THE ENFORCERS & THE GREAT RECESSION

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No one played a more vital role responding to the worst economic crisis since the Great Depression than a small band of state attorneys general (AGs). Yet this story has never been told nor its implications considered. For more than a decade these AGs brought enforcement actions across the residential mortgage lending industry, reaching the origination, servicing, and securitization processes. From roughly 2000 to 2008, they targeted several of the largest subprime lenders for predatory and discriminatory lending. And they moved in the face of federal inaction—at times, even opposition. With the economic crisis everywhere visible by early 2009, they turned toward abuses in mortgage servicing and securitization. While they often collaborated with their federal counterparts during this time period, these AGs continued to lead and shape the enforcement agenda.

This narrative demonstrates that states are integral to the task of consumer financial protection. Congress was right to empower states in the Dodd-Frank Act of 2010 by scaling back preemption and giving the AGs concurrent enforcement powers. The AGs not only serve as a stopgap when federal regulators fail to act, but they also alter the quality of enforcement in positive ways not replicated by even engaged federal regulators. The marks of AG enforcement include information advantages, agility, a remedial focus, resistance to capture, and entrepreneurialism. Moreover, these events also suggest a new enforcement model in the area of consumer protection that may sometimes prove more efficient than earlier approaches: the multigovernment, multiagency action. And while these observations concern consumer financial protection in the first instance, they also have implications for ongoing conversations about federalism and enforcement.

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INTRODUCTION

No one played a more vital role responding to the worst economic crisis since the Great Depression than a small band of state attorneys general. In a different day they might have played a significant, yet secondary role. Federal regulators, vested with powers more broad and refined, might have prevented, or at least curtailed, the worst abuses by the largest offenders, whose activities spanned the nation. But as the crisis approached the feds stood silent. And at times, they even opposed the states that stepped into the breach.

My claim is that before, during, and even after the Great Recession, a handful of state attorneys general (AGs) led the way on enforcement. Their response was evolving, but comprehensive. They demonstrated remarkable collaboration and forged broad enforcement coalitions. Minimally, these states functioned as a stopgap in our federalist system. But they were not just a second line of defense. Even after the feds began exercising their powers, the states were a critical force on the front lines and positively shaped the quality of enforcement in ways not replicated by their federal counterparts. Moreover, the AGs' later partnership with the feds created a new model for state-federal collaboration.

No one has told this story from beginning to end, starting with several enforcement actions against predatory lenders that began in the late 1990s and finishing with more recent actions against the institutions that financed the subprime enterprise. This narrative matters for several reasons. For most of their existence, AGs have flown below the scholarly and popular radar. That obscurity briefly lifted in 1998 with the staggering $206 billion tobacco settlement.[1] A burst of scholarship ensued, much of it critical of the terms and regulatory effects of the deal, as well as the actors behind it.[2] This assessment framed the discussion moving forward. In their response to the subprime mortgage crisis, the AGs have arguably exerted more influence than any other time in modern history. This performance requires rethinking the role of the states' chief legal officers.

This narrative also supports the case for empowered states to protect consumers in the financial marketplace. Acting alone or in concert with federal regulators, the AGs played an indispensable role. In every major case the AGs brought related to the Great Recession, they drew on their state consumer protection acts. Moreover, in the Dodd-Frank Act of 2010, Congress empowered states with a double blessing: scaled-back federal preemption and new concurrent enforcement powers. The story I tell is in part justification for this dual enforcement regime and for strong state consumer protection laws. In addition, the story shines light on the means whereby the states might collaborate with their federal counterparts and craft remedies that avoid the worst costs of "regulation by litigation." And while my focus is consumer financial protection, this story also has implications for larger conversations about federalism and enforcement.

In telling this story, I stay within certain margins. My time frame is roughly 2000–2014 and focuses on a few states[3] and their attorneys general that led the way: California, Illinois, Iowa, Massachusetts, and New York. Two of these states had the same AG throughout nearly the

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1 *Master Settlement Agreement Related Information*, NAT'L ASS'N ATT'YS GEN., http://www.naag.org/naag/about_naag/naag-center-for-tobacco-and-public-health/master-settlement-agreement.php (last visited Apr. 22, 2015).

2 *See, e.g.*, Michael DeBow, *The State Tobacco Litigation and the Separation of Powers in State Governments: Repairing the Damage*, 31 SETON HALL L. REV. 563 (2001); Michael I. Krauss, *Regulation Masquerading as Judgment: Chaos Masquerading as Tort Law*, 71 MISS. L.J. 631 (2001); Jason Lynch, Note, *Federalism, Separation of Powers, and the Role of State Attorneys General in Multistate Litigation*, 101 COLUM. L. REV. 1998 (2001).

3 In addition to states, some cities took steps to combat predatory lending, but were stymied in part because they often failed to establish standing. *See* Kathleen C. Engel, *Do Cities Have Standing? Redressing the Externalities of Predatory Lending*, 38 CONN. L. REV. 355 (2006); Kathleen C. Engel, *The State of Play in City Claims Against Financial Firms*, 40 FORDHAM URB. L.J. CITY SQUARE 82 (2014); Jonathan L. Entin & Shadya Y. Yazback, *City Governments and Predatory Lending*, 34 FORDHAM URB. L.J. 757 (2007); Jonathan L. Entin, *City Governments and Predatory Lending Revisited*, 40 FORDHAM URB. L.J. CITY SQUARE 108 (2014).

entire story: Illinois (Lisa Madigan, 2003–present);[4] and Iowa (Tom Miller, 1979–1990, 1994–present).[5] The other states had multiple AGs: California (Bill Lockyer, 1999–2007; Jerry Brown, 2007–2011; Kamala Harris, 2011–present);[6] Massachusetts (Tom Reilly, 1999–2007; Martha Coakley, 2007–2014);[7] and New York (Eliot Spitzer, 1999–2006; Andrew Cuomo, 2007–2010; and Eric Schneiderman, 2011–present).[8] Collectively, I refer to these officials as the "Enforcers." Others could join this list, including important leaders such as North Carolina Attorney General Roy Cooper (2001–present), Washington Attorney General Rob McKenna (2005–2013), and Colorado Attorney General John Suthers (2005–present).[9] Although I focus on the elected AGs, of course others were critical. A core group of career lawyers within attorneys general offices collaborated on multiple cases.[10] Moreover, state banking regulators were also important, as they had resources and jurisdictional powers that some AGs lacked.[11]

In Part I, "The Backstory," I provide a brief overview of the mortgage lending system and its three primary components: origination, servicing, and securitization. I then identify several threats that emerged within this system. Having set the scene, I turn in Part II to the "Story of the Enforcers," roughly dividing the narrative into two acts. The first Act covers the years 2000–2008, leading up to the Great Recession. Acting alone, the AGs brought a series of actions focused on harms arising out of the loan origination process: namely, predatory and discriminatory lending. The second Act covers the years 2009–2014, where the Enforcers were resolving the earlier cases, but turning their attention to harms arising out of the servicing and securitization processes. In Part III, "What the Story Tells Us," I consider both why

4 *See* ILL. ATT'Y GEN., http://www.illinoisattorneygeneral.gov (last visited Apr. 22, 2015).

5 *See* IOWA ATT'Y GEN., https://www.iowaattorneygeneral.gov (last visited Apr. 22, 2015).

6 *See* CAL. ATT'Y GEN., http://oag.ca.gov (last visited Apr. 22, 2015).

7 *See* MASS. ATT'Y GEN., http://www.mass.gov/ago (last visited Apr. 22, 2015).

8 *See* N.Y. ATT'Y GEN., http://www.ag.ny.gov (last visited Apr. 22, 2015).

9 Although not an exhaustive list, other attorneys general that played an important role included Connecticut Attorneys General Richard Blumenthal (1991–2011) and George Jepsen (2011–present); Delaware Attorney General Joseph "Beau" Biden III (2007–present); Minnesota Attorney General Mike Hatch (1999–2007); and Ohio Attorney General Richard Cordray (2009–2011).

10 A few examples of career lawyers within AGs' offices include Chris Barry-Smith (former Assistant Attorney General and now Deputy Attorney General, Massachusetts Attorney General's Office, 1997–1999, 2002–present); Prentiss Cox (Manager, Consumer Enforcement Division, Minnesota Attorney General's Office, 2001–2005); Deborah Hagan (Chief, Consumer Protection Division, Illinois Attorney General's Office, 2004–present); David Huey (Senior Assistant Attorney General, Washington Attorney General's Office, 2001–present); Tom James (Senior Assistant Attorney General, Illinois Attorney General's Office, 1988–present); Kathleen Keest (Assistant Attorney General, Iowa Attorney General's Office, 1996–2004); Patrick Madigan (Assistant Attorney General, Iowa Attorney General's Office, 2004–present); and Tam Ormison (Deputy Attorney General, Iowa Attorney General's Office, 1997–present).

11 *See infra* note 72.

states matter for consumer financial protection and the means whereby the state and federal governments might collaborate. And then in Part IV, "The Rest of the Story," I sketch an agenda for empirical research to further understand the events of this narrative and its normative lessons.

I. THE BACKSTORY

This story is in some sense but a chapter in the larger story about the Great Recession: its causes, effects, and the responses to the crisis. That tale has been told elsewhere, new versions continue to appear, and debates about the storyline persist.[12] This larger story is beyond the scope of my narrative and parts of that story stray far from the space occupied by AGs. (They have little impact on, say, setting the federal funds rate or the level of foreign currency reserves in China.) Nonetheless, to understand the AGs' role we need to review one of the central themes in that larger story: the residential mortgage lending system and the failures that arose within that system.

A. *The Mortgage Lending System*

Although the crisis eventually touched every area of the economy, it began in the financial sector, and in particular within the system of residential mortgage lending. This system has three primary components: origination, servicing, and securitization.

1. Origination. Loan origination involves a borrower applying for a loan and a lender processing that application. Lenders are of two kinds: depositories and nondepositories (often referred to as "nonbank mortgage lenders").[13] Both types played a significant role in the run-up to the economic crisis. Depository institutions—that is, institutions that take deposits—are the traditional lenders and include both banks and

12 *See, e.g.*, NAT'L COMM'N ON THE CAUSES OF THE FIN. & ECON. CRISIS IN THE U.S., THE FINANCIAL CRISIS INQUIRY REPORT (2011) [hereinafter FINANCIAL CRISIS INQUIRY REPORT], *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf; THE AMERICAN MORTGAGE SYSTEM: CRISIS AND REFORM (Susan M. Wachter & Marvin M. Smith eds., 2011); ALAN S. BLINDER, AFTER THE MUSIC STOPPED: THE FINANCIAL CRISIS, THE RESPONSE, AND THE WORK AHEAD (2013); KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS (2011); JOSEPH E. STIGLITZ, FREEFALL: AMERICA, FREE MARKETS, AND THE SINKING OF THE WORLD ECONOMY (2010); WHAT CAUSED THE FINANCIAL CRISIS (Jeffrey Friedman ed., 2011); Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 GEO. L.J. 1177 (2012); Phil Gramm & Mike Solon, Opinion, *The Clinton-Era Roots of the Financial Crisis*, WALL ST. J., Aug. 12, 2013, http://www.wsj.com/articles/SB10001424127887323477604579000571334113350.

13 ENGEL & MCCOY, *supra* note 12, at 151–52.

thrifts (often called "savings associations" or "savings and loans" institutions). In the American dual banking system, these depositories apply for either a state or federal charter.[14] All banks and thrifts have a federal regulator, and state depositories also have a state regulator. Nonbank mortgage lenders do not take deposits and exist either as freestanding corporations or affiliates of a state or federal depository. The rise of securitization, briefly discussed below, gave rise to the proliferation of nonbank lenders because they could access capital on the market. Prior to the 2010 reforms, the states were the primary regulators of independent nonbank lenders, although the Federal Trade Commission (FTC) had power to address unfair or deceptive acts or practices. Various federal agencies regulated nonbank lenders connected to a federal depository.

For decades, prime lending financed American home sales: a 20% down payment on the purchase price, repaid over 30 years at a fixed-interest rate by a borrower whose capacity to make repayments was documented and secured by the asset.[15] This gold-standard brought benefits for both sides—with modest savings the otherwise capital-poor borrower could purchase a home, while the lender could receive a reasonable return on investment protected by the down payment should the homeowner default in the midst of a dip in the housing market. Variations on the traditional mortgage existed—and government subsidies to grow the ranks of homeowners allowed lenders in certain circumstances to lower the down payment—but prime lending remained the industry's core.[16]

Beginning in the early 1990s, however, lenders began to aggressively market a different kind of financial product, which had existed in limited fashion for several years: the subprime mortgage, as well as Alt-A mortgages.[17] In theory, both products were aimed at persons who otherwise did not qualify for prime lending. In fact, many unscrupulous lenders pushed these products on people who otherwise would qualify for prime lending. This population posed a higher risk of default. The cost of bearing this risk was baked into the loan in the form of higher fees and a higher interest rate. As conceived, subprime mortgages targeted borrowers who posed the most risk—typically persons with poor credit histories and who lacked the savings to make a down payment. Alt-A mortgages often targeted a population who posed

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14 *See generally id.* at 151–53; 1 DONALD RESSEGUIE, BANKING LAW § 1.04 (2015).

15 *See* ENGEL & MCCOY, *supra* note 12, at 15.

16 *See* Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 307 (2005).

17 For an account of these developments, see FINANCIAL CRISIS INQUIRY REPORT, *supra* note 12, at 67–80; ENGEL & MCCOY, *supra* note 12, at 15–42; Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 1015–16 (2009).

less risk, but still had minor credit issues or otherwise were unable or unwilling to document their assets or income.[18]

In time the industry skyrocketed. In 1995 subprime lending accounted for $65 billion in loans and by 2006 it accounted for $600 billion and 24% of all mortgage originations.[19] Likewise, Alt-A loans went from $60 billion in 2001 to $400 billion in 2006.[20] At the same time, the players in the industry changed.[21] Larger financial institutions—commercial banks, investment banks, and others—saw the profit realized in subprime lending and scooped up the smaller players that appeared in the early 1990s.[22] And a few firms that were once small and local, such as Ameriquest and Countrywide, now spread across the nation. As we will see, these firms increasingly used predatory tactics to feed an insatiable mortgage machine.

2. Servicing. Loan servicing—the second component of the residential mortgage lending system—involves two primary functions: the administration of loan repayments and the handling of delinquencies.[23] The repayment process includes sending statements, collecting payments, handling escrow accounts, tracking account balances, reporting to credit bureaus, and applying shifting interest rates in the case of adjustable rate mortgages.[24] The delinquency process includes both loan modifications (i.e., loan restructuring or short sales) and foreclosures.[25] In an earlier day, the originator and the servicer were the same entity: the lender would retain and service the loan until it was fully repaid.[26] That traditional lending relationship, however, is now the exception. Third parties service most loans and do not have ownership rights to the loans they service.[27] The reasons for this shift are several, but the most important reason is the steady rise of mortgage securitization, discussed below, as every securitized mortgage requires a third-party servicer.[28] In the years leading up to the Great Recession, servicers experienced only minimal oversight.[29] For depositories, the

18 *See supra* note 17.

19 *See* FINANCIAL CRISIS INQUIRY REPORT, *supra* note 12, at 70 (chart); Wilmarth, *supra* note 17, at 1015–16.

20 *See supra* note 19.

21 *See* FINANCIAL CRISIS INQUIRY REPORT, *supra* note 12, at 88–89; ENGEL & MCCOY, *supra* note 12, at 25–27.

22 FINANCIAL CRISIS INQUIRY REPORT, *supra* note 12, at 88–89.

23 *See generally* Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1 (2011).

24 *Id.* at 23.

25 *Id.*

26 *Id.* at 11.

27 *Id.* at 11–13.

28 *Id.* at 15–16.

29 *Id.* at 52.

institution's charter determined the regulator, and nonbank servicers were not subject to federal supervision.[30]

3. Securitization. The third and final component of the residential mortgage lending system is securitization. Although not earlier part of the lending system, today it shapes nearly every aspect of it. Securitization involves the creation, packaging, and sale of residential mortgage-backed securities (RMBSs).[31] A mortgage-backed security is a debt obligation, where the holder of the security has a claim to the cash flows from pools of mortgage loans.[32] For more than three decades, the steady trend has been toward originators selling ownership rights to the loans they make on the secondary mortgage market.[33] Today, the majority of mortgages are securitized. Government-sponsored enterprises (GSEs, namely Fannie Mae and Freddie Mac), and private financial institutions (like JP Morgan or Goldman Sachs), underwrite and issue these securities after purchasing and packaging mortgage loans from originators.[34] While the GSEs for years securitized prime mortgages, in the early 2000s the investment banks turned to securitizing subprime mortgages, as well.[35] The forces behind the securitization trend are several and include both demand for capital to ensure a steady stream of funding for mortgages, and a desire by originators to mitigate risks.[36] In many ways, the rise of mortgage securitization fueled the entire enterprise, as it provided demand and financing for new mortgages, especially the higher risk Alt-A and subprime loans.

B. *The Seven Deadly Sins*

The AGs in this story targeted seven types of wrongdoing—the "seven deadly sins," you might say—within the mortgage lending system. Although I am not arguing for the causes of the Great

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30 In August 2013, the Consumer Financial Protection Bureau began supervising nonbank mortgage servicers. *See* Procedural Rule to Establish Supervisory Authority Over Certain Nonbank Covered Persons Based on Risk Determination, 78 Fed. Reg. 40,352 (July 3, 2013) (to be codified at 12 C.F.R. pt. 1091).

31 *See generally* FINANCIAL CRISIS INQUIRY REPORT, *supra* note 12, at 42–45; Viral V. Acharya & Matthew Richardson, *How Securitization Concentrated Risk in the Financial Sector*, *in* WHAT CAUSED THE FINANCIAL CRISIS, *supra* note 12, at 183, 183–99; Ingrid Gould Ellen et al., *The Secondary Market for Housing Finance in the United States: A Brief Overview*, *in* THE AMERICAN MORTGAGE SYSTEM: CRISIS AND REFORM, *supra* note 12, at 7–25; ENGEL & MCCOY, *supra* note 12, at 17–19; Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV 2185 (2007).

32 *See supra* note 31.

33 *See supra* note 31.

34 *See supra* note 31.

35 *See* Acharya & Richardson, *supra* note 31, at 187.

36 *See supra* note 31.

Recession,[37] I do assume that these harms either causally contributed to the crisis or exacerbated it. The first three sins all arose within the loan origination process: predatory lending, discriminatory lending, and mortgage fraud. Predatory lending takes many forms, but involves some type of unfair dealing by a lender, such as misrepresenting the terms of a loan, steering a borrower into a less favorable product than the borrower would otherwise qualify, misleading a consumer about his ability to repay, selling unnecessary products, or including abusive penalties and fees in the terms of the loan.[38]

Discriminatory lending can be a type of predatory lending. Most often discriminatory lending took the form of reverse redlining—targeting certain populations on the basis of race or ethnic origin with predatory lending products.[39] Although both predatory and discriminatory lending lie within the loan origination process, the incentives for both practices trace back in part to the securitization of mortgages that fueled a demand for subprime mortgages on Wall Street.[40]

The third deadly sin, mortgage fraud, also falls within the origination process.[41] These schemes may be simple or complex, involving one person or a network of individuals working in concert. "Fraud for housing" or "fraud for property" schemes typically aim to put a person in possession of a dwelling or property for which that person would not otherwise qualify, whereas "fraud for profit" schemes aim to generate financial gain without giving participants in the fraud possession of the house.[42]

Other harms fell within the loan servicing process. The fourth sin, loan servicing and foreclosure fraud, involves various failures on the part of the servicers to account properly for borrower activity in repaying the loan, as well as unfair or abusive practices in the foreclosure process. Mortgage rescue fraud, the fifth sin, does not

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37 For a discussion of these causes, see *supra* note 12.

38 *See, e.g.*, *Predatory Lending*, NAT'L ASS'N CONSUMER ADVOCS., http://www.naca.net/issues/predatory-lending (last visited Apr. 23, 2015).

