybody's house was increasing in value; we all lived on the assumption that the one thing that was the safest investment and had been for 45 years or more since, the 1950s, was your house. It was going to keep on increasing in value. It wouldn't drop in value. It seemed like everything was almost too good to be true. The only tough part was that the competition was getting more intense.

Andrew Carlins: So you mentioned, the shift to online banking, increased competition, and a change in the mindset of lenders towards more of a statistical analysis. To what extent did this shift and the proliferation of online banking impact Wachovia's work culture?

Lawrence Baxter: It was fairly subtle. Let me mention one other thing I forgot to mention. The introduction of adjustable-rate mortgages, especially ones linked to LIBOR (London Inter-bank Offered Rate). That also was very attractive as a product to sell because for customers who qualified for those mortgages, they could borrow at very low rates and they could always refinance if they thought rates were going to start to escalate. Okay. So to what extent did the internet change the mindset? I'm sorry, Andrew, I interrupted you on that question.

Andrew Carlins: I was curious to know, how did the shift to online banking impact Wachovia's work culture?

Lawrence Baxter: Very slowly in that it was always regarded till about 2003, 2004, as the exception rather than the mainstream. So most bankers did not change a whole lot at that point. The biggest change really came about at the end of 1999 when banks, insurance companies, insurance underwriters and securities and investment banks were allowed to affiliate. That had a very visible change in the culture. But I suspect that as people saw the success of the internet (when I say people, as other of the mainstream or traditional bankers), and they became more familiar with it themselves, I think it probably changed their mindset a little. I can't say I honestly saw a go-go culture or internet culture emerging in the main bank.

I did see the go-go culture emerging from the influence of the investment bank, but that was different. I think that's the case. I think one of the things that

happened, so one noticed the least but was really quite impactful, is that it wasn't only young people who were adopting the internet. That was the earlier prediction. And the conclusion was we can't make money from young people. Not only was that wrong, in terms of making money, but it was also the case that it wasn't only young people adopting the internet. One of the things that developed was that older people started to use computers and you'd say, well, why? Because, you know, the joke that you try to teach your father or your grandfather how to use a computer. But what really happened is that they started to get emails with attachments of their grandchildren and photographs and that was a powerful incentive for older people to start using computers.

And so they did it. Once they had a computer and they were able to navigate around both email and attachments, it was only a very short step to getting them to use the computer for browser based applications. I think that happened across the general, the traditional bank as well. I noticed for example, in the early 2000's more and more traditional bankers becoming more and more curious about what we were doing. In fact, there was even one situation when in the late 1990s where we had to shut down a maverick website that a group in Atlanta created that was horrifically bad. But it was also representing the bank in ways that created a lot of liabilities, so we shut it down. And then, from about 2003 onward, every part of the company was trying to create their own web presence.

That's one of the things that led me to realize that the time had come where you had to sort of weave the internet into the whole bank, not try to keep it centralized. I think that itself suggests that there'd been a change in the culture and, bankers, saw technology as their support, not their enemy. Earlier on, they had seen it as their enemy. They saw a technology with the internet as one that would put them out of a job. But, they started to see all the other advantages of it, and were using the internet at home and their kids were coming home and telling them stuff that was more advanced than what they knew about the internet. And, they started to realize it was the future. The future was already there. So I think to that extent, there was a change in the culture, but I can't directly connect that to a laxity in lending.

I don't think it worked as simply as that. I think it was a very subtle combination of changes between that, the booming economy, amazingly low interest rates for way too long, and the Feds being criticized for not putting interest rates up earlier, and then when it tried, it was too late, and then when it cut interest rates, it was too late. All those things were going on as well. There was also another mindset which was born of the dot.com revolution. So the dot.com revolution was all these startups in the late 1990s funded by venture capitalists that we're trying to deliver web based services. I remember very famously Amazon at the time and a company called Webvan. Webvan was going to deliver groceries to people's homes. And unfortunately the markets laughed at it, and it collapsed.

But we also laughed at Amazon, because I remember many, many times saying, "Just remember Amazon has never turned a profit." You know, now I look back, and I realized that, yes, it certainly has now, but it hadn't then and didn't for a long time. There was a mixture of skepticism and excitement and the early investors pushed the price of these companies up dramatically. And, during that period, I think a lot of traditional bankers started to question whether they should continue opposing it. And they started to get worried about competitors from the, what we would now call, the FinTech world. So there were a lot of things happening at once. It was changing, not just bankers, it was changing the entire society.

