AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Jonathan Miller

Bass Connections

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PREFACE

The following Oral History is the result of a recorded interview with Jonathan Miller by Andrew O'Shaughnessy on July 6, 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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Andrew O'Shaughnessy: My name is Andrew O'Shaughnessy. I'm a J.D. Candidate at the Duke University School of Law. I'm also a research assistant for the Global Financial Markets Center, American Predatory Lending project. It is Monday, July 6th, 2020. I'm speaking remotely with Jonathan Miller to conduct an oral history interview. Mr. Miller, thank you for joining me today.

Jonathan Miller: Thank you, Andrew. [I] appreciate the opportunity.

Andrew O'Shaughnessy: We'd like to start just by establishing a little bit of background, so I understand you attended Georgetown and then [received] a master's in public policy from the Kennedy school. But I think there was a little bit of time in between those two degrees. And I couldn't find much about what you were doing then.

Jonathan Miller: I taught in a small, private high school in Southern Maryland. Sounds not too different than -- in fact the whole school was probably about 80 kids.... And I did that for four years or so. Then I worked in electoral politics for a year and then I went to the [Kennedy School]. So ... altogether it was, what was it? Six years between when I graduated and when I started school. There [were] a few months there where I was a bike messenger in DC too.

Andrew O'Shaughnessy: So, what took you from Harvard to [Capitol Hill]?

Jonathan Miller: It's probably easier to start at being a teacher. So, the school I taught in was called the Canterbury school, in Southern Maryland. …. It was [a] very diverse in every way kind of school and a lot of kids there had challenges and it struck me after three or four years there that …it would take too long and be pretty difficult to solve every person's, every kid's problems, one by one in the school. …

And so, I concluded that you would -- the way to solve a lot of people's problems at the same time was through politics and government. So, I went from teaching to working in politics. This was in the 1984 cycle. And then I [went] to public policy school at Harvard and then to the Hill because it seemed -- I graduated in '87. I was a pretty strongly identified Democrat. There were some opportunities. There were opportunities to go into the bureaucracy and a number of places. But Ronald Reagan was President, and I wasn't yet prepared to do something like work for him. The Hill seemed like a great alternative. And I started in Chuck Schumer's office, [he] was one of the smartest and savviest and best members of Congress. And so that was a terrific start.

Andrew O'Shaughnessy: So, how long did it take after you began working as a congressional staff member for you to encounter issues related to residential mortgage lending?

Jonathan Miller: I pretty quickly ended up with the housing portfolio, which [was] for Chuck Schumer, a representative from New York, Brooklyn, … very important. Both issues of affordable housing for low-income residents and affordable housing for working class folks. And again, if you're in New York or you understand the importance of both rental housing -- the important focus on rental housing and having adequate and affordable rental housing, as well as home ownership opportunities. That was sort of my first exposure to that world.

Andrew O'Shaughnessy: So, that's the early nineties or so at that point?

Jonathan Miller: Late eighties.

Andrew O'Shaughnessy: …[W]hat were… the big issues of the day?

Jonathan Miller: Oh, It's a long time ago. So, I would say there was a big emphasis on adequate funding for public housing. That was really starting with Carter and then [got] dramatically worse with Reagan. We started seeing real cuts in support for affordable housing, including public [housing]. And there was a real, and justifiable in my view, animus against the Reagan administration for its reduction in support of affordable housing, and in particular public housing…. I remember, when we were working for Schumer, the budget for HUD [US Department of Housing and Urban Development] had declined by a third or something like that. So, we actually proposed a bill to take a third of the floors of HUD and turn them into a homeless shelter, sort of as a way to make a point. There was a lot of focus on -- so it was during my time in Schumer's office, that the Urban Development [Action] Grant, UDAG it was called, there was already CDBG, [the] Community Development Block Grant, but the Urban Development Block Grant, was UDAG. I can't remember now what exactly [it was named] ... or my memory is gone. So, that got killed while I was there.

And we tried to get that restored unsuccessfully. That tended to be more economic development focused, but that's an important element in supporting low-income housing. We did a project, … in East New York, which is [the] East part of Brooklyn. It was called Nehemiah Homes. This was a brainstorm of a local guy who developed a non-profit.… And again, people don't remember New York, or they think of New York today, which is closer to Disneyland where everything is, every neighborhood is, especially in Brooklyn, I mean, prices are going up, rents are impossible. It's impossible to find housing. In the late eighties it was a different world.

This guy, Mike Gecans, I believe his name was G-e-c-a-n-s, if memory serves. He managed to raise money and buy a plot of land and built a significant amount of home ownership, housing, row housing, typical for Brooklyn... but for middle-class working-class people. And the theory was, if you create enough of a concentration of working-class housing, it would support small businesses. And those would be -- you'd see that started to develop, and you'd start to see the redevelopment of neighborhoods and bring back neighborhoods, from the inside out. And I think that has proven to be pretty successful. The Nehemiah project, I think it was

called -- I saw an article about it in the last several years and it is apparently doing pretty well. So, that was the focus for us then. The focus was really creating the opportunities and maintaining affordable rental housing to the extent that we could.

