

Pawns for a Higher Greed: The Banking and Financial Services Industry's Capture of Federal Homeownership Policy and the Impact on Citizen Homeowners

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**PAWNS FOR A HIGHER GREED: THE BANKING AND
FINANCIAL SERVICES INDUSTRY’S CAPTURE OF
FEDERAL HOMEOWNERSHIP POLICY AND THE IMPACT
ON CITIZEN HOMEOWNERS¹**

Tracie R. Porter²

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¹ A “pawn” is defined as: to take a pledge or risk (as a verb); or a person serving as security or hostage (as a noun); or one of eight men of one color and of the *lowest value*, usually moved one square at a time vertically and capturing diagonally (in Chess); or *someone who is used or manipulated to further another person’s purposes*. WEBSTER’S NEW COLLEGE DICTIONARY 827 (3rd ed. 2008) (emphasis added). It is the latter of these definitions that the author focuses on in reference to the banking industry’s use of borrowers to further the industry’s profit interests.

² © 2013, Tracie R. Porter. Associate Professor of Law, Western State University College of Law. B.A. 1990, Cornell College; J.D. 1994, Drake University School of Law. A special thank you to Professors andré douglas pond cummings, Victoria Duke, Neil Gotanda, Cheyanna Jaffke, Kristin Johnson, Susan Keller, Charles Sheppard, and Edith Warkentine for their valuable comments on earlier drafts. I am grateful for the faithful support of my friends Tracie M. Gibson, Ph.D., and Michele L. Mekel, Esq. Many thanks to my outstanding research assistants Yihe Yang, Scott Feig, Stephen Hendricks, and Librarian Lei Zhang.

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“BEWARE . . . we exist *close to a state of war* of every man against every man and where *life in the housing market* can often be ‘solitary, poore, nasty, brutish, and short.’”³

I. INTRODUCTION

The banking and financial services industry’s use of its political power and money, in pursuit of maximizing profits, reshaped the fundamentals of American homeownership policy.⁴ It was through this pursuit that the commercial banking and Wall Street financial services institutions (BFSI)⁵ usurped the government’s powerful functions over

³ See David J. Reiss, *Message in a Mortgage: What Dodd-Frank’s “Qualified Mortgage” Tells Us About Ourselves*, 31 REV. BANKING & FIN. L. 717, 721 (2012) [hereinafter Reiss, *Message in a Mortgage*] (emphasis added) (citing THOMAS HOBBS, LEVIATHAN 57 (J.C.A. Gaskin ed., Oxford World’s Classics 2011) (1651)), available at <http://ssrn.com/abstract=2018940> (explaining that borrowers and lenders are in a constant state of competition so if a large entity secures an advantage over an individual in the market, then the entity will take advantage of that opportunity to win or make money).

⁴ To avoid confusion in the references, federal housing policy may also include policies related to rent control, affordable housing, and ownership in general. The author’s reference to federal homeownership policy specifically refers to homeownership through programs used to promote mortgage lending and credit markets. See David J. Reiss, *Three Principles for Federal Housing Policy*, 26 PROB. & PROP. 40, 42 (2012) [hereinafter Reiss, *Three Principles for Housing Policy*].

⁵ Throughout this article, the phrase “banking and financial service industry” and the acronym “BFSI” are used interchangeably to mean the commercial banks and Wall Street financial investment firms that benefited from government bailout funds in 2007, as discussed later in the article. Under the federal banking system, the banking and financial services (or non-banking) industry encompasses commercial banks, thrifts (or money market mutual funds), brokers, investment banks, and insurance companies, as a single entity for the purposes of this article. See E. GERALD CORRIGAN, FED. RES. BANK OF MINNEAPOLIS, ARE BANKS SPECIAL?, 1982 ANNUAL REPORT (1982), available at <http://www.minneapolisfed.org/pubs/ar/ar1982a.cfm>. Corrigan notes that there are three characteristics that distinguish banks from all other non-banking institutions: (1) offering of transaction accounts; (2) serving

regulation, oversight, and standard-setting regarding homeownership policymaking.⁶ Although the government intended these functions to create a transparent marketplace to benefit both private and public participants,⁷ the BFSI relied on its corporate power and wealth⁸ to influence such government functions, which ultimately affected the evolution of homeownership policymaking in several ways. First, the BFSI captured the federal regulatory framework that allows it to operate in a neoclassical economic fashion without any checks and balances on its self-regulatory standards.⁹ Second, the BFSI used its wealth to manipulate laws that were intended to create checks and balances on the industry to avoid economic catastrophe, especially given past economic crises.¹⁰ Third, the BFSI influenced the federal policymakers through lobbying efforts to such a substantial extent

as a backup source of liquidity for all other institutions; and (3) playing a key role in monetary policy. *Id.* at 2.

