AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS
ORAL HISTORY PROJECT

Interview with
Kathleen Keest

Bass Connections

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PREFACE

The following Oral History is the result of a recorded interview with Kathleen Keest, conducted by Andrew O'Shaughnessy on May 28, 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: Kathleen Keest
Interviewer: Andrew O’Shaughnessy

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Andrew O’Shaughnessy: My name is Andrew O’Shaughnessy, a J.D. candidate at the Duke University School of Law, and also a research assistant for the Global Financial Market Center’s American Predatory Lending Project. It is Thursday, May 28, 2020. I am speaking remotely with Ms. Kathleen Keest for an oral history interview. Ms. Keest, thank you for joining me today.

Kathleen Keest: Pleasure to be here. Sounds like an exciting project.

Andrew O’Shaughnessy: That’s the ambition. I'd like to start by establishing your early background. I believe you grew up in Illinois and got your J.D. from the University of Iowa. So a Midwesterner at heart then.

Kathleen Keest: Yes, indeed.

Andrew O’Shaughnessy: You’ve had a varied career. You've represented consumers directly, you've worked in policy and you've also worked in government as a regulator and a consumer of policy. So in the context of your career, when did you first start working on issues related to residential mortgages?

Kathleen Keest: The first one was 1984. And pretty much since the mid-eighties.

It might be useful just in terms of setting a framework for you to understand the way I view the timeline. I think of the subprime mortgage lending, in the run up to the crisis, as three major waves of predominant business models.

What I call the first wave basically ended with the 1994 HOEPA Act, the Homeowners’ Equity Protection Act. There were kind of two different business models [in the first wave]. One was the big, national finance company model that had started as small loan lenders. What they did in the late seventies, early eighties, was move their business model into home-secured lending from small loans. And that business model was exclusively refinance, not purchase money; high interest rates; [fee] packing and flipping.[1] That was the Household[International]’s, Associates [Home Equity Services], Beneficial[Loan Corporation of America]’s — those actors.

[1] “Flipping” as used here refers to the serial refinancing of a customer’s loans, typically with new fees rolled in with each refinance.

The second [of the first wave models] was sort of a more regional one. In the late eighties, early nineties, there was a period of rolling recessions in some areas, followed by housing bubbles, big markups and housing appreciation. In this business model, smaller more regional operators would make one- to two-year balloon loans that were designed to fail and capture the appreciation in these appreciating markets. If the people couldn't make the one- or two-year balloon payment, which most of them couldn't, [the lenders would] foreclose and get a more valuable property. If the [consumers] did find somebody to refinance it, the lenders could take the money and run anyway.

And kind of like generals fighting the last war, the 1994 [HOEPA] Act was designed to bring an end to the balloon model, foreclosure-prompting ones, and curb the excesses of the packing and flipping of the larger companies' model without really taking aim at the core of the [finance company] business model.

The [finance companies] were charging, typically, around 15 or 18% [interest] on these home secured-lendings, and 10% of the principal would be fees of some sort. And HOEPA just knocked those [fees] down to 8%. So you started seeing, you know, 14%, 15% rates with 7.9% fees and points, and a lot of insurance packing because originally they — the [Federal Reserve] and the Congress — didn't count the single premium insurance towards the [8%] limit. (And we'd told them at the time, in 1994, "you're just inviting trouble, and you know that's what they're going to continue to do.") Sure enough, the second wave business model, the period between when HOEPA went into effect in 1995 to around 2002, the second wave business model was the finance company model, and they were in fact doing a lot of insurance packing because those [fees] didn't count towards the 8% rule. And that's when North Carolina started getting interested in passing a new law. And that's when Martin Eakes [CEO of Self-Help Credit Union] noticed what Associates was doing.

Between 1998 and 2002, there kind of started to be a pincer movement on that business model. The FTC and the North Carolina AG's office went after Associates for its insurance packing. The North Carolina anti-predatory lending law took aim at that in 1999. [The state AGs and financial regulators started the Household investigation.] Then, I think it was somewhere between 2000 and 2002 that the Fed finally….

To back up a minute, we were telling them in 1994 that credit insurance was going to be abused if they didn't count it [towards the 8% limit]. The [HOEPA} compromise was to give the Fed authority to add it to the fees and points triggers. So sometime between 2000 and 2002 – I don't remember exactly when – the Fed did do that.

And so that was the pincer movement that started in on the second wave model and [helped cause] it to wane. And in the meantime, what I call the third wave, which is the hybrid, the exploding ARMs [adjustable-rate mortgages] started coming in, and that was partly their moving into the vacuum that was left. And that's the [model] where [the loans are] "designed to sell" and "designed to terminate early" so they could continue feeding the demand from the securitization market. So that's kind of the timeline.

