



PREVENTING ANOTHER  
ECONOMIC COLLAPSE:  
THE NEED FOR ENHANCED FINANCIAL REFORM

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MARTHA COAKLEY, ATTORNEY GENERAL  
DEMOCRATIC CANDIDATE FOR U.S. SENATE

# ECONOMIC CRISIS

The economic crisis exposed critical gaps and weaknesses in our financial regulatory system. Inadequate government oversight and regulation combined with a lack of corporate accountability were two key ingredients in a recipe for economic disaster. Our financial institutions took advantage of the American dream of homeownership, seeing only opportunities for fast growth and disregarding risks. Further compounding the problem, the financial system failed to perform its function as a reducer and distributor of risk. These failures resulted in a devastating loss of confidence in our financial institutions and have contributed to the worst economic climate in a generation.

As a result of this economic recession, people have lost their homes, their jobs, and their retirement - and those who have not are worried that they may be next. These struggles are a daily reminder that, as we move toward getting our economy back on track, we must put in place the necessary and appropriate protections to prevent another crisis. We need more than just temporary fixes to address these failures and establish the necessary protections. We need real, comprehensive reforms.

This summer, the Obama administration presented a plan to modernize financial regulation and oversight. The goal of this plan is to create a more stable regulatory framework that is flexible but also effective, rebuilding consumers' and investors' confidence in our financial system.

I firmly believe that we cannot afford to wait to take action on these problems--the time for reform is now. Real economic recovery is dependent on our ability to regain the public's confidence in the markets. I am very proud of my office's work to address the subprime crisis and its impact on the economy as a whole here in Massachusetts, and in Washington, I will continue to protect consumers at the federal level.

# LEADERSHIP AS ATTORNEY GENERAL

## THE FIRST SIGNS OF TROUBLE

When I first took office as Attorney General nearly three years ago, the foreclosure rate was skyrocketing at an alarming rate, and my office was inundated with complaints about a new type of scam that had cropped up as a result. The widespread emergence of what we now refer to as foreclosure rescue scams – whereby a purported “rescuer” claiming to help a struggling homeowner takes the deed for a property and strips away the equity – was the first sign of trouble for those of us on the ground level of consumer protection work. My office’s response to this new breed of fraud was three-fold.

First, we brought several cases against fraudulent rescue schemes in Massachusetts and attempted to stop it early on in the foreclosure crisis. In June 2008, I reached a settlement with Alec Sohmer/Timeless Funding Foreclosure worth \$1.8 million in mortgage write-downs with ten lenders and servicers that funded 26 fraudulent foreclosure-rescue transactions. I also brought suit against mortgage broker Leo Desire and 17 other defendants for perpetrating a number of fraudulent foreclosure rescue transactions.

Second, realizing that lawsuits were a mere stop-gap, we took quick and decisive action by issuing an emergency regulation banning the schemes altogether in June 2007.

And third, we asked ourselves, why was it that so many homeowners were finding themselves in this situation? Why were there such an overwhelming number of foreclosures? And what role did the brokers and the lenders play?

## TACKLING UNFAIR AND DECEPTIVE LENDING PRACTICES

As we delved into the situation in an attempt to answer these questions, we were deeply troubled with what we found. Local mortgage brokers were engaging in fraudulent activity in order to help unqualified borrowers obtain subprime loans. And large lending institutions were turning a

blind eye; their lending practices were devoid of any meaningful underwriting or consideration of borrowers' ability to meet the obligations of the mortgages they were being offered.

Again, we took a comprehensive approach to addressing the problems we uncovered. First, we took on some of the nation's largest subprime lenders, Fremont Investment & Loan/Fremont General and H&R Block/Option One Mortgage Corporation, filing lawsuits against both and obtaining groundbreaking injunctions that not only restricted those lenders' ability to foreclose on unfair loans, but in fact found that those loans were presumptively unfair.

We also took action to ensure that in Massachusetts, we have the regulatory structure in place to prevent ongoing unfair and deceptive lending practices. In January 2008, I promulgated a more extensive set of regulations governing mortgage broker and lender behavior. Under these new rules, lenders and brokers must consider a borrower's ability to repay a loan, and must base lending decisions on proper documentation and financial information. The regulations made it illegal for a mortgage professional to charge a client an up-front fee for assistance with a loan modification.

## HOLDING WALL STREET ACCOUNTABLE

As our work continued, I made it a priority to seek accountability at all levels of the subprime lending crisis. This included investigating the role of investment banks in the origination and securitization of subprime loans in Massachusetts. As a result of our investigation, we reached a first-in-the-nation agreement with Goldman Sachs whereby the Wall Street giant that provided the capital to subprime lenders like Fremont and New Century agreed to provide loan restructuring valued at approximately \$50 million to Massachusetts subprime borrowers. The loan restructuring program was designed to enable borrowers to replace problem loans with new, more affordable loans that take into account the current value of their properties. Goldman also agreed to make a \$10 million payment to the Commonwealth.

