AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Paul Needels

Bass Connections

Duke University

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PREFACE

The following Oral History is the result of a recorded interview with Paul Needels conducted by Malena Lopez-Sotelo on September 28, 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.

Transcriber: Darielle Engilman | Session: 1
Interviewee: Paul Needels | Location: Durham, NC
Interviewer: Malena Lopez-Sotelo | Date: September 28, 2020

Malena Lopez-Sotelo: I'm Malena Lopez-Sotelo, a graduate student and a member of the Bass Connections American Predatory Lending and the Global Financial Crisis team and today it is September 28, 2020. I'm currently in Durham for an oral history interview with Paul Needels, former Senior Vice President of Strategy and Consumer Success at Informa Research Services, who has joined us via Zoom. Thank you for joining me today, Paul. I'd like to start by establishing a bit about your background. I believe that you went to the University of Colorado Boulder for college, and after college, you then completed a Master's in Business Administration at the University of Southern California. What led you to get an MBA, Paul?

Paul Needels: Just thought it was needed to continue my career, fill in the gaps.

Malena Lopez-Sotelo: In the context of your work life, when and how did you first become involved with residential mortgages?

Paul Needels: I've been involved in residential mortgages since going to work for Home Savings of America, and you see that on my resume. That's where I first got involved with residential lending. We were a portfolio lender. We were the largest lender in the country at the time. That's how I got involved in residential.

Malena Lopez-Sotelo: What attracted you to the sector?

Paul Needels: I don't know that anything attracted me. Previously, I was involved in commercial real estate and just by introduction, I got involved with a really good company [Home Savings] with really good people. The quality of those people like Charlie Reinhardt, William Barrett, Chuck Reed, Mike Muir and Chaz Seale, they were just world class people. They created a great company. So that's what attracted me, the caliber of people in the town. Not really real estate lending, it was really the people.

Malena Lopez-Sotelo: How would you characterize the state of the mortgage market when you began your professional career?

Paul Needels: Vastly different than it is today—much smaller, much more portfolio-based, much more community-based. It was a vastly different market—when I started lending, it was nothing like it is today.

Malena Lopez-Sotelo: What types of institutions made more mortgages? Could you dive into a little detail around what they looked like in terms of typical terms?

Paul Needels: You mean originally when I got into the business?

Malena Lopez-Sotelo: Yes.

Paul Needels: Well, you had your mortgage bankers and brokers and banks that are dealing with agency paper, but you had large [thrifts] like Home Savings of America, Washington Mutual, American Savings, World Savings, that were large portfolio lenders—they made ARM [adjustable rate mortgage] loans largely for portfolio. They were responsibly underwritten. They had very good performance history. The lenders maintained largely their stake in the assets, so they had great interest in the quality of the asset. They tended to service the assets they originated. So, it was a vastly different market.

Malena Lopez-Sotelo: How did the mortgage market change from the time you began your professional career to when you joined Washington Mutual in 2002?

Paul Needels: I don't know that it changed much from when I started to when Washington Mutual came in. Washington Mutual acquired Home Savings and basically, they were just a consolidator of the thrifts that were like Home Savings of America. So, they weren't really doing anything that different, it was an economies of scale game. So, I don't think it changed that much, from my perspective. The biggest changes came when I was at Countrywide. You had the rise of subprime lending. You had the massive increase in wholesale and correspondent lending, third-party lending. You had financial incentives that were drastically different than they were for a portfolio lender. That's where I saw the big changes. Not that they weren't there before, but that's when I started interfacing with them.

Malena Lopez-Sotelo: What about your specific role at Washington Mutual? Did it change at all?

Paul Needels: My role constantly changed. I started off at Home Savings, and I was on the board of a number of subsidiaries. I did turnarounds for them. I managed the re-engineering of the mortgage division, and then we got acquired. Then later on I went to work for Washington Mutual. There, I was responsible for product and residential construction lending. So that was a different role—product support, sales support, that kind of thing.

