AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Ted Tozer, Session Two

Bass Connections

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PREFACE

The following Oral History is the result of a recorded interview with Ted Tozer, conducted by Cameron DeChurch on February 18, 2022. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

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

Transcriber: Sarah Walker	Session: 2
Interviewee: Ted Tozer	Location: By Zoom
Interviewer: Cameron DeChurch	Date: February 18, 2022

Cameron DeChurch: I'm Cameron DeChurch, an undergraduate student and member of the Bass Connections American Predatory Lending and Global Financial Crisis team, and it is February 18, 2022. I am currently in Durham for an oral history interview with Mr. Ted Tozer, the former president of the Government National Mortgage Association, or Ginnie Mae, who has joined us via Zoom. Thank you for joining me today, Mr. Tozer.

Ted Tozer: Thank you for having me. This is a good opportunity.

Cameron DeChurch: …You became involved with residential mortgages around 1985 and organized and started a mortgage company for BancOhio [BancOhio National Bank]. Your work allowed it to sell its loans and build a servicing portfolio. What led you to develop this enterprise?

Ted Tozer: It was a situation where I worked for the broker dealer side of [the] security side of BancOhio. National City Corporation bought BancOhio and didn't want to stay in the broker dealer operation. So, they asked me, since I'd been involved with the mortgage-backed securities broker dealer operations [as] operations and chief compliance officer, that I could start up a mortgage company. So really, it was the idea that the National City Corporation wanted to get away from being an originate-and-hold type mortgage originator to one where they would be selling into the capital markets. So, when we started National City's mortgage company, it was called BancOhio because BancOhio was the retail bank of National City, but it was actually National City Mortgage. It was National City Mortgage, and it changed its name when we bought another mortgage company in 1989. But I basically started National City Mortgage.

Cameron DeChurch: How did BancOhio, in relation with National City Mortgage…fare in a rapidly changing marketplace at the time?

Ted Tozer: Well, in the '80s, it was a windfall. Basically, what happened was, in the 1980s, the savings industry was in a really tough position, and it was basically going out of business. So, National City was in a situation through the mortgage company to actually take market share away from the savings & loans and actually start building a servicing portfolio and using the relationship with Fannie Mae [Federal National Mortgage Association], Freddie Mac [Federal Home Loan Mortgage Corporation], and Ginnie Mae [Government National Mortgage Association] to do that. National City had been in a relationship with Freddie Mac in 1984 to do some mortgage swaps on mortgages it had on its balance sheet after they merged with National City. So, we had a relationship with Freddie Mac. When I was starting the mortgage company, we developed a relationship with Fannie Mae and with Ginnie Mae. Fannie Mae approved National City in 1985, and Ginnie Mae approved National City in 1987. So, we could actually be a full-blown mortgage banker that would not use the bank's

portfolio for mortgages. When we created the mortgage company, the challenge from corporate head[quarters] in Cleveland was to not have any mortgages on the bank's balance sheet. They had gotten burned, and they were not able to match funds for mortgages with deposits. And so, they wanted to truly be an originate-and-sell type environment and just turn it into a fee income business. And we basically grew it. So, within fifteen years or so, we were a top ten mortgage originator.

Cameron DeChurch: How would you say your role changed throughout this process?

Ted Tozer: It…changed a little bit in the fact that initially, when we created the mortgage company, I was the chief financial officer, and I was responsible for all of your normal corporate accounting as well as all the capital markets activities—post-closing and all [the] parts of selling loans in the capital markets. Then City acquired a mortgage company from Shawmut Bank in Boston in '89. And at that point, the mortgage company more than doubled in size. At that point, my role was more limited just to running the capital markets: the product development, the mortgage trading, post-closing, loan delivery. So, my scope was really limited. I had that same scope…until National City was bought by PNC [Financial Services] in 2008. I was responsible for all the product development, pricing, loan delivery, negotiating all the deals with Wall Street [and] all the private investors to sell loans up to that point.

