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[Home](#) > Mozilo Was a Master at Ass-Covering

Mozilo Was a Master at Ass-Covering

By *mark.gimein*

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The clueless CEO is so 2002. Instead, Countrywide had a whistleblower-in-chief.

 [090605_TBM_counrtywide.jpg](#) [1]

Just over a year ago, Angelo Mozilo, the head of Countrywide—in the boom years, the country's biggest mortgage lender—appeared before Congress to plead his case. He put on an undertaker's look of thoughtful concern and [patiently explained](#) [2] that "no one could have predicted the severity and force of the housing market downturn." He talked about how he'd devoted his life to "providing homeownership opportunities for all Americans" and about how Countrywide's toxic loan products "played an important role in assisting borrowers with home purchases and helping them manage their finances."

The performance was worthy of Enron's Kenneth Lay, folksy and soothing, so if you squinted your eyes, you could almost believe that Mozilo was as shaken and confused by everything happening around him as anyone.

It was inevitable that Mozilo's turn in the Capitol would be just a warm-up to the main event. It's taken a little while, but yesterday the Securities and Exchange Commission charges that everyone knew would eventually be filed against Mozilo came down. Unsurprisingly, the SEC's [53-page complaint](#) [3] detailing how he sold \$260 million in stock while watching his company hurtle to disaster paints a very different picture of Mozilo than the one he presented himself. But it also presents a very different picture of him than you might have expected if you've been following the ups and downs of this era of corporate malfeasance.

In the last few years we've seen chief executives in Mozilo's boat over and over play the role of hapless ingénue. When they are hauled into court, the claim—Ken Lay is the prime example—is that they were blissfully disengaged while their subordinates ran amok. They didn't see the numbers. They didn't use e-mail. To argue against this is to push sand, a constant struggle against the dunes of "I didn't know" and "No one told me."

Not so with Mozilo. What makes this case unusual is the clarity and comprehensiveness of Mozilo's objections to the shenanigans at the company *he himself was running*. The man that emerges from the SEC's complaint isn't the willfully disengaged chief executive we've seen in so many other corporate corruption cases. On the contrary, Mozilo systematically sets down a record of everything that is going wrong and how it's likely to end. Over and over again, he casts himself as the worrier-in-chief, always just on the verge of changing things. To read over the SEC charges against Mozilo is to see in action a grandmaster of the most cynical of corporate arts: the cover-your-ass memo.

The heart of the civil complaint is a series of e-mails from mid-2006, around the time that the subprime mortgage market started falling apart. In April 2006, Mozilo shoots off a series of missives to his subordinates, tackling one by one the issues that soon after were to bring down the rest of the mortgage market. First, Mozilo tackles the now infamous "pay option" loans, which let borrowers make payments that didn't even cover the interest on their mortgage until, after a period of time, the mortgages reset with sharply higher payments. Mozilo points out that with 70 percent of borrowers sending in only the monthly minimums, "it is only a matter of time [before] we will be faced with much higher resets and therefore much higher delinquencies." (These, it should be noted, are the very loans that Mozilo flogged to Congress as playing such an important role in helping borrowers manage their finances.)

Then Mozilo turns his attention to no-money-down 80/20 mortgages. Responding to his chief operating officer's claim that subprime, zero-down loans were the "milk" of Countrywide's business, Mozilo says sharply that, on the contrary, they are its "poison." On top of this, in the same month (the complaint doesn't provide an exact date), Mozilo complains about the poor quality of Countrywide's borrowers' credit, sputtering that "no premium, no matter how high" can justify giving loans to borrowers with FICO scores below 600.

A few weeks later, on June 1, Mozilo writes that he's become aware that most of Countrywide's toxic pay-option loans are being underwritten on a "reduced documentation" basis—mortgage-speak for "liar loans" that don't verify borrowers' income. The very next day, Mozilo was presented with an internal audit that showed rampant fraud in these loans, with some 30 percent of borrowers claiming income at least 50 percent higher than they'd reported to the IRS. In September, Mozilo again returned to the pay-option fiasco, with a blistering e-mail in which he said that past mortgage history gave Countrywide little guidance about what would happen to these toxic loans as home prices fell and that Countrywide was "flying blind."

Irresponsible loans to folks lying about their income, toxic zero-down deals, pay-option loans with exploding payments: All the misdeeds that brought the mortgage industry down are cataloged in Mozilo's own e-mails. You would think that with all this coming straight from the top, Countrywide would have been racing to change its practices. But the stunning thing is that this is in no way the case. What's most striking about the Mozilo e-mails is not that he continued to present a rosy picture of Countrywide's prospects to investors. That's dishonest but easy to understand. It's that all those complaints didn't actually change how Countrywide did business.

Those reduced-documentation loans? On the one hand, there are Mozilo's objections and Countrywide's startling internal audit. On the other, there is the stark reality of Countrywide's business: Mozilo complains about the reduced-documentation loans in June, but his company continues churning them out (according to a *Wall Street Journal* [analysis](#) [4], 91 percent of the pay-option loans Countrywide wrote in *all of* 2006 were low-doc loans). And the general issue of those toxic pay-option loans? Look at Countrywide's numbers for the [first quarter of 2007](#) [5]: almost \$10 billion in new pay-option loans, on which, in Mozilo's own words, Countrywide is "flying blind." Those low FICO scores? Check out the [call with stock analysts](#) [6] from 2007 in which Mozilo sits by while his chief risk officer, John McMurray, explains that Countrywide's borrowers' credit scores are even lower than they were. (He also argues that even loans with FICO scores well below 620—the kinds of loan that Mozilo said won't work out under any circumstances—can be "prime.") Those zero-down loans? In March 2007, Countrywide finally announced that it was getting rid of them—only to clarify a few days later that, actually, [it wasn't](#) [7].

