

AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Paul Stock

Bass Connections

Duke University

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PREFACE

The following Oral History is the result of a recorded interview with Paul Stock conducted by Callie Naughton on February 24, 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.

Transcriber: Kate Karstens
Interviewee: Paul Stock
Interviewer: Callie Naughton

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Callie Naughton: I'm Callie Naughton, a graduate student and member of the Bass Connections American Predatory Lending and the Global Financial Crisis team. And today is February 24, 2020. I'm at Duke's Fuqua School of Business for an oral history interview with Paul Stock. Thank you for joining me today.

Paul Stock: It's my pleasure.

Callie Naughton: I'd like to start by establishing a bit about your background. I believe that you went to Duke University for college and UNC Chapel Hill for your J.D. Is that right?

Paul Stock: Correct.

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

Paul Stock: Well, I didn't have many jobs, so I'll tell you about each of them. I worked out of law school at the [North Carolina] legislature for five years, just as a staff attorney, starting in 1974. They were just building a central staff; they had only had one group of attorneys. The Attorney General's office had staffed the legislature prior to that, but [the General Assembly] were building their own [staff]. So, I was on a small staff of attorneys. I did that for five years. And just coincidentally, I staffed the banking committee.

At the end of those five years, I was looking to make a change and the person who was running the North Carolina Savings and Loan League moved it from Greensboro to Raleigh and was rebuilding his staff. And they also had a new lobbyist at that time, a former President Pro Tempore of the Senate, Gordon Allen, a wonderful gentleman, and he suggested that they seek out somebody who had some legislative experience because he was not a lawyer, and he wanted to have somebody who was familiar with drafting and could handle the technical aspects of the lobbying chores, which were going to be part of the duties of this new attorney. And there had not been very many of us, so, it was a very small pool and I was the only fish that happened to be available at that point in time. And so, I took that job on.

And if you remember, in my early years, there were 210 savings institutions in North Carolina – state and federally chartered. In the middle of the 1980s, there was huge failures of savings and loans. That's another story in and of itself. And we started at the Savings and Loan League, offering membership to community banks. The [North Carolina] Bankers Association had far fewer small entities. The handful of large banks supported the organization with much larger dues

and the small banks paid very little. And in return, the big banks didn't want to provide a whole host of services. All they really wanted was lobbying. That's the only thing they felt they got. So, we found a lot of the community banks were interested in that offering. As you move forward for another half dozen years, we had – most of the community banks were members of both organizations and they didn't want to pay two sets of dues., even though the bank was so small.

So, an effort was made to merge the organizations, and at the end of 1996, the two organizations voted to merge. The staff from the Savings and Loan League remained intact. And we added one or two people from the Bankers Association. And we took the name of the North Carolina Bankers Association. The five largest banks pulled out, so the merger was effective the first day of January, '97., So, leading up to the legislative initiative, our organization – the North Carolina Bankers Association – represented all but the five largest banks in the state. And so even though I didn't change offices, I had that same job through the Savings and Loan League, the League of Savings Institutions, the Alliance of Community Financial Institutions, and then the Community Bankers Association, all the same group until we merged with the Bankers Association in '97.

Callie Naughton: Okay. I think during this time, generally across the state, banks increasingly branched as they grew. Can you speak at all to that?

Paul Stock: Well, unlike a lot of states, where unit banking was the rule and a bank could only either have one office or only be in one county, in North Carolina, there was never a limitation on statewide banking for either commercial banks or state chartered savings institutions. And it's one of the things that people felt when interstate banking was permitted – and one of the reasons that NNCB [North Carolina National Bank] and then later Bank of America and some of the other North Carolina banks were so successful – was that they had already achieved some expertise in managing over a relatively far flung geographical area. North Carolina is not very fat, but it's long, over 500 miles. And so, if you had branches across the state, you were not in a single community.

But during that period there was there were a couple things that led to branch networks. Many savings institutions were either merged into other savings institutions to try to develop some size, or they were acquired by banks. And in a lot of cases, in the mid to late '80s, savings institutions had been weakened, and they needed to seek an acquirer, or they had converted to stock, and there were opportunities for financial gain for both the communities and the insiders of the institution. So, there were a lot of acquisitions there. So, a lot of banks filled in their geographic networks rather than starting new branches by acquiring smaller banks and savings institutions.

Callie Naughton: So when the two organizations merged in '97, about how many banks were you representing?