Cameron DeChurch: …What do you think were the main motivations behind National City purchasing BancOhio when it did?

Ted Tozer: Well, they bought BancOhio because BancOhio, at the time, was the largest retail bank in Ohio. And National City at the time was a large commercial bank, but they had no relationships, really, outside of Cleveland. It was really trying to create a more balanced bank, one that would have a large commercial presence as well as having a large retail presence. And that's the reason [why], like I said, when they created the mortgage company, they named it BancOhio because [with] BancOhio, what it was known as [was] from a retail banking perspective. This was during the early '80s. And then as they started acquiring more banks in Indiana, Michigan, and started growing the footprint in the Midwest, they changed their name to be National City because you don't what to be called BancOhio if you buy a bank in Indiana. It doesn't make sense.

So basically, it became National City once they started buying banks outside the footprint. The first bank they bought, I think, was First Kentucky Corporation in Louisville. At that point, that's when they changed the name from BancOhio, from a retail perspective, to National City. I think it was probably around '86 or so when they bought First Kentucky Corporation in Louisville. And it was all part of the grand plan. National City wanted to become the major, the biggest bank in the Midwest, and they acquired banks. That was their goal. So, they wanted to be known as a national bank versus a state-specific bank.

Cameron DeChurch: …Could you talk about your experience at National City leading up to its acquisition of First Franklin?

Ted Tozer: Well, again, we were in a situation where we were a true mortgage banker. We did a lot of business with Fannie Mae, Freddie Mac, Ginnie Mae, as far as FHA [Federal Housing Administration] [and] VA [Veterans Affairs] [loans]. We traditionally did that, but we really did not want to get into subprime. We were in a situation where we wanted to be known as a prime lender. And so, from that perspective, when Bank of America put First Franklin up for sale, the powers that be in Cleveland…they really saw what we were doing in the prime mortgage space and how profitable it was, how well-run we were, and they thought, “Well, we'll move down the credit spectrum.”

I went on a number of due diligences. They went to look at Champion Mortgage in New Jersey. They ended up being bought, I think, by Key Bank. First Franklin was probably the sixth or eighth subprime lender that they actually looked at to actually acquire because they saw in the late '90s the whole proliferation of these subprime lenders and the capital markets' willingness to securitize them. That's when they went on this process of trying to find a subprime originator and ended up with First Franklin.

Cameron DeChurch: What were some of National City's key strategies in the residential mortgage market?

Ted Tozer: As far as the holding corp [holding company], per se, was mainly to be a fee generator. The idea was, in the mid to late-'90s, the big discussion was that the banks had to diversify their income streams away from truly being interest [rate] spread products, because at that point, the Fed [Federal Reserve System] was pretty active in trying to deal with managing money supply. Sometimes, interest spreads really tightened up dramatically for the banks. So, they felt if they had a good base of fee income coming in, that would balance out their volatility on their interest spread products as far as commercial loans, car loans—all those kinds of things that tended to tighten up whenever the Fed was in an easing mode, [when] they tended to tighten up their spreads.

And so, it was this way of trying to have more of a well-rounded policy. And that's the reason why I was told in no uncertain terms by the CFO [chief financial officer] of the holding corp that they did not want to hold any loans on their balance sheet because they looked at us as purely a fee income generator. They did not look at us as any kind of loan generator. The holding corp did not buy any loans from us. Every loan we originated in National City Mortgage ended up going into the capital markets.

Cameron DeChurch: Could you just clarify who "us" is in this sense?

Ted Tozer: …What I meant by "us" was National City Mortgage…They were very big on the fact that National City Mortgage's role in life was to build out this fee business, not to build loan portfolios for the bank.

Cameron DeChurch: …Were you involved in National City's acquisition of First Franklin in any way?

