AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

David Stevens

Bass Connections

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PREFACE

The following Oral History is the result of a recorded interview with David Stevens conducted by Sean Nguyen on March 3, 2020. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

Readers are asked to bear in mind that they are reading a transcript of spoken word, rather than written prose. The transcript has been reviewed and approved by the interviewee.

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Sean Nguyen: I'm Sean Nguyen, an undergraduate student at the University of North Carolina at Chapel Hill and member of the Bass Connections American Predatory Lending and Global Financial Crisis team. Today is March 3, 2020 and today we're joined by David Stevens, currently the Chief Executive Officer of Mountain Lake Consulting Incorporated, and Dave has joined us via telephone today. Thank you for joining us.

David Stevens: Great to be here, Sean.

Sean Nguyen: And so, before we begin, I'd like to start by establishing a bit about your background. I believe that you grew up in Connecticut and went to the University of Colorado at Boulder for college. Is that right?

David Stevens: That's correct, yes.

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

David Stevens: It was after college and I was working for a nonprofit, and honestly, I just needed something that paid me a little more money, and a friend suggested, he had just joined a mortgage company, World Savings, and suggested I interview, and I did, and was hired, and that's sort of the fluke of nature and I think it's pretty common in the mortgage business that, at the entry level, it's oftentimes accidental that people come into this business.

Sean Nguyen: And so how would you characterize the key changes in the national mortgage market between when you first became involved with the mortgage market? And what year was [it when] you got involved?

David Stevens: 1983.

Sean Nguyen: So how would you characterize the key changes in the mortgage market from 1983 to 2008?

David Stevens: Oh, it's dramatic. When I began in the business, there were no automated underwriting systems. There were no FICO [Fair, Isaac and Company] scoring models. Even the GSEs [Government Sponsored Enterprises] were a fraction of the size they became at the peak of the market. There was really no private label securitization market per se. I worked for a savings and loan, every loan we originated, we underwrote, we analyzed the credit.… You stood in line at banks to get verifications of deposit that would show the money's needed to settle. Our underwriters were all in-house. The loans stayed on our balance sheet. We took all the risks. Our appraisals were done by in-house appraisers who did a lot more, I think in many ways than they do today in terms of establishing risk.

…[T]he risk paradigm was significantly different because we held it all. So even though in the early '80s, because we were coming off of the oil patch recession and it was an inflationary recession, interest rates had just reached their peak at about 18%. Thirty-[year] or fixed-rate loans were in the mid-teens, so you could get a fixed rate for 16% or 15%. Variable-rate mortgages were really the product that was the predominant program. And so managing the risks associated, that was pretty significant. We all had cameras given to us by our company, and we would have to drive [to] every home that we did a loan on and personally take a photo of it, and fill out a form about the condition of the property. Because in those days, it was about equity and the value of the collateral. There was really no high LTV, high loan-to-value lending, or very little of it. Most down payments were much higher. And FHA [the Federal Housing Administration] would fill in the gap, but not all lenders did FHA loans, so it was just a very different environment.

In fact — not that this is necessarily relevant — but even with adjustable-rate mortgages, there was no consistency. Some are called ARMs, some are called VRMs, variable-rate mortgages, some are called AMLs, adjustable mortgage loans, depending on which bank you talked to, they might have a different index, a different initial rate, different cap structure, a different margin over the index. So there's no consistency because there was no securitization market, each bank created their own proprietary products. And so it’s this very different world until automated systems and capital markets became the way the business was run. And that didn't even start building until the mid-1990s. So it was a long time before we got to that point.

Sean Nguyen: To what extent did you and others in your organization see the changes that were occurring?

David Stevens: See? Oh, we saw it. It was dramatic. The challenge, what ultimately led to the crisis, … was an extended, decades-long improving credit environment in real estate finance. Homes started becoming a sure thing in the early 1980s and literally, we never had a recession that tested that. And so, as lenders grew more confident in real estate and others wanted to get into that market, which included Wall Street firms, international investors, pension funds, and more, the exuberance over real estate allowed for just the continuous relaxing of standards such as layering of risks.

So, for example, pay option ARMs [payment-option monthly adjustable-rate mortgages] was really an answer to the oil patch crisis that took down the savings and loan industry because they had lent long on 30-year fixed rate loans, but the inflationary environment that ultimately drove rates high was that the short rates became more expensive than long rates, and all these S&Ls [Savings and Loans Associations] were underwater because they held long 30-year fixed rate loans on their balance sheets. So the reason why adjustable-rate loans were primarily introduced was not to market them per se, it was because coming out of that crisis, $350 billion, it took down companies like Lincoln

Savings [Bank] and had all sorts of its own housing crisis, mortgage finance crisis that no one really pays attention to anymore because we've been through a worse one. It was to get a match, a basis match, so something that would adjust more in sync with your deposit costs. And so, that was the onset of the adjusted rate mortgage.