- Paul Stock: I think we still had a total banks and thrifts somewhere in the 140 range, 130, 140, and again, back to the early 1980s, 210 savings institutions and about 80 banks – so close to 300 total – we were half that number in the late '90s.
- Callie Naughton: Right. And what kind of services – you mentioned you were providing services besides just lobbying. What kind of services were you providing?
- Paul Stock: Well, we had a group health insurance program, which was important. We in fact had a fully licensed insurance agency that would offer the sort of buying power for small institutions that big institutions didn't need. That we could have some clout for [purchasing] their bankers bonds, and their directors' and officers' liability [insurance], their own property insurance, there are specialty groups for financial institutions. And we acted as their aggregator to get them the best possible pricing. We endorsed all kinds of providers to them. We screened providers for all kinds of services, payroll programs, anything you'd think of a business that size or bank in particular might need. We felt that we saved a lot of effort.
- Again, some of our smallest institutions might have half a dozen employees. And we were essential for those tiny groups. But even up to 70, 85 employees, we provided a full range of compliance services, both answering questions on the telephone and sending out updates. Every time a new regulation was passed, either the state or the federal level. So, a very, very broad range of services. And they were by and large, very well received.
- Callie Naughton: Great. You started in '74 working with the GA [General Assembly] and you move over in '79, to the Savings and Loan League, and then as you move into the late '80s and early '90s, what were some of the key changes you see taking place in the mortgage market specifically?
- Paul Stock: Well, if I may, I'd actually like to go back to 1978 for just a second. For almost a hundred years, the savings institutions – the savings and loans, savings banks in the Northeast – they had provided the vast majority of mortgage loans in this country and it was in a very regulated environment. Regulation Q of the Fed said “You can pay this much for deposits and you can charge this much for loans. And oh yeah, by the way, savings and loans, you could pay a quarter of percent more for deposits so you'd have a leg up on commercial banks because we want you to be the aggregator for mortgage loans.” And those are the only things that they did: they took savings deposits and made mortgage loans. And that was fine as long as nobody upset the regulated appletart. When Wall Street started offering money market accounts that paid a market rate for interest, all of a sudden people said, “Well, we really liked the deposit insurance but you can't get it on a very big account and for double the interest rate, I'd rather take a chance.” And so, all of a sudden there was tremendous disintermediation in the savings and loan industry.
- And the biggest change, I think, that affected the housing market was done in 1978, when Congress authorized savings and loans and banks to offer six-month

money market certificates. Now at the time, they didn't deregulate what you could charge for loans. What they did is they deregulated one side of the balance sheet. They said, "Okay, your costs are now going to respond to the market, but your fees are going to stay set." And that's what began the great decline in savings and loans. In 1980, the federal government passed the Depository Institutions Deregulation and Monetary Control Act of 1980, affectionately called DIDAMCA. And one of the things they did in Article Two, as I recall, was they passed a federal preemption of state usury laws.

And I bought a house with my new wife in 1981, and our mortgage loan was at 15.75% with a five-year balloon. And I worked for the savings and loan industry. That was the best interest rate I could get. Interest rates had skyrocketed. And in many states, the usury laws – people could not get a house period. Nobody could lend money there. They were frozen. And in one state, Arkansas, they actually had a constitutional limit of 12% on mortgage loans. So the federal government in that DIDAMCA preempted all those usury laws with regard to mortgage loans so that the mortgage market, however pricey, could still exist.

So I think in getting us again toward the end of the '80s, another thing that happened was everybody had always had a 30-year fixed-rate mortgage. Maybe a few innovators had a 15-year because they could afford the bigger payment, pay it off a lot faster. The difficulty in lending in a high interest rate environment challenged people to come up with alternative mortgage instruments, which became a dirty word later on, but initially were very simple things like adjustable rate mortgages that if you went to a local bank or a credit union, it might be every five years with a cap of no more than 1% every five years. But the structure, once it was authorized both by state and federal laws was available. As we got into more and more interesting forms of alternative mortgage instruments, those with negative amortization as a possibility, et cetera, the ability for them to be misused definitely became greater and greater and greater.

And the fact that this federal preemption was in place made it really hard for states to do anything, particularly in the mortgage market. So, as the world economy became more and more globalized – now I guess all of this is my take on it, I did not go to business school – but my take is that as the economy of the world became more and more interactive and national boundaries didn't matter, large piles of money from around the world were always looking for the best return on the safest investment. And for about 100 years, an American mortgage was about as good an investment as you could make. There was very strict underwriting and property values had appreciated steadily, maybe not exactly on a straight line, but quite steadily with only a few dips, notably during the Depression. But it was always seen as a great place to invest.

Now, initially, savings and loans made mortgages and kept them in portfolio. But it turned out that some places had lots of money from depositors and not as much demand for mortgages and other places had a lot of demand for mortgages and not as much cash around. North Carolina, for example, for many,

many, many years – and maybe still, I don't know, I've been retired for eight now – was an importer of mortgage money. Very fast growing, lots of demand, even though we were a pretty big financial state, we still imported our mortgage money and that's where the secondary [mortgage] market developed. Initially Fannie Mae [Federal National Mortgage Association] and Freddie Mac [Federal Home Loan Mortgage Corporation], Ginnie Mae [Government National Mortgage Association], the big national companies, and also huge savings and loans out of California bought a lot of mortgages, big insurance companies, bought mortgages. The secondary mortgage market grew and grew and grew and grew.