Andrew O'Shaughnessy: …[Y]ou had a number of roles as a staff member in Congress, and then you wound up settling into a position on the Senate Committee on Banking, Housing, and Urban Affairs. How did that come about? How'd you make your way there and then why did you stay?

Jonathan Miller: So, I moved eventually to the office of Representative Joseph P. Kennedy II, the current Joe Kennedy that's in Congress is his son, so the third. And Joe came from Boston and very similar to Chuck, housing is an incredibly important issue in Northeastern metropolitan areas, particularly cities, and Joe Kennedy became the top Democrat on the Housing Subcommittee[of] what was then called the House Banking Committee. And I was his Legislative Director and his chief policy person on that subcommittee. And we did an awful lot of work on housing preservation, preservation of affordable housing, on reform of public housing, attempted reform of public housing. And actually, he was the author of the first bill, at least the House author of the first bill that I know of to address predatory lending -- the Homeowner and Equity Protection Act of 1994, [or] HOEPA. And he did that as the chairman of a different Subcommittee in the House. So, another guy was his chief staffer for that, but that was my first exposure to that whole issue.

Andrew O'Shaughnessy: So, did you work on HOEPA, or did that slightly preceed your time in the office?

Jonathan Miller: I was working for Joe at the time, but it was mostly done out of his Banking Subcommittee, which was run by Shawn Maher. Maybe somebody you want to talk to as well about that issue. And they put on a series of terrific hearings. Bruce Marks, he runs or ran a nonprofit. I'm going to forget the name of it, but it was extremely aggressive. ... I believe one old Wall Street Journal profile of the guy that I would recommend you take a look at -- he's from the Boston area and does work around the country. He does it. And I think he was probably one of the chief advocates, pushing or making the most noise and pushing the issues concerning predatory. At that time, I was where he was.

Andrew O'Shaughnessy: So, I imagine that after HOEPA was passed there might have -- what were the next mortgage lending related issues?

Jonathan Miller: One second. I didn't answer your previous question. So, what happened was, having been the sort of chief Democratic housing staffer in the House -- when that job opened up on the Senate committee, I moved over to Senator Sarbanes and Senator John Kerry, who was the Ranking Member of the Housing Subcommittee [and] Sarbanes was the Ranking Democrat of the full Banking Committee. And so, I moved over and just continued to work on the same set of issues. I would say -- so then what started to happen -- the first few years of my time there, they were really focused on legislation involving preserving section 8

housing and public housing reform. So again, context here is important. In the intervening time we had the new Gingrich Revolution, the Republicans had taken over both houses of Congress.

There was a lot of focus on “welfare reform”. And I put that in quotes because people won't see this recording. And that bled over into housing a little bit, with the goal of, how can we move people out of public housing? They shouldn't be living there for so long and so forth and so there was a big -- and I think also public housing was based on the 1937 Housing Act [under] Franklin Roosevelt. There was an effort to extirpate the New Deal from the Federal Code. And ... that was an issue, very loaded, that took several years to resolve. I think it was finally resolved, reasonably well, from my … point of view. And that was probably in '98.

It was after that, that I started hearing about issues with predatory mortgage lending. I would say that a majority of the concerns came to me through advocacy organizations, NCLC, [the] National Consumer Law Center was one of the big ones. Margot Saunders was … was sort of their liaison to the Hill. And she had a lot of credibility with the Sarbanes staff and others. And Sarbanes represented the state of Maryland, including Baltimore and Baltimore was a place where there were a lot of problems. They had a very good person in Baltimore, too, who worked for the legal services, or the equivalent of legal services named Diane Cipollone, if I recall correctly.

So, we had good reason to be supportive of doing something, both policy [wise], because it was something that we believed in, and politically, because it was hurting our own big city. And Sarbanes' colleagues in the Senate, Barbara Mikulski, and in the House, Elijah Cummings, were all hearing about this. All the offices were very concerned about it. This came to us in many ways. One was a big case dealing with a subprime mortgage servicer named Fairbanks. And learning about how Fairbanks really screwed the subprime borrowers for whom they serviced mortgages was really an insight. We also heard--

Andrew O'Shaughnessy: Do you recall what that looked like?

Jonathan Miller: It was a pyramiding of fees. It was... you would pay your mortgage. And remember, you're writing a check and you're putting it in the mail, and they opened a check, but they don't deposit until after the due date. So, you're hit with a late fee [and] now you don't owe $800, you owe $875 on your next payment, but you don't realize that. You pay the $800 and now that's an insufficient payment. They get the payment. So, you're late again, and the fees start piling up and now you're delinquent. So, they pay an appraiser, which coincidentally works for them, or is an affiliate of theirs.

