AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Ted Tozer

Bass Connections

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PREFACE

The following Oral History is the result of a recorded interview with Ted Tozer, conducted by Malena Lopez-Sotelo on March 23, 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.

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Malena Lopez-Sotelo: I'm Malena Lopez-Sotelo, a graduate student at the Fuqua School of Business and member of the Bass Connections American Predatory Lending and the Global Financial Crisis team. Today it is March 23, 2021. I'm currently in Durham for an oral history interview with Ted Tozer, [former] President of the Government National Mortgage Association, or Ginnie Mae, who has joined us via Zoom. Thank you for joining me today, Mr. Tozer.

Ted Tozer: Thank you for having me. Appreciate it.

Malena Lopez-Sotelo: I'd like to start by establishing a little bit about your background. I believe that you went to Indiana University and received a BS in Accounting and Finance. Is that right?

Ted Tozer: That's correct.

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

Ted Tozer: I got involved in 1985. I was one of the people that organized and started a mortgage company for a bank in Ohio, because at that point the bank was an originate and hold— they would hold all the mortgages they originated. At that point they wanted to create a situation where they would originate and sell to Fannie Mae [The Federal National Mortgage Association] and Freddie Mac [The Federal Home Loan Mortgage Corporation], and the bank would no longer hold interest rate risk in its balance sheet. It would literally sell to investors. So, we were charged to set up an organization to allow the bank to sell all of its loans and [build] a servicing portfolio, and that mortgage company is now PNC Mortgage Company. So, we started with basically twenty employees and now it's a multi-billion-dollar organization. I was with that organization until I left in 2010 to become president at Ginnie Mae [The Government National Mortgage Association]. By that point, the mortgage company was a top ten originator, and we were probably one of the largest producers of Alt-A[1] loans in the country when I left to join Ginnie Mae in February of 2010.

Malena Lopez-Sotelo: What was the name of that bank?

Ted Tozer: At that point it was BancOhio [BancOhio National Bank]. Then BancOhio was bought by National City Corporation, and the mortgage company was [renamed] National City Mortgage. National City Corporation was bought by PNC [Financial Services] at the end of 2008 because National City Bank, [subsidiary of National

[1] Alt-A loans is short for Alternative A-paper, and is a type of mortgage that typically refers to low-documentation or no-documentation loans.

City Corporation], got caught up in the housing crisis and literally failed, and the failed bank holding company was bought by PNC at the end of 2008.

Malena Lopez-Sotelo: What first attracted you to this mortgage sector?

Ted Tozer: It was a twist of fate. Up to 1985 I was chief operations officer for the broker dealer operation for the bank. BancOhio had a large dealer operation. When National City bought us in 1984, they decided not to be in the broker dealer business, so they dissolved it. And the CEO of BancOhio came to me and said, “You want to help start a mortgage company?” So, it was just kind of a fluky thing. At that point, there really wasn't that many mortgage companies around. We were one of the first bank mortgage companies in the country. It was just kind of a fluke. I had no intention of ever getting into mortgages. … [It] was a twist of fate…..

Malena Lopez-Sotelo: Was National City Mortgage based out of Ohio as well?

Ted Tozer: Yes, we were based in Dayton, Ohio. We were actually in Miamisburg, which is a suburb of Dayton.

Malena Lopez-Sotelo: What were the geographies served by National City Mortgage? Was it just Ohio or did it go national as well?

Ted Tozer: We were national. To give you an idea, in 2004, we did $115 billion in production. So like I said, we were Freddie Mac's third largest servicer, we were Fannie Mae's 10th largest servicer. We sold our jumbo loans to Bank of America. We were Bank of America's, I think probably the third or fourth largest company supplying them jumbo loans for the Bank of America Corporation. We had offices in Durham. We were one of the biggest originators in the Raleigh-Durham area. We were the largest originator in Washington, DC, even though we didn't have any banks there. So, we were a large national mortgage company.

Malena Lopez-Sotelo: Were there certain populations served, certain customers that differentiated National City Mortgage from BancOhio, for example?

Ted Tozer: Well, again, [with] BancOhio we were truly just an Ohio originator, but then as time went by, we became bigger and bigger. We started buying other mortgage companies and their origination staffs. So, basically until probably about 1995, we were probably, I would guess, just in the Midwest, just Pennsylvania, Indiana, Ohio, Kentucky. In 1995, we started buying other mortgage companies, and that's when we actually started going national, it was in 1995, because at that point the decision was to get the economies of scale of servicing. You had to grow. And so, the issue was either you were out of the mortgage business, or you’re going to grow big. And the mantra, I think, of all bank mortgage companies going into the 2000s was either you had to be a top twenty or get

out of the business, because the cost of servicing and automation was so high that you had to have scale.

Malena Lopez-Sotelo: At the time you talked about National City Mortgage going national around 1995, how would you characterize the state of the market in the United States during that timeframe compared to 2008?

Ted Tozer: There was a lot of changes going on. It was kind of evolving. 1995 was the time that credit scores came out. So it started getting more and more automated both serving more and more technology. Fannie Mae and Freddie Mac brought out Desktop Underwriter and Loan Prospector. So, I think there was sort of a turning point in the mid-90s. We went from the old school where you would have this big paper loan file, you'd have a person who would look through the loan file and actually determine if it was a good borrower, it was pretty much based on their experience to a point we had more and more technology coming in at 1995. When I got in the business in ‘85, when we used to get loans pulled by Fannie Mae and Freddie Mac for review, they said, “Make sure you send all the notes from the underwriter because we want to understand what made them think this guy was a good borrower.”

They really wanted to understand what it was. Truly, underwriting was an art. It wasn't a science back then. In ‘95, it started becoming a science. It started to become where you had FICO scores, you had automated underwriting. And at that point, the art of underwriting became more of a data validation where you upload the data and put it into a system. Algorithms came in, all that started happening in 1995. And I think that somehow led, I think, to some degree to the problems we had in 2000’s, because at that point you took the common sense out of underwriting and became just truly what the black box told you.

Malena Lopez-Sotelo: In terms of the institutions that made mortgages, what did some of those look like?

Ted Tozer: Back in ‘95, we were in a situation where if you had any kind of high risk, for example, people did no doc [no documentation mortgage loans] and Alt-A, but they required large down payments. For example, if you were going to do a no doc loan, you had to put down a 30% down payment. The idea was that you couldn't do a 90% limited doc [limited documentation loan]. If you did some sort of “no income” verification, you needed to have really, really strong credit; plus you had to be self-employed. You couldn't do it if you were just regular [paycheck borrower]. So, there's so much more common sense when people underwrote. People truly at that point were really risk averse, I think, back in the 90s, and they really were out to try to make loans, but they truly had to make sense. They really had to make sense both from the risks that lenders were taking on as well as the borrowers' ability to be successful.

Malena Lopez-Sotelo: You mentioned a couple of terms that I'd like [you] to clarify, specifically, no doc and Alt-A. Can you describe those terms?

Ted Tozer: Basically, what happened was no doc…was pioneered by a savings and loan out of New York City. And their concept was that you have people out there whose income is very volatile. Let's say, for example, if you're an entertainer, your income could be really high one year, low the next year - It's very volatile. And so what they did was they said, Okay, how about all we get for these people is a credit report and appraisal on their house? And we basically required a large down payment. So, if all of a sudden, things go wrong, we'd have plenty of equity in the home for the foreclosure. But with the no document, there was no income verification [or] there was no employment verification...

All you had was a credit report and an appraisal, and this was a no doc loan. And that was, like I said, pioneered by a savings and loan out of New York City, and they went nationwide, but it was mainly geared toward people that were self-employed that had volatile income strains. And then Alt-A was the concept where you have a full doc-- which is a a quality [credit risk]—but they called it Alt-A, because they said, "Okay, if a person has really, really good credit score, why can't we loosen up some of these other aspects of the loan? If they have really good credit, how about if we don't require them to document all their income, or we don't require them to add different aspects?"

