# AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

# ORAL HISTORY PROJECT

Interview with

Mike Krimminger

Bass Connections

Duke University

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# PREFACE

The following Oral History is the result of a recorded interview with Mike Krimminger conducted by Katie Kaufman on October 23, 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 spoked word, rather than written prose. The transcript has been reviewed and approved by the interviewee.

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Interviewee: Mike Krimminger
Interviewer: Katie Kaufman

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Katie Kaufman: My name is Katie Kaufman, and I am a law student at Duke and a member of the Bass Connections American Predatory Lending project. It is Friday, October 23rd, 2020. I am conducting an oral history interview with Michael Krimminger, currently senior counsel with the law firm Cleary Gottlieb, who is joining us via Zoom. Thank you for joining me today.

Mike Krimminger: Thank you. It's nice to [speak with you].

Katie Kaufman: I'd like to start by establishing a bit about your background. I believe that you went to UNC Chapel Hill for undergrad and Duke for law school, right?

Mike Krimminger: I did.

Katie Kaufman: And you joined the FDIC in 1991 and then served as counsel, senior counsel, senior policy advisor, and then general counsel until 2012. Is that correct?

Mike Krimminger: Correct.

Katie Kaufman: You started at the FDIC in 1991 at the end of the Savings and Loan (S&L) crisis. Were you at all involved with any of the legislative reforms that were enacted as a response to that crisis?

Mike Krimminger: I was not involved in initial legislative reforms that were a response to that crisis. Real, major legislative initiatives in response to the S&L crisis through 1989 was the, what's called FIRREA [or the] Financial Institutions Reform, Recovery and Enforcement Act of 1989. [FIRREA].... put in place [clearer and] more strict standards regarding when a receivership would be initiated by the FDIC of a troubled bank or thrift. And then [it] codified what would have been longstanding common law and federal and state law on the conduct of receiverships. So it became kind of the touchstone for future receivership analysis and development. ...When I joined [the FDIC] in 1991, [I was a lawyer in]... the appellate litigation group at the FDIC. ... I was persuaded to do that in large part because of the opportunity, which really proved to be true, to take a new area of law and kind of guide how it'd be interpreted by the courts. And I would just say as an aside that if you have an opportunity like that –

seize it – because there's nothing more fun and interesting and creative than taking something that is fairly broadly written and then ... defining, by the way you argue before the courts and persuading courts, that this is the proper interpretation of the congressional statute. Defining how that law is going to be interpreted. That [was a highlight of] my career …

Katie Kaufman: And so then transitioning to your work in the early 2000s --were you involved in the FDIC's mortgage work in the years leading up to the '08 crisis? Or how did you become involved in that area?

Mike Krimminger: ...This was a part of my career that was interesting as well, in that doing the litigation, trying to help define how these statutes should be looked at, I had the opportunity to learn myself about [new] areas of the law… Back in private practice, prior to '91, I [was] a primary litigator as well as a bankruptcy practitioner. So looking at some of the developments in repos and structured finance that came into play, even in the thrift crisis, [this experience] educated me, frankly, about how those transactions were looked at under the law and what would probably be the best public policy following up on them. So that kind of became the linchpin to the development of what I was doing at the FDIC during the '90s that led into the 2000 period we're talking about. For example, the FDIC and RTC in particular, -- [the Resolution] Trust Corporation, helped to resolve the thrift crisis -- did a lot to start and generate additional volume in the securitization markets because the RTC particularly had a huge volume of failed thrift assets [and had to be creative in how they sold those assets]. The FDIC was somewhat less involved as well, to help develop securitization structures. Take non-performing assets, [so-called] bad assets, out of failed thrifts or failing thrifts and banks, structured them and packaged them into securitization structures. [By structuring the pools so that senior bonds received first dibs on the income, you could create valuable securities even with large pools of poor assets.] So those securities get sold to the market in a way that would be enticing to investors.

And the way they would be enticing to investors, of course, is by the alchemy of securitization, if you will, of taking layers of a pool of assets so that the top layers [can be sold more easily]. The top-level securities usually get a triple A rating, are much more valuable because they have the preference for all of the income stream coming out of all the mortgages or assets in the pool. So that they can, you can get a triple A rating at the top level of those securitization structures, even though the assets themselves may not be very well-performing. [The RTC and

FDIC] would even take non-performing assets, even charge-offs, judgements, and delinquencies and restructure them and sell them in the securitization market. It would help create additional securitization markets, which were important I think in educating the marketplace about all the different things you could do with securitization, and how you could get good quality assets out of a pool that was itself overall, not very well performing by preferring the income stream [of] the good quality assets. And therefore, you have a [income] for a return for the investors[1].

Mike Krimminger: So that was something that developed throughout the 1990s. And during my work at the FDIC, I also spent time working with the leaders of an interagency group, working with the industry on resolution and insolvency-related issues, dealing with derivatives and of course, securitization assets as securities [2]. And we reformed the Bankruptcy Code, the Federal Deposit Insurance Act, the … Commodities Exchange Act, and other [statutory] provisions that dealt with the insolvency of financial institutions to provide for certain protected rights to securities holders. This goes back to the early '80s[3]..... One of the differences even today between the U.S. financial markets and the European financial markets is that the U.S. financial markets[, and not banks, are the principal tool to]finance business, real main street businesses[4] . Europe relies much more [on] banks. So it gives you a much deeper, much broader financial markets in the U.S. Not saying it makes it immune to problems, of course, but that does give you some advantages over Europe, which is very bank dependent.