And you're paying now $800 or $500, whatever it is. It was an appraisal fee. Now we want to make sure that our lien is perfected. So, we have our attorney make sure this also works for me, Fairbanks. …. But these are subprime borrowers, likely to [have] lower income, perhaps less true than now, but income not as consistent, not as regular. Maybe it's a truck driver and they have leaner and better months and

so forth. All of a sudden now you have a bill you can't possibly pay, and none of it is [an] accident. All of it is based on policy, ... unwritten procedures of how you're going to gin people up. And at the end of the day, you [Fairbanks] have the House.

So, the FTC [Federal Trade Commission] -- we got involved pushing the FTC to take action. They took action. There was a settlement. We tried to keep track of that, but that was my first real taste. Now, we also saw the more traditional kind of predatory lending, equity stripping, lending that was really hurting Baltimore neighborhoods. Again, Baltimore has a series of pretty good non-profits that will work with deep roots in the neighborhoods with which Senator Sarbanes was familiar, and Senator Mikulski. So, they had credibility and they would walk us through the kinds of things that they were seeing. Now we're talking loans that people cannot afford to repay. Basically, lending on the equity in the home. Serial refinancing till the equity is stripped out, the high points and fees. In many cases, the FHA [Federal Housing Administration] was an unwitting partner in this -- the poor FHA has a lot of sins to atone for, even when it intended to do well. I think it hurt a lot of neighborhoods. It's a mixed story that's for sure.

Andrew O'Shaughnessy: Could you elaborate on that? Like, in what ways did they enable equity stripping?

Jonathan Miller: So, they did not. Actually, Mikulski had a series -- Kit Bond who was the chair-- Mikulski was on the Appropriations Committee, even when she was in the minority. She was the ranking Democrat on the Housing Subcommittee of the Appropriations Committee. And Kit Bond, who is a kind of Republican you rarely see these days, had a commitment to affordable housing -- and we got windows through the FBI [Federal Bureau of Investigation] and Mikulski. He let Mikulski hold a series of hearings, and there's a public record. In Baltimore, there was just a series, it was pure fraud. There were straw buyers-- I mean, this was part of it. This was one branch of it, I think. But it got to be pretty serious in Baltimore, and there were other problems too. But it was straw buyers, fake appraisers on the take.

In fact, the FBI got wind of this because an appraiser -- and then loan officers making FHA loans, which were insured. So, the FBI got wind of this, because one of the mortgage realtors or brokers in on the deal hadn't paid the appraiser, what the appraiser thought he or she had been promised. So, he [the appraiser] calls up the FBI to complain that he'd been ripped off. That's the most blatant form, but there were others where ... you have a legitimate home buyer, they would see a property. They would be promised a property that might not be up to code now, but go ahead, we'll close the loan and we'll fix it up after that. And it never gets fixed up. So, it becomes an FHA loan. And it becomes uninhabitable. So, it not only hurts the FHA fund, but it hurts the neighbors because rather than being an asset in the neighborhood, it's an eyesore, it's an abandoned building. Over appraisals ... again, these seem to be the provenance of FHA tools.

Andrew O'Shaughnessy:So, the problem is insufficient scrutiny of the mortgages that they're guaranteeing?

Jonathan Miller: Right. And there were some reforms that were put into place as a result of that.

Andrew O'Shaughnessy:You mentioned with Fairbanks, the FTC had the legal authority to address the problems once they were raised. And FHA, similarly, for at least some of the issues, once they got wind of what was going on and had some pressure applied to them, they could do something about it too. I'm curious, these problems sound pretty bad, what tension was there, if any? And from whom, was there [tension] in creating new regulations to address some of these?

Jonathan Miller: So, in 2001 Sarbanes became chairman of the committee and we held two powerful hearings on predatory lending. This is all [in] the public record. And then another issue of predatory lending, generally speaking, and then another, specifically on the issue of yield spread premiums. I would recommend [you] at least glance through the record of those, some of them. I have to say -- so we worked very closely with Congressman John LaFalce in the House, who was in the minority still, to craft anti-predatory lending legislation. And we worked very closely with a number of advocacy groups. In particular, the Self-Help Credit Union, which there was no Center for Responsible Lending yet. I had seen Martin Eakes speak, I can't remember where it was. And, yeah, I mean, the guy, have you seen him speak? You must've, you were in North Carolina...

Andrew O'Shaughnessy:Actually. I've talked to a number of people from Self-Help, but not yet.

Jonathan Miller: There's got to be a YouTube of him speaking somewhere. He's an amazing guy, charismatic. He talks about how he started. So, why and how he started Self-Help with a bake sale. So, he's working his [butt] off, you know, to help African-Americans, in particular, initially into home ownership. And then he started seeing people come to him, to the credit union, with these loan documents of refinances of loans that he had given them, which were terrific, or maybe not even his loans, saying I'm going to lose my house, help me. And he looks at these documents and they were from some place called Associates, which, later on, would be New Century.

