Update to CJR's March/April 2010 Article by Jeff Horwitz

"The Education of Herb and Marion Sandler:
When two patrons of aggressive journalism became its targets,
they cried foul. They have a point."

In July 2010, the Columbia Journalism Review added an update to its original story. The original story is attached. The updates are noted below and also appear in the on-line version of the story at www.cjr.org.

Immediately after the headline of the story, CJR has added the following:

> *As of July 16, 2010, the end of this story has been updated with new information about Paul Bishop's wrongful termination hearing.*

At the end of the story, CJR has added the following update:

> ***Update, July 16, 2010:*** *Paul Bishop subsequently lost his case against World Savings/Golden West, and definitively. Judge Raymond D. Williamson, Jr, the independent arbiter, ruled that not only was Bishop not a whistleblower, but was "an extremely difficult employee" who offered no proof of his charges against the bank.*
>
> *Among other things, the judge found in a March 2010 ruling that Bishop*
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> - *"was continuously rude to his co-workers and bullying and condescending to his support staff."*
> - *"stunned his supervisor" by ripping up his first performance review in front of her*
> - *"rarely met company goals" and on many occasions "did not even come close."*
> - *Was terminated for repeating abusive conduct that he had been warned about, (in this case, venting his spleen at a senior vice president over what he thought was somebody interfering with his client, when in fact he had not properly put his name on the form that would have let co-workers know that the client was his.)*
>
> *Regarding Bishop's charges of illegalities at the branch, the judge wrote, Bishop could come up with no specifics, just a "gut feeling." The judge ruled that Bishop "has failed to prove his case" and awarded him "nothing."*
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> *60 Minutes subsequently posted a link to a PDF of the arbitration decision on its February 2009 story, "A World of Trouble," on its Web site, along with a letter from Herbert Sandler. It has not posted a correction or clarification of the story, which centered on Bishop's claims.*

The Education of Herb And Marion Sandler

When two patrons of aggressive journalism became its targets, they cried foul. They have a point.

BY JEFF HORWITZ

In March 2008, Herb and Marion Sandler sat down with Joe Nocera of *The New York Times* to explain the creation of ProPublica, an investigative journalism startup launched with $10 million of their money and the promise of more. Journalists weren't doing enough investigative work that mattered, they felt; work with moral force. ¶ The Sandlers are in their late seventies, billionaires who built an Oakland, California, bank, Golden West Financial Corporation, into a respected institution with 285 branches operating under the name World Savings Bank. Over the years they earned a reputation for criticizing the banking industry's risky and predatory practices. And when they sold Golden West to Wachovia Corporation in 2006, they took the better part of $2.4 billion and embraced a muscular brand of philanthropy full-time. Supporting serious journalism, they believed, was in keeping with their support for organizations like Oceana, Human Rights Watch, and The Center for Responsible Lending. The journalism would highlight, and maybe rectify, injustice. "It starts with outrage," Herb Sandler told Nocera. "You go a little crazy when power takes advantage of those without power."

Two years after ProPublica's launch, the Sandlers seem happy with the freestanding newsroom. Under Paul Steiger, a former editor of *The Wall Street Journal*, it has collaborated with some top news outlets and brought researched exposés to an array of smaller ones. Its work has spurred an overhaul of California's nurse-disciplinary system, heightened the sense of the risk that natural gas hydrofracking poses to America's water supply (which won a Polk Award), and raised red flags over the dire straits of unemployment insurance funds nationwide.

The Sandlers' relationship with the rest of journalism has not fared as well. After decades of depictions of the couple as meticulous lenders, consumer advocates, and a lovable husband-and-wife team, the Sandlers' reputation was recast during the financial crisis. In the 1980s, their bank popularized the "Pick-a-Pay" loan, a subtype of the option adjustable-rate mortgage (option ARM) that would later be blamed for some of the housing boom's excesses—largely because they allowed borrowers to temporarily make payments that do not cover even the interest on the loan, meaning later payments must rise sharply. Worse, the Sandlers were accused of lowering their underwriting standards to juice loan volume, then pocketing billions by foisting the toxic mess on Wachovia—an acquisition that poisoned America's fourth-largest bank.