Ted Tozer: Mainly just from the standpoint of doing some due diligence on them and being able to try to explain to the individuals in Cleveland the issues around [the] capital markets aspect of the mortgage business. [I was] just giving them some insight into what the acquisition would mean as far as what I'd seen on the prime side, as far as how deep the markets were, what they could expect as far as capital markets execution, and those kind of processes. But that was really the extent of it because, really, what I found out very quickly was [that] National City wanted to buy a subprime originator. My role was just to tell them where the problems might be, just so they wouldn't possibly buy an organization that may come back to haunt them. But it wasn't a question of whether they were getting in or out of the business, the question was who they were going to partner with. And so, it was my job to tell them, "Well, this guy looks a little better than this guy" type of situation.

Cameron DeChurch: What were some of the main risks that you wanted to alert National City of, and how did you feel that First Franklin fared in terms of these factors?

Ted Tozer: Again, my whole thing was that I just wanted to make sure that people were aware that in a lot of the securitization transactions that were done during that time period, the subprime originators would front-load all of their income—just this huge gain on sales, and [they would] leave very little money to service the loans. So, their books looked really good, but because of that, you had this ongoing process where you had to keep originating or you're going to fall apart because you took all your money out with the first deals you did. And you had to make sure that you kept creating more business or you're going to fall apart because there wasn't any fee income in the back end. And I was warning National City when looking at those kinds of transactions. My understanding was, I don't think First Franklin was that extreme. But one of the big things I was warning them about was [for] a person that looked really good on paper as far as earnings-wise, look to see what the residual income streams were for the backend, because if not, if this volume ever slowed down, it was going to be a really tough economic situation for National City. That was the main thing I warned them for when we looked at all these subprime acquisitions.

Cameron DeChurch: You already touched on this, but a lot of National City's reports indicate that they wanted to increase their subprime loans. What would you say was the primary motivation of this goal? I believe you were mentioning earlier about diversifying and becoming more well-rounded in terms of their income streams?

Ted Tozer: I think what happened was, initially we were looking at trying to just get more business. But then when they found the premium rate they would get on these subprime loans, all of a sudden they started to portfolio them. Like they told me

that at National City Mortgage that I couldn't portfolio them because the yields weren't adequate for the interest risks they were taking on. I think when they got to First Franklin, they found that the interest rates were high enough. They had enough spread in them to portfolio them. What I found was that First Franklin loans got portfolioed and we [National City] weren't because there wasn't as much…interest spread in the prime market. I think that's what differentiated us from First Franklin—the credit exposure that National City had with First Franklin that they did not have with National City Mortgage.

Cameron DeChurch: I also noticed in National City's reports a mention of an increase in real estate loans. Could you talk a bit about this?

Ted Tozer: Well, again, National City, I think, got caught up in the concept—like a lot of people did in the early 2000s—that home prices would never go down, and so the credit risk was somewhat minimal. And they saw these yields you would get as being very, very attractive. So not only did they get involved with people like First Franklin on the subprime side, but they also created [something] almost like a subprime home equity line group too. They ran [that group] out of the bank also. And again, it was stuff that we didn't get involved in. For example, the home equity loans we did, we ended up selling in the capital markets because National City didn't think our yields were high enough. But they created this subprime HELOC [Home Equity Line of Credit] subsidiary to basically do that, and it was a department of National City Bank. So it was all about the concept of, they thought that these were just too great of yields that they couldn't pass it up. To some degree, they got kind of greedy of what they were looking at, and they lost sight of the reason yields were so high was because there was a lot of credit risk.

Cameron DeChurch: In our previous interview with you, you discussed this association between real estate loans and how they contributed to predatory lending. You talked about your role in this interview with National City in terms of alerting them of the risks of subprime lending. I'm wondering if you could talk any more about how the management within National City actually viewed these risks associated with subprime lending?

Ted Tozer: Again, I think National City was caught, like with the whole industry at the time, [on the idea] that home prices wouldn't go down. So, as long as you've got equity in the property and as long as home prices were continuing to appreciate, there's not a whole lot of risk. You can always foreclose on somebody. I think that was the thing that trapped them, because during that time period, we were having substantial home value appreciation. I think that lulled them into this false of security that the risks were really minimal on what turned out to be these high-risk loans.