Associates at first was not bad. At least we thought. And these loans with terms that were absolutely predatory in the sense that they were unaffordable. A person could not pay the mortgage and meet her or his other obligations, utilities, taxes, transportation, just couldn't do it. So, these were loans that he would say, "were designed to fail." So, either you could refinance them with charges, [and] huge amounts of fees, which would just go straight to your bottom line as the lender, or eventually you get the property. And the property was always worth more than the loan. And, as he [Martin Eakes] said, it really pissed him off and he made it his life's work to stop it. And he tells some pretty good stories, but, absolutely, he's incredibly charismatic and devoted. I can't quite remember how we met, LaFalce's office or me and Sarbanes' office -- somehow, we reached out to them, and we included [Self-Help] in developing that first legislation.

That was in 2001 or so. We had a couple of hearings, I think, that helped us develop the foundation for the legislation, but we couldn't -- it was, at the time, a pretty progressive piece of legislation. And, frankly, unlikely that we, at that time, would have even gotten it out of the Banking Committee without making significant compromises. Cause we had plenty of more conservative, more moderate Democrats and it was not yet a widely perceived problem. Then, WorldCom and Enron happened, and we got totally diverted into that and that grew into Sarbanes-Oxley, which was all consuming.

Andrew O'Shaughnessy: So, I'm curious, before those developments shifted the agenda, what were the grounds for opposition to the legislation that you had put together?

Jonathan Miller: So first of all, this may not have flipped you because you've been doing a bunch of work here, but I think -- it's interesting actually, you're making me think as I respond to that. We may be living in a unique moment in understanding, in some ways, the completely parallel lives that particularly African-Americans lead in the United States. But it's an unusual moment and it's new. In 1998, 2000, and 2001, if you told people that loans were made on this basis, they just didn't believe you, or it's such a minor thing or it's ... why are they being so stupid? Why'd they -- it was so outside the experience as a typical staffer, that it just -- I bought a house [and] that was not my experience.

First of all, I actually knew some, a friend of mine was a mortgage banker. So, I had a level of trust. I mean, I had options, I had choices, I was a reasonably good credit risk, all the rest of that. It is outside of the everyday normal experience of a typical Capitol Hill staffer, and certainly outside of the experience of most members of Congress. And that bill that was written in 2001 or so was incorporated as part of Dodd-Frank by Mel Watt. Mel Watt became the chief author of that [bill] in the House. And it got incorporated in a House version of Dodd-Frank, and then it lived through the conference. The truth is it was important. It lowered the triggers for what was a HOEPA loan, probably most significantly both the points and fees in the APR [annual percentage rate] triggers.

I sort of forget some of the other things that it did. But, in truth -- by the time we were hitting the -- it would not have addressed the issues that blew up the market and the economy in 2000, because we didn't have these 2/28 hybrid ARMs [adjustable rate mortgages] or the interest-only, or pick-a-pay Option ARMs that let you pay less than even the interest, where the principal would accrue. So, I think that was basically it. The notion was you're going to pass this law [and] you're going to cut off credit to a whole segment of people, and they'll never become homeowners. And the notion is [that] it's still somewhat un-American to say-- well, you look at the reaction on payday lending loans.

People need access to credit. And even if that credit, [with] the conditions it's offered will almost certainly result in driving that person into deeper financial trouble, just seems un-American to deny them the opportunity. At least it's un-American, if it's done by the government, it's not un-American if it's done by a bank or another lender. Then it's just a business decision to make, to simplify things. But I just

think it was too outside of the lived experience of most of my colleagues and certainly the other senators and members of congress.

Andrew O'Shaughnessy: You mean, because these loans were disproportionately being marketed to disadvantaged communities and communities of color.

Jonathan Miller: Right. When a Senator or a Member of Congress needs a loan, they don't have to worry. They're not worried about being sold a crappy product, where they're paying six or seven points just for the privilege of paying APOR [average prime offer rate] APOR plus five percentage points. They're getting a prime product and they're getting a prime product experience, as members of Congress. Oftentimes with kid gloves. Even staffers would typically get pretty good -- most people are prime borrowers. So, they just didn't have the experience of living in this alternative credit market then. I mean, not just African-Americans, but disproportionately African-Americans. I mean, it was always a goal of ours, when we got witnesses to the committee, we wanted to make sure we had some consumers who had been ripped off that were white. Because it would have been too easy to dismiss it as a problem in the black community and had it been able to be dismissed in that way, it would've been easier to look the other way.

Andrew O'Shaughnessy: So, the draft legislation that came out of these hearings, would you characterize it, for all the reasons that you were just describing, as pretty much dead on arrival, with a lot of committee members, or was there real big risk organizing on the part of industry to push some of the arguments that you recall hearing?

Jonathan Miller: Oh, the industry clearly saw it as a shot across the bow. They knew it wasn't going to pass. And of course -- but they also knew it wasn't the end of the debate. There continued to be, for right up [to], active debates about predatory lending and predatory lending legislation, up to Dodd-Frank. I mean, in the House, Bob Ney, a Republican of Ohio, even had developed a bill that he tried to get Barney Frank's support for, which ended up going nowhere. But again, I think it became harder and harder for people to ignore what was going on.