⁶ Michael S. Carliner, *Development of Federal Homeownership Policy*, 9 HOUSING POL'Y DEBATE 299, 318 (Fannie Mae Foundation 1998), available at <http://www.michaelcarliner.com/HPD98-OwnershipPolicy.pdf>. Carliner set forth three mechanisms used to exercise federal government policy toward homeownership: (1) tax benefits; (2) regulation of and participation in the financial system; and (3) direct subsidies to producers and consumers. *Id.* at 300; see generally J. Michael Collins, *Towards a Strategic Federal Policy Promoting Homeownership*, FED. HOMEOWNERSHIP POL'Y 2 (2004), available at <http://www.policylabconsulting.com/documents/UNC%20HO%20Policy.pdf>. This article focuses on the second mechanism: regulation.

⁷ See Collins, *supra* note 6, at 2; see also Carliner, *supra* note 6, at 318 (stating most programs promoting homeownership have been created for some other purpose).

⁸ See generally STEVEN A. RAMIREZ, *LAWLESS CAPITALISM: THE SUBPRIME CRISIS AND THE CASE FOR AN ECONOMIC RULE OF LAW* 37 (2012) [hereinafter RAMIREZ, *LAWLESS CAPITALISM*].

⁹ See Charles J. Abrams, *Fannie and Freddie Flipped: A Backward Induction Analysis of the GSEs' Meltdown*, 3 WM. & MARY POL'Y REV. 157, 163 (2011) (stating that due to these lobbying efforts and the government guarantee, Fannie and Freddie were permitted to hold highly leveraged balance sheets); see generally FIN. CRISIS INQUIRY COMM'N, FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 495 (2011) [hereinafter FCIC], available at <http://www.gpoaccess.gov/fcic/fcic.pdf>; Edward Pinto, *Acorn and the Housing Bubble*, WALL ST. J., Nov. 12, 2009, <http://online.wsj.com/news/articles/SB10001424052748703298004574459763052141456>; *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010) (finding that the speakers, such as industry lobbyists, have influence over—or access to—elected officials). The court in *Citizens United* stated:

Favoritism and influence are not . . . avoidable in representative politics. It is in the nature of an elected representative to favor certain policies, and, by necessary corollary, to favor the voters and contributors who support those policies. It is well understood that a substantial and legitimate reason, if not the only reason, to cast a vote for, or to make a contribution to, one candidate over another is that the candidate will respond by producing those political outcomes the supporter favors. Democracy is premised on responsiveness.

Id. at 359 (citing *McConnell v. Fed. Election Comm'n*, 540 U.S. 93, 297 (2010) (Kennedy, J., concurring)).

¹⁰ For example, during various economic crises, presidents have implemented legislation to address the problem. See Carliner, *supra* note 6, at 309–10.

that the federal housing policy has been reshaped to meet the industry's needs, rather than adequately protecting national economic or consumer interests. The BFSI's motivation for capturing and molding homeownership policy is profit maximization, at any expense.

This article analyzes how the commercial banking and Wall Street financial services industry disregarded regulatory policies directed at safety and soundness, and used its wealth and power to manipulate consumers, politicians, regulatory agencies, rating agencies, and even a few of its own members,¹¹ as pawns to serve its insatiable greed. Because of the increasing interconnectedness within the BFSI¹² that fed the continued drive for ever-increasing profiteering in the residential mortgage and securitization markets,¹³ financial institutions within the industry caused a catastrophic financial collapse, not only within the BFSI but also the national and international economies, when the risky securitized mortgage products the BFSI introduced into the markets became unstable.¹⁴ The ripple effect¹⁵ of

¹¹ Darrell Issa, *Unaffordable Housing and Political Kickbacks Rocked the American Economy*, 33 HARV. J.L. & PUB. POL'Y 407, 418–19 (2010). Other pawns include mortgage brokers, appraisers, underwriters, and any other provider necessary for the BFSI to maximize profits.

¹² The FCIC found that the interconnectedness among the BFSI primarily occurred in the securitization of mortgages and the insurance structure aimed at protecting those securitized investments. FCIC, *supra* note 9, at xxv. For example, American Insurance Group (AIG), formerly the nation's largest insurer, provided insurance known as collateral debt securities to cover the collateralized debt obligations (CDOs) created from mortgages that the BFSI purchased. *Id.* While the system was very convoluted because it lacked any transparency, the value of the investments makes the picture more clear. *Id.* AIG held \$79 billion in derivative exposure. *Id.* Citigroup considered \$49 billion in highly-rated derivatives a small deal. Merrill Lynch owned \$55 billion in what it considered the safest level. FCIC, *supra* note 9, at xxi. These institutions failed with collective liabilities of more than \$183 billion with these figures. *Id.* Nevertheless, AIG and Merrill Lynch failed, and other institutions subsequently acquired them. *Id.* Citigroup not only received initial TARP bailout funds, but subsequently received additional taxpayer dollars because of its unstable investments. *Id.*

¹³ See also U.S. CENSUS BUREAU, 2006 SERVICE ANNUAL SURVEY (Mar. 2008) (finding the total revenue of companies engaged in securities, commodity contracts, and other financial investment activities was \$499.2 billion in 2006 as compared with \$406.3 billion in 2005, representing an increase of 22.8% on a year-to-year basis). For the period spanning from 2000 through 2006, the total revenue of these companies increased at a compound annual growth rate (CAGR) of 4.4%. CAGR is not “the actual return in reality,” but an “imaginary number that describes the rate at which an investment *would have grown if it grew at a steady rate.*” Investopedia, *Compound Annual Growth Rate*, <http://www.investopedia.com/terms/c/cagr.asp> (last visited Sept. 5, 2013) (emphasis added). These players—individuals and corporate entities—acquired historically unprecedented profits and wealth building on speculation, which benefited a small elite group of executives and investors.