We also began to see the broader impact that the securitization of subprime mortgages was having on investors, including our already cash-strapped cities and towns, as well as other government agencies. Many local governments were misled by investment banks into investing

in risky mortgage-backed Auction Rate Securities. Using the False Claims Act, my office was able to recover \$77 million for municipalities across the Commonwealth from UBS, Morgan Stanley, Citibank, and Merrill Lynch.

## MANDATING COMMERCIALLY REASONABLE LOAN MODIFICATIONS

Since the outset of this crisis, it has been clear to me and many others who have worked closely on these issues, that reasonable loan modifications are critical to reducing the number of foreclosures. I have advocated for restructuring distressed mortgages, not only to keep struggling borrowers in their homes, but also as a way to insert a floor beneath plummeting property values. In order to stem community and borrower harm, lenders should be required to undertake loan modifications when the value of the modified loan exceeds the anticipated losses at foreclosure. Despite my best efforts over the last two years to urge lenders and servicers to offer loan modifications, reasonable loan modifications are still not occurring in Massachusetts on the scale needed to prevent further harm to our communities and families. While community-based banks have made an effort to restructure the comparably smaller number of delinquent loans they service, national lenders who hold a much more significant portion of the loans in distress in the Commonwealth have resisted reasonable loan modification programs on a large-scale basis.

Once it became clear that lenders were not voluntarily achieving loan modifications, I filed state legislation along with a coalition of legislators seeking to require such modifications when commercially reasonable. The bill, *An Act to Require Commercially Reasonable Efforts to Avoid Foreclosure*, is a significant step in setting a new policy for avoiding foreclosures and stabilizing the housing market in Massachusetts. The bill, requiring commercially reasonable efforts to avoid foreclosures, follows up on the promises made to my office by the national industry, and serves to help our neighborhoods survive these hard economic times. I believe this bill will have a significant impact on minimizing the ongoing foreclosure crisis and I am committed to working with the Legislature over the coming months to get this bill passed.

## ADDRESSING LOAN MODIFICATION SCHEMES

As pressure for loan modifications has mounted, we have seen yet another new breed of scam artists who take advantage of struggling homeowners by charging them illegal up-front fees to assist them in obtaining a loan modification. In fact, the new consumer protection regulations we enacted in January 2008 make it explicitly illegal to charge such fees. We have undertaken significant public awareness efforts to educate consumers about this scam, while also taking action against the perpetrators.

Under our regulations, in early 2009, I obtained a consent judgment requiring “Loan Mods by Lawyers” to pay \$7,300 in restitution and \$25,000 in civil penalties, for demanding advance fees from homeowners for help obtaining loan modifications, in violation of the regulations my office put in place in 2007. We have also brought additional lawsuits and obtained injunctions against several other similar schemes.

## CONSUMER PROTECTIONS AGAINST CREDIT CARD FEE GOUGING

As a result of the economic downturn, many Americans find themselves immersed in credit card debt. It is critical that we rein in unfair actions by national banks before we can hope to regain consumer confidence and get the economy working again. Abusive credit practices and unfair fee gouging by the national banks that issue credit cards must be addressed.

As Attorney General, I advocated for federal legislation increasing consumer protections in credit card agreements. In March 2008, at an event alongside Congressman Barney Frank, I urged Congress to adopt protections such as: (1) requiring 45 days notice for credit card companies to change account terms such as increasing interest rates; (2) preventing credit card companies from retroactively increasing the interest rates on the existing balance of a card holder in good standing; and (3) prohibiting double-cycle billing where interest is charged on debt that is paid on time during the grace period. In May 2009, Congress enacted the *Credit Card Accountability, Responsibility and Disclosure Act of 2009*, which adopted many of these requirements. I was proud to be a leader on this issue and to be invited by the White House to attend the signing of the legislation.

## REAL RESULTS FOR MASSACHUSETTS

As a result of our multi-faceted approach to tackling the foreclosure crisis, my office has obtained relief and protection for more than 12,600 Massachusetts homeowners. Behind each of those numbers is a human story – a family whose share of the American dream was jeopardized by reckless and irresponsible behavior by unscrupulous brokers, lenders, and investment firms. Each foreclosure has ripple effects through a neighborhood and community, leaving in its wake vacant properties, increased crime, and lower property values and local tax revenue. My office's results highlight the important role that state officials play in regulating and responding to such conduct.

