AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Hank Cunningham

Bass Connections

Duke University

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PREFACE

The following Oral History is the result of a recorded interview with Hank Cunningham conducted by Michael Cai on March 23, 2020. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

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

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Interviewee: Hank Cunningham
Interviewer: Michael Cai

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Michael Cai: I'm Michael Cai, undergraduate student at Duke University, and a member of the Bass Connections team, American Predatory Lending and the Global Financial Crisis. It is Monday, March 23rd, 2020. I'm joined by Hank Cunningham over the phone for an oral history interview. Hank is the former president of Cunningham & Company, a mortgage bank that served the North Carolina area from 1990 to 2017. Hank, thank you for joining me today.

Hank Cunningham: You're quite welcome Michael.

Michael Cai: To get started, we'd like to know a little bit more about your career. When in your career did you first become involved with residential mortgages?

Hank Cunningham: I started to work with a company called Cameron- Brown Company, which was part of First Union Corporation in 1973, and worked with them from 1973 until December of 1984.

Michael Cai: Looking at your background, I see you spent almost your entire career in mortgage banking. I'm curious to know how you were drawn towards the industry after graduating?

Hank Cunningham: I went to Duke, majored in economics and political science and my father was involved in a related industry, which is the mortgage insurance business, which really was in its infancy. I graduated from Duke in '73. I would say the late '50s, early '60s, mortgage insurance began to evolve. My father was one of the early members of a company called American Mortgage Insurance Company that evolved and is now Genworth Mortgage Insurance. I was around the real estate mortgage business sitting around the dinner table. So, I really gained interest in real estate at an early age.

Michael Cai: … During your time as president of Cunningham & Company, I'm really interested in learning more about North Carolina's mortgage banking landscape. Could you describe your official responsibilities?

Hank Cunningham: I started Cunningham and Company in 1990. I ultimately sold the company at the end of 2011, but continued to work for the company that bought Cunningham and Company and then subsequently other mortgage companies since that point in time. I think your question really related to my role as president of Cunningham and Company. At that time, yeah there were certainly capital requirements in North Carolina to be a broker or to be a lender. I opted to be a lender. Well, there was a difference in capital requirements between the two. I also opted to be an approved FHA [Federal Housing Administration] lender, VA [Veteran Affairs] lender, and subsequently a Fannie, Freddie sellerservicer. Fannie Mae being The Federal National Mortgage Association, Freddie Mac being The Federal Home Loan Mortgage Corporation. So, I really began the company [Cunningham & Company] wanting to make sure that I had all the approvals required from the regulatory bodies, including the Commissioner of Banks in North Carolina, Federal Housing Administration, later the Government National Mortgage Association, Fannie Mae, and Freddie Mac.

So, I wanted to be positioned as an independent mortgage banker that had all the approvals necessary to [provide] the best loan products available to the consumer, as well as being able to control the process. As an independent mortgage banker, we weren't a bank, therefore to fund mortgage loans we had to use warehouse lines of credit. So, I had warehouse lines of credit with various banks to fund the loans that we were actually originating. I was also during that period of time, president of the Mortgage Bankers of the Carolinas in '90, '91, and still do it serve with the legislative committee for the Mortgage Bankers of the Carolinas in North Carolina, which means I interact frequently in North Carolina with the Commissioner of Banks as well as legislative leaders as we lobby and have conversations about different bills affecting our industry.

Michael Cai: What was it like to have this position as president during the housing boom?

Hank Cunningham: Obviously we were, during the housing boom, we were busy. But I would also say that it depends on what period of time are you really referring to when you talk about the housing boom?

Michael Cai: I think we're very curious maybe to the decade preceding the financial crisis.

Hank Cunningham: Okay. So, in the early ‘90s, there wasn't really a housing boom. In fact, in the early ‘90s when I started Cunningham and Company, it was actually a recession at that point. But leading up until the early '00s yeah, you're right, there was a lot of activity. Still most of that activity was what I would refer to as prime mortgage activity with independent mortgage bankers, banks, credit unions, community banks, all participating in the mortgage industry through the decade of the '90s that you’re referring to. Most of the product was vanilla, meaning that you didn't have many alternative products. If I think about the early days, you had some lenders that did offer what I'd refer to as subprime loans, but they were specialty lenders that really dealt in low loan-to-value higher interest rates, but rates that were fixed over a period of time, Home Beneficial being an example of a lender like that. So there weren't balloon mortgage payments, the borrower knew they were accepting a higher interest rate for their credit issues, they had to have a lot of equity in the property, so most of those were more refinances than they were actually purchases. Hope that answers your question.