As an aside, when Europe had issues with its banks in the 2010, 2012-13 time period, it was in some ways much more of a severe problem for the European businesses because they finance so much of their growth – of their leverage in their business through the banking system. And if [the banking system] was in trouble, that was a problem. Frankly, … [European] government finances [are closely tied to] banking as well, so it was more problematic there than the way it had been

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[1] It created a huge growth in securitization through the mid-2000s in all types of assets, including mortgages. The 2007-10 crisis killed the private label mortgage securitization market – for good reasons – but securitizations for many other asset classes continued strong even through the crisis.

[2] Mike Krimminger served as the informal leader of the interagency team negotiating with the industry and represented the group in discussions with the Clinton and George W. Bush Administrations as well as Congress.

[3] The goal was to provide clarity, and strengthen protections, for investors in securities and to improve resiliency of the financial markets.

[4] While banks are important to finance in the U.S., in Europe most businesses continue to get bulk of their financing from banks.

here[5].

But going back to the securitization issues [and market in the 1990s] as those began to develop and you have the securitization market beginning to develop in the U.S., it became important to provide some clarity to the investors who would be holding the securities about what would happen to their securities, their income stream, … if the [originator of the underlying securitized assets became troubled or insolvent].[6] The laws were modified. The initial proposal came out, giving comfort to the investors that help support the market. Basically what you were saying was that [with] the securitization market, the investors would be protected from insolvency under the law....

Mike Krimminger: By the mid-nineties, there had been a proposal developed by an inter-agency working group ... working with the industry itself [to address questions about the insolvency treatment for] ... securities and other derivatives. And that was proposed in 1997.[7] Just as an aside on American politics. That proposal was completely supported by the industry, by the agencies, and really didn't have any opposition in large part because a lot of people didn't understand it.[8] But it didn't get adopted until 2005 because there kept being abortion riders added to the [omnibus] Bankruptcy Reform Act every year it would be put up. ... [Finally, in] 2005, it was adopted [with] the abortion riders stripped out. So it became law and [protected], in particular, securities holders more than in the past.

...And in the late '90s another issue came up relating to securitizations and … [treatment of securities in insolvency] -- [There] was a concern that had been raised in the accounting profession over whether or not you could truly get so-called legal isolation treatment for the stream of payments to the bond holders or securities holders out of securitization trusts.[9]

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[5] European governments have historically been much more dependent – and tied financially – to their large banks. If the banks are troubled, business and government often are as well. The United Kingdom is more like the U.S. than the rest of Europe, but it is still more dependent on bank financing.

[6] The idea behind the revised insolvency laws was to separate the rights of the investors in securitization bonds or securities from the risk that the originator would become insolvent. This allowed investors to buy bonds from securitization trusts without being concerned if the bank or other company generating the loans itself became insolvent.

[7] Krimminger and others then went through a long process of review and explanation of the amendments with the Administration and Congress.

[8] Many were willing to rely on the joint agency recommendations even if they did not fully understand the financial or legal mechanisms.

[9] The accounting profession raised concerns over whether or not the securities issued by a securitization trust and the income stream to investors was truly "isolated" from the insolvency risks associated with the originator of the underlying securitization assets. In short, could you truly get so-called "legal isolation" treatment for the stream of

And what was important for legal isolation, at least in the part I was working on, was if the bank that had … sponsored the securitization trust were to become insolvent, would the FDIC need to recapture the income stream or the underlying assets in the trust, and put them back in the receivership? Because the FDIC receivership powers give it very broad authority when a bank fails over all the assets of the bank [to] sell them to investors to recover as much money as possible [in order to repay] the FDIC deposit insurance fund so it doesn't go insolvent. And the deposit insurance fund, of course, is what provides for your deposit [insurance] up to $250,000 per account holder type.[10] So, the accounting industry was very concerned about this, legal isolation of the assets in the trust, from the risk of the FDIC.

Let me explain for a second what that means. When a bank sponsors a trust for securitization purposes, or any kind of entity sponsors a trust for securitization purposes, what they're doing is they take a pool of assets like mortgage loans in this case -- it can be credit card loans in other types of cases. They move those into the trusts. And the idea is that the bond holders pay solely out of the assets in the trust, the monthly payments of the mortgage holders [that are going] into the trust, and will be paid out as interest to the bond holders. Of course, through the waterfall process, the AAA investors get paid first, then AA and A and so on down the waterfall. So the important thing from [an] investor perspective is to know that I've got these assets in my trust, and I'm going to get paid for these assets no matter what happens to the bank or other company that sponsored the trust.[11] So the insolvency risk [would exist] if that bank fails and the FDIC could seize the assets in the trust, they were not legally isolated. Then that would mean that suddenly they would be thrown back into the bank receivership and the bond holders would not be protected

payments to the bond holders. If not, then the assets in the trusts should be treated for accounting purposes as if they remained on the balance sheet of the originator. The capital and rating agency implications were enormous.