Andrew O'Shaughnessy: So, when did you start seeing the first movement on, after this -- what were some of the next milestones in that debate before Dodd-Frank?

Jonathan Miller: Well, I would say most of the action, once the Republicans took back the Senate, was in the House. And again, I give a lot of credit to Barney Frank for keeping the issue alive there. Barney is a formidable guy. There was not a lot of activity -- so there was, let me just, I'm trying to remember now. I don't think there was a lot. Again, we didn't control the agenda in any way.

Andrew O'Shaughnessy: You said there were -- [when] did the Republicans take the Senate back?

Jonathan Miller: So, in the 2000 election campaign, the Senate was 50, 50, and then Jim Jeffords switched. So, in 2001 [and] in the election of 2002, so starting in 2003, the

Republicans took the Senate. And they kept it until the election of 2006. The Democrats, you should check all this -- in 2006, the Democrats won the election, took over, I think, both the House and the Senate. So, Dodd became the chairman in 2007. The other issue, and, then initially the issue, that well -- so this is how in 2003, 2004, 2005, Fannie and Freddie started becoming the big housing issue. Fannie Mae and Freddie Mac, because of their accounting scandals. So, that's what started to drive the housing agenda then.

There was a big focus in both chambers on them. That's a whole, you could do a whole separate thing on that. That was very, very interesting and useful. That's where the Housing Trust Fund -- that's eventually where we got the Housing Trust Fund when Dodd became chairman, and we passed the Housing and Economic Recovery Act. So, what happened was, that's when the economy had started its tailspin. Freddie Mac looked like it could be potentially going insolvent. They were worried about Fannie [Mae] likely following. At the same time, people started seeing the foreclosure crisis starting to gin up, and we were able on a bipartisan basis in the Senate to pass legislation expanding FHA's ability to make more loans.

Andrew O'Shaughnessy: Sorry, was that the federal housing administration modernization act of 2008?

Jonathan Miller: Probably. Yeah. Which ... was attached to the Housing and Economic Recovery Act. So, in that FHA bill we had -- and the GSE [government-sponsored enterprises] reform bill, which eliminated OFHEO [Office of Federal Housing Enterprise Oversight] and created the Federal Housing Finance Agency [FHFA], created a Capital Magnet Fund, Affordable Housing Trust Fund, both funded out of Fannie and Freddie. And which gave [Treasury Secretary] Paulson the bazooka that he wanted, in case Fannie and Freddie faced a run on their debt. So, this was really based on -- so now we're really seeing the crisis scatter scheme.

Andrew O'Shaughnessy: Can you go into a little bit more detail about some of those provisions? For instance, I'm not familiar with the Affordable Housing Trust Fund. We have been focused on state responses.

Jonathan Miller: So, I will say this is, when I say my achievement, me and many others, I don't mean exclusively me. One of our, I would really say, important achievements. So as part of, you know -- Fannie and Freddie were really having trouble. They had an incredibly weak regulator, totally captured. Although, the final director of that agency, Armando Falcon, was really a tough guy. He, in spite of intense congressional pressure, kept the screws on them for their failures, their accounting shenanigans. He deserves an enormous amount of credit. Also, he wanted them to have more capital, which I think it was clear they needed. And they fought him every step of the way, but they sort of led to their own ... they killed themselves, essentially, with their accounting problems [and] shenanigans. They lost all support.

Andrew O'Shaughnessy: Sorry if I could interrupt for a second. I'm curious what you meant by Fannie and Freddie being captured by the industry. What were the incentives?

Jonathan Miller: No, no. The Fannie and Freddie's regulator was captured by Fannie and Freddie, until Armando came into the picture. And in any case, he -- so there was a strong bipartisan agreement that before him that it had to happen. The Democrats were focused on reforming, maintaining and deepening Fannie and Freddie's affordable housing requirements, as part of that, because they were still private stockholder companies. The evidence was clear that they were getting huge benefits, those private stockholders, from their association with the federal government and its implied guarantee [of Fannie and Freddie's debt]. And we wanted to take a bigger chunk of that and focus it on the public, give the public benefit. Part of that benefit, we wanted it to be specifically making sure that they use the process that they use their securitization machine, to help lower- income home buyers.

But also, then we targeted, I can't remember how, what the formula was. This was Senator Jack Reed who put this together. This was his amendment in the Senate and his staffer, Kara Stein, became a SEC [Securities and Exchange Commission] commissioner. She worked with people to develop -- I can't remember whether it was a certain number of basis points per loan or whether it was some formula that she developed that took a segment of their profits or funding or some stream of income and divided it into two separate funds. One, the Affordable Housing Trust Fund, which was focused primarily on very low-income rental housing and something called the Capital Magnet Fund, which was focused on equity investments into CDFIs, community development financial institutions, which would then use that equity capital to do what they do, which is an array of report projects; dealing with home ownership, dealing with economic development, childcare, charter schools, the whole range of things they do. So, that was -- and then, of course, they went into receivership, or I should say conservatorship. Although Mel Watt finally started those -- once they started getting solvent again, started generating income. He started requiring them to make those payments. The idea there was to really make sure that you add a couple of important housing and community development, economic development, focused entities that were outside of the appropriations process that would benefit from the work of Fannie and Freddie.

