AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Steve O’Connor

Bass Connections

Duke University

2021

PREFACE

The following Oral History is the result of a recorded interview with Steve O’Connor, conducted by Darielle Engilman on March 30, 2021. 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: Olivia Wivestad
Interviewee: Steve O'Connor
Interviewer: Darielle Engilman

Session: 1
Location: By Zoom
Date: March 19, 2021

Darielle Engilman: I'm Darielle Engilman, an undergraduate student and member of the Bass Connections American Predatory Lending and the Global Financial Crisis Team. It is March 30th, 2020. I'm currently in Durham for an oral history interview with Steve O'Connor, the former Head of Public Policy and Industry Relations for the Mortgage Bankers Association, who has joined me via zoom. Thank you for joining me today.

Darielle Engilman: I'd like to start a little bit by establishing about your background. I believe that you received a bachelor's degree in Political Science from Marquette University and a master's degree in Political Science from American University. Is that correct?

Steve O'Connor: Right.

Darielle Engilman: And so, in the context of your work life, when and how did you first become involved with residential mortgages?

Steve O'Connor: It was right after my undergraduate degree. I had aspirations to go to grad school, which eventually I did, and the caveat from my parents as the oldest of five kids is I had to pay my own way. So, I got a job working in the real estate finance industry right out of college and got my graduate degree at night. It just happened to be that I loved the housing sector, and so, eventually, I moved into policy related roles. And I've been in the housing policy space for most of my career and in housing finance for my entire career.

Darielle Engilman: Your biography mentions that you worked in Government Affairs for the National Association of Realtors and for Freddie Mac. Can you talk a little bit about the work you did there?[1]

Steve O'Connor: The Freddie Mac job was very much kind of entry level monitoring; congressional hearings, tracking state legislation, doing some analysis, some writing. Then, with the National Association of Realtors, I progressively moved into larger roles, first as an analyst and eventually managing a cross-sector team within the government affairs where I focused on housing policy and homeownership issues.

Darielle Engilman: How did your work there differ from the work you would later do at the Mortgage Bankers Association?

Steve O'Connor: I was representing different interests. Freddie Mac is a secondary market investor, so the issues there were more around system processes and the role

[1] Steve O'Connor worked at Freddie Mac from 1990-1991.

of the investor. Then, real estate agents and brokers were our primary clients at the National Association of Realtors, so the broker owners and the prospective agents. So, it was really looking at those same issues from the perspective of the point of sale, real estate transaction. But looking at the whole value chain and then at MBA [Mortgage Bankers Association], it's representing mortgage lenders, but it's a broad ecosystem; it's not just lenders, it's investors and all of the risk intermediaries as part of the process.

Darielle Engilman: How would you characterize the key changes in the overall residential mortgage market from when you entered the market and then when you transitioned to the Mortgage Bankers Association in 1996?

Steve O'Connor: Yeah. Profound changes. So, when I first started, it was right during the immediate aftermath of the savings & loan crisis, right? So there had been a disintermediation, the savings and loans, the thrift industry, and the smaller banks are being displaced as the secondary capital markets, through Fannie and Freddie, were just starting to hit their stride. And so, you had the growth of independent mortgage bankers and the mortgage originate-to-deliver channel. And during the pre-S&L crisis, it was primarily [an] originate and portfolio model. So, it was completely different business model that took hold, starting in the late 80s. And so, that's more or less the system we have today. Of course, we've gone through a couple of crises since then, not to mention the Great Recession, which I know is a topic for this conversation.

Darielle Engilman: I know you touched on this a little bit earlier, but can you describe your initial role at MBA, and what you did there?

Steve O'Connor: I was running the residential policy team focused primarily on loan production issues, to some degree on secondary and capital markets, but more around credit policy. As an advocate and analyst, around the changes that needed to be made to allow lenders to more efficiently originate loans and deliver those into secondary and capital markets.

Darielle Engilman: What were the MBA's main policy goals when you joined, and how did those priorities change leading up to the crisis?