Cameron DeChurch: Looking at First Franklin's role within National City, where did First Franklin fit into National City's organizational structure? Was it part of the overall mortgage operation [or] was it more of a separate division or subsidiary?

Ted Tozer: It was a separate operation. Both First Franklin and National City Mortgage reported up through the retail side of the bank through to the vice chairman of the corporation for retail banking. But they were a separate company just like National City Mortgage. So, my interactions with them were very limited except for just the concept of, every once in a while, talking to them about things we were doing and they were doing, because National City Corp always thought that there was something that we might be able to help each other out on—execution, whatever it might be. So, from that perspective, we'd have a conversation from time and time. We were sister companies. Our managers were not tied together at all.

Cameron DeChurch: Would First Franklin report to someone in National City at all? And if so, who would it have been?

Ted Tozer: Well, they reported to the same person that the president of National City Mortgage reported to, and that was the vice chairman of the holding company for retail banking.

Cameron DeChurch: Did the acquisition of First Franklin affect National City's organizational structure at all? Or did National City remain pretty much the same organizationally before and after the acquisition?

Ted Tozer: Well, we got involved with First Franklin because what happened was, when the subprime market really started heating up in the 2000s, the originators at National City came back and said, "When we talk to a realtor [who] has a person that wants to buy a home, we would much rather give them an alternative versus declining them." And so, what we would do is, a lot of times we would take a person we were going to decline and say, "Okay, we are going to decline you, but First Franklin might be able to help you." So we became kind of a lead generator for First Franklin for some of these subprime loans that we couldn't make because we couldn't get comfortable with their credit.

Cameron DeChurch: So was there a bit of a synergistic relationship between First Franklin and National City in this sense?

Ted Tozer: Exactly. Because, like I said, our loan officers' point was that they didn't care about getting paid really anything by First Franklin, but they just hated to go to a realtor and say, "We can't help you." Because they'd like to go back with something positive and say, "We can't help you, but this person can." So it was more synergistic from the standpoint that it helped…our loan officers build relations with the realtors and knowing that they were working with a realtor to try to get the transaction closed, if at all possible.

Cameron DeChurch: Do you think that National City expected or anticipated this relationship or this aspect of the relationship before the acquisition? Or was this something that developed once National City and First Franklin had already been together?

Ted Tozer: Yeah, it developed over time. Because when we first bought First Franklin, the subprime market was just kind of developing. But it really took off once you got into 2004, 2005, and that's when our loan officers were under a lot of pressure because a lot of their competitors, other mortgage companies, were calling the same realtor [and] would give them a subprime offering when they were declined. Again, we didn't want to get involved in the subprime side, so our best deal was to refer them to First Franklin and basically let them do what they needed to do. And so basically, that was the handoff type of situation we developed. We did a little bit of subprime as far as pushing them out to people like RFC, [Residential Funding Corporation] the ones First Franklin wouldn't take, because our whole issue at the end of the day was, in the heyday of 2004, 2005, and 2006, to make sure our originators always had some option to give a realtor if we were not going to do the loan ourselves.

Cameron DeChurch: …Going back to before the acquisition, was there anything about First Franklin that struck you as unique in terms of when, as you said National City was going to acquire a player in the subprime lending market?

Ted Tozer: No, there really wasn't. When National City bought First Franklin, the subprime market was somewhat depressed because we had gone through a really major shakeout in the late '90s, like '99 or so. So basically, National City got First Franklin for a steal from Bank of America because really Bank of America didn't see a lot of value because the market was on a downswing. So, all we knew about First Franklin was that the sector was really under stress. National City wanted to try to find somebody that they could buy relatively cheap. That's really all I knew about First Franklin…because again, I was in a different world. I was truly prime, and First Franklin was in the subprime world. So, my path never really crossed with them that much until National City acquired First Franklin.

Cameron DeChurch: …Could you talk a bit about National City's restructuring efforts that occurred around 2000?