We were focusing on the very end of this what I call the second wave, and the beginning of the third wave, which are two different business models. The legislation and the regulatory responses and the law enforcement kind of — because they're backward looking, you know — they're focusing on the end days of wave two business model, while we hadn't yet seen the problems inherent in the third wave.

I mean it's kind of interesting to me that in 1994, when we were working on the HOEPA legislation, the people in Congress – even those who were wanting to do the reforms – are saying, "We don't want to interfere with the *responsible* subprime lenders." And at the time, Household was considered one of the "responsible" subprime lenders. Fast forward to 2000 – I think it was 2000, 2001 – when there's a [U.S. Senate] hearing on predatory lending which is focusing on the second wave finance company model. And I remember at that point I was working for [Iowa Attorney General] Tom Miller. Tom Miller and Martin Eakes and a consumer from West Virginia were on a panel with a guy from AmeriQuest, which was one of the biggest lenders of the third wave model. And at that point, AmeriQuest was considered one of the "responsible" subprime lenders because they didn't do insurance packing. And then of course, it wasn't four years later that AmeriQuest was the target of new inquiries because, you know, we'd begun to see what that third model problems were. And then because [that model] was securitized and "designed to terminate" and "designed to be sold", — it's the one that had the seeds of the global meltdown with it.

And so that's the way we focused on the policy and the way we focused on where we thought the problems were, depending

on how much time had elapsed, where we had time to see what those problems were.

I was working on the first wave through the early nineties, and then the second wave up into 2004. And I personally didn't get into the third wave until I went to CRL in late 2004. [The states had just] started on AmeriQuest before I left the AG's office.

Andrew O'Shaughnessy: That is very helpful…. In the context of your career, then, when did you first start working professionally on matters related to residential mortgages?

Kathleen Keest: 1984 was when I started and that was with the first wave.

Andrew O'Shaughnessy: I'm curious about what continuity there was between these waves of business models and the backward-looking regulation of those models, or whether they were really distinct.

Kathleen Keest: Well, in some senses there was an evolution. The evolution I think was driven in part by opportunities of both market adjustments and – let's see. The second wave model at the beginning was all about equity stripping. It was sort of no-risk lending in the sense that, even when people couldn't afford to pay off their mortgage, the lender was targeting cash-poor house-rich people, and then flipping [the loans], taking as much equity out of the property as [they] could. I think in 1998 or so, [U.S. Senator] Chuck Grassley was head of the Select Committee on Aging and he held a hearing called "Flipping, Stripping, and Packing Their Way to Profits," or something, which was about that. And his conclusion at the end of it was, "Isn't this a shame? Too bad we can't do anything about it, because it would involve regulation." I might be overstating the case.

But then, at the same time, what you had with their model was that housing appreciation was creating a whole lot of opportunity that unmoored itself from the capacity to pay. People were saying, "take advantage of the appreciation." This was still a lot of a refinance market — refinancing your debt. And I guess it has continuity in the sense that markets evolve to take advantage of loopholes, and so you can't really think of them as separate. It was an evolution. It was an evolution created by a lot of macro developments. The whole securitization thing, I think, was driven in part by a global glut of savings, looking for a place to park, and mortgage-backed securities would do it.

There was a way in which the second wave and the third wave melded in terms of business opportunities. For example, because mortgages have to be recorded, brokers or loan

officers at AmeriQuest, their whole model was to have these deceptively low teaser rates that exploded after two years at a fixed rate. …. So you would have somebody, a broker or an AmeriQuest-, Countrywide-type retail officer looking through filings, seeing somebody who's got a Household loan. Household rates are like 15, 16%. And if you have one of their home equity second [mortgages], it's 20, 22%. So you get a broker cold call on you and saying, “Hey, I see you've got a Household loan and I bet you're paying a really high interest rate on that.” “Um, well yeah.” And he says, “I can really lower those payments for ya. You know, I can give you a 7% rate, cut your payments down to blah, blah, blah.” “Well, um, that's great.”

It created a really serious problem [AGs or advocates are] starting to think about whether or not you can do a UDAP [Unfair & Deceptive Acts & Practices] approach to it, which is what a [state Attorney General’s] primary tool is. Because the way the [Federal Trade Commission] started defining “unfairness” in 1980 involved essentially a cost-benefit analysis is, “did [the practice cause] substantial harm, not outweighed by benefit?” Well, if you're somebody that's got a 16% insurance-packed Household loan being offered a 7% loan to get out of it, is that…? [UDAP]'s not well designed to deal with the frying pan to the fire kind of [situation] you know. Which is worse? Who knows? So to the extent that the regulations tried to avoid getting specific and we're left with UDAP, then that very transition, that very boundary wall between the second wave and the third wave created its own enforcement problems and offered real opportunities for brokers to set themselves up as the good guys like AmeriQuest did in that hearing in 2000.