Steve O'Connor: That's a really good question. I have to think back. A lot of it was around making the Federal Housing Administration more user-friendly, effective and efficient as it relates to our members, and so the different programs and policy changes we were advocating for. And then, similarly with Fannie Mae and Freddie Mac, there was a lot of influence by Freddie and Fannie at that time and it was continuing to grow. There were some concerns among the industry and the need to have better guardrails in place to make sure that they didn't exercise outsized influence in the mortgage sector. And so, there was a lot of focus there on the need to ensure some secondary market reforms to preserve the balance between originators and the secondary market investors in terms of influence.

Darielle Engilman: When you were lobbying on behalf of the industry, what were some of those goals, and did those efforts change in any way as we approached the crisis?

Steve O'Connor: It was really about making this system more efficient for transactions and having the right balance in place. There's always this tension between having good consumer protection measures and having an efficient marketplace that also allows for responsible innovation. There was also a lot of emphasis by policymakers at that time, the Clinton administration, to increase minority homeownership. There was a national homeownership strategy and the goal there was to help address the racial homeownership gap. So, there was a strong push by policymakers to be more aggressive there. At the same time, lenders, while they want to broaden access to credit, they are always mindful of doing it in a responsible way because you want loans to perform, right? You want sustainable home ownership and it's in nobody's interest if the loans can't perform. It's to the detriment of not just the consumer, but to the lender and the investor as well.

Darielle Engilman: Which stakeholders were you engaging with to help accomplish your policy?

Steve O'Connor: Both policymakers at the federal and state level, particularly the regulatory community, Congress, and then other industry stakeholders. So, the realtors, the National Association of Realtors, National Association of Home Builders, American Bankers Association, a lot of consumer groups, civil rights groups. It's really the broader, what I call 'housing stakeholder ecosystem,' if you will, that we were interacting with. I always think of it in terms of kind of three steps. One is you want to work with your members in each case. At MBA, it was the lender members primarily but others too to get the right policy, right, to decide what it is that you want to advocate for and do it in an evidence-based way. So, you marshal your evidence, your data to support your case and anticipate where people might disagree getting the policy right. And then, you're trying to get alignment. You're trying to figure out, "What other stakeholders share our goals? And can we get aligned with them around the objectives?" Because obviously it is more effective when you have coalitions, and you collaborate with others. And then, the third piece is the blocking and tackling of advocacy. It's going up and meeting with the regulators, or the members of Congress and their staff. It's the congressional testimony. It's regulatory comment letters. It's op-eds. It's all the different pieces that go into influencing and persuading people who are going to make decisions in a way that you want them to make those decisions.

Darielle Engilman: On that point, what was some pushback you have received while lobbying, and how did you deal with that?

Steve O'Connor: There's almost always going to be some pushback to some degree, whether it's major or minor. It would depend on which period of time we're talking about. Traditionally, we've had very good relations with the consumer advocate community, but, at times, there's a different perspective depending on the issue about where that balance should be struck between consumer protection and efficient markets. And so, it's constantly a dialogue about trying to, again, hit the right point along that continuum so that the markets are working well, and you're providing a reasonable protection, but you're not stifling the innovation you need to be effective in the marketplace. I liken it to kind of setting the speed limit. If you didn't want any accidents or fatalities, you'd set the speed limit very low, but you wouldn't have a very efficient highway system. People wouldn't be able to get from point A to point B. So, you want to find the right speed limit and then put other protections in place, whether it's speed cameras, cops on the side of the road, or other things to make sure enforcing the rules. And that you're having appropriate driver education and teaching people about the consequences of not driving safely, but at the end of the day, you're trying to manage all these different pieces. You want to protect people on the highway, but you want them to be able to get from point A to point B in a timely manner. It's the same thing when you're talking about the rules in the mortgage marketplace.

Darielle Engilman: How did lobbying efforts change in the years immediately preceding the crisis? How and when did these conversations change in light of the mortgage market decline?

Steve O'Connor: I think for a variety of reasons, some of which had nothing to do with the mortgage industry, you had additional rules put into place around lobbying to ensure that it was done ethically. The mortgage sector has always had considerable influence as an advocacy operation because of the importance of housing. Shelter is a basic human need and necessity. And so, when I say the housing sector, I'm talking about lenders, home builders, real estate professionals to broader industrial set of interests in the housing marketplace. We've always had a considerable amount of influence because of that basic human need and because of the significant role that real estate plays in the U.S. economy. And so, we've always been a key player on policy and advocacy. I think, in the run-up to the crisis, there was a lot of growth in the marketplace and a lot of market activity that probably—we obviously know needed to be reined in—but probably wasn't recognized at the time for what it was, which was stretching the envelope too much. And so, you had this correction, both in the marketplace and then in the public policy space with the Dodd-Frank Act and all the rules that followed from that.