In *The New York Times*, the Sandlers option ARM loans were the "Typhoid Mary" of the housing crisis. *60 Minutes* featured a whistleblower who accused them of "sitting on an Enron." To cap it all off, *Time* included the Sandlers on its list of "People to Blame for the Financial Crisis" at number twelve, right after Lehman Brothers' Dick Fuld.

The case against the Sandlers appeared cut and dried. It was already a truism that other purveyors of option ARMs had been predatory and reckless; the Sandlers' Golden West wasn't being tarred with anything that hadn't been said of Angelo Mozilo's Countrywide Financial or Kerry Killinger's Washington Mutual. Nor was there any doubt that a little over two years after the Sandlers sold their portfolio, Wachovia faced billions of dollars in Pick-a-Pay losses. The Sandlers' record of support for consumer protections, when noticed at all, was recalled with dark irony.

The couple bitterly protested the stories and by early 2009 began demanding corrections, aided by an attorney. In the case of the *Times*, the article about them was eventually appended with four corrections—ranging from the removal of the word "pariah" from the headline to a half-point interest-rate error. But the Sandlers wanted more, from the *Times* and others. And they had a point.

The Sandlers' Golden West was neck deep in some of the

MARCIO JOSE SANCHEZ / AP PHOTO

housing market's most overheated regions. They fought to hold market share, maintaining an uneasy relationship with the increasingly dominant independent mortgage brokerage industry, a constituency Herb Sandler deemed "whores." And when the crash finally came, the Sandlers were retired and gone, though the portfolio they created and Wachovia expanded suffered terrible losses.

But the media's insistence on conflating the Sandlers with Countrywide, New Century, Ameriquest, and other notorious lenders—who sold products with short "teaser" periods that would soon explode, made a joke of underwriting standards, and off-loaded their toxic paper into the secondary market—points up the difficulty journalists had understanding the mortgage mania and identifying the truly bad actors. The press lumped the egregious with the unlucky.

IN HINDSIGHT, WACHOVIA VASTLY OVERPAID FOR GOLDEN West when it bought the bank for $25.5 billion in May 2006. When an analyst suggested on a conference call that month that Herb Sandler might be dumping Golden West on Wachovia at the top of the market, the seventy-six-year-old banker got testy. "That's a bunch of garbage," he said. Two years later, as the market tanked and Wachovia began to rack up losses, Sandler pointed to his continued stock holdings in the bank as evidence that he hadn't predicted the carnage. Still, on the timing, at least, the analyst had been correct.

Wachovia itself was sold in the fall of 2008, during the panic following the collapse of Lehman Brothers, and the media began to see the Sandlers in a new light. Oddly, an early broadside came in an October 4 *Saturday Night Live* skit that accused the Sandlers of corruption and joked that they "should be shot." The executive producer of *SNL*, Lorne Michaels, later apologized. He'd somehow thought the Sandlers were fictitious. "When I spoke to them, I can assure you this: they are very, very real," he told the *Los Angeles Times*.

Then, in a piece on Christmas Day 2008, originally titled ONCE TRUSTED MORTGAGE PIONEERS, NOW PARIAHS, *New York Times* reporters Michael Moss and Geraldine Fabrikant described a "broad and aggressive effort" by Golden West "to market risky loans at the height of the housing bubble." The *Times* said the couple had "embraced practices" such as using unscrupulous independent brokers and increasing loan volume at the same time they lowered the bank's lending standards. After initiating the sale to Wachovia, the *Times* reported, Golden West had dropped its minimum payment to a "rock bottom" 1 percent interest rate, luring in an inferior class of borrowers. The *Times* found a clip from a World Savings sales-training video encouraging buyers not to worry about making payments that were less than the interest due—even though it would increase the balance of their loans.