Still, it was hard to satisfy as we work our way up through the '80s and into the '90s, the global demand for investments, safe investments. And because they had always these two words, “American mortgage,” had always been such magic, the demand for that particular investment was huge. Well, where there's a lot of demand, somebody's going to figure out a way, or ways, to supply it. And what we know, and as we get up into where we started dealing with legislation, lots and lots and lots of bad practices developed in order to generate the volumes of supposedly sound investments, which were not, to reap those funds. And lots of alternative instruments, but even more so, just bad practices, almost all of which, I think, started off well intentioned in small numbers.

One example was the “low doc” loan. I don't know if anybody's mentioned that to you yet, but mortgages had always had more paperwork than just about any other kind of loan, and the process from the time you say, “I want to buy a house,” to when you closed your loan, seldom could be less than a month, and it was usually more like two months. And some of the participants in the mortgage market – I think largely board mortgage bankers – said, “Well, you know, we ought to have a category of mortgage loans that are so vanilla that we can make those “low doc” loans where you just don't have to do as much. Maybe you get the borrower to tell you how much they have in their accounts and what their salary is and this, that and the other. But maybe you don't verify them all. You get their credit score and maybe you get a couple of other things from reporting agencies, but you don't go back and do the things that are so time consuming. And maybe instead of a full appraisal, you do a property evaluation.” It's been so long now, I don't remember all the things that went into making low doc, but it speeded up the process tremendously. One: you didn't have to get all those things filled in, and two: people didn't have to review as many documents because there weren't as many. Low doc! A great idea, very bad result.

But I think the thing that truly – well, a couple of things. You had lots of people making mortgages and the biggest number generators were the mortgage brokers. They were a new entity. Both mortgage bankers and banks and savings and loans all used them because they helped them expand the numbers tremendously on the mortgages that could be made. Mortgage brokers had no skin in any game. They got paid X dollars for every mortgage they produced. If the mortgage didn't pay back, they didn't care. So you're already doing low doc

loans and if you've got a customer there and they're looking at a house they never thought they'd be able to own and they'd say, "Well, we're going to do everything we can to get you qualified. How much money are you making?" [The mortgage applicant would say,] "X." [The mortgage broker would say,] "You know, I don't think you're going to be able to buy that house with that salary. Let's just work with two X. Let's just, let's just put that down just for arguments sake." They just fudge the numbers. And this went on in unbelievable volumes.

But the thing that took all these practices and expanded it into a trillion-dollar hole in the ground was the securitization and the derivatives. And I can't claim after all these years to still understand all of it. I do know one thing that happened is you take this huge pile of mortgages, a lot of which were very bad to begin with, and you divided it into tranches. The rating agencies – also a culpable entity – would rate them from high to low. This is AA, B plus whatever down to a junk bond level. Nobody really wanted to pay much for those junk bond level. So, if you took all of those, you packaged them up again, just another big pile of those, and you divided that into tranches and you took the best tranche and you labeled that AA. So now you've got bad stuff and you're giving it a high rating.

Appraisers [were] not getting work unless they brought appraisals in that met the need. You can really go right down the list. Banks – in some parts of the country, I don't know that we had the problem here – would essentially rent their charters to non-bank entities that wanted to charge high rates, but they didn't have the benefit of the preemptions that the federal government had passed. You had to have some connection, you had to be FDIC [Federal Deposit Insurance Corporation] or FSLIC [Federal Savings and Loan Insurance Corporation] insured, or you had to be at least a seller to Fannie Mae, Freddie Mac, the federal agencies that required financial reserves. But, a mortgage brokerage company could work out a deal with a small community bank in Denver and using their preemption, sell, originate mortgages all around the country in huge volumes. And with almost no rules. They could just select the states with no licensure or financial responsibility requirements. Anyhow, and all of this led to a huge volume of bad loans.

But then when you take the power of Wall Street, you aggregate [the loans], and you give investment quality ratings for lots of them. And it was just a time bomb. It is. It's really sort of amazing. Now, I didn't know any of this until in the late summer, early fall of 1998, I got a call from Phil Lehman – who I know you've spoken with – from the Attorney General's Consumer Protection Division. And he said, "We're having some issues with junk fees charged primarily by mortgage brokers. And I wonder if you'd get together with us and maybe the mortgage bankers and a couple of other groups and just talk about this, maybe some of the finance companies." I think their junk fee stuff was primarily mortgages, but not exclusively mortgages. So we had one meeting to talk about that. I felt like we could address their concerns.

And then Phil's boss, Alan Hirsch called and said, "There's really a much bigger problem. I think [Phil's] group would be a useful group to start discussing this. And I'd like to bring Martin Eakes over there for you to talk to him." And so Martin from the Self-Help Credit Union and the Center for Responsible Lending came over, and he painted a picture for us that was unbelievable. Absolutely unbelievable. A lot of the stuff we're talking about – which is very believable in retrospect – in 1998, the mortgage market is humming. It's not surprising to find because it was a such a huge volume of dollars, that there were bad actors involved, but the scope that he was describing and the extent to which there was malfeasance throughout the chain of mortgage lending was shocking to us.

