

Countrywide’s Subprime Scandal

Countrywide Financial was founded in 1968 by Angelo Mozilo and David Loeb. In 1992, it was the largest originator of single-family mortgages in the United States. By 2006, the company was ranked 122 on the Fortune 500 list and had become one of the nation’s largest mortgage lenders. That same year, Countrywide financed nearly \$500 billion in loans. The company would lend to both prime borrowers—those with high credit scores—and subprime borrowers—those with lower credit scores who may have difficulty with repayment schedules. In general, subprime loans have higher interest rates in order to compensate for potentially higher credit risk.

Mozilo was very outspoken and acted as the face of Countrywide. He described the importance of including minority and immigrant customers as both a company mission and for its business. He believed that promoting homeownership could lead to a more equal society. In 1994, Countrywide greatly increased the number of loans for African-American and Hispanic customers and became the first mortgage lending company to sign a fair-lending agreement with the Department of Housing and Urban Development. By 2004, the company became the leading lender to what it referred to as “multicultural market communities.”

As Countrywide grew, Mozilo held tighter control and insisted that the company be held to high standards. He enjoyed giving speeches, motivating his employees, and talking to the press. He was very public about his ambitions for his company and his opinions on other companies. In 2002, he publicly set an ambitious target of achieving 30 to 40 percent of market share. At that time, no company owned more than 13 percent of market share. This required an aggressive approach to sales, and the firm implemented a commission-based sales system that it had long resisted. Many sales representatives made millions of dollars a year pushing mortgages that were of lower and lower quality.

In 2005, he warned of the direction of the lending industry, stating, “I’m deeply concerned about credit quality in the overall industry,” continuing, “I think that the amount of capacity that’s been developed for subprime is much greater than the quality of subprime loans available.” In 2006, he stated, “I believe there’s a lot of fraud.”

And yet, Mozilo publicly insisted these were not issues for Countrywide. However, in internal emails, he later described the company’s 80/20 subprime loan (involving a first lien for 80% of the purchase price and a second lien for 20%) as “the most dangerous product in existence and there can be nothing more toxic.” In another email, he wrote that he “personally observed a serious lack of compliance within our origination



system as it relates to documentation and generally a deterioration in the quality of loans.” This included a “piggyback” loan that enabled borrowers to purchase a house without putting down any money of their own. One Countrywide executive asked: “What will we do next—pay borrowers to take loans?”

Countrywide also overcharged more than 200,000 African-American and Hispanic homebuyers. Black customers were more than twice as likely as white customers to be offered subprime loans.

The company’s computer systems, pay structures, and employee sales training all incentivized maximum profits for Countrywide and often steered customers away from lower-cost loans, even if they qualified for them. But, as the housing market dropped in 2007, so did Countrywide’s profits. In 2008, Countrywide was forced to sell itself to Bank of America for \$4 billion, just a fraction of its value just a short time before.

The Department of Justice (DOJ) brought civil fraud charges against Countrywide stemming from its relationships with federal mortgage companies Fannie Mae and Freddie Mac. A federal jury found Countrywide liable. The DOJ also charged Countrywide with \$335 million in a residential fair-lending settlement for discrimination against African-American and Hispanic borrowers. Bank of America assumed these liabilities and many others.

Mozilo left Countrywide in 2008. In 2010, he was charged by the Securities and Exchange Commission with securities fraud and insider trading. The charges were based primarily on the discrepancy between the optimistic public statements that Mozilo made about the subprime mortgage market and his company’s practices and his private e-mails that were often pessimistic as well as his decision to sell \$160 million of Countrywide stock while publicly lauding the firm. In 2010, Mozilo paid \$67.5 million to settle with the SEC on insider trading charges. In 2016, the DOJ dropped prior charges of mortgage fraud against Mozilo.

Concept: Self-Serving Bias

Ethical Insight:

Countrywide was the largest issuer of private mortgage securities in the run-up to the 2007-2008 subprime scandal and financial crisis, which caused an economic meltdown in the U.S. in 2008. Through a perhaps unconscious self-serving bias, Countrywide’s co-founder and CEO Angelo Mozilo seemingly was able to convince himself that there was nothing seriously wrong with the mortgage instruments his company was issuing despite his public warnings of ominous economic signs at other companies and his private worries expressed in intra-company e-mails.

Discussion Questions:

1. In what ways did Angelo Mozilo demonstrate self-serving bias? Explain.
2. It is likely that in the actions of Countrywide's employees, one would find evidence of both a very conscious self-serving bias as well as some measure of unconscious self-serving bias. Explain how each might have been manifested in this case.
3. Do you think the unconscious version or the conscious version of the self-serving bias played the more significant role in causing the Countrywide scandal?
4. Mozilo believed in the importance of minority and immigrant customers because he faced discrimination as an Italian American in the 1960s. Do you think he upheld his commitment to serve minority and immigrant customers? Why or why not?
5. Why might Mozilo speak publicly about the failings of the lending industry but not heed his own warnings? Explain.
6. How could Countrywide have protected itself from the pitfalls of self-serving bias? Do you think other lending companies were susceptible to self-serving bias during the 2007-2008 financial crisis? Why or why not?
7. According to Gino, Ayal and Ariely, pitcher Andy Pettitte, when caught using a banned substance, explained that he didn't do it "to get an edge," but instead to get off the disabled list so that he would not "let his team down." They labeled this explanation "self-serving altruism." People are more likely to give themselves permission to violate the rules if they can still think of themselves as good people because they can view their action as helping others, even when it also (and maybe primarily) helps themselves. Do you see some self-serving altruism in Countrywide's actions and explanations? Explain.
8. Can you think of other business leaders who may have been susceptible to self-serving bias during their careers? What did they do and how did they demonstrate self-serving bias? Explain with examples.

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