Malena Lopez-Sotelo: Can you clarify what residential construction lending is?

Paul Needels: Well, imagine you want to buy a home that needs a substantial amount of renovation, or you may have a piece of ground and you want to build from scratch, and you're looking for a loan that is both a construction and a permanent loan, and they're all in one. So, it was a single-close construction product. So one loan did your construction and your permanent loan— very efficient for the consumer.

Malena Lopez-Sotelo: I believe the role was previously in Colorado and now you are sitting in California. Was that different in any respect from state to state?

Paul Needels: Well, when I've been involved in mortgage lending, it's always been in California.

Malena Lopez-Sotelo: Now moving more into your specific role at Washington Mutual. What opportunities did you see there in your specific role?

Paul Needels: What do you mean opportunities?

Malena Lopez-Sotelo: More broadly, what opportunities you saw as an employee, whether that's at the state level or on the national level?

Paul Needels: Washington Mutual was a very interesting company. It had been growing very rapidly. It had scale. The people were very nice. They had, I thought, seemingly a good culture that valued employees. So, there was good opportunity because it was growing, and they had scale.

Malena Lopez-Sotelo: What was the function of your role in terms of the stakeholders that you might've worked with?

Paul Needels: At Washington Mutual?

Malena Lopez-Sotelo: Yes.

Paul Needels: I reported to the head of sales, who was responsible for both direct as well as third-party originations for the company. I was responsible for making sure that our sales force had the products they needed to compete, that they understood the products, and that they had incentive plans that were appropriate and equitable. I was responsible for also running both the origination and operations of the construction.

Malena Lopez-Sotelo: You brought up the term third parties. Can you clarify what those are?

Paul Needels: So in order to [do] lending, you can be a direct lender. So [to] give you an example, Bank of America is lending directly to you. You go to Bank of America, and they underwrite it, then they fund it. Third party is where the Bank of America, in this case—but Bank of America doesn't do third party today, but they did when I was with them—let's say Bank of America did third-party lending today. They could buy loans that were originated by a third party, meaning a mortgage banker or a mortgage broker. So that's the difference. Instead of Bank of America, as an example, dealing directly in underwriting, having a loan officer that handles the application and handles the funding and does the servicing, Bank of America could buy from a third party—so where they're not the one that's originating the loan originally. They could be table funding it, or they could be buying it as a closed loan, but they're not the ones that are originating at the start. That's third-party lending, and that's grown to be huge.

Malena Lopez-Sotelo: You used the term table funding. Can you clarify and explain a little bit more of what that is?

Paul Needels: Let's distinguish, we're in the category of third-party lending. So there's direct lenders, there's third-party. There's a couple of flavors of third-party. One flavor is you're a broker. Brokers typically are the least capitalized. They're a big part of the market, they're very important. They offer very good value to consumers because they have a lot of choice, but they don't have the capital, typically, to fund the loans. So what they do is they work with a bank who has a wholesale lending division who would actually send the money to the escrow company to fund the loan. So it's not "ABC Mortgage Broker's" funds that are funding the loan—it's the lender. It's your Bank of America that's actually funding the loan. But as far as the customer's concerned, the consumer, they're blind to it really because all they care about is, "Did I get the loan that I expected to get? Did I get the money I expected?" That is what a mortgage broker is. A mortgage banker is more well-capitalized and they have warehouse lines of credit that enable them to fund the loans and then sell them as funded loans to a Bank of America or Wells Fargo, or whoever's buying closed loans at the time. That's third-party lending, and there's wholesale correspondent.

Malena Lopez-Sotelo: How did you decide which third parties to work with, or Washington Mutual?

Paul Needels: You have a sales force that is targeted, that is chartered with knowing who are the largest originators in a given market that you want to participate in, and you think you can be competitive in, and you have staffing for. The sales force is chartered with account representatives that are chartered then with going out and soliciting them, and explaining why we're really good to work with, and why they should fund loans through us. They have to go through an application process, there's net worth requirements, there's quality controls to make sure that you're dealing with reputable people, but that's generally the process.