And again, my unique background was I started with a bunch of mortgage lenders. So even though I was working for the banking industry and that was largely commercial business. Sort of residential lending was in our DNA there and I was shocked about it. But Martin absolutely had the evidence and I listened. I mentioned Gordon Allen who wanted me to get hired, Gordon was a fabulous gentleman, but his approach to lobbying was not universal at all. And he felt that it wasn't a process of trying to win, but it was a process trying to reach the best solution. Now when you have clients, that means satisfying your client's needs, but if they're willing, it doesn't mean satisfying all their wants.

And when we were the Savings and Loan League and again as the Bankers Association, we were a pretty potent force in state politics and government. And in a lot of states when these issues first arose and the consumer advocates were seeking to get a foothold they always, I think, reached out to the Bankers Association. In most cases, they just didn't want to talk about it. But that was never a really our approach to anything. Gordon said, "You know, if you can be successful and not make an enemy in the process," He'd say, "You can't go through a career that way, but I think you could do that almost all the time." So, we never felt like we had to get the whole nine yards and our membership was very good. They understood how the person who is on the other side of an issue today in the legislature may be your champion tomorrow, but if you go around making enemies, it's harder to do that. So, I had a really receptive audience.

We started those meetings and were not ready to talk about anything we presented yet, because we met starting in September, we had a room full of lawyers. We expanded our group. We had the brokers represented. Now, the big banks remember, still weren't part of our group. They had their own little group called NCAFI, the North Carolina Alliance of Financial Institutions. And we invited their lobbyist to come join us, a nice fellow named Jim Lofton. And he'd been a Republican operative in state government for a while. Also ran one of the best B&Bs [bed and breakfast] in Raleigh with his wife, beautiful place in Oakwood. And a good guy, I'd known him a long time and in consultation with his membership – it was easy for him, he had five members – they concluded that they didn't want to be involved in those sessions. That they would look at whatever was put together, which in hindsight for them was a poor choice. I was unhappy with this because they had unbelievable legal expertise, especially the entities that were already in multiple states had expertise about how these

things would play out working in it. And it was harder with just smaller entities to deal with that.

We were fortunate. One of the companies that was not a member of ours was First Citizens Bank and when they acquired a savings and loan in Hendersonville, they picked up a lawyer there who had been outside counsel to the savings and loan, then went inside, Jim Creekman, and when they acquired the bank, they took him on as counsel. They'd never had general counsel in-house before. And he just happens to be a brilliant attorney, and a really hard-working attorney. And I asked their lobbyist [Alex MacFadyen] if, even though, I explained to him – he was a friend of mine – what we were doing. And what Mr. Lofton had told us is they decided to, I said, “You think there's any chance you and Jim, or at least Jim could be involved in this?” And he said, “Well, let me talk to Jim.” Jim said he wanted to be, and so we had Jim there. Occasionally some of the other big bank lobbyists would come by to stay apprised. But if they weren't lawyers, they didn't want to be there because it was awful. Even if you were, it was awful.

And we met often three or four times a week for six or eight hours at a time. And then, Mike Calhoun [of the Center for Responsible Lending] and Jim Creekman would leave and do bunches of drafting to send back and bring to the group. It was an amazing amount of work and everybody got along very well. The mortgage brokers, I think, felt a little picked on in the group. But again, I think their contribution to the problems was disproportionate to any benefit they had provided. These other entities had been around most of them a long, long time and had done a lot of very positive things for the state. Now since that time, the mortgage brokers have increased, both in the requirements that are placed on them and I think they do a better job, and the laws are in place to – if the current Congress doesn't undo all of them – keep some of those same things from happening.

Of course, one of the problems is you can't rely on having addressed the old issues. It's amazing how many really smart people would rather steal from poor people or take advantage of less sophisticated folks rather than use their same talents to legitimately make money and do well. Like cybercriminals, you know, those are all such smart people. So anyhow, that's the way it was. And we just barely had a draft completed in time for the crossover, the introduction deadline in April of '99.

And by that time, we had a draft that I was able to take to my members. And our members' first reaction – first my legislative committee and then my executive committee and then my board, because this was big stuff – was “No, we're not going to. You know we worked so hard to get most of this stuff deregulated. We're not going to put new regulations on. We will just refinance all of these people in North Carolina out of their bad mortgages.” And I said, “Well, when you see the sophistication to which they were locked into these bad mortgages, plus some of these people can't qualify for any mortgage, mortgages were made to them that should not have been.” I said, “You will find, I believe, that you can't do that.” And so I brought them a lot of the material [we

had reviewed in our working group,] and eventually they said, “This is the worst thing we've ever seen.”

And they gave me pretty much carte blanche to go ahead with the kinds of things we were talking about with the understanding that I did have some of the attorneys from our bigger companies looking at this stuff and having input and going back, but always with the idea of getting a product that we could support. When it came to the end, the big three all got behind it. We did, the Mortgage Bankers [Association] did, and the Center for Responsible Lending and Self-Help, the Attorney General's Office supported it. All the people you're going to be talking to pretty much supported the bill. And at that time, the attorney general was Mike Easley, and the senator that handled the bill was somebody you may have heard of, Roy Cooper.