Then came the *60 Minutes* report, a thirteen-minute segment that aired February 15, 2009. It focused on a for-

Getting out Herb and Marion Sandler addressing Golden West shareholders in 2006.

mer World Savings mortgage salesman named Paul Bishop who was suing Golden West for allegedly firing him after he raised questions about the quality of the company's loans and, Bishop says, threatened to try to derail Golden West's sale to Wachovia. Wachovia had been "so badly wounded" by the Golden West portfolio losses, Scott Pelley reported, that it had to be sold to Wells Fargo in October 2008.

The heart of both stories was that Golden West had intentionally sacrificed its lending standards to boost sales of a predatory product. Both pieces generally defined Golden West's Pick-a-Pay loans as option ARMs with a "cheerful name," as *60 Minutes* put it. "Over all, analysts expect the option ARM fallout to be brutal," the *Times* wrote. "Fitch Ratings, a leading credit rating agency, recently reported that payments on nearly half of the $200 billion worth of option ARMs it tracks will jump 63 percent in the next two years—causing mortgage delinquencies to rise sharply."

That point was problematic. Golden West's loans weren't among the soon-to-implode option ARMs that Fitch tracks. Fitch rates securitized loans, not whole mortgages held on banks' books. The detail highlights a contradiction in the notion that the Sandlers intentionally lowered Golden West's underwriting standards. For a portfolio lender like Golden West—one that holds on to its loans rather than sell them in the securities markets—issuing loans to borrowers who can't afford to pay them would be suicidal. The skin in the game, as the phrase goes, was Golden West's own.

Being a portfolio lender also meant that a high volume of loans wasn't as essential to earnings as it was to companies like New Century and Countrywide Financial. Those companies made money by producing a constant stream of mortgages for investors, whereas Golden West earned most of its revenue from interest on loans. While some growth in lending volume was good—and in the years leading up to the bust the bank did grow at a faster pace than its historical average—Golden West's business wasn't dependent on it.

Setting aside the question of motive, however, there is limited evidence that Golden West went out of its way to ramp up volume in the months before its sale to Wachovia. While new mortgages grew from $21 billion to $49 billion annually between 2001 and 2004, they barely changed for the eighteen months before the Wachovia deal was consummated. The percentage of loan applications that the bank approved during the boom, in fact, was lower than it had been for most of the 1990s. And between 2004 and 2005 the bank raised the minimum payments on new loans it issued, making it harder for borrowers to get a Golden West loan. At the bank's annual retreats, documents that the Sandlers provided to CJR show, its managers were asked to debate whether high loan growth could compensate for an increased risk of loan losses. The correct answer was no.

That's not to say that Golden West was immune to the competitive pressures of the mortgage market during the bubble. Both the *Times* and *60 Minutes* reported that the average credit scores of new Golden West borrowers slipped in the bank's final years of independence. And a few months after the Wachovia buyout was announced—but while the Sandlers were still in charge—Golden West did lower its minimum payment rates from 2.85 percent to 1.5 percent, a step that would have brought in more marginal borrowers.

A similar point can be made about Golden West's use of independent mortgage brokers. The Sandlers were indeed publicly critical of the industry for low quality controls, but such brokers accounted for the majority of the market. To protect the quality of its portfolio, the Golden West staff often independently reviewed the income of borrowers before approving brokered loans. But not always, and as *60 Minutes* showed with the case of Betty Townes, an elderly widow who took out a series of brokered Golden West loans based on her deceased husband's income, some bad loans got through.

WHILE THE OPTION ARM HAS BECOME IMPLICATED IN THE housing crisis, its origins weren't sinister. The loan was created in the early 1980s to address interest-rate risk. With the prime rate hovering around 20 percent, banks were paying more to borrow money than they were earning from their lending and, not surprisingly, going broke. The adjustable-rate mortgage offered a solution, in that it tied the rates a bank charged to its own interest costs.