But, it was compensated for with much stricter underwriting standards, loan-to- value limitations, not deeply discounted teaser rates, that ultimately became the case. What we saw over time was everybody wanting to get in on that business. And so Countrywide [Financial] as an example, which I remember it as a tiny company, and just saw it balloon, but they came the loss leader of that particular product for example, and ultimately, leading up to the recession, they would do those loans with an 80% loan-to-value with a 20% second mortgage, meaning it was 100% financed. That's one big layering of risks — so you lost all the equity protection in the event of default — and they would allow them with more lax underwriting standards, higher debt-to-income ratios, less than pristine credit, and those kinds of things.

So ultimately what we saw, what I saw happening from the origins of your dad's banking world or whatever you want to call it, was we went from a very hands-on, slow-moving, risk-focused portfolio lending market to the massive emergence of players that came in to leverage the secondary market, the growth of the GSEs, and once companies realized that they can offload their credit risk to a Freddie [The Federal Home Loan Mortgage Corporation] or a Fannie [The Federal National Mortgage Association], and then ultimately, Wall Street, decided they were going to get in that space and aggressively target loans that were typically Freddie and Fannie eligible. The rule of the day as business went on for lenders across the country was: if the investor will buy it, you can originate it. And, with really no responsibility to determine, in general terms, whether the loan was sustainable or not because – one, we had had a … two-and-a-half decade or two-decade environment of no risk; actually, close to three-decade environment of no risk in the residential real estate [market] in the United States and a progressive laxing of credit standards, but yet no incidence of default because we hadn't had any significant recessions. There had been, there's been the 2000, the 1994, I mean there were little short-term pockets of correction, but we had no real testing of any of the credit standards, and that just piled on.

And that built ... an industry that grew into mortgage brokers, and independent mortgage bankers, non-bank lenders. They were there back in the day, but never to the extent they … are today. And not that that's bad or good necessarily, I'm just saying that became an outcry because you no longer needed a balance sheet to lend money. You didn't have to be a bank. You could open up an independent, non-bank company, whether it's Countrywide [Financial] or Quicken [Loans Inc.], or some of these megas, or smaller companies that exist today, because you could always sell those loans to Freddie or Fannie or sell them into a Ginnie Mae [The Government National Mortgage Association] security, using FHA, VA [US Department of Veterans

Affairs] or USDA [US Department of Agriculture] …, or sell them into the private label securitizations market. So, obviously massive change, and it was right in my windshield as I watched it.

Sean Nguyen: You mentioned Government Sponsored Enterprises, such as Fannie Mae, Freddie Mac, and I'm aware that you transitioned from World Savings to Freddie Mac, I believe in 1998. Could you talk more about that transition and how your responsibility shifted from your role in World Savings and when you went to Freddie Mac for those seven years?

David Stevens: … I started, as I said, by accident. You do that job for 17 years, or however long, and I forgot how many years I was there, '83 to '98…. And I progressively grew up through the ranks of this bank that was growing pretty dramatically and I was group Senior Vice President and running a very large chunk of the company. And, I really, at that point, was interested in expanding my horizons in terms of knowledge. I was still young. And an executive recruiter reached out to me to consider an interview at Freddie Mac; and to me that was the perfect balance. I'd spent a long time in the primary market. Freddie Mac is the secondary market. Freddie Mac doesn't originate loans, they buy loans from lenders. I went from a portfolio lender that did very little business with Freddie, and I wanted to learn about how the rest of the world was operating in mortgage finance. And, in those days, Freddie and Fannie were large, powerful, dominant institutions, and did business with the largest banks in the nation.

And so when I went in as Senior Vice President, initially to head sales for Freddie, ultimately within just a pretty short period of time, I was promoted to be the head of all Single Family[1]. But, my responsibility was to essentially drive the business that would come into the institution. Freddie was a very different experience because, one, I didn't understand how MBS, mortgage backed securities, were structured. I didn't understand, buy ups and buy downs, or the dynamics of TBA [forward-settling mortgage-backed securities trades], and hedging and all the aspects that are involved in the secondary market. I learned it now, but I really was an infant coming into that job. I came in as a guy with really strong sales and communications and business management experience. And the initial goal was for me to help improve the perception of Freddie with clients around the country and be more engaged and be more, for lack of a better word, sales-like, to augment the strong capital markets and at the time what was considered to be superior risk management skills at Freddie. And so … there was a team there, and so whenever you're negotiating a deal, back in those days you would write contracts. So Wells Fargo [Bank] would come in once a year. Wells [Fargo Bank] is our biggest customer, so you'd meet with them constantly, but about once a year we'd renew an annual agreement. It would be a contract, would be a very extensive contract. And we'd bring in the Chief Risk Officer of the company, the head of capital markets, the head of affordable lending, the whole group and the President of Freddie would be

[1] A division of Freddie Mac that focused on the purchase of mortgages on single family residences.

involved. Ultimately, it would be presented to the President and CEO, the final deal, before it got approval. … [I]n those days, you'd end up writing a couple hundred-billion-dollar contract with Wells. I think it was actually, in its biggest year, if I recall, it could have even been a $400 billion contract I wrote for one year….