And, in years after it passed here – and I'll just throw in this anecdote – I spoke to a lot of bank lawyer groups that I was a member of. I mean, people that I knew, but sometimes I would go to speak to a regional group of CEOs of bankers associations like Peter Gwaltney. He was — and my boss Thad — were all members of a national organization and they all had regional meetings. I spoke to a couple of regional ones. Got to go to the Bahamas once on one, which was pretty good. And when I told these guys, a lot of them were themselves, the state lobbyists. So, they were very hands on, on the way these things worked.

And they said, “Well, why didn't you just kill it?” And I said, “Well, the same reason you won't kill it when it comes to your state.” And one, they can go in and say, well, Bank of America went along with this thing and what are you going to do then? Bank of America is your second biggest bank or your biggest bank. But also when you sit down long enough to let them present what they have to show, there's no not going along with it. And they say, “Well, I'll tell you this,” – I make this up, but I like saying it – they said, “Well, if that ever happened in our state, the Attorney General and the Senator would not have their jobs the next election,” I said, “Well, that happened to us too, the Attorney General is now Governor, and the Senator is now Attorney General.” So the same thing happened there.

The passage of the law was very, very easy. With the folks lined up, there was never a close vote at any stage of it. It was so complex. And the thing that made the complexity of the drafting so hard was all these federal preemptions you couldn't just say, “You can't do this. You can't charge this. You can't do that,” because all these federal preemptions were in place. You could prohibit certain entities from doing certain things, but that wouldn't come close to tackling the problem. And so, we had to create something brand new and it took a long time to do it and some really talented draftspeople. And I mostly provided the cookies and the board room that we met in and tried to keep everybody in good humor. And there were times when it was better, then times when it was worse. But the work that was put into it by everybody involved was truly amazing. Thousands of man hours. And I think we came up with a creative product. It was much more complex [than it should have been]. You spend all

these years working for simplicity and understandability and this was very complicated, but it really made it hard for a predatory lender to work in North Carolina. So, it was something I think we're very proud of. Did I answer a bunch of your questions in one long speech? I'm sorry.

Callie Naughton: It's great. That was wonderful. When you think about the law now looking back, do you think it prepared the state for the change – we talked about the changes that happened in the '80s and '90s, but we also know that there were more changes coming around the corner in the early 2000s. Do you think the law prepared the state for those changes?

Paul Stock: Well, I think we addressed the particular issues to the extent we could do it in North Carolina. There had been another fight going on around the same period of time over payday lending and that was also successful. And we got involved in that a little bit. And although it was not something that our members were doing, but because it was it was usury-related and that had been a field that we'd done a lot of work in, we were consulted by a lot of legislators on both issues and we were always able to say “Nothing that puts people already in stress in worse stress is a good thing.”

But payday lending had a very powerful message, and they had no trouble getting testimonials from customers. They set up in strip malls, and they were friendly to the people when they came in, and they didn't break their legs if they didn't pay, but they kept them in this cycle of debt and they managed to extract. And in a way, predatory lending was just that on steroids. It's just the same thing. I think we did all we could. I think the fact that a few other [states] started doing it, and the fact that – as Martin explained to me in '98 – this [collapse] was already inevitable. The volume had gotten so huge. It was just a matter of when it was going to happen. So, I don't think we could prepare for that. And you didn't know how bad it was going to be, but you knew it was going to be really bad.

I remember – one of my bad habits is I like to gamble sometimes. And I remember going to Las Vegas after the crash and I had read that 25% of the properties in Las Vegas were in foreclosure. But [I couldn't relate to] that [number] – you just didn't get a feel. So anyhow, instead of taking a taxi to my hotel, when I got there, I said, “You got time to spend an extra 30, 40 minutes? Drive me around. Let me look at all these places that were under construction and had stopped or whatever.” And he said, “If you're paying the meter, I've got all the time.” And we drove around and it looked like a movie about a dystopian society after some sort of Armageddon. I mean, all these places where the, you know, the PVC pipes come out of the ground up to where they were, 20%, 30%, 40%, 50%, 60% completed. These huge condo developments, individual houses and just stopped. There were many, many, many places around the country like that. So, in a way, I think it's a huge testimonial to the resiliency of our economy that – we're not ready for the next bubble, the market was down 1,000 points when I last looked – that we've come as far as we have. In 10 years, I'd say we really had recovered from it, and it was a deep hole.

Callie Naughton: You were talking earlier about some bad practices you saw developing in the '80s and '90s. Were your members participating in those bad practices? Were there low doc loans or some of the other innovations?

Paul Stock: No, I mean, you know, during the, the '80s and early '90s with our small bank membership, the savings and loans typically were still doing things the way they always had. And the smaller community banks, some of them got into mortgage lending, but not in a big way. They were primarily small business banks. I think some of the bigger banks had mortgage companies and I know some of them had finance companies and did a variety of things. But our membership, I can't say they were 100% pure, but I'm not aware of real involvement. One of the larger community banks, I think, had a mortgage company that might've made Martin's list. And I talked to their lawyer about it, and I think they divested that company before we got the bill passed is my recollection. That's a long time ago.