Michael Cai: I'm very interested in what you were mentioning about prime mortgages versus subprime mortgages. For the subprime mortgages, was that something that you were seeing growing during this housing boom as well as some of these new mortgages that were coming out?

Hank Cunningham: Yeah, thinking back, that was a long time ago. Thinking back, I don't really remember. I mean there were mortgage products that were developed, during the '70s, '80s, '90s, that were mainly programs developed by the Federal Housing Administration to assist lower-income borrowers for affordable housing. There were products that were developed that were adjustable-rate products that had graduated payments. So, they were graduated payment mortgages during those earlier decades. But again, all usually part of the government landscape, whether it be FHA, Fannie or Freddie, but I wouldn't call them exotic.

I didn't really see a lot of that start to develop until the early 2000s, I guess 2001, 2002. Somewhere in the late '90s, maybe '98 or so, Fannie Mae and Freddie Mac both came out with their automated underwriting engines. Previously, you're underwriting a loan according to Fannie and Freddie's written guidelines that were contained in their policy manuals. So, it became a responsibility the lender to interpret those guidelines. And obviously if the investor, Fannie or Freddie, had a different interpretation, they would ask you to repurchase the loan. They came out with underwriting engines in the late '90s, that I automated part of that process and the agencies would instill confidence in lenders to rely on the findings of the automated underwriting engines, desktop underwriter or loan prospector, one of those two engines, and rely on those findings and only document what was actually required by the automated underwriting engines. So, I think that was the beginning of when lenders began to reduce some of the documentation from borrowers that had previously been required.

Michael Cai: You've mentioned some of the regulations from Fannie Mae and Freddie Mac. Could you tell us a bit about some of those government agencies, both state or federal, that you worked closely with on the issues related to the residential mortgage market?

Hank Cunningham: I probably, from a state standpoint, worked with the Commissioner of Banks Office in North Carolina. I also was really active in the Mortgage Bankers of America. And later, after the crisis, served as chairman of the Residential Board of Governors of the Mortgage Bankers of America and had the opportunity to testify before Congress about the Crisis and some of the things that were being proposed afterwards, such as Dodd-Frank. So, working with Fannie or Freddie would have been through the Mortgage Bankers Association of America, not on a local level or a state level.

Michael Cai: Between these federal and state regulating agencies, did you see any kind of overlap in their duties and was there any tension between federal and state agencies?

Hank Cunningham: So, if you were thinking about Fannie Mae and Freddie Mac, they were both government sponsored enterprises. Unlike FHA and VA loans that are put into securities with the Government National Mortgage Association (Ginnie Mae),securities have the full faith and credit of the U.S government. Loans put into securities for Fannie and Freddie who are government sponsored enterprises i, don't have that full faith and credit They have an implied faith and credit because those GSEs [government sponsored enterprises] were really semi-private. Both were authorized [chartered] at different times, Fannie Mae in the '30s during the Great Depression, and Freddie Mac later – seems like it was in the late '60s – to provide access, really to provide liquidity in the [mortgage] marketplace. So we, as a lender, could put a conventional loan into a mortgage backed security, Fannie or Freddie mortgage backed security, and sell it into the marketplace. And it made the marketplace very liquid. That was certainly a positive in terms of bringing competitive rates to the consumer.

Do they overlap? Yes. A lot of their products do overlap, and yeah, they also competed with each other. So, there is a lot of competition between Fannie and Freddie, competing in the marketplace as it relates to Fannie, Freddie, trying to override— I wouldn't say Fannie and Freddie were trying to override state regulations. I would say that, some of the banking regulators, supervising national banks might try to override state law to create a federal preemption so that national banks could lend across all fifty states without having to adopt different standards in different states. But that became important, I think especially as different state regulators began to see rising delinquencies regulations passed at the state level, North Carolina being one, the first actually, that passed the Predatory Lending Bill of 1999. So, North Carolina is the first to start paying attention to some of those things, and [federal] banking regulators would try to preempt that to allow national banks to continue to lend in all fifty States without consideration of a patchwork of state laws.

Michael Cai: …I'm also interested in hearing what your interactions were with consumers at the time, people hoping to get mortgages, looking to borrow. What do you recall from those interactions in the decade leading up to the financial crisis?