Ted Tozer: What restructuring were you referring to?

Cameron DeChurch: One specific thing I was interested in is, I was wondering if you could explain any of the logic behind National City's exit from the automobile leasing business, which I believe was somewhat low return. And then they were also closing a lot of their underperforming consumer finance stores.

Ted Tozer: The biggest problem when they got into leasing—a lot of people got into leasing back then—what happened was they found that the residual value that they were putting on cars was way too high. And the whole industry had a real shocker because when the leasing came out, they tried to keep lease payments as low as possible. And they put a high residual value on the autos. Well, they found that the services they were using were completely overly aggressive and National City had big losses because they couldn't sell the cars for what they thought they were worth at the time that the lease expired. So, they got out. A lot of people got out because, again, they found that leasing was a lot more of a

science than they thought it was as far as understanding residual values, and that's when they got out.

And again, the finance business they got out of because, again, the early issue was, we'd gone through a little bit of recession back then and unsecured debt had its issues. And that's the reason why National City jumped in on the First Franklin side because you've got a house. So, the idea [was] going away from unsecured debt [to] actually having a home that's going to appreciate. It gives you a little more security of playing in more of these higher-risk type loans because, again, National City was like everybody else in the 1990s. They were trying to build out their...interest income, loans, because they wanted to get as high a yield as they could. So, they were trying to do that through leasing as well as these finance companies. And it turned out they both were disasters when you have a major economic downturn that we had the late '90s, early 2000s.

Cameron DeChurch: …To what extent did National City and First Franklin participate in the debate over Georgia's anti-predatory lending law [the Georgia Fair Lending Act]? And if they were involved at all, did you have any role in this?

Ted Tozer: I didn't handle it directly, but National City was really the lead on the Supreme Court decision in Georgia. Our problem was, at National City Mortgage, it wasn't so much that the Georgia law was good or bad, but the problem is when you're a national lender, trying to keep track of all these rules. Not only state level, but city, county. I mean your compliance [team] is pulling its hair out. So, our issue was not so much that Georgia was bad, but give us a national rule book. The idea [was] so that we could actually say, if we're originating a loan in Virginia, or Georgia or Ohio—because by that point we were one the largest retail lenders. For example, in Washington, DC, we were the largest retail mortgage lender. We didn't have a bank there. So again, we had to deal with all the regulatory issues of District of Columbia, Maryland, Virginia. It was really expensive and really costly to try to maintain that. That's the reason we tried to get the exemption from the OCC [Office of the Comptroller of the Currency] because we were a national bank—just so we could literally have one set of rules that we could rely on. So, I just want to make it clear, when National City went to bat on that, it was not about the Georgia rule itself, it was more just trying to get a national standard that we could work with.

Cameron DeChurch: As a mortgage industry veteran, what is your view of such laws?

Ted Tozer: I would agree 100% that I think having national rules is really critical to keeping your costs of origination down. And again, that's where I was really hoping that you'd have a situation where the CFPB [Consumer Financial Protection Bureau] could step into that role of trying to be somewhat balanced in their approach between lenders and consumers so you're fair to everybody and create a national standard that everybody could really deal with. When we're dealing with all these different regulators, auditors, all kind of stuff, it really hasn't happened. You still have all the states and so forth that are still trying to put their own stamp of approval or their own twist.

And what's happened now is [that] since the banks have gotten out of the mortgage business, that OCC exemption has have gone away. So now, the mortgage bankers have to deal with this plethora of rules. And because of that, the cost of originating a loan and servicing a loan is multiples of what it was years ago because they have to comply with all these various places that they're servicing loans, originating loans. So it's really become very costly for the consumer.

That's what I always tried to tell people when I was in Washington—it's that mortgage bankers don't absorb anything. If you charge a mortgage bank or something, the consumer pays for it. Because a lot of people always think, "Well, we're going to do this or that to help the consumer." And my point to them was always,"Okay, make sure you balance out the benefit versus the cost. There's no free lunch. You can get a benefit of this, but you need to make sure that the costs aren't exceeding that." And a lot of times, I couldn't get people to understand that concern or that situation, that that was the trade off in the mortgage business.