39 *See* Winnie F. Taylor, *Eliminating Racial Discrimination in the Subprime Mortgage Market: Proposals for Fair Lending Reform*, 18 J.L. & POL'Y 263, 269–77 (2009).

40 *See* ENGEL & MCCOY, *supra* note 12, at 17–19. The American Civil Liberties Union has filed a class action lawsuit against Morgan Stanley based on the theory that the firm incentivized discriminatory lending. *See* Class Action Complaint, Adkins v. Morgan Stanley, No. 12 CIV. 7667, 2012 WL 4856708 (S.D.N.Y. Oct. 15, 2012). The district court denied the defendants' motion to dismiss plaintiffs' Fair Housing Act claim. Adkins v. Morgan Stanley, No. 12 CIV. 7667, 2013 WL 3835198 (S.D.N.Y. July 25, 2013) (order denying motion to dismiss in part).

41 *See* FBI, 2010 MORTGAGE FRAUD REPORT: YEAR IN REVIEW 5 (2011), *available at* http://www.fbi.gov/stats-services/publications/mortgage-fraud-2010. Note that the FBI definition of "mortgage fraud" also includes what I call "mortgage rescue fraud" and "fraud in the servicing of mortgages." I use the term mortgage fraud more narrowly to cover only fraud for property and fraud for profit schemes.

42 *Id.*

involve the actual loan servicers, but third parties—typically small companies and often a single individual—that target distressed homeowners with false promises to help. A typical scheme that repeated itself countless times involves a promise for services, an upfront fee for those services, and then a failure to deliver part or often all of the services promised.[43]

The final harms stem from the securitization process. The sixth sin involved fraud in the creation, package, and sale of residential mortgage-backed securities.[44] The financial institutions behind these securities often misrepresented the risk of the underlying assets. And the seventh sin involved fraud by the agencies that rated these securities, several of whom continued to give AAA ratings to toxic investments through the eve of the crisis.[45]

This Article divides the story of how the Enforcers confronted these seven deadly sins into two Acts. The beginning of 2009 serves as a rough dividing point. By then the economic crisis was in clear view, following a dramatic unfolding of failures and rescues in the last half of 2008. Within a few weeks into the new year, the nation had a new administration and a new Congress. At the same time, states shifted their focus as the crisis unfolded and as the Enforcers gained a deeper understanding of what was taking place and who was to blame.

II. THE STORY OF THE ENFORCERS

From 2000–2008, the Enforcers led the fight against mounting forces that resulted in the cataclysmic events of 2008. With one exception, they led with little help from federal law enforcement officials—and in some cases with opposition from them.

A. *Act I: Before the Fall (2000–2008)*

In this first part of the story, the Enforcers confronted head on some of the wrongdoing that would give rise to the events of 2008, while laying the groundwork for later actions in other areas. Most important, these states and their AGs confronted the deadly sins that stained the loan origination process, especially rampant predatory lending.

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43 *See id.* at 20–21.

44 *See* ENGEL & MCCOY, *supra* note 12, at 43–58.

45 *See id.* at 47–51; Press Release, Dep't of Justice, Department of Justice Sues Standard & Poor's for Fraud in Rating Mortgage-Backed Securities in the Years Leading Up to the Financial Crisis (Feb. 5, 2013), *available at* http://www.justice.gov/opa/pr/2013/February/13-ag-156.html (summarizing the Department of Justice civil fraud suit against Standard & Poor's (S&P)).

1. Predatory Lending

Subprime lending is not, by definition, predatory.[46] In the best light, it creates opportunities that would otherwise not exist for a significant segment of the population. But for multiple reasons that I will not examine here, the subprime lending that lay behind the Great Recession was at times shockingly predatory.[47] Fueled by Wall Street's dollars and demand, the industry increasingly employed fraudulent tactics to bring new originations in the door.

With a few exceptions, the federal government was missing in action from 2001–2008.[48] A review of all Department of Justice Press releases during this time period relating to residential mortgage lending reveals not a single predatory lending case, even while abuses in the industry were rampant and peaked in 2006.[49] The two primary regulators of nationally chartered depositories—the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency—issued very few enforcement orders, even though they were charged with consumer protection.[50] And even worse, not only were the federal regulators failing to hold wrongdoers accountable, but they also enabled the harm by waging an aggressive campaign to preempt new state laws

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46 *See* Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1261 (2002).

47 For an in-depth account of predatory lending leading up to the economic crisis, see MICHAEL W. HUDSON, THE MONSTER: HOW A GANG OF PREDATORY LENDERS AND WALL STREET BANKERS FLEECED AMERICA—AND SPAWNED A GLOBAL CRISIS (2010) and see also BETHANY MCLEAN & JOE NOCERA, ALL THE DEVILS ARE HERE: THE HIDDEN HISTORY OF THE FINANCIAL CRISIS (2011).

48 The Federal Trade Commission (FTC) was an exception. *See, e.g.*, Press Release, Fed. Trade Comm'n, FTC Charges One of Nation's Largest Subprime Lenders with Abusive Lending Practices (Mar. 6, 2001), *available at* http://www.ftc.gov/news-events/press-releases/2001/03/ftc-charges-one-nations-largest-subprime-lenders-abusive-lending (complaint against First Capital Corp. and Associates Corp. of North America); Press Release, Fed. Trade Comm'n, FTC Charges that Sub-Prime Lenders Misrepresented Loan Terms to Consumers (Oct. 4, 2000), *available at* http://www.ftc.gov/news-events/press-releases/2000/10/ftc-charges-sub-prime-lenders-misrepresented-loan-terms-consumers (complaint against First Alliance Mortgage Co. (FAMCO)). Nonetheless, the role of the FTC was limited. The agency's resources were tight, the scope of its responsibilities broad, and most important, the agency lacked jurisdiction over federal depositories and their affiliates. *See* Julie L. Williams & Michael S. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks*, 58 BUS. LAW. 1243, 1243–49 (2003).

49 Spreadsheet of State and Federal Press Releases: 1999–2014 (on file with author). For press releases from July 1994 through January 2009, see *Justice News Archive: Press Releases*, U.S. DEP'T JUSTICE, http://www.justice.gov/opa/press-releases.html (last visited Apr. 24, 2015). For press releases from February 2009 through present, see *Justice News*, U.S. DEP'T JUSTICE, http://www.justice.gov/opa/justicenews.php (last visited Apr. 24, 2015).

50 *See* Arthur E. Wilmarth, Jr., *Turning a Blind Eye: Why Washington Keeps Giving in to Wall Street*, 81 U. CIN. L. REV. 1283, 1338–40 (2013).

targeting predatory lending, state laws prohibiting unfair and deceptive practice ("UDAP" statutes), and state fair-lending laws.[51]

The reasons for federal inaction are many and are explored elsewhere,[52] but the end result was a vast enforcement vacuum that the states filled. During this time period the states filed suits alleging predatory lending against five of the largest subprime lenders: First Alliance Mortgage Company (FAMCO), Household Finance Corporation (Household), Ameriquest Mortgage Company (Ameriquest), Fremont General and Fremont Investment and Loan (Fremont), and Countrywide Financial Corporation (Countrywide).

The case against FAMCO, a nonbank mortgage lender headquartered in Orange County, was first. The company's founder and CEO, Brian Chisick, cut his teeth selling copies of the *Encyclopedia Britannica* door-to-door, later sold office machines, and then moved into the mortgage business.[53] Chisick opened FAMCO in 1971.[54] His success depended on two factors: an aggressive sales force recruited from large auto dealerships and money from Wall Street.[55] He fine-tuned a sales pitch known as the "Track," which he required his sales representatives to know forward and back.[56] The "Track" was scripted to disarm, distract, and ultimately mislead targets—usually people with poor credit histories—into believing they were acquiring a product in their best interest.[57] The capital behind these products came from investors: first from private sources and later from Wall Street.[58] By the end of the 1990s FAMCO's largest investor was Lehman Brothers, which provided capital by purchasing the mortgages, and then packaging and selling them as residential mortgage-backed securities (RMBS).[59] These investments enabled FAMCO to extend its reach across the nation.

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51 *See id.*; *see also* ENGEL & MCCOY, *supra* note 12, at 157–59; Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 79–83 (2008); Kathleen C. Engel & Patricia A. McCoy, *Federal Preemption and Consumer Financial Protection: Past and Future*, 31 BANKING & FIN. SERVICES POL'Y REP. 25 (2012); Catherine M. Sharkey, *Inside Agency Preemption*, 110 MICH. L. REV. 521, 553–56 (2012); Arthur E. Wilmarth, Jr., *The Dodd-Frank Act's Expansion of State Authority to Protect Consumers of Financial Services*, 36 J. CORP. L. 893, 910–15 (2011).

52 *See* Mark Totten, *Credit Reform and the States: The Vital Role of Attorneys General After Dodd-Frank*, 99 IOWA L. REV. 115, 122–25 (2013).

53 For background on the FAMCO case, see HUDSON, *supra* note 47 and Diana B. Henriques & Lowell Bergman, *Profiting from Fine Print with Wall Street's Help*, N.Y. TIMES, Mar. 15, 2000, at A1.

54 *See supra* note 53.

55 *See supra* note 53.

56 *See supra* note 53.

57 *See supra* note 53.

58 *See supra* note 53.

59 *See supra* note 53.

By the mid-1990s, multiple AGs were receiving complaints about FAMCO. The need for public enforcement became increasingly clear.[60] After extensive investigations, Illinois, Massachusetts, and Minnesota all initiated civil suits against FAMCO in 1998, and several other states followed, including California and New York.[61] The FTC filed its own complaint in October 2000, citing violations of the federal UDAP as well as disclosure requirements under the Truth in Lending Act and Regulation Z, which implements the statute.[62] The state complaints all alleged violations of the state UDAPs. According to the California complaint, FAMCO used telemarketing and direct mail solicitation to target homeowners with poor credit histories, especially the elderly.[63] Using the "Track" sales pitch, representatives would mislead consumers about the amount of origination fees, which ranged from 10% to 25% of the loan, as well as the interest rate and monthly payments on the adjustable rate mortgages (ARMs).[64] For example, these loans typically included "teaser" interest rates that looked attractive, and in the case of refinancing would often lower the monthly payment, but would expire within six months and rapidly escalate.[65] Representatives would suggest that the initial rate would stay constant unless market conditions deteriorated, when in fact they automatically climbed.[66] Using this method, FAMCO sold thousands of subprime loans nationwide.[67]

The states, the FTC, and private plaintiffs settled with FAMCO in March 2002 for $60 million.[68] FAMCO faced a court-ordered liquidation, an order for Chisick to pay $20 million of the settlement out

60 *See* HUDSON, *supra* note 47, at 109.

61 *See The Causes and Current State of the Financial Crisis: Hearing Before the Fin. Crisis Inquiry Comm'n* 4 (2010) (testimony of Lisa Madigan, Illinois Att'y Gen.) [hereinafter *Madigan Testimony*], *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0114-Madigan.pdf; *Promoting Homeownership by Ensuring Liquidity in the Subprime Mortgage Market: Joint Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit and the Subcomm. on Housing & Cmty. Opportunity* 1–2, 5 (2004) (testimony of Pamela Kogut, Massachusetts Assistant Att'y Gen.), *available at* http://democrats.financialservices.house.gov/media/pdf/062304pk.pdf. Other states included Arizona, California, Florida, Illinois, Minnesota, and New York.

62 Press Release, Fed. Trade Comm'n, Home Mortgage Lender Settles "Predatory Lending" Charges (Mar. 21, 2002), *available at* http://www.ftc.gov/news-events/press-releases/2002/03/home-mortgage-lender-settles-predatory-lending-charges.

63 Press Release, State of Cal. Dep't of Justice, Office of the Att'y Gen., Attorney General Brings Consumer Protection Action Against Major "Subprime" Lender in California (June 12, 2001), *available at* http://oag.ca.gov/news/press-releases/attorney-general-brings-consumer-protection-action-against-major-subprime-lender.

64 *Id.*

65 *Id.*

66 *Id.*

67 *Id.*

68 Press Release, State of Cal. Dep't of Justice, Office of the Att'y Gen., Attorney General Bill Lockyer Announces Settlement of Major Predatory Lender Lawsuit (Mar. 21, 2002), *available at* http://oag.ca.gov/news/press-releases/attorney-general-bill-lockyer-announces-settlement-major-predatory-lender; Press Release, *supra* note 62.

of his own pocket, and Chisick was banned from lending in the states that brought suit.[69] The FTC claimed the settlement at the time was its largest recovery against a predatory lender, and the second largest settlement in the history of the FTC.[70]

The next big case was against an even larger participant in the subprime lending world, Household Finance, which by time of the settlement faced a united front of all fifty states—a rare demonstration of solidarity.[71] Also joining the state AGs in this case and other predatory lending actions were several state banking regulators, which extended the jurisdictional reach of the law enforcement team beyond the typical multistate action.[72] Based outside of Chicago, Household was a major subprime lender. The company had extended $100 billion in loans to 50 million customers—primarily subprime mortgages to borrowers with bad credit histories.[73] Allegations were similar to what the states had encountered with FAMCO: misrepresentations concerning loan points, origination fees, and interest rates; misleading consumers about the necessity and benefits of accompanying insurance products; misleading borrowers about prepayment penalties; and undisclosed balloon payments.[74] These practices, the states claimed, violated their state UDAP laws.[75]

Household finally agreed to a landmark $525 million settlement in October 2002, which dwarfed the already record-setting settlement with FAMCO and covered residential loans from 1999 up to the time of settlement.[76] Leading the talks was Iowa AG Tom Miller, who at the time chaired the Subprime Lending Committee of the National Association of Attorneys General (NAAG).[77] This resolution was notable in two ways. First, at the time it was the largest direct restitution

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69 Press Release, *supra* note 62.

70 Diana B. Henriques, *A Home Lender in a Settlement for $60 Million*, N.Y. TIMES, Mar. 22, 2002, at A1.

71 *See generally* HUDSON, *supra* note 47, at 168–72; Peter Eavis, *Lawsuits and Regulators Shadow Big Lender's Future*, N.Y. TIMES, Aug. 17, 2002, at C1; Martha McNeil Hamilton, *Household International to Repay Borrowers*, HONOLULU ADVERTISER (Oct. 12, 2002), http://the.honoluluadvertiser.com/article/2002/Oct/12/bz/bz09a.html.

72 For example, the State of Washington Department of Financial Institutions played a key role. *See* Sally Peacock, How the Household Settlement Uncorked a Law Enforcement Bottleneck (Fall 2003) (unpublished paper, Columbia Law School), *available at* http://web.law.columbia.edu/sites/default/files/microsites/career-services/How%20the%20Household%20Settlement%20Uncorked%20a%20Law%20Enforcement%20Bottleneck.pdf. Banking regulators were important partners in states where the state consumer protection act did not reach the credit industry. *See id.* at 24.

73 *See* Hamilton, *supra* note 71.

74 *See, e.g.*, Complaint, Iowa v. Household Int'l, at 2–5 (not filed with court).

75 *Id.* at 5.

76 *See, e.g.*, Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., Miller: Iowa's Share of Household Settlement Could Reach about $1.3 Million (Oct. 11, 2002), *available at* http://www.state.ia.us/government/ag/latest_news/releases/oct_2002/Household_Iowa.html.

77 *See* Hamilton, *supra* note 71; Press Release, *supra* note 76.

consumer protection settlement ever reached by a state or federal government.[78] Second, the settlement included extensive injunctive relief that many states hoped would serve as a model for future settlements and legislative reforms.[79] Among the terms was a limit on prepayment penalties to only the first two years of a loan; a requirement to ensure the loan provided an actual benefit to the consumer; limits on points and origination fees; and improved disclosure requirements.[80]

The leaders behind the Household settlement turned next to Ameriquest.[81] At the time of settlement, it was the largest subprime lender in the nation. The company was the baby of Ronald Arnall, a California businessman whose lending empire made him a billionaire and one of the nation's wealthiest people by 2004.[82] Arnall launched his business as a small thrift in 1979, but in 1994 transformed the company into a nonbank mortgage lender that made loans through independent mortgage brokers and retail operations.[83] The company experienced explosive growth through the same formula that FAMCO employed—aggressive sales tactics and Wall Street investment. And its name was well known—the result of an aggressive marketing campaign that included a NASCAR race, the Ameriquest 300; two blimps; and the 2005 Ameriquest Mortgage Super Bowl XXXIX Halftime Show.[84]

By now, closing the mortgage deal involved poorly underwritten and fraudulently documented loans. For example, AG investigations revealed that Ameriquest secured inflated appraisals.[85] Moreover, they also discovered widespread use of fabricated or inflated income on loan applications, which were encouraged or recorded by Ameriquest representatives.[86] As Illinois AG Lisa Madigan would testify before the Financial Crisis Inquiry Commission, "For those of us on the state level, the Ameriquest investigation marks the moment when we began to see

78 *Household to Pay Record Fine and Change Lending Practices*, N.Y. TIMES, Oct. 12, 2002, at C4; Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., Miller: All Fifty States Join Settlement with Household Finance (Dec. 16, 2002), *available at* http://www.state.ia.us/government/ag/latest_news/releases/dec_2002/hhold.html.

79 *See* Prentiss Cox, *The Importance of Deceptive Practice Enforcement in Financial Institution Regulation*, 30 PACE L. REV. 279, 295 (2009).

80 Press Release, *supra* note 78.

81 *See* HUDSON, *supra* note 47, at 172.

82 *See* ENGEL & MCCOY, *supra* note 12, at 26; HUDSON, *supra* note 47, at 224–46 (for a longer account).

83 *See* ENGEL & MCCOY, *supra* note 47, at 26.

84 *See* HUDSON, *supra* note 47, at 221, 228.

85 *See, e.g.*, Complaint at 6, People v. Ameriquest Mortg. Co., No. RG06260804 (Cal. Super. Ct. Mar. 21, 2006), *available at* http://oag.ca.gov/system/files/attachments/press_releases/06-005_0a.pdf; Press Release, State of Cal. Dep't of Justice, Office of the Att'y Gen., Attorney General Lockyer Announces $325 Million Settlement with Ameriquest to Resolve National Predatory Lending Case (Jan. 23, 2006), *available at* http://oag.ca.gov/news/press-releases/attorney-general-lockyer-announces-325-million-settlement-ameriquest-resolve.

86 *See supra* note 85.

the underwriting practices of mortgage lenders erode at a disturbingly accelerated pace."[87]

The Enforcers all led in the investigation. Iowa, California, New York, and Illinois (along with Washington) formed the negotiation team, with Iowa AG Tom Miller again at the helm.[88] After more than two years of investigation and negotiations, the states and Ameriquest agreed on a $325 million settlement in January 2006, making it the second largest consumer protection settlement after the Household deal.[89] Like its predecessor, the Ameriquest settlement included important injunctive provisions like a procedure for ensuring appraisal independence, a prohibition on encouraging borrowers to misstate income sources and amounts, and reforms to the incentive system for sales representatives.[90] In crafting this settlement, Madigan explained that the intent was to create "a lender code of conduct" that would serve as a model for broader reforms.[91]

The FAMCO, Household, and Ameriquest cases all demonstrated remarkable coordination among the AGs. But sometimes they acted alone. Massachusetts AG Martha Coakley's investigation and enforcement action against California-based Fremont from 2007–2008, shortly after taking office, is one example.[92] In making her case, Coakley claimed that Fremont failed to assess borrowers' ability to repay, and that this failure amounted to a UDAP violation.[93] Moreover, Coakley also found rampant abuses in the foreclosure process. Fremont sold its loans to Wall Street, but agreed to act as the servicer. Among other problems, Coakley's investigation revealed that Fremont purported to offer a loan modification program, but charged additional fees for the service without ever providing any help.[94]

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87 *Madigan Testimony*, *supra* note 61, at 4.

88 Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., Ameriquest Will Pay $325 Million and Reform its Lending Practices (Jan. 23, 2006), *available at* http://www.state.ia.us/government/ag/latest_news/releases/jan_2006/Ameriquest_Iowa.html.