[10] For originating banks – and this was Krimminger's specific issue – the question was whether the FDIC as receiver for an insolvent bank could reclaim the assets in the trust as part of the bank's estate and then distribute the proceeds to bank creditors, and not the trust's securities investors. Very big issue. Simple for the FDIC because the FDIC had long treated the securitized assets as separate from the bank – that was how the RTC and FDIC had securitized assets back in the 1980s and 1990s. It was a long-standing practice. But, the FDI Act gave the FDIC very broad receivership powers over all the assets of the bank when a bank fails so that the FDIC could sell them to investors to recover as much money as possible. This also was critical to the FDIC because the FDIC had a duty to the deposit insurance fund to recoup the amounts paid to insured depositors from the assets of the failed bank. Each depositor is entitled to up to $250,000 coverage (then it was $100,000), and the FDIC repays the fund through the sale of failed bank assets. So, the question came down to this – are the securitization trust assets really separate or are they still bank assets?

[11] Otherwise, an investor will have to calculate the insolvency risks of the bank or other company originating the loans. That would destroy the simplicity of the market and make securitization pricing very expensive.

by the assets of the trusts. So that's a big deal from an accounting perspective and they would, would prevent trusts from being able to get a AAA rating, and probably even AA rating[, for senior bonds]. Because there would be insolvency risk from the bank permeating into the trust. So in the late '90s, there was a lot of work done by accountants, lawyers, policy makers, and others about how you can insure the bonds in a trust …

... [O]ne of the most frustrating things throughout my legal career, not being an accountant, was dealing with accountants. Because I could talk until I was blue in the face about how something was incredibly unlikely. I could never say impossible because you don't want to say impossible about very many things. But incredibly unlikely that the FDIC would ever try to seize these assets because from an analysis of the value of the assets [netting out] the amount of payments you'd have to make [to bondholders for terminating a sale into the trust – meant] the net present value return to the FDIC would be virtually zero[12]. I can say all that, demonstrate it with numbers and the accountants didn't care. Because I couldn't say it was [impossible]. So the regulation in 2000, which has been updated in 2010, and then in 2015 and 16 with some just, relatively, in this particular issue, relatively minor modifications on other issues.[13]

But the main concept here [was to clarity the] separation of the assets that are put in this securitization trust. It was clear the FDIC said that as long as you do certain things to show it was a valid securitization, the FDIC would not seek to try to capture those assets if the bank failed. So that led in the 2000 time period to much greater clarity from the accountant's perspective-- and from the market's perspective -- because the accountants were happy understanding that, okay, these securities, these assets are clearly outside of the bank. Banks can [create] securitization trusts, move mortgages into securitization trusts, and the bank's risk is not going to be affecting the trust. And the trust's issues are not going to be affecting the bank in theory. So that, that helped contribute. I won't say it led to it because I don't think that's true, but it certainly helped provide more clarity over how sacrosanct the assets in the securitization trusts were for the investors. And investors became much more comfortable.

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[12] Note: this glosses over a very lengthy legal and value analysis, but it is the FDIC analysis. So, even if the FDIC legally "could" theoretically terminate the trust and seize the asseets, its net present value return would be minimal.
[13]So, the FDIC adopted a regulation in 2000, which was updated in 2010, and then in 2016 with minor clarifications (unrelated to the underlying issue), which stated that so long as the securitization met certain standards, the FDIC would not seek to reclaim the securitization assets as part of the bank receivership.

Accountants, most importantly, and the rating agencies, even more importantly, were able to give a much more frequent and much more comfortable..., opinion that the top-level bonds in a securitization trust composed of crappy mortgages – it's a technical term – were still getting AAA treatment[14]. And so bond holders say I'm getting a AAA security. That's great. I don't even need to look at the assets underlying it. And I think that's one of the flaws of the securitization process is that you put AAA on something and the investors' minds tend to shut down. They don't look beyond the AAA.

And one of the things that we tried to do in some of the reforms ... following [the financial crisis and after adoption of]...on to the Dodd-Frank Act from 2010 and on, was to be clear that there was still some risk by the banks through risk retention in the underlying securitization.[15] You still get the legal separation. The FDIC still will say, we're not going to seize the assets, but the bank would be holding some risk in order to try to incentivize the banks to make better mortgages. Put better mortgages in the trust because you were kind of recognizing that investors' minds just shut down. One of my most frustrating discussions throughout this period was trying to understand why investors, I understood why on its face, but why that no one was looking at the quality of the underlying mortgages. And it was simply that they got a AAA rating. They didn't care anymore. And in fact, the SEC had put out regulations requiring a certain level of transparency about the performance of the underlying mortgages in a securitization trust [-- but only for a limited period of time after the trust issued securities].

I remember talking to the SEC in 2008 [and] 2009. Well, why did your regulation effectively mean: limit or stop having to do that reporting a year after the trust was created? And the reality was that nobody in the investor community, who the SEC's supposed to be looking out for, nobody in the investor community cared about the performance of the mortgages after about a year. And so they basically just kind of, again, that the mind of the investor shuts down when they get, they have that AAA rating. And they're not really looking at the underlying issues....

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[14] In other words, they were able to opine that the assets were separate from the originator and simplify the process of giving AAA ratings for bonds even if the underlying assets were poorly performing loans.

[15] Following the financial crisis and after adoption of the Dodd-Frank Act from 2010 and on, the federal government required the banks to retain a certain percentage of the risk from the securitization – so they would continue to have 'skin in the game' and hopefully originate better loans.