¹⁴ The exotic mortgages securitized and sold on the secondary mortgage market defaulted at unprecedented rates. David Schmudde, *Responding to the Subprime Mess: The New Regulatory Landscape*, 14 FORDHAM J. CORP. & FIN. L. 709, 725 (2009); Mehrsa Baradaran, *Reconsidering the Separation of Banking and Commerce*, 80 GEO. WASH. L. REV. 385, 387 (2012) [hereinafter Baradaran, *Separation of Banking and Commerce*] (stating banks make increased profits when they take increased risk and have incentive to engage in risk-

the financial crisis forced the government to use taxpayer dollars as a means of last resort to bail out the BFSI's losses to avoid an industry collapse, and ultimately to prop up the national economy.¹⁶

In the pursuit of Mount Everest-size profits,¹⁷ the BFSI devastated former homeowners, who lost their equity wealth and homes to foreclosure, and existing homeowners (citizen homeowners), who lost equity wealth due to property devaluation.¹⁸ In addition, all American taxpayers, whether homeowners or not, had to pick up the tab to save banks and Wall Street

taking behavior due to explicit and implicit government support). Especially with banks serving as the backup sources of liquidity for other financial institutions through credit arrangements, other institutions' outstanding debt obligations to banks impact bank soundness, and, in some cases, liquidity when those debt obligations could not be paid. *See generally* CORRIGAN, *supra* note 5. For example, Washington Mutual and IndyMac banks both faced liquidity problems when they were unable to pay their debt obligations on the commercial paper market, as well as their transaction deposits accounts (causing a run-on-the-bank). *Failed Bank List*, FED. DEPOSIT INS. CORP. (Dec. 24, 2013), <http://www.fdic.gov/bank/individual/failed/banklist.html>; *see* Wendy Kaufman, *Indymac Collapse Fuels Fears About Wamu*, NAT'L PUBLIC RADIO (July 27, 2008), <http://www.npr.org/templates/story/story.php?storyId=92642046>.

¹⁵ This is because banks and non-banks borrowed from each other to participate in these transactions, so when one institution failed, the impact rippled through the entire financial market. This effect created too-big-to-fail institutions. *See generally* CORRIGAN, *supra* note 5, at 4.

¹⁶ *Id.* at 4. In periods of selective and generalized financial stress, such as the financial shock of the 1970s and early 1980s, troubled financial and non-financial banks and non-banks turned to the banking system to provide a bridge until more lasting solutions worked out in order to prevent the problem from spreading to other institutions or to the financial system generally. *Id.* The interconnectedness of bad investment practices and management did not allow for this in 2007 when the financial crisis arose because too many in the BFSI, especially when large banks, such as Washington Mutual, Countrywide, Wachovia, and IndyMac, could not find stable, liquid bank sources due to the enormous debt obligations they owed to other financial institutions. *See generally* Baradaran, *Separation of Banking and Commerce*, *supra* note 14, at 407 (stating that because banks can only be owned by or merged with other banks, they have become too large and too interconnected).

¹⁷ *See* U.S. Corporate Profits After Tax, YCHARTS, http://ycharts.com/indicators/corporate_profits (last visited Nov. 6, 2013) [hereinafter *Corporate Profits After Tax*] (showing statistics on profits during height of the predatory lending period); *see generally* RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 176 (stating bank reserves in 2012 were above \$1.5 trillion). *Cf.* KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 5 (2011) (stating that, between 2000 and 2007, the market generated more than \$2.1 trillion in just subprime mortgage-backed securities).

¹⁸ *America's Lost Trillions*, CNNMONEY, June 9, 2011, http://money.cnn.com/2011/06/09/news/economy/household_wealth/index.htm; *Weathering the Great Recession: Did High-Poverty Neighborhoods Fare Worse?*, THE PEW CHARITABLE TRUSTS (Oct. 2012), http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_urban_neighborhoods_report.pdf; *Wealth After the Great Depression: Who Lost, Who Recovered, and Why?*, RECESSION TRENDS, <https://www.stanford.edu/group/recessiontrends/cgi-bin/web/resources/research-project/wealth-after-great-recession-who-lost-who-recovered-and-why> (last visited Sept. 8, 2013).

firms and to rebuild the economy.¹⁹ The government has recovered losses from the BFSI for foreclosed-upon former homeowners.²⁰ The government, however, has not sought adequate restitution from the BFSI for current homeowners who lost significant equity wealth.²¹ Congress, therefore, must hold the BFSI accountable for its reckless and negligent conduct that resulted in unprecedented, historic losses for the economy and citizen homeowners.²² Thus, because of the BFSI's intricate link to the financial crisis, this article proposes that the government seek a lump sum settlement from the BFSI on behalf of citizen homeowners who cannot sell their homes to recapture their equity, or who have been unable to access equity wealth by refinancing their mortgages.²³