Andrew Carlins: Throughout your time at Wachovia, the company went through a few large acquisitions like Metropolitan West Securities, West Corp, South Trust, Golden West Financials to name a few. Did you see any shift in work culture at Wachovia as a result of these acquisitions?

Lawrence Baxter: Yes, there was a very specific shift. So the first set of acquisitions by the Winston-Salem based Wachovia, the one that I started with, really involved absorbing those target companies into a culture that we had that was very longstanding, somewhat Moravian influenced (because of being in Winston-Salem), very trusted, and I'll never forget the first CEO when I went to work there saying to me, "never forget, this is not your money." It was a very conservative, what I've called a *custodial* culture. When we acquired South Trust and other companies, they had to sort of conform with us and we really only bought such companies if their work fitted that culture.

We actually looked at companies, I won't mention now, but we turned away from them because they didn't have that culture. But, First Union had a much more go-go culture, their CEO at the time, Ed Crutchfield, also saw the promise of technology. In fact, he was the driving force behind the founding of the Bank Information Technology Secretariat (acronym BITS), precisely because he saw that technology was going to be the future in finance and he encouraged a lot of experimentation and entrepreneurial behavior. So, First Union did quite a few interesting things and then they did something that destroyed them rather like Golden West later destroyed the new Wachovia (which was a combination of them): they bought the Money Store, a subprime lending company—and it wasn't just subprime real estate, it was subprime lending of all kinds—and they paid an enormous amount of money for it.

I remember one afternoon looking at the Money Store with my boss and we said, "we won't touch that." They (First Union) went ahead, however, and bought it the next day. We were stupefied that they would take that risk, but they were a go-go culture. They were willing to take such risks. They also bought Core States, which was a big bank in the mid-Atlantic region and they paid an incredible premium for it. And we started to worry, and rightly I think, that we've missed the boat because NationsBank in Charlotte and First Union in Charlotte were expanding dramatically. So whereas the old Wachovia has been one of biggest banks in the SouthEast, perhaps the most highly respected bank

probably in the country, and one of the biggest, all of a sudden we had these two companies in Charlotte that were really becoming able to call the shots.

They were so big. We realized we may well have missed the boat. We started to learn this in really concrete terms when it was hard to recruit young people to come to Winston-Salem. By then, Winston-Salem been through the RJR tobacco buyout and Sarah Lee had moved, Hanes textiles, a lot of the headquarters had moved from Winston-Salem. It was not a fun place to be young and single. The center of the city was still derelict, and the concern was that we couldn't recruit the talent we needed to recruit. First Union in the meantime had paid way too much for the Money Store and Core States, and they were struggling to survive. And that's how the First Union/Wachovia combination came about. The two CEOs decided that maybe there were security of numbers, size and location (Charlotte). When we agreed to merge, those of us at the old Wachovia who survived the merger (meaning we took over the divisions that we were head of in Winston Salem), then headed many of the combined company divisions. We were moved to Charlotte, and it was a cultural change that was dramatic. So whereas we would measure ten times and cut once at the old Wachovia, in a very conservative culture, First Union would cut and then measure. It was that kind of difference. I kind of liked it for excitement, but I also found it was somewhat distasteful as a banker.

There was a clash of cultures down there, in which, because of the rapidly expanding economy, that one won out. But it went in two stages. The first stage was that because First Union was in so much trouble with the markets, they adopted the Wachovia name and they rallied behind a very conservative logo. That was the first thing. And, until 2006, I think very specifically in 2004 and 2005, Wachovia was considered by everybody in the country as the best bank in the country. That was now the new Wachovia. Everybody was behaving largely like the traditional Wachovia. We were doing very well financially. And, the cultural constraints were visibly the old Wachovia

But then steadily, one by one, those of us who came from the old Wachovia ran out of track. For example, I explained earlier that I farmed the internet into all the business lines in 2005 and they more or less turned and said, "Well, then what are you doing here anymore?" And, that happened to others in the company as well. One by one leaving until there were only a couple left.

After this the new Wachovia reverted very obviously to the First Union culture, the go-go entrepreneurial culture. One of the driving forces was the corporate and investment bank, which was doing very, very well. Investment bankers are totally different from traditional bankers. They think very differently. They are deal makers. They're much bigger risk takers, and, they leverage their transactions in various ways that are not as visibly dependent on depositor's money. So that culture started to loom large and success bread dominance. The traditional bank was doing fine, but it was seen really just as one of equal parts, no longer the dominant part of the company. And, with that cultural change,

made the desire to be nationwide, the new Wachovia leadership could not stand the idea that Bank of America was now very much coast to coast.