Katie Kaufman: You brought up some really interesting things specifically about ... working with industry participants, and then agency cooperation. Could you speak a little bit more in the period leading up to the crisis [about] how the FDIC was engaging with industry participants, to try to understand what the market looked like and then what the cooperation with other agencies was in the period leading up to the crisis?

Mike Krimminger: Sure. Well moving up to the 2000s now. The FDIC had always maintained a[n] effective research arm [that] reaches across the country [through its regional offices].... Today, the U.S. financial system is kind of trifurcated. It was quadrifurcated, if you will, previous to Dodd-Frank. [Today,] at the federal level [banks] are regulated by the Fed [Federal Reserve], the FDIC and the Office of the Comptroller of the Currency (OCC). The Office of the Comptroller of the Currency is the primary federal regulator for national banks. Those are chartered by the OCC. The Federal Reserve is the primary regulator for bank holding companies, as well as for banks that are chartered by states and are members of the Federal Reserve system. The FDIC is the deposit insurer and the receiver for failed banks, and is the primary federal regulatory agency for state banks -- banks chartered by the states -- that are not members of the Federal Reserve system.

So what that, what that means in practice is that the largest U.S. banks, like ...Citibank, Bank of America, et cetera, the big national banks … [are] primarily regulated by the OCC with the Federal Reserve being the overseer for their holding companies like Citicorp, Bank of America Corporation. The banks that the FDIC regulates tend to be much smaller because they're state banks and they're not members of the Federal Reserve system. And that means that they usually work through a correspondent banking relationship with a bank that is a member of the Federal Reserve system. And why is that important? Being a member of the Federal Reserve system, or having access to a member of the Federal Reserve system, allows you to get access to the payment system. ... The Federal Reserve banks operate the payment systems around the country.

So, with that background, it meant that the FDIC, the Fed and the OCC needed to work together about emerging issues, but they saw it from different perspectives. The FDIC always has been viewed quite accurately, frankly, as being rather conservative on the regulatory side because the FDIC is the deposit insurer. It's responsible for maintaining the strength of the deposit insurance system. And it's also the receiver. So when a bank fails, it's responsible for paying off the insured deposits out of the deposit insurance fund and selling the assets

of the failed bank and getting that money – as much money back as possible so the fund doesn't go bust. So anytime you're responsible for the bad side of the market, the banking market, it's going to make you a little bit leery about people going gung-ho on the risk side, right?

The OCC, as the chartering authority for national banks, is going to look at their banks and – let's be honest – sort of become protective of their banks because, you chartered them and you've been regulating them. If something goes wrong, it's kind of on you, is the way people sometimes look at it. I kind of view it as being more on the banks, but nonetheless, it's kind of on you, [the OCC].

The Federal Reserve is responsible for the holding companies of those OCC banks. And so it's sort of on the Federal Reserve too. So that creates a little bit of an interesting dynamic at times, when there becomes a[n] increasingly stressful environment for the banking system.

In the early 2000s [there was] a huge run-up in real estate prices and [huge expansion of private-lavel] securitized mortgages. Traditionally, the mortgages that are done through the, Freddie Mac and Fannie Mae, government-sponsored enterprises, were the predominant part of the mortgage market because they are the standard 30-year fixed rate mortgage.... Interest rates go up and down, but those mortgages would be underwritten under pretty standardized processes. As another aside, had Freddie Mac and Fannie Mae, I think I can prove this. This is certainly my view but it's provable. Had Freddie Mac and Fannie Mae stuck to the traditional mortgages that they made, met their underwriting standards, and not bought securities from securitizations of other mortgages issued by banks in securitization trusts --then Freddie Mac and Fannie Mae would never have failed in 2008. My view. I think that's, I think that's the generally held view now, finally.

...In the early 2000s, you saw [rapid escalation in residential real estate values], particularly on the West coast and the East – Southeast coast of the United States. California, Arizona, [and] Nevada, [saw rising residential real estat valus and were] ...fast-growing regions of the country at that time. Georgia and Florida also weer very fast growing parts of the country in terms of real estate, residential real estate. So you saw housing prices go very rapidly up. It had a long run that at end of this, 2006-7 period, by that point it had been about 15 years of generally increasing real estate prices.

So people were using their houses as [ATMs]. … Your house goes up by 15% this year, I got 15% more money I can spend. [So many decided to] mortgage it up to the hilt. [It got to be a problem] later on in 2007, 2008 and 2009. But for a long time, people were getting told, don't worry about the terms of your mortgage. It's a two-year note at this rate, low rate, a very low rate for your credit quality and it's going to reset, but in two years, we'll refinance because your house is going to continue to go up in prices, in value over time. So that had led to a huge [escalation in housing prices and pumped up the economy as well].

And there had been a huge increase also in the early 2000s [in the number and activity of] mortgage companies that were not banks. The difference between a mortgage company that's not a bank and a mortgage company that is a bank or banked, is that a bank has insured deposits. So it's got liquidity that's guaranteed by the U.S. government or the FDIC Deposit Insurance Fund [which is ultimately backed by the full faith and credit of the U.S. government]. Yeah, it pays a cost for the insurance [through assessments], but [deposit insurance is] a big advantage. That's one of the reasons they're regulated quite heavily. It's a big advantage to have [a FDIC guarantee supporting your] liquidity, which is effectively your asset if you're a banker, because all you do is you deal with money, make loans to people at a better rate than you're paying them for their deposits, right? That's what banking is all about. So … they could get liquidity from the government, so they needed to be regulated.