But, I would not say – now it could have made the problem much more politically difficult for me if they had been invested in it. I can honestly say at both my legislative committee, my executive committee, my board meeting, which are kind of increasingly large groups, everybody was appalled when you could finally convince them that these practices were out there. And even then, we weren't talking about the derivatives and all this stuff. We were just talking about the lending practices and the extent of it. I didn't feel myself competent to educate people on the extent of the problem. I just told Martin I hope he was a lot dumber than I thought he was and that he was wrong, but I never thought that was the case.

Callie Naughton: Did that change in the early 2000s? Did your clients start extending into this space at all? With ARMs [adjustable rate mortgages] or negative amortizations or anything like that?

Paul Stock: There was definitely ARMs. ARMs became very popular.

Callie Naughton: And what kinds of ARMs, just to clear? Like 2-and-28, five-year ARMs?

Paul Stock: I think it varied tremendously, not much in the way of negative amortization. The savings and loans and community banks dealt with the clientele that, by and large, did not have to buy on negative amortization. One of the scary things is in the in the '90s and early 2000s a lot of the lenders were lending on expensive homes on mortgages that had negative amortization. And, sufficiently controlled, if a young couple with two professionals that are working, are just a few years out of college, but they're in steady jobs and they want to buy a little more home than they can afford, maybe they want to start a family soon or whatever, and they're in a mortgage that adjusts every five years with a maximum of 1%. It's a whole different world to adjusting every year with no limit. I can't say that I know of any of our members ever getting into them.

If you're a mortgage lender by history and profession, you know that's a recipe for disaster. Even when some of the savings and loans started selling more of their mortgages, which the bigger ones did, making good loans was just a part of who they were and some of them packaged loans and sold them with recourse. So, you know, they didn't want to have bad loans. And plus, if you sold a lot of bad loans – the theory was – you wouldn't be able to sell any longer to Fannie and Freddie and whoever your investors were. You know, I can't speak to the mortgage banking industry. I'm not sure what was going on there. Given the way their business worked, I'd be surprised if they were doing large volumes of them either. And I think there were a lot of brokers selling to aggregators, and I don't know who those aggregators were, who then packaged them and sold them to Wall Street. I really don't know. And some of your other folks that you've talked to I think would have a better feel for that.

Callie Naughton: By aggregators, you're talking about finance companies that are not chartered as banks?

Paul Stock: Correct.

Callie Naughton: We spoke before about some changing underwriting standards as well, that underwriting standards evolved over this period. But just from your point of view, do you think that was driven by brokers? So, we have this group of brokers that are kind of trapping appraisers, right? You'd said like, appraisers might not get work unless they're willing to play the game with brokers. What do you think drove those changes? Was it brokers? Was it the whole group of them?

Paul Stock: That's really a good question. Again, some of the practices I think started legitimately, and if your underwriting is still solid, you can do lots of things to speed up efficiency, to improve efficiency, without making the underlying loan bad. But if you couple that with falsifying information – and I again, it may be just my recollection, but my recollection is that the biggest part of that problem was coming from mortgage brokers.

Callie Naughton: There's an element of outsourcing maybe that was happening with, between mortgage brokers and whoever they were selling to.

Paul Stock: Everybody. In hot markets, which was everywhere during a lot of these years, the brokers offered a cheaper method of production, seemingly, a cheaper method of production that was really very expensive. But you didn't know that for a while. It's hard for me to see how the savings and loans or any people that had been in the mortgage profession and had substantial investment, had their own skin in the game, how they could purposely falsify the information. The false information, the false appraisals, all those things, you knew you were making a loan that was unsafe. You knew you weren't producing an investment for whoever ended up with it that was going to be worth what it looked like on its face it was worth. So, I don't see how any companies that had an investment

in [the final product] could or would want to do that. But that's always the way I've looked at it.

Callie Naughton:

One thing our project is interested in is, is how do people learn about these problems? We spoke with Phil Lehman last week and he talked about how he had consumers, he had people calling him and saying, "I have this mortgage I don't know how to get out of it and it's a problem." Or "I had all these fees on my mortgage and I didn't know that was going to be there." So that's how he learned about it. Besides sitting in a room with Martin Eakes, how did you learn about what was going on? How did that evolve over time?

Paul Stock:

Well, I have to say that it really was first started with Phil in the junk fees, and then it was total immersion with Martin. I didn't get to wade into it gently. I mean I felt like I was drinking from a fire hose pretty fast, so I did not become aware of this from my members until I started learning about it. I'd bring it up in my legislative committee and some of my members would say "We're really having a problem with appraisers. Either they're so busy they never get back to you on time or if they get back to you on time, you really feel like they didn't do the job."