89 Kirstin Downey, *Mortgage Lender Settles Lawsuit*, WASH. POST, Jan. 24, 2006, http://www.washingtonpost.com/wp-dyn/content/article/2006/01/23/AR2006012301523.html.

90 *See, e.g.*, Permanent Injunction and Final Judgment at 12–35, People v. Ameriquest Mortg. Co., No. RG06260804 (Cal. Super. Ct. Mar. 21, 2006), *available at* http://oag.ca.gov/system/files/attachments/press_releases/06-005_0b.pdf?.

91 *Madigan Testimony*, *supra* note 61, at 5.

92 ENGEL & MCCOY, *supra* note 12, at 184–85; Press Release, Office of the Att'y Gen., Commonwealth of Mass., Attorney General Martha Coakley Files Lawsuit Against National Mortgage Lender-Fremont Investment and Loan (Oct. 5, 2007) (on file with author); Marc Tracy, *Mass. AG Sues Lender for Predatory Loans*, LAW 360 (Oct. 17, 2007, 12:00 AM), http://www.law360.com/articles/37738/mass-ag-sues-lender-for-predatory-loans.

93 Complaint ¶ 20, Commonwealth v. Fremont Inv. & Loan, No. 07-4373 (Mass. Super. Ct. Oct. 4, 2007).

94 *Id.* ¶¶ 110–16. Fremont was a state-chartered bank not regulated by the Federal Reserve, and, therefore, under the powers of the Federal Deposit Insurance Corporation (FDIC). In one of the otherwise rare instances of federal involvement, the FDIC issued a Cease and Desist Order against Fremont on March 7, 2007 for its predatory practices. Order to Cease and Desist, *In re*

The enforcement action resulted in two significant outcomes, in addition to $10 million to the state. First, on application for a preliminary injunction the trial court held[95] that under these circumstances a lender's failure to assess a borrower's ability to repay or to issue a loan that predictably will result in foreclosure ("designed to fail") is unfair and in violation of the state's UDAP law.[96] Although most of these cases brought by AGs went straight to negotiations, Massachusetts chose to litigate for more than a year and a half before settling. This decision both allowed the state to better tell the story of the abuses by predatory lenders and also to establish valuable precedent. In part as a result of this case, Massachusetts had one of the most expansive UDAP statutes in the nation. As we will see, the *Fremont* injunction proved helpful in other cases. The second significant outcome was the trial court's creation of a notice and objection system that ultimately required court approval for a foreclosure if Fremont could not remedy any concerns of the attorney general.[97]

After a series of record-setting cases, the Enforcers turned next to Countrywide Financial, a state-licensed nonbank mortgage lender which by 2005 had become the nation's largest subprime lender under the leadership of its CEO, Angelo Mozilo.[98] From 2000 to 2006, the firm's reported securities trading volume grew from $647 billion to $2.9 trillion.[99]

Although most states eventually joined in the settlement, Illinois AG Lisa Madigan and then California AG Jerry Brown launched the investigation in Fall 2007 and led settlement negotiations the following summer.[100] The investigations revealed fraudulent practices aimed at

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Fremont Inv. & Loan, No. FDIC-07-035b (FDIC Mar. 7 2007), *available at* http://www.fdic.gov/bank/individual/enforcement/2007-03-00.pdf. Knowing this order was coming, Fremont shut down its subprime lending operations. *See* ENGEL & MCCOY, *supra* note 12, at 184–85.

95 Commonwealth v. Fremont Inv. & Loan, No. 07-4373-BLS, 2008 WL 517279, at *10 (Mass. Super. Ct. Feb. 26, 2008), *aff'd*, 452 Mass. 733 (Mass. 2008).

96 Commenting on this holding, Professor Kathleen Engel stated: "The Fremont case was probably one of the most important [mortgage fraud] cases nationwide." Jenifer B. McKim, *Coakley Blazes Path as Advocate for Homeowners*, BOS. GLOBE, Dec. 19. 2011, http://www.boston.com/business/articles/2011/12/19/massachusetts_attorney_general_martha_coakley_blazes_path_fighting_alleged_foreclosure_fraud (alteration in original). For extended discussion criticizing this ruling, see Wayne van Rooyen, Massachusetts v. Fremont*: Predatory Lending and the Creation of an Extraordinary Ex Post Facto Suitability Standard*, 5 BUS. L. BRIEF (AM. U.) 59 (2008).

97 *Fremont Inv. & Loan*, 2008 WL 517279, at *16–17.

98 *See* ENGEL & MCCOY, *supra* note 12, at 26–27; HUDSON, *supra* note 47, at 211; Dina ElBoghdady, *Bank of America to Modify Mortgages from Countrywide*, WASH. POST, Oct. 7, 2008, at D3; Gretchen Morgenson, *Illinois Suit Set Against Countrywide*, N.Y. TIMES, June 25, 2008, at C1.

99 Complaint ¶ 28, People v. Countrywide Fin. Corp., No. LC-081846 (Cal. Super. Ct. June 24, 2008), *available at* http://oag.ca.gov/system/files/attachments/press_releases/n1582_draft_cwide_complaint2.pdf?.

100 *Madigan Testimony*, *supra* note 61, at 5–6; ElBoghdady, *supra* note 98.

maximizing loan volume akin to what the states had discovered in all the earlier cases.[101] The case was striking in part because of the size of the settlement: an estimated $8.7 billion (recall that the previous record was Household at $484 million),[102] although the actual value was less than this amount.[103]

The settlement terms were unique in a few respects. To the regret of Madigan and Brown, the settlement did not include injunctive relief as had the previous deals.[104] During the course of the AG's investigation Countrywide transferred its loan origination operations from its state-licensed subsidiary to its federally chartered thrift subsidiary.[105] This act of regulatory arbitrage allowed Countrywide to enjoy the strong preemption policies defended by the Office of Thrift Supervision, which severely limited state powers.[106] At the same time, the settlement was notable for establishing the first loan modification program in the nation—an important precedent for later settlements.[107] Coming during the rise of the foreclosure crisis, several of the states involved in negotiation pushed hard for this program, which set a standard for future foreclosure policy.[108]

At the same time that the AGs were bringing these predatory lending cases against some of the nation's largest subprime lenders, then New York AG Cuomo was also eyeing the appraisal system.[109] As the

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101 *Madigan Testimony*, *supra* note 61, at 5–6.

102 ElBoghdady, *supra* note 98. The settlement later grew. While the other AGs signed off on the $8.4 billion deal, Massachusetts AG Martha Coakley refused to consent, concluding it was too easy on Countrywide. Eighteen months later, under pressure from Coakley, Countrywide allocated another $3 billion in mortgage assistance, a portion of which went to Massachusetts. McKim, *supra* note 96; Press Release, Office of the Att'y Gen., Commonwealth of Mass., AG Coakley Secures $3 Billion in Loan Modifications for Homeowners Nationwide in Agreement with Mortgage Lending Giant Countrywide (Mar. 24, 2010), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2010/ag-coakley-secures-3-billion-in-loan.html.

103 *See* Alex Ulam, *The Bank of America Mortgage Settlement Fiasco*, NATION, Oct. 13, 2010, http://www.thenation.com/article/155380/bank-america-mortgage-settlement-fiasco.

104 *Madigan Testimony*, *supra* note 61, at 7.

105 *Madigan Testimony*, *supra* note 61, at 6.

106 Subsidiaries and Equity Investments, 61 Fed. Reg. 66,561 (Dec. 18, 1996) (codified at 12 C.F.R. pts. 545, 559, 560, 563, 567, 571); Lending and Investment, 61 Fed. Reg. 50,951 (Sept. 30, 1996) (codified at 12 C.F.R. pts. 545, 556, 560, 563, 566, 571, 590); *see also supra* note 51.

107 Press Release, Ill. Att'y Gen., Illinois Attorney General Madigan Leads $8.7 Billion Groundbreaking Settlement of Lawsuit Against Mortgage Giant Countrywide (Oct. 6, 2008), *available at* http://www.illinoisattorneygeneral.gov/pressroom/2008_10/20081006.html; *see also* Gretchen Morgenson, *Countrywide to Set Aside $8.4 Billion in Loan Aid*, N.Y. TIMES, Oct. 6, 2008, at B1.

108 *See, e.g.*, Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., AGs Reach Agreement with Countrywide Financial that Will Help Borrowers Facing Foreclosure (Oct. 6, 2008), *available at* http://www.state.ia.us/government/ag/latest_news/releases/oct_2008/Countrywide.html.

109 Press Release, N.Y. State Office of the Att'y Gen., NY Attorney General Sues First American and Its Subsidiary for Conspiring with Washington Mutual to Inflate Real Estate Appraisals (Nov. 1, 2007), *available at* http://www.ag.ny.gov/press-release/ny-attorney-general-sues-first-american-and-its-subsidiary-conspiring-washington; *see also* Vikas Bajaj, *New York Says*

AG's discovered during the Ameriquest investigation, subprime lending practices had compromised appraiser independence.[110] After a nine-month investigation, General Cuomo filed suit against eAppraiseIT.[111] The complaint charged that eAppraiseIT colluded with Washington Mutual, a major subprime lender, to use a list of preferred appraisers willing to inflate the value of homes.[112] A week after filing suit, Cuomo sent subpoenas to Fannie Mae and Freddie Mac seeking information on the mortgages they purchased from banks—including Washington Mutual—and the due diligence practices the financiers used for assessing appraisals.[113] Within a few months, Fannie and Freddie agreed to buy loans only from banks that followed new standards.[114] The new policy, which Cuomo helped craft, came under strong criticism from many sides that claimed it exacerbated the problems and added costs for consumers.[115] After losing a fight to have the lawsuit dismissed on grounds of preemption, eAppraiseIT agreed to a $7.8 million settlement and voluntarily left the appraisal business.[116]

2. Discriminatory Lending

Predatory and discriminatory lending often go hand-in-hand. In particular, predatory lenders often engage in what is called "reverse redlining": targeting a certain population for predatory loans based on that population's race or other similar characteristics.[117] The years leading up to the Great Recession were no exception. And once again it was the states—and especially the Enforcers—that led in combating this practice.

During the height of the subprime lending boom the federal government did not bring a single enforcement action to stop reverse

Appraiser Inflated Value of Homes, N.Y. TIMES, Nov. 2, 2007, at C3; *New York Widens Inquiry on Mortgages*, N.Y. TIMES, Nov. 8, 2007, at C8.

110 *See supra* note 85 and accompanying text.

111 Press Release, *supra* note 109.

112 *Id.*

113 *Id.*; *see also New York Widens Inquiry on Mortgages*, *supra* note 109.

114 Press Release, N.Y. State Office of the Att'y Gen., New York Attorney General Cuomo Announces Agreement with Fannie Mae, Freddie Mac, and OFHEO (Mar. 3, 2008), *available at* http://www.ag.ny.gov/press-release/new-york-attorney-general-cuomo-announces-agreement-fannie-mae-freddie-mac-and-ofheo.

115 David Streitfeld, *In Appraisal Shift, Lenders Gain Power and Critics*, N.Y. TIMES, Aug. 18, 2009, http://www.nytimes.com/2009/08/19/business/19appraise.html.

116 Press Release, N.Y. State Office of the Att'y Gen., A.G. Schneiderman Secures $7.8 Million Settlement with First American Corporation and eAppraiseIT for Role in Housing Market Meltdown (Sept. 28, 2012), *available at* http://www.ag.ny.gov/press-release/ag-schneiderman-secures-78-million-settlement-first-american-corporation-and.

117 *See* Taylor, *supra* note 39.

redlining by mortgage lenders.[118] At the end of the Clinton Administration in 2000, the Justice Department along with other federal partners brought an action against Delta Funding Corporation.[119] The next federal action did not come until late in 2008, when the Justice Department reached a $185,000 settlement with a small state-chartered bank in Alabama for charging higher interest rates to African Americans who took loans out on manufactured homes.[120]

Leading the charge initially for the states was then New York AG Eliot Spitzer. In April 2005 Spitzer launched an investigation of eight major national banks, seeking information from the institutions about their lending practices to determine whether they violated state fair lending laws.[121] He was armed with newly released data under the Home Mortgage Disclosure Act (HMDA), a federal law requiring lenders to publicly disclose information about loan applications and originations, including demographic information about the applicants.[122] The Federal Reserve, which implements the law, had amended its disclosure requirements to allow users to identify the race and ethnicity of

118 *See generally* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-704, FAIR LENDING: DATA LIMITATIONS AND THE FRAGMENTED U.S. FINANCIAL REGULATORY STRUCTURE CHALLENGE FEDERAL OVERSIGHT AND ENFORCEMENT EFFORTS 53–61 (2009), *available at* http://www.gao.gov/new.items/d09704.pdf; Charlie Savage, *Report Examines Civil Rights Enforcement During Bush Years*, N.Y. TIMES, Dec. 3, 2009, at A26.

119 Press Release, Fed. Trade Comm'n, FTC, DOJ and HUD Announce Action to Combat Abusive Lending Practices (Mar. 30, 2000), *available at* http://www.ftc.gov/news-events/press-releases/2000/03/ftc-doj-and-hud-announce-action-combat-abusive-lending-practices. The case later settled. *See* Press Release, U.S. Dep't of Hous. & Urban Dev., Delta Funding Corporation Settles U.S. Charges of Fair Lending and Consumer Law Violations (Mar. 30, 2000), *available at* http://archives.hud.gov/news/2000/pr00-67.html.

120 Press Release, U.S. Dep't of Justice, Justice Department Resolves Case Alleging Race Discrimination by Alabama Bank (Sept. 29, 2008), *available at* http://www.justice.gov/opa/pr/2008/September/08-crt-864.html. In the final days of 2008, the FTC also filed a complaint and settlement with Gateway Funding, a home mortgage lender, for charging higher fees to African-American and Hispanic customers. Press Release, Fed. Trade Comm'n, Mortgage Lender Agrees to Settle FTC Charges that It Charged African-Americans and Hispanics Higher Prices for Loans (Dec. 16, 2008), *available at* http://www.ftc.gov/news-events/press-releases/2008/12/mortgage-lender-agrees-settle-ftc-charges-it-charged-african; *see also* John L. Ropiequet, *Fair Lending Litigation and the Impact of* Wal-Mart Stores, Inc. v. Dukes, 66 CONSUMER FIN. L. Q. REP. 158, 163 n.73 (2012).

121 Press Release, N.Y. State Office of the Att'y Gen., Countrywide Agrees to New Measures to Combat Racial and Ethnic Disparities in Mortgage Loan Pricing (Dec. 5, 2006) [hereinafter Press Release, Countrywide Agrees], *available at* http://www.ag.ny.gov/press-release/countrywide-agrees-new-measures-combat-racial-and-ethnic-disparities-mortgage-loan; Press Release, N.Y. State Office of the Att'y Gen., Fed Study Confirms Racial Lending Disparities (Sept. 14, 2005), *available at* http://www.ag.ny.gov/press-release/fed-study-confirms-racial-lending-disparities; *see also* Kirstin Downey, *Spitzer Launches Inquiry into Lending Bias*, WASH. POST, Apr. 29, 2005, at E1.

122 12 U.S.C. §§ 2801–2809 (2012).

consumers who received subprime loans.[123] But Spitzer wanted more detailed, nonpublic information from the banks.

With one exception,[124] the banks balked and together with their federal regulator, the Office of the Comptroller of the Currency (OCC), filed suit in federal court to stop Spitzer's investigation and potential enforcement action.[125] They argued that OCC regulations under the National Bank Act prohibited state investigation or enforcement of state laws against national banks. In the short-term the banks and their federal regulator won—litigation dragged on past Spitzer's term in office and halted the investigation. But when the U.S. Supreme Court decided *Cuomo v. Clearing House Ass'n* in 2009, it was largely a win for the AGs.[126] The Court in part rejected the agency's interpretation of the statute and the scope of the agency's powers, while affirming the power of states to enforce their general laws—including fair lending laws—against national banks.[127]

Before the Court ruled in *Clearing House*, AG Coakley in Massachusetts filed a major lawsuit in June 2008 against Option One and its parent company, H&R Block, alleging both predatory and discriminatory lending practices.[128] Option One was a nonbank, subprime mortgage lender with an extensive national presence. Coakley's suit was the first in the nation to charge a subprime lender with discriminatory lending after the crash of the subprime market.[129] Her investigation revealed that Option One charged higher points and fees to African-American and Latino borrowers, and targeted these

123 Home Mortgage Disclosure, 67 Fed. Reg. 7222, 7228 (Feb. 15, 2002) (codified at 12 C.F.R. pt. 203). The Federal Reserve began the process of requiring pricing disclosure in late 2000, after several federal agencies held hearings on the rise of predatory lending. *Id.* at 7222.

124 Countrywide fully complied with the demand and entered into an agreement with New York to increase its fair lending monitoring activities, compensate borrowers who were harmed, and educate consumers. Press Release, Countrywide Agrees, *supra* note 121.

125 Complaint, Clearing House Ass'n v. Spitzer, No. 05 Civ. 5629(SHS), 2005 WL 1803330 (S.D.N.Y. June 16, 2005) (industry suit); Complaint for Declaratory Relief, Preliminary Injunction and Permanent Injunction, Office of the Comptroller of the Currency v. Spitzer, No. 05 Civ. 5636, 2005 WL 5153922 (S.D.N.Y. June 16, 2005) (OCC suit). For a chronology of events, see *Preemption of State Law Enforcement*, 123 HARV. L. REV. 322, 323 (2009).

126 557 U.S. 519 (2009).

127 *Id.* at 535–36. Congress later codified this ruling. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 § 1047, 12 U.S.C. § 25b (2012). *Clearing House Ass'n* came with some limitations, in particular on investigation. The holding would seem to prevent AGs from engaging in pre-complaint discovery outside the judicial process against national banks as an effort to determine whether or not to file a law enforcement action, as inconsistent with the federal government's exclusive "visitorial powers." *Clearing House Ass'n*, 557 U.S. at 531, 536.

128 Press Release, Office of the Att'y Gen., Commonwealth of Mass., Attorney General Martha Coakley Files Lawsuit Against National Mortgage Lender Option One and Parent H&R Block for Deceptive and Discriminatory Lending Practices (June 3, 2008) (on file with author); *see also Massachusetts Settles Suit Against a Mortgage Lender*, N.Y. TIMES, Aug. 10, 2011, at B4.

129 *See supra* note 128.

same consumers with predatory mortgage products.[130] Option One eventually settled with the state for $125 million, with commitments to modify affected loans.[131]

Around that same time, Illinois AG Lisa Madigan opened investigations into the fair lending practices of Wells Fargo and Countrywide,[132] just a few months before filing her predatory lending suit against the latter.[133] The catalyst for Madigan's probe was a December 2007 article in the *Chicago Reporter*.[134] Based on an examination of HMDA data, the report concluded that African-American borrowers in the Chicago area were two-and-a-half times as likely to receive a high-cost loan as white borrowers in the years preceding the crisis.[135] By March of that next year, Madigan had subpoenaed Wells Fargo and Countrywide for more data. The Second Circuit Court of Appeals had just ruled against AGs in *Clearing House Ass'n v. Cuomo*, concluding that the National Bank Act and OCC regulations prohibited states from enforcing their laws against national banks, and prohibited investigations in support of such actions.[136] Although Countrywide provided data, Wells Fargo moved its mortgage operations under OCC jurisdiction and then claimed that Illinois lacked authority to obtain the requested documents.[137]

As already explained, the U.S. Supreme Court issued the final word in June 2009, restoring most of the powers to the AGs.[138] With the path cleared to reach a national bank,[139] Madigan filed suit against Wells Fargo one month later. Her complaint alleged that the firm pushed African Americans and Latinos into subprime loans when they

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130 *See* Complaint, Commonwealth v. H&R Block, Inc., No. 08-2474-BLS (Mass. Super. Ct. June 3, 2008).

131 Press Release, Office of the Att'y Gen., Commonwealth of Mass., H&R BLOCK Mortgage Company Will Provide $125 Million in Loan Modifications and Restitution (Aug. 9, 2011), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2011/option-one-settlement.html; *see also Massachusetts Settles Suit Against a Mortgage Lender*, supra note 128.