And that's where the Alt-A comes, from alternative. So the question was, you still get a quality loan, but you had such strong compensating factors you could basically back off with some of the documentation requirements. All that really came about with people who were self-employed that didn't have a W-2 to turn over [to document] income. So the issue was, if you have a really high credit score, then why do we require they bring all their tax returns? At that point, if you were self-employed, you had to bring three years of tax returns and all documents [for] all your income, because you didn't have an employer that you could call and verify their income. So, I'll tell you [it] was the beginning of that. Now that was pioneered by a company that was called Residence Financial Corporation in Minneapolis that was eventually owned by GMAC [General Motors Acceptance Corporation][2].

They pioneered the Alt-A back in about 1992 [or] 1993. But then by the time we got to 2000, Alt-A became different. All of a sudden you started having the reduced documentation without the good credit. All of a sudden Alt-A became like Alt-B when we got to the 2000s, but this all set the seeds for the problems we had in 2008, because [when] we started in the '90s, we had really good sound financial reasons for why we were not requiring documentation, allowing people to do things that appeared a little riskier. But then we got to the 2000s, all of a sudden, the compensating factors, to the point where it made sense financially, started loosening. And that's what led up to the crisis.

Malena Lopez-Sotelo: Was there a standard list of trade-offs that underwriters could use, or how did that process work in terms of understanding what could be loosened or what needed to be tightened?

[2] Rebranded Ally Bank in 2009.

Ted Tozer: Like I said, it was an art. You had some basic guidelines that the investors had put out saying, we want this kind of a credit score. We want this kind of income—whatever it might be. But they also gave underwriters discretion because an underwriter, for example, [who] had been underwriting for ten, fifteen, twenty years really felt that they understood what made a good loan. So they kind of looked to see, "Okay, what's their job history been like? If they've been consistently having jobs, or have they been laid off a lot?" They look at different aspects, and they get a lot of discretion. It truly was an art and underwriters pretty much relied on their experience to really have a good handle on what to expect. That's the reason why back in the ‘90s, a really good, experienced underwriter in the 80s commanded a pretty good compensation, because there were people who really could ferret out who was going to be successful borrower and who wasn't, just because of their sheer experience, and seeing what they've approved in the past, and how those loans performed over time.

Malena Lopez-Sotelo: You mentioned that some of these trade-offs were investor-driven. Can you describe who these investors might have been and where they fit into the larger mortgage ecosystem?

Ted Tozer: I think the theory, it depends on how extreme you are talking about. A lot of them were [Wall Street] investors. In the mid-80s to probably the late ‘90s, most investors really did believe the concept that underwriters knew what they were talking about to the point where Fannie Mae and Freddie Mac would allow discretion, like I mentioned before, when they would pull a loan for audit. Their issue was, “Give us every scrap of paper in that file so that we can understand where the underwriter’s head was, why they feel this was a good loan.” And they tended to give a lot of benefit of doubt to the underwriter because they believed in what the underwriter knew. And so the concept was that really the investor tried to explain to the underwriter in the documentation on the programs what their risk [tolerance] was. Were they planning to get really, really strong A credit? Were they trying to get more of a B-type credit? And the underwriter kind of worked around that to understand what level of delinquencies and what amount of performance that they were willing to accept as far as losses and so forth.

And then the underwriter would take that into consideration. Back then all they were called underwriting guidelines. There were no underwriting rules. They were called guidelines. And it was intentional guidelines, because the investors wanted the underwriters to really make as many loans as they could do that would fit the theory or the philosophy they were trying to develop for their programs. And again, Fannie and Freddie were really as big then as they are today, as far as…the loan amounts that were fully doc [A credit quality] loans, pretty much all with Freddie and Fannie. The Wall Street firms mainly liked terms like with RFC, which is Residential Funding Corporation, which was owned by GMAC (General Motors Acceptance Corporation). They kind of… pioneered Alt-A [along with] Prudential Life Insurance. [Prudential] had a huge mortgage company that basically did a lot of these Alt-A type loans as far as [loans on]

non-owner occupied [properties] and people with, for example, condominiums. But Fannie and Freddie required that a condominium complex be over 50% owner-occupied, or if you're building a new condo complex, you wouldn't know who's going to buy your units.

All these companies came out and, like RFC and Prudential, would buy condos before the condominium were all pre-sold because Fannie and Freddie wouldn't buy them. So there was all these [Wall Street based investors], starting with Prudential and RFC, they would buy the mortgages from Fannie and Freddie, because of documentation or the type of property it was, starting [with] building alternatives to Fannie and Freddie. Wall Street [firms] didn't get involved with any mortgages at all until about 2001 or 2002. The Wall Street guys didn't think there was enough money to be made on mortgages.

Malena Lopez-Sotelo: At this time, around 2006 to 2008, what parts of Ohio were different or similar in any significant respects in terms of the mortgage landscape?

Ted Tozer: [During] 2002 and [to] 2008, like I said, Ohio was a relatively small part of our business. We were doing tens of billions of dollars a year in production. We were probably [originating] less than a billion dollars or so at a while... [in Ohio]. Ohio was never really recovered 100% from the rust belt issues [from] back in the 1980s. So in Ohio, we had an interesting mix of customers. We had places like Cincinnati and Columbus that were doing really, really well. And you had places like Cleveland that were still trying to recover from the rust belt of the 1980s. You had rural Ohio, which was again—some parts were doing pretty well because they had an agricultural base. In some parts of the state [for example],Youngstown [and] Akron, were still trying to recover.

So, it was kind of an interesting state from that perspective of all the various groups and how they recovered from the 1980s. And even today, there's parts of Ohio -- in decline. In 1990, Dayton, Ohio was the second largest cohort of GM employees in the country. By 2008, they didn't have any GM employees left, GM shut down all their plants, [the] National Cash Register had their corporate headquarters, they moved out to Atlanta. So, by the time I left in 2010, [downtown] Dayton, Ohio was a [virtual] ghost town. In 1990, its airport was a hub for US Air and American Airlines. Now their airport doesn’t have anything in there at all. So Dayton, for example, during that time period went from a tremendously bustling city to now - you read about the opioid crisis and everything else in Dayton, Ohio. So -- each [Ohio] region had their own issues that they were dealing with.

Malena Lopez-Sotelo: Can you describe your role at National City Mortgage when you began your career, as it evolved, and when you started, what opportunities did you see at the time?

Ted Tozer: When I started in National City Mortgage, I was chief financial officer. I had all the financial [work]. I had progress reporting servicing requirements from the investors. I ran capital markets, aligned all the investor [relationships], dealt

with all the underwriting guidelines, did all of the sales of loans to investors. In 1989, National City bought a mortgage company ... based in Dayton that was part of Shawmut Bank in Boston, and they merged Shawmut Mortgage with National City Mortgage. At that point, Shawmut was bigger than [National City Mortgage]. And at that point, my role changed from being a CFO to running capital markets. I ran all the pricing of the loans, sales of all the loans to investors, set up all the best [investor] relationships, all the design of the products for National City. I did that up to the point I left to go to Ginnie Mae in 2010.

Malena Lopez-Sotelo: Under your role in capital markets and pricing of loans, what kind of thought process went into pricing a loan? Can you provide an example of what one might have looked like at the time?

Ted Tozer: Well, in theory pricing was relatively simple because … [our] charge from our parent -- was that they did not want to have any kind of risk on the balance sheet, except for [mortgage] servicing rights.… So, all the cash flows and all the credit risk had to be sold. So, literally what my staff and I would do ... is say, “Okay, what's the market price of this loan?” We would price [the loan] on a rate sheet....We retained on conventional loans one quarter of 1% of the [loan’s interest rate] for servicing fee, all the rest of the cash flows of the mortgage [were sold].