Darielle Engilman: Who would you say you were primarily representing in these lobbying efforts?

Steve O'Connor: The mortgage lending community. And by that, I mean lenders and, by some extension, investors in the mortgage assets, but primarily the lenders, the originators, and servicers of those loans.

Darielle Engilman: When you were doing those lobbying efforts, would you say that concerns among the industry were similar? Did larger institutions and smaller mortgage banking operations have different requests?

Steve O'Connor: That's a good question. On certain issues, you did have differences based on size, geographic location, business model – the larger institutions had a lot of influence with Fannie Mae and Freddie Mac. They got preferential pricing. They had certain benefits that weren't available to mid-size and smaller lenders, and they would use those benefits to have a better vantage in the marketplace. And so, a lot of smaller and mid-sized institutions wanted greater equity and parity in terms of access to Fannie and Freddie and in terms of pricing. And so, depending on an issue and the lens through which those institutions looked at that issue, they might have differences of opinion on what should be done.

Darielle Engilman: Did your lobbying efforts ever successfully influence policy? And if so, can you give some examples?

Steve O'Connor: A whole host of things. We were trying to get FHA loan limits raised at one point in the late 1990s, and we were very successful in getting that done. There were a number of interests that were against that effort, Fannie and Freddie and private mortgage insurance. We felt a higher FHA loan limit would allow FHA to be more effective in reaching low and moderate income and first-time home buyers. So, that was an example of something we worked on. At the end of the day, when you look particularly at all the rules that came out of Dodd-Frank and the regulations that were proposed and ultimately finalized, there were a lot of discrete things in there that we got changed. It's almost too many in number, but whether it's the risk retention of qualified mortgage rule that came out and trying to get an exemption from risk retention for loans that were considered qualified mortgages, we were successful on that. Trying to get a safe harbor versus just a rebuttal as part of the presumptions of the ability to repay qualified mortgage rule, we were successful on that. You really got to take it piece by piece. There are a lot of moving parts in those big rules or those big pieces of legislation. And so, victory is ultimately defined by often discrete small changes you get made around definitions or terms or amounts.

Darielle Engilman: Were there conversations at MBA regarding red flags in the housing market leading up to the crisis? What were your colleagues and various MBA members saying about these changes?

Steve O'Connor: More around the marketplace dynamics, there were a lot conversations that I had where people felt like the investors in particular were underpricing risk or under-appreciating the risk, and that it was often too easy for consumers to get loans. There was a lot of competition in the marketplace. I remember talking to a loan officer once and he said, "God, Steve, it's crazy. I can turn somebody down for a loan because I don't think they're qualified and it's not a good risk for us. And they'll go down the street and somebody else will give them the loan." And so, what that did is it created a race to the bottom because institutions were losing market share. Now the institutions that ultimately survived were the ones that stuck to more traditional underwriting, were more conservative and more cautious, but a lot of those institutions were losing significant market share during the boom. Some of them were under intense pressure to be a little less stringent in their standards. I remember talking to a

CEO who was telling me—a well-known CEO at a major institution—he was constantly under pressure. Why are we losing market share? He said to his boss, "I don't think that's good business. I don't think we should make those loans." And so, every quarter when their market share would drop, he would get more pressure, but he wouldn't give in. I'm sure that there were a lot of CEOs who did give in to that pressure. We know, in retrospect, there were others who lost their jobs because they wouldn't give in. And then, the ones who gave in and, ultimately, they lost their companies. So, there was a lot of pressure as the market expanded for people to be willing to stretch the credit risk envelope, if you will.

Darielle Engilman: Would you say that these conversations influenced policy efforts in any way?

Steve O'Connor: Inside the organization, there were a lot of candid conversations. I remember somebody using the metaphor that it's like a bunch of guys standing around a keg at a frat party and they've had too much to drink and somebody says maybe we should stop and go home now. All the other guys say, "No, this is too much fun. Let's stay out for another couple hours." It was like that. The guy who says that we should stop now has got to make a decision that he goes home or hangs out with his friends and gives into the peer pressure. But those conversations at least got us thinking that this was a marketplace that was a little sloppy.