To compensate citizen homeowners, the BFSI should then annually pay into a fund managed by a government agency, not the BFSI as with other settlements.²⁴ Existing citizen homeowners can then apply for funds directly, with minimum criteria, if they purchased their homes between 2000 and

¹⁹ See Christian A. Johnson, *Exigent and Unusual Circumstances: The Federal Reserve and the U.S. Financial Crisis*, in LAW REFORM AND FINANCIAL MARKETS 269 (Kern Alexander & Niamh Moloney eds., 2011) [hereinafter Johnson, *Exigent and Unusual Circumstances*] (explaining that even with this most recent financial crisis, the size and complexity of financial institutions remain the same with little regulation implemented to address how banks need to change their business model to avoid future crisis, and financial harm to Americans). There is great concern that, by injecting historically unparalleled amounts of liquidity into the financial system, the Federal Reserve may have set a precedent with respect to its willingness to intervene in future crises. *Id.*

²⁰ See *State Attorneys General Who Signed the Joint State-Federal Mortgage Settlement by State*, NAT'L MORTG. SETTLEMENT, <http://www.nationalmortgagesettlement.com/states> (last visited Nov. 4, 2013) [hereinafter NAT'L MORTG. SETTLEMENT]; see also *About the Mortgage Settlement*, OFFICE OF MORTG. SETTLEMENT OVERSIGHT, <https://www.mortgageoversight.com/about-the-mortgage-settlement/#settlement-documents> (last visited Nov. 4, 2013) (providing the settlement terms).

²¹ Despite government-sponsored or government-mandated programs and legal settlements with the BFSI to assist former and current citizen homeowners, these programs provided inadequate assistance. Timothy Cavanaugh, *Bloomberg (News): Obama Shoulda Made HAMP, HARP Bigger*, REASON.COM (June 13, 2012, 7:04 PM), available at <http://reason.com/blog/2012/06/13/bloomberg-news-obama-shoulda-made-hamp-h> (reporting that the Home Affordable Modification Program (HAMP) and the Home Affordable Refinance Program (HARP) did not avert the projected number of foreclosures or allow for sufficient refinance of homes underwater (meaning the value of the property was less than the mortgage principal balance owed on the property)).

²² See CORRIGAN, *supra* note 5. Historically, troubled banks could turn to the London market or other foreign markets for financial assistance, but the foreign markets were not forthcoming with assistance for American banks during the 2007 financial crisis. See *generally* TOO BIG TO FAIL (HBO Films 2011). The BFSI created and offered investments in some of the most risky residential MBSs, creating a dire economic strain on the American and global economies when those underlying mortgages defaulted in record numbers. *Id.*

²³ FCIC, *supra* note 9, at 245.

²⁴ NAT'L MORTG. SETTLEMENT, *supra* note 20; Jessica Silver-Greenberg & Petter Eavis, *Wall Street Predicts \$50 Billion Bill to Settle U.S. Mortgage Suits*, WALL ST. J., Jan. 9, 2014, <http://dealbook.nytimes.com/2014/01/09/wall-street-predicts-50-billion-bill-to-settle-u-s-mortgage-suits/> (reporting that banks have also set aside large reserves to absorb the litigation costs).

2007 and lost equity, or currently owned their homes before 2000 but lost and have not recaptured substantial equity wealth since the 2007 financial crisis. The BFSI received bailout funds from taxpayer dollars without applying for the funds and with no restrictions on the use of these funds, which the BFSI employed to cover economic losses and to pay large executive bonuses. Citizen homeowners should not be mandated to follow an onerous application process to establish their equity wealth losses any more than the BFSI was required to demonstrate losses to obtain bailout funds, especially when the BFSI created a financial crisis that it could have avoided.²⁵

The 2007 financial crisis and subsequent recession stemmed from the residential mortgage market crisis and the secondary residential mortgage market implosion, which were the results of BFSI profitability initiatives aimed at reshaping America's homeownership policy.²⁶ The U.S. Congress, which vested federal regulators with enforcement authority over the BFSI, should therefore require the BFSI to pay restitution for the harm it caused to citizen homeowners.

Section II of this Article analyzes the historical context of the government's use of homeownership and how the BFSI influenced that policy for its own economic gain. It looks at the legislative actions aimed at promoting homeownership and economic stability that the BFSI eroded. Section III of this Article identifies the ways in which the BFSI primarily used consumers, politicians, regulators, and rating agencies to fuel the primary and secondary residential mortgage markets with high-risk, non-traditional mortgage products²⁷ that were contrary to safety and soundness standards and practices. This section also analyzes how the BFSI used its power as a lobby to influence politicians and regulators to create a self-regulatory industry that abused rather than protected consumers and rocked the economic stability of the nation. This Article argues in Section IV that the nexus between the BFSI's reckless and negligent behavior and the toxic mortgage products it introduced into the residential finance market caused the financial crisis. It further argues why Congress should mandate restitution to citizen homeowners who lost equity wealth, while the BFSI

²⁵ FCIC, *supra* note 9, at xvii.

