# AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

# ORAL HISTORY PROJECT

Interview with

Richard Cordray

Bass Connections

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# PREFACE

The following Oral History is the result of a recorded interview with Richard Cordray conducted by Sean Nguyen on April 8, 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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Sean Nguyen: I'm Sean Nguyen, an undergraduate student at the University of North Carolina at Chapel Hill and a member of the Bass Connections American Predatory Lending and the Global Financial Crisis team. Today is April 6, 2020 and I am conducting an oral history interview by phone with Richard Cordray, former Ohio Attorney General and former Director of the Consumer Financial Protection Bureau. Thank you for joining us today.

Richard Cordray: My pleasure.

Sean Nguyen: I'd like to start by establishing a bit about your background. I believe you received your Bachelor of Arts from Michigan State University in 1981. Is that correct?

Richard Cordray: Yes.

Sean Nguyen: Wonderful. So after college, you then completed a Juris Doctorate at the University of Chicago School of Law in 1986. Is that correct?

Richard Cordray: Yes.

Sean Nguyen: In the context of your work life, when and how did you first become involved in residential mortgages?

Richard Cordray: Well, in the early 1990s, I served in the Ohio legislature and I worked on my first piece of consumer protection legislation. It was a bill to require Ohio sellers of residential real estate to disclose material defects in the home to buyers who might not be aware of those defects. Interestingly, it was a bill that was asked for by the realtors, to regulate their own industry. They recognized that their business was hurt by dissatisfaction with home sales where people felt that they had been misled or things had not been disclosed to them that were significant in the selling price. And I got that bill passed in the Ohio legislature.

Then I dealt with real estate and mortgages again when I served as the County Treasurer in Franklin County, Ohio in the early part of the 2000s. I was elected in 2002, and we began to see problems in the real estate market and the mortgage market. A growing number of foreclosures were being caused — it appeared — by bad mortgages, predatory mortgages, irresponsible mortgages. And that became a full-blown crisis that eventually led to the financial crisis in the entire nation. And during that period as State Treasurer, and then State Attorney General, I created a set of “save our homes” task forces, county by county around Ohio, to try to help keep people in their homes as they were facing foreclosure.

Then, during my time at the Consumer Financial Protection Bureau, as the leader of that new agency for its first six years, we were instituting regulatory reforms to the mortgage market to help forestall any future economic crisis of the same kind that had occurred to the nation in 2008. So, in all those ways, I've had dealings with the mortgage and housing markets.

Sean Nguyen: How would you characterize the key changes in the Ohio mortgage market between when you first became involved in the late 1990s and 2008?

Richard Cordray: The key change was that somewhere in the period of the late '90s, in the decade between the late '90s and 2008, a very relaxed attitude took hold in mortgage lending. What was happening was, the mortgage lenders who make the loans to homeowners for you to buy a house, were finding that they were more and more being able to sell their loans on to Wall Street financiers. The financiers, in turn, were bundling these mortgages into new securities and new debt instruments for sale to other investors. And the easy assumption that began to underlie this market was that home values were very steady and would always remain steady or typically increase over time. That had been the historical evidence from about World War II on. Of course, it did not account at all for what happened during the Great Depression. Loans were being made according to more relaxed underwriting criteria that deteriorated dramatically over this period. In fact, the lenders began to feel that they didn't really even have to qualify good borrowers to take these loans because the value of the collateral, that is the home, would always make up for the borrower’s inability to repay the mortgage, and they could always foreclose on the home and sell it and get their money back.

As a result, completely irresponsible lending practices were engaged in during that period. It got to be very common to make a no doc [no documentation] loan, where they didn't bother to verify the income or assets of the borrower. Loans were made on misleading terms, for example, where a teaser interest rate would be artificially low for the first year or perhaps two, and then it would jump up later on, and they would underwrite that mortgage as though the teaser rate was going to apply over the entire life of the mortgage. There were also various exotic mortgage products that were being innovated at that time to help get more people to qualify for mortgages. And the underwriting was bad enough that eventually, the market crashed, home values actually declined, and the entire set of assumptions was upset. And that led to the financial crisis, the credit freeze, and the Great Recession of 2007-2009 that led to a sluggish economic recovery for about the next decade.

Sean Nguyen: The changes that you just described in the mortgage market, were they happening across the country, or were there certain aspects that were unique to Ohio?