The rivalry between the two is just remarkable and really quite fascinating. If you wanted to do something risky, what you would have to do is demonstrate to the CFO and CEO that Bank of America was doing it or planning to do it. That would quickly get their attention. And in that cultural ethos at a time when the economy seemed bulletproof, round about 2006, 2007, the conditions were ripe for Wachovia to make its fatal step, of buying Golden West. I remember that at the time, the competition was such that the head of consumer lending at Wachovia said, we have to offer an optional adjustable-rate mortgage, meaning what Golden West called the "pick-a-pay mortgage." That is that you could choose to pay or not pay on a particular month because the equity in your house was rising so fast. The CEO said, "No, we couldn't do that. It's too risky." But a few months later, the company bought Golden West, the prime architect of the adjustable-rate mortgage, adjustable at the option of the borrower. And so, it was a great experiment. But Golden West, the Sandler's husband and wife who owned the company, sold high and Wachovia bought high and ended up crashing because it was already the end of the era. Real estate started to collapse in value and then everything imploded from under the residential real estate products.

Andrew Carlins: I'm wondering if you noticed as a result of this change in culture, any changes in the key goals of Wachovia or that Wachovia's executives had in the years before the housing boom really took off, vis-a-vis during the housing boom.

Lawrence Baxter: It wasn't a stark change. I remember McKinsey would come in and give us these presentations from about 1998 onward in which they would say that a "high performing company" had to be earning a return on investment somewhere along the lines of 12-18%, which was a huge return on investment. And I remember thinking this is quite a stretch because we were in a 2 to 3 percent GDP growth economy. That meant there had to be some very big losers if we were going to get that. But we actually did it and I'm afraid we thought most of us thought we really did it by ourselves. But what we didn't understand was going on at the same time was stock buybacks, which were inflating the value of the shares amidst a very increasing short-termism. So in other words, we were able to produce returns that were cycling on a shorter and shorter term that tends to lead to a neglect in long term investing. So there was that problem that was afflicting all companies. McKinsey was selling this to everybody. And, so I don't think that that was specific to lending, but there was pressure to get returns and lending that would match that. And in fact, we used to have meetings with the CEO where he would look at the returns and want to know why a particular division was not meeting them. So the whole mindset became, we're "high performing," this is what "high performing" companies do, and if you haven't done it, you're not succeeding. Why are you still in that job? That was sort of a generic change in culture. It wasn't specific to lending, it affected everywhere. I think it was possibly influenced by investment banking, where the returns are very high, but of course the risks are also extremely high. So, I don't

know how conscious we were about it. I think it was very little conscious awareness. The other thing that changed during that time was the romance of the idea of a universal bank. So in the 1990s, American banks were still on Glass-Steagall, they were not allowed to affiliate with securities and investment banking or with insurance underwriters or other branches of the financial markets. And that was very frustrating then because European banks were, and in fact, in the UK, the bank would have all those other branches of financial markets as subsidiaries.

The bank was at the top of the pile and bankers in America started to say, "We are being held back. We can't compete." And the beauty of the universal bank in their minds—I must admit in my own mind—was that you had a diversified portfolio. You had, for example, a credit card company. You had a lending company. You had a deposit-taking company or savings company, you could call it, and you had an investment and commercial banking company. And the economic cycles were such that they tended not to all cycle in unison. So you created a diversification that seemed very attractive. And the CEO of Wachovia made his famous speech at the Bank Structure Conference in Chicago in which he said, "The secret of modern banking is the universal bank model. And if you can pull that off, if you can get that right, the sky's the limit."

A few months later, he bought Golden West and everything exploded because he didn't pull it off right, timed it badly given the impending slump in residential values. Nevertheless, that was the thinking. It was not so much that one should get looser in lending, but rather that one should get smarter in financial services. And the other term that was used over and over again, was also introduced, I think generally by McKinsey, but some of the other consulting firms as well, was "share of wallet". I remember hearing that over and over again. It was not enough to have a certificate of deposit from a customer. You also needed to have them understand that it was very valuable for them also to take a loan from you or to invest in mutual funds or engage you as their stockbroker. So, "share of wallet" meant that you should try to get as much of that customer's business across the field of financial services as possible.