Darielle Engilman: During this period of subprime lending growth in the early 2000s, what perspective did mortgage bankers and the MBA have regarding regulators?

Speaker 2: It gets back to, at the end of the day, you want a marketplace that works and that's safe because it's very expensive for everybody when the loan goes into default and can't perform. So, there's always that tension. Sometimes, when things are going really well, you have a tendency to discount the dangers. There was an unrealistic assumption that home prices would continue to go up, or if there were market corrections, they would be regional at most, mostly local corrections. Nobody expected to see kind of the national correction we saw in home prices where the bottom kind of fell out. So, if you go back into the pre-crisis mindset and you believe that homes are going to, by and large, generally appreciate or hold stable, and there might be tiny bubble, if you will, markets where you have some correction, but across the board, it's going to be a market in which home prices grow, then you're going to diversify your risk and accept that some markets might not perform as well, but in the aggregate, you're going to do well. The problem is when, in the aggregate, it doesn't go well, and everything starts to go south all at once. It's like musical chairs; the music stops and there's not enough chairs. That's what started to happen. And then, there's this flight to safety and everybody starts to discount and try to get out at the same time, and it just becomes a self-perpetuating downward spiral.

Darielle Engilman: Do you think the concerns during that period led to a lot of changes in business practices?

Steve O'Connor: Yes, I do. I'm a firm believer that people tend to have short memories when it comes to these things, which is why I think you need rules. Rules can be helpful if they're well-structured and if they're dynamic rules, rules that you recalibrate as you learn more, or when you learn what's not working. You don't want to be too stringent or limit access to credit too much because that creates other problems. But I think there was a general course correction in the mindset of the industry and the policymakers. It was a collective failure, the crisis. It was across the board. Regulators not taking seriously enough or recognizing some of the risk in the marketplace. Lenders and investors having unrealistic assumptions around home price appreciation, and consumers having unrealistic expectations around home price appreciation. And so, I think it was a collective psychic failure. We learned a lot from that. But I think that's why you need guardrails in place, so that it doesn't happen again.

Darielle Engilman: Your biography mentions that you serve on multiple advisory boards, including Freddie Mac's Affordable Housing Advisory Council and the Homeownership Council of America. What are these councils and what drove you to serve on them?

Steve O'Connor: I'm a big believer in trying to create an equitable housing system and trying to do more on the affordable front. And so, that's always been my interest and passion. In part, I do it for professional reasons, and part, for personal reasons. I serve on a number of boards with a focus on affordable housing and that's also my current role, so it's perfect alignment of what I like to do and what I get paid to do. So, it works out well.

Darielle Engilman: What were some of the conversations or concerns that these councils that you serve on were having in the early 2000s with the rise of subprime lending?

Steve O'Connor: With a couple of exceptions, most of my councils that I'm involved with now and in the past years occurred after the crisis.

Darielle Engilman: How did the conversation regarding affordable housing change, in your opinion, in the wake of the financial crisis?

Steve O'Connor: There was a recognition that the key, the holy grail, if you will, was sustainable home ownership. It's not just getting somebody into a home but ensuring that they be successful longer term. And so, it's about preparation for homeownership, making sure somebody is informed with all the obligations. It's about having interventions if somebody starts to run into trouble making their mortgage payments. It's about expanding the credit risk envelope enough that you're creating access but not in a way that you're putting somebody into a home they ultimately can't afford. All with the recognition that there are going to be life events that occur that you cannot predict and that have nothing to do with credit. They're just somebody loses a job or gets a divorce or has a health crisis in their family. Those things are going to happen. In terms of basic blocking and tackling around credit risk and underwriting, you want to be looking at long-term sustainability. The other thing that's been changed is how you measure risk, particularly in the changing economy with gig workers and such where people don't necessarily have one job but multiple jobs and income from a lot of different jobs and the way that income might be documented is different. So, as an industry, we were starting to look more creatively at different ways to measure credit risk.