²⁶ "Owning one's home is . . . an *empowering act*, giving people a stake in society and a *sense of control* over their lives. Put differently, homeownership strengthens the social fabric." Joan Williams, *The Rhetoric of Property*, 83 IOWA L. REV. 277, 327 (1998) (emphasis added).

²⁷ See generally Tracie R. Porter, *The Field Between Lions and Zebras . . . Evening the Playing Field Between Lenders and Borrowers: Conflicts of Interest and Legal Obligations in the Residential Mortgage Transaction*, 30 QUINNIPIAC L. REV. 623, 623 (2012) [hereinafter Porter, *Conflicts of Interest*]; see ENGEL & MCCOY, *supra* note 17; see also SHEILA BAIR, *BULLS BY THE HORNS: FIGHTING TO SAVE MAIN STREET FROM WALL STREET AND WALL STREET FROM ITSELF* (Free Press 2012) (discussing statements of the former FDIC Chairman making reference to these types of mortgages as non-traditional mortgages, or NTMs).

profited not only from the investments that caused the financial collapse but also from taxpayer bailout funds. Finally, Section V sets forth a restitution theory Congress could adopt based on existing federal laws, such as the Federal Trade Commission Act (FTCA), in order to redress the harm caused to citizen homeowners by the BFSI's fraudulent and deceptive practices in mortgage lending practices. It calls for Congress to require the BFSI to bailout citizen homeowners who lost equity wealth, given the BFSI received a bailout for its losses.²⁸

In 2009, the six largest commercial and investment banks²⁹ within the financial sector constituted more than sixty percent of the gross domestic product (GDP).³⁰ By 2012, the United States' national residential finance market was valued at more than \$11 trillion.³¹ For commercial banks, Wall Street investment firms and their investors, the residential mortgage market created the opportunity for lucrative returns, both for short-term and long-term profits.³² To accomplish such unprecedented returns, the BFSI used its

²⁸ As a caveat, the author is not optimistic that lobbying efforts can be eliminated or sufficiently counteracted to mandate regulation, particularly given the armada of resources the banking industry has at its disposal compared to that of consumer advocate agencies or the voices of private citizens. This article certainly recognizes that money and power create a large stumbling-block to curbing bank influence in housing policy.

²⁹ In 2007, the five biggest investment firms included: Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley. FCIC, *supra* note 9, at xix. Two of the firms were acquired by commercial banks: Bear Stearns by JP Morgan Chase (through government guaranteed acquisition) and Merrill Lynch by Bank of America. Lehman Brothers went bankrupt in September 2008. See Patrice Hill, *Lehman Brothers Files For Bankruptcy*, WASH. TIMES, Sept. 15, 2008, <http://www.washingtontimes.com/news/2008/sep/15/lehman-files-for-bankruptcy/?page=all>. By 2009, the six biggest entities now include banks JP Morgan Chase, Bank of America, Citibank, Wells Fargo, and the investment banks of Goldman Sachs and Morgan Stanley. See Bob Ivry et al., *Secret Fed Loans Gave Banks \$13 Billion Undisclosed to Congress*, BLOOMBERG MARKETS (Nov. 27, 2011), <http://www.bloomberg.com/news/2011-11-28/secret-fed-loans-undisclosed-to-congress-gave-banks-13-billion-in-income.html> (stating that six banks and investment companies, including JP Morgan Chase Bank, N.A., Bank of America, Citigroup Inc., Wells Fargo & Co., Goldman Sachs Group Inc., and Morgan Stanley, accounted for sixty-three percent of the average daily debt to the Federal Reserve Bank, among all publicly traded U.S. banks, money managers, and investment-services firms.)

³⁰ RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 37. The GDP is the market value of all officially recognized final goods and services produced within a country in a given period of time. *Id.* GDP per capita is often considered an indicator of a country's standard of living. See generally *Gross Domestic Product*, WIKIPEDIA, http://en.wikipedia.org/wiki/Gross_domestic_product (last visited July 25, 2013).

³¹ David Reiss, *Message in a Mortgage*, *supra* note 3 (citing *Market Data*, FED. HOUS. FIN. AGENCY, <http://www.fhfa.gov/Default.aspx?Page=70> (last visited Oct. 6, 2013)); President Barack Obama, 2012 State of the Union Address (Jan. 24, 2012) (transcript available at <http://www.whitehouse.gov/the-press-office/2012/01/24/remarks-president-state-union-address>); see FCIC, *supra* note 9, at xv.

³² The short-term profits result from the interest borrowers pay monthly on the principal balance of mortgage loans and through other fees lenders charge borrowers when lenders originate mortgage loans. The long-term profits come from income on securitized mortgage loans sold initially to the secondary mortgage market and then repackaged as

financial stronghold on the residential finance market to co-opt policymakers and regulators in Congress.