Hank Cunningham: When I say typical, you're offering primarily thirty-year fixed-rate and adjustable-rate mortgages. But adjustable mortgages that had caps and were typically 1 year, 3, 5, 7 and 10 year, adjustable-rate mortgages, all of which had caps. Thirty-year fixed-rate mortgages, all of which could be sold to Fannie and Freddie. FHA loans, that were typically thirty or fifteen-year,l. VA loans, which were 100% for veterans. U.S Department of Agriculture (USDA), they had a product that was a 100% product in more rural counties. But there was nothing exotic about those mortgage products at that time. Underwriting guidelines were pretty vanilla. You had to document income, you had to document assets. You looked at credit. . Did you believe, as you're underwriting the loan, that the borrower's credit history would lead you to believe they had the ability to repay the loan you're getting ready to make. So, leading up to the crisis, really, we're talking about in the '90s, I'd say that it was a plain vanilla world, at least what I experienced in North Carolina.

Michael Cai: And specific to the months leading up to the Crisis, did you see your interactions changing at all? And what changes did you experience?

Hank Cunningham: I'm sorry, repeat that question.

Michael Cai: As we mentioned the decade leading up to the financial crisis, but in particular, in 2006, 2007, 2008, were these interactions you were having with consumers changing at all, and what changes did you experience?

Hank Cunningham: There were a lot of products that were available to consumers in '06, '07, '08, and even prior to that, probably beginning in 2001 or maybe 2000. Evolution occurred. There were adjustable-rate products that were certainly available. You began to see products that required less income documentation, some stated income products where the borrower just stated what their income was. Some products that were no income, no asset; meaning they didn't verify the borrowers' income, you didn't verify their assets. So, from my perspective, it moved away from traditional mortgage lending. Lenders such as, I use Countrywide as an example, had a product called "fast and easy," and that product was a stated income even for a borrower that was a W-2 salaried borrower.

I wouldn't participate in those products because from my perspective, if a borrower wasn't willing to give you a W-2, which is a pretty simple form of documentation, then the only reason was because they weren't being truthful about their income. So we really, Cunningham & Company didn't really participate in any of the no income, no asset products, but there were a lot available. There were big players, including Countrywide, Washington Mutual Savings Bank, Great Western. Those were just an example of a few that were really big national lenders using a lot of what I'd call "alternative mortgage products." Alternative meaning deviating from standard mortgage documentation.

Michael Cai: Did you ever feel any source of competition with these national mortgage lenders that had these alternative mortgage products?

Hank Cunningham: I mean, we certainly had competition. I could have, as a lender, could have originated those loans and sold them to those lenders so I could have offered those products. But quite frankly, I was concerned about the sustainability of that product and my obligation, or liability, if the borrower went into default, to have to repurchase those loans. So, I was probably more conservative during that timeframe because of my concern about the financial health of the company and the risk of having to repurchase at a later point in time if borrowers went into default. I think a lot of that [product] was built around the idea that real estate values only went up. They didn't go down.

And quite frankly, for a lot of decades, that was true with the exception of probably the oil patch states, maybe in the '80s or so, when values really declined because of problems with the oil industry. Real estate values, nationwide, hadn't seen a significant decline. So it was almost— I'd equate it to musical chairs. As long as real estate values go up, borrowers could refinance out of these loans they originally purchased the property withr— could refinance out of those loans up to a more standard product once their credit or income situation improved. Well, once real estate values went down, that was no longer possible. And obviously, as rates went up, some of these borrowers were trapped in these alternative mortgage products and it led to significant delinquencies and repurchases of loans by various lenders.

Michael Cai: You mentioned the concern that you had with some of these alternative mortgage products. And you mentioned how your company, for instance, always required W-2 forms from potential borrowers. Was this concern something that you saw from some of those other mortgage banks at the time? And did you and your colleagues express any other concerns related to the housing and mortgage market during this lead-up to the financial crisis?

Hank Cunningham: I guess to answer your first question, I wouldn't say we didn't participate in some alternative credit products. I never participated in no income, no asset products, and we didn't participate in products that were adjustable-rate products that required a prepayment penalty that would tend to trap a borrower and were based off a payment rate rather than the actual interest rate. Those products were all available. We could have participated, we chose not to. A lot of the conversations that I had, and the industry had, really in North Carolina, between Joe Smith and Mark Pierce and Martin Eakes, in Durham. We all had a lot of conversation about mortgage products and probably about the time that some of those— what you described in 1999 with the Predatory Lending Bill. We had a lot of conversation about some of those products that were beginning to evolve. And that bill began to restrict some of the practices at that point in time that the industry was beginning to see. I think on a nationwide basis there was certainly resistance to adopt some of those early warning signs that North Carolina had adopted right at the turn of the decade.