Darielle Engilman: Through these interviews, we hear a lot of people's opinions on what caused the crisis. One narrative that we've heard emerge is efforts to increase affordable housing lowered underwriting standards and contributed to home appreciation. To what extent do you see this as being true?

Steve O'Connor: I think there are multiple causes. I think if you do a diagnosis of what led up to the crisis: 1) you had risk layering, so, you had no income, no assets, no verification of assets, low doc or no doc. You had risk layering. Any one of those is probably okay if you have compensating factors, but when you layer one risk factor on top of another that becomes an issue. Then, you had a misuse of products. Interest-only, ARMs [Adjustable-Rate Mortgages] and other products that have a valid place in the marketplace were often being used, rather than for sophisticated borrowers as a cash management tool, to get borrowers into homes as a way to qualify at an artificially low price. So, you had to misuse a product, so that was a second piece.

Then, you had misaligned incentives in the marketplace with the originate-to-distribute model. Some originators could originate that loan, and then they'd be off the hook on the risk that the ultimate investors are going to bear. So, the person originating that case with the originate-to-distribute isn't as concerned about the long-term performance of the loan. So, that was, I think, another issue. Then, you had asymmetrical information. As an originator or loan officer or mortgage broker, you understand the products, but the borrower may not always. With that asymmetrical information, if there's misplaced trust, if somebody's taken advantage of somebody because they're vulnerable, it's a lot easier to do that when the information is not symmetrical, when it's not as transparent, and the disclosures aren't as robust, and somebody doesn't have somebody they trust helping them navigate the system. So, I think it was a combination of all those factors.

Darielle Engilman: Were there specific parts of the mortgage banking process that seemed to be more affected by regulatory changes?

Steve O'Connor: When you're talking about Dodd-Frank and the plethora of roles, that's the largest rewrite of financial laws in U. S. history by wide scale. You had this mammoth set of rules and regulations come out as a result of that act, but it affected the entire mortgage ecosystem. It clearly had a big impact on the underwriting, credit, and the evaluation of ability to repay. So, there was a big impact there on having to document in a different way, be very thorough, be much more careful in the credit policy decisions you make based on the new Dodd-Frank rules. But then, equally important is on the backend, on the servicing because of all the servicing rules and the additional cost of servicing a non-performing loan or a loan that goes delinquent, the cost is much higher than servicing a performing loan, so you want to make sure that the loan doesn't go into default because it starts to put a strain on the economics of a lender and servicer. I would say it's across the board and it really results in, in addition to more cost, credit overlays and other measures to be a little more conservative on the underwriting.

Darielle Engilman: Leading up to the crisis, we've seen that a number of states pass laws limiting predatory lending practices. What are your thoughts on the topic of stricter state legislation surrounding these practices?

Steve O'Connor: In my own opinion, I think, you're better served with national standards when it comes to predatory lending and consumer protection to the extent to give states the appropriate discretion to protect their residents, but you have a national mortgage system. So, if you're a multi-state lender and you're having to navigate different laws from state to state, that's a level of complexity and cost that's being layered on that also gets passed onto the consumer. I think trying to have uniformity is important, and I also think it benefits the consumer to have uniformity so that there's one set of rules that protects everybody.

Darielle Engilman: Were there generally different reactions to these strict legislations? Or was there a general consensus that everyone was okay with it or not okay with it?

Steve O'Connor: I think the concern on the industry side was the balkanization of the national mortgage system. You have all these disparate rules from not just states, but localities were passing predatory lending ordinances and it was going to make it harder to operate, to scale as a lender. If you're a smaller, local player or a smaller regional player, the challenges aren't as great. But if you're a bigger player and you're operating across more borders, state borders, you want uniformity and standardization. It makes it more efficient for you to operate.

Darielle Engilman: Did MBA leadership ever get complaints that caused concerns surrounding this abusive conduct in the lending space?

Steve O'Connor: Yeah. You always heard complaints from different corners through our conversations with consumer advocates, civil rights, policymakers. Anytime there was a congressional hearing on Capitol Hill, you had different points of view around these issues. And so, we would be part of congressional hearings in which there were disagreements on what to do about some of these challenges.

Darielle Engilman: How would you personally define predatory lending?