And so, we had an organization that would call on small lenders. And then I called that community lending and … they'd call in 10 to 20 community banks or independent mortgage bankers. And they had, for a company like Wells, I had a team on Wells with one lead and a group. Because they were a market segment unto themselves. I will tell you that the experience, and I've talked about it openly, between Freddie and Fannie was very destructive to the housing finance system.

Freddie Mac was the first to strike, but they created, in an effort to grab market share, created what's called alliances. We cut a deal. I think Wells was the first one, where in exchange for credit terms and pricing terms, credit variances and pricing variances to the normal structure that we would give to the lenders, we would get all their business or the majority of it. And I think Freddie struck first. Fannie then struck with Countrywide, and it became a domino effect with the largest lenders. That was really a race to the bottom, ultimately, because Countrywide and Wells and companies that don't exist today, like ABN AMRO [Bank] and others who were huge at the time, Washington Mutual [Bank], of course, JP Morgan, Bank of America, you name it, they were all in there. But there were other players that were huge and do not exist today. But they would use their leverage to say, "You either give me these terms, or I'm going to go to Fannie." And this duopoly became actually very destructive. I'm not a fan of the duopoly as it stands now because ultimately you had shareholders really pressuring you to get the market share high enough to keep liquidity in your mortgage-backed securities because we had a different security than Fannie's; because investors and shareholders needed to see that.

And as a result, products were created as a tradeoff to getting these market share deals that never should have been in the market in the first place. Yeah, I still remember them to this day. The fast and easy loan that Countrywide had, allowed borrowers to get a 30-year fixed-rate loan that went into the regular mortgage backed securities market, standard TBA pools. But if you had a certain FICO score, you didn't have to have any documentation at all. No verification of anything. And these kinds of things really eroded credit standards, on top of what was happening on Wall Street. So, it was just an interesting time.

Sean Nguyen: How would you describe the key goals of Freddie Mac in the years before the housing boom? Before the 2000s really took off. And did these goals change in any way during the boom?

David Stevens: Well, the stated goals were pretty consistent. And we had scorecards, so we were all measured on and paid against [them]. And my goals were not dissimilar from the head of credit risk or capital markets because we all ultimately wanted to accomplish, in the very early days, returns to shareholders was the goal. X percent, I can't remember what it was, but we had goals to give a certain return to shareholders because you're a public company; in our view, completely public. I think the fact that we had a government wrap on our MBS [mortgage backed security], it was just a side effect, side benefit, but we never thought [of] ourselves as quasi-governmental or anything like it. We were viewed as, again, private entities. So return to shareholders was preeminent. But we also had political risk and a lot of it. …[U]ltimately public companies that are shareholder owned, ultimately, their number one goal is to return value to shareholders.

And so subsidizing mortgages for underserved communities that are clearly higher risk and bring in lower returns. It would only be done in a normal environment— in a Freddie Mac and Fannie Mae world of this — because of political pressure, affordable housing goals that the Congress demanded be in place. And frankly, that's a whole other rabbit hole we can go down if you want to, but that was very much of a gamed system and I'm not sure it ultimately accomplished what it should have. But it certainly allowed Freddie to make public statements about what it was doing in affordable lending, as did Fannie. So yes, our goals would be shareholder returns, general administrative expense controls, market share, affordable housing mix. So that kind of objectives would be standard for us.

Sean Nguyen: To what extent, if at all, did your organization express concerns about the changing nature of credit extension during the 2000s?

David Stevens: Yeah. You know what, people in our organization did. I will tell you personally, I raised concerns about other things. I was very concerned about the disparate impact to smaller banks that was happening because of these deals being struck with the big guys. And so, I wasn't looking directly at the credit …but it did happen and I will tell you that, the Chief Risk Officer at the time, there were two of them, Don Bisenius and David Andrukonis. But Don and — poor Don got an SEC [Securities and Exchange Commission] letter after they went into default and he never showed up, and it's all been cleared to this day — but Don was the one when he saw these waivers being ultimately agreed to which would go to the president of the company. And again, it was equal over at Fannie, equal or worse. But I remember Don once saying, "When, when we finally go into a true correction, we're going to be driving trucks up to these lenders and returning all of these loans that have misrepresentations in them, defects we call them." And the rationale there was Don felt concerned that we were — yeah, all of us — the market was too extended in credit and that there wasn't enough due diligence happening on the individual loan transactions being delivered through a Freddie Mac security, by many of these lenders, and it was his assumption that in the event of default, in looking at these loan files that there would probably be errors — what we call defects — and that would be a cause for repurchase. And so that was Don's humor about — I don't think it was humor, it was more foreboding humor that … there'd be a lot of defaults, marked across the market if we ever had a correction.