Andrew O’Shaughnessy: I'd be remiss … if I didn't get a sense of your narrative encountering mortgage issues for the first time. So you mentioned 1984. I understand that is towards the tail end of your time at the Legal Services Corporation [of Iowa]?

Kathleen Keest: Yes, it was. And that was the case that went to the Eighth Circuit called Besta v. Beneficial Loan Company of Iowa or something like that. And it was a classic example of the finance companies moving from the small loan model, taking it into home-secured model. So at the time, Iowa had the Iowa Consumer Credit Code, and [lenders] couldn't take a security [interest] on real estate for loans under $2,500. So what Beneficial did was take what could have been like an $1,800 refinancing, packed it with insurance and the costs of filing fees to take the loan over that limit. And so basically what they did was turn what could have been a $2,500 loan into a $5,400 loan or $5,000, and took a

security interest on the home. And that case is reported…. [O]ne of the volunteer lawyers in Cedar Rapids then had asked me about it…. [T]hat was my first case.

Then I went to the National Consumer Law Center and was doing consumer credit stuff. We were still dealing with the first-wave models. Then I was involved in the Landbank litigation. For example, they were making loans at 15 to 18%, but with 20 points or so, so that the APRs were really more like 25%. [Landbank was] operating I think in five states. I think North Carolina they weren't, but I'm not sure about that. But there was litigation involved in all of that and we were involved as co-counsel in the Virginia litigation on that one. And what was kind of interesting to me was that in that they were calling the 15 or 20 points "discount points" and telling people it was to give them a discount on the rate; kind of like, well yeah, but when your rate's 18%, I'm not sure where the discount is. And so we were doing that through '85, '86, '88, something like that. Then we were involved with the 1994 HOEPA legislation.

I don't know if you're familiar with the law — with the National Consumer Law Center and what it does.

Andrew O'Shaughnessy : …[C]ould you elaborate?

Kathleen Keest: Yeah. Well, basically it was a support center for legal services programs around the country. One of the real advantages that I had at that point was that I was able to see patterns from all over the country and seeing what kinds of cases were coming in. So that's where we were seeing a lot of Associates cases. There was one that ultimately made, I don't remember whether it was the front page of the *Wall Street Journal* or… must have been the *Wall Street Journal*. In '98, I think '97 or '98 about, a guy named Benny Roberts, who was an older guy in his seventies, I think, who had bought a freezer meat plan on installments for $1,200 that got sold to Associates, who then flipped him to the point where by the time the legal services program in Virginia was trying to defend a foreclosure, he'd had eleven different loans. Each one of the loans does not look like it has any violation, but this guy just got screwed. And when I went through and did a financial analysis of the flow of the money through each of these [refinancings], it was sort of like he'd gotten actual cash value of something like $25,000, mostly refinancing his own loans at rates that went from 12 to 18%, with a few dollars advances, but they now had a $45,000 loan principal lien on his real estate.

It was kind of like one of those things where, you know, Shakespeare's "if the law can't deal with this, then the law is an ass." They really didn't have any tools in Virginia, so we just kind of laid it out. I think what really got through, what really saved Benny Roberts was the fact that for some reason I was talking with a reporter named Jeff Bailey for the *Wall Street Journal,* who was really fascinated. And so [the case] ended up appearing on the front page of the *Wall Street Journal* and they settled. But we were seeing that kind of stuff. That was a paragon of that [finance company] business model. So that's where we were in the late eighties, early nineties.

Andrew O'Shaughnessy: My understanding of the National Consumer Law Center was that a lot of your work in support of [local legal services programs] was through publications. Could you talk a little bit about what you were publishing at the time to help legal aid services working on these sorts of matters?

Kathleen Keest: I had two volumes, because consumer credit was my field. And so I did the *Truth in Lending* volume, or was primarily responsible, not exclusively. And credit regulation, which in '95 we reconceptualized as *The Cost of Credit*. And the reason we did that was because since 1980 and the deregulation movement, which basically got rid of usury ceilings, people had needed new tools.

With *Truth in Lending*, what happened was there was the rescission right,[2] which only applied to refinancing, but that's where most of the subprime lending was going on back then. That had kind of been dormant up until this wave of mortgage subprime lending started in the eighties. And so we ended up focusing a lot in the *Truth in Lending* volume on arguments that they could use to rescind these loans. And then *The Cost of Credit*. We were also trying to deal with all of the payday loans that were just beginning. I think I did my first writing on payday loans in 1988. We were trying to give them tools to deal with overreaching lending. There's a whole chapter on what we call overreaching, where there's no [specific] statutory problem, but how to analyze a transaction so that the fundamental unfairness of it would speak to a judge or a jury. The best litigators are good storytellers. If you could —like in the Benny Roberts case — if you could lay out the facts, anybody who's got any sense of fairness or justice is just going to go, "This ain't right."