For a lender who holds loans rather than sells them, issuing loans to people who can't afford them is suicidal.

That protection came at a price, however: ARMs transferred interest-rate risk to borrowers who sometimes weren't equipped to absorb it. To avoid a rash of defaults when interest rates, and thus payments, rose, the Sandlers and others designed payment "option" ARMs. The borrower could shift between several monthly payments, which ranged from high ones that speedily reduced principal to low ones that covered only a portion of the interest due. In the latter option, the loan would negatively amortize, meaning its balance (and the size of future payments) would grow. Interest couldn't be deferred forever, and after either ten years or the balance growing to 125 percent of its original size, the option ARM would be "recast" into a standard, fixed-rate mortgage.

This obviously could get dangerous, but "Neg Am" never accounted for more than a few percentage points of the Sandlers' total Pick-a-Pay portfolio. Over decades, they developed a reputation for only underwriting loans to borrowers with the ability to pay down principal, and then closely monitoring for signs of distress. In the 1990s, the bank weathered a seven-year trough in national home prices with losses that peaked at 0.18 percent. Other portfolio lenders went bust. In

order to figure out how the portfolio would perform under varying scenarios, Golden West ran thousands of simulations, "but never one where it declined 50-70 percent," Herb Sandler says. "If you operated under the assumption that home prices could have gone down 50 percent, all lending would stop."

Negative amortization wasn't the main risk to borrowers, as the Sandlers saw it; shoddy underwriting and excessively high loan-to-value ratios were. Golden West's financial statements show it almost never underwrote loans with less than a 20 percent down payment.

In the early 2000s, a new wave of option ARMs entered the market. Generally marketed to borrowers with subprime credit scores, the loans shared the Pick-a-Pay characteristics of allowing the borrowers to choose their payment for a period of time, run up some degree of negative amortization, and then recast to a fixed-rate mortgage. But that was where their resemblance to Golden West's product ended.

While Golden West's minimum payments were designed to rise gradually over a decade, the "option" period in this new wave of loans was often no more than a few years, guaranteeing a massive jump in payments when the loan recast. Instead of cushioning borrowers against interest-rate hikes, the teaser rates just let them temporarily make payments on homes they couldn't afford.

Meanwhile, entities like New Century and Countrywide had no stake in the loans after they wrote them. When investment banks opened a new market by securitizing the first option ARMs in the 1990s, the Sandlers were horrified. Golden West's business model was premised on the idea that option ARMs required meticulous underwriting and monitoring. By packaging and selling such loans as securities to investors, its rivals dispensed with the obligation to do either.

How badly did the Sandlers' portfolio do? Any portfolio of loans written in Golden West's key markets—the less costly areas of California, Nevada, and Florida, where the current percentage of foreclosed-on and delinquent mortgages is far in excess of the national average of 14 percent—would take massive losses when the market began its deep crash in 2006. Still, it is hard to tell how much was lost under Golden West, because the Pick-a-Pay portfolio Wells Fargo now holds includes loans that Wachovia wrote for a year and a half after it bought Golden West, sometimes at the rate of more than $3 billion a month. What is apparent from Wells Fargo data and the bank's public statements is that the Pick-a-Pay portfolio is in much better shape than securitized option ARMs, and that Golden West's loans performed better than the ones subsequently written by Wachovia.

Upon taking possession of the portfolio, Wells Fargo divided it between similarly sized "impaired" and "unimpaired" categories after Wachovia's purchase. The average age of the unimpaired loans that Wells expects to perform well is five and a half years, squarely in the period when Golden West was writing them.

The impaired loans, meanwhile, skew significantly toward Wachovia's tenure, with an average age of just over three and a half years. "Half of the problem loans had been generated after" the Pick-a-Pay portfolio was purchased by Wachovia, says one former Wachovia executive who had access to bank statistics. To entirely blame the Sandlers, he says, is "a bit unfair."