For example, BFSI's special interest groups lobbied federal politicians and bank regulators in order to divert the political agenda and to redirect the regulatory regime regarding homeownership by using its wealth to influence promulgation of new legislation and regulatory oversight decision-making.³³ From 1998 to 2008, the BFSI's federal lobbying expenditures hovered between \$2.7 billion and \$3.4 billion,³⁴ not including the additional \$1 billion in campaign contributions from private individuals affiliated with the industry and political action committees used to fund federal political campaigns.³⁵ The result of the BFSI's lobbying efforts was a significant impact on governmental regulation of the residential mortgage finance industry, including a lack of meaningful oversight and standards-setting to ensure stability in the primary and secondary residential mortgage markets and, ultimately, the national economy.³⁶

The behemoth amount of money spent on lobbying efforts ensured that a self-regulatory regime would be the norm and that government interference would be minimal or, in some cases, eliminated.³⁷ Regulatory agencies compromised with the BFSI, instead of taking enforcement actions. For some agencies, the BFSI was the primary source of funding, thus, allowing the industry to greatly influence the agency's actions.³⁸ The BFSI, ultimately, became a self-regulating industry that agreed to comply with safety and soundness practices and standards promulgated by its regulators as a principle-based compliance program.³⁹ These safety and soundness

mortgage-backed securities, also known as MBSs, or in the case of residential mortgages, RMBS. *See generally* FCIC, *supra* note 9.

³³ Issa, *supra* note 11, at 413–17; Reiss, *Three Principles for Housing Policy*, *supra* note 4, at 41; *see* Deniz Igan & Prachi Mishra, *Three's Company: Wall Street, Capitol Hill, and K Street*, VOX, Aug. 11, 2011, <http://www.voxeu.org/article/did-anti-regulation-lobbying-fuel-subprime-crisis> (stating that “the financial industry fought, and defeated, measures that might have allowed for a timely regulatory response to some of the reckless lending practices and the consequent rise in delinquencies and foreclosures that most think played a pivotal role in igniting the crisis In fact, banks continued to lobby intensively against tighter regulation and financial regulatory reform even as the industry struggled financially and suffered from negative publicity regarding its role in the economic crisis.”)

³⁴ FCIC, *supra* note 9, at xvii; RAMIREZ, *LAWLESS CAPITALISM*, *supra* note 8, at 37. From 1998 to 2008, financial institutions had spent an estimated \$2.7 billion in lobbying expenses at the federal level. *Id.*

³⁵ FCIC, *supra* note 9, at xviii.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *See* BAIR, *supra* note 27. The Office of Thrift Supervision (OTS) is no longer an agency in the federal government because of the collapse of thrift institutions following the financial crisis. *Id.*

³⁹ *See* Vincent DiLorenzo, *Barriers to Market Discipline: A Comparative Study of Mortgage Market Reforms* (St. John's Legal Studies Research Paper No. 1969405, Dec. 7, 2010), available at <http://ssrn.com/abstract=1969405>. Safety and soundness practices and standards were premised on concern about the concentration of financial power and risks the BFSI would engage in using depositor funds. *See* CORRIGAN, *supra* note 5, at 1, 7.

standards were put into place to assure consumers of the financial stability of financial institutions, as well as to provide public confidence in the financial markets, despite the fact that the standards were not mandatory but merely suggested best-lending practices.⁴⁰

The public confidence about the financial soundness of the BFSI and its prudent practices to control risk and management was supposed to serve as a public safety net. The practices were mainly for banks that held depository accounts and for financial service entities that engaged in bank-like activities.⁴¹ From a self-regulatory perspective, the BFSI blatantly disregarded safety and soundness standards and practices and, as a result, eroded the public policy safety net.⁴² For example, the BFSI introduced non-traditional, high-risk mortgage products—often referred to as toxic mortgages—into the primary residential finance market and then bundled those mortgages into mortgage-backed securities on the secondary mortgage market. The toxic nature of these mortgage products, destined for default, caused a devastating ripple effect on both national and global investors who bought these securities.⁴³ In 2007, as result of the BFSI refusing to follow safety and soundness standards that the industry itself was to police, the American economy and citizen homeowners suffered the cataclysmic impact of the BFSI’s high-risk investments. Even in 2013, citizen homeowners were still in financial distress due to the economic instability the BFSI caused in the residential housing market.⁴⁴ The American dream of homeownership has become a nightmare because Americans who bought homes during the mortgage finance boom that spanned from 2000 to 2007 are arguably in far worse financial shape than they would have been had they not bought a home at all.⁴⁵

For many Americans, owning a home is the American dream.⁴⁶ Owning one’s home is an empowering act that gives middle-class citizens a stake in society and a sense of control over their lives.⁴⁷ This notion became especially entrenched following the Great Depression of the 1930s when the federal government used home construction as a means to strengthen the

⁴⁰ DiLorenzo, *supra* note 39.

⁴¹ See CORRIGAN, *supra* note 5.