Richard Cordray: At first, Ohio was an early arrival to the foreclosure crisis. Around 2004 or 2005, it wasn't at all clear why we were having elevated numbers of foreclosures during a time when the economy was doing pretty well. We were not in a recession. We were in a period of normal growth. And so, it wasn't obvious why this was happening.

At first, Ohio, Michigan, and Indiana had the highest numbers of foreclosures in the country. And so, we thought for a time that it was just a Midwestern phenomenon, had something to do with the Rust Belt and perhaps declines in the manufacturing economy. As it turned out later, that was maybe a small part of the problem, but the larger issue was that this new wave of irresponsible predatory lending started somewhere in the country and then gradually moved to other areas. And one of the areas where it began was in Ohio, Michigan, and Indiana, and bad loans were being offered to people, and the borrowers did not know any better, believing the lenders had their interests in mind, or at least that their interests were aligned. People were taking these mortgages that ended up failing and ousting them from their homes. And then eventually those practices spread more broadly around the country. There were a set of mortgage lenders who were highly irresponsible during this time. Some of them grew to be the largest mortgage lenders in the country, and they ultimately went out of business: Washington Mutual, Countrywide, AmeriQuest, and others. And that was the genesis of the crisis.

Sean Nguyen: I want to go back to a comment you mentioned earlier about the new loans featuring exotic instruments. What did these new types of loans and these new innovations, what did they mean for consumers?

Richard Cordray: For consumers, they meant two things. First, it created more availability of credit for consumers because these more exotic instruments made it possible to qualify people for mortgages who, according to traditional underwriting criteria, may not have qualified, probably would not have qualified. In fact, a story I tell in my book *Watchdog* — which was just released last month, which is a story about consumers, consumer finance, and the work done by the CFPB to protect consumers — is illustrative of the problem. The head of a community bank in Ohio found a Lamborghini in the parking lot at the bank. At a meeting, he asked who owned the Lamborghini, [which is an extremely expensive car]. And it was one of his mortgage loan officers who said, "It's great. You know, we don't even have to qualify people for these mortgages. We can make these mortgages to anyone, and as long as the housing market keeps going up, it's all fine." The head of the bank became alarmed by that casual approach and he shut down their mortgage lending unit. And what happened, here and many other places, was a lot of those loan officers went elsewhere and kept making the same kind of irresponsible loans while people who were trying to adhere to more traditional underwriting standards were left out. So what happened was more credit was made available to consumers. Some of it was irresponsible and undeserved credit or unjustified credit. Traditional lenders were losing market share to the more irresponsible lenders, which created a race to the bottom in the market.

The second part is that those loans which the traditional lenders knew weren't going to work, but the borrowers could get from someone else if the traditional lenders said no, ultimately did crash and burn in a spectacular way. And though it didn't happen immediately, it happened eventually. And many of those people who got those loans ended up losing their homes. And by the way, many others who didn't get those loans ended up losing their homes too. Because, as I talk about in my book, if you had a number of foreclosures in the same subdivision, then the housing prices in the subdivision would crater for everyone, even though some of the loans were responsible and sensible loans. People could not afford to sell their homes because they owed more on their mortgages than the house was worth, and people were frozen in place, unable to move. And it caused a lot of woe throughout the American economy.

Sean Nguyen: In your experience, did you find that there were people who could qualify for prime or conventional loans, that would wind up in subprime, or exotic mortgages?

Richard Cordray: With increasing frequency that happened, yes. And in fact, there was a practice at this time that was common in the market. I talked about it again in my book *Watchdog*, which was called the yield spread premium, where the borrower would be across the table from the lender. The borrower makes the natural assumption that the lender has the borrower's best interest in mind, or if that's too heroic, at least the lender has financial interests that are aligned with the borrower. That is, you won't lend me money if you think I won't be able to pay it back because you would be at risk of not getting your money back. Right? So, the borrower tends to assume that the lender is making a responsible loan that they believe will succeed and therefore they will get their money back.