[2] 15 U.S.C. Sec. 1635 gives consumers a right to rescind certain home-secured loans in the event of specified material violations of the Act.

And then the other thing we tried to do was say, understand the business model, break down the transaction. Don't just take a Truth in Lending checklist and go, “Is this disclosure there? Is this disclosure there? Did they calculate the APR right?” Look and see the financial implications of this transaction. See what it does and then try to tell the story.

Then we went looking for any nonspecific litigation handles that could be used and making suggestions about that kind of thing. And, again, since we had the national perspective, we could do that. That first case I worked on, the Besta case, it went to the Eighth Circuit. That was one where it was sort of almost unheard of because the Eighth Circuit overruled a trial judge on unconscionability.[3] And they also said it was both substantively and procedurally unconscionable, but we're going to base our ruling just on the procedural unconscionability. But you know, the fact that an Eighth Circuit, which was a pretty conservative circuit, would do that about overreaching gave some plausibility to making some of these arguments.

That was what we were doing in the writing. And then the other thing that we were doing is explaining developments that we would learn from one case, and then make it available to everybody else so that they could start looking for things that might've been overlooked. So that was the benefit. And then the other benefit of it was if there were decisions that looked sketchily reasoned, we could point out how they could distinguish those cases. Or if there were facts that made a difference, to give them a tool to counter bad precedent as well as giving them access to good precedent.

Andrew O’Shaughnessy: So what made you want to move from that work back to Iowa?

Kathleen Keest: Primarily it was personal. Iowa is just kind of like a yo-yo. You know… I got thrown out to the East Coast for 11 years, and then I came back to Iowa for eight years, and then I got thrown out to Durham for five years. Then I came back to Iowa. Thrown out to DC for four years and then I came back. It's just the draw of roots, I guess. CLC was probably my ideal job.

Andrew O’Shaughnessy: What makes you say that?

Kathleen Keest: Because I like to diagnose problems. I'm a diagnostician, not a treatment specialist. But I could diagnose the issues and come up with suggestions for dealing with them and then leave other

[3] Unconscionability is a legal doctrine whereby a court can refuse to enforce a contract because its terms are unfair or oppressive. See *Unconscionability*, Blacks’ Law Dictionary (11th ed. 2019).

people to follow through. So that I didn't have to go through dealing with two years of litigation and dealing with stupid motions for summary judgment, discovery battles and stuff like that. And it gave me a place to sort of put my writing. When you're thinking about problems and thinking about what the solutions could be – having a vehicle to write – it gives you a place to put it[.]

Andrew O'Shaughnessy: At the AG's office, my understanding is you had broad responsibilities for consumer credit protection.

Kathleen Keest: Yeah. We were one of the States that adopted the Uniform Consumer Credit Code. We were one of only two states that adopted the 1974 version, which was the more consumer oriented of the [two versions[4]]. And there was a position there called the Administrator. One of the people in the division of consumer protection, the head of it was designated as the Administrator, and one of the people in it was designated as the functional Deputy Administrator. And so [the latter] was my role. But because there was a… $25,000 loan cap on the applicability of the [Iowa Consumer Credit Code], some of the finance company loans would be under that cap. But a lot of the subprime mortgage loans were over that cap because [loans over $25,00 still fell within the state UDAP statute.] So I was the one that had [a focus on consumer credit]. Others had telemarketing or the auto dealers. Those were the two big other issues. So pretty much the whole spectrum of credit was mine there.

Andrew O'Shaughnessy: At that time, where did residential mortgages fall in the hierarchy of things you worried about?

Kathleen Keest: In terms of the number of complaints we got in Iowa, it was probably number two, with auto finance being bigger. Payday was starting to be big. We had Norwest Financial, which was one of the big subprime lenders, which later became merged with Wells Fargo. But it was one that was a big issue because I knew it was a big issue. Iowans tend not to complain, so we didn't get a lot of complaints, because people A) don't know they're getting screwed and, B) if they do, it's easy enough for them to think, "I should have been smarter," even though these things are so complicated that plenty of people with more experience, we'll put it that way, get taken.

But I remember that one of the things that we did was we worked with what has been a movement that grew out of the

[4] There were two versions of the Uniform Consumer Credit Code — 1968 and 1974.

NCLC constituent community, the National Association of Consumer Advocates [NACA], and Cathy Mansfield, who was one of the few professors at a law school that did consumer stuff from a consumer standpoint. (Drake [University] is just a few blocks down the street here and Cathy's a friend of mine.) We worked with NACA, with her on behalf of Drake, and NCLC to create a home mortgage lending conference here in Des Moines. And I think that was 1999. And the reason I mention this is that it actually had a huge payoff.