Cameron DeChurch: The Georgia law also included a provision that made purchasers of mortgages potentially liable in the case of civil actions that alleged fraud in the origination process for those mortgages. To what extent did this assignee liability provision in the statute strike participants in the mortgage market as a serious threat to their operations?

Ted Tozer: Assignee Liability threated to stop mortgage operations. The problem is that nobody would buy loans. In states that had assignee liability, you couldn't find investors. Because you're in a situation where they're not going to take on this assignee liability, and you have almost unlimited liability. It's one thing when you're buying a loan, for example, a $100,000 loan, the max you lose [is] $100,000. But [with] assignee liability, you could have a $1 million loss on a $100,000 loan. So, the problem we ran into was, a lot of these assignee liability states backed down once they found that nobody would originate there. What happened was…during the 2000s, Wall Street got more and more involved. And in going to Wall Street, they wouldn't touch anything from a state that had assignee liability because of the concerns that they had.

Cameron DeChurch: Do you think that the Office of the Comptroller of the Currency was justified in asserting the federal preemption of such laws? And if so, why?

Ted Tozer: Well, I mean, as far as I'm concerned, I think that they should, they're the regulator of these national banks. And so, again, they should be holding the national banks to some level of consumer protection and so forth. That's their role. If you're regulating, then why, just because you're doing mortgages, should you have different regulators? The question is, you should have somebody overall looking at the whole relationship and not just looking at the mortgage side. That's the way I look at it.

So to me, the biggest problem you have right now in today's world is that there is no OCC for IMBs [independent mortgage bankers], because independent mortgage bankers don't have any regulators except for states that are looking at some of their predatory lending issues, whatever. But it's not as fulsome as an FDIC [Federal Deposit Insurance Corporation] or OCC that will be coming through and looking at their financial strength, looking at everything they're doing. And I think the OCC doing it made sense because the OCC had actually gotten involved with credit cards and lot of consumer debt already. So including that into that preemptive process for credit cards and consumer debt, why should mortgages be any different? I guess that's the question too, is when you ask should the OCC have had that ability, they had it already for other consumer debt.

Cameron DeChurch: …What factors do you believe led to National City's ultimate selling of First Franklin?

Ted Tozer: Well, I think they originally sold because it was a huge amount—the amount of money that Merrill Lynch was going to pay for it. National City, I think, wanted to, as I understood, spend a lot of money for capital improvements, as far as in retail banking. [They] wanted to roll out a lot of the technologies you see today as far as websites and automating the tellers and things we are seeing today. It was beginning then and that was very capital intensive.

So, I think at that point National City thought, "We sell them for over $1 billion, and we take that $1 billion and plow it back in to making our retail operations more competitive." Because they saw on the horizon that the consumer was going to be wanting to go to some sort of a remote type of activity through the website [and] now that ended up being smartphones. All that was very expensive at the time. They wanted to go to imaging and all these kind of things. So, that was a big driving factor—they thought that First Franklin had probably done its job in really helping them build up this portfolio of loans and now they can cash out. Because I think they made over $1 billion when they sold First Franklin, [compared to] what they paid for it, and they could plow that money back into the infrastructure of the bank.

Cameron DeChurch: In your previous interview, you discussed the growing prevalence of aggressive mortgage lending leading up to the 2008 crisis, with much of that lending tipping over into abuse and deceptive practices. In light of First Franklin's focus on the subprime market, I'm curious whether those wider trends shaped its practices, whether around training of brokers or modes of due diligence?

Ted Tozer: First Franklin's big pitch was that they were so simple. They had a grid: credit score versus LTV [loan-to-value ratio]. They weren't going to look at your credit report. They didn't care how many lates you had. All they cared about was you had a credit score of X and an LTV of Y. And they sold it as this concept that it's really simple. You don't have to worry about all this due diligence and all this originating and whatever.