Steve O'Connor: That was actually a topic of considerable debate at different points with the regulators and in Congress. Predatory lending is where you have misplaced trust and where somebody's trust is abused. They're taken advantage of in terms of either pricing or they're given a loan that they're overcharged or given a loan that ultimately, they're not going to be able to perform on. And whoever's making that loan is doing it in a way to enrich themselves at the expense of the consumer, not being a steward for their customer, not caring about the longer-term consequences for the consumer. To me, that's predatory. You're extracting something for your own benefit at the cost of somebody else.

Darielle Engilman: What were some of the predatory lending practices that you observed personally in the mortgage market leading up to the crisis?

Steve O'Connor: I wouldn't say I observed any of them personally, but I'm aware of what happened in the marketplace. I wasn't an originator or a practitioner or an underwriter or an investor. I was a policy advocate. You had, for instance, adjustable-rate mortgages with teaser rates—the exploding ARMs as people called them—and once the teaser rate period expired, there would be a significant increase in the payment, what we call payment shock. The consumer often was not told about those terms, that it was a teaser rate, that it would expire, that their payments could and would likely go up and could go up by a significant amount. Those sorts of things are an example where there's either a lack of disclosure or people were intentionally misleading, not just by not telling, but misleading somebody, which is unethical and illegal. Unfortunately, there was that in the marketplace.

Darielle Engilman: How has this influenced your current work with affordable housing?

Steve O'Connor: It's very much about ensuring sustainability, focusing on expanding opportunities for people to become homeowners but to ensure that they're prepared for homeownership and there are ways to help that person if they start to run into trouble. It's about continuous care leading into the homeownership stage and then, after they become homeowners, making sure that they're able to maintain homeownership.

Darielle Engilman: Do you feel that efforts within affordable housing have changed pre- and post-crisis?

Steve O'Connor: They have, of course. First of all, you have a whole different regulatory regime. Then, there's the issue of trust in the marketplace. There's a lot of scar tissue from the crisis, particularly in underserved communities, communities hard hit by the recession. People who saw their parents lose their home, or their neighbors lose their home, and they're reluctant to trust the financial system. And so, how do you create that trust in the affordable housing arena? A lot of it's about working with trusted advisors, the right partners, so you're having the right messages to resonate with the people you're trying to reach to explain that homeownership is a viable option, it can help them create and build wealth. You're trying to get the right messengers to deliver those messages. Often, it's working closely with the counseling community or other non-profits to create that network. I would say those are two of the biggest things: trying to get the trust built by the right messages and the right messengers and partnerships.

Darielle Engilman: After the housing bubble ultimately burst, what was the response by the MBA and how did that influence your role there?

Steve O'Connor: I think the immediate reaction from a lot of folks throughout the housing system was that this was a temporary course correction. I think that was the thinking around a lot of policymakers. So, if you go back to August of 2007, when the credit markets froze, you saw the immediate response coming out of the U.S. government, that was Hank Paulson, the Treasury Secretary, Ben Bernanke at the Federal Reserve, and others saying this was a healthy purging of the subprime market. There were excesses in the subprime sector and the course corrections we were seeing taking place would ultimately result in a healthier housing market. But it quickly became known that these weren't confined, if you will, to the subprime sector, this fear was spreading throughout the financial markets and starting to metastasize into a global crisis. The credit markets started to shut down, and it wasn't just in the U. S. You had emergency injections of liquidity by the Federal Reserve Bank, the Bank of Canada, the Bank of Japan, European Central Bank.

It became a US-Western European-style crisis because suddenly people were holding mortgage paper and they weren't sure what they were holding, because they thought they were often holding investment grade paper, but because of the way either the credit rating agencies were not being as stringent as they could have been, or because of the securities that were being created, collateralized debt obligations, CDOs, and CDO squared, all that different machinations that were taking place on the securitization front, people were buying what they thought was investment grade paper.

And then, when they realized this maybe wasn't investment grade, and it created a panic in the marketplace. When the crisis first started to unfold, the general thinking was this is a temporary course correction. There were excesses in the marketplace, the system will naturally ring those excesses out, and market discipline will return. But that did not happen because it was so pervasive that the proliferation of these instruments and the immediate retrenchment and the fear really of not being confident about the quality of the paper they were holding.

Darielle Engilman: To clarify, what qualifies something as an investment grade?