Michael Cai: I think the 1999 North Carolina Anti-Predatory Law is definitely something I want to touch more on. So, could you speak about what those conversations were like with Joe Smith and Martin Eakes? What was your thought on the policy during its passage and how it was implemented in its aftermath?

Hank Cunningham: So, I think a lot of the conversation we had, and it was a policy conversation, we were both trying to all seek solutions. So in between, you've got access to credit. Certain borrowers might not have access to credit because of their credit histories. They may not have access to sufficient funds for down payment. During that same period of time, if you think about the Clinton administration trying to create a legislation CRA [Community Reinvestment Act] that would provide greater access to credit for borrowers through the banking system. There's a lot of conversation about how to drive up the homeownership rate for consumers that were getting closed out of the opportunity. So, part of that conversation was, how do you grow the homeownership rate in the United States? And there was certainly a movement at the federal level to do that, even Barney Frank, if you go back in time and listen to some of his dialogue in the late '90s, he was supportive of some of the same things that Dodd-Frank later came back and addressed.

So, I think there was a changing dialogue over a period of time moving from trying to be creative with mortgage products that provided the opportunity for home ownership that evolved into products that, as a result of greed, provided the opportunity but also trapped the homeowner in a product that might not have been a good product long-term, and trapped them with a prepayment penalty, and potential for rising interest rates. So changing dialogue over that period of time, I think that was reflected in some of the dialogue that Martin Eakes, Joe Smith, and I and others had around the table, of talking about the Predatory Lending Bill that really began as a discussion about how to limit fees that lenders were charging, and evolved into the bill that was passed in 1999.

Michael Cai: And when the bill was passed, amongst your colleagues in the banking industry, how was it generally received?

Hank Cunningham: I will tell you that how it was received in North Carolina, and how it was received elsewhere, might be two different answers. In North Carolina, I don't remember a big uprising regarding that. I do remember a lot of conversation and a lot of negotiation to try to get a bill in place that was workable and didn't cut off credit to consumers that maybe didn't have the best credit scores. However, if you look outside of North Carolina, large national lenders, especially those that were offering alternative products, voiced a lot of concern even to the point of saying, "We're no longer going to do business in North Carolina," and might have quit for some short period of time. But I think what took place in North Carolina evolved over the next few years and [spread] to many states.

Michael Cai: And so did you think that policies, like you previously mentioned the changes to the Community Reinvestment Act as well as this 1999 Anti-Predatory Law, do you believe they were effective in accomplishing the goal of increasing home ownership?

Hank Cunningham: Well, the Predatory Lending Bill would be the reverse. It might have cut off some products that would have increased home ownership, but would have added a greater focus on sustainable homeownership, if that makes sense to you.

I think that if you really look at how a lot of this credit evolved, you moved from an environment, I'd say in the '90s where Fannie and Freddie, FHA, USDA, those loans were made by lenders and brokers, but lenders had a significant share of the marketplace, brokers were a small component of that marketplace. But, as these other products began being offered, brokers were a great avenue, salesforce if you will, to promote those products. And as a result, their share of market, of mortgage loans made, increased significantly. Those products were enabled by Wall Street firms that created private mortgage backed securities, not mortgage backed securities where Fannie and Freddie were the issuers or we were issuing for Fannie and Freddie, but private mortgage backed securities, that were composed of these alternative mortgage loans that the rating agencies rated. So, you had Moody's and others that were rating the private mortgage backed securities, and I don't know how far you want to go on this dialogue, but at that point, Fannie and Freddie, I'm thinking 2005, 2006, 2007, began to recognize that from a competitive situation they were, and I'll put it in quotations, "missing out," so they began offering some alternative mortgage products. Not as creative as some offered and put into private mortgage backed securities, but they too were participating at that point.

Michael Cai: The first concluding question is, over the last decade, we've seen a number of different narratives emerge to explain the financial crisis. How do you understand what caused that Crisis?