And what we found was…that's the reason they were subprime., …I always used to get pushed in National City about why we didn't do something like that. Because National City, we were a big Alt-A originator. But with us, we always looked at the credit report. How many lates did the guy have? Because what we found was, if you're starting at an 800 credit score and you have a foreclosure, that'll go down to 700. Well, if a person goes to 700 because they were foreclosed on, that's not a good credit situation. But if there's at a 700 because they had a bad economic event, medical bills, whatever, and now they worked their way back up to 700, that's a whole different animal.

First Franklin didn't look at that. All they looked at was, if a guy's 700, [he] must be perfect. So, we'll do it. And that's what they sold them on, this idea that if you get this guy with a certain amount of equity in their home, a certain amount of credit score, no questions were asked. It was almost like a no doc type loan [no documentation loan]. They didn't care about their income level or whatever. It led into this predatory [behavior] because you had people, like I said, they had economic problems, their credit is deteriorating, but they can basically get a prime rate because their credit score was so high and [they had] a large equity position on their home.

Cameron DeChurch: In the context of the importance of the context of credit scores and things like that, how did National City executives make sense of the changes that were going on in the mortgage market? Were there any voices raising concerns about growing risks?

Ted Tozer: They were torn. We can't speak to First Franklin because, again, I didn't have a lot of discussion with them. But at National City, our biggest challenge was, like I said, we were this huge retail operation. And the pushes we got from our originators were, everybody else was doing it, why can't we do it? And so, we were always caught in this dilemma of how do we try to push the envelope without actually changing our credit profile?

Because of that we did some things like, for a certain credit score or whatever, we might loosen some things up here or there. We got a lot of pushback. It was really, really difficult because of the fact that the regulators wouldn't step in. I had discussions with our examiner from the OCC, the head examiner who examined both us and First Franklin, and I would be so upset because, “do something.” And her issue was, "Well, you know…", all this rigmarole about why they wouldn't step in to do a lot of this stuff.

And the best part was, I think I mentioned this in the other interview, but there was a big push for pick-a-pay [pick-a-payment] mortgages. It was big, as far as loans. And I remember we came up with one that was really pretty consumer friendly. You could say it was pick-a-pay, but it really wasn't anything as crazy as these other ones. There was still a lot of consumer protection in it, and I remember talking to our OCC examiner and she said, "I have no problem with you originating it as long as you're not portfolioing it." I said, "Wait a minute,

you're going to tell me that if I portfolio, you would say no, but as long as I'm pushing the credit risk with somebody else, you'll let me do it." She says, "Yeah."

So, to me, it shows again that regulators were just completely complicit to some degree because nobody wanted, politically, to stop this economic boom that was being fed by cash-out refinancing and all the stuff that was going on in the early part of 2000s. And so, that's how we tried to deal with it. We tried the best we could to hold our line on credit quality and did a lot of spinning, of trying to say, "Okay, this is how you sell it. It's close to what you're looking for but it is not quite there." And so, we tried to sit down with our originators and explain to them how they could spin a product. We had to make it look like somebody else's, even though it wasn't somebody else's.

Cameron DeChurch: In looking at National City's selling of First Franklin, in May of 2006 National City CEO, David Daberko dismissed the idea of offloading First Franklin. However, in the second half of the year, management decided to sell First Franklin, and reports indicate that this was largely due to decreasing margins. There seems to be an attitude shift in 2006 among National City. Could you speak to this at all?

Ted Tozer: I mean, it makes sense because in 2006, you were starting to see cracks in the subprime market. You started seeing issues with Bear Stearns and other things that were happening. Also, National City was having some earnings problems too. So, I think there was probably just a lot of it, they were looking at the market. But again, I also know that they were looking for capital. They were looking to put money into the retail side. So, I think there was a lot of things that came about where they saw that subprime lending was not going to be as lucrative because Wall Street was catching on to the losses and the risks. And so, I think they looked at the amount of money that Merrill Lynch was offering. There were a lot of things going on, but to the end though, they didn't sell the loan portfolio to Merrill Lynch. They just sold the platform, they hung onto the loans. So that indicates to me that they still thought the loans were going to perform. Because Merrill Lynch wanted the loans as well as the platform, and all they sold was the platform.