I want to go back a second if you don't mind. FICO as a model was invented in 1993 if I recall. And it was, I remember when the credit scores came out….[W]e talked about in our bank, "We'll never use a credit score. It doesn't do the same as actually reading your credit report." And, of course, proven well wrong, but that, that was the beginning. Then automated underwriting systems, the first of which was Loan Prospector at Freddie and then Fannie's Desktop Underwriter. That rolled out in 1998 or 1997, maybe something like that, something in that range. And so, when I joined Freddie, automated underwriting systems were just beginning to boom, but it boomed overnight and, literally, banks had AUS, automated underwriting systems, AUS systems embedded in their underwriting logic within a couple of years. Everybody from that point forward were originating loans on models. The model was FICO and data-driven decision making through an AUS that had never been tested and we had never had a recession to run it against.

Sean Nguyen: And what year is this development happening?

David Stevens: I Oh, it's late '90s, is when it's really beginning to happen, but it boomed. It was an explosion of technology advancement that burst through the system through the industry. And the reason is just, Wells always had an internal underwriting system called, at the time it was called ECS and all the other big ones had their own systems too, [I'm] just using Wells as an example. And they manually took Freddie Mac's underwriting guidelines, which were basically a big manual, we had a big book, HUD does too, FHA. Every big buyer of mortgages has a big underwriting manual of standards. It probably still exists at Freddie in paper form perhaps, I'm not sure. But big banks, in order to create efficiencies, would try to take the majority of those [underwriting guidelines], they would then manually input them into their system, was called ECS [Electronic & Commercial Services], and they would try to get as close as possible to what they thought the real guidelines were.

So when Freddie introduced its own underwriting system, which said, "If you go through our system and it gets approved, you're good as gold. I mean, you don't even have to worry about whether you got your system right, because we're guaranteeing ours, we'll buy off of ours." And you suddenly eliminate all this repurchase risk. So the moment Freddie developed their system, everybody just wanted to get that damn thing embedded in … their own logic, rather than using their own systems that they've manually kind of put together based on how they read… the guidelines from Freddie. So it was really quick. And I sort of came into Freddy when that was all happening and saw it grow. And today, obviously automation is moving at an extraordinary track on all levels and all aspects of the manufacturing of a mortgage, but that was pretty big at the time.

The reason why I often focus on that is, like all these things, nothing had been tested and the entire mortgage market, multitrillion [dollar] market with investors globally and people's retirements invested in them in pension funds, whether in Ireland or in Cleveland – [it] didn't really matter. They were all backed by these mortgages that were now being automated on a lot of automated credit evaluation technologies that had never really been tested against anything. And the pooling of mortgages was all determined by Freddie and Fannie. So if Freddie determined – if Freddie had 30-year fixed-rate loans, whether they were 99% loan-to-value or 100% loan-to-value or 50% [loan-to-value], they would all get pulled into the same TBA security and investors would buy a big security based on weighted averages; WAC, WALA, all these kinds of things — weighted average coupon, weighted average loan amount, weighted average credit score — and they didn't see what we called the tails, the tail risk that was in those mortgage backed securities because data transparency just wasn't that good.

All of the automated underwriting came in. It all came into new securities. Freddie and Fannie are racing for market share. They're cutting deals with Countrywide and Wells and WaMu [Washington Mutual] and you name it, to get their business. It's really leading to lax standards. All of that shit's being pulled into this big MBS that has a government guarantee on it, which gives it a AAA rating, which allows it to be marketed globally to any sovereign, because many sovereigns required AAA only, and they wouldn't invest in PLS [private label securities], for example, if it didn't have a AAA. That's a whole another story with the ratings agencies and the non-agency stuff. That's how this whole soup started getting stirred up.

And, Wall Street — you've seen the movie — but Wall Street suddenly gets interested. Lou Ranieri, I see him in the opening of The Big Short, Lou's a pretty good friend. And I don't think anybody knew what was going to happen downstream. ….He thought you could create a mortgage backed security and pool loans together, sell them to investors. Wall Street started saying, "Well, we can get you higher yield by pooling no doc [documentation] loans, stated income, NINA [no income, no asset] loans, all this stuff together, this stuff will be 30-year fixed rate also. The WACs and WALAs, and everything else looked pretty good. And you can buy pieces of it or you can buy the whole thing. You can buy slices both vertically and horizontally." … Likewise, that stuff too had higher rates because they were considered higher risk. And so, yield chasers could go after that. And then the tranching of that brought in all the investors at the AB levels. [2]