Steve O'Connor: The highest quality is AAA, but I think A and above, A, AA, AAA, where you feel that there's a repayment stream, when you tranche these securities, when you slice them, right. And so, the folks that are going to get paid first in that waterfall, if you will, the first couple of stages of payment on the securities are the investment grade. As you go farther down the tranches, if you will, you can get a higher yield or higher return, but you're taking greater risk. All of that works if the ratings are accurate and well understood. It's when the risk is mispriced and misunderstood that you start to have problems.

Darielle Engilman: How involved were you in the legislative response to the crisis, including the Dodd-Frank Act?

Steve O'Connor: I managed a team that did a lot of work on trying to craft policies. By craft policies, [I mean] either suggest policies, or suggest modifications to policies, or helping write congressional testimony, regulatory comment letters, preparing witnesses to testify. [I was] very involved in trying to ensure that our voice was heard along with all the other voices that were weighing in across the ecosystem.

Darielle Engilman: How do you understand what caused the crisis?

Steve O'Connor: I think it was a combination of factors. As a friend of mine once said, it's like an Agatha Christie novel. When you read it, you think everybody did it because everybody's a suspect in some way. If it's a good crime novel, you start to think it's this person or it's that person. But at the end of the day, it was a collective failure. As I said earlier, the regulators not minding the shop in the way they could have. I'm not saying the way they should have, but you can make that argument, but the way they could have. Industry mispricing risk, misallocating risks, not having the right alignment of incentives, [and] not being as prudent as it should be on credit policy. You don't want to blame the consumer—and I'm certainly not doing that—but there was this misplaced faith, an optimism, irrational exuberance as Greenspan once referred to it, more in the context of the stock markets, in the housing market. But this misplaced confidence that home prices would always go up. And so, it was a collective failure across the board.

Darielle Engilman: To what extent do you see your personal experience adding something important to our understanding of what happened in the run-up to 2007-2008?

Steve O'Connor: I had a front row seat at one of the major organizations in the housing system and spent every working day talking to people who were wrestling with these issues. It's like any other crisis, when you're in the middle of it, you don't have a full appreciation for it. It's the fog of war. There's so much noise and so much activity, and you're trying to figure it out real time. It's only later on when you can step back, and you see the playing field more clearly that you understand what happened. There was a lot of anxiety at different times in 2007, 2008, 2009 as people were trying to grapple with these issues, and then we realized we were in this for the long haul. This was a structural change in the housing finance system. One has to only look at the fact that Fannie Mae and Freddie Mac became insolvent, the two linchpins for the secondary and capital markets, and they're still in conservatorship today. I think just underscores the scope of the challenges we faced and are still trying to rebuild from.

Darielle Engilman: Looking back on the crisis decade later, what do you see as its most important lessons for mortgage originators?

Steve O'Connor: For mortgage originators, having good policies in place and constantly revisiting them. Really assessing your risk appetite and trying to assess how realistic it is. At the end of the day, investors make calibrations, if you will, on risk adjusted rates of return. So, you have to take some risk in the marketplace. That's the nature of lending. You're not always guaranteed that you're going to get paid back. If you're an investor, you're not always guaranteed that you're going to get paid. But constantly checking yourself as an institution and your policies around your risk tolerances, and keeping an eye on the marketplace, and trying to be realistic about where markets are going and not suspend belief because suddenly things seem too good to be true. Because if they do seem too good to be true, they probably are too good to be true.

Darielle Engilman: Is there anything else that I should have asked or anything else that you'd like to add before we finish up?

Steve O'Connor: The only thing I'd add is the biggest concern for any of us who've been through that period is that we repeat it, and we don't want to have that happen again. But I've seen multiple crises during the course of my career from the S&L crisis when I started to any number of mini-crises, and the big one in 2007, 2008, 2009, the Great Recession. The next crisis—and there will be one at some point—will have a different character. And so, constantly being vigilant to see what that next crisis might look like. I hope not to see one in my career, but there are no guarantees. Invariably, something will happen. The Black Swan, the unpredictable event will happen. Constantly looking at different potential outcomes in the marketplace, and re-evaluating those. I think just constant vigilance is needed both for the regulators and policymakers and the industry itself.

[END OF SESSION]