That was considered to be a secret to a successful high-performing bank. So the mindset was changing dramatically and we were so unaware of that change that I have a little anecdote to give you after my time at Wachovia that to this day I remain shocked at, that involved me personally. But, that's a better way to describe it. We were all in it and we were all drinking the Kool-Aid. And you know, if you've ever seen the movie Wall Street (I think it was Wall Street), one of them has the little vignette of the stripper who was buying houses in Florida and she said she was making much more money that way. Well, people laugh. But that was a true story. That was exactly how people were thinking. My family and I had a place down at Seabrook Island and we had a pool man who would come once a week, especially when we weren't there. I liked him. And I came out on the balcony one day and I said hello to him. He was down by the pool and he said, "Oh, Mr. Baxter, this is my last day here. I'm sorry I'm leaving." I said, "What?" I said, "I hate that. You know, you're so good. What are you going

to do?" I thought he was going to another pool company. He said, "I'm going to join my brother in Florida. We're going to be selling mortgages." And I should have known at that time that the entire society had lost its mind because he knew no more about mortgages than I knew about building bridges.

But we were all drinking the Kool-Aid. We all thought the world was going to enjoy never ending prosperity. It was what was often called the "peace dividend" with the collapse of the Berlin Wall and the collapse of the Soviet Union and so on. And, people just thought things were going to get better and better. We had economists who would come and talk to us. One of them in particular stands out in my mind. He came and said, "We don't have to worry about economic cycles anymore. We've got smart economists, econometrics experts who know how to avoid that problem."

I should have known at the time that that was going to be proved nonsense. That they were really claiming one could bypass thousand-year-old rules that weren't just going to change that way. This naïve suspension of belief was similar to the way that I should have known at the time of the dot.com boom that when a company in its prospectus for an IPO says—as it was legally required to say—that, "this company has no prospect of making profits for the foreseeable future," I should have said at that point, "I'm out."

But instead we thought, well, there's some kind of magic going on. And, just like as recently as a few months ago, here, the economy was supposedly booming. I always thought that was a bit of a feint because the "prosperity" was being achieved at the cost of an escalating deficit; but who could have predicted the coronavirus? Some experts did, but unfortunately even our government didn't. Suddenly, what my first CEO had said to me became true again: "You never see the lightning that strikes you." Suddenly the lightning we never saw just struck us, until we were very quickly into perhaps the greatest economic catastrophe that we will ever live through. So that was the mindset. It was one of the, "everybody's happy let's get happier."

Andrew Carlins: To what extent, if at all, did figures within Wachovia or in your industry, express concerns about the changing nature of credit extensions and lending practices during the 2000's and did those concerns lead to any kind of significant internal debates or changes in Wachovia's practice?

Lawrence Baxter: Very little, but I would be unfair to some of them because not being in loan administration, which was, until about 2000, the inner sanctum of all banks like Wachovia. I bet there were people there who had concerns, but if there were it was kept very low level and not brought out into public discussion. The first time that a caution at the old Wachovia developed was when we had two of our major industrial customers went bankrupt because of the emergence of what were then known as the maquiladoras in Mexico, where furniture was being built much less expensively than in the United States as a result of NAFTA, and we realized we could lose money on a much bigger scale. So there was a caution there, but paradoxically what it did was put Wachovia in a position where out of

desperation it had to do the Hail Mary pass of the merger with First Union, instead of acting cautiously from then onward and merging with SunTrust, which was the deal that the investment banking world expected. (They used to call that possibility the Coke and Smoke deal because Wachovia used to be the bankers to RJR.)

We went with the wildly unsuspected merger with First Union, which would have been a great success if we could have held on to the old Wachovia culture, but we didn't. So I don't remember visible objections. On the contrary, I think people who expressed too much caution weren't overly scorned, because that wasn't the culture of the company, but they were certainly regarded that they sort of somewhat patronizing view of, "you just don't get the new economy buddy" kind of thing. And it was easy to have that "new economy" outlook because that view was society wide.

I mean, you know, Wired magazine and Fast Company, Business 2.0, Red Herring all those magazines were out there praising the endless bounty of technology. And traditional bankers started to feel foolish. They hadn't got the internet, and so now they would be accused of not getting the new economy. And you had these, in retrospect, snake oil salesman, but these were economists who would come and tell us that the economy was never going to be the same again. You had Alan Greenspan talking about the magic of the market and how it's automatically self-correcting. And boom, everything was like a herd. The herd mentality was very strong and the effort to resist the herd would have led you to be marginalized virtually immediately, because everything looked so different.