Hank Cunningham: I think that the first thing that caused the Crisis was lenders making available products that didn't create sustainable homeownership; putting borrowers in houses that probably had no business owning a home at that point in their credit cycle. Well, I think the first step was product. I think the second step was, we had an environment where we were trying— “we” being the federal government – to encourage homeownership and to grow homeownership. Some of the earlier CRA and other programs being an example of that. But then you had Wall Street firms that began to create these private mortgage backed securities. And if they'd only created the mortgage backed security, and those borrowers went into default, I don't think the Crisis would have been as extreme. But rather than just leave mortgage backed security with whole loans, they sliced it into different tranches and created alternative instruments like credit default swaps that created further leverage. So, rather than individual home loans in this mortgage backed security, you were selling different tranches, which just multiplied the leverage, and it just multiplied how severe the downturn was. And they were not just sold here. They were sold all over the world. Sold to insurance companies, companies like AIG [American International Group] were offering credit default swaps, and I think at the end of the day, when Treasury had to step in and the Fed stepped in, I think they ultimately picked winners and losers. And some firms survived, others didn't — like Bear Sterns or Lehman — survive. AIG did survive. Goldman [Sachs] survived. So, I think that the lesson learned was the importance of making sure we've got mortgage products that create sustainable homeownership.

Michael Cai: Looking back on the Crisis over a decade later, what were some of the important lessons that you think mortgage bankers can take away?

Hank Cunningham: Well, I think one was, again, returning to the roots of documenting income, assets, etc., which are required under Dodd-Frank, I think was important to the process. I think that we had a lot of pieces that came out of that, whether it be the SAFE Act [Secure and Fair Enforcement for Mortgage Licensing Act] that licensed mortgage lenders, mortgage originators, independent mortgage bankers, and [established] a federal register that follows each individual loan officer. So, from a regulator standpoint, you have greater transparency to see the bad actors if you will. So, we've got the SAFE Act, Dodd-Frank required documentation, debt-to-income requirements, we put Fannie and Freddie into conservatorship. They're still in conservatorship, I don't think that's a good thing to be in. And we've got to find a way for Fannie and Freddie to get out of conservatorship. But, I think the lessons learned are: products that are sustainable for borrowers creates sustainable homeownership, lenders taking the responsibility to document income and assets and credit history. You've got the appraisal rules around appraiser independence, that kind of creates a wall between the loan officer and the appraiser, so that you have a better opportunity for fair value to have a role. So, I think all of that documentation, all of those things that evolved, I think were prudent. I think there are certainly things that we can modify and improve the process and I'm sure we'll continue to do so.

Michael Cai: And lastly, we wanted to know, to what extent do you see your personal experience as adding something important to our understanding of what happened in the run-up to 2007, 2008?

Hank Cunningham: I'm not sure I understand the question.

Michael Cai: So I guess we're just curious to hear, how your personal experience would be useful to our understanding of the events that led up to the financial crisis.

Hank Cunningham: Well, I think everybody that you've interviewed, and I don't know how many people you've interviewed, but everybody's got a different, or many can have a different perspective. I think that as an independent mortgage banker operating in North Carolina with the responsibility and liability to repurchase loans that didn't perform, I may have operated differently than a large national lender with shareholders, or a national bank with shareholders might've operated differently because it's my personal balance sheet versus a balance sheet financed by shareholders. So, I'm giving you my perspective as a smaller independent mortgage banker who also was positioned to sit down with the regulators in the state, other constituents,- groups in the state, to talk about legislation. In my perspective too, serving and being active with Mortgage Bankers of America, and seeing how some of that legislation played out maybe gives you a different perspective than others you might have interviewed.

Michael Cai: And so, just wrapping this up, I was wondering is there anything that you feel like we should have asked or something you want to add to your responses to today's questions?

Hank Cunningham: The only thing that I would comment on is I think that, and I'll use Fannie and Freddie for instance, Congress put in place housing goals for Fannie and Freddie. I don't remember — I think it was probably in '98 or so, maybe around the Clinton administration, but you'd have to fact check that for me. But, [Congress] put in housing goals for Fannie and Freddie —they were well intended. Intended to create an opportunity to provide homeownership to the underserved. But over time, the only way that Fannie and Freddie felt they could meet some of those housing goals was either A.) to originate lower quality loans or B.) purchase those loans in the marketplace.

So, I think that some of those housing goals at least encouraged Fannie and Freddie to reach in their lending beyond what might've been prudent at the time and what might've been their typical underwriting standards. So, their credit standards changed around some of those housing goals. And then, I think that the availability of capital and the desire for yield, so now you can interpret that as greed, really drove Wall Street, and exotic bifurcations of the security process just blew up a housing market that wouldn't have been nearly as bad as had those loans been whole ones rather than in mortgage backed securities that had an infinite amount of leverage.

[END OF SESSION]