132 Press Release, Ill. Att'y Gen., Illinois Attorney General Madigan Issues New Subpoenas to Countrywide and Wells Fargo (Mar. 6, 2008), *available at* http://www.illinoisattorneygeneral.gov/pressroom/2008_03/20080306.html.

133 *See supra* notes 98–108 and accompanying text.

134 Kimbriell Kelly, *The High Price of Home Ownership*, CHI. REP. (Dec. 1, 2007), http://www.chicagoreporter.com/high-price-home-ownership#.Usbvb7S0Zjs; *see also Madigan Testimony*, *supra* note 61, at 6–7.

135 *An Equal Opportunity to Pay More*, CHI. REP. (July 2, 2008), http://chicagoreporter.com/equal-opportunity-pay-more.

136 Clearing House Ass'n v. Cuomo, 510 F.3d 105 (2d Cir. 2007), *aff'd in part, rev'd in part sub nom.* Cuomo v. Clearing House Ass'n, 557 U.S. 519 (2009).

137 Complaint ¶ 8, People v. Wells Fargo & Co., No. 09CH26434 (Ill. Cir. Ct. July 31, 2009), *available at* http://illinoisattorneygeneral.gov/pressroom/2009_07/WELLS%20FARGO%20COMPLAINT_07-31-2009_13-44-30.pdf.

138 *See supra* notes 126–27 and accompanying text.

139 Madigan testified: "In fact, the Cuomo ruling green-lighted my decision to file a fair lending lawsuit against Wells Fargo." *Madigan Testimony*, *supra* note 61, at 11.

otherwise qualified for prime loans (a process called "steering"), or at a cost significantly higher than similarly-situated white borrowers.[140] Like Madigan's case against Countrywide for predatory lending, this case was ambitious. Wells Fargo was one of the largest lenders in the nation during that time, and by 2008 was the largest residential lender, originating one out of every four mortgages in the nation.[141] A year later Madigan also filed suit against Countrywide, making similar allegations.[142]

Before the parties settled, the U.S. Department of Justice joined Madigan, expanding the scope of her efforts across the nation.[143] Both firms finally settled: Countrywide in late 2011 for $335 million;[144] and Wells Fargo in summer 2012 for $175 million.[145] Madigan won two landmark cases. According to the Justice Department, the cases were the first and second largest fair lending settlements in the Department's history, dwarfing the previous $6.1 million record.[146] Moreover, the cases represented the first time the Justice Department alleged and won relief for consumers who were victims of steering. For Madigan's part, she became the first AG to sue a national bank for its role in the

140 Complaint, *Wells Fargo & Co.*, *supra* note 137, at 2.

141 Complaint ¶ 4, United States v. Wells Fargo Bank, No 1:12-cv-01150 (D.D.C. July 12, 2012), *available at* http://www.justice.gov/iso/opa/resources/9512012712113719995136.pdf; *see also* Press Release, Ill. Att'y Gen., Madigan Sues Wells Fargo for Discriminatory and Deceptive Mortgage Lending Practices (July 31, 2009), *available at* http://www.illinoisattorneygeneral.gov/pressroom/2009_07/20090731.html.

142 Complaint ¶ 4, People v. Countrywide Fin. Corp., No. 102CH27929 (Ill. Cir. Ct. June 29, 2010); Press Release, Ill. Att'y Gen., Madigan Sues Countrywide for Discrimination Against African American and Latino Borrowers (June 29, 2010), *available at* http://www.illinoisattorneygeneral.gov/pressroom/2010_06/20100629b.html.

143 Press Release, U.S. Dep't of Justice, Justice Department Reaches $335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Financial Corporation (Dec. 21, 2011), *available at* http://www.justice.gov/opa/pr/2011/December/11-ag-1694.html; Press Release, U.S. Dep't of Justice, Justice Department Reaches Settlement with Wells Fargo Resulting in More than $175 Million in Relief for Homeowners to Resolve Fair Lending Claims (July 12, 2012) [hereinafter Press Release, DOJ Reaches Settlement with Wells Fargo], *available at* http://www.justice.gov/opa/pr/2012/July/12-dag-869.html.

144 Charlie Savage & Nelson D. Schwartz, *Countrywide Will Settle a Bias Suit*, N.Y. TIMES, Dec. 22, 2011, at B1; Press Release, DOJ Reaches Settlement with Wells Fargo, *supra* note 143; Press Release, Ill. Att'y Gen., Madigan, U.S. DOJ Reach $335 Million Settlement with Countrywide/Bank of America Over Discriminatory Lending (Dec. 21, 2011), *available at* http://illinoisattorneygeneral.gov/pressroom/2011_12/20111221.html.

145 Charlie Savage, *Wells Fargo Will Settle Mortgage Bias Charges*, N.Y. TIMES, July 13, 2012, at B3; Press Release, DOJ Reaches Settlement with Wells Fargo, *supra* note 143; Press Release, Ill. Att'y Gen., Madigan, U.S. DOJ Reach $175 Million Settlement with Wells Fargo over Discriminatory Lending (July 12, 2012), *available at* http://illinoisattorneygeneral.gov/pressroom/2012_07/20120712.html. In addition, the settlements also contained extensive injunctive relief that applied to both Wells Fargo employees and independent mortgage brokers that might sell the company's products. Consent Decree ¶ 7, *Wells Fargo Bank*, No. 1:12-cv-011150.

146 Savage & Schwartz, *supra* note 144.

economic crisis, as well as the first to bring and resolve a fair lending claim against the same.[147]

3. Other Actions

The most significant contribution by the Enforcers and their other state partners during this time was their serial enforcement actions against predatory and discriminatory lending.[148] These efforts were especially important given federal inaction and sometimes antagonism. But the AGs acted in other areas and ways, as well. They brought dozens of enforcement actions against individuals and small firms that, collectively, were significant contributing causes to the coming crisis. They laid the groundwork for major actions that would only ripen after the crisis hit. And they were advocates at the state and federal level for structural reform.

By 2006 at the height of the subprime-lending boom, and then for many years after, these states (and others) were bringing dozens of enforcement actions to stop mortgage fraud. These schemes usually involved an individual or a small group of people who work together to fraudulently obtain loans for profit.[149] The states sometimes brought criminal charges. The 2008 case against the Sandella Group out of New York is exemplary.[150] From at least 2001–2006, the members of this enterprise collaborated to steal millions of dollars from financial institutions.[151] After recruiting people to pose as legitimate real estate buyers, they would supply lenders with false information about the straw buyer's employment, income, and other assets, along with false appraisal reports.[152] Typically, they would inflate a property's value by $100,000 or more, pocket the surplus, and then let the loan go into default.[153] These schemes were repeated hundreds of times across the nation, contributed to the crisis, and AGs were at the front lines of response.

Several years before the bursting of the housing bubble and the onset of the foreclosure crisis, a new menace that emerged was the mortgage rescue scam: various schemes whereby wrongdoers preyed on

147 *Madigan Testimony*, *supra* note 61, at 11; John L. Ropiequet, *The Supreme Court Limits Federal Preemption in* Cuomo v. Clearing House Association, L.L.C., 63 CONSUMER FIN. L. Q. REP. 146, 83 (2009).

148 Spreadsheet of State and Federal Press Releases: 1999–2014, *supra* note 49.

149 *See supra* note 41 and accompanying text.

150 Press Release, N.Y. State Office of the Att'y Gen., Eight Indicted in Massive Mortgage Fraud Ring (Apr. 25, 2006), *available at* http://www.ag.ny.gov/press-release/eight-indicted-massive-mortgage-fraud-ring.

151 *Id.*

152 *Id.*

153 *Id.*

already distressed homeowners.[154] As was the case with mortgage fraud, lying behind most of these schemes were individuals flying solo or working together in small groups. For example, early in 2006 Illinois AG Lisa Madigan filed suit against a small company known as MarTav Services for a fraudulent practice known as "equity stripping."[155] In one instance, a victim of MarTav underwent open-heart surgery and had to quit her job, causing her to fall behind on her mortgage payments.[156] Facing foreclosure, she signed on with MarTav who told her she could pay a monthly rent check and get her home back in a year.[157] In fact, MarTav obtained title, took out a new mortgage greater than what was owed on the existing mortgage, and then later sold the house to a third party.[158] Although federal enforcers would later play a much more active role,[159] through 2008 the states were most active. In a December 2011 press release announcing another mortgage fraud lawsuit, Madigan said her office was filing its 50th civil action and had issued 622 cease-and-desist letters ordering rescue operations to stop illegally charging upfront payment for services.[160]

In addition to these law enforcement actions against small-scale mortgage fraud and mortgage rescue fraud operations, the Enforcers were also laying the seeds for large-scale enforcement actions that would bear fruit after the onset of the Great Recession. One effort was the states' early response to the emerging foreclosure crisis and abuses by mortgage servicers through formation of the State Foreclosure Prevention Working Group.[161] In New York, Attorneys General Spitzer and later Cuomo[162] launched investigations into the role of the credit rating agencies that gave their highest marks to toxic residential mortgage-backed securities. And AG Coakley in Massachusetts investigated the securitization of subprime loans, an action that would later result in a series of enforcement actions based on harm to state pension funds and provide a roadmap for a larger state-federal response.[163]

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154 *See supra* note 43 and accompanying text.

155 Press Release, Ill. Att'y Gen., Madigan Files 50th Suit Against Mortgage 'Rescue' Scheme, Leads Nation In Crackdown On Scams Targeting Distressed Homeowners (Dec. 19, 2011) [hereinafter Press Release, 50th Suit], *available at* http://illinoisattorneygeneral.gov/pressroom/2011_12/20111219.html.

156 *Id.*

157 *Id.*

158 *Id.*

159 Between 2000 and 2008 the Justice Department and FTC announced eight separate actions against mortgage rescue operations. *See, e.g.*, Press Release, Fed. Trade Comm'n, FTC Stops Bogus Mortgage Loan Modification Business (June 21, 2011), *available at* http://www.ftc.gov/news-events/press-releases/2011/06/ftc-stops-bogus-mortgage-loan-modification-business.

160 Press Release, 50th Suit, *supra* note 155.

161 *See infra* notes 193–219 and accompanying text.

162 *See infra* notes 280–84 and accompanying text.

163 *See infra* notes 254–65 and accompanying text.

Lastly, the Enforcers played an advocacy role at the state and federal levels. Several of the AGs championed new laws to stop predatory lenders,[164] protect homeowners in foreclosure,[165] and target mortgage rescue schemes.[166] And in the years leading up to the crisis, Iowa AG Tom Miller regularly sounded the warning alarm before congressional committees.[167]

B. *Act II: After the Fall (2009–2013)*

After peaking in 2006, the subprime mortgage market took a precipitous fall in 2007 that soon affected the credit markets, devastating the financial sector and eventually the broader economy.[168] In 2007 the warning signs came one after another. In February, Freddie Mac announced it would no longer purchase the most risky subprime loans.[169] New Century Financial, one of the largest subprime lenders, filed for bankruptcy a few months later. And by August Fitch Ratings was slashing its rating of Countrywide Financial—at that time the largest subprime lender in the business.[170] By 2008 the major financial institutions were reeling. Bear Stearns, Lehman Brothers, and

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164 *See, e.g.*, Press Release, Office of the Att'y Gen., Commonwealth of Mass., Attorney General Martha Coakley Proposes New Consumer Protection Regulations (Aug. 7, 2007) (on file with author); Press Release, Ill. Att'y Gen., Madigan Applauds House Passage of Bill to Combat Predatory Lending (May 30, 2003) (on file with author); Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., Miller Asks Lawmakers to Tackle Predatory Mortgage Lending (Feb. 13, 2007), *available at* http://www.state.ia.us/government/ag/latest_news/releases/feb_2007/pred_lending.html.

165 *See, e.g.*, Press Release, Ill. Att'y Gen., Madigan Announces Comprehensive Strategy to Address Looming Home Foreclosure Crisis in Illinois (Mar. 26, 2007), *available at* http://www.illinoisattorneygeneral.gov/pressroom/2007_03/20070326b.html.

166 *See, e.g.*, Press Release, Office of the Att'y Gen., Commonwealth of Mass., Attorney General Martha Coakley Announces Public Hearing Date for Emergency Regulations Prohibiting Foreclosure Rescue Transactions and Foreclosure Related Services; Solicits Public Comment (July 31, 2007) (on file with author); Press Release, Ill. Att'y Gen., Madigan, Lawmakers Take on Mortgage Foreclosure "Rescuers" (Jan. 30, 2006), *available at* http://www.illinoisattorneygeneral.gov/pressroom/2006_01/20060130.html.

167 *See, e.g.*, *Congressional Review of OCC Preemption: Hearing Before the Subcomm. on Oversight & Investigations of the House Comm. on Fin. Servs.*, 108th Cong. (2004) (statement of Tom Miller, Iowa Att'y Gen.); Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., Iowa Attorney General Tom Miller Testimony on "Improving Federal Consumer Protection in Financial Services" (June 13, 2007) (testimony before U.S. House Committee on Financial Services); Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., Miller Tells Congressional Committee of Predatory Lending Problems and Vows They Will Be a Main Priority of His Office (July 26, 2001).

168 *See generally* FINANCIAL CRISIS INQUIRY REPORT, *supra* note 12, at 233–386; ENGEL & MCCOY, *supra* note 12, at 99–121.

169 *See* Vikas Bajaj, *Freddie Mac Tightens Standards*, N.Y. TIMES, Feb. 28, 2007, at C1.

170 Julie Creswell & Vikas Bajaj, *Home Lender Is Seeking Bankruptcy*, N.Y. TIMES, Apr. 3, 2007, at C1.

Washington Mutual Bank disappeared altogether.[171] And on the theory of too-big-to fail, the federal government orchestrated a series of rescues for firms such as AIG, Citigroup, and Bank of America.[172] On Main Street, the fallout included wiped-out retirement savings, loss of employment, underwater mortgages, and foreclosures.[173] By the dramatic events of September 2008 the crisis was visible everywhere.

The onset of the Great Recession brought some federal enforcement actions after years of slumber,[174] but the shift occurred with the changing of the guard at the White House in January 2009. To many state AGs, the most dramatic shift was the commitment by various federal agencies to partner with the states. In March 2009, Attorney General Eric Holder addressed forty-three state AGs at a National Association of Attorneys General (NAAG) meeting and called for state-federal collaboration, especially in response to the housing crisis.[175] And by summer 2009 a few state AGs—including Iowa Attorney General Tom Miller—were at the U.S. Department of Justice sitting across the table from top federal officials representing multiple agencies to discuss how they could collaborate.[176]

This partnership emerged out of a shared mission, but it was also strengthened by relationships already in place: then-Senator Lisa Madigan was at one time the President's seatmate in the Illinois Senate, and AG Tom Miller had travelled with Obama by bus around the back roads of Iowa for months. Moreover, in building the team at the new Consumer Financial Protection Bureau, Elizabeth Warren and later Director Richard Cordray—former Ohio Attorney General—would bring in many former state assistant attorneys general and state banking regulators who valued the vital role the Enforcers and other leading states had played and who had the relationships to strengthen state-federal collaboration.[177]

In November 2009, the President established the interagency Financial Fraud Enforcement Task force to coordinate enforcement

171 *See* ENGEL & MCCOY, *supra* note 12, at 99–121.

172 *Id.*

173 FINANCIAL CRISIS INQUIRY REPORT, *supra* note 12, at 390–94.

174 *See, e.g.*, Press Release, U.S. Dep't of Justice, More than 400 Defendants Charged for Roles in Mortgage Fraud Schemes as Part of Operation "Malicious Mortgage" (June 19, 2008), *available at* http://www.justice.gov/opa/pr/2008/June/08-odag-551.html.

175 Eric Holder, Jr., Att'y Gen., Remarks by Attorney General Eric Holder to the National Association of Attorneys General (Mar. 2, 2009), *available at* http://votesmart.org/public-statement/412345/remarks-by-attorney-general-eric-holder-to-the-national-association-of-attorneys-general# ("I think [responding to the housing crisis] is one area where, in particular, I think we can work together. You're going to know in your states perhaps better than we do at the federal level what's going on, have a better sense of how we might prioritize the limited resources that we all have.").

176 Telephone Interview with Patrick Madigan, Assistant Att'y Gen., Iowa Att'y Gen.'s Office (Jan. 31, 2014).

177 *Id.*

actions across the different agencies and with the states.[178] In addition, the first few years of the new administration witnessed extraordinary structural reforms with passage of the Dodd Frank Act and the creation of the new Consumer Financial Protection Bureau (CFPB) in summer of 2010.[179] Convinced that industry had captured the federal regulators who had the power to prevent the crisis, Congress created a single agency charged with the sole mission of protecting consumers in the financial marketplace and armed with new powers to achieve that task.[180] New substantive rules governed mortgage lending,[181] and Congress harnessed the forces of federalism by placing limits on agency preemption[182] and empowering AGs to enforce federal consumer finance laws.[183]

The Enforcers welcomed these changes. In fact, several played a significant role in bringing about the reforms. All five states were outspoken advocates for Title X of the Dodd Frank Act and creation of CFPB,[184] with Attorneys General Lisa Madigan, Tom Miller, and their staff playing an especially important role behind the scenes.[185] They lobbied for limits on agency preemption, which had blocked so many of their efforts over the past decade,[186] with Madigan making a personal appeal to the president to secure a last-minute victory.[187] And they fought for concurrent enforcement powers to ensure consumers would always have a cop on the beat, even if the federal regulators were

178 Press Release, U.S. Dep't of Justice, President Obama Establishes Interagency Financial Fraud Enforcement Task Force (Nov. 17, 2009), *available at* http://www.justice.gov/opa/pr/2009/November/09-opa-1243.html; *see also* Exec. Order No. 13,519, 74 Fed. Reg. 60,123 (Nov. 17, 2009), *available at* http://www.whitehouse.gov/the-press-office/executive-order-financial-fraud-enforcement-task-force.

179 *See generally* Michael B. Mierzewski et al., *The Dodd-Frank Act Establishes the Bureau of Consumer Financial Protection as the Primary Regulator of Consumer Financial Products and Services*, 127 BANKING L.J. 722 (2010); Wilmarth, *supra* note 50, at 920–48.

180 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, tit. X, 124 Stat. 1376, 1955–2105 (2010).

181 *Id.* § 1422, 124 Stat. at 2157.

182 *Id.* § 1041(a)(1), 124 Stat. at 2011.

183 *Id.*; *see also* Totten, *supra* note 52.

184 *See, e.g.*, Letter from Twenty-Three State Att'ys Gen. to Senators Dodd & Shelby and Representatives Frank & Bachus (Aug. 17, 2009); *see also* Press Release, Office of the Att'y Gen., Commonwealth of Mass., Massachusetts Attorney General Martha Coakley Urges Congress to Support Legislation Creating the Federal Consumer Financial Protection Agency (Aug. 18, 2009), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2009/ag-coakley-urges-congress-to-support.html.

185 *See* LARRY KIRSCH & ROBERT N. MAYER, FINANCIAL JUSTICE: THE PEOPLE'S CAMPAIGN TO STOP LENDER ABUSE 130–31 (2013).

186 Letter from Nat'l Ass'n of Att'ys Gen. (signed by 38 AGs) to Senators Dodd & Shelby and Representatives Frank & Bachus (Nov. 4, 2009), *available at* http://agportal-s3bucket.s3.amazonaws.com/uploadedfiles/Home/News/Press_Releases/2009/Final%20Preemption%20with%20Signatures%20110409.pdf (regarding preemption of state laws).

187 *See* KIRSCH & MAYER, *supra* note 185.

missing in action.[188] In the midst of Senate inaction, they called for confirmation of the agency's first Director, Rick Cordray—one of their own.[189] While Ohio AG from 2009–2011, Cordray had witnessed firsthand the fallout of the economic crisis and during his few years in office helped lead the fight.[190] The Enforcers knew they needed a strong federal partner and were outspoken advocates for reform.