So, for example, if you had an 8% mortgage, we would … sell it off, and all the credit risk and all the interest risks went to the investor. We were simply charged with [processing] payments from borrowers, having a relationship with the borrowers for questions about the loan, the loan went into default. We were responsible for foreclosure, loss mitigation, because investors didn’t want to talk to [or deal directly with] borrowers. So, for a 25-basis point fee, we became the investors’ face to the borrower.

Malena Lopez-Sotelo: And you used a term called basis points. Can you clarify what that is?

Ted Tozer: Okay. A basis point is the 1/100th of a percentage point. So, for example, a quarter of 1% is 25 basis points. So, 0.25% is 25 basis points.

Malena Lopez-Sotelo: And what were basis points used for in the larger mortgage originating process?

Ted Tozer: This is a term that was used so we talked about basis points. So we'd say, “How much is this [alt-A loan] worth?” They were talking [27] basis points, because again, it was the cost. You don’t talk in percentage [points] because a percentage on a mortgage is a large portion of the cashflows. So, you would go down to basically 1/100th of 1% of the annual interest paid on the loan to be your increment of value that you were transferring. So, would say really five basis points, or some people would say, “Okay, which basis point in rate? I'll give you, for example, two basis points of [dollar] price.” So you'd have what they call a DV01. DV01 says for each basis point in [interest] rate, I will give you this

much in price. So while loan is that what you're talking about, I sold [a mortgage] with a the DV01 of 3, which meant for every [additional] basis point in rate I would give the investor, they would give me three basis points in cash up front.

Malena Lopez-Sotelo: At the time, was there a sweet spot for basis points for National City Mortgage?

Ted Tozer: All we wanted to do was maintain the 25 basis points servicing fee. I mean, it was no different than trading any other commodity. First, a mortgage is a commodity. A mortgage came in and we basically would look at our Bloomberg and other quotation systems, and we would literally use that to determine where the interest rates were, and calculate what we thought the market rate was, because most all mortgages at that time trade off the ten-year treasury.... Mortgage traders are doing the same thing today. When you go into your local mortgage [lender] to get a mortgage, your rate that you're paying is basically just somebody ... in capital markets looking at their [MBS quotation] screens and say, "Okay, where is the Fannie Mae security trading at?"

And based on that security, here's your price, or Ginnie Mae security, this is your price. … the Fannie Mae, Freddie Mac, and Ginnie Mae market [combined] is the second largest fixed income market in the world. The only market that's bigger is the U.S. Treasury [market]. So, because it's about, a $7 trillion market. So it's a very liquid market out there. So, you can get indications throughout the day up to the second....

Malena Lopez-Sotelo: In what ways was National City Mortgage different than its competitors?

Ted Tozer: … [National City Mortgage] had the scale, so we were able to really drive our costs down because to me, mortgages are no different than any other retail commodity itself, no different from Walmart or anybody else. The bigger you are, the more your infrastructure costs, [can be] spread over a bigger base so you can offer a better price to your consumers. And National City had three blocks types of consumers. We did business directly with borrowers, but we also worked through correspondents, which were mortgage bankers who actually would originate loans to borrowers,... put them on their balance sheets, and then sell [the loans] after they closed to a mortgage company [along with the] servicing [rights]. And because we want to build our service portfolio suite by servicing those correspondents, [National City] also used [mortgage] brokers, and what brokers would do is we would send [mortgage brokers] our rate sheet and they would originate and we would pay them a fee for generating a loan application. And then we would process a loan application and actually close the loan ourselves. So, we had three different channels that we operate in to build our servicing portfolio.

...[O]ne of the biggest areas that got people in trouble in the 2000s was the broker channel, which is the one where [brokers] were taking applications for a fee that turned out ... to be fraudulent. We at National City lost a substantial amount of money through fraud, because these brokers would commit fraud

with our applications. So that was one of the areas in 2000 that really got out of control. ...

Malena Lopez-Sotelo: How typically were brokers selected or presented to National City Mortgage?

Ted Tozer: Well, it's a combination. We had sales staff that went out to try to acquire them. [The sales staff would] go to various industry conferences and so forth, and talk about how competitive our rates were, because … a mortgage broker is very, very similar to an independent insurance agent. The independent insurance agent represents ten different insurance companies and they take an application for whoever has the best rate. And that's basically what brokers does. So, we had sales people out there that were trying to convince them to put us in their group of five or six mortgage companies that they were selling their loan applications to. And then also, we would have a lot of referrals. The ... mortgage insurance companies [sales people] back then were a huge source of referrals because a mortgage insurance company salesman tend to talk to all these [brokers]. And so, they would refer people to us and say, "Hey, you know, this person's a good guy and you want to probably pursue doing a business with them." So, it was mainly between our sales people trying to bring brokers on board, as well as referrals from people like a mortgage insurance company representative.

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

Ted Tozer: Well, what was their incentive? Well, it was a fee we'd pay them. For taking the application, we would pay them probably anywhere from a one to two percentage points of a loan amount. So, their incentive was the fees. They took a $300,000-loan application, the loan closed, we would probably pay them about $5,000 of fees.[3]

Malena Lopez-Sotelo: Did you see their role change over time as up 2008 approached?

Ted Tozer: Two things happened. Because of the volumes, … we had this huge refinance work in 2004. A lot of the brokers tried to become correspondents, where they would actually close the loans themselves because they believe that instead of making a point or two percentage points, I can make more if I actually close it themselves. So it's a lot of brokers trying to become correspondents in the 2000s, but the biggest thing I saw was brokers became more and more aggressive in trying to acquire loan [application] and get them closed to the point where we started seeing more and more fraud. As far as them sending us applications that contained [fraudulent] documents, for example, that had different verifications that were fraudulent. They actually signed documents for the borrower, and they whited-out documents, and they made changes on them.

[3] The "fees" here are also more commonly referred to as "commissions".

So, we had a lot of fraud, and we turned a lot of people over to the FBI. The FBI were busy in the early to mid-2000s. The number one crime the FBI was fighting was mortgage fraud. Mortgage fraud was bigger than narcotics and anything else as far as organized crime…in the early 2000s. That was the number one organized crime. It was so lucrative because home prices were going through the roof, and so they were playing all kinds of games as far as ways to defraud the housing finance system.

Malena Lopez-Sotelo: What did that process look like for brokers in order to start closing loans themselves?

Ted Tozer: It was a situation where a lot of them had to convince banks to give them lines of credit to enable them to actually have the money to close, because again, while these brokers were initially just maybe one or two people, they were just working out of their home, they would take an application and send it to us. All of a sudden, if they want it to be a correspondent, they would actually have to close the loan, finance the closing, and hold it on their balance sheet for some period of time before they can be able to sell it to a company like National City. Well, definitely they had to convince a bank to give them a line of credit to actually finance those loans so that when they were closing a loan, the title company, the bank would advance the funds, so they would have the funding source. …[The brokers] biggest challenge, was trying to convince a bank that they were a good credit risk to finance their [closed loan inventory]. The same way that a Macy's gets financing for inventory, that's the same thing that a broker had to do. The broker had to literally find a person who would finance their inventory for them until they could sell it to a mortgage company.

Malena Lopez-Sotelo: You mentioned a number of fraudulent efforts in the run up to 2008. To what extent was the company aware of brokers' behavior?