And I will say, there was something that I think crept into our industry, and I think it may have come from the mortgage brokers in a way. I think people started paying incentives to originators. And that was not intrinsic to the savings and loan industry over the years. But when you're out hiring mortgage originators, people to make mortgage loans and other people are paying the same employees an incentive for every one they close, all of a sudden, you're having trouble hiring if you're not doing that. I think that had crept into the industry. I don't know that it was universal yet, but I think it was. And of course, once again, then once you're getting paid to close the deal, you're getting an incentive to do it, so maybe you're a little more inclined to cut a corner or two and bend a rule. So that may have happened.

But mostly what I recall is members, once I brought it up to them, they said, "Yes, we are starting to have that problem." Now, that's not necessarily the kind of thing I would have heard complaints. The regulations on appraisers were not really much in place yet. They came in. It seems like maybe some of those came in with FDICIA [Federal Deposit Insurance Corporation Improvement Act], but I can't remember for sure. So, it was not a regulatory kind of thing. It was just that they weren't doing it right. But my recollection is I raised these issues with them and then I got feedback from them saying, "Yeah, we are seeing these problems in some of those areas, but it's from service providers." And of course, I know if they were doing something wrong, they're not going to come to me and say, "Well, we're doing this too."

But we always did surveys of various sorts, and savings and loans because they were traditionally so heavily regulated. Banks and savings and loans were regulated differently [from] their beginnings. Banks were given sort of a framework in which to operate and then were told to go be good bankers and

savings and loans were told how to open the mail, which end you put the letter opener in, and their regulations were unbelievably specific. I want to say that there was a [publication] that the national savings and loan group put out, The US League of Savings Institutions, called the Federal Reporter and it was all the federal regulations [applicable to the savings and loan industry]. There were six volumes this size. And they set out monthly supplements to all of them. And that was just one of the services my predecessor on the job had. He had five or six – some of which were totally unnecessary – but five or six services, a full bookshelf of them. And they were without a lawyer for eight months. And first day on the job, there were all these boxes stacked up. I started unpacking and there were months and months of the supplements to those, you know, they were tissue paper thin. It was horrible.

But savings and loans were told everything from A to Z. And so, they were used to being told how to do something and they didn't change their procedures very easily. Now one thing that did happen in 1977, the North Carolina Legislature, before my time with the savings institutions, and it was not anything that I was involved in – interestingly, I'm not sure what committee... probably came through Finance – but they passed a law permitting state-chartered stock savings and loans. Prior to that time, all savings and loans were mutual. They were like a credit union except they were taxed.

Callie Naughton: Can you describe the difference between stock and mutual?

Paul Stock: Yeah. It's huge. It's a huge difference. Let's say this, if you were on the board of directors of a savings and loan, pretty much what they gave you for your service, you got to go to the annual convention. Every year we'd take 1,500 people to an annual convention because they all brought a bunch of directors. They might get \$100 a month for a board meeting, maybe \$50 a month. The CEOs in many, at least little ones, they earned less than a mailman. They were not lucrative operations. They were seen as a public service in many, many ways, almost like utility. I mean they were regulated like a utility. They told you how to do everything. They told you how much you can charge and how much you could pay. So, I mean they grew up in such a controlled environment.

But the people who started these stock savings and loans were different. They were entrepreneurs. There was nothing wrong with it. In order to evade – avoid is probably a better word – avoid federal regulation, a private insurance company had been formed, the North County Mutual Guarantee Corporation and so they didn't have to follow FSLIC rules, the Federal Savings and Loan Insurance Corporation. It was the thrift counterpart of the FDIC until they merged them in '91, I think it was, maybe earlier. And they didn't have to follow those rules. They were not subject to Regulation Q. So, they charged, I think at this time, savings and loans we were paying 5%, they pay 6% on savings deposits. So, they managed to exacerbate the federal thrifts disintermediation.

But in the mid '80s, when the savings alone crisis hit, the guy who was running our private insurance, a fellow named Don Beeson – a very prominent lobbyist

since then – but he was running the private deposit insurance corporation. And I remember he called [my boss] and me into his office. And the first thing he did was showed us their plans for expanding nationally. And then he said to us, “We've got to shut this thing down.” He said the first thrifts that are going to start to go under [are those that are not federally insured], and he said, “Would you help me work with the FSLIC to mass convert all these privately insured institutions to FSLIC insurance?” And we managed to do that. And his foresight [was crucial], because I want to say in Maryland, their fund failed. And there were a lot of the thrifts that failed there because of it. And we weren't unscathed, but it was a minor thing.

But based on the pressure by North Carolina, other states authorizing stock-chartered savings and loans, the federal regulators, the Federal Loan Bank Board, authorized federal thrifts to convert to stock, and then eventually authorized de novo stock institutions. Well, if you don't have an ownership in your institution, which mutuals don't, and you don't have stockholders, your drive for profit is less. You still want to be profitable and you want your board to pay you more money. And you want to have a good career and you want to grow your institution. Just all natural things. But when you don't have stockholders who are your ultimate responsibility ... improving their investment, making money on their investment, it is a different outlook.

