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 states3 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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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); and Iowa (Tom Miller, 1979–1990, 1994–present). The other states had multiple AGs: California (Bill Lockyer, 1999–2007; Jerry Brown, 2007–2011; Kamala Harris, 2011–present); Massachusetts (Tom Reilly, 1999–2007; Martha Coakley, 2007–2014); and New York (Eliot Spitzer, 1999–2006; Andrew Cuomo, 2007–2010; and Eric Schneiderman, 2011–present). 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). 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. Moreover, state banking regulators were also important, as they had resources and jurisdictional powers that some AGs lacked.

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

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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: depositaries and nondepositaries (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

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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. 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. 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.

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. 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

14 See generally id. at 151–53; 1 DONALD RESSEGUIE, BANKING LAW § 1.04 (2015).
15 See ENGEL & MCCOY, supra note 12, at 15.
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.\textsuperscript{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.\textsuperscript{19} Likewise, Alt-A loans went from $60 billion in 2001 to $400 billion in 2006.\textsuperscript{20} At the same time, the players in the industry changed.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{24} The delinquency process includes both loan modifications (i.e., loan restructuring or short sales) and foreclosures.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{28} In the years leading up to the Great Recession, servicers experienced only minimal oversight.\textsuperscript{29} For depositories, the

\textsuperscript{18} See \textit{supra} note 17.
\textsuperscript{19} See \textit{FINANCIAL CRISIS INQUIRY REPORT, supra} note 12, at 70 (chart); Wilmarth, \textit{supra} note 17, at 1015–16.
\textsuperscript{20} See \textit{supra} note 19.
\textsuperscript{21} See \textit{FINANCIAL CRISIS INQUIRY REPORT, supra} note 12, at 88–89; ENGEL & MCCOY, \textit{supra} note 12, at 25–27.
\textsuperscript{22} \textit{FINANCIAL CRISIS INQUIRY REPORT, supra} note 12, at 88–89.
\textsuperscript{24} \textit{Id.} at 23.
\textsuperscript{25} \textit{Id.}
\textsuperscript{26} \textit{Id.} at 11.
\textsuperscript{27} \textit{Id.} at 11–13.
\textsuperscript{28} \textit{Id.} at 15–16.
\textsuperscript{29} \textit{Id.} at 52.
institution’s charter determined the regulator, and nonbank servicers were not subject to federal supervision.\textsuperscript{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).\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{34} While the GSEs for years securitized prime mortgages, in the early 2000s the investment banks turned to securitizing subprime mortgages, as well.\textsuperscript{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.\textsuperscript{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


\textsuperscript{32} See supra note 31.

\textsuperscript{33} See supra note 31.

\textsuperscript{34} See supra note 31.

\textsuperscript{35} See Acharya & Richardson, supra note 31, at 187.

\textsuperscript{36} See supra note 31.
Recession, 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.

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. 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.

The third deadly sin, mortgage fraud, also falls within the origination process. 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.

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

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

43 See id. at 20–21.
44 See ENGEL & MCCOY, supra note 12, at 43–58.
45 See id. at 47–51; Press Release, Dept 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. 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. 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. 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. 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. 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.


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).


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.


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

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60 See HUDSON, supra note 47, at 109.
64 Id.
65 Id.
66 Id.
67 Id.
of his own pocket, and Chisick was banned from lending in the states that brought suit.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{74} These practices, the states claimed, violated their state UDAP laws.\textsuperscript{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.\textsuperscript{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).\textsuperscript{77} This resolution was notable in two ways. First, at the time it was the largest direct restitution

\textsuperscript{69} Press Release, supra note 62.


\textsuperscript{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.

\textsuperscript{73} See Hamilton, supra note 71.

\textsuperscript{74} See, e.g., Complaint, Iowa v. Household Int’l, at 2–5 (not filed with court).

\textsuperscript{75} Id. at 5.