However, what they mistake is that sometimes the lender's interests are not aligned. There may be other side agreements that they know nothing about. The yield spread premium was an example of that. Maybe a real estate agent or broker is able to qualify you for a loan at 4% interest based on your credit risk profile, but you don't know what the price is going to be for you and instead they offer you a loan at 8%. And if you don't shop around, you may think that's the fair price. You may just assume it's an off-the-shelf price. But in fact, they were splitting the extra 4%, taking half and sharing half with the lender, that was called the yield spread premium. That was common. It was banned as a result of the financial crisis and the mortgage market meltdown. And that was one of the things that we helped eliminate in our new regulations of the mortgage market. But yes, there were plenty of instances where the borrower didn't get the loan they should have gotten. By the way, sometimes it's because of racial discrimination. The lender eyeballs the borrower and thinks that person is not a good negotiator [based on race or ethnicity or gender] , so I will offer them a higher-cost loan. And if the borrower accepts the rate that's offered, nobody is the wiser and the lender makes more than they should have based on the person's credit history.

Sean Nguyen: You mentioned earlier that you served as Treasurer for Franklin County, Ohio in 2002 to 2007 before becoming Treasurer of Ohio from 2007 to 2009. Is that correct?

Richard Cordray: Correct.

Sean Nguyen: Can you describe your official responsibilities in those roles and how they related to the market of residential mortgages at the time?

Richard Cordray: When I was the county treasurer from 2002 to 2007, it was my responsibility to collect the property taxes on all real estate in the county, commercial or residential. And we saw that if people were behind on their mortgage they were often behind in their property taxes, and the property tax delinquency rate, which was climbing at that time, was a harbinger of the fact that mortgage problems were happening at the same time. And so, we saw that, and we began our initial work to identify and address the foreclosure crisis. When I was the state treasurer, I began to see the same problem all over the state. It wasn't limited just to central Ohio, where I'd been a county official, and we began "Save our Homes" task forces across the state to address the same issue, to enlist local officials who had similar responsibilities in their counties to deal with this. It was not part of my statutory responsibilities as the state treasurer. It was an interest of mine and a recognized necessity and a source of distress in our state. And so, I took it on, and my people took it on as an extra duty above and beyond our statutory responsibilities. In 2009 to 2010, I then served as the Ohio Attorney General and we continued that work and continued the existing coalitions because the crisis was still playing out through that whole period.

Sean Nguyen: During your time as the Treasurer of Ohio, as well as the Attorney General of Ohio, what agencies, whether state or federal, did you work with most closely on issues relating to the residential mortgage market?

Richard Cordray: Well, one of the problems with the residential mortgage crisis was that it fell in between various responsibilities. And this is a problem that was solved in part by the creation of the U.S Consumer Financial Protection Bureau in 2010. The mortgage market was regulated by a variety of hands, and therefore there was not overall responsibility for what was going on in that market. Let me explain that. The mortgage market is one that has various kinds of financial institutions competing against one another. There are banks and credit unions, and banks can be divided into larger national banks with a national charter, and state-chartered banks, which are typically smaller community banks with a more local footprint. Credit unions also, some have a national charter, many have local charters. And the different regulators meant that nobody had a bird's eye view of the entire market.

Add to that, that many of the mortgages made in the mortgage market in the United States are not made by banks or credit unions but are made by other mortgage lenders who are not chartered like banks or credit unions. These are mortgage companies like Rocket Mortgage, which is one of the biggest lenders today. So those were typically regulated state by state, and if they were larger companies, they often eluded effective state regulation. So, you had both different people at the state level doing this, different people at the federal level doing this, all of them somehow covering the whole market, but none of them having a good grasp of the entire market. And there was nobody with market monitoring capacity to really understand what was happening in this market. I have spoken to both Janet Yellen, and Ben Bernanke before her, as Chair of the Federal Reserve who said that at that time, they didn't have enough visibility to appreciate that the mortgage market could actually collapse the economy. That was addressed in part in the Dodd-Frank Act by assigning the Consumer Bureau a task to create a national mortgage database to keep better data on what's happening in the mortgage market and to be comprehensive.

Sean Nguyen: How, if at all, did the stakeholders that you were serving as the Treasurer of Ohio as well as Attorney General communicate the concerns that they had regarding the mortgage market, and how did your office respond to those concerns?

Richard Cordray: Well, again, I had a perspective on this as a local official because we were seeing the distress. The same people getting behind on their mortgages were getting behind on their property taxes and that fell within our area of responsibility. So the [conceptual] leap was from that to the mortgage and foreclosure problems. Again, that was arguably pretty unique. But that was how I began to see it. Yet the issues kind of fell in between some of the cracks in state government and of course we had no authority over national banks. So effective oversight was certainly impaired by the divide between federal and state government. And that helped lead to the issues not being addressed adequately.