So that took us -- then Fannie and Freddie basically got taken over into conservatorship. The market goes totally to hell, and we are into Ben Bernanke coming to the Hill to tell us that all of the biggest American corporations are about to go bankrupt because you're not going to be able to turn their commercial paper over. We need TARP [troubled asset relief program], an antecedent to Dodd-Frank.

Andrew O'Shaughnessy: As far as the consumer protection provisions of Dodd-Frank, is it as simple a story as the folks who, the legislators and staff members, had been skeptical of those provisions in the past? They simply had constituents closer to their own experience suffering these problems, or were there other things happening that allowed it to --

Jonathan Miller: The world had blown up. [It was a] completely new world, with lots of middle-class people losing their homes, not to mention moderate and lower income

families, people getting [and] losing their homes because they were sold really terrible mortgages that they should never have been sold. And this was on a scale that was unseen in the past, or in any of our lifetimes. It was seen in the lifetime of the country. In fact, there was a model in the great depression, the Home Owners' Loan Corporation, the Home Owners' Loan Act [HOLA] [of 1933] it's worth looking up. It was passed. It preceded FHA. And then it was incorporated into FHA, the homeowners loan act and the homeowners loan corporation, which was created by HOLA.

Barney Frank and Chris Dodd had a similar program embedded in HERA [Housing and Economic Recovery Act]. I think it was HERA it was called the HOPE for Homeowners Act, which did not -- because of the complexities of the modern mortgage market, didn't quite work as well. Because so many mortgages were encumbered, encompassed by second liens. In order to make that work, the second lien holders had to basically accept the fact that their second liens weren't really worth anything. And they weren't willing to do that, and the regulators were, frankly, complicit in allowing it.

Andrew O'Shaughnessy: Could you elaborate a little bit on how that program was supposed to work hope for homeowners?

Jonathan Miller: Basically, you buy a house for a hundred thousand dollars. It's now worth $80,000. We're going to give you an [FHA] loan for, let's say 95% of the $80,000 so that -- and you're going to be forgiven the outstanding [principle above that amount]. ... We [also] want to give you a stake in your home, like you used to have, with equity. We'll lend you up to 90-95% of that [value]. Now your new loan is $75,000. You've automatically got $5,000 worth of equity. ... But the original lender has to agree to that, to take that $18, $28, or whatever it is, $25,000 loss. Any second lien holders, of which there were many, many of these poor borrowers [who] also got -- Household [Finance] had a particularly corrupt program where they would give you a loan for 80% of the value.

Then [they'd] immediately give you a line of credit or a second mortgage taking you up to 100% or 110%.

So, those second loans, which are now really worth -- so if I were to sell my house at $80,000, not only would the first lien holder lose some money, but the second lien holders would be wiped out. So, the theory behind the law or the program was they ought to be willing to settle for a nickel on a dollar or 3 cents on the dollar [because they'd lose everything if the home went into foreclosure]. It was something like that. But it turned out they were not willing to do that. It was hard to match up who the second lien holders were; in some cases they were securitized. I'm sort of speculating a little bit here, but one of the real concerns, I think, was a lot of banks had a home equity lines of credit, or a second lien out on these loans. And had they been forced to write them down to the market value, which they should have been doing anyhow, it would have wiped out too much of their capital. My guess is [Treasury Secretary] Geithner was worried about that. And so [he] never put the pressure on them to do that, which he should have done.

My main criticism -- so at this whole process of the Obama administration was that they focused all their energy on saving the financial system and not nearly enough energy on saving homes.

Andrew O'Shaughnessy: Which regulators, and you mentioned Tim Geithner, in particular...

Jonathan Miller: The OCC [the Office of the Comptroller of Currency], because that's who had the big, the second liens.

Andrew O'Shaughnessy: Are there any other examples that stand out to you of that problem of the, at this point, democratically appointed regulators...

Jonathan Miller: That the OCC, the Comptroller of the Currency was a hold over.

Andrew O'Shaughnessy: Okay. Well, so are there other examples of the administration having the ability or powers, or resources given by Congress, but not using them because of their focus on that?

Jonathan Miller: The other thing is there was an attempt to -- under bankruptcy law, any debt can be discharged. I mean, it's gotten much harder, because of "bankruptcy reform". Again, for those reading this and not seeing it, I put air quotes around that because there was not reform in any meaningful sense of the term, unless you're thinking about it from the bank's point of view. Any debt can be discharged [it's] increasingly difficult, but [it] can be discharged, except for mortgage debt and student loan debt. And actually, Obama came in saying that he was for what was called [a] cram-down of mortgage debt. Again, in bankruptcy law -- I'm not a lawyer, but my recollection is -- anytime a loan is outstanding on an asset that exceeds the market value of the assets, that loan is crammed down to the market value in bankruptcy.