Amidst these changes, the states continued to lead and in many ways shape the law enforcement agenda. At the same time, their focus shifted. They might have doubled-down on harms in the origination process and continued on the path cleared by the *Household* and *Ameriquest* cases with large, multistate cases. But they went a different direction. Many of those predatory and discriminatory lending cases they launched earlier continued toward settlement. And the smaller-scale actions against persons engaged in mortgage fraud or mortgage rescue fraud came at a steady rate. But along with their new federal partners, their attention turned toward two new challenges: stopping abuses in the mortgage servicing and foreclosure business, and holding Wall Street accountable for fraud in the securitization of toxic mortgages.

1. Servicing and Foreclosure Abuse

The Enforcers and their other state partners led the response to abuses in the mortgage servicing industry. The culmination of their efforts was the February 2012 settlement with five of the nation's largest mortgage servicers.[191] The National Mortgage Settlement, valued at $25 billion, was the second largest settlement ever reached by AGs.[192] The agreement was ultimately the joint effort of the states and their federal partners, but its roots went back nearly five years.

The subprime lending frenzy that peaked in 2006—and the predatory schemes behind it—assured a foreclosure crisis when the housing bubble finally burst. Meeting in the summer of 2007 and very conscious of the crisis unfolding in their states, thirty-seven AGs and several state banking regulators formed the State Foreclosure Prevention

188 Letter from Nat'l Ass'n of Att'ys Gen., *supra* note 186.

189 Letter from Nat'l Ass'n of Att'ys Gen. (signed by 33 AGs) to Senate Majority Leader Harry Reid & Senate Minority Leader Mitch McConnell (Oct. 18, 2011), *available at* http://signon.s3.amazonaws.com/20111018.signon.Cordray_Letter_of_Support.pdf (regarding confirmation of Richard Cordray to head CFBP).

190 *See* Michael Powell, *The States v. Wall Street*, N.Y. TIMES, Oct. 12, 2010, at B1.

191 *See infra* notes 223–52 and accompanying text.

192 After tobacco, which was for $206 billion and was reached in 1998. *See supra* note 1.

Working Group.[193] Eleven AGs joined the Executive Committee, including all five Enforcers.[194] Leading the effort was Iowa AG Tom Miller.[195] The Group was policy-focused and its goal was "to reduce the number of foreclosures by encouraging loan modifications and other sustainable, long-term solutions."[196]

The State Working Group began in the Fall of 2007 by twice meeting with the top twenty subprime mortgage servicers, who collectively represented 93% of the nation's subprime loans.[197] Miller and his colleagues expressed their concerns that the banks were proceeding with unnecessary foreclosures, which loss modification efforts might otherwise have avoided.[198] Although the servicers' seemed to agree about what needed to happen, the AGs worried that the ground-level reality was far different. Lacking the information they needed to make firm assessments, the AGs launched a data-gathering effort to monitor the success of the servicers' foreclosure avoidance programs.[199] Although several financial institutions agreed to cooperate, the Group's efforts were hampered when the large national banks refused, including JP Morgan and Wells Fargo. The AGs would later learn that OCC expressly advised the banks not to cooperate.[200]

Although this lack of cooperation prevented the AGs from developing a full picture, they were still able to draw several conclusions in a series of reports issued between February 2008 and August 2010.[201]

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193 STATE FORECLOSURE PREVENTION WORKING GRP., ANALYSIS OF SUBPRIME MORTGAGE SERVICING PERFORMANCE, DATA REPORT NO. 1, at 3 (2008) [hereinafter SERVICING PERFORMANCE REPORT 1], *available at* http://www.csbs.org/regulatory/Documents/SFPWG/DataReportFeb2008.pdf.

194 *Id.* at 3 n.1. Other members included the AGs of Arizona, Colorado, Michigan, North Carolina, Ohio, and Texas, along with the state banking regulator from New York and North Carolina.

195 Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., States' Foreclosure Prevention Working Group Produces First Report on Mortgage Servicers' Loss-Mitigation Performance (Feb. 7, 2008), *available at* http://www.state.ia.us/government/ag/latest_news/releases/feb_2008/Foreclosure_prevention.html.

196 SERVICING PERFORMANCE REPORT 1, *supra* note 193, at 4.

197 *Id.*

198 *Id.* at 6. For explanations of the economics and incentives behind the decision to favor foreclosures over loan modifications, see Levitin & Twomey, *supra* note 23 and Patricia A. McCoy, *Barriers to Foreclosure Prevention During the Financial Crisis*, 55 ARIZ. L. REV. 723 (2013).

199 SERVICING PERFORMANCE REPORT 1, *supra* note 193, at 6. The Working Group sought input from both federal regulators and servicers to reduce reporting costs for the servicers. *Id.*

200 Letter from Deborah Hagan, Chief, Consumer Prot. Div., Office of the Ill. Att'y Gen., to the Fin. Crisis Inquiry Comm'n (Apr. 27, 2010) (on file with author) (citing a letter that JP Morgan sent to the Working Group, where the bank says: "[w]e have consulted with the OCC and they have advised us that it would be inconsistent with the OCC's exclusive oversight and examination of a national bank for information of the kind required to complete the call report to be provided to officials other than the OCC").

201 The Working Group issued a total of five reports, which are available at http://www.csbs.org/regulatory/Pages/SFPWG.aspx.

They found that between 60% and 80% of all seriously delinquent homeowners were not participating in any kind of loss mitigation program, such as a payment reduction plan.[202] The numbers continued to affirm what several AGs had thought from the start: that the servicers were sending homeowners into foreclosure when they might have avoided that outcome through some loss mitigation measure. With each report the AGs continued their early call for "systematic, long-term solutions,"[203] and proposed several specific steps including (1) stopping the process of "dual-tracking," whereby the servicers continued to foreclose on a property at the same time they pursued loss mitigation efforts; and (2) prioritizing principal reduction as a more sustainable and effective means of loss mitigation.[204]

The State Working Group expressed its ongoing concerns when it issued its fifth (and final) report in August 2010, but the report also sounded a positive note: the more recent loan modifications were performing better than earlier adjustments.[205] This development was enough for Illinois AG Lisa Madigan to indicate that the most recent report gave "reasons to be optimistic."[206] But any optimism vanished on Monday, September 20, 2010 when a major mortgage servicer, Ally Financial (formerly General Motors Acceptance Corporation, or GMAC), announced it was imposing a moratorium on foreclosures in the twenty-three states with judicial foreclosures.[207] The reason? Improprieties in the servicer's handling of the foreclosure process. The company was outed by one of its own: a mid-level manager named

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202 SERVICING PERFORMANCE REPORT 1, *supra* note 193, at 1; STATE FORECLOSURE PREVENTION WORKING GRP., ANALYSIS OF SUBPRIME MORTGAGE SERVICING PERFORMANCE, DATA REPORT NO. 2, at 1 (2008) [hereinafter SERVICING PERFORMANCE REPORT 2], *available at* http://www.csbs.org/regulatory/Documents/SFPWG/DataReportApr2008.pdf; STATE FORECLOSURE PREVENTION WORKING GRP., ANALYSIS OF SUBPRIME MORTGAGE SERVICING PERFORMANCE, DATA REPORT NO. 3, at 2 (2008) [hereinafter SERVICING PERFORMANCE REPORT 3], *available at* http://www.csbs.org/regulatory/Documents/SFPWG/DataReportSep2008.pdf; STATE FORECLOSURE PREVENTION WORKING GRP., ANALYSIS OF SUBPRIME MORTGAGE SERVICING PERFORMANCE, DATA REPORT NO. 4, at 2 (2010) [hereinafter SERVICING PERFORMANCE REPORT 4], *available at* http://www.csbs.org/regulatory/Documents/SFPWG/DataReportJan2010.pdf; STATE FORECLOSURE PREVENTION WORKING GRP., ANALYSIS OF SUBPRIME MORTGAGE SERVICING PERFORMANCE, DATA REPORT NO. 5, at 1 (2010) [hereinafter SERVICING PERFORMANCE REPORT 5], *available at* http://www.csbs.org/regulatory/Documents/SFPWG/DataReportAug2010.pdf.

203 SERVICING PERFORMANCE REPORT 1, *supra* note 193, at 2.

204 SERVICING PERFORMANCE REPORT 4, *supra* note 202, at 3.

205 SERVICING PERFORMANCE REPORT 5, *supra* note 202, at 1.

206 Press Release, Ill. Att'y Gen., Success Rate of Loan Modifications Improving, Say Attorney General Madigan and Foreclosure Prevention Working Group (Aug. 24, 2010), *available at* http://illinoisattorneygeneral.gov/pressroom/2010_08/20100824.html.

207 David Streitfeld, *GMAC Halts Foreclosures in 23 States for Review*, N.Y. TIMES, Sept. 21, 2010, at B4; Denise Pellegrini & Dakin Campbell, *Ally's GMAC Mortgage Halts Evictions Across 23 States*, BLOOMBERG (Sept. 20, 2010), http://www.bloomberg.com/news/articles/2010-09-20/gmac-mortgage-halts-home-foreclosures-in-23-states-including-florida-n-y-.

Jeffrey Stephan who testified in various depositions that he was signing as many as 10,000 affidavits a month with no personal knowledge about the truth of the claims, as state laws required.[208] Although the term was not yet a household name, Stephan was what the industry had already dubbed a "robo-signer."

Individual AGs responded swiftly, with AG Jerry Brown calling on Ally to extend its moratorium to California (a nonjudicial foreclosure state);[209] Illinois AG Lisa Madigan demanding a meeting with Ally officials;[210] and Iowa AG Tom Miller launching a civil investigation.[211] But Ally was just the beginning. Nine days later, JPMorgan announced it was halting more than 56,000 foreclosures for the same reasons.[212] Bank of America soon followed.[213] The entire mortgage servicing system, it seemed, was compromised.

The cadre of assistant attorneys general who had worked these cases for years—some going all the way back to FAMCO—sensed immediately that these failures were colossal.[214] But the scope of their authority to address these harms was uncertain.[215] The major servicers, after all, were all national banks. Were the states preempted? Dodd-Frank had become law that past summer, but its anti-preemption provisions were untested and OCC had already issued proposed rules that attempted to leave its preemption policy nearly intact.[216] And how would the servicers react? The banks had been unwilling even to provide data to the AG's Working Group in the past.

But the world looked different in 2010 than it did in 2007. Not only did the passage of Dodd-Frank alter the regulatory environment, but the robo-signing fiasco and the role of the states in responding to that crisis also grabbed the attention of the national media to a degree that had never happened in the prior cases.[217] Fairly quickly, the major banks

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208 Streitfeld, *supra* note 207.

209 Press Release, State of Cal. Dep't of Justice, Office of the Att'y Gen., Brown Directs Nation's Fourth Largest Home Lender to Suspend Foreclosures Until It Proves It Is Complying with the Law (Sept. 24, 2010), *available at* http://oag.ca.gov/news/press-releases/brown-directs-nations-fourth-largest-home-lender-suspend-foreclosures-until-it.

210 Press Release, Ill. Att'y Gen., Attorney General Madigan Demands Meeting with Mortgage Lender at Center of Foreclosure Controversy (Sept. 24, 2010), *available at* http://illinoisattorneygeneral.gov/pressroom/2010_09/20100924.html.

211 Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., Miller Launches Ally/GMAC Foreclosure Probe (Sept. 24, 2010).

212 David Streitfeld, *JPMorgan Suspending Foreclosures*, N.Y. TIMES, Sept. 30, 2010, at B1.

213 David Streitfeld, *3rd Lender Will Freeze Foreclosures in the Courts*, N.Y. TIMES, Oct. 2, 2010, at B1.

214 Telephone Interview with Patrick Madigan, *supra* note 176.

215 *Id.*

216 Dodd-Frank Act Implementation, 76 Fed. Reg. 30,557-01 (May 26, 2001) (codified at 12 C.F.R. pts. 4, 5, 7, 8, 28, 34).

217 *See* Telephone Interview with Patrick Madigan, *supra* note 176.

would engage and join the states at the negotiating table.[218] Even though the preemption issues remained formally untested in court, in a sense the course of events answered that question and the state AGs would leave this episode with more power than when they entered.

In mid-October all fifty AGs announced a joint investigation of the mortgage servicing industry.[219] A fifty-state action has precedent, but is nonetheless rare. And yet the coalition formed with ease.[220] Although the Working Group had been a policy project, it provided the infrastructure for legal action. Iowa AG Tom Miller again led the effort,[221] and California, Illinois, and New York joined the Executive Committee, among other leading states. [222]

Later in October, word leaked that the federal government was also launching a probe.[223] By then a few of the leading states and federal officials were in conversations about working together.[224] The potential for a state-federal partnership on this issue was not immediately apparent. The alleged wrongs were matters of state law, which governs the foreclosure process, in the first instance. But the allegations gave rise to potential federal liability as well—both for regulatory failures and potential civil or criminal prosecution.[225] The states had some reason to be distrustful, given the past decade. With Iowa taking the lead, however, the states and the federal government soon joined hands, turning a multi*state* action into a multi*government* action. The partnership broke new ground. The states and the feds had worked together in the past on antitrust litigation.[226] Moreover, the more-independent FTC and the states had a history of coordinating in cases such as FAMCO.[227] But the national mortgage settlement was the first consumer protection, multigovernmental action where the states not only had a federal partner, but also collaborated with agencies across the federal government: in this instance, the Department of Justice, The Department of Housing and Urban Development, the new Consumer

218 *See id.*

219 Press Release, Nat'l Ass'n of Att'ys Gen., 50 States Sign Mortgage Foreclosure Joint Statement (Oct. 13, 2010), *available at* http://www.naag.org/joint-statement-of-the-mortgage-foreclosure-multistate-group.php.

220 *See* Telephone Interview with Patrick Madigan, *supra* note 176.

221 Andrew Martin, *Foreclosures Spur Action from U.S. and States*, N.Y. TIMES, Oct. 14, 2010, at B9.

222 Press Release, *supra* note 219.

223 Zachary A. Goldfarb, *U.S. Probe Targeting Foreclosure Documents*, WASH. POST, Oct. 20, 2010, at A1.

224 *See* Telephone Interview with Patrick Madigan, *supra* note 176.

225 Federal regulation of mortgage servicing was light. *See* Levitin & Twomey, *supra* note 23, at 52 ("There is little regulation or monitoring of servicers," but possible avenues included claims made to the federal housing agencies that insured residential mortgages; securities violations in the representations made to investors; and mail and wire fraud in the filing of false paperwork.).

226 *See infra* note 370.

227 *See supra* notes 53–70 and accompanying text.

Financial Protection Bureau, the Treasury Department, the banking regulators, and others.[228] This level of collaboration was unprecedented.

Holding together fifty AGs—most of whom are elected politicians—was a challenge. From the start, the states and the feds had broad agreement that they did not just want to levy a fine on the banks and walk away; they wanted structural reforms that would help struggling homeowners. As AG Miller commented, "[w]hat we're really trying to do is change a dysfunctional system."[229] At the center of this effort was loan modification, which many of the AGs had called for from the early days of the State Foreclosure Prevention Working Group.[230] On the details, however, the principals did not all agree. Federal banking regulators, as well as some states, were opposed to principal reductions.[231] Early on the banks also took a firm stand against this proposal, claiming moral hazard. Asked about whether he would consider this option, JP Morgan CEO Jamie Dimon had told reporters: "Yeah, that's off the table."[232] Moreover, the states also disagreed about how to structure a loan modification program and the size of civil penalties.[233] And a few states that claimed the deal was not tough enough walked away or threatened to walk away, although they eventually returned.[234]

In what some critics saw as an attempt to undermine the state-federal investigation and give the banks political cover,[235] the banking regulators announced in April 2011 that they had reached consent agreements with the fourteen largest servicers.[236] Although some of the terms in the agreements were on AG Miller's agenda, such as a prohibition on "dual tracking" whereby a bank would consider a loan

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228 *See* Telephone Interview with Patrick Madigan, *supra* note 176.

229 Dennis Brady & Dina ElBoghdady, *Mortgage Servicers Under Scrutiny for Abuses*, WASH. POST, Mar. 8, 2011, at A10.

230 *See supra* note 196 and accompanying text.

231 David Streitfeld, *Servicers Said to Agree to Revamp Foreclosures*, N.Y. TIMES, Apr. 6, 2011, at B4.

232 David Streitfeld, *In Foreclosure Settlement Talks with Banks, Predictions of a Long Process*, N.Y. TIMES, Mar. 31, 2011, at B5.

233 Brady & ElBoghdady, *supra* note 229*;* Streitfeld, *supra* note 232.

234 *See* Alejandro Lazo & Nathaniel Popper, *State Exits Settlement Deal Talks*, L.A. TIMES, Oct. 1, 2011, at B1; Louise Story, *California Leaves Talks in Settling Mortgages*, N.Y. TIMES, Oct. 1, 2011, at B1.

235 David Streitfeld, *New Rules for Top Mortgage Servicers Face Early Criticism*, N.Y. TIMES, Apr. 11, 2011, at B3 (quoting Professor Adam Levitin, who called the agreements a "sham settlement").

236 David Streitfeld, *Rules for Mortgage Servicers Are Criticized as Ineffective*, N.Y. TIMES, Apr. 13, 2011, at B4; David Streitfeld, *supra* note 231; Press Release, Bd. of Governors of the Fed. Reserve Sys., 2011 Enforcement Actions (Apr. 13, 2011), *available at* http://www.federalreserve.gov/newsevents/press/enforcement/20110413a.htm; Press Release, Office of the Comptroller of the Currency, OCC Takes Enforcement Action Against Eight Servicers for Unsafe and Unsound Foreclosure Practice (Apr. 13, 2011), *available at* http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47.html.

modification at the same time as it was proceeding with a foreclosure, Miller was not surprised to see that the central term was missing: mandatory loan modifications to prevent unnecessary foreclosures.[237] Moreover, the agreements raised questions about enforcement and whether the regulators were leaving the banks to police themselves.[238]

After more than a year of negotiations and numerous missed deadlines, the parties finally came to terms in early February 2012.[239] The settlement was wide-ranging and included new mortgage servicing standards.[240] Among other standards, banks could foreclose only after reviewing loss mitigation options, and had to follow clear procedures.[241] The new standards went further than both what the federal banking agencies had put in place, and any other existing provisions at the time in state or federal law.[242] The agreement also included about $20 billion toward borrower relief: principal reduction in the case of delinquency or near-delinquency; refinancing for underwater mortgages; and other forms of relief such as short sales and anti-blight programs.[243]

The agreement also came with compliance provisions.[244] Several of the states had openly worried that the earlier settlement with Countrywide for predatory lending did not include sufficient oversight.[245] The National Mortgage Settlement identified clear deadlines for when the servicers had to fulfill their obligations and created an enforcement administrator empowered to review compliance and impose penalties.[246] Moreover, as mentioned, the agreement did not grant broad immunity to the banks. The law enforcement parties were

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237 Dina ElBoghdady, *A Deal on Foreclosure Practices*, WASH. POST, Apr. 14, 2011, at A14; Streitfeld, *supra* note 235.

238 Streitfeld, *supra* note 236.

239 Dennis Brady & Sari Horwitz, *Foreclosure Fraud Talks Close to Deal*, WASH. POST, Feb. 9, 2012, at A12; Alejandro Lazo, *Foreclosure Aid Deal Near Completion*, L.A. TIMES, Feb. 9., 2012, at AA1; Nelson D. Schwartz & Shaila Dewan, *$26 Billion Deal is Said to Be Set for Homeowners*, N.Y. TIMES, Feb. 9, 2012, at A1; Press Release, U.S. Dep't of Justice, Federal Government and State Attorneys General Reach $25 Billion Agreement with Five Largest Mortgage Servicers to Address Mortgage Loan Servicing and Foreclosure Abuses (Feb. 9, 2012) [hereinafter Press Release, $25 Billion Agreement], *available at* http://www.justice.gov/opa/pr/2012/February/12-ag-186.html; Press Release, Iowa Dep't of Justice, Office of the Att'y Gen., Miller Announces $25 Billion Joint State-Federal Mortgage Servicing Settlement on Foreclosure Wrongs (Feb. 9, 2012) [hereinafter Press Release, Miller Announces Joint Settlement].