## IN WASHINGTON

As a result of my experience as Attorney General, I know that any regulatory reforms undertaken at the federal level must take into account the role states play in this process, and allow states to enforce laws and regulations free from federal preemption. I will continue to fight against preemption of state enforcement because I strongly believe that state regulators and Attorneys General must have the ability to combat unfair and deceptive acts by national banks. In addition, I will support proposed enhanced financial regulatory reforms, including:

- Focusing on the safety and soundness of the market as a whole, not simply individual entities, by requiring institutions to maintain sufficient capital to keep them safe in times of system-wide stress.
- Fighting for stricter regulations for securitization by imposing robust reporting requirements on the issuers of asset-backed securities, reducing investors' and regulators' reliance on credit-rating agencies, and requiring the originator of a securitization to retain a financial interest in its performance.

- Supporting the creation of the new Federal Consumer Protection Agency which will focus on providing support to consumers while allowing the states to work with the Federal Government to prevent unfair and deceptive tactics by banks and credit card companies.
- Providing the federal government with the necessary tools to contain and manage a future financial crisis by allowing Treasury to appoint the FDIC or Securities and Exchange Commission as a receiver for any large financial holding company that poses a threat to financial stability; and
- Opposing federal preemption of state regulation that would restrict states' abilities to prevent and remedy misconduct by financial institutions.

In Washington, I will make it a priority to work toward developing and implementing tough, effective regulatory reforms in order to prevent another economic failure and to give the government the necessary tools to protect the market in the future. Part of this process includes working with the business and financial community as well as other stakeholders, and to listen to their concerns and to formulate the most effective reforms possible. On October 9, 2009, I was invited to the White House to speak with President Obama about the importance of financial regulatory reforms, particularly in the wake of this economic crisis. I was part of this discussion because of my strong record and experience in taking on these tough problems and getting real results for Massachusetts families. As Senator, I will support efforts to enhance financial regulatory reforms and I will work to ensure that the government is no longer forced to choose between bailouts and a financial collapse. I will also work to increase corporate accountability and to prevent companies like AIG, that were bailed out using taxpayer money, from giving million dollar executive bonuses.

When I go to Washington, I will continue to advocate that Congress mandate commercially-reasonable loan modifications. Over the past two years, as I have brought enforcement actions against subprime lenders, as part of the settlement process I have required meaningful loan

modifications with those companies.<sup>1</sup> This is because from day one of my work on the subprime lending crisis, it has been clear that large-scale loan modifications are the only real way to combat the destruction that this crisis is bringing to our communities.

Modifications of monthly loan payments to a sustainable, affordable level make economic sense for all parties involved, lenders and borrowers alike. Loan modifications allow the lender or investor a continuing, though decreased, income stream, the value of which exceeds the expected losses suffered at foreclosure. Data provided to Congress in July 2009 shows that each foreclosure averaged losses of \$144,000, in contrast to the most costly loan modifications that averaged losses of \$14,000. That same data showed that for the month of June 2009 investors lost a total of approximately \$4.6 billion on foreclosures and \$45 million on loan modifications.<sup>2</sup>

Beyond the benefits to investors, affordable loan modifications make sense for all Massachusetts citizens. Allowing families to stay in their homes makes our communities more stable. Local governments do not lose tax revenues and spend less safeguarding neighborhoods that fall victim to clusters of foreclosures. According to a report issued by Congress over two years ago, the average cost of a foreclosure for a local government is \$19,000, and the impact on neighboring home values is \$1,500.<sup>3</sup> Those numbers have surely increased since that time, only further supporting the need for the reasonable loan modifications. In Washington, I will continue to advocate for loan modification mandates at the federal level because they make good business sense and good common sense.

Because of the unique role I play as Attorney General, I have the benefit of on-the-ground experience tackling these problems. I have addressed each layer of the crisis – from the local street-level brokers, to the large lending institutions, to the Wall Street investment banks –

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<sup>1</sup> Attorney General's Office was able to obtain agreements with current servicers, such as Litton Loan Servicing, LLP, Carrington Mortgage Servicing and American Home Mortgage that require commercially reasonable loan modifications.

<sup>2</sup> Most costly loan modifications refer to loan modifications with write-offs (as opposed to loan modifications with no write-offs). Testimony of Alan White, Valparaiso University School of Law, Before the House Subcommittee on Commercial and Administrative Law, Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? (July 9, 2009), available at: <http://judiciary.house.gov/hearings/pdf/White090709.pdf>. The underlying June 2009 data is available at: <http://www.valpo.edu/law/faculty/awhite/data/index.php>.

<sup>3</sup> Special Report by the Joint Economic Committee of the U.S. Congress, *Sheltering Neighborhoods from the Subprime Foreclosure Storm*, April 11, 2007.

seeking accountability from all those who had a hand in this crisis. I have a deep understanding of the underlying problems that led to this meltdown, as well as a true appreciation for the impact on the lives of the average families and individuals whom we have fought to protect. My work on these issues has afforded me with a clear vision of the type of oversight we so direly need – regulations that protect consumers and our economy while also being fair and balanced and allowing economic growth. As a Senator, I am prepared to use this perspective and experience to continue to fight for all Americans, to make sure that we learn from our mistakes, and to get our economy back on track.