When I left Wachovia and I was dabbling with the startups I had a friend (still a friend to the present day). He was a niche investment banker in Charlotte. I went to lunch with him and I asked him, "What worries you the most?" (This would've been about 2007, late 2007). And he was very serious in responding, "Lawrence, what worries me the most is that consumer credit as a proportion of annual income has doubled in the last five years." So it went from 30%, which was the historic ratio of household credit to annual income, to 60%. I looked at him, I said, "Really?" I said, "Well, that just shows how we can be so much more sophisticated about funding even of households." He said, "Yeah, but it worries me." He said, "I don't like the look of it."

I didn't give his caution the credit that I should have. Then about a month later, I got a power point deck sent to me by my former boss who had also retired from Wachovia and she said, "What do you think of this?" This was late 2007 maybe very early 2008. No, it was late 2007, and I wish I could find it. I might be able to one day. I looked at it and it wasn't done by a banker; it was done by an engineer. He had put together the remorseless logic of the subprime bubble, as it was at that time, and the inevitable financial collapse. I read through it all and I wrote back to her and I said, "You know, logically he's right, but I can't, I can't believe this is really going to happen. I hope he's wrong." He was dead, dead right. So the cold-eyed logisticians did see it, just like the cold-eyed

epidemiologists could see this Coronavirus coming, you know, now it's a pandemic. But I chose not to believe it.

There was another example that I had very clear, early warning of, and chose not to believe it. I went to a political fundraiser at the top of the city club in Charlotte. I'd been a member there, but by that time, I wasn't a member anymore but I was invited and the guest speaker was Robert Rubin. This was a political fundraiser for Erskine Bowles, who went on to become President Clinton's Chief of Staff. He was running for Senator, I think, at the time. Robert Rubin, who was the former Treasury Secretary and then chairman of Citibank, a former CEO of Goldman Sachs. He spoke and painted a potentially horrific picture of the structured security business. In it, he described what could go wrong, which would have been catastrophic, and said, these are things we have to watch. And, I remember getting in the elevator and walking out at the bottom of the building onto Tryon Street with my wife and saying, "My God, I hope he's wrong..." not *I hope* he's wrong. It was, "my God, I hope there are people that are keeping tabs on it." Well, there weren't. And I chose to dismiss that out of my head. You know, just don't worry about it sort of thing. I think that was very typical of the mindset everywhere.

Yeah, there were a few people, and of course there are people who like to celebrate themselves for being prophets. Nouriel Roubini is one example, and I'm forgetting some of the other names now. But the truth is that some of the prophets have since then predicted many a crisis, which hasn't occurred, reminding us that, even a broken clock is right two times a day. That's not to say Roubini was just a broken clock, but there were a few prophets who have been wrong most other times. They were not being listened to, just like the real experts, epidemiologists, were not being listened to about the pandemic.

- Andrew Carlins: Given Wachovia's position, I'm wondering how the housing boom impacted Wachovia or Wachovia's online banking services uniquely relative to either other parts of Wachovia or Wachovia's counterparts.
- Lawrence Baxter: I do remember that that whole LendingTree concept, which had been regarded as an aberration by the traditional bank had, by the early 2000's, had evolved into a platform in which our own bank knew it had to compete. So, it was getting enough volume that it must have changed behavior in the businesses themselves. But since I wasn't originating the loans or underwriting loans or evaluating the risk on them, I can't say directly whether the internet was changing their thinking. I suspect it was. You certainly got lots of inquiries and we certainly got a lot of support once they adopted the internet in offering the products online. But exactly how that all shifted in the mindset there, I don't, I can't say for sure. I think it was a sliver of the more complex picture that I've been talking about.
- Andrew Carlins: How did executive compensation practices change at all during your time at Wachovia?

Lawrence Baxter: Well, they definitely changed a lot. Especially stock awards—options and grants—became a much more dominant form of executive compensation. Restricted stock awards, in which the stock would vest over a period of time, it was one of the main ways bonuses were paid (though cash bonuses were always still there as well). So stock definitely became much more prominent. We started to become familiar with the Black-Scholes model for valuing stock options whereas when I first got to Wachovia in the beginning of 1996 was only just emerging at that time. So, the notion of total compensation became a much bigger one than just cash compensation.

And that started to incentivize people to do everything that they could to make the stock price rise. I don't know to what extent that that generated more risky behavior. I can't say for sure, but I do remember I used to meet with our investment analysts when they'd come down from New York at the early days of the internet because as I mentioned earlier, we were one of the leaders in the field and the Wall Street analysts were very interested to know how this was going to change the business. And I remember one ridiculous occasion that I gave a good talk to one of the analysts and our stock jumped immediately. And even I knew that was ridiculous because we were such a small part of the bank that the market was being silly to think that suddenly the value of Wachovia had increased by that much in such a short time. Sure enough, the stock price settled back down.