Malena Lopez-Sotelo: At your role at Washington Mutual, did you ever interact with any regulators?

Paul Needels: No, I don't remember interfacing with regulators.

Malena Lopez-Sotelo: How would you describe the key goals of Washington Mutual and your division while you were at Washington Mutual?

Paul Needels: The key goals?

Malena Lopez- Sotelo: Yes.

Paul Needels: Quality growth.

Malena Lopez-Sotelo: Is there a little more detail around what quality growth might mean in the context of your role?

Paul Needels: I guess I'm not sure what you're asking me. I mean the goal of any profit institution is to grow and to increase its return to its shareholders. So, our charter was to have the best products, have the most motivated, educated sales force with all the best tools, and to do so efficiently, and to continually grow. So my job was to help make sure they had the right products, that our sales force understood what they were doing. I didn't manage the sales force directly, but I was a piece of the support function.

Malena Lopez-Sotelo: Thank you. And your time at Washington Mutual, how would you describe the firm's culture?

Paul Needels: It was friendly, but I'd say kind of inbred. There was kind of a culture of those that were originally with the company, and I guess maybe because they'd acquired so many different companies, they assumed that they knew best. So there was a little bit of an attitude of, "We know best, you don't, and we really don't need your input, thank you." So there was some of that.

Malena Lopez-Sotelo: As I understand it, your next move after Washington Mutual was moving to Countrywide. What motivated you to join Countrywide?

Paul Needels: The person that I reported to who's head of sales went to Countrywide and asked me to come work with him, which I was happy to because I [had] great respect for him.

Malena Lopez-Sotelo: In what ways was Countrywide different than Washington Mutual?

Paul Needels: There was no comparison. Washington Mutual was a mess. They grew through acquisitions, but they never integrated, systematically, all of their operations. So at one point, I think we had a dozen operating systems that we were supporting. That adds tremendous complexity cost, customer service errors, so it was just operationally a mess because of their infrastructure decisions that they made, and they never overcame that. So Washington Mutual, while the people were good, and I enjoyed it there, operationally, because of their infrastructure and systems failures, it was a mess. Countrywide is like comparing a razor against a dull knife. They were a razor. Smartest people. Operationally, very savvy. Financially, very savvy. Very singular focused. Washington Mutual was big in mortgages, but they had a lot else going on. They had retail branches and maintained such. Countrywide was laser focused on mortgage originations, and they weren't limited to by any means, but they wanted a portfolio. So, it was a very different type of environment. A much harder place to work, much more demanding, brutal at times. They paid very, very well, but you earned every nickel. Very different.

Malena Lopez-Sotelo: Was Countrywide, in your experience, regulated differently than Washington Mutual? And if it was, how did that impact your role?

Paul Needels: I think we were. I don't know that it impacted my role, and I can only surmise how we were regulated differently. We had a bank [at] Countrywide. It wasn't anything on the scale of Washington Mutual. Most of the loans that we originated we sold off, so we kept the servicing. It was just a different model. I can't really speak to how the regulators differed between the two institutions.

Malena Lopez-Sotelo: Earlier, you mentioned two terms: wholesale lending and custom construction. Can you describe how that affected your specific role at Countrywide?

Paul Needels: Let's be clear, at Countrywide, I was in the wholesale division. So we had a direct division, we had a correspondent division, and we had a wholesale division. I was in the wholesale division. We did have a construction product that I also was responsible for at Countrywide. I had a similar role in terms of sales support at Countrywide as I did at Washington Mutual. Correspondent was, let’s say, a competitor channel. We were all very competitive. So much so that you didn't go onto the other floor. It was like a different business. We were very competitive.

Malena Lopez-Sotelo: Earlier as well you described brokers and where they fit in the landscape. How did you identify brokers to partner with at Countrywide?