\textsuperscript{77} See Hamilton, supra note 71; Press Release, supra note 76.
consumer protection settlement ever reached by a state or federal government. Second, the settlement included extensive injunctive relief that many states hoped would serve as a model for future settlements and legislative reforms. 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.

The leaders behind the Household settlement turned next to Ameriquest. 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. 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. 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.

By now, closing the mortgage deal involved poorly underwritten and fraudulently documented loans. For example, AG investigations revealed that Ameriquest secured inflated appraisals. Moreover, they also discovered widespread use of fabricated or inflated income on loan applications, which were encouraged or recorded by Ameriquest representatives. 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

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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, 222.
86 See supra note 85.
the underwriting practices of mortgage lenders erode at a disturbingly accelerated pace.\footnote{Madigan Testimony, supra note 61, at 4.}

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.\footnote{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.} 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.\footnote{Kirstin Downey, Mortgage Lender Settles Lawsuit, WASH. POST, Jan. 24, 2006, http://www.washingtonpost.com/wp-dyn/content/article/2006/01/23/AR2006012301523.html.} 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.\footnote{See, e.g., Permanent Injunction and Final Judgment at 12–35, People v. Ameriquest Mortg. Co., No. RG062660804 (Cal. Super. Ct. Mar. 21, 2006), available at http://oag.ca.gov/system/files/attachments/press_releases/06-005_0b.pdf?.} 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.\footnote{Madigan Testimony, supra note 61, at 5.}

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.\footnote{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.} In making her case, Coakley claimed that Fremont failed to assess borrowers’ ability to repay, and that this failure amounted to a UDAP violation.\footnote{Complaint ¶ 20, Commonwealth v. Fremont Inv. & Loan, No. 07-4373 (Mass. Super. Ct. Oct. 4, 2007).} 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.\footnote{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


\(^{97}\) *Fremont Inv. & Loan*, 2008 WL 517279, at *16–17.


\(^{100}\) *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. 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), although the actual value was less than this amount.

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. 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. 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. At the same time, the settlement was notable for establishing the first loan modification program in the nation—an important precedent for later settlements. 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.

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.

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101 Madigan Testimony, supra note 61, at 5–6.
104 Madigan Testimony, supra note 61, at 7.
105 Madigan Testimony, supra note 61, at 6.
AG’s discovered during the Ameriquest investigation, subprime lending practices had compromised appraiser independence. After a nine-month investigation, General Cuomo filed suit against eAppraiseIT. 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. 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. Within a few months, Fannie and Freddie agreed to buy loans only from banks that followed new standards. 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. 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.

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. 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 redlining.
redlining by mortgage lenders. The end of the Clinton Administration in 2000, the Justice Department along with other federal partners brought an action against Delta Funding Corporation. 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.

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. 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. The Federal Reserve, which implements the law, had amended its disclosure requirements to allow users to identify the race and ethnicity of

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

With one exception, 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. 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. 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.

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. 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.

Her investigation revealed that Option One charged higher points and fees to African-American and Latino borrowers, and targeted these

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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.
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.
129 See supra note 128.
same consumers with predatory mortgage products.\textsuperscript{130} Option One eventually settled with the state for $125 million, with commitments to modify affected loans.\textsuperscript{131}

Around that same time, Illinois AG Lisa Madigan opened investigations into the fair lending practices of Wells Fargo and Countrywide,\textsuperscript{132} just a few months before filing her predatory lending suit against the latter.\textsuperscript{133} The catalyst for Madigan’s probe was a December 2007 article in the \textit{Chicago Reporter},\textsuperscript{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.\textsuperscript{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 \textit{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.\textsuperscript{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.\textsuperscript{137}