If you're a non-bank mortgage originator, how do you get money? You get money by selling the mortgages you originate. You can either sell them one by one into the market, which is very inefficient and costly and will not make you money, except in very rare markets. Or you can sell [a large pool of mortgages] into a securitization trust. In the early 2000s -- not so much today for a variety of reasons, Dodd-Frank and others. .... You can sell them into a securitization trust, and you can get a AAA rating for all that crap you originated, and you can go sell those mortgages into a trust and then go back and take the money you got from selling the mortgages into the trust, and then, make more mortgages.

Well, if that's the only way you're funded, how does your business function, except by continuing to make mortgages? Churning the mortgage market. So, as more and more people got new refinanced mortgages in the early 2000s, third-party

mortgage companies had [to continually reduce their underwriting standards]. …[16]

Mike Krimminger: … So as the mortgage origination companies began to make such a huge volume of mortgages and began to seize over 50% [of the market], those were not … being run through Freddie Mac and Fannie Mae.[17] [This evolution] began to put pressure on the whole market. First of all, for the mortgage companies, they had to continue to reduce their underwriting standards in order to find new people to make mortgages to. You know, look, you can refinance and go on a vacation. Everybody that was around back then saw these ads.

You can fix your house up, build a pool, whatever you want to do. Send your children to college. You can do any kind of thing you want to. Have a party. That's fine too. So you kept having to reduce your underwriting standards as a result of that. And so gradually the underwriting standards began to dive down.

And since these mortgage companies were seizing more of the market, the banks and Freddie Mac and Fannie Mae were under market pressure to compete with them on underwriting standards in effect to reestablish market share. So the bank's underwriting standards went down as well. Then gradually Freddie Mac and Fannie Mae, they didn't, they don't make mortgages, obviously, they just buy them on the secondary market, they bought securities issued by these mortgage companies and by banks with the crappy underwriting standards they were using by that point in the 2004, 2005, 2006, and 2007 time period, and put them on their balance sheet in order to deal with the loss of market share from these originating companies that were just churning the market.[18]

...[G]etting back to your question about the coordination between the regulators. I will give a lot of credit to my boss. Starting in 2006, I went to work for chairman Sheila Bair at the FDIC. There were other people, some of the academic

[16] The goal was to find more "eligible" borrowers. This led these companies to require virtually no real underwriting – all based on the expectation that housing prices would continue to rise. The mortgages were structured to fail – in effect – if housing prices did not continue to rise.

[17] So as we moved into 2006, private-label securitizations by mortgage origination companies and banks began to encompass over 50% of the total market – and fewer mortgages were being packaged by the government-sponsored secondary mortgage market companies, Freddie Mac and Fannie Mae.

[18] As the market share for Freddie Mac and Fannie Mae declined, they sought a way to participate in the spread of income in the private level securitization market because their base-line standards for mortgages packages in Freddie Mac and Fannie Mae securities had to meet much better standards than ht prevailing in the market. So, to participate in that market, they themselves began t buy securities and actual mortgages issued by these mortgage companies and by banking to hold in the Freddie Mac and Fannie Mae securities portfolios. So, Freddie Mac and Fannie Mae were now exposed to greater mortgage risk – through the securities and non-GSE mortgages they held.

economists and some others in the marketplace, talking about how this was a serious problem, and it was a rising risk in the marketplace at the same time that many others in the marketplace were saying, this can continue forever. A caution for the future is that anytime somebody tells you that this is a "new paradigm", this is a new way of doing [things, or] the old risks don't apply, check your pocket or your purse, find your wallet and make sure you have the same money that you had when you walked into the room. Because every time you hear somebody say that, something's going to really fall apart. [The same risks always apply, in my experience. They just manifest themselves in different ways.]

And so they were saying this is a new paradigm, securitization, slices and dices risk, all the investors can take what they're willing to pay. There's no real [concentration of risk, because] it's spread all over the market. So it's not going to affect anybody even if things go badly.

The downside to that is that since the securitization of these crappy mortgages [was] spread throughout the market, if things went badly, and the market reacts as the markets tend to do with [a] panic attack, everybody in the market eventually is affected by that panic attack because they've all got some of the risk. Then the lack of transparency I talked about a moment ago because nobody was really following the performance of the mortgages. [Nothing] in the securitization structures [provided] transparency about underlying mortgage performance [of each pool] very effectively. There weren't very automated ways of analyzing that. That meant that[the pools supporting the securitization securities] it became completely opaque [where] the risk [was] flowing around, and risk effectively spread everywhere. So the regulators were trying themselves to figure out how to analyze this.