In its basic shape, the case against Mozilo might seem at first to resemble the case brought by Eliot Spitzer against [Henry Blodget](#) [8], then a stock analyst at [Merrill Lynch](#) [9] (MER), which was also based on e-mails in which Blodget expressed qualms about what the bank was doing that were at odds with Merrill's public

statements. But the similarity is superficial. The difference is that Blodget was an analyst involved in a complicated tug of war among the bank's divisions, genuinely trying to get his colleagues to change their practices. Mozilo, on the other hand, was in charge of the company. So how could Mozilo have such a clear view of what Countrywide was doing wrong and yet let Countrywide keep doing it?

One possibility is that Mozilo was a figurehead, the mortgage industry's public face, and had lost control of his own company. There's a good chance that over the next month this is what Mozilo and his minions will argue. Unlike Enron's Ken Lay, Mozilo doesn't have the option of claiming that he just had no idea of what was going on. But we have no reason to think this is the case. Perhaps more e-mails will emerge that show Mozilo complaining that his objections were being ignored. But, as yet, we don't have them. What we do have is Countrywide elevating David Sambol, the guy who thought that zero-down subprime loans were the milk of the business (and whom the SEC has charged together with Mozilo), to its board of directors—unquestionably with Mozilo's blessing.

Another option is that Mozilo was genuinely concerned about where Countrywide was headed but was less interested in changing his company's practices than in getting rid of the bad loans. The SEC complaint gives some reason to think this. In September 2006 and again in January 2007, Mozilo wrote to urge his subordinates to find a way to sell Countrywide's portfolio of toxic pay-option loans, making them someone else's problem. Without a doubt, selling the loans—and ultimately, selling the company—was a genuine goal of Mozilo's. It's a strategy that Countrywide pursued eagerly and which culminated in [Bank of America](#) [10] (BAC) [purchasing Countrywide](#) [11] and so (amazingly) grabbing the grenade out of Mozilo's shaking hands.

But there's one more option—call it the cover-your-ass-memo theory—to think about if you are willing to consider the possibility that what's going on here is not a bona fide discussion of business options but just another chapter in the bottomless mendacity and cynicism of the housing bubble. It is that Mozilo is perfectly willing to send out a stack of e-mails registering his objections while sitting back, selling \$260 million in stock, and letting the game run its course. That would make Mozilo a kind of anti-Ken Lay. Enron's chief, and many others in similar circumstances, pretended to know nothing of what their minions were doing. Mozilo does them one better, putting his gripes on the record, repeatedly and comprehensively, so that if or when the bomb exploded he could say that he was doing his best to defuse it.

In fact, it's hard to find another light in which to view Mozilo's shocked June 2006 e-mail explaining that suddenly—well into the worst excesses of the mortgage boom—he has become aware that most of Countrywide is writing loans without asking borrowers to prove they have the income to repay them. By mid-2006 the whole industry routinely called these low-doc loans by the far less polite nickname of "liar loans," and every mortgage broker in California knew they were a barely veiled way of getting borrowers to take loans they could never, ever afford under any sentient underwriting standard. Yet, there is Mozilo, Mr. Magoo suddenly putting on his glasses and pointedly noting that he'd suddenly observed this obvious fact about the loans that were the very engine of Countrywide's business. And doing so the very day before an audit "reveals" just how many of these loans are essentially fraudulent.

There's one other e-mail that's worth pointing to in the SEC complaint, which comes a lot later in Countrywide's history than most of the rest. It's from November 2007, and in it Mozilo finally announces clearly that Countrywide should put an end—no ifs, ands, or buts—to the toxic pay-option loans. These, you will recall, are the loans about which he had sounded the alarm ("We are flying blind") more than a year earlier. And here, with the housing market well past its peak, the subprime mortgage industry essentially defunct, investors running from

mortgages, and his own business sliding into oblivion, Mozilo rides in and says finally, dramatically, "Stop!"

When folks start shutting the doors long after the horse has left the barn, watch out. In this case, the horse had not only left the barn but already galloped into a ditch and broken its leg. What Mozilo's mental calculations might have been as the mortgage market collapsed around him we may find out soon, or never. It's possible that Mozilo preferred to face an accusation of hyping his company's stock than one of running the levers of a mortgage machine guaranteed to produce defaults and foreclosures on a scale not seen since the Great Depression.

Thanks to all the objections he put on the record, Mozilo's exposed himself to the SEC's charges of ripping off shareholders. He's the latest in a long line of chief executives caught this way. But so far, he's escaped prosecution for what really made Countrywide unique: running a company that systematically lured its customers into a mortgage mess that would create misery for millions. The Securities and Exchange Commission's rap on Angelo Mozilo is that he didn't bother to tell shareholders the risks they faced. The deeper problem is that Mozilo and his Countrywide colleagues didn't tell millions of homebuyers that the risks *they* faced were even worse.

Author:

[Mark Gimein](#) [12]

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[3] <http://www.sec.gov/litigation/complaints/2009/comp21068.pdf>

[4] <http://www.portfolio.com/views/blogs/market-movers/2007/10/24/how-egregious-was-countrywides-option-arm-lending>

[5] <http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/04-12-2007/0004564113&EDATE=>

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[10] <http://www.thebigmoney.com/search/quotemedia/BAC>

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