As already explained, the U.S. Supreme Court issued the final word in June 2009, restoring most of the powers to the AGs.\textsuperscript{138} With the path cleared to reach a national bank,\textsuperscript{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

\begin{itemize}
\item \textsuperscript{133} See supra notes 98–108 and accompanying text.
\item \textsuperscript{134} Kimbrell Kelly, \textit{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.
\item \textsuperscript{135} \textit{An Equal Opportunity to Pay More}, CHI. REP. (July 2, 2008), http://chicagoreporter.com/equal-opportunity-pay-more.
\item \textsuperscript{138} See supra notes 126–27 and accompanying text.
\item \textsuperscript{139} Madigan testified: “In fact, the Cuomo ruling green-lighted my decision to file a fair lending lawsuit against Wells Fargo.” \textit{Madigan Testimony}, supra note 61, at 11.
\end{itemize}
otherwise qualified for prime loans (a process called “steering”), or at a cost significantly higher than similarly-situated white borrowers.\textsuperscript{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.\textsuperscript{141} A year later Madigan also filed suit against Countrywide, making similar allegations.\textsuperscript{142}

Before the parties settled, the U.S. Department of Justice joined Madigan, expanding the scope of her efforts across the nation.\textsuperscript{143} Both firms finally settled: Countrywide in late 2011 for $335 million;\textsuperscript{144} and Wells Fargo in summer 2012 for $175 million.\textsuperscript{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.\textsuperscript{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

\textsuperscript{140} Complaint, Wells Fargo & Co., \textit{supra} note 137, at 2.
\textsuperscript{145} Charlie Savage, \textit{Wells Fargo Will Settle Mortgage Bias Charges}, N.Y. TIMES, July 13, 2012, at B3; Press Release, DOJ Reaches Settlement with Wells Fargo, \textit{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), \textit{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 \S 7, Wells Fargo Bank, No. 1:12-cv-011150.
\textsuperscript{146} Savage & Schwartz, \textit{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

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149 See supra note 41 and accompanying text.
151 Id.
152 Id.
153 Id.
already distressed homeowners. 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.” 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. 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. 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.

Although federal enforcers would later play a much more active role 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.

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. In New York, Attorneys General Spitzer and later Cuomo 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.
Lastly, the Enforcers played an advocacy role at the state and federal levels. Several of the AGs championed new laws to stop predatory lenders, protect homeowners in foreclosure, and target mortgage rescue schemes. And in the years leading up to the crisis, Iowa AG Tom Miller regularly sounded the warning alarm before congressional committees.

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. In 2007 the warning signs came one after another. In February, Freddie Mac announced it would no longer purchase the most risky subprime loans. 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. By 2008 the major financial institutions were reeling. Bear Stearns, Lehman Brothers, and

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


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 ENGE & MCCOY, supra note 12, at 99–121.
172 Id.
173 FINANCIAL CRISIS INQUIRY REPORT, supra note 12, at 390–94.
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. 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. 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. New substantive rules governed mortgage lending, and Congress harnessed the forces of federalism by placing limits on agency preemption and empowering AGs to enforce federal consumer finance laws.

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, with Attorneys General Lisa Madigan, Tom Miller, and their staff playing an especially important role behind the scenes. They lobbied for limits on agency preemption, which had blocked so many of their efforts over the past decade, with Madigan making a personal appeal to the president to secure a last-minute victory. And they fought for concurrent enforcement powers to ensure consumers would always have a cop on the beat, even if the federal regulators were...


179 See generally Michael B. Mierzweski 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.


181 Id. § 1422, 124 Stat. at 2157.

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

183 See also supra note 52.


187 See KIRSCH & MAYER, supra note 185.
missing in action.\textsuperscript{188} In the midst of Senate inaction, they called for confirmation of the agency’s first Director, Rick Cordray—one of their own.\textsuperscript{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.\textsuperscript{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 \textit{Household} and \textit{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.\textsuperscript{191} The National Mortgage Settlement, valued at $25 billion, was the second largest settlement ever reached by AGs.\textsuperscript{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

\textsuperscript{188} Letter from Nat’l Ass’n of Att’ys Gen., supra note 186.
\textsuperscript{191} See infra notes 223–52 and accompanying text.
\textsuperscript{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.\(^{201}\)


\(^{194}\) 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.