Ted Tozer: We were aware usually once fraud [was discovered] either through our quality control [review] after it closed, we would find it, or investors would during their quality control. This is how we'd find it. So, after the loan was closed, we would do some verification, we'd contact the borrower, validate data, we'd find out they lied about their income or their broker manipulated the income data because we'd ask people. We'd hire people who would knock on doors and say, "Would you go through the application? How much money do you make?" and all that stuff. We'd find out that what they told the broker was not what the broker told us. Things like that is what we found when we started doing these investigations. And then we would also be contacted sometimes by the FBI. They would tell us that there was a ring in Las Vegas or Phoenix, and they would ask us if we were doing business with these people. And so a lot of times we thought that it was a really good coordinated effort with the FBI to try to reign in some of this organized crime activity.

Malena Lopez-Sotelo: On the topic of interacting with regulators, can you describe any additional interactions and what those may have looked like?

Ted Tozer: Well, the biggest issue that I see with regulators [starting in] 2005, the regulators really backed off. I think the regulators were so concerned about the economy, because once we got into the 2000s, the economy was growing mainly through cash[out] refinances. People were taking money out of their homes, plowing it back in the economy. And I think the regulators in Washington, whether you were talking to the OCC [Office of the Comptroller of the Currency], the Savings & Loans regulator, which is now defunct, FDIC [Federal Deposit Insurance Corporation] or the Fed [Federal Reserve System], nobody wanted to really stop that refinance wave. And so, because of that, I was really disappointed with some of the regulators that I talked to because we saw [no problem with] the pay-option ARM [payment-option adjustable-rate mortgage]. People talked about that with you, where people literally could qualify for NegAm [negative amortization] in ARMs. I talked to regulators about how I thought that was really inappropriate and they wouldn't take any action because they all were saying, "Well, you know, lenders know what they're doing, and we're not going to worry about." I'm here thinking that this stuff is predatory. I think the regulators in the 2000s really backed off and didn't really shut down a lot of the fraud and predatory lending that they should have done because lenders were talking to them about it….

Malena Lopez-Sotelo: How would you describe predatory lending at the time?

Ted Tozer: Predatory lending, in the 2000s... we start talking about HGTV and these TV shows "Go flip this house and [make a fortune]" they got people believing that real estate was the way to becoming a multimillionaire. And so, what happened was the greed got to the borrowers because borrowers perceived that if they bought a property and they fixed it up, they'd make all this money. So more and more of lenders and borrowers both became caught up in full concept of just speculation. The homes became no different than a stock on the New York Stock Exchange that you could flip properties, make a bunch of money off them, [with very little risk]. And that's where I saw the lending approach change, because instead of lenders telling borrowers, "No you're missing the point. There's a lot of risk here," they gave him what they wanted.

And that's where I guess my point with predatory lending is, a lot of people blame the lenders, but a lot were the borrowers too. Borrowers had no common sense either from the standpoint that they got caught up in this greed. So, you would see this greed was feeding greed. Wall Street was making a ton of money on these predatory loans, what they could sell the [predatory loans] for in the capital markets. Lenders were making a lot of money off of it. And borrowers were saying the fact that they were going to own all these properties and that they were going to make all this money. I mean, for example, there were some lenders that were offering non-owner occupied, which means [mortgages on] rental properties, to people who had never owned a house before. I kept telling my people at National City…I said, "How can a person that has never owned a house and has no idea what it cost to maintain it, no idea what it's like to own it, is going to buy rental properties?" I mean, that made no sense.

But those kinds of things were being offered the 2000s, because again, these people were renting an apartment, so this is their way to financial freedom. If they could buy rental property, then maybe they get a bit of money, they could actually get a down payment to buy a house themselves, which seems some kind of backward in my mind. So those are the things that I saw. I saw greed was rampant, and the regulators didn't try to stop it because they saw what it was doing for the U.S. economy. And then I also saw the lenders didn't stop it either. So, it was just greed was everywhere in the early 2000s.

Malena Lopez-Sotelo: You mentioned a wave of cash refinances. Did you notice that that wave started in a particular part of the U.S. over another part of the geography?

Ted Tozer: It started with wherever there was a lot of appreciation, and there was a lot appreciation in California, in the Arizona, Phoenix area. There was a lot of them in Florida, especially Miami. But again, wherever there was appreciation. The best example I saw with the impact of cash refinances was while I was at Ginnie Mae. It must have been around 2012, there was a move by some housing advocates to actually use eminent domain as a way to take over a mortgage and then basically cut the principal amount back to something the borrower could afford. And there's a town just outside San Francisco, Richmond, California. In Richmond, they had twenty loans or so they wanted the eminent domain on.

We looked at those twenty loans and in every one of them, if the borrower had not had serial cash refinances, they would not have been underwater. The underwater situation was created because they kept taking cash out of their house and that's what caused them to be underwater. It wasn't because the lender put them into a house, they couldn't afford day one. They'd been in the house for like five [or] six years. If they would have ... never refinanced it, they would not have been underwater, but they were underwater because they continue to strip the equity out.

Malena Lopez-Sotelo: In terms of demographics, and this eminent domain usage, did you see a trend around income or family size or non-native English-speaking in terms of the folks who did do cash refinancing?

Ted Tozer: No, it was across the board. It was the fact that everybody was really pushing for that. It was, I mean, between the concept of category finances and home equity loans. Banks were doing home equity loans up to like 90% or 95% loan-to-value back then. Everybody [bought into the concept] that home prices would never go down. So, the banks and the mortgage companies were all just basically just beating that drum that your house is [a source] of wealth - tap into it. You want to go to Disney World this summer with your kids for vacation? We will gladly give you a loan to do it, just use equity in your home. So, it was this phenomenon across the country where everybody was doing it because everybody perceived that home prices would never go down. So, lenders thought, "Well, okay, the guy gets into trouble. I'll just foreclose and take his home, and I'll have plenty of equity to take care of it because home [prices

have] got to go up." But when homes went down, the whole house of cards fell apart.

Malena Lopez-Sotelo: After mortgage loans were made at National City Mortgage, can you describe what the company did with them? Did they keep them on their balance sheet, sell them to a Fannie Mae or Freddie Mac, or securitize them, for example?

Ted Tozer: When we were set up in 1985, we set up the concept that we would not to portfolio anything. Every loan we made, we had to sell to an investor because the only thing National City wanted to build was a servicing portfolio. They wanted to diversify their income because back in the 80s and 90s, banks believed they were too dependent on interest income and their loan portfolios, so they wanted to develop what they called non-interest income-type products, and servicing looked [like] a way to do that. You would get paid a fee. Whether rates went up or down, you'd … [receive] a fee every month. So, we sold everything, sold to the Fannie, Freddie, [Ginnie, and] to Wall Street firms.

We literally wouldn't talk about securitization. We never really securitized because ... National City we were big enough. We would never start closing, but we weren't too big. And what that meant is, for example, I would get calls from Goldman Sachs, and they were saying, "Hey, if you can give me a hundred million of these types of loans by Friday, I'll pay you more than what Fannie and Freddie would pay for them, or anybody else would pay for them." So we were the big supplier of last resort for the Bear Stearns, the Goldman Sachs [of the world], who literally were going to do a billion-dollar deal, but they were short, you know, 150 million dollars, and they would use our loans to be the filler. And so we literally were the largest non-securitizer in that time period. So, we didn't securitize anything, but if you looked at a lot of deals that were done a lot of times, we were the single largest supplier of loans for that deal....

Malena Lopez-Sotelo: In your opinion, who carries the risk in loans that are sold and securitized versus those that are not sold and securitized?

Ted Tozer: If you don't sell your loans, you'll literally have the interest rate risk, the credit risk, you have everything, I mean, you're completely open to all risks involved. Again, if you sell your loans, depending on what you sell, you can transfer the risks [to a third party]. For example, back in the 2000s, a lot of investors, a lot of mortgage bankers would do securitizations. The reason they did them was because they believed that they really knew their credit risk and they would hang on to a lot of what they called subordinate bonds. I don't know how much you've gotten into that, but like in a private-label security or securitization, you take a security and you create mini-securities.