And this was all happening, all leading up into an interest rate environment that from 1980 to … 2005 had dropped from 18% down to single digits. And so the volume [of mortgage origination] was just extraordinary. 2003 was the largest mortgage origination year in U.S. history. It was $3.9 trillion. And those refi's [refinances] were driven by two things. One, this rate rally that had happened over decades and the extraordinary equity in homes because we hadn't had a market correction anywhere to speak of in the nation over those decades. And so the ability to do cash out refinances was outrageous, and second mortgages, and HELOCs [Home Equity Lines of Credit] built this whole other industry of

[2] Securities rated in the A or B ranges.

tapping into equity — which was done with far riskier underwriting standards — stripped away the equity that Americans had in their homes. And all of this led us to the precipice in 2008 when we had equity stripped homes, … excessive debt on too many Americans because they had, many of them, had been equity stripping and spending the money they pulled out and then equity stripping again on the next 10% appreciation rate over the next few years. And then layering of risk and lax credit standards both at the GSEs and the non-agency market.

And the last thing I'll tell you is, … the defenders of Freddie and Fannie will say, "Well we never, we only collapsed because they did." I expect the worst of them will say that we never should have put been put into conservatorship. The fact is that Freddie and Fannie both had big portfolios, and they were outside of what we call the flow business. The front end, the business that I was focused on, was buying 30-year fixed-rate loans and 15-year fixed-rate loans from banks. Now, more variable credit terms for volume deals, but the portfolio, which is the other business, it was essentially a hedge fund that was able to use the AAA wrap given by the U.S government. So anything Freddie bought or sold came with their lower cost of capital and … bought it, rewrapped it and sold it, they [investors] could buy it. They could buy it rich to Freddie and sell it much cheaper back to the market because it would be wrapped with a AAA bond. We call them off-label deals.

So, rather than TBA flow — which is what you call standard 30-year fixed-rate loan — we created things like T-deals which is an off-label deal. It could have been a pool of pay option ARMs from Washington Mutual that Freddie would take in on the portfolio side, wrap it, and sell it out to the market as a T-structure. But that would end up being triple AAA [rating] by Moody's [Investors Service] and Fitch [Fitch Ratings Inc.] because it came from Freddie backed ostensibly under the implicit guarantees provided by the charters of the two institutions.

So what really brought down Freddie – and it wasn't just pay option ARMs, they were doing, they were buying the sub pieces and sometimes the A slices on subprime deals and more, so they were helping to replenish capital to Wall Street. Because Freddie and Fannie were huge buyers of this stuff on the portfolio side and that actually allowed that business to get even larger. So, again, there were people saying, "Hey, this is going to come to an end…[N]o one expected the crisis [of] this entire market — but I remember multiple conversations like, "When this happens, when there's an event, we're going to have pockets in this country that are simply way over-extended." And again, we had never tested the underwriting standards. Property appreciation had never been checked because of homebuyer demand driven by low interest rates and beliefs about wealth generation. It's just the perfect storm that ultimately led up to this massive collapse, which everybody now can look back on and say, "Okay, we learned these things." And whether that sticks going forward. It's a big question, but yeah, that's essentially the story.

Sean Nguyen: To switch gears for a moment, you've mentioned a few minutes ago the affordable housing goals and how they were related or affected the impact of Freddie's business. Would you be able to speak more to that?

David Stevens: Well, Freddie and Fannie both had goals that were set on them by the regulator. And if you recall, in your research, FHFA [Federal Housing Finance Agency] their regulator was not as it is today. So FHFA today is the independent regulator with much greater heft. But back in the day, the regulator for Freddie sat in HUD [United States Department of Housing and Urban Development] under the Federal Housing Commissioner. It's hard to believe, but that's having been the FHA Commissioner, I never had that regulator, but I was just shocked that that would be the case because they were unregulated entities.

But nevertheless, one thing the regulator was responsible for was establishing annual affordable housing goals upon the two institutions and reporting those to Congress. And the goals were based on three different factors. One was percent of loans at or below 50% of median income. The next was at or below – I can't remember – I think it's a lower percentage. And the third goal was based on targeted census tracts that were considered underserved, and the GSEs had to get a certain percentage of their mix of business from those markets. Well, most of it was settled in the below 50% of median income, which, if you're looking at a distribution of mortgages, you're naturally going to have a big pile of your loans that are below the 50% median. Even if they're 49%, 48%, north of 46%; it's a big chunk of loans. So that was one way to achieve those goals. The second way to achieve the goals if you couldn't buy them as whole loans or through normal securities, is by offering effectively really good products to help minorities and first time home buyers and underserved communities get access, which the GSEs both did a good show to try to do that.