\(^{196}\) 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. 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,” 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.


[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.


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. 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); Illinois AG Lisa Madigan demanding a meeting with Ally officials; and Iowa AG Tom Miller launching a civil investigation. But Ally was just the beginning. Nine days later, JPMorgan announced it was halting more than 56,000 foreclosures for the same reasons. Bank of America soon followed. 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. But the scope of their authority to address these harms was uncertain. 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. 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. Fairly quickly, the major banks

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208 Streitfeld, supra note 207.
211 Press Release, Iowa Dep’t of Justice, Office of the Att’y Gen., Miller Launches Ally/GMAC Foreclosure Probe (Sept. 24, 2010).
214 Telephone Interview with Patrick Madigan, supra note 176.
215 Id.
217 See Telephone Interview with Patrick Madigan, supra note 176.
would engage and join the states at the negotiating table.\textsuperscript{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.\textsuperscript{219} A fifty-state action has precedent, but is nonetheless rare. And yet the coalition formed with ease.\textsuperscript{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,\textsuperscript{221} and California, Illinois, and New York joined the Executive Committee, among other leading states.\textsuperscript{222}

Later in October, word leaked that the federal government was also launching a probe.\textsuperscript{223} By then a few of the leading states and federal officials were in conversations about working together.\textsuperscript{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.\textsuperscript{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 multistate action into a multigovernment action. The partnership broke new ground. The states and the feds had worked together in the past on antitrust litigation.\textsuperscript{226} Moreover, the more-independent FTC and the states had a history of coordinating in cases such as FAMCO.\textsuperscript{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

\textsuperscript{218} See id.
\textsuperscript{220} See Telephone Interview with Patrick Madigan, supra note 176.
\textsuperscript{222} Press Release, supra note 219.
\textsuperscript{224} See Telephone Interview with Patrick Madigan, supra note 176.
\textsuperscript{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.).
\textsuperscript{226} See infra note 370.
\textsuperscript{227} See supra notes 53–70 and accompanying text.
Financial Protection Bureau, the Treasury Department, the banking regulators, and others. 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.” 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. On the details, however, the principals did not all agree. Federal banking regulators, as well as some states, were opposed to principal reductions. 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.” Moreover, the states also disagreed about how to structure a loan modification program and the size of civil penalties. And a few states that claimed the deal was not tough enough walked away or threatened to walk away, although they eventually returned.

In what some critics saw as an attempt to undermine the state-federal investigation and give the banks political cover, the banking regulators announced in April 2011 that they had reached consent agreements with the fourteen largest servicers. 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

228 See Telephone Interview with Patrick Madigan, supra note 176.
230 See supra note 196 and accompanying text.
233 Brady & ElBoghdady, supra note 229; Streitfeld, supra note 232.
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").
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.\footnote{237}{Dina ElBoghdady, \textit{A Deal on Foreclosure Practices}, \textit{WASH. POST}, Apr. 14, 2011, at A14; Streitfeld, \textit{supra} note 235.}

Moreover, the agreements raised questions about enforcement and whether the regulators were leaving the banks to police themselves.\footnote{238}{Streitfeld, \textit{supra} note 236.}


The settlement was wide-ranging and included new mortgage servicing standards.\footnote{240}{For the primary documents, see \textit{JOINT ST.-FED. NAT’L MORTGAGE SERVICING SETTLEMENTS}, \url{http://www.nationalmortgagesettlement.com} (last visited Apr. 26, 2015). For a detailed overview of the terms, see Robert E. Bostrom et al., \textit{Final Agreement Filed in Attorneys General $25 Billion Settlement with Servicers}, 66 \textit{CONSUMER FIN. L. Q. REP.} 130 (2012).}