240 For the primary documents, see JOINT ST.-FED. NAT'L MORTGAGE SERVICING SETTLEMENTS, http://www.nationalmortgagesettlement.com (last visited Apr. 26, 2015). For a detailed overview of the terms, see Robert E. Bostrom et al., *Final Agreement Filed in Attorneys General $25 Billion Settlement with Servicers*, 66 CONSUMER FIN. L. Q. REP. 130 (2012).

241 Press Release, $25 Billion Agreement, *supra* note 239.

242 *See* Bostrom et al., *supra* note 240, at 131.

243 Press Release, $25 Billion Agreement, *supra* note 239.

244 For an overview, see Bostrom et al., *supra* note 240, at 132–33.

245 Shaila Dewan & Nelson D. Schwartz, *Deal is Closer for a U.S. Plan On Mortgages*, N.Y. TIMES, Feb. 6, 2012, at A1; Alejandro Lazo & Jim Puzzanghera, *State Shuns Bank Deal*, L.A. TIMES, Feb. 7, 2012, at B1.

246 Press Release, $25 Billion Agreement, *supra* note 239.

still free to pursue criminal actions related to mortgage servicing, civil or criminal suits related to securitization, and individual borrowers could still file claims.[247]

The agreement was not without its weaknesses. Most glaring, mortgages owned by Fannie Mae and Freddie Mac were not covered.[248] Although the settlement set records for the amount, it was still a drop in the bucket. Underwater mortgages at the time were estimated to equal about $750 billion in negative equity.[249] And the servicing standards only applied to the five large servicers party to the settlement, although they covered about fifty-five percent of the market.[250] But the settlement was also remarkable in a few ways. As AG Miller said: "One of the hardest battles I fought over the last 16 months was over principal reduction. . . . . At first the banks tried to tell us that was a nonstarter. We kept fighting back, and now I'm very proud to say that we got it across the finish line."[251] Moreover, the limited immunity was also a win. As Madigan said, the settlement "is neither the beginning nor the end of our work to hold banks and other institutions accountable."[252]

2. Securitization Fraud

The final area where the Enforcers acted was fraud in the securitization of predatory loans that in many ways fueled the mortgage meltdown.[253] Starting in late 2007,[254] Massachusetts AG Martha Coakley launched the first and most comprehensive challenge to the investment banks that financed the subprime boom. Although it is now common wisdom that Wall Street was closely tied to the subprime mortgage crisis, the connection was not widely discussed at the time.

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247 *Id.*

248 Schwartz & Dewan, *supra* note 239. The Federal Housing Financial Agency, which regulates Fannie and Freddie, supported the decision out of moral hazard concerns. Press Release, Fed. Hous. Fin. Agency, Statement by Edward J. DeMarco, Acting Director, FHFA, on the Use of Principal Forgiveness by Fannie Mae and Freddie Mac (July 31, 2012), *available at* http://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-by-Edward-J-DeMarco-Acting-Director-FHFA-on-the-Use-of-Principal-Forgiveness-by-Fannie-Mae-and-Freddie-Ma.aspx.

249 Dennis Brady & Sari Horwitz, *Settlement Launches Foreclosure Reckoning*, WASH. POST, Feb. 10, 2012, at A1.

250 Bostrom et al., *supra* note 240, at 131.

251 Press Release, Miller Announces Joint Settlement, *supra* note 239. The number of servicers would later grow, including the December 2013 settlement with Ocwen Financial. *See* Nathaniel Popper, *Big Subprime Mortgage Loan Servicer Agrees to $2.2 Billion Settlement*, N.Y. TIMES, Dec. 20, 2013, at B8.

252 Brady & Horwitz, *supra* note 249.

253 *See supra* notes 44–45 and accompanying text.

254 Press Release, Office of the Att'y Gen., Commonwealth of Mass., Attorney General Martha Coakley & Goldman Sachs Reach Settlement Regarding Subprime Lending Issues (May 11, 2009), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2009/attorney-general-martha-coakley-and-goldman.html.

Massachusetts made an early and deliberate choice to focus limited enforcement resources on securitization. As we will see, in the larger enforcement picture across the fifty states, this decision yielded benefits that went well past state borders: Massachusetts led enforcement efforts in a critical and complex area of the crisis where few other states had gone. The state also led in the face of federal inaction: when Coakley began her efforts, the SEC had not brought any major claims against the large investment banks for fraud related to RMBSs.[255] From 2009 through 2013, Coakley settled claims against many of the largest institutions: Goldman Sachs ($60 million);[256] Morgan Stanley ($102 million);[257] Royal Bank of Scotland ($52 million);[258] Barclays ($36 million);[259] J.P. Morgan ($34 million);[260] and Countrywide Securities ($17 million).[261]

Coakley's case against Morgan Stanley is representative.[262] The firm was a financer for New Century Financial Corporation, a major subprime lender in the years before the collapse. Coakley's investigation alleged two types of wrongdoing: (1) the firm provided a steady stream of funding for New Century to originate loans that Morgan Stanley knew were designed to fail and generate profits off fees and possible refinancing; and (2) the firm would then purchase these loans from New Century, place them into a securitization pool, and sell investments

255 Press Release, Sec. & Exch. Comm'n, SEC Actions During Turmoil in Credit Markets (Jan. 22, 2009), *available at* http://www.sec.gov/news/press/sec-actions.htm.

256 *See* Jenifer B. McKim, *State Gets Subprime Loan Cuts for 700*, BOS. GLOBE, May 12, 2009, at 1; Leslie Wayne, *Goldman Pays to End State Inquiry into Loans*, N.Y. TIMES, May 12, 2009, at B3; Press Release, *supra* note 254.

257 *Morgan Stanley to Settle Case over Subprime Loans*, N.Y. TIMES, June 25, 2010, at B5; Press Release, Office of the Att'y Gen., Commonwealth of Mass., Morgan Stanley to Pay $102 Million for Role in Massachusetts Subprime Mortgage Meltdown Under Settlement with AG Coakley's Office (June 24, 2010), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2010/attorney-general-martha-coakley-reaches-102.html.

258 Press Release, Office of the Att'y Gen., Commonwealth of Mass., Royal Bank of Scotland to Pay $52 Million for Securitization Role in Subprime Mortgage Meltdown Under Settlement with AG Coakley's Office (Nov. 28, 2011), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2011/2011-11-28-rbs-settlement.html; *see also* Jenifer B. McKim, *Bank Settles Subprime Loans Case for $52m*, BOS. GLOBE, Nov. 29, 2011, at B5.

259 Press Release, Office of the Att'y Gen., Commonwealth of Mass., Barclays to Pay $36.1 Million for Securitization Role in Subprime Mortgage Meltdown (Sept. 9, 2013), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2013/2013-09-09-barclays-aod.html; *see also* Deirdre Fernandes, *Barclays Settles with AG for $36.1m*, BOS. GLOBE, Sept. 10, 2013, at B6.

260 Press Release, Office of the Att'y Gen., Commonwealth of Mass., JPMorgan to Pay $13 Billion in Federal-State Deal over Mortgage Backed Securities (Nov. 19, 2013), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2013/2013-11-19-jpmorgan-settlement.html; *see infra* notes 275–76 and accompanying text.

261 Press Release, Office of the Att'y Gen., Commonwealth of Mass., AG Coakley Announces $11 Million Payment to State Pension Fund from Settlement with Countrywide Securities Corporation (Dec. 30, 2013), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2013/2013-12-30-countrywide-settlement.html; *see also Countrywide Settlement to Give Mass. Fund $11m Boost*, BOS. GLOBE, Dec. 31, 2013, at B7.

262 *See supra* note 257.

backed by the pool, knowing the securities did not meet its underwriting standards and otherwise violated state law.[263] Coakley alleged that the investment bank's actions harmed homeowners, investors, and the state through its two pension funds.[264] The settlement included direct relief for homeowners in the form of loan modifications, a sizable payment to the state pension fund, and a fine payable to the Commonwealth.[265]

With Coakley's success, the question was whether other states and especially the federal government would support a larger investigation that went beyond the boundaries of one state. The question was answered in the State of the Union Address on Tuesday, January 24, 2012,[266] when the President announced a new unit within the Financial Fraud Enforcement Task Force that would investigate the financing of the subprime lending industry—the RMBS Working Group.[267] The President appointed New York Attorney General Eric Schneiderman as one of the co-chairs.[268]

From a resource perspective the state-federal partnership was promising.[269] Schneiderman had fifteen attorneys focused on the issue in his office.[270] Now he would coordinate not only with other states, but also with various federal agencies that would contribute fifty-five attorneys, agents, and analysts.[271] Moreover, the states and the federal government each brought different strengths. Having the IRS on the team allowed investigation of possible tax violations. At the same time, New York had the Martin Act,[272] granting broad subpoena powers and—unlike federal securities law—allowing the AG to establish fraud

263 Press Release, *supra* note 257.

264 *Id.*

265 *Id.*

266 Barack Obama, President of the U.S., Remarks by the President in State of the Union Address (Jan. 24, 2012), *available at* http://www.whitehouse.gov/the-press-office/2012/01/24/remarks-president-state-union-address.

267 Jim Puzzanghera, *New Initiative Will Coordinate Probes of Mortgage Meltdown*, L.A. TIMES, Jan. 27, 2012, http://articles.latimes.com/2012/jan/27/business/la-fi-mortgage-working-group-20120127; Edward Wyatt & Shaila Dewan, *New Housing Task Force Will Zero in on Wall Street*, N.Y. TIMES, Jan. 25, 2012, at B1; Memorandum from Eric Holder, Att'y Gen., U.S. Dep't of Justice, to the Fin. Fraud Enforcement Task Force (Jan. 27, 2012), *available at* http://www.justice.gov/ag/residential-mortgage-backed-securities.pdf; Press Release, U.S. Dep't of Justice, U.S. Attorney General Holder, State and Federal Officials Announce Collaboration to Investigate Residential Mortgage-Backed Securities Market (Jan. 27, 2012), *available at* http://www.justice.gov/opa/pr/2012/January/12-ag-120.html.

268 Press Release, N.Y. State Office of the Att'y Gen., A.G. Schneiderman and Federal Officials Detail Joint Investigation into Mortgage Crisis (Jan. 27, 2012), *available at* http://www.ag.ny.gov/press-release/ag-schneiderman-and-federal-officials-detail-joint-investigation-mortgage-crisis.

269 *But see* Phil Angelides, Op-Ed., *Will Wall Street Ever Face Justice?*, N.Y. TIMES, Mar. 2, 2012, at A25 (Angelides co-chaired the Financial Crisis Inquiry Commission).

270 Harold Meyerson, Op-Ed., *Holding the Banks Accountable*, WASH. POST, Jan. 31, 2012, http://www.washingtonpost.com/opinions/eric-schneiderman-new-york-ag-shaped-drive-to-hold-banks-accountable/2012/01/30/gIQAjWxCgQ_story.html.

271 Press Release, *supra* note 267.

272 N.Y. GEN. BUS. LAW §§ 352–359h (Consol. 2014).

without a showing of intent.[273] And the New York and Delaware AGs had power under state law over the trusts that held the pooled mortgages and issued the mortgage-backed securities.[274]

Schneiderman and his other state and federal partners announced their first legal action in October 2012: a suit against JPMorgan for fraudulent misrepresentations and omissions to investors in the creation, packaging, and sale of RMBS.[275] The firm misled investors, the suit claimed, about the quality of the underlying loans. The charges were for actions committed by Bear Stearns, which JP Morgan absorbed in 2008. A year later JPMorgan settled for $13 billion.[276] The settlement was unique in that it included an express admission of wrongdoing by JPMorgan.[277] In the wake of this action, the enforcement team later reached settlements with Bank of America[278] and Citigroup[279] based on similar accusations of wrongdoing.

The investment banks were not the only targets in the world of subprime finance. The Enforcers also targeted the credit rating agencies, which assessed the risk of RMBSs and through 2007 were handing out

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273 DANIEL J. FETTERMAN & MARK P. GOODMAN, DEFENDING CORPORATIONS AND INDIVIDUALS IN GOVERNMENT INVESTIGATIONS §§ 9:8–9:13 (2012) (overview of Martin Act); Frank C. Razzano, Essay, *The Martin Act: An Overview*, 1 J. BUS. & TECH. L. 125 (2006); Nicholas Thompson, *The Sword of Spitzer*, LEGAL AFF., May–June 2004, at 50.

274 Alison Frankel, *Pauley's BofA MBS Ruling is Boon to New York, Delaware AGs*, REUTERS, Oct. 25, 2011, *available at* http://blogs.reuters.com/alison-frankel/2011/10/25/pauleys-bofa-mbs-ruling-is-boon-to-new-york-delaware-ags.

275 Gretchen Morgenson, *JPMorgan Unit Is Sued over Mortgage Pools*, N.Y. TIMES, Oct. 2, 2012, at B1; Michael Virtanen, *Clock Runs out for Felony Charges in Mortgage-Securities Meltdown*, WASH. POST, Oct. 5, 2012, at A13; Press Release, N.Y. State Office of the Att'y Gen., A.G. Schneiderman Sues JPMorgan for Fraudulent Residential Mortgage-Backed Securities Issued by Bear Stearns (Oct. 2, 2012), *available at* http://www.ag.ny.gov/press-release/ag-schneiderman-sues-jpmorgan-fraudulent-residential-mortgage-backed-securities-issued; Press Release, U.S. Dep't of Justice, Residential Mortgage-Backed Securities Working Group Members Announce First Legal Action (Oct. 2, 2012), *available at* http://www.justice.gov/opa/pr/2012/October/12-opa-1196.html.

276 Andrew R. Johnson, *In Wake of Bank Pact, a Template Emerges*, WALL ST. J., Nov. 21, 2013, at C7; Jessica Silver-Greenberg & Ben Protess, *JPMorgan Reveals How It Formed Mortgages*, N.Y. TIMES, Nov. 20, 2013, at B1; Press Release, N.Y. State Office of the Att'y Gen., A.G. Schneiderman-led State & Federal Working Group Announces $13 Billion Settlement with JPMorgan Chase (Nov. 19, 2013), *available at* http://ag.ny.gov/press-release/ag-schneiderman-led-state-federal-working-group-announces-13-billion-settlement; Press Release, U.S. Dep't of Justice, Justice Department, Federal and State Partners Secure Record $13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages (Nov. 19, 2013), *available at* http://www.justice.gov/opa/pr/2013/November/13-ag-1237.html.

277 *See supra* note 276.

278 Press Release, U.S. Dep't of Justice, Bank of America to Pay $16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis (Aug. 21, 2014), *available at* http://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading.

279 Press Release, U.S. Dep't of Justice, Justice Department, Federal and State Partners Secure Record $7 Billion Global Settlement with Citigroup for Misleading Investors About Securities Containing Toxic Mortgages (July 14, 2014), *available at* http://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-7-billion-global-settlement.

their highest rating to investments that proved toxic. Although it did not result in any enforcement actions, New York AG Eliot Spitzer launched an investigation into Moody's practices in 2005.[280] His successor, Andrew Cuomo, continued the probe and in the summer of 2008 announced agreements with the three primary rating agencies: Standard & Poor's, Moody's, and Fitch.[281] Among other reforms, the agencies agreed to change their compensation system. For years critics had argued that the rating agencies had a fundamental conflict of interest: they are paid by the firms whose securities they rate, allowing the arrangers to negotiate the ratings.[282] In settling with Cuomo, the agencies agreed to accept a fee-for-services model whereby they would be paid for a proposal regardless of final selection.[283] Although the settlements marked significant reforms, critics raised concerns.[284] The fundamental conflict of interest that arose because the investment banks paid the ratings agencies still existed. Moreover, the settlements were prospective and did not hold the agencies accountable for their role in the mortgage meltdown.

In the next few years, several states sought accountability. Connecticut led the way with a suit against Moody's and Standard & Poor's (S&P) in 2010.[285] Illinois followed in January 2012 with a suit against S&P in state court.[286] Madigan charged that the firm misrepresented itself as independent and objective in violation of the state's consumer protection law. As an important test case, Madigan's suit caught the attention of onlookers when it survived a motion to

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280 Eric Dash & Jenny Anderson, *Attorney General Investigates Moody's Credit Rating Polices [sic]*, N.Y. TIMES, July 30, 2005, at C3.

281 Aaron Lucchetti, *Big Credit-Rating Firms Agree to Reforms*, WALL ST. J., June 6, 2008, at C3; Press Release, N.Y. State Office of the Att'y Gen., Attorney General Cuomo Announces Landmark Reform Agreements with the Nation's Three Principal Credit Rating Agencies (June 5, 2008), *available at* http://www.ag.ny.gov/press-release/attorney-general-cuomo-announces-landmark-reform-agreements-nations-three-principal.

282 *See, e.g.*, Nan S. Ellis et al., *Conflicts of Interest in the Credit Rating Industry After Dodd-Frank: Continued Business As Usual?*, 7 VA. L. & BUS. REV. 1, 6–11 (2012).

283 Press Release, *supra* note 281.

284 *See, e.g.*, Jenny Anderson & Vikas Bajaj, *Rating Firms Seem Near Legal Deal on Reforms*, N.Y. TIMES, June 4, 2008, at C1; Tomoeh Murakami Tse, *Rating Agencies Agree to Changes*, WASH. POST, June 6, 2008, at D2.

285 Chad Bray, *Connecticut Sues Raters Moody's and S&P*, WALL ST. J., Mar. 11, 2010, at C6; Walden Siew, *Connecticut Sues Moody's, S&P for "Tainted" Ratings*, REUTERS, Mar. 10, 2010, *available at* http://www.reuters.com/article/2010/03/10/ratings-connecticut-blumenthal-idUSN1013603420100310; Press Release, State of Conn. Office of the Att'y Gen., Attorney General Sues Credit Rating Agencies for Illegally Giving Municipalities Lower Ratings, Costing Taxpayers Millions (July 30, 2008), *available at* http://www.ct.gov/ag/cwp/view.asp?A=2795&Q=420390.

286 Press Release, Ill. Att'y Gen., Madigan Sues Standard & Poor's for Enabling Financial Meltdown (Jan. 25, 2012), *available at* http://illinoisattorneygeneral.gov/pressroom/2012_01/20120125.html.

dismiss in November 2012.[287] The agency had argued that federal regulation preempted the suit and that the ratings were opinions protected by the First Amendment. The court rejected both arguments.

With the Connecticut and Illinois cases moving forward, a broader state-federal coalition followed. In February 2013, the Justice Department and a dozen other states announced similar actions.[288] AG Holder was flanked by his counterparts from California, Illinois, Iowa, and elsewhere for the announcement.[289] The media reported that the federal government decided to move after talks broke down, with S&P refusing to pay a $1 billion penalty and admit wrongdoing.[290] The Federal litigants argued that S&P engaged in a scheme to defraud investors through RMBSs and that the firm falsely represented its independence, all in violation of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA).[291] Following the lead of Connecticut and Illinois, the state cases argued that S&P's actions violated the various state consumer protection laws.[292]

III. WHAT THE STORY TELLS US

This narrative demonstrates why states are integral to the task of consumer financial protection, and how states might partner with each other and the federal government to achieve this end. The states not only serve as a stopgap when federal regulators fail to act, but also alter the quality of enforcement in positive ways not replicated by their federal counterparts. Moreover, these events suggest a new enforcement model in the area of consumer protection that may prove more potent and efficient than earlier approaches: the multigovernment, multiagency action. While these observations concern the substance of consumer

287 *See* Alison Frankel & Ted Botha, *Illinois S&P Suit: Bad Omen for Rating Agencies?*, CHI. TRIB., Nov. 8, 2012, http://articles.chicagotribune.com/2012-11-08/news/sns-rt-ratingsagency-lawsuits-column-20121108_1_standard-poor-s-actual-ratings-agencies.

288 Andrew Ross Sorkin & Mary Williams Walsh, *U.S. Accuses S.&P. of Fraud in Suit on Loan Bundles*, N.Y. TIMES, Feb. 5, 2013, at A1; Jia Lynn Yang, *U.S. Suit Accuses S&P of Fraud*, WASH. POST, Feb. 5, 2013, http://www.washingtonpost.com/business/economy/federal-lawsuit-accuses-sandp-of-defrauding-investors/2013/02/05/ae63e10e-6fa5-11e2-ac36-3d8d9dcaa2e2_story.html; Press Release, *supra* note 45.