The truth is they never competed with FHA in that market and they don't today. FHA does the majority of African American, Hispanic, and first-time home buyers by far over either Freddie or Fannie. And they did it back then. So to meet the goals, … I remember being called in around September, October, and we'd suddenly [have] all the senior executives in a room, and we'd show where we are, we're short. And then we'd go out to Citicorp and JP Morgan and whoever the hell had a balance sheet and we'd offer a big pay up because we were printing money in those days, right? Profits were huge leading up to the Recession. And you say you'd pay anything essentially to get what you needed. And you go to those banks and … we wanted to look at a cape of all your mortgages with these parameters, either from these locations or these income distributions. And they could have already been … securities that were wrapped by Fannie Mae, and Freddie would look at them and say, "We'll buy that pool and we'll just rewrap it as a Freddie." And a lot of that happened, there was a lot of this purchasing going on towards the year end by both Fannie and Freddie, just simply to show Congress that they hit the number, when in reality, they were just double counting because Freddie was wrapping Fannie's and Fannie was wrapping Freddie's. And it was a little bit of the gamesmanship.

And I continue to harken back to the point and something that I argue with Mark Calabria even today is: releasing these entities back to shareholder-owned — out of conservatorship — companies back under the auspices of their original congressional charters, in my view, is going to replicate the entire environment that led them into failure in the first place because we won't have changed anything. And I can assure anybody that shareholder interests will rule the day as time goes on.

And so, it was just a very interesting period to be sitting there because in the end of the day you have to hit the affordable housing goals, period. And you're going to do it, even if you have to pay double for loans that somebody already originated and are sitting on their balance sheet. It's not like you're creating a new loan, you're just creating capital relief off of another balance sheet on a loan that was already created once before. …

Sean Nguyen: … Moving forward a little bit, I believe that you served as the US Assistant Secretary of the Department of Housing and Urban Development starting in 2009. Can you describe your official responsibilities in that role? And what that position entailed during that time?

David Stevens: … I was running a big real estate company and I got contacted about whether I would consider joining the Obama administration. I went and met with Secretary [Shaun] Donovan. I will tell you, the excitement of coming to HUD, for me, was not necessarily to run the FHA program day in and day out. I knew that I wanted to. I knew FHA was in trouble. I testified about it. If you read my testimony during my confirmation hearing before I was even in the job, I told the Senate Banking Committee that FHA is in deep trouble and they're being adversely selected. So I knew what was about to come there, it just hadn't actually hit until I walked in the door. But we knew that tidal wave, you could see it, just had to wait until it hit the shores. So I wanted to focus on that.

And then secondarily, the President's team was putting together what's called the housing team. And that consisted of people from: key people from HUD, which I was part of, key people from Treasury [United States Department of the Treasury], which Tim Geithner and his team was in charge of, and then folks from the National Economic Council [NEC], which at the time, Larry Summers, who you may remember, president of Harvard, was head of the NEC. He led the effort. To me, … the job of the housing team was to essentially fix the housing crisis anyway we could and come up with as many solutions as possible – when we were implementing HAMP [Home Affordable Modification Program] and had all the big services coming in periodically and that kind of thing. That was spearheaded by Larry [Summers] and Tim [Geithner].

Anyway, so my responsibilities at FHA officially were, I was a US Assistant Secretary of Housing and Federal Housing Commissioner. It's the number three job at HUD after the [Deputy Secretary], and the Secretary, of course. It has the majority of the employees at HUD, and we're responsible for the single-family lending business. We were, at the time: the single family lending business, insurance business, multifamily, and hospitals and nursing homes. And then on top of it, I had the Office of Regulatory Affairs [Office of Risk Management and Regulatory Affairs]. Much of that has been dissected post-Dodd-Frank [the Dodd–Frank Wall Street Reform and Consumer Protection Act] and moved over to CFPB [the Consumer Financial Protection Bureau]. But we did RESPA [Real Estate Settlement Procedures Act] and HMDA [Home Mortgage Disclosure Act] and things of that sort that came out at the time. But again, the primary mission obviously was — HUD had a very different focus from the GSE's. We're [HUD] not shareholder owned, but government owned. People felt a mission to help communities. So much of our work and the audiences that we dealt with were touring low-income apartments in hard-hit sections of Denver, flying to New Orleans with the Secretary and all of us to spend several days looking at some of the hardest hit areas after the floods that occurred there, and trying to help support recovery of those areas. …

I'll narrow into two areas of focus. One was I knew FHA was being adversely selected, and it's largely because after the collapse of the subprime business, FHA never had a credit score floor. You could originate I think down to 400. And if you look at loans that were originated — it's all public on their website, you have to go back and go through their data — but loans originated in 2007 and 2008 and 2009, there was a significant surge in loans under 500 credit scores, let alone 500 to 600, all of which are disastrous credit scores. But when the subprime industry collapsed, a lot of the originators flocked [to] companies that allowed them to come in and started originating some really bad stuff. And so we knew that expected defaults were going to fly through the roof.