Cameron DeChurch: In 2008, Merrill Lynch then later accused National City of misrepresenting First Franklin in the deal. How did National City executives regard these allegations?

Ted Tozer: Again, I wasn't involved in those discussions, but what I was hearing in the mortgage company as far as feedback was that again, their issue was, it's all there. That's what due diligence is all about. It's all about you coming through and taking a look to see what's there. And you know, that they claim that they showed Merril Lynch everything that was there as far as their books and their due diligence. They had the opportunity to ask every question they wanted to ask, and Merrill Lynch should be sophisticated. They should have been the people that knew what to look for.

Cameron DeChurch: Merrill Lynch acquired First Franklin largely to vertically integrate their mortgage organization and securitization process. How would you describe their

expectations, especially given the time in which they were making this acquisition?

Ted Tozer: …Wall Street firms, at that point, a lot of them were getting into this concept of getting into the origination business. For example, Lehman Brothers had Aurora Mortgage [Aurora Loan Services] out in Colorado. A lot of them had acquired [originators] because the issue was, they would make a substantial amount of money on these securitizations, but they figured they could make more if they could control the flow of the product going into the securities. And so from that perspective, Merrill Lynch wanted to get into that game, because Merrill Lynch never really had a standalone mortgage originator like Lehman Brothers had, or Bear Stearns and these other guys had. They were trying to catch up, but everybody else got into the mortgages years earlier than Merrill Lynch. They got in at the end of the game. They got in when everyone else [was getting out], when they should have been getting out.

Cameron DeChurch: [Were there] any additional factors that led to this movement and any discrepancy related to [securities dealers attempting to get more involved in the loan origination business?]

Ted Tozer: There was a big deal because all the Street firms were looking at what they were having to pay originators to buy loans from them, and they thought they could control the quality and the pricing better if they actually acquired loans themselves versus going through third parties, which are mortgage originator companies. And we felt the pain of that. For example, it wasn't until probably 2006 that I couldn't sell loans to Bear Stearns because Bear Stearns had their own mortgage company, and they really were trying to support it. They really didn't want to buy from me. But when their mortgage company started slowing down its production, they came to me to fill out some of the securities.

And so, because like I said, they really were trying to vertically integrate, thinking that they could maximize their earnings if they controlled everything from the loan app [application] to the consumer, all the way through to closing and to securitization, they wouldn't have to pay any tolls along the way to get access to that money. Because that's pretty substantial. There's a lot of money made by everybody—loan originators, security dealers, investors. So, if you could take somebody out of the equation, that's more money in your pocket. And that was driving that whole, I think, decision process.

Cameron DeChurch: Is there anything else related to this topic or any of the topics we've discussed or anything else that you'd like to mention that we have not yet discussed today?

Ted Tozer: One thing I would simply say is that, again, the whole concept of First Franklin, of all these subprime lenders, [was based on this idea that] home prices were never going to go down. It was crazy. I used to have underwriters come to me and say, "I can't believe these loans are getting approved." And it was all because people looked to the fact that there was no risk because loans weren't

going to lose value. So no matter how crazy it was, they were making these loans. And it turned predatory because the borrower had no intention or no ability to repay, but everybody said, “Well if you have equity in the home, I'll make it.” I used to see loans come through with 50, 60 DTIs [debt-to-income ratio], but the guy had a 40 or 50% down payment. It was like, "Okay, the guy's got equity, so who cares if he can make his payment?" And I think that was the big thing with First Franklin: it was all predicated on the concept that the equity was going to be there, and so you didn't have to worry about the ability for a person to repay the loan.

Cameron DeChurch: Thank you.

[END OF SESSION]