Paul Needels: Well, as I explained before, you're looking for originators that have scale, have net worth, and have quality production. So you're not looking for somebody who's under-capitalized, produces no volume, and can't produce a quality loan. There's just going to be a headache, and you're going to have a lot of failures, and it's not going to work out. So, those were the goals.

Malena Lopez-Sotelo: Can you describe the incentives in place for brokers to work with Countrywide?

Paul Needels: Well, the incentives were the same for pretty much everybody—us as well as all our competitors in the wholesale space. They could earn points on the deal from the origination. They could earn yield spread premiums, which was a huge issue as time grew in terms of originating loans that shouldn't have been originated. So, yield spread premium is where, if the broker can get the borrower to agree to a higher rate, there's a yield spread premium that can be paid to that broker. So, that can be very substantial at times, especially when there was subprime lending going on.

Malena Lopez-Sotelo: Were you ever concerned about broker behavior during subprime lending, for example?

Paul Needels: Constantly, constantly. There is a saying, “If you leave a little hole in your protective armor, they'll drive a truck through it.” Brokers are very entrepreneurial, and they're very smart. They're very cagey. And when they see a window of opportunity, they'll flood it. So, yeah, you're constantly worried about it.

Malena Lopez-Sotelo: So to what extent was Countrywide aware of brokers' behavior as you described?

Paul Needels: What, that they're interested in their own self-profiting? Fully. Yeah. We knew who our client was.

Malena Lopez-Sotelo: In terms of [when] after mortgage loans were made, can you describe what Countrywide did with them? For example, did they keep them on their balance sheet or sell them to an entity like Fannie Mae or Freddie Mac, or securitize them?

Paul Needels: Well, okay. You're talking about two different things. So, there's the principal of the loan, and then there's the servicing of the loan. I believe that Countrywide, to a very large extent, kept the servicing and built up a large servicing portfolio and would have sold the paper, either through an agency or through bundling into mortgage bonds if they were non-agency paper. But Countrywide, its ability to survive depended on its ability to sell its assets. It didn't have a huge balance sheet that you could just continue to pile assets onto. What it originated it had to package and sell, take a profit, and maintain the servicing, spread, and move on to your next. That's the business model.

Malena Lopez-Sotelo: What was your perspective on the mortgage market and its impact on house prices as it evolved?

Paul Needels: Well, clearly the whole subprime lending and non-agency, aggressive lending practices that came into play, caused assets (homes) to be appreciated because people were buying—people had the ability to get loans that they shouldn't have been able to get. And therefore you had more demand for housing driving up housing prices and then on the flip side, when it all fell apart, it had the opposite leveraged effect. So, it caused trauma on both sides of the equation.

Malena Lopez-Sotelo: Did you think the market was overheated at all?

Paul Needels: Oh yeah, absolutely. We thought it was insane. Didn't make sense.

Malena Lopez-Sotelo: To what extent do you feel securitization had a role to play in the global financial crisis?

Paul Needels: Well, what I would say is that to the extent that you have institutions that are profit-motivated like Countrywide, and they have demands for growth, [to] keep that stock price going, and there is another party that is willing to take the risk, and thinks it's a good risk and is willing to take the risk and offload it, that lender is going to underwrite loans that it normally would not underwrite. And that's what happened. Countrywide had no interest in originating bad loans. My perception was that there was a realization that the underwriting terms, especially in subprime, were extremely aggressive and risky. Countrywide was not at direct risk, because all the assets were either guaranteed or sold off to the agencies, and everything was originated per parameters. So everything was done correctly, and a third party took the risk. So, why not originate it? That was kind of the attitude. And so that obviously fueled large volumes of loans that shouldn't have been originated.

Malena Lopez-Sotelo: On that topic, to what extent, if at all, did figures within your firm, whether [at] Countrywide or Washington Mutual, express concerns about the changing nature of credit extension during the 2000s?

Paul Needels: Was there concern voiced?