THE SANDLERS' REQUESTS FOR CORRECTIONS FROM *THE New York Times* began with the headline that labeled them "pariahs." In a December 30 letter to executive editor Bill Keller, they cited that wording as one of "at least forty statements in the story that were inaccurate, misleading, and/or at best, confusing" and requested an editors' note. In a letter dated a week later, Keller wrote that the headline was regrettable and would be corrected. The new headline would be: ONCE TRUSTED MORTGAGE PIONEERS, NOW SCRUTINIZED.

The letter was gracious, but the correction that accompanied it was not fulsome. Herb Sandler wrote back the same day requesting five specific corrections, including one correcting that day's correction. What followed was protracted negotiation between the Sandlers and the *Times*, in letters, phone calls, and an attorney-chaperoned meeting between Herb Sandler and Tim O'Brien, who edited the original piece. Yet as adamant as the Sandlers were that the *Times* had essentially gotten the story wrong, most of the alleged errors they cited were matters of framing or emphasis, not unambiguous fact. Aside from excising "pariah" from the headline, the *Times*'s corrections were limited to adjusting a numerical error, adding context to a former regulator's quote, and fixing a misstatement regarding the Center for Responsible Lending's position on loan prepayment penalties. None of these things significantly altered the story's central contention: that the Sandlers, after decades of being known for reputable and cautious lending, had sold junk loans at the height of the housing bubble. The Sandlers failed to convince the *Times* that their company had not changed.

The corrections saga ended in August, eight months after the *Times* story ran, when a twenty-two page letter from the Sandlers and the response by Keller were appended to the original article. There were many things about which the *Times* and the Sandlers would continue to disagree, Keller wrote, but he hoped they did not view the story as an attack on their reputations. "It was, on the contrary, a story about how even bankers who were recognized as the gold standard of integrity in that industry could not remain untouched by the exploding mortgage crisis," Keller wrote.

"In retrospect, any story could be done differently and perhaps none are ever as perfect as you would like them to be," the *Times* wrote in an e-mail to CJR. "But we still stand by our Golden West story and believe it was a very strong piece to pursue and that we framed it fairly." The Sandlers remain unsatisfied, but say they have put the matter to rest.

The story of the Sandlers' discussions with CBS is simpler. The Sandlers had background contacts with *60 Minutes* producer Graham Messick before the segment aired, and quarreled strongly with *60 Minutes*'s decision to use Paul Bishop as a key whistleblower source. Bishop, who is still pursuing a wrongful termination suit against Golden West (it's in mediation), left behind clear records of his discomfort with lending practices in Golden West's San Francisco office, where he worked as a loan salesman. But other former employees

disagreed, and scores of them wrote letters vouching for the integrity of Golden West's lending, which were posted on the Sandlers' GoldenWestWorld.com Web site.

Following the airing of the *60 Minutes* story, "A World of Trouble," the couple went to the top, writing a March 20 letter to Les Moonves, the CEO of CBS. *60 Minutes* has steadfastly declined to discuss its reporting or the Sandlers' response, and the newsroom has never revisited the piece. Yet the Sandlers eventually did get a letter from management that praised their ethical standards but did not apologize: "Based on the information you shared with us subsequent to the broadcast, we now better understand your position that at no time did you change your historic focus on the quality of your lending to a focus on volume," a February letter from Moonves and CBS General Counsel Lou Briskman said. It concluded, in language remarkably similar to the letter from the *Times,* that Briskman and Moonves had "come to appreciate why your ethics and integrity have been recognized as the gold standard in the industry."

Five months after the *Times*'s "pariah" story ran, the paper's Floyd Norris wrote a column about Golden West's loans. The business columnist had entirely missed the original piece on the Sandlers, he says, and knew little about their bank's history. Like other option ARMs, Norris wrote, Pick-a-Pay loans were racking up big losses. But when reading Wells Fargo's first-quarter earnings report, he noticed that less than one-third of 1 percent of Golden West's loans were expected to recast before the end of 2012, meaning that borrowers wouldn't see large payment increases for many years. "That struck me as an amazing number," he says. "How the hell could that be?"