FHA was also being impacted because of one product, the reverse mortgage program, and another product called seller funded down payment assistance. Those two loans, the seller funded down payment assistance, was a congressionally authorized product that allowed sellers to finance the down payment, which really not did nothing more than result in inflated home prices that made people have to live underwater in their homes, no matter what happened. And they had 30-ish% default rates. That [seller funded down payment assistance] expired in 2009, but we were stuck with that portfolio. And then the reverse mortgage program got moved from another fund called the GISRI [General Insurance and Special Risk Insurance] fund that handles multifamily into single-family, and the reverse mortgage program has just a multitude of problems – still does to this day — and has whipsawed the value of that fund around.

So, we had all these defaults coming in from the reverse [mortgage] program. We had huge problems with HECMs [Home Equity Conversion Mortgage], with technical defaults going on there, that still no one's ever really written a story on. And then, we had a ton of lenders doing really bad things by originating really bad loans. So I think in my first year and a half there, they self-terminated something like 1,100 lenders out of the program. And I chaired what's called the Mortgagee Review Board, and we would meet every month and review a whole slew of cases of lenders that had violated the guidelines and we'd either exact penalties or terminate them. Shaun Donovan once called me “Sheriff Dave….”

But, they really screwed up. We changed the underwriting standards. We put in a FICO [score] minimum. And there's some challenges to that because wherever you draw that line, it’s going to ultimately impact primarily minority borrowers because FICO distributions are not the same in African American communities, as they are white, non-Hispanic. So this was all data-driven, but we ultimately put in a 580 FICO floor, instead of having it go down to 400. And even there, there's a lot of risk, but most lenders even self-corrected by putting minimum [FICO scores] floors of their own at 620 to 640, so that problem got solved.

And then the other side of it was the meetings, which really became the majority of my time, was meeting with Tim Geithner, who led the effort on a day-to-day basis. And a team of about eight of us who met three to four days a week. Just focused solely on what do we do, what other solutions can we present to the President in order to help stem the collapse, because on all of this, the goals here during that period was to stop the bleeding, stop the downward spiral. That was number one. Number two was to protect as many homeowners as we could without creating moral hazard, which is a very difficult thing in policymaking. And that's why it didn't become a giveaway, even though that was discussed. And then third, was to implement a whole series of new rules and promote the Dodd-Frank legislation and more to help make sure this never happens again. And those were the three missions outside of my day to day job that I participated in, with obviously, a very interrelated team out of the White House, Treasury, and HUD.

Sean Nguyen: We have two more questions for you, David, and we're approaching the close of our interview. How would you say your experience in the private sector informed your perspective when in positions of leadership during your time in the public sector?

David Stevens: Well, look, I will tell you — and by the way, this is anybody who was in the business like I was — we all made mistakes in the private sector. We all were active participants in the business as it evolved to what ultimately led to the precipice. So, none of us, me included, could claim innocence.

But, I knew, walking into the door at HUD, more about how the primary market and the GSE market operated. I knew more about how that market worked than anybody in the administration. And I literally remember a meeting — at that time I would meet with the President fairly frequently, which was rare for an FHA commissioner — but we met about every three weeks because we were in the midst of what we were in. I remember one meeting I couldn't be there and they changed the meeting. And — short anecdote — my very first meeting with the President, I remember texting my wife. At the time, you could bring in cell phones, now you can't bring them into the Roosevelt room in the White House. But, I remember walking in the room and everybody's got a master's or PhD from Harvard [University] or Yale [University]. And I'm walking with my BA in political science, which I barely got because I skied too much. I thought it was absurd and I was literally going to sit in the back couches in the Roosevelt room. And it was Geithner who looked at me, and goes, “You're Stevens, right?” I said, “Yeah.” And he goes, “I want you at the table.” So besides the table, the President walks in, and he always had read everything. He was very knowledgeable — unlike the current guy — and he said, “Look, I've read all the information. I just have one question: Can someone explain what a warehouse line is?” And at the time, back in early 2009, mid 2009, the administration was contemplating using remaining TARP [Troubled Asset Relief Program] funds to create a warehouse lending facility because for people to fund mortgages, they needed short term lines of credit and that had all dried up. And so, the table goes silent and Tim [Geithner] looks down to me at the end of the table and says, “Stevens, answer the question.”

So I start explaining what a warehouse line is, which to me seemed like how to ride a tricycle, and no one else is understanding. No one else really could explain what it is. If they had understood it was a short-term credit facility, or we talk about a repo line [repurchase line], the Wall Street guys could've talked about it in that context. They had never heard the term warehouse line. So I started explaining it to the President and I look up and I see the President of the United States, who at time was sort of my hero, staring at me. So here's this rookie — unlike you guys who are getting your MPPs [Master of Public Policy] or whatever the hell you're getting in your academic pedigree — I was just the school of hard knocks, but I became extremely invaluable to the point where Tim would always want me in the room. Larry Summers would always want me in the room because I knew how the business ran. So if they're coming up with some crazy idea that they're going to get banks to do, I could say, “There's no effing way that's going to happen.”