You have a block that's AAA [rated], which is probably going to be like 75% of the security. Then you have these other ones where if the loan goes delinquent, or you lose money on the sale of the loan at foreclosure, the losses come from these other securities that are part of it, the other 25%. And those bonds, sometimes mortgage bankers would hang on to them because they didn't think

that the Street was paying them what they thought they were worth. And that's the reason it took down a lot of people like RFC, like I mentioned before, because they hung on to a lot of sub-loans because when the crisis hit in 2008, those bonds all were worthless because all losses were taken. And so, because of that, when you do a security, you can hang on to some of the credit risk, or you can get rid of all of it. And we got rid of all of it. We found if we got rid of all the credit risk, why do you want to securitize? Because there's nothing to hang on to, we sold all the cash flows, all the credit risk when we sold the loan. A lot of my peers didn't do that, they figured that they were smarter than the Street and they would hang on to the credit risk on securities. A lot of them went broke.

Malena Lopez-Sotelo: Do you think that having risk on your balance sheet versus not having risk on your balance sheet created different types of behavior for these different institutions and what might that have been?

Ted Tozer: Yeah, I mean, I agree. In theory you could say that companies that, for example, there were correspondents for National City who you sold the loan and sold the servicing to, these guys had no risk at all, because they are in a situation they say, "Here's all the credit risk, here's the risk." Plus, they never talked to the borrower again. I mean, if you [keep] the servicing, you'll need to deal with the delinquencies and the problems. In National City we still had some skin in the game because we had to deal with that borrower. We had to deal with the politics, like when the housing crisis occurred in 2008, we were buried in phone calls. I mean, you saw the press, how the banks were criticized for not being able to deal with the tsunami of foreclosures and National City did that.

We had a ton of risks in the public relations-side and dealing with the customer because we are in the servicing. But then you [had] other people who didn't sell all the credit risks and hung on to the credit risk. Well, those guys had both the servicing problems that we had as far as the tsunami and foreclosures and phone calls, plus they were also losing money through their investments…. They actually have all their risk on the balance sheet, inventory and credit, and they were dealing with the same [servicing] issue. They had problems with the customer call and servicing department, and their loans were going worthless. So those guys got hit. So, everybody, I think, had risks to some degree, except for the people that sold service release, because they had no risk whatsoever.

And like I said, brokered [loans] I mentioned, they were full of fraud. A lot of the correspondents that sold to us had some fraud, because again, they had nothing to lose. But the servicers had a lot to lose. And, because you think about the banks, ever since the crisis, have gone away from being big servicers, mainly because they saw how much risk you have being a servicer. Because prior to the crisis, banks thought it's just fee income. It's money you're paid. It's a mechanical process. Then they realized in 2008 [and] 2009, they could get called before Congress, that they could be headlines in local paper. Banks now are no longer the major mortgage players that they were as [prior to] the crisis. And that's because they realized servicing has a lot of risks to it.

Malena Lopez-Sotelo: In this timeframe around 2008, 2009, what were some of the challenges or changes that National City Mortgage was now facing in the mortgage origination process?

Ted Tozer: Well, again, the biggest issue we dealt with was our servicing area. We were just not set up for what we were seeing as far as borrowers calling in wanting to deal with their delinquencies. We didn't have a staff. I mean, literally, prior to the crisis, maybe have 1 or 2% of your loans would go delinquent. [During] the crisis we had 15 [to] 20% of federal loans being delinquent. We didn't have the phone people trained to talk to people. We didn't have people trained to really talk about the various [loss mitigation] alternatives. Plus, we also were hamstrung because [whole loan investors] had sold so much of these loans into securitizations. Securitizations were set up where...there's nobody to talk to about unique situations, because you need to do a securitization. It's just [a shell] legal structure. There's no company.

For example, when Fannie and Freddie -- actually National City [asked] both Fannie and Freddie to physically sit in our delinquency area and work out deals with us -- tell us, “Oh yeah, well you can do this with a borrower.” Like a borrower calling and say, "Can I sell somebody's house for this amount?" Or, you know, whatever. They actually had people that were there to say, “Yeah, go ahead and do it.” Or, you know, you can modify the payment and forgive some of the principal, whatever it might be. But when you can sell into a private-label security, there's nobody there. I mean, you sold it in and you have a trustee who literally pays all the bondholders their monthly payments. But if you want to call them and say, "You know, I got a person that's got a deal for me. He is willing to sell his house for this amount. Can you accept that loss?" There's no one to call.

I mean, literally we went through every one of our contracts we had on each one of these securitizations. I think we had something like 500 contracts. Each securitization had its own contract. So, we went through and we hired attorneys and every one of them said we had no flexibility to help borrowers out. Because all the contracts said once a person missed three payments, you foreclosed on them. We couldn't stop it. Congress was very frustrated because they felt that servicers should do more to keep people in their homes. We couldn't, because we could be sued for violating our servicing agreements. It finally took an act of Congress to actually say that lenders could actually have more flexibility in dealing with borrowers when they brought up the HEN [Housing and Essential Needs] programs in like 2010, 2011, but there was the biggest problem we had right then was private-label securities contracts gave servicers no flexibility to deal with borrowers in distress.

Malena Lopez-Sotelo: Do you think that Congress understood these contract securitizations' limitations?

Ted Tozer: No. The problem we ran into, and I saw it firsthand when I got to Ginnie Mae, [was that] from the outside world, the mortgage industry had done a very good job of [making it so that] you, as a consumer, felt that the servicer was your

lender. It was a joke that people still believed that the Bailey brothers from *It's A Wonderful Life* were still around—that you got your mortgage at the Bailey brothers, and the Bailey brothers held it on their balance sheet. And then the Bailey brothers could help you. They didn't realize that the Bank of Americas or the National Cities or the Wells Fargos—we sold all those loans to a third-party and were acting as a contractor to collect their payments. We had no flexibility. We had a contract that stated that our job was to fulfill the requirements of the investor. The average consumer, which means the average politician, didn't understand the complexities of the capital markets.

They still believed the mortgage business went back to the 1960s and 70s before Fannie and Freddie were created, [that] there was no capital markets. There was no secondary market. So, I think that the biggest problem we had in '08, '09, and '10 was that Congress and the politicians didn't understand the complexities. They oversimplified everything as far as what could be done. I mean, I remember when I was at the meeting at the White House. One person came to me, and they said, "We talk about all these different things we can do, and you keep pointing out the problems." I said, "Well, I'm just pointing out to you the fact that there's always unintended consequences, and there's always limitations." And one guy said, "We fixed the auto industry. Mortgages can't be that difficult. We can fix the auto industry." I said, "Well, I'm just telling you how it actually works." And he said, "You keep tying our hands." I said, "I'm not tying your hands. I'm just telling you how it actually operates." And they said, "We're frustrated, because," at that point he said, "President Obama can't understand why we can't get this housing thing under control." I said, "Well, I'm going to explain to you how it works."

Malena Lopez-Sotelo: Pivoting to post-2008, what did your transition to Ginnie Mae look like? At the time, how were lending practices changing post-crisis?