We were rather surprised that people came from, you know, as far away as the Puerto Rican legal services program. But we wanted to have it not just be a legal services community conference. We wanted to bring in AGs' offices and state financial regulators. And so that was, I think, the first time there was interaction over mortgage lending among the advocacy community, the AGs, and the state financial regulators together at a conference. And then what happened was, both the Minnesota AG's office and the Minnesota financial regulator's office was represented at this conference. And so there developed a kind of personal connection.

A year or so later I got a call from the financial regulator in Minnesota who had been at that conference saying, "are you hearing complaints about Household?" And we talked about that a little bit. And so we said, "okay, Scott, you call your community, I'll call my AGs community, we'll call around and see what we're getting." And so we had a call then that for the first time brought together AGs and state regulators. And I think at the outset there were only eight states. But, for example, in New York, both the financial regulator, the Department of Financial Services — the department of banking —whatever it's called, and the New York AG were looking at Household, but they hadn't been talking to each other, if I remember correctly. And so that's what ultimately grew into the multistate Household [investigation]. And that was the first time that, I think, that AGs and financial regulators worked together on a multistate. The working group was 20 or 21 states, but ultimately all states signed on.

And the reason that [coordination is] important is partly because of the amount of information that's accessible under ordinary circumstances, because regulators can go in and examine, whereas AGs can't. The [AGs] have to get their information first by complaints and then by discovery. But even more important was the leverage, the tools that [the financial regulators] had. I mean, AGs mostly just have UDAP, with financial penalties and maybe some injunctions, whereas the

banking regulators can pull their license. And that's [the lenders'] lifeblood. And so it gave a different dynamic.

And then the other thing that happened with that really upped the ante on it was – and I'm going to give Tom Miller credit for this. He was Iowa's Attorney General, still is. He was very interested in this. And we had a very active consumer Saul Alinsky-type on-the-ground activist group, called the Citizens for Community Improvement. They were going out and they were talking to the people who were victims of subprime, predatory lending and they were bringing people to our office's attention. And I had been working with them since their inception back in the mid-seventies, when I was in a local Legal Aid office here. So they felt pretty comfortable. And then Tom Miller is totally accessible. There were at least two suicides that were directly attributable to the pressures of an impending foreclosure. And Tom Miller was really, I think, affected by this personal thing.

The first time there was going to be a meeting between the state assistant AGs that were working on the case and the people from Household, Tom said he was going to come, which I don't think [AGs] normally do. And he then called Roy Cooper, who was the AG [in North Carolina] and had had experience with Associates and the 1999 [NC] predatory lending law. And then Chris Gregoire, because the state of Washington was doing a lot, both in the AGs office and because they had a very active Department of Financial Institutions at the time, and had a big case against Household. So he told Chris and Roy that he was coming. And then one of the deputies from the New York [Department of Financial Services] found out that these AGs were going to be coming, and so she talked to her [boss] — the Superintendent, a woman named Elizabeth McCaul. And so, from the get-go at the meetings, there was this really high-profile, high-leverage design to that. That ended up with what at the time was the largest mortgage settlement ever, $484 million or something like that.

Andrew O'Shaughnessy: When was that settlement reached?

Kathleen Keest: I believe that was 2002. And at that point we were starting to see the AmeriQuest problem. That was the next target. And that was just beginning.

And that actually kind of began with a whistleblower — a whistleblower about appraisal fraud within AmeriQuest. And so it began as sort of a narrow issue. But we'd had somebody who was working inside and called and told us that basically what they were doing was they were getting appraisals, but if they

didn't – In Iowa we were not having the housing appreciation bubble that they were [having] in other parts of the [country.] And so basically what was happening was that when the appraisals were [made], if they didn't support the loan [that] the loan originator wanted to make, [that appraisal] went into the wastebasket and [the originator would come] up with other [appraisals]…. This notion of "made to order" appraisals coming up to support these loans would not have been necessary in states where there really was a housing bubble.

When [the whistleblower] called, I think she said she knew of people in Texas and Colorado and a couple of other states where that was going on. So that's how the AmeriQuest things started then, with the appraisals. I think it ultimately grew into a lot of other problems that were uncovered during the course of investigation.

Andrew O'Shaughnessy: As the inquiry grew beyond the initial fraudulent appraisals, did you feel like you had the legal tools necessary to pursue what you were turning up?

Kathleen Keest: That's where I think the problem with the UDAP issues come up. But I think it was like February of 2004 or something like that when AmeriQuest started, and I left the AG's office in July of 2004. So somebody else, Patrick Madigan, my successor, took over from then. But I think the issue with the tools is how adequate UDAP is. And then you also get into the, you know, what I call the "zeitgeist matters" [factor], because deception and unfairness can be sort of in the eyes of the beholder.