Sheila Bair came into office in June of 2006. Iwent to work with her early in July of 2006. [She] was already very much focused on this and talking to a number of economists concerned about this. She had been doing academic work at the University of Massachusetts, Amherst prior to becoming chairman of the FDIC. Before that she'd had a number of jobs in the governmental sector as well. And so she was concerned. She felt it was a real rising risk and things [that] the market should be focusing on. So she had a lot of FDIC economists and analytical people, in the Division of Research at that time, which is what it was called, taking a look at the risks that were rising in different parts of the country. The FDIC was well aware that looking back at the Savings and Loan crisis in the 1980s, early

1990s, that that had been a very geographically focused crisis and big losses there. And the big bulk of the failures were in Texas, the oil region of the U.S. – Texas, Oklahoma, that area. Because the oil economy had collapsed in the late '80s and then a lot of the absurd pricing for all types of assets in Texas was unsupportable by the economic activity…

...The FDIC was well aware of how that crisis had occurred, had done a lot of work on the origins of that crisis and what had been done to resolve it. ...One of the things about the FDIC that was actually very useful in the [2007-2010] crisis was that there were a lot, a large number of very long-term FDIC employees. I started at the FDIC in '91, ... compared to a lot of people who had been there since the '70s even, and they had seen these cycles [before] and actually provided very good advice about how to look at the [evolution of economic cycles and crises].

… The OCC and the OTS, Office of Thrift Supervision, which was the [thrift] regulator prior to Dodd-Frank, was looking at it as well. Thistension, I'd mentioned earlier about the inherent kind of bias of the various regulators, where the FDIC [was] more conservative and doesn't have a dog in the fight, if you will, about the chartered entity, did play out as well. Even in that early period, the FDIC was more willing to raise the concern than some of the other regulators were.

Katie Kaufman: In thinking about the FDI[C]'s unique position with respect to some other agencies and as the dynamics are playing out in the market, [was] the FDIC pushing for certain reforms that [their counterparts] just don't have like...?

Mike Krimminger: Well, the FDIC was – I'm talking about the 2006, 2007 time period – was really raising the flags of concern about certain structures of mortgages that had been put into place as you had churning of the mortgage origination market. Particularly what's referred to as the 2/28s and 3/27 mortgages....2/28 is a mortgage with a fixed rate for two years that then is reset to a higher interest rate for the following 28 of the 30-year mortgage structure. So it becomes very much a floating rate. So you might have a fixed rate of, for someone who doesn't have great credit, and they weren't like cheap mortgages, but they might have a fixed rate for, let's say 7% back then, inflation was higher. It sounds crazy now, but that was not unusual back then – 7%, 8%. But then when it resets after two years or after three years for a 3/27, it might go up by 500 basis points.

So I go from a 7% interest rate to 12%. I'm underwritten if I'm the borrower, the loan was made based on my income to

support the 7% rate. It's not designed to – the bank or the mortgage origination company doesn't even look at whether I can make the payment at 12% because going back to what I said before: Oh, you can always refinance. Don't worry about the 12% rate because you'll get a refinance... Well, about 2005 housing prices started to decline. Oh shit. They started [to] decline. So suddenly you can't refinance. You're kind of stuck in this mortgage that is, that you see going in two years to 12%, it's going to be a serious problem for you.

And so yes, the FDIC was raising concerns about the 2/28s and 3/27s. Truth be told a lot of the other regulators were still saying that well, [we] got all the risk spread around. Even if things get a little bit dicey there, it's not going to really damage any particular institution. And we were saying, well, why don't we try to get ahold of the problem now, in 2006 and 2007, late 2006, 2007, why don't we try to [fully understand and address] the problem now by making recommendations, trying to get the servicers to look at the mortgages individually. [For example], if you've got someone who clearly cannot make [payments at a] 12% [fully amortized] rate... then let's modify the mortgage to keep it at the 7%. Oh no, we don't want to mess ... this is the industry too, the American Securitization Forum and others… oh no, we don't want to mess with the structure of the mortgages and all this kind of stuff.

[I and Chairman Bair responsed – in many meetings and calls – that failing to modify predictably troubled mortgages will create] a lot more foreclosures or a lot of delinquencies and that's not a good thing either. So why don't we look at the net present value, NPV test, are you going to be better off by keeping the 7% rate now, or by having a foreclosed mortgage at 12%? If the person can't pay the 7% and they can't pay the 12%, it's going to go into foreclosure and that's probably [not] your best net present value, but if they can keep paying the 7%, or keep paying 8% or 9%, maybe modify it a little bit in the interim. And if you've got monthly payments going into the trust and out to the bond holders for the AAA [securities and to] support the underlying, the lower rated bond, isn't that a better thing than going to foreclosure? Let's just do an NPV. And there was a huge resistance to that.

... I was sort of the FDIC's mortgage point person from like the fall of 2006, late 2006, through [the end of] Sheila Bair's tenure in [July] 2011 and under Marty Gruenberg [until] 2012. And I spent a huge amount of time in California and [other states] talking with people around the country about what can be done. And the lore of the land at that time was that not much

can be done because securitization trust documents, legal documents, prevented you from making modifications to the mortgages and you had to go to foreclosure. That was the lore, but if you did the hard underlying work and I did this work with other people, I didn't do it all myself, but I read a number of underlying securitization documents, to make sure I could verify what people were telling me. If you looked at the documents, only about 20% of the securitization trust had documents that prevented you from making modifications, and you had to go to foreclosure. About 75 to 80% or more actually allowed you to make modifications if the net present value of the modified mortgage exceeded the net present value of the foreclosed mortgage. Or if the modification was necessary to prevent foreclosure or prevent default, the anticipation of default, you can do it in anticipation of default, or you can do it after default.