Sean Nguyen: A topic that has come up during our oral histories interviews is the topic of federal preemption, which I believe you spoke about a moment before. Were there instances during your time as a state regulator where you think federal preemption was, or was not, the right approach from the federal government in regards to regulating banks?

Richard Cordray: You have to understand that at that time, I was a state official so I tended to define federal preemption as simply an impediment to me doing my job well because it disabled me at times from addressing issues that I could see were affecting people in my state.

Let me give you an example. Separately from the whole mortgage lending set of problems that we have talked about, was the problem of mortgage servicing. When you have a mortgage loan, you make payments every month, and the payments typically cover the payments due on the loan, and potentially property taxes and insurance. You typically make those payments to a company which is called a mortgage servicer. That may be the same company you got the loan from originally, but often it's not. Often the original lender will contract out the mortgage servicing to someone else who's more expert at it or they will sell the mortgage to someone else and therefore there will be a new servicer contracted to perform this role. You may not even know that those changes have occurred; you may get notified, or at that time you might not have even gotten notice of the servicing rights changing hands.

So, if you have a mortgage and then several years later you start having problems repaying it, you would potentially be in a situation where you didn't know where to go to get those problems addressed. And the mortgage servicers were very sloppy in the paperwork as they were buying and selling these mortgages and contracting about the servicing, and the loans were often being bundled up and sold off as securities on Wall Street and nobody knew who had which rights in them. And so, some of the servicers began, when they wanted to foreclose on a property and they didn't have the right paperwork in their file, they began just making up the paperwork to fill the gap. That was the mortgage servicing robo-signing scandal that began to emerge in 2010.

I was the Ohio Attorney General at the time, and the five largest banks that serviced mortgages, four of them were nationally chartered banks, Bank of America, Chase Bank, Citibank, and Wells Fargo. And we could not sue them for what we considered to be, and what turned out to be, massive fraud. I could sue GMAC, General Motors Acceptance Corporation, which was the fifth largest servicer, because it was a state-chartered bank and we were not preempted there. And so I did. That was the only lawsuit filed in that whole scenario [by a state attorney general]. It helped prompt a national investigation, which ultimately led to a multibillion-dollar settlement with all the major mortgage servicing companies for their pattern of fraud that they committed in this area. But preemption often got in my way.

Now, the advantages of preemption for these national companies is that they are national, operating throughout the country. They don't want to have to operate state by state and be subject to a patchwork quilt of state regulations. We understand that, although many companies operate nationally, and they deal with state by state laws on employment and taxes and a whole variety of different issues. So, in any event, I was at that time a foe of preemption and I carried that outlook into my federal service as well. The Dodd-Frank Act loosened up preemption and gave states more authority to operate in the area of consumer finance. And I think that that was a positive move.

Sean Nguyen: You mentioned during your time as a state regulator and state official, federal preemption perhaps being an obstacle at times. Did you communicate those concerns to federal regulators? And then what were the reasons why the federal regulators did not then pursue lawsuits against nationally chartered banks?

Richard Cordray: We communicated our views. There was a major case that went to the United States Supreme Court in that era called Cuomo vs Clearing House, which had to do with states objecting to federal officials blocking them from being able to exercise visitation rights to oversee the operations of banks. And somewhat to our surprise, the Supreme Court ruled in the favor of the states. That was in 2010, I believe, and started a bit of a rollback on the rather vigorous, zealous, preemption that the federal agencies, especially the Officer of the Comptroller of the Currency, had put in place up to then. So, one of the difficulties with preemption is that the higher entity – and it can be both the federal government preempting states or it can be state governments preempting local municipalities, both of which I've seen over the years – the higher entity can preempt the lower entity from doing anything about a problem even though the higher entity isn't doing anything about the problem itself.

And that exactly was what was happening here. The federal agencies were deregulatory in that era. This was the George W. Bush administration. They celebrated their deregulatory nature and felt that the free market was the right answer to everything. Ultimately, that laxness all blew up the economy in 2008 and it didn't look so good in retrospect, but they were not taking vigorous measures to oversee or enforce the law against these institutions. The institutions were being allowed to do pretty much what they pleased. I talk about this in Chapters 1-4 of my book, and it led to tremendous misery for many Americans. Millions of Americans lost jobs, millions of Americans lost homes. All of us lost a substantial chunk of our retirement savings.