Among other standards, banks could foreclose only after reviewing loss mitigation options, and had to follow clear procedures.\footnote{241}{Press Release, $25 Billion Agreement, \textit{supra} note 239.}

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.\footnote{242}{See Bostrom et al., \textit{supra} note 240, at 131.}

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.\footnote{243}{Press Release, $25 Billion Agreement, \textit{supra} note 239.}

The agreement also came with compliance provisions.\footnote{244}{For an overview, see Bostrom et al., \textit{supra} note 240, at 132–33.}


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.\footnote{246}{Press Release, $25 Billion Agreement, \textit{supra} note 239.} Moreover, as mentioned, the agreement did not grant broad immunity to the banks. The law enforcement parties were
still free to pursue criminal actions related to mortgage servicing, civil or criminal suits related to securitization, and individual borrowers could still file claims.\textsuperscript{247}

The agreement was not without its weaknesses. Most glaring, mortgages owned by Fannie Mae and Freddie Mac were not covered.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.”\textsuperscript{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.”\textsuperscript{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.\textsuperscript{253} Starting in late 2007,\textsuperscript{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.

\textsuperscript{247} Id.
\textsuperscript{250} Bostrom et al., supra note 240, at 131.
\textsuperscript{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.
\textsuperscript{252} Brady & Horwitz, supra note 249.
\textsuperscript{253} See supra notes 44–45 and accompanying text.
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 RMBS. From 2009 through 2013, Coakley settled claims against many of the largest institutions: Goldman Sachs ($60 million); Morgan Stanley ($102 million); Royal Bank of Scotland ($52 million); Barclays ($36 million); J.P. Morgan ($34 million); and Countrywide Securities ($17 million).

Coakley’s case against Morgan Stanley is representative. 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...

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.
262 See supra note 257.
backed by the pool, knowing the securities did not meet its underwriting standards and otherwise violated state law.\textsuperscript{263} Coakley alleged that the investment bank’s actions harmed homeowners, investors, and the state through its two pension funds.\textsuperscript{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.\textsuperscript{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,\textsuperscript{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.\textsuperscript{267} The President appointed New York Attorney General Eric Schneiderman as one of the co-chairs.\textsuperscript{268}

From a resource perspective the state-federal partnership was promising.\textsuperscript{269} Schneiderman had fifteen attorneys focused on the issue in his office.\textsuperscript{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.\textsuperscript{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,\textsuperscript{272} granting broad subpoena powers and—unlike federal securities law—allowing the AG to establish fraud

\textsuperscript{263} Press Release, \textit{supra} note 257.
\textsuperscript{264} \textit{Id.}
\textsuperscript{265} \textit{Id.}
\textsuperscript{266} Barack Obama, President of the U.S., Remarks by the President in State of the Union Address (Jan. 24, 2012), \textit{available at} http://www.whitehouse.gov/the-press-office/2012/01/24/remarks-president-state-union-address.
\textsuperscript{271} Press Release, \textit{supra} note 267.
\textsuperscript{272} N.Y. GEN. BUS. LAW §§ 352–359h (Consol. 2014).
without a showing of intent. 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.

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. The firm misled investors, the suit claimed, about the quality of the underlying loans. The charges were for actions committed by Bear Stearns, which JPMorgan absorbed in 2008. A year later JPMorgan settled for $13 billion. The settlement was unique in that it included an express admission of wrongdoing by JPMorgan. In the wake of this action, the enforcement team later reached settlements with Bank of America and Citigroup 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


277 See supra note 276.


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. 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. 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. 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. Although the settlements marked significant reforms, critics raised concerns. 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. Illinois followed in January 2012 with a suit against S&P in state court. 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

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.
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. AG Holder was flanked by his counterparts from California, Illinois, Iowa, and elsewhere for the announcement. 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. 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). Following the lead of Connecticut and Illinois, the state cases argued that S&P’s actions violated the various state consumer protection laws.