So that, that became essentially my role for that period. And I ended when the midterm elections came and the Tea Party took over… in 2011, I knew nothing more was going to be done. And a lot of people were dropping like flies. I left, Geithner left, Diana Farrell, who is the player in the White House who really ran everything for Larry Summers, left. I mean, we started seeing these folks walking away at the midterm mark. And so I was never going to be a government guy, and I certainly didn't want to sit around and just run FHA for two more years. So I decided to exit the building.

Sean Nguyen: What extent do you see your personal experience as adding something to our project’s understanding of what happened in the run-up of 2007 to 2008?

David Stevens: Trust but verify. Always anticipate what could go wrong. It's interesting because this wasn't a bunch of ignorant people, right? You had Kings of Wall Street. This powerhouse that built Lehman [Brothers Holdings Inc.], and Bear [Sterns Companies, Inc.], DLJ [Donaldson, Lufkin, & Jerette]. All these guys on Wall Street, you had mega banks. Wachovia bought Golden West [Financial] for 30-something billion dollars, only ultimately to completely collapse and be taken over by [Wells Fargo]. Nobody saw what was coming. And I think a lot of that was because the pace of change, the introduction of technology, the uncorrected, untested real estate market in the United States created a euphoria that made people believe you can do no wrong.

And, Elizabeth Warren, who I've gotten to know very well, I have handwritten notes from her on my office wall because we've had a very good relationship.. . . "Why hasn't anybody gone to jail?" has always been one of her mantras. And I think the reason is, nobody — very few, at least, I mean [Lee] Farkas, there's few guys who are in jail right now — but very few people really committed a crime. It was a massive set of ignorant actions, not recognizing that creating false assumptions based on untested models that, ultimately, upon testing proved to be the biggest single failure in the US economy since the Great Depression. I see some of it now, quite frankly.

This shortage of inventory in the real estate market is creating unprecedented appreciation because of supply and demand stress. And I think home prices are just inflating well beyond what they should be, if we were developing a supply chain that made sense. There's a whole new growth of non-QM [Qualified Mortgage] lenders. … It's the qualified mortgage rule that everybody else abides by, including the GSEs for the most part. There's a whole bunch of quote unquote, non-QM lenders, bringing back ways to do stated income using bank statements and things of that sort. It's in its infancy, but there's got to be warning signs.

The other thing I would just say to you guys is you need strong regulators. Freddie and Fannie's regulator was weak. There was really no regulator overseeing the Wall Street expansion that had any heft. It was the SEC, I guess. So there, there was really nothing there. The attacks on the CFPB by the conservatives, to me, worries me. I think you need someone who's literally considered by the lending community as a pain in the ass. I think Rich Cordray was an extremely invaluable part of the housing finance system. [Joseph Smith, Former North Carolina Commissioner of Banks] down in North Carolina who I think referred me to you, played a big role. You need folks like that, that bring an independent oversight with heft, with power, with the ability to stop the train. And that just didn't exist.

State regulators didn't do their job. Federal regulators didn't do their job. They let Wall Street grow out of proportion and bank executives and GSEs were spending hundreds of millions of dollars collectively on their lobbyists. And to paper the campaigns and payrolls backside — not payrolls in an illegal sense — but the fundraising efforts of members of Congress. Wall Street can buy politics and you need to have civic leaders who have backbone and understand the business and will stop it when they see it's coming. And we didn't have it then. Even the head of the Federal Reserve, I was in a car with the CEO of Freddie Mac one day and he said, "I got to make a call." And he was on the phone with [Alan] Greenspan and they were like buddies. Literally, everyone was at fault for what happened here.

By the way, homeowners were too, but you can't blame them per se, because they were convinced. If the lender says I can borrow the money, I'm sure I can borrow it. But I do believe the hindsight right now is, we've got to keep that rear-view mirror front and center in front of every decision maker, executive finance executive. I think finance leaders should have an obligation to go through an annual risk evaluation. It should be a required reading to constantly look back at this period and compare what you're doing now to what happened then because the goal for profits and the power of some of the largest financial institutions is going to trump the regulatory framework, because we tend to create crisis regulatory environments, which is what happened post-recession. And that will weaken over time, especially as we go through a period of continued improvement.

Under the Republican administration — not to be partisan, but I'm going to be — this desire to weaken regulation, to allow the private sector to do its thing cause that's better for the economy. I just think that's ultimately shortsighted in this system. It's too easy to make mistakes and there's too much at risk.

[END OF SESSION]