Malena Lopez-Sotelo: Yes, from figures.

Paul Needels: You're asking me for figures? I'm confused.

Malena Lopez-Sotelo: No, sorry. I'll repeat the question. To what extent did figures or people within your firm express concerns about the changing nature of credit extension during the 2000s?

Paul Needels: I wasn't in underwriting, but I did participate in the senior leadership meetings. There was extensive discussion about underwriting, underwriting quality in the industry, propensity for failure, whether or not we should be participating in the marketplace given how overinflated we saw [it]. There was a constant debate about that. There was unquestionably an awareness that this was not sustainable.

Malena Lopez-Sotelo: On those internal debates or those concerns that were put out, did any changes occur within your time there, whether it’s business practice, for example?

Paul Needels: Well, yeah, we got out of the subprime business. But, I'd say the biggest change is the market fell apart, and we couldn't sell our loans, and we had to sell to Bank of America. I mean, at the end of the day, that's what changed our practices was our ability to originate and sell assets. And when the market stopped, there was no liquidity in the market, it ceased and an entity like Countrywide lives because it can originate and immediately sell off those assets. You couldn't sell off those assets. You could still originate them, but you couldn't sell them off. And so, we had to completely change everything we did because we went with BofA [Bank of America], which was completely risk averse. And it turns out it was a horrible acquisition for them, just disastrous for them.

Malena Lopez-Sotelo: On the topic of the transition from Countrywide to Bank of America, what was the culture like at BofA when your team began to transition into the company?

Paul Needels: The BofA people were very professional. It was just a very different culture in that it was very bureaucratic and layer upon layer upon layer of control, extremely slow moving, and very, very risk averse. So much so that after a while, they worked on bridging in the wholesale group into Bank of America, they shortly thereafter closed it out. They then sold the correspondent group to PennyMac, so then they got out of third-party lending altogether, so obviously everything changed.

Malena Lopez-Sotelo: Were there any additional challenges outside of the culture that you experienced within Bank of America?

Paul Needels: No. The main challenge with BofA is it was so large. Your ability to really do anything as an individual was challenging. It was just a giant model.

Malena Lopez-Sotelo: Did your role change at all during your time there?

Paul Needels: Not really. I was on the transition team, and it was designed to be an interim position.

Malena Lopez-Sotelo: These are some concluding questions. Over the last decade, we have seen a number of different narratives emerge to explain the financial crisis. How do you understand what caused that crisis?

Paul Needels: The mispricing of risk is how I would surmise it. If at Countrywide or Washington Mutual or anywhere else, if the markets were properly pricing risk, we would not have been able to originate the loans that we did. So at the end of the day, that's the failure. It's pretty simple. Risk was completely mispriced. So, if you can get somebody to buy your loan that should be at par, but the reality is because of the risk, it should be greatly discounted. You're going to generate those all day long, because somebody's paying you above market. That's what happened. And this goes to the rating agencies, the Moody's and the like. There was obvious either incompetence or some kind of corruption that led them to not properly assess the systemic risk that the market was facing with the kind of lending practices that were commonplace. What I'd say is, just because you can do something doesn't mean you should do something. It's pretty clear that the industry should not have originated many of the loans that they originated. But they could, and unfortunately, they did. But again, it goes back to—the risk was mispriced.

Malena Lopez-Sotelo: To what extent do you see your personal experience as adding something important to our understanding of what happened in the run up to 2007 and '08?

Paul Needels: I have no idea, because I have no idea what you've learned or know. So, I have no idea.

Malena Lopez-Sotelo: Looking back on the crisis over a decade later, what do you see as its most important lessons for mortgage lenders?

Paul Needels: Just because you can doesn't mean you should. Sometimes you should just walk away. Again, there's money there, but is that who you are, and is that good for the community? Don't be such a profit whore. Take a long view.

Malena Lopez-Sotelo: Thank you for that reflection, Paul.

[END OF SESSION]