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

289 See Press Release, supra note 45.
290 Sorkin & Williams, supra note 288.
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 depositaries, 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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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, 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. 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; discriminatory lending; mortgage fraud; mortgage rescue fraud; abuses in servicing and foreclosure; fraud in the creation, packaging, and sale of RMBS; and fraud by the credit rating agencies.

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

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.
Truth in Lending Act,\textsuperscript{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.\textsuperscript{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.\textsuperscript{313} An exception that will become more important over time is CFPB and its power to enforce the new UDAAP-ban.\textsuperscript{314} Although FTC has always had the UDAP power in Section 5, resource and scope-of-authority limitations restricted the agency’s influence.\textsuperscript{315} CFPB is less confined and has the broader UDAAP prohibition, which also bans “abusive” acts and practices.\textsuperscript{316} But the agency also has resource limits and in some areas the states have jurisdiction that the new federal regulator lacks.\textsuperscript{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.\textsuperscript{318}

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.


\textsuperscript{312} See Pridgen, supra note 310, at 417–20.

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


\textsuperscript{315} See Williams & Bylsma, supra note 48, at 1243–49.

\textsuperscript{316} See Totten, supra note 52, at 131–36.

\textsuperscript{317} Id. at 171 n.361 and accompanying text.

\textsuperscript{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,\textsuperscript{319} which offered three advantages.\textsuperscript{320} The first advantage we have already explored: an ability to reach the substantive terms of the products and services they investigated.\textsuperscript{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.\textsuperscript{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.\textsuperscript{323}

And third, the Enforcers had a menu of remedial options under their UDAP laws.\textsuperscript{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,\textsuperscript{325} but even where the law is silent most AGs have standing under the common law doctrine of \textit{parens patriae}.\textsuperscript{326} In some ways such cases are the


\textsuperscript{321} See supra notes 302–17 and accompanying text.

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


\textsuperscript{325} CARTER & SHELDON, supra note 319.

\textsuperscript{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. 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. While AGs may have political incentives to seek large monetary payouts, here they demonstrated a commitment to crafting measurable assistance for affected 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. Although this remedy later became a feature of the states’ efforts, at the time it was uncommon. 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. 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.

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—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

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. 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. 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. Those same forces may bear less influence against at least some AG offices. 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. 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.

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. 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. 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. Most important,

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.

345 See supra notes 266–79 and accompanying text.
346 See supra notes 286–87 and accompanying text.
348 See Provost, supra note 342.
349 See Bostrom et al., supra note 240, at 133.
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 multistate 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. And limited state-federal partnerships have existed in the related field of antitrust enforcement for several decades. But the coalition on the servicing case was unprecedented for the breadth of its scope: all fifty states and multiple federal agencies.

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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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.\textsuperscript{356} These fears are well founded and the costs potentially high.\textsuperscript{357} Nonetheless, context matters and nearly all accounts fail to seriously consider crisis situations such as what the states encountered this past decade.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{363} More important, the presence of

\begin{thebibliography}{99}
\bibitem{357} See infra notes 359–61 and accompanying text.
\bibitem{358} See, e.g., Morriss et al., supra note 356, at 170–71.
\bibitem{359} See id.; Regulation Through Litigation, supra note 356, at 3; Meyer, supra note 356, at 909–14.
\bibitem{360} See Regulation Through Litigation, supra note 356, at 2, 10; Gifford, supra note 356, at 920.
\bibitem{361} See Meyer, supra note 356, at 912.
\bibitem{362} See supra notes 111–16 and accompanying text.
\end{thebibliography}
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, \textit{supra} note 239.

\(^{365}\) See \textit{supra} notes 235–38.

\(^{366}\) See, e.g., Brady & ElBoghdady, \textit{supra} note 229.

\(^{367}\) See \textit{supra} note 350.

\(^{368}\) See \textit{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 \textit{Morriss et al.}, \textit{supra} note 356, at 172–73.

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


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.