⁴² BAIR, *supra* note 27 (reporting that banking officials admitted to self-regulation, then admitted that the problem was “bad regulation”); see generally CORRIGAN, *supra* note 5.

⁴³ FCIC, *supra* note 9.

⁴⁴ *Id.* at xviii.

⁴⁵ Edward L. Glaeser, *Rethinking the Federal Bias Toward Homeownership*, 13 CITYSCAPE: J. OF POL’Y DEV. & RES. 5, 8 (2011), available at http://www.huduser.org/portal/periodicals/cityscape/vol13num2/Cityscape_July2011_rethinking.pdf.

⁴⁶ Reiss, *Three Principles for Housing Policy*, *supra* note 4, at 41 (comparing the “yeoman farmer,” who was the “ideal citizen because he was self-sufficient, earn[ing] his own keep . . . [guarding] his liberty and unalienable rights,” to the 20th century “homeowner”).

⁴⁷ Williams, *supra* note 26, at 327.

national economy and homeownership to rebuild a strong social fabric.⁴⁸ The political belief of the time was that homeownership and stable housing were fundamental ideologies ingrained in American citizenship.⁴⁹ When the federal government developed homeownership policy in the early 1930s, it sought to provide citizens with a foundation for stability through homeownership and, ultimately, to create better citizens.⁵⁰ Nearly every president since the 1930s has supported homeownership⁵¹ because homeownership has generally been seen as good for the national economy. Homeownership spurs construction, which creates jobs and aids in economic recovery through spending. It also establishes communities of citizens and allows citizens to participate in equity wealth building.⁵² The historical

⁴⁸ This privilege of home ownership was previously accessible only to the well-to-do and wealthiest Americans in the early 19th century. Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2192–93 (2007). Citizen homeowners built their homeownership dream on the premise that owning their home was like owning a piece of America, a wealthy country with vast resources. See generally Reiss, *Three Principles for Housing Policy*, *supra* note 4, at 42.

⁴⁹ See Reiss, *Three Principles for Housing Policy*, *supra* note 4, at 42 (discussing the ethics of federal homeownership policy and referring to the “Housing as a Bulwark of Democracy” ethic in which politicians approach the notion of federal housing policy).

⁵⁰ *Id.* at 42 (referring to visions of the federal housing policy as based on *caveat emptor* or based on a vision of housing as a foundation for a stable life for homeowners and their families); Carliner, *supra* note 6, at 301, 315 (stating that homeownership builds character and citing that the goal of the Cranston-Gonzalez National Affordable Housing Act of 1990 was “that every American family be able to afford a decent home in a suitable living environment”).

⁵¹ Carliner, *supra* note 6, at 301 (asserting that homeowners are more likely to be voters while non-homeowners are not, thus promotion of homeownership is always a favorable political tactic). Prior to the 1930s, state law regulated residential mortgage lending without federal government intervention except with regard to land trusts. *Id.*

⁵² This premise is generally true given the extraordinary support of past presidents. President Franklin D. Roosevelt created federal homeownership policy through the creation of the Federal Housing Administration (FHA) and government-sponsored entities (GSEs). See generally Vincent J. Cannato, *A Home of One's Own*, 3 NAT'L AFFAIRS 69 (2010), available at http://www.nationalaffairs.com/doclib/20100317_Cannato.pdf. As part of President Lyndon B. Johnson's war on poverty, he created and established the Department of Housing and Urban Development (HUD). See generally Department of Housing and Urban Development Act, 42 U.S.C. §§ 3532–37 (2012). See also *Questions and Answers about HUD*, HUD.GOV, <http://portal.hud.gov/hudportal/HUD?src=/about/qaintro> (last visited Nov. 6, 2013). At the request of President William “Bill” Clinton, HUD worked with dozens of national politicians and the housing industry to implement the National Homeownership Strategy, also referred to as the HOPE Program. See generally DEP'T OF HOUS. AND URBAN DEV., URBAN POLICY BRIEF NUMBER 2 (Aug. 1995), <http://www.huduser.org/publications/txt/hdbrf2.txt>. President George W. Bush built on Clinton's goal for increasing homeownership by setting a new goal to create 5.5 million new minority homeowners by the end of the decade in 2010, referred to as the Minority Homeownership Plan. See Michael Lawson & Kat Aaron, *Promoting Homeownership Through the Years*, INVESTIGATIVE REPORTING WORKSHOP, July 21, 2011, <http://americawhatwentwrong.org/story/promoting-home-ownership/> (stating that the Bush administration's “ownership society” framed homeownership as an engine to help eliminate persistent racial inequalities). In response to the mortgage crisis that resulted from the 2007 financial crisis, President Barack Obama created a

perspective of homeownership held true for many citizens during the housing boom between 2000 and 2007. Citizens who otherwise would not have been able to become homeowners lived the American dream because the BFSI deceptively enticed them as borrowers into unstable mortgage products. These unstable mortgage products then ultimately caused them to lose their homes, their wealth accumulation, and the sense of control over their lives. The good that government homeownership policy sought to create was devastated by the greed of the BFSI.⁵³ Armed with the money and control, the BFSI gradually converted homeownership policy to its own end in the name of profit.⁵⁴

