Chain of Blame

How Wall Street Caused the Mortgage and Credit Crisis

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Mathew Padilla

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Contents

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Introduction

I first met Angelo Mozilo, the co-founder and CEO of Countrywide Home Loans, 20 years ago. It's hard to put an exact date on it, though I do remember the first time he came to my Washington office on G Street two blocks from the White House. He was dressed in a dark gray suit, and was wearing a white shirt with a blue collar and a red tie. It was the kind of shirt that investment bankers wore when they appeared on CNBC (FNN) to discuss the vicissitudes of the stock market. Later on I would learn that Angelo was none too fond of investment bankers, though he did like the shirts they wore. (He also was a big fan of CNBC.)

During his visit to my office he had a PR flack (as we journalists like to call them) at his side, but the PR man (who has since gone down the road) was there strictly as a formality. You might say he was corporate bling. He was there because every CEO, of course, had his own PR man. Angelo, by this time, was already at the epicenter of the mortgage industry in the United States. He needed a PR man like he needed an extra brain. Back then no one spoke for Angelo Mozilo. When he talked no one interrupted him to help clarify or shape his message. The CEO of a firm that would one day become the nation's largest residential lender knew exactly what he wanted to say before he said it.

One reason Angelo came to trust me as a reporter had to do with a book I co-wrote about the savings and loan (S&L) crisis of the late 1980s and early 1990s, *Inside Job: The Looting of America's Savings and Loans*. He had read the book, admiring its detail and its financial morality tale—a story about so-called honest businesspeople who took advantage of newly passed laws that allowed them to loot federally chartered S&Ls (thrifts). He was genuinely appalled by the audacity of both legitimate businessmen (real estate developers mostly) and con artists who were allowed to own S&Ls and treat them like their own personal piggy banks. The S&L crisis led to the indictment of hundreds of men (and a handful of women). Dozens went to prison. Others walked.

Angelo lobbied me on one point, and he said it almost every time we talked about the S&L crisis—that the criminality inherent in the thrift mess could never happen in the world of residential mortgage banking, where loans were securitized into bonds and sold every day by the billions. (The huge thrift losses were caused by commercial real estate boondoggles and junk bond investments.) "The capital markets are the regulator in our business," I recalled him saying. "Wall Street would snuff it out." He wasn't crazy about the Street, but he believed that because Wall Street firms were the gatekeepers between the lenders (and hence the homeowners) and the institutional investors, it was in their best interests to keep everything clean, to promote honesty and integrity.

He had made this argument before subprime lending began to boom in 2003. He believed it down to his toes—that Wall Street (despite his contempt for it) would keep the housing market honest because the Street controlled the mortgage bond business, where most of the money for home lending came. It was in the Street's best interests. I wasn't so sure. I became even less sure when the losses (the nice word being write-downs) at banks and Wall Street firms topped $300 billion in the spring of 2008. To me and my co-author, Mathew Padilla, something had gone awry. A million or so people had lost their homes to foreclosure. Two or three million would follow in their path by the end of the decade. It wasn't just housing and mortgages that were ailing. It seemed as though the nation was getting hit from all different directions: rising energy and commodities prices, falling home values, banks pulling credit lines of all sorts including commercial and student loans. The mortgage virus had spread, infecting the entire body. It was as though the U.S. economy, which had burned so brightly during the Bush years, was a mirage. Angelo had been wrong. The capital markets—Wall Street—had failed us. This is the story of how it happened.

Paul Muolo

Cast of Characters

Descriptions include only information that is relevant to the stories in this book.

The Central Cast

Roland Arnall: founder of Ameriquest Mortgage, Long Beach Mortgage, and other subprime lenders; chairman, Ameriquest Capital Corporation.

Eric Billings: co-founder, chairman, and chief executive of investment banker Friedman Billings Ramsey (FBR).

Michael Blum: managing director in charge of global asset-based finance at Merrill Lynch.

Ralph Cioffi: founder and senior portfolio manager of Bear Stearns' two subprime hedge funds.

Robert Cole: co-founder and CEO of New Century Financial Corporation.

Bill Dallas: First Franklin founder and chief executive. Dallas also started Ownit Mortgage Solutions, which Merrill Lynch owned part of.

Patrick Flood: president and chief executive of HomeBanc Mortgage.

Ed Gotschall: co-founder of New Century Financial Corporation.

Steven Holder: co-founder of New Century Financial Corporation.

David Loeb: co-founder of Countrywide; Angelo Mozilo's onetime boss and partner.

Brad Morrice: co-founder, president, and CEO of New Century Financial Corporation.

Angelo Mozilo: co-founder, chairman, and chief executive officer of Countrywide Financial.

Stanley O'Neal: Merrill Lynch CEO.

Lewis Ranieri: co-inventor of the mortgage-backed security (MBS); former vice chairman of Salomon Brothers.

Jim Rokakis: treasurer of Cuyahoga County, Ohio.

Warren Spector: co-president of Bear Stearns; supervisor in charge of Bear Stearns Asset Management (BSAM).

The Supporting Players

Adam Bass: outside counsel to Ameriquest who eventually joined the company and became vice chairman of Ameriquest Capital Corporation; nephew to Roland Arnall.

Betsy Bayer: first vice president of compliance at Countrywide.

Kenneth Bruce: Merrill Lynch stock analyst who covered Countrywide.

Warren Buffett: unofficial advisor to Mozilo.

James Cayne: CEO of Bear Stearns.

"Carl Chamberlain": contract underwriter for the PCI Group/Clayton Holdings.

Craig Cole: Long Beach Mortgage executive who worked for Roland Arnall.

Peter Samuel Cugno: management trainee at Beneficial Finance.

George Davies: loan trader at Merrill Lynch.

Alan Greenspan: former Federal Reserve chairman.

Joy Jenise Jackson: director and manager of Metropolitan Money Store, a foreclosure "rescue" company.

Russell and Becky Jedinak: The husband-and-wife team that managed Guardian Savings and later on Quality Mortgage.

James Johnson: chairman and CEO of Fannie Mae; friend of Angelo Mozilo.

Gary Judis: chief executive officer of Aames Financial.

Stanford Kurland: president and chief operating officer of Countrywide who at one time was considered to be Mozilo's heir apparent.

Kirk Langs: executive in charge of retail mortgage lending at Ameriquest.

Wayne Lee: executive in charge of wholesale/broker mortgage lending at Argent Mortgage, an affiliate company and arm of Ameriquest.

Jack Mayesh: chief executive of Long Beach Financial Corporation/ Long Beach Mortgage, a wholesale mortgage lender.

Mike McMahon: Sandler O'Neill stock analyst who covered Countrywide. He also was a warehouse lending executive at First Interstate, which lent money to subprime lenders.

Henry Paulson: Treasury secretary in the Bush administration; also the former head of Goldman Sachs.

Dan Phillips: founder and chief executive officer of First Plus Financial, a high-LTV lender.

Charles Prince: chief executive of Citigroup; former general counsel, Commercial Credit.

Jonas Roth: Countrywide executive in charge of the firm's early trading desk.

David Sambol: president and chief operating officer of Countrywide who replaced Stan Kurland.

Rick Simon: press spokesman for Countrywide.

Rock Tonkel: senior executive and president of Friedman Billings Ramsey (FBR).