Andrew O'Shaughnessy: So not long after that, you've been at the Center for Responsible Lending for a little bit when, in 2006, I think it was, you all published Losing Ground, which was, would it be fair to characterize it as a relatively early exhaustive look at the third wave [of predatory business models]?

Kathleen Keest: [Nods yes.] And this brings up a point that I think is really important to keep in mind in terms of how the problem was able to get so big before it was noticed. Regulators and AGs, law enforcement, focus on one actor at a time. You could look at Household's foreclosure rates, but you can't quite get the broad picture. And part of the problem is the data. So access to data was key here. That data was primarily available to the industry and only the industry. For example, investment analysts could have access to Loan Performance [a large proprietary database.] They could look at the collection of the securities that had started to be sold in the private market. (Now this is private market mortgage-backed securities, not the GSE's [Government

Sponsored Entities].[5]) A subscription to that database was something like a quarter of a million dollars a year. The Fed might've been able to afford it, but certainly a state department of financial institutions couldn't do it. Academics couldn't do it. Most nonprofit advocacy groups certainly couldn't do it. But what happened was that the Center for Responsible Lending was started out with enough funding to be able to do the job and do the job right. And then when the hiring was started at CRL, they brought, not just lawyers, they brought in statisticians and you know, number-crunchers who were able to able to do [analysis].

It was really because for the first time somebody consumer-oriented, non-industry-oriented could look at the data from a perspective that was informed by knowledge of what was happening on the ground. We in the advocacy community and the AG enforcement community were able to see what was going into the pipeline and knew what those problems were. But we did not have access to a broad array of data. And so it was really the fact that CRL could afford that database and was smart enough to hire people who had the number- crunching skills to do it and had experience with what was going into those loans to know what to be looking for.

Up until then, that delinquency data was slice-in-time: how many foreclosures or serious delinquencies that subprime lenders in each state had at a given point in time. But with this database, for the first time somebody not in the industry had the capacity and the desire and the wherewithal to look at *longitudinal* performance of these loans. That was kind of the key. And it is important, though I don't know how many other people will say this, but what happened next was that *Losing Ground* came out in December of 2006. [T]hen the next thing that CRL did with the data was look at to see the racial disparities [in lending], because a lot of people were going or looking at the credit worthiness and… going, "Well, of course they're paying more because they're higher risk, you know, what do you expect?"

[It was important enough that they tried to limit the use of data for public consumption.] I happened to be in the place where the fax machine was when the fax came in from Loan Performance saying [paraphrasing], "You need to cease and

[5] Keest is referring here to Fannie Mae and Freddie Mac. Lenders could sell so-called "conforming loans" meeting defined standards to these GSEs. The subprime loans, by contrast, did not conform to GSE standards, and so went into the private securitization market.

desist publishing. It's on our data. We have a non-publication provision in our contract." Well, what Loan Performance hadn't realized was that when they signed the contract with CRL or Self-Help, whoever it was, our people were smart enough to take [that provision] out at that point. (When you're talking about trying to sell a quarter-of-a-million-dollar subscription, [perhaps the sales person thinks] it's kind of like, "Whatever.") Loan Performance didn't realize that that provision was not in ours. But when you think about how much the industry was trying to protect its data [from scrutiny]…. Anyway, after that, they couldn't cancel our subscription but they could refuse to renew it.

Andrew O'Shaughnessy: So as these reports were coming out, what was the reception to your research like?

Kathleen Keest: "Oh, worst case scenario. Oh, worst case scenario. That'll never happen, that will never happen." What the prediction was, was one in five. You know, we're gonna have two million foreclosures in the next few years, one in five [loans will] collapse. So partly it was, "Worst case scenario." Partly it was, "What do you expect? These are risky borrowers."

Andrew O'Shaughnessy: Was that the universal reaction? Was there any variation, were some states more interested?

Kathleen Keest: Well, it wasn't so much the states because at that point it was more of a state-federal [conflict]. Because at that point the OCC [U.S. Office of the Comptroller of the Currency] in particular had gone into high dudgeon to protect their national bank charter and make it the charter of choice. And so the OCC kind of became a bête noire.

Back to whole "zeitgeist matters" — the industry had kind of morphed from the "we want to get rid of the bad apples" to "we believe in deregulation, period" —no matter what the evidence is.

But then the Fed became interested and we were trying to convince the Fed to make more use of its UDAP authority. Meanwhile, the OCC was out there [pushing a deregulatory and preemption agenda]. And the problem with the OCC, which just regulates national banks, is that there were all of these tagalong preemptions, so that what they did gave preemptive rights to non-national banks because of these tagalong, parity things.