But we used to have people watching the stock price all the time because their compensation packages had changed. We were pushing stock awards and stock options further and further down in the company below the executive levels. The general idea was that it was because it encouraged people to think of the company performance as a whole as opposed to that of their immediate business unit. But I think part of it probably had to do with the fact that it may have been a less expensive way to pay people. I just didn't know enough about corporate finance to know for sure. What I do know is that all my savings I thought were prudently diversified, part of which was in a 401k, in which I selected various funds and one of them was Wachovia common stock funds. I was hopelessly overconcentrated in Wachovia stock from the point of view of personal savings and from the point of view of retirement savings which gave me a double hit when the stock collapsed. That was my own stupidity actually. But just offering that common stock fund was an example of how the company was doing what all the rest of them are doing as well, which was essentially using every financial lever they could do to make sure the fund was, the stock price was up.

Andrew Carlins: Looking back on the crisis, more than a decade later, what do you see as its most important lessons for origination and state policy, state level policymakers and financial institutions?

Lawrence Baxter: Okay. You say state level, you mean literally state level or government level?

Andrew Carlins: Both at the state and at the federal level.

Lawrence Baxter:

I think we allowed the override of specific state consumer protection provisions too easily. There was a big attraction to having standard nationwide consumer protection in place, because we had moved from being a very localized type of business to being, not only nationwide, but with the internet, global. And it's a complicated process, but that process enabled national banks and then state chartered banks to override state restrictions on interest rates, for example. I think that went too far too fast. I think North Carolina was actually a good example of doing the right thing, which was that the North Carolina Banking Commissioner fiercely defended North Carolina state consumer protection laws, as did a few other states. California was another one. But a lot of states basically abandoned any effort to try to impose their restrictions. They did for various reasons. South Dakota did it to get Citibank's credit card business, and so on and so forth. So I think we made a mistake in not thinking through the risks to consumers. And an example of that would have been in subprime lending. Consumers were really not in a position, and in many cases now they still aren't in a position, to negotiate on equal terms with lenders. And, maybe it's my bias, but frankly bank lenders are safer to deal with than non-bank lenders, if only because they're regulated more holistically by what we call the prudential bank regulators. Whereas a lot of the non-bank lenders are subject to much less constraints. So that was one thing.

Secondly, the idea that you could lend a NINJA loan (no job, no income, no assets) was just outrageous, but it was part of the party. And then there were liar loans. I don't think our company ever did any of that, but there were big portions of loans made on the basis of false statements by borrowers, often encouraged by lenders. It was the belief that something that looked rock solid as collateral, like a residential home, would not lose value. I think it was shattered. They did lose value dramatically. And in fact, the entire Value At Risk (VAR) model that was used by securities firms to estimate the risks involved was fatally flawed because one of its assumptions was the prices in residential real estate would rise as consistently over the next 10 to 15 years as they had in the previous 40 years. If that assumption had been tweaked into taking into account the collapse in housing prices in the Great Depression, you would have had a very different model, VAR risk model that would have made much of the business look much less profitable. So I think, I like to think we've gotten much more cautious of that. There was too little appreciation of the fact that bad lending not only involved consumer exploitation but also posed a threat to the safety and soundness of the lending institutions themselves.

The other lesson I think was that the resilience of a bank is certainly going to be at least in part a function of its capital position and capital was simply not taken as seriously then as it is now. It's a long additional story to discuss. And then finally, liquidity, when there's a run on a bank, because banks borrow short and lend long. That's part of the intermediation and maturity mismatch process. If there is a run on the bank for the short term depositors taking their money out, you're in big trouble when you're stuck with the long term loans that you can't collect a repayment for because you committed to 30 and 15 year old, 15 year mortgages.

The adjustable rate mortgage I think is looked at more carefully now than it was then. And I think responsible banks know that the collateral that they have for lending, no matter how rosy it looks at the time of the loan can suddenly turn south. Think of all the oil companies that have assets in the ground that have suddenly lost enormous value. And you can go through every part of the economy on that. Commercial real estate in past weeks has just collapsed in value, because of the pandemic. So, bankers that weren't taking that into account, were just downright stupid because they should have learned that lesson. I think some of the better ones had, and they had made adequate provision. But I'm not close enough to know, to be able to say that with authenticity.

[END OF SESSION]