289 *See* Press Release, *supra* note 45.

290 Sorkin & Williams, *supra* note 288.

291 *See* Press Release, *supra* note 45; *see also* Complaint for Civil Money Penalties and Demand for Jury Trial, United States v. McGraw-Hill Cos., No. CV13-00779 (C.D. Cal. Feb. 4, 2013), *available at* http://www.justice.gov/iso/opa/resources/849201325104924250796.PDF.

292 *See, e.g.*, Complaint for Treble Damages, Civil Penalties and Permanent Injunction for Violation of the California False Claims Act, Unfair Competition Law, and False Advertising Law, People v. McGraw-Hill Cos., No. CGC 13-528491 (Cal. Sup. Ct. Feb. 5, 2013) [hereinafter Complaint, People v. McGraw-Hill Cos.], *available at* http://oag.ca.gov/system/files/attachments/press_releases/S%26P%20complaint.pdf.

financial protection in the first instance, they also have implications for ongoing conversations about federalism and enforcement.[293]

A. *Why States Matter*

The states' role surrounding the economic crisis was unprecedented. The AGs' focus on consumer protection was not new. Consumer protection has been a key responsibility of AGs since at least the 1960s.[294] Moreover, interstate cooperation against national threats was also not new. For at least three decades now AGs have collaborated to enforce the law against large institutions.[295] The most well-known example is the tobacco litigation which resulted in a $206 billion settlement in 1998.[296] But what lacked precedent was the breadth of the AGs' response. In the tobacco case, the targets were a handful of major companies. By contrast, here the targets were participants in an industry that reached from Main Street to Wall Street. The offenders were individuals who ran fly-by-night scam operations, as well as major financial institutions bearing the names of giants in the industry. They were brokers, real estate agents, appraisers, lawyers, state and federal depositories, nondepository lenders, mortgage rescue operators, loan servicers, investment bankers, and credit raters, among others. At every level and against all seven deadly sins, the Enforcers and their allies were active throughout an entire sector of the economy.

Not only was the states' role unprecedented, but it was also vital. As Illinois AG Lisa Madigan testified before the Financial Crisis Inquiry Commission, "[w]e must recognize that a dual state-federal regulatory regime . . . is vital to the health of our economy."[297] State AGs played a

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293 *See, e.g.*, Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15 (2010); Margaret H. Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, 126 HARV. L. REV. 486 (2012); Margaret H. Lemos & Max Minzner, *For-Profit Public Enforcement*, 127 HARV. L. REV. 853 (2014); Margaret H. Lemos, *State Enforcement of Federal Law*, 86 N.Y.U. L. REV. 698 (2011); Amanda M. Rose, *State Enforcement of National Policy: A Contextual Approach (with Evidence from the Securities Realm)*, 97 MINN. L. REV. 1343 (2013); Amy Widman, *Advancing Federalism Concerns in Administrative Law Through a Revitalization of State Enforcement Powers: A Case Study of the Consumer Product Safety and Improvement Act of 2008*, 29 YALE L. & POL'Y REV. 165 (2010); Amy Widman & Prentiss Cox, *State Attorneys General's Use of Concurrent Public Enforcement Authority in Federal Consumer Protection Laws*, 33 CARDOZO L. REV. 53 (2011).

294 NAT'L ASS'N OF ATT'YS GEN., REPORT ON THE OFFICE OF ATTORNEY GENERAL 395–96 (1971). During the 1960s, Michigan Attorney General Frank Kelley established the first Consumer Protection Division in the office of a state attorney general. *See* FRANK J. KELLEY & JACK LESSENBERRY, THE PEOPLE'S LAWYER: THE LIFE AND TIMES OF FRANK J. KELLEY, THE NATION'S LONGEST-SERVING ATTORNEY GENERAL (forthcoming Sept. 2015).

295 *See* STATE ATTORNEYS GENERAL: POWER AND RESPONSIBILITIES 244–45 (Emily Myers & Lynne Ross eds., 2d ed. 2007).

296 *See supra* note 1.

297 *Madigan Testimony*, *supra* note 61, at 12.

critical role on both the first and second lines of defense. At a minimum, the states functioned as a *stopgap*. In Act I the AGs filled an enforcement breach when federal regulators failed to act. Their powers were limited—because of agency preemption in the early years the states could not confront some of the greatest abuses. And in the end they did not prevent the economic crisis. They were not a failsafe. That the Enforcers did not halt the crisis, however, does not lessen their contribution—sounding the alarm, mitigating harms, providing consumer redress, and crafting strategies and solutions that would bear fruit later.

The AGs were not only an important stopgap, however. As Act II demonstrates, they were also vital partners on the front line. Against some of the deadly sins, such as mortgage rescue fraud, they were the primary enforcement agents. Even against the sins committed by large institutions that reached across the nation, the Enforcers and their state allies played an indispensable role.

Clarity about the contribution these states made—why states matter—is important for two reasons. First, and looking backward, this story explains why Congress decided it was important to empower states and supports that decision. In Title X of the Dodd-Frank Act, Congress scaled back the preemption of state law,[298] and created a dual enforcement regime whereby AGs could enforce federal laws that protect consumers in the financial marketplace.[299] Second, and looking forward, this narrative counsels in favor of preserving these powers even when federal enforcements efforts are robust, and ensuring strong state consumer protection laws.

So what do states bring to the table? Or stated differently, what do AGs contribute as sentries on the first and second lines of defense? Toward answering this question, I offer five hypotheses about the advantages of AG enforcement in the realm of consumer financial protection.[300]

1. *Information advantages. The states often have distinct information advantages because of their proximity to the harms and the type of laws they enforce, which facilitate more responsive enforcement.* The AGs and their staff were far closer to the harms that were sweeping across middle-class America than any of the beltway regulators. The

298 *See supra* note 182 and accompanying text.

299 *See supra* note 183 and accompanying text.

300 For general discussions about the quality of state enforcement, see Barkow, *supra* note 293, at 56–58; Jessica Bulman-Pozen & Heather K. Gerken, Essay, *Uncooperative Federalism*, 118 YALE L.J. 1256, 1284–91 (2009); Lemos, *State Enforcement of Federal Law*, *supra* note 293, at 744–64; Rose, *supra* note 293, at 1371–75; Widman, *supra* note 293, at 209–14; Wilmarth, *supra* note 51, at 948–53.

states all have complaint-gathering systems,[301] and every day their offices received first-hand accounts of the spreading disease. Sometimes people would walk right into their offices and share their stories. And because the states have both informal and formal mechanisms for sharing data, the AGs had a better sense than anyone—including the federal banking regulators—of the emerging epidemic at a local, regional, and national level.

But their advantage was more than just proximity. It was also the types of laws they enforce.[302] Against each of the seven deadly sins, the states wielded one primary weapon: their consumer protection acts. These statutes are often called "UDAP" laws because many of them generally ban unfair and deceptive acts and practices. Although the Enforcers would sometimes evoke the common law or a particularized statute, their consumer protection acts supported the strongest civil claims against each of the seven deadly sins they confronted: predatory lending;[303] discriminatory lending;[304] mortgage fraud;[305] mortgage rescue fraud;[306] abuses in servicing and foreclosure;[307] fraud in the creation, packaging, and sale of RMBS;[308] and fraud by the credit rating agencies.[309]

Until recently, federal law protecting consumers of financial products and services was primarily disclosure-based.[310] Statutes like the

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301 Prentiss Cox, *Regulatory Perspectives & Initiatives: State Attorneys General Case Selection and Investigation*, *in* 12TH ANNUAL CONSUMER FINANCIAL SERVICES LITIGATION INSTITUTE 86 (Alan S. Kaplinsky ed., 2007).

302 *See generally* Cox, *supra* note 79, at 301–03.

303 *See, e.g.*, Complaint, Iowa v. Household Int'l, *supra* note 74, at 1.

304 *See, e.g.*, Complaint, Commonwealth v. H&R Block, Inc., *supra* note 130, at 1. Note that Illinois Attorney General Lisa Madigan brought her suits against Wells Fargo and Countrywide under a specific fair lending law available in Illinois. *See, e.g.*, Complaint, People v. Wells Fargo & Co., *supra* note 137, at 1.

305 The majority of the mortgage fraud cases were criminal prosecutions, but the civil suits usually looked to the state consumer protection act. *See, e.g.*, Press Release, N.Y. State Office of the Att'y Gen., Attorney General Targets Mortgage Fraud Ring (Nov. 29, 2006), *available at* http://www.ag.ny.gov/press-release/attorney-general-targets-mortgage-fraud-ring.

306 *See, e.g.*, Press Release, Office of the Att'y Gen., Commonwealth of Mass., AG Coakley Targets Financial Companies for Predatory Loan Practices, Warns Homeowners About Foreclosure Relief Scams (Mar. 7, 2013), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2013/2013-03-07-imod-pinnacle.html.

307 *See, e.g.*, Complaint ¶¶ 102–10, United States v. Bank of America Corp., No. 1:12-cv-00361-RMC (D.D.C. Mar. 12, 2012), *available at* http://www.justice.gov/opa/documents/complaint.pdf.

308 *See, e.g.*, Complaint ¶¶ 24–25, People v. J.P. Morgan, No. 451556/2012 (N.Y. Sup. Ct. Oct. 1, 2012), *available at* http://www.ag.ny.gov/sites/default/files/press-releases/2012/jpm complaint.pdf. The New York complaint also contained a claim under the Martin Act. *Id.* ¶¶ 82–83.

309 *See, e.g.*, Complaint, People v. McGraw-Hill Cos., *supra* note 292, at 1.

310 *See, e.g.*, Dee Pridgen, *Sea Changes in Consumer Financial Protection: Stronger Agency and Stronger Laws*, 13 WYO. L. REV. 405 (2013). An important exception was the Home Ownership and Equity Protection Act of 1994 (HOEPA). Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, §§ 151–158, 108 Stat. 2190, 2190–98 (codified as amended at 15 U.S.C.). This law gave the Federal Reserve power to regulate high-risk mortgages,

Truth in Lending Act,[311] for example, require lenders to provide certain information to borrowers about the terms of their products. Although they have the benefit of lower compliance costs, these laws alone proved inadequate to protect consumers.[312] Industry can run through a checklist and have reasonable confidence of conformity with the law. Enforcement is less costly for the same reason. The downside, however, is that disclosure-based regulation often does not take the regulator into the details of the alleged harm.

By contrast, UDAP enforcement requires that the enforcer closely examine individual cases. The strongest UDAP laws create a broad standard prohibiting unfair and deceptive acts and practices. By their nature, standards force the regulator to dive into the details of a case: its facts and circumstances. With this understanding, the enforcer can then develop arguments as to why certain activities are unfair or deceptive. In addition to the advantages that follow proximity, this difference between disclosure-based regulation and laws that reach the substance of consumer transactions creates an information advantage for state AGs, who often have more extensive, timelier, and higher-quality information about emerging harms than federal regulators.[313] An exception that will become more important over time is CFPB and its power to enforce the new UDAAP-ban.[314] Although FTC has always had the UDAP power in Section 5, resource and scope-of-authority limitations restricted the agency's influence.[315] CFPB is less confined and has the broader UDAAP prohibition, which also bans "abusive" acts and practices.[316] But the agency also has resource limits and in some areas the states have jurisdiction that the new federal regulator lacks.[317]

2. *Agility. States will often have the ability to respond to emerging harms more swiftly than their federal counterparts because of the nature of their offices and the type of law they enforce.* The first reason is straightforward: AGs have less bureaucracy. In the vast majority of states, the AG is a separately elected, constitutional officer and, therefore, does not report to any higher authority.[318] Sprawling federal

although the agency never exercised the power until after the subprime mortgage market had crashed. See ENGEL & MCCOY, *supra* note 12, at 195–96; Wilmarth, *supra* note 51, at 899.

311 Truth in Lending Act (TILA), Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601–1667f (2006)).

312 *See* Pridgen, *supra* note 310, at 417–20.

313 For further discussion about the nature of UDAP enforcement, see Cox, *supra* note 79, at 301–03.

314 Dodd-Frank Act § 1036(a)(1)(B), 12 U.S.C. § 5536 (2012); *see* Totten, *supra* note 183, at 131–36.

315 *See* Williams & Bylsma, *supra* note 48, at 1243–49.

316 *See* Totten, *supra* note 52, at 131–36.

317 *Id.* at 171 n.361 and accompanying text.

318 *See* STATE ATTORNEYS GENERAL: POWER AND RESPONSIBILITIES, *supra* note 295, at 17–18.

regulators can have multiple layers of review that mean delay when states are nimble.

Moreover, many state consumer protection acts are designed to give the enforcer agility. The Enforcers all had strong UDAPs,[319] which offered three advantages.[320] The first advantage we have already explored: an ability to reach the substantive terms of the products and services they investigated.[321] Although some states expressly exempt application of their consumer protection acts to the credit industry, the Enforcers all had authority to reach the various actors involved in the subprime lending system. Second, the state UDAP laws also provided the Enforcers with a flexible standard to address evolving threats across the system. Some states prohibit only enumerated harms and deny their AG rulemaking powers, requiring the legislature to act each time a harm appears in some new form not already covered by the statute.[322] The Enforcers, however, all enjoyed broad prohibitions on unfair and deceptive acts, providing them critical flexibility to act quickly against evolving harms. Moreover, three of the states granted their AGs rulemaking authority.[323]

And third, the Enforcers had a menu of remedial options under their UDAP laws.[324] The ability to recover on behalf of state consumers was especially advantageous. Many state UDAPs expressly empower their AG to seek restitution on behalf of consumers in their state,[325] but even where the law is silent most AGs have standing under the common law doctrine of *parens patriae*.[326] In some ways such cases are the

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319 *See generally* CAROLYN L. CARTER & JONATHAN SHELDON, UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 15.5 (7th ed. 2008); Christopher J. Willis & Stephanie H. Jackman, *What Is an Attorneys' General Burden of Proof? Evidentiary Requirements in UDAP Actions Brought by State Attorneys General*, 1789 PLI/CORP 1003 (2009), at 1026–54 (noting that California and Illinois have the two broadest state UDAP laws); Alan S. Brown & Larry E. Hepler, *Comparison of Consumer Fraud Statutes Across the Fifty States*, 55 FED'N. DEF. & CORP. COUNS. Q. 263 (2005), *available at* http://www.thefederation.org/documents/Vol55No3.pdf.

320 *See generally* Mark E. Budnitz, *The Federalization and Privatization of Public Consumer Protection Law in the United States: Their Effect on Litigation and Enforcement*, 24 GA. ST. U. L. REV. 663, 674–77 (2008); Henry N. Butler & Joshua D. Wright, *Are State Consumer Protection Acts Really Little-FTC Acts?*, 63 FLA. L. REV. 163, 167–73 (2011); Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts*, 54 U. KAN. L. REV. 1, 15–32 (2005).

321 *See supra* notes 302–17 and accompanying text.

322 *See, e.g.*, COLO. REV. STAT § 6-1-105 (2014); IND. CODE § 24-5-0.5-3 (2014).

323 *See* CARTER & SHELDON, *supra* note 319, at 11. The AGs in Illinois, Iowa, and Massachusetts all had this power. *See, e.g.*, Press Release, Office of the Att'y Gen., Commonwealth of Mass., Attorney General Martha Coakley Issues Final Mortgage Broker and Lender Regulations (Oct. 17, 2007) (on file with author).

324 *See* Raymond H. Brescia, *Tainted Loans: The Value of a Mass Torts Approach in Subprime Mortgage Litigation*, 78 U. CIN. L. REV. 1, 13–23 (2009); Willis & Jackman, *supra* note 319, at 1005.

325 CARTER & SHELDON, *supra* note 319.

326 For background, see STATE ATTORNEYS GENERAL: POWER AND RESPONSIBILITIES, *supra* note 295, at 102–04; Richard P. Ieyoub & Theodore Eisenberg, *State Attorney General Actions, the Tobacco Litigation, and the Doctrine of Parens Patriae*, 74 TUL. L. REV. 1859 (2000); Jack Ratliff,

functional equivalent of a private class action, but without many of the limitations that legislatures and courts have increasingly placed on the class action to restrict access.[327] The relatively flat organizational structure of AG offices and the flexibility afforded by many UDAP laws give the states agility that federal regulators may lack.

3. Remedial focus. *State AGs embody a problem-solving approach that seeks consumer-driven injunctive relief and restitution.* Interviewees at the center of the events discussed in Part II repeatedly reinforced that these remedies, rather than civil penalties, were the Enforcers' chief focus and concern throughout negotiation talks.[328] While AGs may have political incentives to seek large monetary payouts,[329] here they demonstrated a commitment to crafting measurable assistance for effected consumers.

The National Mortgage Settlement is the best example and reflects the evolving experience of a core group of attorneys working these cases for several years. Recall that the Countrywide settlement was the first time the states negotiated loan modifications for consumers into the terms of a settlement.[330] Although this remedy later became a feature of the states' efforts, at the time it was uncommon.[331] The Countrywide case set an important precedent for later settlements, including the National Mortgage Settlement. Under that deal, the banks agreed to new servicing standards and about $20 billion in loan modifications and other consumer relief.[332] From one perspective, this remedy was surprising. The wrongdoing at issue was primarily procedural; a failure to properly foreclose under state foreclosure laws. Absent these failures of process, most of the foreclosures would have still likely occurred. The more typical remedy for procedural violations was a civil penalty. And yet the AGs converted these civil penalties into relief for homeowners, while also putting into place new rules governing the servicers moving forward. This commitment to consumer-focused relief is a hallmark of AG enforcement.[333]

Parens Patriae: An Overview, 74 TUL. L. REV. 1847 (2000); Jim Ryan & Don R. Sampen, *Suing on Behalf of the State: A Parens Patriae Primer*, 86 ILL. B.J. 684 (1998). Although the common law doctrine has evolved over centuries, the most important modern case interpreting the bounds of the doctrine is *Alfred L. Snapp & Son, Inc. v. Puerto Rico*, 458 U.S. 592 (1982).

327 *See* Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, *supra* note 293, at 488.

328 *See, e.g.*, Telephone Interview with Patrick Madigan, *supra* note 176.

329 *See* Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, *supra* note 293, at 517.

330 *See supra* note 107 and accompanying text.

331 Telephone Interview with Patrick Madigan, *supra* note 176.

332 *See supra* notes 239–47 and accompanying text.

333 *But see* Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, *supra* note 293, at 525–30 (arguing that AGs may have conflicting incentives that cause them to reach smaller settlements in parens patriae cases than the consumers they represent might otherwise recover).

4. *Resistance to capture. When federal regulators are captured and fail to take necessary actions to protect consumers, at least a few states are likely to enter the enforcement gap. Moreover, because of the profound spillover effects that can accompany AG enforcement actions, even one leading state can protect consumers across the nation.*

No individual state AG is per se resistant to capture[334]—and a recent investigative report has documented the previously unrecognized influence of lobbying on the state AG world[335]—but understood collectively it is likely that at least a few states will act. Resistance is a feature of the whole, not any one part. This hypothesis rests on the multiplicity of state actors: the fact that while we have one federal government, we have fifty state sovereigns whose AG offices have varying budgets, ideological commitments, and laws. In our federalist system, these diversities are strengths which can work to promote accountability and create a strong tendency for at least some states to act.

The likelihood of AG action in the face of federal passivity depends upon at least four factors: authority, resources, ideology, and motivation. In some measure, a surplus in one area can make-up for deficiencies in other areas. The first two factors are relatively fixed and less interesting. They are prerequisites to action, but are not themselves anti-capture properties of the office. Although enterprising AGs can craft novel legal arguments, at some point they may lack the authority to act. State laws may be weak or preempted by federal law. Moreover, while AGs can concentrate resources in certain areas, and some AGs have worked with outside counsel on a set-fee or a contingency fee basis,[336] a limited pot may preclude action in certain areas. Ideology matters and may forestall action even where the officeholder has the authority, resources, and political incentives to act. To the extent that consumer protection comes at a cost to industry, some AGs who favor industry may be disinclined to lead or even join multistate consumer protection cases.