Then you also had to deal with the fact that these third wave models — hybrid ARMs — [were protected by other federal preemption laws.] The 1980 DIDA [Depositary Institutions

Deregulation and Monetary Control] Act had [preempted state laws and] deregulated interest rates and points, although some states could opt out of it. (And Iowa was one of the states that opted out of the 1980 Act.) But then the 1982 [Alternative Mortgage Transaction Parity] Act had preempted any state laws on "creative" financing. It dealt with the structure of the loans and features other than interest rates, and that included adjustable rates. So the states were by [federal] statute prohibited from dealing with kind of the heart of the matter there. Add to that the regulatory overreach from the OCC. And so [advocacy] was really kind of focusing on Congress and the federal regulators.

Andrew O'Shaughnessy: I believe *Losing Ground* came out in December 2006. At that point, how long did you all think you had to reach federal regulators and Congress?

Kathleen Keest: Well, we didn't know, partly because the [housing] market was still in theory appreciating and partly because we also….

Well, we knew about securitization. We knew that that was a problem. We knew that this whole design, the "originate-to-sell, designed-to-terminate, to keep the pumping-out machine going" [model] was a problem. But when it was all going to collapse was of course just as much a mystery to us [as anyone.] If we were to extrapolate from the [finance company] business model, the second to third refinances is where things started to fall apart. But with these originate-to-sell kinds of things and with the housing bubble, that wasn't necessarily going to be predictive because the more the property values went up and the more you got appraisals to order, that check of market value on loans was not really gonna operate. So we didn't know.

I'd also like to say by way of background that the other thing that we — or at least that I — didn't know about was this whole thing about the derivatives. I think U.S. Senator Phil Gramm has not gotten sufficient blame for his role in this because back in 1999 or 2000, in an omnibus budget reconciliation bill that was something like 1,800 pages long, passed right before Christmas break, he got in a provision that said *nobody* at [either the] state or federal level could regulate derivatives. Which was all of these collateralized debt obligations and default swaps and all this other stuff. So everybody is operating in the dark because of Phil Gramm. That was the context in which Ben Bernanke said a subprime crisis is going to be limited to the subprime sector because that was, like I said, a black box to them as well as everybody else. So we didn't really know.

So we'd been writing [Losing Ground] through 2005 - 2006. They'd [CRL researchers] been doing the data analysis through 2005 - 2006. But I think it was in February of 2007 when I think Household and one other big subprime lender (– HSBC had bought Household by that time –) said they were putting —I don't know, $10 [b]illion or you know — boatloads of money into a reserve against credit losses. And that was kind of a first crack. So we didn't know, but in fact, I think the first crack started just two months later and in August came those hedge fund collapses.

Andrew O'Shaughnessy: In our oral histories, we've heard a number of different narratives about what caused the financial crisis. And so we make a habit of asking everyone we speak to what their understanding of that is.

Kathleen Keest: Well, first off, it is *not* about getting low- and moderate-income people their first [home purchase] loans because this thing overwhelmingly started as refinancing loans. A large number of people who had gotten their homes in the prime market lost them in the subprime market up through probably 2003, 2004. Anyway, that belies the whole notion that it was, you know, pushing homeownership beyond its boundaries.

Although once it started getting into the purchase money market, it was more a problem. Not so much [pushing first-time home ownership] as a mismatch between – and I think this was a significant thing – a mismatch between income and affordability. So for example, in California in 2005, I think the affordability index statewide was 14%. (The affordability index is what percentage of people could afford to buy a median-priced house at [standard prevailing loan] terms.) So the problem became, I think in part, this mismatch between the value of the asset — the price of the asset — and the fact that nobody was paying attention to ability to repay. There's a problem when 86% of the population of California can't afford a median-price home [there]. And so wage stagnation and the extreme [economic] inequality is playing into it. It is really starting to play havoc with the housing market — a real serious part. I mean, a serious part of the [problem] and nobody's paying attention to it or recognizing it. So that's kind of a fundamental problem, a fundamental macroeconomic problem.

And to the extent that the refinancing lending and the debt consolidation — which was a big part of home equity lending [market] — was people borrowing to try to get out of debt, [those factors are at play, too.] People kept talking about [borrowers] "living beyond their means," but, at some point, it's

an income insufficiency problem. And nobody is trying to deal with it except [by] making more debt accessible to them, but you can't really borrow your way out of an income insufficiency problem.

Then, on top of that, there is this whole zeitgeist of deregulation and, "Nope, don't interfere with the markets. The markets are self-correcting." This blind, almost religious faith in a self-correcting market — those to me are the macro causes of it. Things flowed from that. It's this uber capitalism, this "greed is good," and "we don't want to regulate," "people are responsible for their own actions." And at some point I said, "Why should every commercial transaction for a low-income person be an exercise in self-defense?" Because this rugged individualism [means that [consumers must protect themselves from those who have more experience with all these complex products. There's often disparity in education, experience, or degree of cynicism and trust. (Someone described the subprime problem as largely a matter of misplaced trust.)