Ted Tozer: When I get to Ginnie Mae, everything had changed dramatically. You're in a situation where the housing market was in crisis. Lenders that were lending money to mortgage companies, for, like I said, lines of credit and so, they pulled them all. So, a lot of the non-bank mortgage companies were having a tough time getting money to actually close new loans because the banks would not lend to them because of the mortgage industry and how it was falling apart. The banks—because of all the issues they were having around the foreclosures, and overwhelming the servicing, and bad press—they were pulling back. So, we were in a tremendous, tight credit. The idea there was [that] you couldn't get credit back then. At that point, that was where we stepped in at National City or at Ginnie Mae. FHA [Federal Housing Administration] stepped in, because FHA became really where everybody went to, because Fannie and Freddie had pulled back. The lenders had pulled back. But they felt comfortable coming to FHA because FHA, they were guaranteeing 100% loan amount. People started to do more FHA lending. Prior to the crisis, the outstanding Ginnie Mae securities—as far as securities guaranteed by Ginnie Mae—it was only about $500 billion...in 2008. I think by the end of 2010, '11, it was over a trillion dollars in Ginnie Maes. Again, the main funding source for all FHA and VA lending. We also saw a big

spike in VA [United States Department of Veterans Affairs] lending. Again, a lot of veterans ... had been put into Fannie or Freddie or FHA loans over the years, because a lot of people didn't understand, as far as realtors, the VA program. The VA program was really a great program. It really is a huge money saver for veterans, and that took on a new spin too. We started seeing more of the VA product coming up in that time period, because, again, the government guaranteeing your credit risk became huge. Because back in 2009, '10, nobody knew where home prices were going to settle at.

There was [a substantial] oversupply [of homes]. Home prices were collapsing. And to have the government step in and say, “We'll make you good on any credit losses.” Lenders felt comfortable lending with that backstop. So, we saw a huge move to the government lending in the 2010, '11 time period because of the whole issue of oversupply of housing and how it was just kind of falling apart. Because it was backed then too by Alt-A [loans]. I remember there were people who owned, for example, two or three homes. And when the whole housing market fell apart, they couldn't make their [mortgage] payments on the houses they didn't occupy. So, all of a sudden, those houses were on the market. We had this huge number of empty homes. It just depressed the home prices across the country.

Do we work off that oversupply? That's when we started seeing investors coming in to buy excess inventory and turn them into rentals. Again, I think right now, about 2% to 2.5% of all the single-family rentals are owned by institutional investors. Back in 2008, there was zero. None of them were owned by institutional investors. So, the institutional investors started buying up these properties to put a floor in the market for homes at that point. And now it's become a big deal. You have three or four major companies now that do single-family rental. That all came out of the glut of housing stock in 2008, '9, '10.

Malena Lopez-Sotelo: In addition to, or including, this oversupply of housing, how would you describe the key goals that resulted from these changes at Ginnie Mae as compared to National City Mortgage?

Ted Tozer: Again, it's a whole different world. I went from one side to the other. In National City, we were a beneficiary. We were using Ginnie Mae's guarantees. Prior to the crisis, [National City was one of] Ginnie Mae’s our biggest issuers. The way Ginnie Mae works is you create a mortgage-backed security, and then Ginnie Mae guarantees that mortgage-backed security. So, at that point, it's almost like an FDIC [Federal Deposit Insurance Corporation] insured deposit. People don't care if it's a National City security or Wells Fargo because it's got the government guarantee on the security. It was...probably around 2007, National City was Ginnie Mae's biggest issuer. So, again, I went from being a person who used Ginnie Mae as a guarantee [of my MBS] to being the guy who was actually trying to evaluate these companies, determining who should actually get a guarantee.

That was the biggest thing we saw just starting with Ginnie Mae was, when I got to Ginnie Mae, there was maybe six or seven companies that controlled two-thirds of all the business Ginnie Mae did. As I mentioned before there were correspondents, the people selling loans to... [lenders] like Wells Fargo, Bank of America—were huge people that bought loans from correspondents because of their scale. They were huge Ginnie Mae issuers. The same thing with, Chase, [JPMorgan Chase Bank] ..., U.S. Bank [U.S. Bank National Association], GMAC. [When] I got there, those guys controlled it. And then what happened was, they all got out of business. They all started wanting out of correspondent [business], so the move toward independent mortgage bankers [dominating the market] started at Ginnie Mae starting at 2012, 2011, when, for example, companies like, Quicken [Quicken Loans]... was approved by Ginnie Mae in 2012.

I think...in 2011 or 2012, Quicken didn't even service. They sold all their loans. They were a correspondent for Bank of America. They sold all their production to Bank of America. When Bank of America got out of that correspondent business when the whole thing blew up in 2008, Quicken came to us at Ginnie Mae and said, "Could we get our own independent approval?" And that's the big change I saw at Ginnie Mae, was when we went from having four or five major banks being our counterpart to having hundreds of independent mortgage bankers. The reason that's important is, like I said, Ginnie Mae is like FDIC. These [organizations] issue these mortgage-backed securities, and Ginnie Mae guarantees that the mortgage bankers will be able to make their payments to the bondholders—same way the FDIC guarantees the bank will make its principal interest payments on its deposits.

So, our counterpart is not the borrower, it's the company. Ginnie Mae's whole life changed overnight because prior, when I got to Ginnie Mae, [Ginnie Mae] used FDIC, and the OCC as kind of their regulatory arm. Because again, the FDIC and OCC wanted to make sure they were sound, especially the FDIC because they had their deposits. Well, independent mortgage bankers didn't have deposits. So, all of a sudden Ginnie had to build out a risk management structure overnight. It was a big change that we had to go through it. We had to build out risk models. We had to actually create a miniature FDIC in a matter of months, because all of a sudden, we went from having a Chase or a Bank of America as a counterpart to having a Freedom Mortgage or having a Quicken, who are a completely different risk profile than a Chase or Bank of America.

And we'd [have to] evaluate them. We were getting hundreds of applications at a time [from lenders] wanting to become Ginnie Mae issuers. We got a lot of complaints. Sometimes, it was taking a year to get approved because we just couldn't get through the applications. So, that's a big shift I saw, and it continues today. Ginnie Mae right now, I think the [last] number I saw, maybe 70 to 80% of all the business Ginnie Mae does today is done with non-banks, [whereas] prior to the crisis, it was flipped. It was 20% done with non-banks, 80% done with banks. So, we saw that shift after the crisis and that changed Ginnie Mae dramatically in how it did business.

Malena Lopez-Sotelo: Who did Ginnie Mae lean on to create these new arms internally?

Ted Tozer: When I was President of Ginnie Mae, I was so lucky in the fact that, during the time period for whatever reason, Fannie and Freddie were getting rid of some of their high-paid employees. They thought that they could cut their costs. I was really lucky to get some incredible people that Fannie and Freddie had let go. For example, the chief risk officer at Ginnie Mae, and he's still there today, was the head of counter-party risk for Fannie Mae's multifamily, because Fannie's multifamily is very similar to Ginnie Mae. If you do a multifamily project, that's like a big hundred-unit apartment complex, and if you did a loan on it, the way Fannie operates is, you do a risk share. So, Fannie Mae will take 80% of the loss, and 20% of the loss becomes the mortgage banker's.

The person I hired was the person making sure that that guy could actually pay 20% of the losses [in the Fannie Mae program]...So, I was lucky to get him, and he brought a lot of other people in with him to build out a risk-management side. In general, we also brought the people on our issuer-relationship side. We built that out with people from Fannie and Freddie also. So again, we relied heavily on Fannie and Freddie. Our securitization platform that we used –… if you do a Ginnie Mae, you have to issue off our Ginnie Mae platforms. We have standardization, so if you buy Ginnie Mae anywhere in the world, you get your checks on time and all your reports. I was lucky to get the guy who was one of the major people running Freddie Mac's [securitization] platform...

And he runs the platform today at Ginnie. So, I got some really good hires—we were lucky—that helped us build up and build the company. When I got to Ginnie Mae we only had 50 employees, and now I think Ginnie's up to about 175. So again, part of it was just also hiring. That was a big challenge, with the shift that occurred. Plus, a frustration I had was most people in Washington had no idea what Ginnie Mae ever did. Because, again, nobody dealt with Ginnie Mae. If you were a consumer, you would deal with FHA or VA, or you would hear about Fannie and Freddie because they had underwriting guidelines. Ginnie Mae was the FDIC. Nobody really understood what we did. And that was the biggest frustration I had with trying to explain to people the risk that was occurring with the shift in the risk Ginnie Mae had and were taking on.