So, the lore of the land, just, in my view, was frankly false. So I spent a lot of time in late into 2006 and 2007, being a prophet of securitization modification because we saw it as a hell of a lot better to [modify mortgages and slow or stop the growing loss in home values as foreclosure rose.]... The FDIC was concerned that if housing prices continued to decline -- and increased foreclosures would mean the housing prices decline at an even sharper rate -- that could have an effect, not only [on] the [non-bank] mortgage origination companies... [such as] Option One, New Century, New America – they always had [names] ... sounding like they were the grand future of the universe. Almost all of them had failed because they couldn't sell their mortgages anymore because the market had started pulling back the mortgage-related assets as housing prices declined and as foreclosures increased.

And the delinquency rates had started to increase quite dramatically by the middle of, late 2006. You see a huge upsurge in late, in 2006, and it continued to increase in 2007. I was monitoring [this] on a daily basis by middle of 2007, as were others who were more sophisticated in these things than I was. Various indices that measured the kind of the risk premium, including the risk premium as shown ... by securities default calculations, as what would be the likelihood of a default on a security that were being recorded on a daily basis by this point by the marketplace. And it was dramatically escalating as you got towards July, August, September of 2007. And I emphasize this because people think: well, the crisis started in 2008. No, no. The crisis started far before that.

It became a veritable financial collapse in 2008, but the run-up to it was very longstanding and there were a lot of precursors to it. [During] 2007, we spent a lot of time, as I said being prophets of making modifications. Governor Schwarzenegger of California and some of his advisors – David Crane and some others – recognized that California was an epicenter of the problem because California had an enormous volume of the 3/27, 2/28 mortgages I was talking about. Subprime mortgages that had been financing large developments in San Bernardino, California --... that whole area is referred to as the “Inland Empire”, which is basically East of Los Angeles, East of Orange County. Also a huge development of subprime mortgages in the Central Valley, which is kind of [a] boom and bust areas … agriculture, oil. Boom, bust… Fresno, Bakersfield, up north towards Sacramento there was this huge volume of subprime mortgages of the 3/27s [and] 2/28s types there.

And so I began talking with David [Crane] on a regular basis about what we were seeing. Our people in ... the San Francisco regional office at the FDIC were talking with the California [Banking] Department there at the time about what they were seeing as well. And in the fall of 2007 in September, October time period, I spent a [significant] amount of time in California in Sacramento working with David and others in the governor's office, as well as with the servicers who had these mortgages, ... trying to persuade them... to look at the documents [and see what can be done]. Let's not just assume that you can't do anything about this. I know that it's difficult and time-consuming, but we can do some things to try to deal with this issue.

Another huge component of the failure to take action then, and this is something that, I think, can't be overstated, is that the servicing, the servicers themselves were not [adequately] compensated for dealing with troubled mortgages. Period. Because of the competition in the marketplace, as you had a run up of all these securitizations, servicers had priced down their services dramatically over the years from about 2000 through the 2005, 2006, 2007 time period .... They were simply taking the cash in from the, from the mortgagers, the homeowners, and paying it out to the bond holders. Any additional expense they had was going to end up definitely putting them upside down from a profit perspective. And they were going to lose money. Their financial incentive was completely oriented towards saying, we can't do anything to fix these mortgages. They just got to go to foreclosure. We don't, we can't modify them, the documents prevent us from doing that. So, I totally understand that. I'm not unsympathetic to that

issue at all. In fact, I think in some ways the FDIC was frequently accused, I think erroneously of trying to, micro-manage these issues.

But nobody else was looking at the … need to actually have some changes made to the servicing structure and the financing and servicing. If you're going to have the servicers [perform special servicing – but they are not adequately compensated for making that extra effort --] they're not going to do it. And they weren't being paid for special services. So that was another problem as well.

But in the fall of 2007, Governor Schwarzenegger, to his credit, said: "but we got a serious problem in the Central Valley and the Inland Empire, we've got to do something." And he assembled a group meeting in the governor's offices in Sacramento.[19] And [at a] group meeting [with servicers for California mortgages, we] managed to cajole, persuade, arm twist, however you want to put it, the servicers into agreeing to a mortgage modification protocol, which basically said, take the 2/27s, 3/28s or other troubled mortgages in your securitizations – unless absolutely prevented – we will help you go through the document with you --... and let's modify them, where the net present value will exceed [the value] by going into foreclosure and [let's] not just go automatically into foreclosure....

That was the first state initiative of which I'm aware. I think it was the very first one where a state government had sat down and gotten the agreement with servicers to do something that significant. There was a lot of opposition from the servicers, a lot of opposition from various industry groups, the American Securitization Forum, securities investors group SIFMA (Securities Industry and Financial Markets Association). But they did kind of come aboard once they saw that there was a little bit more flexibility and it would probably be [beneficial], if you're talking purely about a net present value test. Frankly, how do you argue that we're doing anything that's like a social program? That's always the accusation, Oh, you're just operating a social program for government here. [No, we'll be driven by the numbers – but modifying mortgages based on NPV also can ameliorate the decline in housing prices by reducing foreclosures.]

I think one of the qualities for better or for worse, that I always carried through my government service and probably carried

[19] Krimminger was invited by the Governor to attend as an advisor from the FDIC, and to work with David Crane and the Governor's team.

through every other part of my service, if you will, in private practice as well, [was that] I could be relatively blunt. And I would say, … let's look at the numbers. And if the numbers are telling you that foreclosure is worse for you, you'd be an idiot to foreclose. So let's go through the numbers. You can't just tell me something, and I'm just going to blindly accept it. Show me, show me the documents where it prevents you. And if it prevents you, it will.

