The morning panel of the conference consisted of Tom Perrelli, former U.S. Associate Attorney; Lisa Madigan, Illinois Attorney General; Damon Smith, Special Counsel, U.S. Department of Housing and Urban Development; and Patrick Madigan, Assistant Iowa Attorney General. Each panelist had a different perspective, and had different authorities and responsibilities in regards to the settlement. These differences led to an all-encompassing, behind the scenes narrative of the government response to the housing crisis and the process that eventually led to the settlement. This inside look, shed light on what was described as an unprecedented and unique collaboration of state and federal decision makers.

The backstory to the settlement starts all in 1998, not 2007, when the housing industry started to get national media attention. In 1998, Illinois along with Minnesota and Massachusetts, sued First Alliance Mortgage Company because of deceptive mortgage lending practices, most notably their sale of 2 year adjustable rate mortgages. Four years later Attorney General Madigan started noticing a pattern of consumer fraud complaints regarding mortgage terms. Most of the complaints were about confusing mortgage terms and unaffordable payments. Patrick Madigan noticed a similar trend in Iowa, noting the Attorneys General were the first contact for mortgage issues over the years, and they were aware of problem at least 12 years ago.

After becoming aware of the issue, the states went to the federal government for help. Even though Attorneys General act as the country’s consumer law enforcers they still needed the federal government’s power to implement underwriting standards, especially for the banks which were involved in the mortgage lending market on a national level. According to the Attorneys General these requests fell on deaf ears and in some cases federal law preempted the states from dealing with the situation on their own accord.

The first signs of cooperation on a national level came in 2007. During the fall of that year, P. Madigan noticed a change in the consumer complaints about their mortgages. Instead of complaints about the process of originating the loans, consumers were being taken advantage while the loans were serviced. The most notable violation was the implementation of robo signing.

This new development motivated the AG’s to embark on a cohesive action plan. In July of 2007, all the AG’s were invited to Chicago to attend a conference created to discuss the prediction of an impending housing crisis. The result was the State Foreclosure Prevention Group (SFPG). The SFPG urged subprime mortgagors to modify loans, to which they tentatively agreed to do, but never actually acted on. This is was a sign that states needed the leverage that could only be obtained by the power of the federal government. Nonetheless, there was still no collaboration with the federal government at that point.

As far as the federal government was concerned, the states did not have consumer protection jurisdiction and could not see the effects on consumers the same way states could. This was before the Dodd-Frank legislation was passed and the CFPB was created. They were getting a small glimpse of the problem in federal bankruptcy courts, because the forms provided to the courts included home loan documents displaying the terms of the loans. The tipping point
for the federal government to join the fight against harmful mortgage lending practices came in 2009.

After the crisis began, HUD set up the TARP and HAMP programs to set a framework for mortgage modifications to keep people in their homes. Many of these loans were insured by the federal government through the FHA. The insurance deals had provisions that required loss mitigation on behalf of the banks, so if a home was foreclosed the burden forced on the government would be less. The loss mitigation tools consisted of letting borrowers make partial payments or conducting short sales among others. The vast number of foreclosures and the large balances left on the loans motivated the FHA to launch a massive investigation to check if lenders were performing the required loss mitigation practices.

The investigation uncovered massive noncompliance by the banks as well as led to the discovery of robo signing practices by the federal government. Later in 2009, a conference was held bringing together government agencies, public safety and law enforcement groups, AG’s and state bank regulators to figure out a solution to the problem and to build relationships that ended being integral to the settlement. This meeting between AG’s, state agencies and numerous federal agencies set a new precedent in the world of state-federal enforcement collaboration.

All sides involved saw this evolution as necessary considering the complexity of the problem. A solution resulting in 50 different policies would not have worked for any of the parties involved, including the banks. This realization motivated the banks to be willing partners in the negotiation, as well. Their willingness to cooperate was the final piece to complete the multi-layered negotiation.

The government coalition made a conscious decision to go after the top 5 mortgage servicers which claimed about 60% of all home loans in the country. After close to a year of investigations by the HUD inspector general, the bankruptcy trustees and state bank regulators, the sides began to negotiate a deal that would incorporate aspects of remedial compensation and future guidelines to home loan servicing. The cooperation during the investigation stage was another display of the strengthening relationship between the different levels of government. The investigation was aided immensely by the states familiarity with the issues and the previous work they had done relating to the SFPG. In all the investigation and negotiation of the settlement took a little over a year. The state and federal government realized the time pressure they were under. The longer it took for a deal to be done, the more people would likely lose their homes.

The negotiation period tested the new coalition’s cooperation and trust on a new level. The federal government played the role of communicator between the states and the lenders and any other group that had an interest in the settlement. The coordination that was needed to satisfy all the states interests enough to get them to formally agree to the settlement was another unprecedented and unique element of the new alliance.

The organization of the states was another feat in itself. They got AG’s from both parties to come together and work for a common goal. Each one felt the need to help their constituents and everyone involved realized that no matter what their political views were, in this instance all of their constituents needed the same things. A bipartisan committee was formed consisting of eight senior assistant AG’s. The members of the committees worked the phones for 16 months to coordinate the interests of all the states and keep everyone up to date on the negotiations.

By the end of the negotiation a relationship was built between the individual states themselves and between the states with the federal agencies. The settlement itself had aspects that all parties felt were important, such as the credit program which gives lenders monetary
incentives to take actions which aide consumers in some fashion like implementing fair modifications terms, enacting principal reductions, eliminating personal deficiencies and performing short sales when appropriate. The panel was very optimistic not just about the settlement itself, but the relationships built between the levels of government and the newly formed template that can be used to solve future national scale problems; hopefully, in a more preventative fashion.

There was also a sense of realism poking through that optimism. Everyone on the panel agreed that they are on the right track, but there is still much work to be done to fix the problem. After, relaying this narrative to the crowd, this realism was tested by questions from the audience.

The questions included concerns about the lack of criminal indictments and programs in place to help displaced veterans. The panel acknowledged that no solution is perfect, but what was done has and will continue having a very positive impact citing an estimated $45 billion in homeowner benefit as a result of the settlement so far. More information on the substance of the settlement can be found at nationalmortgagesettlement.com and mortgageoversight.com.