And so as the industry converted to stock, it did drive the need for profits, which I don't think I mentioned earlier, but the first thing the feds did when was to deregulate the deposit side. You can have six-month money market certificates. Well, when this started leading to all kinds of problems and they had to make more money in order to fund these liabilities, the Fed said, “Okay, thrifts, we're going to give you all these expanded powers. We're going to let you make commercial loans, or we're going to let you have ‘now’ accounts – not commercial but checking accounts.” And so, some thrifts handled it well. They hired experienced commercial bankers and they moved into these other things. Others thought, well, maybe the S&L guy had been a banker and had as a young banker, had been hired to run the S&L and he'd spent 40 years at the S&L and thought he knew enough to be a full-fledged CEO of a commercial bank, but didn't really.

And so, a number of them got overextended and made loans that a commercial bank wouldn't make. And that should have been probably a tip, but it wasn't in a lot of cases. So, all of that added to the savings and loan crises. But I would say that the community banks were not as big participants in the mortgage market to begin with. And those that were, were not major users of, I would say, the more extreme alternative mortgage instruments. Yes, all kinds of variable rate mortgages and adjustable rate mortgages, I think those things were very widespread. There was a time that even the State Employee's Credit Union wouldn't make a fixed rate mortgage. I think that may still be true. But they have a very reasonable – I think it's typically a five-year adjustable with a limit on the increase in five years – but the savings and loans here at least were not vigorous users of anything too exotic.

Callie Naughton: Just to move us toward some concluding questions. Let me just check some off my list here. Over the last decade we have seen a number of different narratives emerge to explain the financial crisis. How do you understand what caused the crisis?

Paul Stock: That is a summary question. I would say the huge demand for investment in the American mortgage market fed a less than properly handled explosion of investment opportunities and the combination of declining product standards and the power of Wall Street to cover those weaknesses. And I, again, I don't claim to have great knowledge of how the rating agencies work, but how they could put investment grade or any positive ratings on these volumes of just garbage. I would say that's the single biggest factor in making it such a global crisis. The lending practices themselves were at least equally as big in making it – in building the problem in the United States. But I think that the Wall Street involvement was the single biggest thing in making it a global crisis.

Callie Naughton: How do you see your personal experience adding something important to our understanding of what happened in the run up to 2007 and 2008?

Paul Stock: Well, I don't know – it's interesting – I'm not sure how different my perspective will be from others. I know that I was unusual in being at a role in a large state banking trade association, having a history with a mortgage lending institutions like the savings and loans, but I also think that I was very fortunate in that our policy-making leaders were not interested in just winning a legislative fight. They were really willing to understand why the problem was bigger than some fraction of a percentage point on their bottom line. I felt humbled by the way our membership as a whole was willing to be reasonable about it and let us stay engaged. I don't know that I would have found that true in many other states.

I'm sure there would be some others, but I think that I was glad to be involved and I made some lifelong friends and learned a great, great deal. But I certainly wasn't the primary draftsman and I wasn't the creative force behind it. I did come up with a couple ideas which I won't take credit for it because I probably would not be popular with people I would like to stay popular with, if they knew it was my fault. But it was a very interesting process. The 2007, 2008 wasn't interesting. It was horrible. But a lot of people were already suffering before 2008. The people that personally were in these bad mortgages were suffering all throughout the 2000s. And it was just when it finally got to the tipping point when people realized what that volume truly was, that the whole house of cards came down.

Callie Naughton: Looking back on the crisis over a decade later, what do you see as its most important lessons from mortgage originators and state level policy makers today?

Paul Stock: You know when you – it seems so obvious immediately afterwards that when you develop sound practices for making a certain product useful and valuable to everybody involved: the seller, the buyer, the investor. You spend a hundred or

more years figuring out what really works well, rapidly changing 80% of those practices in a short period of time might lead to some problems. It seems so obvious, but, you know, I think a couple of things. One, I think it's fine what the federal government did in response. I think some of the stuff they did, it's not clear to me how exactly it related to the crisis. Again, the, the federal response was so much more complex than our state law although they did follow our structure in a lot of ways and things that we were able to address, which is not surprising because Eric Stein was one of the primary drafts people on that project in Congress, Josh Stein's brother, and a former leader at the Center for Responsible Lending. He was in DC for all of that process. I think the long arm of North Carolina's efforts was very involved.

I think the only risk is believing that because we address the problems of the past, we've taken care of the problems of the future. One, other problems will come because things happen in the economy that haven't happened before, so you can't prepare for them. And secondly, no matter how hard you work to address criminal undertaking and just shoddy financial practices, maybe that don't rise to the level of criminal, some folks are going to cut corners and others are going to use their substantial intelligence and assets to try to cheat people rather than be honest. And so there will be other crises. I would hope that we won't see – I doubt that in my lifetime I'll see anything that big again. Although like I said, the market was down a 1,000 last time I looked. I think that the response was appropriate in its extent. I think that the things that I do understand were appropriate in the approach, but I think that the best takeaway is to not be comfortable that we've kept this from ever happening again. We may have kept this from every happening again, but there's a “that” in our future and we probably haven't gotten to address “that.”

[END OF SESSION]