Jumping ahead for a moment to 2008. The FDIC took over a very large mortgage origination company called IndyMac in Pasadena, California. And for about a month in October of 2008, I effectively ran the servicing of mortgages that IndyMac had originated on behalf of the FDIC. It was [then in a] conservatorship, really, kind of like a [bridge] bank structure. And we were trying to turn it around a little bit and sell it back into the marketplace.[20]

And so I knew a little bit about the mortgage structure. They were going to have to do a deep dive there, but in their structure, again, it was kind of replicated.[21] [For] about 25% of their [securitized] mortgages. – The securitization trust prevented any modification, and basically said you had to go to foreclosure. But for 75%, we could do it with securitized mortgages. Well, we put in place a loan modification structure. I can talk about [this] more later on. In order to have a demonstration project even that late in the game, we're still getting pushback about the idea of doing mortgage modifications. So it proves we could do it. I spent a lot of time working with homeowner support groups in Southern California, Northern California, meeting with pretty much anyone [that would meet with me to talk about this. Putting the numbers obviously in].[22] We even actually had the Governor come down to the FDIC receivership offices at IndyMac, to kind of see what we were doing, kind of like a meet and greet.

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[20] The FDIC created a "conservatorship" to operate IndyMac temporarily until a private bank would buy the operations and assets. In July-August, Krimminger helped devlop a loan modification protocol for the mortgages held by or serviced by IndyMac based on the NPV analysis previously described. At Chairman Bair's request, Krimminger spent most of October 2008 in Pasadena – then shuttled back to Washington – running the servicing of mortgages that IndyMac had originated.

[21] Former IndyMac employees continued in their jobs excpt for the executives. While Krimminger was the FDIC representative on servicing [FDIC COO John Bovenzi was in overall charge of the conservatorship], he worked through IndyMac employees. He had to be blunt sometimes, but they worked well together. They were going to have to do a deep dive into their documentation, but the FDIC saw that most mortgages still owned directly by IndyMac.

[22] Homeownership groups wanted to work with the FDIC and Sheila Bar had a lot of credibility as somone who was championing the rights of homeowners.

So it was an interesting environment. One little, one little slight mention here. I think it's actually of interest for the time period. Arnold Schwarzenegger is an interesting guy in a lot of ways and in a lot of things good, bad and indifferent. But he also had a penchant for cigars. And like all California government offices, [in] the governor's office no smoking [was] allowed within 10 feet of the building. So the governor's offices were situated around a large open [air] kind of atrium. That was probably about 50 feet by 50 feet. The building's surrounding it with windows, and it's all air conditioned, of course. So, [to accommodate Arnold's love of cigars,] they had built a little kind of office for him more than 10 feet, about 15 feet away from the doorway on the open atrium[, covered by a canopy]. And he had a big desk in there with carpet [for him to have a vigar while continuing to work]. ...

So it was kind of open air so he could sit out there and do governmental business while smoking a cigar, which I always thought was pretty interesting. [It was included as] part of the tour I was taken on, the Arnold outdoor office.

But he was – I will say this about Arnold Schwarzenegger -- [a consumer politician]. When you saw him working politicians and people in Fresno, which for a very long time was a depressed part of California and other areas – you can understand why he was an effective politician. Because he was very, very good at utilizing his celebrity, if you will, and his knowledge of the politicians and knowledge of the issues to be able to schmooze and cajole and persuade them to do a lot of different things that [he] felt were in the interest of California because he just managed to exude that kind of personality that actually worked very effectively.

Katie Kaufman: ... When you think about like your work with the governor's office in California, were you taking the initiative, you being the FDIC to go in and say, we really need to sit down and talk about this, or [were] the state policymakers coming to you and saying, this is something we see, can we have your help and your expertise?

Mike Krimminger: Honestly, I think it was a little bit of both. We were very conscious of the issues in California based upon the research the FDIC had been doing, monitoring the performance across the country of subprime mortgages at that point. Remember in [the] 2007 time period, we're still talking about the 2/28's [and] 3/27's. [It was] primarily viewed as a subprime mortgage issue. It later became clear it was also a so-called Alt A mortgage issue, which was mortgages that were being issued to people

that were not subprime borrowers, but this was kind of the churning part necessary that really didn't rely, require you to get a job, or income, and assets or anything.[23] [If you want a mortgage,] … we'll give you a mortgage. So the states were very conscious of these issues. States also – the federalism issue generally, actually probably healthy in some ways, unhealthy in other ways -- the state generally didn't want the federal government coming in and telling them what ... the federal government thought should be done.

So we kind of had to focus it very much on issues with banks that were under the state purview. The FDIC always had a really good working relationship, almost always, with the state bank regulator. So we would work and talk with the state bank regulator a lot. It just became such a big issue early on in California and Nevada that California took the initiative to say, we need to do something ourselves. You're the people who seem to be interested in doing something. So it was kind of a mutual reaching out, but certainly the FDIC reached out to Georgia, Florida, Nevada, and other states. California, was just more open to kind of a cooperative joint venture on this.

[END OF SESSION 1]

[23] However, the Alt-A mortgages had both inherently unstable structures [often with low payments, bullet structures, etc.] and virtually no underwriting [sometimes requiring no proof of income, job, assets, etc.].