The most important factor, and the factor which in some cases can render the office of state AGs less susceptible to capture, is motivation. Certain incentives shape the office that are not present, at least to the same degree, among federal regulators. Moreover, forces that can capture federal regulators may be absent or diminished within the office

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334 *See generally* PAUL J. QUIRK, INDUSTRY INFLUENCE IN FEDERAL REGULATORY AGENCIES (1981); Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 COLUM. L. REV. 1260, 1284–92 (2006); Barkow, *supra* note 293, at 21–24.

335 Eric Lipton, *Lobbyists, Bearing Gifts, Pursue Attorneys General*, N.Y. TIMES, Oct. 29, 2014, at A1.

336 *See* David A. Dana, *Public Interest and Private Lawyers: Toward a Normative Evaluation of Parens Patriae Litigation by Contingency Fee*, 51 DEPAUL L. REV. 315, 315 (2001).

of the state AG. This environment shapes the motivations of AGs and the actions they bring.

In forty-three states the AG is popularly elected.[337] The vast majority of state AGs, therefore, share the same political incentives that influence other elected offices: the desire to satisfy certain constituencies, please past or future campaign contributors, and grab headlines to augment one's reputation, among other motivations. These incentives also have liabilities—the possibility of over-enforcement, for example—but my focus now is the way in which these incentives can make state AGs an effective counterbalance to a captured federal regulator.[338] Although AGs have other outlets, their primary means of action is enforcement of the law. And so for AGs with the authority, resources, and ideological alignment, the motivation to bring an enforcement action against an entity that federal regulators have refused to regulate may be exceedingly strong. Those are the moments that forge reputations—and political careers.

At the same time, some AGs may escape some of the forces that capture federal regulators. No elected official is immune from lobbying, and yet different actors in different states attract different lobbyists. In Act I of the story, the financial institutions' lobby wielded tremendous influence over OCC and OTS, in part because of defects in agency design.[339] Those same forces may bear less influence against at least some AG offices.[340] If the states are not empowered, either because of preemption or because of weak laws, motivation will be of little value. But where these four factors align, states have the potential to step into the gap left by federal regulators who fail to act.

Moreover, the actions of even a single AG can have profound spillover effects if other states follow. The multistate action against Countrywide eventually included forty-two states, but it began with the investigations of California and Illinois.[341] While a single state cannot wield the influence of a federal regulator, a single state joined by several dozen other states can have significant impact. And the fact that a state may choose not to lead because of deficiencies in any of the four abovementioned areas does not mean that state will refuse to join the settlement. Even AGs who refuse to lead for political or ideological reasons may take the money when all that is required is a signature.

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337 *See* STATE ATTORNEYS GENERAL: POWER AND RESPONSIBILITIES, *supra* note 295, at 17. The Governor appoints the AG in Alaska, Hawaii, New Hampshire, New Jersey, and Wyoming. In Maine, the state legislature selects the AG by secret ballot. And in Tennessee, the state supreme court appoints the AG.

338 *See, e.g.*, Lemos, *State Enforcement of Federal Law*, *supra* note 293, at 759–64.

339 *See* Bar-Gill & Warren, *supra* note 51, at 86–95; Wilmarth, *supra* note 51, at Part I.

340 *See, e.g.*, Telephone Interview with Patrick Madigan, *supra* note 176.

341 *See supra* note 100 and accompanying text.

The story of the Enforcers gives credence to this hypothesis about why at least some AGs act when their federal counterparts are captured. Although the multistate coalitions in Act I included states from across the political spectrum, it is not surprising that the leading states identified with the President's opposing party. Other factors were at work, but the opportunity to make a mark by stepping-in where the President had failed is strong motivation to act. And while the banking lobby had strong ties inside the beltway, its influence in state AG offices may be less.

5. Entrepreneurialism. *Lastly, the states can create, test, and refine new enforcement strategies and remedies that larger state coalitions or the federal government can later borrow and scale.* The multiplicity of states permits broad experimentation as one state or a group of states focus their limited resources on specific harms. For the majority of AGs who are elected, innovation may carry political rewards as a reputation-building tool.[342] Innovation can take at least two forms: the crafting of new enforcement strategies that reach new targets or reach existing targets under new theories; and the crafting of new remedies that help consumers and stop future harm. Moreover, the efforts of even one state can have national effect as a coalition of states or the federal government bring these ideas to scale.

The story of the Enforcers in Part II exhibits this entrepreneurialism. At several moments the states crafted new enforcement strategies that the federal government later borrowed. Perhaps the best example is Attorney General Martha Coakley's decision at the start of her term in 2007 to devote considerable resources to investigate and bring enforcement actions against firms that committed fraud in the securitization process.[343] This decision came at a cost; even the most well-funded AG's office faces considerable constraints and focusing on one harm means little or no resources for other harms. Massachusetts, for example, did not bring actions against the credit ratings agencies for their misrepresentations about toxic RMBSs through 2007, and the state's absence may have been the consequence of focusing on the investment banks. Yet Coakley's decision proved enormously beneficial well beyond state borders. Her office crafted the legal theories for liability under the state consumer protection act, making Massachusetts the first state to hold the investment banks accountable and the only state to systematically bring actions throughout the subprime financing industry.[344] Most important,

342 Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143, 199–200 (2009); *see also* Colin L. Provost, *State Attorneys General, Entrepreneurship, and Consumer Protection in the New Federalism*, 33 PUBLIUS 37 (2003).

343 *See supra* notes 254–65 and accompanying text.

344 *See supra* notes 254–65 and accompanying text.

Coakley's efforts that began in 2007 created the template for actions brought by the federal government several years later through the RMBS Working Group, including the $13 billion settlement against J.P. Morgan in late 2013.[345]

Illinois AG Lisa Madigan played a similar role. Following Connecticut, Illinois was one of the earliest to investigate and file suit against Standard and Poor's, the credit rating agency that was giving AAA ratings to toxic mortgage securities up to the collapse of the subprime market.[346] After surviving a motion to dismiss in November 2012 that raised substantial constitutional arguments regarding free speech and federal preemption, other states and the Department of Justice followed suit in early 2013.[347] Madigan played a similar role in bringing discriminatory lending cases against Countrywide and Wells Fargo, with the Department of Justice later joining. The states have the potential to serve as a testing ground and persuade other actors who may be more hesitant to act. As elected officials, AGs are well-positioned to serve this role because political incentives can foster a willingness to take risks that appointed bureaucrats and their civil service ranks may lack.[348]

The states were also innovating on the remedy side in ways that trickled up and shaped national policy. The best example is the mortgage servicing standards which became the exemplar for later federal rulemaking. The standards that came out of the National Mortgage Settlement were only binding on the five servicers that were party to the agreement, but because they represented about fifty-five percent of the servicing market, the standards were effectively national.[349] Two months after settlement, CFPB announced it would issue rules governing mortgage servicing,[350] which became final in January 2013.[351] As several commentators observed, the new rules drew heavily on the servicing standards.[352] Not only are governors and state legislatures at work in the laboratories of democracy—AGs are as well.

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345 *See supra* notes 266–79 and accompanying text.

346 *See supra* notes 286–87 and accompanying text.

347 *See supra* notes 288–92 and accompanying text; *see also* Press Release, Ill. Att'y Gen., Madigan: U.S. DOJ & 14 States Join In Litigation Against Standard & Poor's (Feb. 5, 2013), *available at* http://illinoisattorneygeneral.gov/pressroom/2013_02/20130205.html.

348 *See* Provost, *supra* note 342.

349 *See* Bostrom et al., *supra* note 240, at 133.

350 Press Release, Consumer Fin. Prot. Bureau, CFPB Outlines Borrower-Friendly Approach to Mortgage Servicing (Apr. 9, 2012), *available at* http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-outlines-borrower-friendly-approach-to-mortgage-servicing.

351 Truth in Lending (Regulation Z), 77 Fed. Reg. 69,738 (Nov. 21, 2012) (to be codified at 12 C.F.R. pt. 1026); Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10,696 (Feb. 14, 2013) (to be codified at 12 C.F.R. pt. 1024).

352 *See, e.g.*, J.C. Boggs, *CFPB Amends Rules Governing Mortgages and Mortgage Servicers*, KING & SPALDING WASHINGTON INSIGHT (Jan. 23, 2013), http://www.kslaw.com/library/

B. *How Governments Partner*

The story of the Enforcers not only suggests why states matter in the realm of consumer financial protection, but also how states might partner with each other and the federal government to achieve their goals. The multistate actions that formed the plotline in Act I raise interesting questions about the conditions and forms of collaboration among states. But the most important contribution of this story to the challenge of how governments work together to enforce the law comes in Act II with the National Mortgage Settlement and the new model of multigovernment, multi-agency actions in the field of consumer protection.

For several decades now, and certainly since the tobacco litigation in the mid-1990s, the multi*state* action has been a regular feature of the public enforcement landscape in the area of consumer protection. Although the response to the servicing debacle at first took the shape of a traditional multistate action, within a few months it had transformed into what is better called a multigovernment action. The mere fact of state-federal partnership in consumer protection cases was not new. The FTC, for example, has a rich history of cooperating with the states.[353] And limited state-federal partnerships have existed in the related field of antitrust enforcement for several decades.[354] But the coalition on the servicing case was unprecedented for the breadth of its scope: all fifty states and multiple federal agencies.[355]

The advantages of this enforcement vehicle against certain harms are several. Most apparent, the multigovernment, multiagency action aggregates strengths. The states bring to the table the benefits previously described. The federal actors bring additional authority under federal law; in some cases expanded jurisdiction; additional manpower; specialized resources such as economists and forensic accountants, which states often lack; and the increased leverage that shadows federal involvement.

Less apparent is the possibility for the multigovernment, multiagency action to mitigate the potential costs of forward-looking remedies. As mentioned earlier, AGs often understand their role as problem-solvers who are not just compensating victims, but also preventing future harms. Consequently, AGs have historically placed considerable focus on crafting injunctive remedies meant to reform

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newsletters/WashingtonInsight/2013/Jan23/article8.html; Elizabeth L. McKeen et al., *CFPB Issues New Mortgage Servicing Regulations*, O'MELVENY & MYERS LLP (Sept. 5, 2012), http://www.omm.com/cfpb-issues-new-mortgage-servicing-regulations-09-05-2012.

353 *See, e.g.*, HUDSON, *supra* note 47 and accompanying text.

354 *See* antitrust sources cited *infra* note 370.

355 *See supra* notes 219–20 and accompanying text.

broken systems. While this approach has benefits, especially where federal regulators are captured, it also bears certain costs. The casebook example of "regulation by litigation" is the 1998 tobacco settlement.[356] These fears are well founded and the costs potentially high.[357] Nonetheless, context matters and nearly all accounts fail to seriously consider crisis situations such as what the states encountered this past decade.[358] And more importantly as I explain below, the multigovernment, multiagency model has the potential to mitigate several of these costs.

Critics raise several concerns. At the top of the list is a concern about democratic accountability.[359] Settlement talks are done in private and, unlike the legislative process or notice-and-comment rulemaking, affected parties may have no voice in the process. This approach can lead to inefficient outcomes as legitimate concerns are overlooked. Critics also raise concerns about the absence of systematic and expert evaluation.[360] In the agency context, expert administrators can have a synoptic perspective and take account of the consequences of any regulatory choice for other parts of a system and thereby increase efficiency. Litigation, by contrast, is piecemeal. And lastly, prospective relief backed by a consent decree may restrict future flexibility for reform.[361]

These concerns are valid and the Enforcers did not fully escape them. New York AG Cuomo's settlement with Fannie Mae and Freddie Mac on the heels of his investigation of the appraisal management firm, eAppraiseIT, is an example.[362] The multigovernment approach in the National Mortgage Settlement, however, mitigated several of these costs. The size of the coalition—fifty-one sovereign governments—meant internal dissent that provided an outlet for opposing views. For example, a group of states led by Virginia AG Kenneth T. Cuccinelli lobbied against principal reductions.[363] More important, the presence of

356 *See generally* MARTHA DERTHICK, UP IN SMOKE: FROM LEGISLATION TO LITIGATION IN TOBACCO POLITICS (2d ed. 2005); ANDREW P. MORRISS ET AL., REGULATION BY LITIGATION (2009); REGULATION THROUGH LITIGATION (W. Kip Viscusi ed., 2002); Donald G. Gifford, *Impersonating the Legislature: State Attorneys General and Parens Patriae Product Litigation*, 49 B.C. L. REV. 913 (2008); Timothy Meyer, Comment, *Federalism and Accountability: State Attorneys General, Regulatory Litigation, and the New Federalism*, 95 CALIF. L. REV. 885 (2007); Lynch, *supra* note 2.

357 *See infra* notes 359–61 and accompanying text.

358 *See, e.g.*, MORRISS ET AL., *supra* note 356, at 170–71.

359 *See id.*; REGULATION THROUGH LITIGATION, *supra* note 356, at 3; Meyer, *supra* note 356, at 909–14.

360 *See* REGULATION THROUGH LITIGATION, *supra* note 356, at 2, 10; Gifford, *supra* note 356, at 920.

361 *See* Meyer, *supra* note 356, at 912.

362 *See supra* notes 111–16 and accompanying text.

363 David Streitfeld, *In Foreclosure Settlement Talks with Banks, Predictions of a Long Process,* N.Y. TIMES, Mar. 31, 2011, at B11.

multiple federal agencies prevented the states from pursuing reform goals at odds with the federal regulators. In addition to the Department of Justice, other federal participants included the Department of Housing and Urban Development, the Department of Treasury, CFPB, the Federal Reserve, OCC, and FDIC.[364] Although the federal banking regulators eventually reached a separate agreement,[365] they remained a voice at the table as the group crafted new mortgage servicing standards. And beyond government and industry actors, the advocacy community found several AGs responsive to their concerns.[366] This path did not carry all the safeguards for democratic accountability that adhere within the legislative or agency rulemaking processes, and yet it demonstrated a remarkable level of participation.

Moreover, rather than posing a roadblock to future reform, the servicing standards that came out of the settlement provided a template for later rulemaking. Two months after settlement, CFPB announced it would issue rules governing mortgage servicing,[367] which became final in January 2013.[368] As earlier mentioned, the new rules looked to the servicing standards coming out of the national settlement. The multigovernment approach facilitated this outcome.[369]

IV. THE REST OF THE STORY

The Enforcers and their other state allies played a critical role before, during, and after the Great Recession for many reasons, but one reason was essential: they collaborated. Absent coordination, the states could have never exercised this influence. Of the eighteen cases that form the narrative in Part II, fifteen were either collaborative from inception or planted the seeds for such suits later. These actions allow individual states to overcome constraints that might otherwise prevent action, including a lack of authority, resource constraints, and ideological and political obstacles.

Nonetheless, the role of multistate and multigovernment actions remains understudied. Some scholars have approached the subject from a theoretical perspective,[370] but the field lacks robust empirical study.[371]

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364 *See* Press Release, $25 Billion Agreement, *supra* note 239.

365 *See supra* notes 235–38.

366 *See, e.g.*, Brady & ElBoghdady, *supra* note 229.

367 *See supra* note 350.

368 *See supra* note 351.

369 Further reforms to the settlement process could further mitigate costs. For example, courts might publicize a proposed settlement, invite responses, and perhaps require the parties to respond to the concerns raised prior to judicial approval. *See* MORRISS ET AL., *supra* note 356, at 172–73.

370 *See* Cornell W. Clayton, *Law, Politics and the New Federalism: State Attorneys General as National Policymakers*, 56 REV. POL. 525 (1994), *available at* http://www.jstor.org/stable/1407967;

Moreover, the literature is often focused on the tobacco litigation, which is historically important, but may distort more general conclusions given the idiosyncratic features of that settlement.

The narrative in Part II suggests several further questions ripe for empirical investigation. These questions fall into four distinct areas: leadership; authority; collaboration; and remedies. The story shows that leadership matters. While many states may participate, absent leadership these actions may never begin. Which states and which AGs are leading? Why are they leading? And furthermore, what are the rewards of leading? Are there financial rewards for the state, beyond perceived electoral advantages that might accrue with leadership?[372]

The story of the Enforcers also suggests that state UDAP laws are a highly important weapon for AGs, at least in the area of consumer financial protection. A second set of questions considers authority. By introducing the source of law as a variable, what do we learn? In particular, what effect does UDAP strength have on leadership and participation in these cases? Do states with weak UDAP laws participate less? Or does participation in multistate or multigovernment actions overcome weaknesses in state law?

Future empirical research should also focus on multigovernment cases. When are the states collaborating with the federal government? Which federal agencies are collaborating? Do certain types of cases more often lead to collaboration?

And a final area of questioning concerns remedies. In responding to the financial crisis, the states typically sought three types of relief: civil penalties, consumer restitution, and in some cases injunctive relief. How often are the states pursuing these various forms of relief? Under what

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DeBow, *supra* note 2; Krauss, *supra* note 2; Meyer, *supra* note 356; William H. Pryor Jr., *A Comparison of Abuses and Reforms of Class Actions and Multigovernment Lawsuits*, 74 TUL. L. REV. 1885 (2000); Lynch, *supra* note 2. Scholars have also looked at multigovernment actions in the antitrust context; *see, e.g.*, Richard A. Posner, *Federalism and the Enforcement of Antitrust Laws by State Attorneys General*, *in* COMPETITION LAWS IN CONFLICT: ANTITRUST JURISDICTION IN THE GLOBAL ECONOMY 252 (Richard A. Epstein & Michael S. Greve eds., 2004); Stephen Calkins, *Perspectives on State and Federal Antitrust Enforcement*, 53 DUKE L.J. 673 (2003); Harry First, *Delivering Remedies: The Role of the States in Antitrust Enforcement*, 69 GEO. WASH. L. REV. 1004 (2001); Michael S. Greve, *Cartel Federalism? Antitrust Enforcement by State Attorneys General*, 72 U. CHI. L. REV. 99 (2005).

371 Two studies are strictly focused on the tobacco litigation: Thomas A. Schmeling, *Stag Hunting with the State AG: Anti-Tobacco Litigation and the Emergence of Cooperation Among State Attorneys General*, 25 LAW & POL'Y 429 (2003), and Rorie L. Spill et al., *Taking on Tobacco: Policy Entrepreneurship and the Tobacco Litigation*, 54 POL. RES. Q. 605 (2001). Apart from these case-specific studies, Colin Provost has produced the only broad empirical research on the role of states in multigovernment actions. *See* Colin L. Provost, *An Integrated Model of U.S. State AG Behavior in Multi-State Litigation*, 10 STATE POL. & POL'Y Q. 1 (2010); Colin L. Provost, *The Politics of Consumer Protection: Explaining State Attorney General Participation in Multi-State Lawsuits*, 59 POL. RES. Q. 609 (2006); Provost, *supra* note 342.

372 *See* Provost, *An Integrated Model of U.S. State AG Behavior in Multi-State Litigation*, *supra* note 371, at 10 & 20–21 n.7 (noting that his study does not consider who initiated the lawsuit).

conditions? And how often does injunctive relief stimulate later regulation rather than stifling it? Answering these questions is critical to understanding the rest of the story.

CONCLUSION

In the years before, during, and after the Great Recession, the Enforcers and their state partners spearheaded actions against the worst abuses in the residential mortgage lending industry. The states might have played a secondary role. Their primary means of enforcement, the lawsuit, was a blunt tool compared to the precision instruments available to federal regulators: rulemaking and the power to supervise and examine depositories. Moreover, the contamination had national reach, demanding a national response. But in the years leading up to the crisis the federal government did not act and the states rightly stepped in to treat the wounded and stanch the spreading disease. That the states acted is testimony to the vitality of our federalist system. That the states will have to play this role at some point in the future is certain. At a minimum, the states served as a second line of defense. But even after the federal government joined their efforts, the Enforcers continued to lead. This story suggests that states play an important role on both the first and second lines of defense, while also modeling a new form of state-federal collaboration.