So, if you have a boat that costs $100,000, you took out a $100,000 loan, but the market value today of that boat is only $80,000, you go into bankruptcy. The $20,000 difference between the market value and the outstanding loan is wiped out. That does not apply to mortgages. Now, Obama came and proposed that it should apply to mortgages, and Geithner couldn't have been less enthusiastic. In testimony, probably before the Finance Committee, I can't remember exactly what he said, but he essentially invited them to ignore that proposal.

Now, there was some [negotiation]. Dick Durbin, Senator Durbin from Illinois, was a very strong advocate of that. He was a Majority Whip of the Senate. So, he had some juice. He was a very strong advocate for cramdown. And we were working to negotiate an acceptable solution with industry, and we had more or less settled on allowing cram down for second mortgages just in the bankruptcy [process]. We had a number of big banks willing to live with that. But ironically it wasn't clear to credit unions, who also happened to have a lot of second liens, that they were willing to live with it. And in the end of the day... McConnell basically told the banks, if you make any deal on this, you never -- again, I'm saying this

as a fact, I was led to understand, I was told -- McConnell basically said to the industry, if you make this deal with the Democrats, never come to ask me for anything. Did that really happen? I don't know, but it's a great story.

All right. So let me get -- cause we're pressing on time here. Let me get to -- so, you asked the question about CFPB [Consumer Financial Protection Bureau]. In 2007, we're looking at the world starting to come to an end. We're looking at Fannie and Freddie really going into crisis and their impact on the economy would have been disastrous. We see the Lehman Brothers' stuff, we have TARP. Basically, as part of the deal, the TARP was broken into two tranches. They got half the money at the end of the Bush administration. Then we had a second vote right at the beginning of the Obama administration for the second half the money. And there was a lot of reluctance among Democrats, who are now in the majority and, well, they were the majority in both cases, a lot of reluctance to vote for that money.

I think it would have been terrible if we hadn't. It would have been a real confidence killer. Dodd actually had a dinner with all the Democrats on the committee to talk about this and what to do. And it was clear that many members said, "okay." They understood that most -- I think all but one, maybe, I'd have to go back and check the record. They were all reluctant to vote for it, but what they finally came to was, all right. We can vote for this but there's got to be a commitment that we're going to pass some kind of reform legislation to make sure this doesn't happen again. And that was, I think, Dodd [that] made that commitment. And of course, the Administration was working on something, and Barney was happy to -- was working on something.

We were all working with the Administration, it wasn't in a vacuum. And the Administration sent up a bill and in the bill was a separate consumer agency. We urged them to send up a bill, because it's a big and complex set of issues and they have many more resources to address those thoughtfully and adequately than we did. And we would use the bill to work off. The statutory language, bill legislative language is the coin of the realm. I think the fact that the President introduced legislation with a separate consumer protection agency, meant that anything Dodd was going to do or Barney was going to do was going to include a separate consumer agency. And it was our job essentially to bring people along with that. That's in the end, what we did.

Andrew O'Shaughnessy: To what extent were these consumer provisions in Dodd-Frank watered down or compromised by opposition from Republicans?

Jonathan Miller: So, it's not just Republicans. I mean, there's a host of -- you lay down the language, let the games begin. There are multiple interests, the industry comes in, the consumer groups come in, state attorney generals come in, state banking commissioners come in. [There were] just millions of issues, preemption, state preemption. I will say the AGs [attorney generals], on the whole, were more important, because the truth is the worst actors in the market were state licensed actors and the commissioners didn't do enough in most cases.

It's understandable. It's hard to essentially close down a [business]. It would have been very hard for the banking commissioner, whatever the name of the office is in California, to close down Countrywide, close down New Century, close down Ameriquest, close down all those bad players in the absence of a national -- cause they [would] just move to Las Vegas or somewhere else. And maybe lose all of those jobs and they'd get criticized and so forth. The incentives all work in the opposite direction, but the attorney general had every incentive to bring cases, lawsuits, and enforcement actions, until preemption prevented them from doing so. So, it was the state's attorneys general that were the important state actors, in terms of pushing for the bill and allowing us to say, "well, more than one cop on the beat is never a bad thing." They helped us in that regard.

But, when the bill came up from the administration, it gave the consumer bureau authority over all consumer protection regulations, laws and supervision for all banks. And Barney put in the $10 billion cut off, which was a brilliant strategic move. Once Barney did it, the Senate couldn't keep that from happening. The bill came up from the administration with a commission, or a board of directors. Barney kept that. We changed it to a single director in the Senate. There's always -- the preemption language was very hard fought over. On our committee ... we had the Senator from Delaware, where all the national banks are headquartered, or many national banks are headquartered because of the preemption law, because of the corporate laws there. So, there was plenty of negotiating taking place with Republicans and with Democrats. And ... Chris Dodd will say over and over again, "while we only got a few, very few Republican votes, there were a lot of ideas in the final bill that were put forward by Republicans." It was more bipartisan in substance than in vote. Although we got the votes that we needed obviously to get to 60.