Malena Lopez-Sotelo: On the topic of risk, how does risk work for a government entity as opposed to something more private like National City Mortgage?

Ted Tozer: Again, it...depends on where you're at. For example, if you're a National City Mortgage, you're a bank, and you're hanging on to your loans and your loan portfolio, FHA takes all the credit risk off your hands. Basically, for example, if you want to hang on to the interest rate risk but you don't want any credit risk, you can just buy insurance from FHA, and FHA takes on all the credit risk that you'd have in the private sector...Ginnie Mae is a situation where we actually facilitated transferring the interest rate risk from the lender to the capital markets. Ginnie Mae didn't take any interest rate risk, but by guaranteeing the security, that security could [for example] be held by the Japanese Central Bank

[or] could be held by a mainland Chinese [bank]. Everybody would buy it because it had the government guarantee behind it.

So, the interest rate risk is eventually held by the Japanese, the Chinese, the South Koreans, whoever it might be, but Ginnie Mae's was at risk because they had to make sure that those [monthly] payments going to those investors...were made because it's like the FDIC. If the lender went broke and couldn't make its payments, … if a borrower is delinquent in the Ginnie program, the servicer is still [required] to make the payments to the bondholder. So, if you're in a situation where you have huge delinquencies like in 2008, [where] you have 20 [or] 22% delinquencies, that could take a ton of cash out of your own pocket. And Ginnie Mae is there to make sure that you can make those payments. So, Ginnie Mae's risk is different in the fact that it's guaranteeing the obligations of a corporation or an independent company...

It depends on which government agency you're looking at and how it compares to a private sector lender. But that shows its complexity. Everybody's got little pieces. There's no one place that really holds all the risks anymore. And that's a problem [politicians] didn't understand in 2008, that we had basically specialized all the various people who hold all the various risks. For example, we found that with Ginnie Mae, the Japanese and the Koreans have no problem holding interest risk. They don't want any credit risk. They bought Ginnie Mae [MBS], because everyone specializes. People hold credit risk. There are some people like private-label securities, all they'll buy is subordinate bonds because they know credit risk, and they'll take the credit risk or people only buy the triple A's on the private labels.

So, we're so specialized...There is no one place where, if you talk about a traditional lender, they've got all the cash flows, all of the pieces coming off their mortgage. When you get into capital markets, it's all cut up and sliced up, and everybody's got all different pieces. And even with interest rate risks, that Ginnie Mae again, not to get into the technical aspects but if you've ever heard of the term tranches. Even at Ginnie Mae, we actually split up the interest rate risk so that actually a person would come to us, buy a bunch of Ginnie Maes, and then actually tranche out all the interest rate flows. So, [if] there were a person [who] only wanted to buy a security that had, let's say a three-year maturity, they could buy a three-year maturity on a thirty-year mortgage because they would get all the principal payments that came off that mortgage for the first three years to pay off their piece.

And then the person who only wanted the thirty-year security, they would get the last of the principal payments. And so on, this even enabled you to split up all the interest rate risks in a varied specialization. The other thing people realized was that mortgages are cashed out so specifically that when it gets to a crisis like 2008, there's so many people have hands in that mortgage. Because your mortgage, if you're a borrower, could be owned by fifty people, as far as different parts of that mortgage. There's not that one person to go to and say, "What can we do to try to help you out?" Because everybody's got a different

piece of the process. We specialized it so dramatically. But that's the reason why our mortgage rates were the lowest in the world, because...no one else in the world had done this specialization. Other countries have tried it or are trying it, ... numerous people who have talked to me in the world who want to recreate our capital market system because we, by far, have the lowest mortgage rates in the world. Our thirty-year mortgage rates are equivalent to most countries' three and five-year ARMs.

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

Ted Tozer: It had a huge [role to] play because what happened in that situation was, in my mind, you had such a process where you took these securities, and you created all these various, sub-bonds [subordinated bonds] and AAA bonds. I think Wall Street didn't really explain a lot [to] people [what they] were buying. They didn't understand the risks they were buying. And so, because of that, you got some unsophisticated people on the other side buying. I remember talking to one of the major high-level managers at a Wall Street firm, and he said that he got a call from an investor who was upset because he actually took a loss on some of the subordinate bonds. He didn't even know what he was buying. He knew he was getting a better interest rate, but he didn't understand the risks he was taking on for those [higher yields].

And so, because of that, I think that's the problem that the securitization process actually exacerbated. Plus you're in a situation where Standard & Poor's and Fitch [Fitch Ratings] and all the credit rating agencies were supposed to keep everybody honest, but I think they also dropped the ball. I remember talking to some people at the credit rating agencies about pay-option ARMs, and they were assessing the same amount of subordinate bond losses for a NegAm ARM [negative amortizing adjustable-rate mortgage] as they were for regular ARMs. That makes no sense logically. A person's going NegAm, you're going to have bigger losses. And their point to me was, “Well, we haven't seen losses yet on this. We really can't make these kinds of knee-jerk reactions. We really have to have hard facts.” I said, "Wait a minute. You're waiting for the hard facts. You're going to wipe a lot of people out."

But to me, that was just their way of trying to convince themselves that they really didn't need to assess that high of a cost to those risks. Well, if you do that, then all of a sudden what you're paying as a consumer is not priced properly. All of a sudden, if they're not pricing the credit risk on the security right, then when the mortgage banker offers a price to you as a consumer, they're not passing along the cost of your product. So, you think you're getting a great deal. You're saying, "Well, why would I want to get a regular ARM if I can get a NegAm one to have lower monthly payment, [with] the same interest rate [and] the same price?" So, it perpetuated this whole movement of risk because the securities were mispriced.

And I have to kind of go back to some degree to the rating agencies that really didn't, I think, be fair sometimes in their analysis, especially because of the fact that they were paid by the issuer. So, all of a sudden, most issuers, what they would do is they would show their package to all three credit rating agencies. And the one that gave them the best deal, they would go with him. And the [rating agency] only got paid if they got the deal. So, they would tend to make their support levels as attractive as they possibly could, which meant the whole system got out of whack. And the realtors also didn't help at all either. I think they got out scot-free, I've heard a lot about realtors who got people to buy homes they couldn't afford because it would put them in these Alt-A programs, other programs, that didn't require them to document their income. They would buy too much house and set themselves up to fail.

So, I think the realtors and the ratings agencies, I think to some degree, have not gotten … black eyes than they should have gotten out of this whole thing too. Because they could have stopped it. Regulators could have stopped it. The realtors could have stopped it. The ratings agencies could have it. But again, it was all greed. Everybody was making money. The realtor—[borrowers] paid [too much] for houses. The more of a real estate commission they would make. The rating agencies—they don't get the deal, they don't get paid. So, everybody was in this situation where everybody was making money. And the poor borrower, again, was being told that they had nothing to lose. And then the whole thing fell apart and fell apart in a big way.

Malena Lopez-Sotelo: Did your concerns or those of any others lead to any significant internal debates or changes in business practices during the financial crisis around 2008?

Ted Tozer: Yeah, I mean, you saw Dodd-Frank [Dodd-Frank Wall Street Reform and Consumer Protection Act]. Dodd-Frank was the reaction to the concept of the government, at least in my mind, with Dodd-Frank said, basically, the consumer and other people can't be trusted to do the right thing. So, Dodd-Frank was a way to [fix the system]. [For example, most] Alt-A loans were made illegal. You did all these things to protect [consumers]. The CFPB [Consumer Finance Protection Bureau] was created. All those things were created, my feeling was, because they believed that the regulatory frame was such that the borrower really couldn't be protected against themselves, that the consumer could be convinced to do things that weren't in their best financial interest. So, I think Dodd-Frank was a direct reaction to all the breakdown of all these internal checkpoints that should have kept the system going properly—Dodd-Frank was a way to reign that in.