And then you had the federal regulators like the OCC bound and determined not to do anything to make the problem better. And a Congress who at some point had become wussy. And an industry that looked at any regulation as the camel's nose under the tent. And then the Fed, which was just gradually [coming to the conclusion something should be done]. And that was only after Ben Bernanke and Yellen — Greenspan's just a loss. That's kind of where I think the problems are.

And then the industry was really good at creating middlemen. This whole securitization thing. Well, to get back to that…. Between 2005 and 2007, there were some Republicans, conservatives looking at federal regulation that was trying to create a low, low bar to preempt all these other state laws. At that point, Brad Miller and Barney Frank, and – I can't remember whether Barney was doing it or not – but a couple of Congressman from North Carolina were trying to create a counter with federal legislation and, from 2005, introduce something. By 2007, Barney Frank was in there, but I remember the discussions at that point in 2006, 2007 on this federal bill that the consumers advocates were trying to do. But the idea [in Congress] was still very much, "We want to protect the securitization market because these securitizations" – and again, I'm talking about the private mortgage backed, not GSEs – "are really important to the economy, and it's really important to the liquidity of the housing market. And so while we want to get to the heart of the problem, we don't want to interfere with the securitizations."

And so the issue of assignee liability and whether or not a consumer who's screwed by an AmeriQuest could raise a claim in defense against foreclosure against whoever owns that thing later on was a huge issue. And because of the way those CDOs were structured, even figuring out who the hell the assignee is, and the legal conceptions for ordinary people who were trained in the ordinary concept of an assignee back when we went to law school – it was just so hard. It was so hard to understand, because who the hell owns this note by the time it's been sliced and diced or whatever. The 2007 discussions on assignee liability to protect the securitization market was a real contentious issue. And then after the crash in 2008, when Dodd-Frank came up and Title XIV, which was the mortgage origination reforms, came up, at that point Congress got a little bit at that. People in that Congress were a little bit more inclined because they recognized that securitization was in fact part of the problem and not a hundred percent something to be secured [from liability.] So there's limited assignee liability in Dodd-Frank. But how much we protect the big institutions kind of thing. So yeah. It's not easy identifying a single causal factor, but all of those things come together. And I'm a believer in Complexity theory. So all those things came together to magnify those negative impacts.

Andrew O'Shaughnessy: What lessons would you want state-level policymakers to take away from this history?

Kathleen Keest: One, that responsible regulation is good for everybody, including the industry players. Two, that policy should be driven by experience and evidence, not by ideology. And then law enforcement and regulators need the tools.

But this issue of preemption and a self-correcting market is – to me, that's kind of it. That's based on a fallacy. "Assume away reality and then get rigorous" just isn't going to work. And that's kind of what it's based on.

Andrew O'Shaughnessy : What haven't we talked about, would you like to mention or be sure to emphasize, if anything?

Kathleen Keest: Well, I think one of the issues that's going to be really ongoing is disparate impact. I started out practicing in 1975, which at the time I didn't sort of realize was sort of the apogee of a consumer movement. And then most of the rest of my career has been watching through the perigee. I thought 2010 and Dodd-Frank and the [Consumer Financial Protection Bureau] was going to be the beginning of a resurgence. But boy did I call that wrong.

But discriminatory treatment is a lot more prevalent than I think the industry recognizes. There's a really fascinating study by Ian Ayres on auto sales, but it translates to this: he found both gender and race bias in negotiated prices on cars. And he said, "It's not part of our study here to explain this, it's just to find out whether it exists or not." But he did offer some suggestions. He said some of it was animus-driven, but some of it had to do, he thought, more [with] the salesperson's perceptions of who would be easier marks, who would be easier to kid. When we did studies on yield spread premiums and the racial differences on yield spread premiums or mortgage brokers and that kind of stuff, you found that the legitimate indicia of creditworthiness had some explanatory [value], but [it did not fully explain the differences]. And so the notion of the implicit bias or explicit bias comes into play. But that's all discriminatory treatment, which is usually very, very hard to prove.

But during most of my legal career, it was not a question that discriminatory impact was relevant and actionable. But because discriminatory impact is easier to prove than discriminatory treatment, this assault on it as the law is just the wrong direction at a time when – I've got to take it back to the "zeitgeist matters" – when racism is becoming legitimized in some quarters. It was a huge problem. It's going to be a huger problem. And the whole thing about the inequality and the refusal to take the inequality of the income distribution is going to have a huge impact, to get back to the mismatches.

I don't know, with the housing trends, what it's going to be like, but until we start paying attention to the fundamentals, everything else is going to be nibbling around the edges….

Andrew O'Shaughnessy: Ms. Keest, thank you so much for your time and your generosity with it.

Kathleen Keest: No problem. It's going to be important to have a record to counter the ideologically-driven revisionism.

[END OF SESSION]