Sean Nguyen: And you've mentioned this earlier in the interview, but from 2012 to 2017, you served as the Director of the Consumer Financial Protection Bureau. Is that correct?

Richard Cordray: It is.

Sean Nguyen: How did your opinion change on federal preemption once you took the office of a federal regulator?

Richard Cordray: It didn't. There's a section in my book on the dynamics of federalism and the fact that the Dodd-Frank Act had muscled up the states to be more involved with more authority in this area. And what I did as the Director of the federal agency, I felt that we should welcome everybody who wanted to join in the effort to protect consumers, the more the merrier. And we worked closely with states – both state attorneys general, of which I had been one, so these are my former colleagues, and state financial supervisors who regulate financial companies in their states. We worked closely with them as well. We brought many enforcement actions where we paired up with some number of states, often with all 50 States, and that helped us get a lot of relief for consumers against bad practices and violations of the law.

Sean Nguyen: Over the last decade, we've seen a number of different narratives emerge to explain the financial crisis. How do you understand what caused that crisis?

Richard Cordray: The crisis was caused by increasingly irresponsible lending in the mortgage market that ultimately led to the mortgage market failing. The transmission of those bad loans through sophisticated financial investments and mechanisms into securities and investments that were peddled on Wall Street to all kinds of investors, ranging from consumers to pension systems to other companies. And when the underlying assets deteriorated, the investment instruments also deteriorated, which caused a crash in the financial markets.

Let me tell you a story that I talk about in my book. Senator Johnny Isakson from Georgia described to me how he and Senator Harry Reid went over to the Middle East to inspect our troops. This is during the era when the financial crisis was beginning to build momentum. They stopped off in Kazakhstan. They drove in from the airport to meet with the leaders of Kazakhstan on their way to the Middle East. And on the way in, he saw all kinds of construction projects, but they were all idle. Nobody was working on them. So when he arrived at the meeting, he asked the officials they were meeting with whether it was a holiday, why it was that nobody was working on these construction projects. They said, no, it's subprime mortgage loans from America, from Lehman Brothers. They had bought a boatload of those, the investments had gone bad, and the bank was not able to continue lending to these construction projects for a period of time. Senator Isakson was startled to find that the contagion that had started in the United States had now spread halfway around the globe during this period. And that was early in the emergence of the crisis.

Sean Nguyen: You mentioned earlier in the interview that as a state regulator and state official, you filed suits against banks and rating agencies. What was the strategic goal of those lawsuits?

Richard Cordray: The strategic goal of those lawsuits was very specifically, get back money that we thought Ohio taxpayers and pension systems had been cheated out of – this was when I was attorney general – had been cheated out of by Wall Street firms and big banks. Then, as the head of the Consumer Bureau, we brought many enforcement actions against financial companies where our investigations had demonstrated violations of the law that had harmed consumers. We worked to get consumers' money back for them that had been wrongly taken from them.

Sean Nguyen: To what extent do you see your personal experience as adding something important and valuable to our understanding of what happened in the run-up to 2007 and 2008?

Richard Cordray: I think my personal experience is invaluable. It happened, just coincidentally, that I started as a local official dealing with these financial issues, then as a state official, and then ultimately as a federal official. Seeing these issues unfold at those different levels of government gave me a perspective on these problems that is probably unique among the people you're in a position to interview here and try to reconstruct what happened at that time.

Sean Nguyen: Looking back on the crisis over a decade later, what do you see as its most important lessons for mortgage originators and state level policy makers?

Richard Cordray: For mortgage originators? I think that the important lesson is that you must stick to underwriting criteria that you know will work with your customers. You should continue to do that and not be misled into thinking that you can deviate from what you know are responsible practices and that the deviations will be a sustainable business model over time. Now we put in place at the Consumer Bureau significant reforms in the mortgage market, new regulations, new safeguards, that I think protect that market much better against the kinds of irresponsible and predatory practices that we have been discussing. As for regulators, I think it's important for them to monitor these markets closely to make sure that regulations and the laws are being followed. They should be wary of accepting at face value the claims of companies that they can do things in some new and different and better way. The regulators were given their authority for a purpose. They must take care to oversee what the companies are doing. They must make sure that when people deviate from what's legal, when they cheat or deceive their customers, that they are called to account. I think oversight of these markets is very important. I think the markets have adjusted significantly to the new regulatory regime, which has produced a better mortgage market with more satisfied customers and better outcomes for consumers and lenders alike.

[END OF SESSION]