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

Ted Tozer: To me, the crisis I think was created by the concept that we had this huge refinance boom in 2004. At that point, mortgage companies [and Wall Street] built a tremendous amount of capacity to handle all the refinance activity. Wall Street and everybody built up all this infrastructure. We got to 2005,

[origination volumes] fell off because everyone refinanced. And everybody was trying to find a way to use this excess capacity. On Wall Street, the mortgage bankers, investors around the world started buying mortgage-backed securities. So, in 2005, that's when we started seeing this concept of trying to push the [credit] box to try to say, Okay, how do we create more demand? How do we basically keep the system running? And, pretty much that was done by Wall Street. I mean, really, Fannie and Freddie get a lot of criticisms, but in reality, from my perspective, Fannie and Freddie did some, but it was mainly coming from Wall Street. Because Wall Street was the ones that believe that they had the rocket scientists. [They] sliced and diced to all these credit risks that you mentioned before [from Private Label Securities] subordinate bonds...And they could make things so that they could actually expand the availability credit because they literally could find ways to shift the credit risk and move it around to a point where they could actually make it so nobody held that much credit risk. So, the systematic risk is minimal because everybody would hold a small piece of all this risk around the world. And they convinced themselves. So, we had this growth in the Alt-A and the no-doc-type activity...

The only thing Fannie and Freddie did, from their perspective, that possibly did some things that may have messed up the market was, DU [Desktop Underwriter] and LP [Loan Prospector]. Prior to 2006, they were based on the amount of money that Fannie and Freddie would lose on a loan, not the probability of the person [defaulting]—So, when they did their algorithms, all they said was, “Okay, if this part goes into foreclosure, how much money do we lose?” They didn't care if it got into foreclosure. The question was how much we lose. So, all of a sudden, if a person made a big down payment or has mortgage insurance on it, they allowed them to have really high debt-to-income ratios and so forth, because the [potential] losses were minimal. They changed it in 2006, and we saw it really starkly. I think about...10 [to] 20% of loans that were getting approved, they weren't approved anymore once they changed their model in 2006.

But still, the big issue was mainly Wall Street. Wall Street was the one that was really pushing a lot of these [high-risk loans]. And then Fannie and Freddie got involved in around 2007 to try to keep market share, because Fannie and Freddie's market share was falling because Wall Street was taking [market share] away from [them]. [Fannie Mae] stepped up in about 2007 and started buying [Alt-A] loans and so forth.

That led to, I think, the downfall of Fannie and Freddie when they got involved in that market. Because we were one of the largest suppliers of loans to Fannie's portfolio, and [I understand] the losses they took on that stuff were phenomenal.... Because they came to us at National City just before I left to go to Ginnie Mae, and they bought all the servicing from us because they wanted to turn over to a high-touch servicer. A [servicer] set up to deal with high-risk [loans] because they knew that those loans were going to perform very poorly, and they wanted to have somebody who could do a better job than we could at National City. So, they got into it at that [high] point. And that was probably

what took Fannie and Freddie down—those loans they bought in the last year before the crisis I think ended up [being] where most of their losses came from.

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

Ted Tozer: I just hope that the big thing [you] walk away with is, I think the issue you're running into is, I think Fannie and Freddie have really been picked on more than they should have been. I think they really tried to hold the line the best they could. And so, it was a Wall Street, I think, driven crisis to some degree...And the other thing I think I realized too is that it was just a go-go time. Everybody really felt that housing was never going to fall in prices. Because of that, all aspects of the market were just consumed by greed. What were the banks doing—the second mortgages. If it was Wall Street—doing all these securitizations. Mortgage bankers with fees. Realtors—commissions. Individual borrowers thinking they can make money by flipping houses and speculation on homes.

It was just something to realize. It was just a crazy time that nobody would step back and actually say, Well, don't. I'm not sure if this has come up in your discussions, [President] Bush and secretary of the treasury Snow [John Snow], tried to stop it to some degree. Because they came out, I think it was 2005 or '06, and they tried to require Fannie and Freddie to hold more capital. They actually were fought. Actually, Fannie and Freddie [lobbied] to Congress to passed a law saying that the Secretary of the Treasury and the president couldn't force them to hold more capital. I told people, Fannie and Freddie were so powerful back then they actually defeated the President of the United States. But Secretary Snow really tried. If they would have gotten their proposal through, Fannie and Freddie would not be in conservatorship today. And so, there was stuff that was tried.

It was just the fact that there was so much money being made in all aspects that we just couldn't stop it. So, that's one thing to walk away with was that there were some [attempts]—Also too, like I said, with the OCC, when I was at the National City, I used to have talks with my auditor, my regulator. And she was very frustrated...She said the field was very frustrated because they were telling people in Washington about what was going out in the field, and Washington really didn't want to talk to them. Nobody wanted to stop this because they knew that if you put a stop on housing in 2005 or '06, the economy would have slowed because the economy was not that strong. It had been fueled by this speculative bubble, and nobody wanted to pop that bubble.

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

Ted Tozer: I think the most important lesson they could walk away with is that if you don't regulate yourself, the government will regulate, and you don't want it. The government will overreact. Because I said in numerous meetings for the Mortgage Bankers Association in 2005 and '06, seeing these different products,

and I said, "Guys, we need to reign ourselves in. We need to actually self-regulate." And I kept getting all this pushback saying that mortgage bankers are entrepreneurs, and they're creative, innovative. I ended up saying, "Guys, we need to do this." And they wouldn't do it. If we would've done what we talked about back in that time period, we probably would not have had the crisis because mortgage bankers would have been united. The problem you have is that if one mortgage banker is offering it, your sales staff, since they're on a commission, come back to you as a manager and say, "Wait a minute, if the guy down the street offers it, why can't we offer it? Because I'm losing deals." But if we, did it as a united front, then we could have. Because everybody I talked to in the industry agreed with me. Things like these predatory lending loans, subprime, the pay-option ARMs. They were all stuff [that] were bad for the consumer, but nobody wanted to be the guy who said no to the salesforce if everybody else was still offering it. And so it had to be united front, and I could not get them to do it. I went to the OCC and the FDIC and tried to get them to do it and try to stop it as a regulator. And they wouldn't do it. It was so crazy. We finally were forced toward the end of National City to offer some pay-option ARMs.

We tried to put a lot of protections in for the consumer. My OCC auditor told me, she said, "I'll let you offer this program since you're not holding it on balance sheet. If it was on the balance sheet, I would have stopped you." That's the way of it. I said, "You're telling me that this loan is so high risk that I can sell it to somebody else and you'll let me do it, but if I put it on my balance sheet, you'd shut it down?" I said, "What about the poor consumer?" And she said, "Well, we're not that concerned about that." So, it just shows how the whole thing got out of control because nobody was willing to say no. And like I said, as far as industry, my feeling back to them is when you see things that are going wrong, you've got to have some responsibility because if you don't, other people take responsibility for you. And you're not going to like it.

Like right now, with the CFPB and everything, I think they mean well, but they don't understand the business well enough. And we see all these unintended consequences with stuff the CFPB is doing and so forth. Whereas if we would just regulate ourselves back in 2005, '06 and '07, we wouldn't have a CFPB today. And by doing that, we'd all be lot better. Then our costs of origination would be lower. The consumer would be doing better. But the industry wouldn't do it, wouldn't self-regulate. So, that's one thing I would bring up: the [meaningful] self-regulation.

Malena Lopez-Sotelo: Thank you, Mr. Tozer, that concludes our interview. Thank you so much for being here.

[END OF SESSION]