It was the ten-year option at work. Over the next few days, Norris researched the terms of Pick-a-Pay loans, and concluded that the loans' ten-year option and high loan-to-value cap were remarkably generous, and an attempt to do right by borrowers. Yet in a catastrophic market decline, those terms stripped the bank of leverage. Homeowners could pay less than interest-only in the hope that the market would recover, restoring their equity. If prices stayed depressed, however, they didn't have much to lose, as their payments "could well be less than the cost of a comparable rental," Norris wrote.

"I understand it makes some people feel better to know that they have identified someone who acted outrageously," Norris says. "But sometimes it's more interesting when nobody acted particularly outrageously and things blew up anyway."

BACK WHEN THE *TIMES* PUBLISHED THE SANDLERS' INSTALLment in "The Reckoning," the generally excellent series in which it appeared, ProPublica was working closely with *The New York Times Magazine* on an exhaustive, 12,000-word investigation of alleged euthanasia in a New Orleans hospital during Hurricane Katrina, written by freelancer Sheri Fink over two years. ProPublica picked up much of the story's estimated $400,000 cost.

The Sandlers say they were unaware of the joint project. Still, this had the makings of an awkward situation, touching on a central fear about foundation-funded journalism: that a news organization would feel indebted to the sponsors of its work. Both ProPublica and the *Times* said the Sandlers' feud with the paper had no bearing on the collaboration. According to the *Times,* the ProPublica relationship is "with Paul Steiger and Steve Engelberg, both well known to us, and with their reporters—not with the Sandlers." This is, of course, exactly what the *Times* would be expected to say. What lends it credibility is that the Sandlers are still irate about what they characterized as the *Times*'s "vicious" wording on several corrections, and that Bill Keller's letters to the couple accuse them of splitting hairs.

"Keller did not back down," says Clark Hoyt, the *Times*'s public editor. "I think you could look at this and suggest that what has happened here worked the way it should work."

While ProPublica kept its relationship with the Sandlers separate from its dealings with the *Times,* Steiger occasionally addressed the attention ProPublica's patrons were receiving in other forums. Following the *Saturday Night Live* skit, for instance, Steiger wrote to Lorne Michaels to say that he thought the skit was off the mark.

A potentially awkward moment arrived last April, at a symposium at the University of California, Berkeley. Both Steiger and Bill Keller were among those asked to discuss the future of investigative journalism. The Sandlers were in the audience. When the panel took questions, PBS's Mark Glaser raised the issue of nonprofit journalism's relationship with its backers. Would ProPublica write a story that was critical of its founders? According to Glaser, Steiger said: "We would report on them if we found anything worth reporting on, and we haven't found anything." The conversation moved on.

Back in December of 2008, just weeks before the *Times* story on the Sandlers was published, Steiger flew to California to talk money. Under ProPublica's original deal with the Sandlers, the couple had committed to rolling, three-year payments of $10 million annually. At each year's end, they can either recommit to three years or tell the newsroom that it's being cut off in two.

The Sandlers will not discuss ProPublica's funding beyond saying that they're extremely proud of ProPublica's staff and its work, and that ProPublica's funding will become more diversified, as is typical for the Sandlers' other nonprofits. "It's not healthy for ProPublica or any nonprofit to be dependent on one or two funders," Herb said.

As chairman of ProPublica's board, Herb Sandler says he regularly talks with Steiger and general manager Richard Tofel. By strict agreement, though, the Sandlers and the board have no control over editorial decisions and are not told about ProPublica's investigations before they are published.

But they can make suggestions. Herb Sandler pushed for hiring more financial reporters early on, and it's no secret that he's partial to stories about the issue of money in politics. Sitting in a conference room at the Sandler Family Foundation headquarters overlooking the San Francisco Bay, he says he remains a believer in meticulously researched, crusading journalism. "Keep the story alive, pressure people, shame them," he says. **CJR**

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