Andrew O'Shaughnessy: Well, with just under 10 minutes left, there are a few questions we like to put to everybody that we talk to. In more than a decade since the financial crisis, we've heard a number of different narratives emerge about its origins, what caused the financial crisis. And so, we like to ask everyone what their understanding of the beginning of the financial crisis is.

Jonathan Miller: From my point of view... The fodder, the raw material, were the mortgages that couldn't be repaid, right? It was the abundance of these bad mortgages, whether they were hybrid ARMS or any alternative A, Alt-A loans, the interest-only, and so forth mortgages, that the borrowers just could not afford to repay. They just did not have enough income to cover the payment once it reset. That was because that was getting more and more into the public sphere. And those all got packaged up in these various mortgage-backed securities. They got repackaged into this collateralized debt obligations, the CDO [collateralized debt obligation], CDO squared, all with these AAA ratings. Look, [that] is a whole other area, not my area of expertise, but clearly the incentive structure there is not particularly in favor of objective analysis.

So, you had a foundation of sand in mortgages that couldn't be repaid. You had lots and lots of financial engineering built on a foundation of sand. The engineering pushed the building

higher, higher, higher, built on a faulty assumption that home prices would always rise. The models that these guys use don't require the insight that I gained from talking to people. On Wall Street, it doesn't matter what the default rate is of a set of mortgages in a mortgage-backed security, as long as you price those mortgages to cover the expected loss. Right? If they're saying, "ah, 15%." -- [And] remember a typical default rate may be less in a prime loan, less than 1%. --[they would say,] "Yeah, it could be 50 weeks, by 15% default rate. We're going to charge accordingly, and we can cover that loss." That was sort of the insight to me.

But in any case, they were wrong, even at the higher levels of default they expected, because the sand shifted, either because the Lehman brothers, or whatever the cause -- I think a combination of forces, and you had AIG [American International Group] and all those credit default swaps. It was all this sophisticated, overly leveraged, super structure built on a foundation of sand. The sand was unaffordable subprime mortgages, and the engineering was the transmission method that's shot at around the world and destroyed the whole economy.

Andrew O'Shaughnessy: What would you say policymakers should learn from the mortgage crisis and its effects?

Jonathan Miller: [laughter] in 10 seconds or less? Yeah, I can be long-winded, I apologize.

Andrew O'Shaughnessy: No, not at all.

Jonathan Miller: So, the mortgage parts of [Dodd-Frank]; the CFPB was a pretty good response. And the mortgage rules are pretty good. Now, there'll be problems in the mortgage market, but there'll be new problems, which is progress. I think, people [will] lose their jobs, no matter how well underwritten the mortgages are. If they have no income, they can't pay the mortgages. The key to the mortgage rules and to the laws requiring those mortgage rules is that, at the time of underwriting, the lender has a reasonable expectation that barring unusual life circumstances, illness, divorce, loss of job, that's a loan that can be repaid. I think there are a broader set of lessons, way outside my area of expertise, regarding requiring liquidity in the financial system, requiring capital in the banking system, requiring transparency in the derivatives and swaps markets, which were learned but seem to have been unlearned somewhat. I don't think the current stock of regulators has acted soon enough. Although, I think now is not a wise time to reduce liquidity and capital standards, [that's] likely to happen. So, maybe that's a lesson that hadn't been learned adequately. I think you cannot avoid -- you can't create a system that's not ultimately dependent on the judgments of human beings.

We'll see what happens in November and whether or not that brings in a new crop of regulators that pay more attention to what I think the lesson should have been. But you have others who I'm sure feel like that we over learned a set of lessons and required too much capital [and] liquidity and held the economy back. Although, I think it's hard empirically to argue that, because bank lending -- this is an important

point to make. We recovered faster than Europe because we required our banks -- we made realistic assessment of what their position was. We required them to raise capital quickly. We required them to get rid of their bad loans more quickly. So, we had a healthy banking sector, well capitalized. One that's weathering the storm, so far, quite well. Two, was able to lead us out of the recession. If you go back and look at the data, I believe it's true that for many, many quarters in a row, years, bank lending grew at a faster pace than the economy grew, which means the banks were pulling the economy, not holding it back. They were able to do that because they had adequate capitals required by Dodd-Frank and the regulators that implemented Dodd-Frank.

Andrew O'Shaughnessy: Well, I think that is a great note to end on. Jonathan, it was really a pleasure. We always appreciate people being so generous with their time. And we learned a lot from an important, new perspective here.

Jonathan Miller: Good. I hope so. I'm glad to help, if it was a help.

[END OF SESSION]