Historically, lenders have taken advantage of government policy to ensure profits and liquidity in the residential mortgage market. With the creation of Federal Housing Administration (FHA)⁵⁵ standard mortgages in 1934, government policy sought to provide liquidity in the residential mortgage markets. Subsequently, government-sponsored entities (GSEs) would aid lenders by allowing them to sell mortgages they held on a secondary market to purchasers in exchange for cash in order to free up

comprehensive plan to stabilize the U.S. housing market by helping homeowners get mortgage relief and avoid foreclosure. *See generally About MHA, THE MAKING HOME AFFORDABLE PROGRAM (MHA)*, <http://www.makinghomeaffordable.gov/about-mha/Pages/default.aspx> (last visited Nov. 6, 2013).

⁵³ For many lending institutions, especially local savings and loan associations, the depository accounts used to lend money for mortgages stayed in the community where homeowners lived and worked. In the post-depression era of the late 1930s, this concept of local lending changed and lenders on a national level sought to enter the mortgage lending market. *See Peterson, supra* note 48, at 2191–92.

⁵⁴ While many scholars and experts point to government deregulation, non-enforcement of existing regulations, minority and low-income borrowers, or anyone other than banks and Wall Street, the reality exists that banks have been self-regulating in regard to mortgage lending for many decades. *See DiLorenzo, supra* note 39; *see also Peterson, supra* note 48, at 2185. *See generally* Raymond H. Brescia & Sonia Steinway, *Scoring the Banks: Building A Behaviorally Informed Community Impact Report Card for Financial Institutions*, 18 *FORDHAM J. CORP. & FIN. L. REV.* 339, 339 (2013); Jack T. Gannon, Jr., *Let's Help the Credit Rating Agencies Get It Right: A Simple Way to Alleviate A Flawed Industry Model*, 31 *REV. BANKING & FIN. L.J.* 1015, 1015 (2012); Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 *N.C. BANKING INST.* 5, 5 (2009). *Cf. Schmudde, supra* note 14.

⁵⁵ The FHA was created by the National Housing Act of 1934. Pub. L. No. 73-479, 48 Stat. 1246 (1934) (codified as amended at 12 U.S.C. §§ 1701–50 (2012)). *See also The Federal Housing Administration (FHA)*, U.S. DEPT. OF HOUS. & URBAN DEV., http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/fhahistory (last visited July 25, 2013). The FHA became a part of HUD's Office of Housing in 1965. *Id.*

President Roosevelt created the FHA as a part of many New Deal programs following the 1938 Depression. *Id.* In an era where the housing market needed a boost, the FHA created an opportunity for lenders to make safe loans guaranteed by the government and for more Americans to be able to attain affordable loans. *Id.* The mission of the FHA was to strengthen the social fabric through creating homeowners who would be invested in improving the economic condition of the society. *See Peterson, supra* note 48; *see* David Reiss, *The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab*, 42 *GA. L. REV.* 1019, 1022–23 (2008).

funds for future lending. Lenders then could make new mortgages with money they received from these secondary market transactions, in addition to making short-term profits.⁵⁶ The objective of using the FHA to set affordable loan standards was to ensure the quality, in terms of soundness and safety, of the mortgages that GSEs purchased.⁵⁷ The secondary mortgage market made sensible government policy because the FHA already guaranteed the mortgages, and the FHA standard mortgages that GSEs acquired on the secondary market were those mortgages that the FHA had already deemed safe for borrowers.⁵⁸ GSEs then bundled these mortgages into securities, commonly known as mortgage-backed securities (MBSs) or residential mortgage-backed securities (RMBSs), and sold them to investors to raise revenues. The secondary market promised lenders a guaranteed return on FHA mortgage investments. With no secondary market for other more profitable, non-FHA (or conventional) mortgages, the BFSI began to put pressure on the government to allow GSEs to acquire less stable and less safe mortgage products.⁵⁹ With increasing BFSI pressure on policymakers and the conversion of GSEs to privately-owned,⁶⁰ but still government-sponsored and guaranteed entities, lenders benefitted from selling GSEs riskier mortgages that yielded the BFSI more profitable returns.⁶¹ Seizing the opportunity to increase their profits as well, private financial investment firms purchased conventional loans that they bundled as private-label securities and then sold to national and global investors.⁶² These private-label MBSs would comprise the riskiest—but most profitable—investments for investors. These investors, including banks and other investment firms, using sophisticated vehicles such as collateralized debt obligations (CDOs) that were insured by credit default swaps (CDSs), ultimately would account for the financial crisis and mortgage collapse of 2007.⁶³ Through such greed, the

⁵⁶ The profits were from the interest and fees that lenders collected at the closing of mortgage loans, in addition to the premium that lenders then received from selling the mortgages to GSEs or investment firms on the secondary mortgage market. *See generally* Peterson, *supra* note 48. *See also* *FHA*, *supra* note 55.

⁵⁷ FCIC, *supra* note 9, at xxvi. The BFSI was intent on serving the national and international financial markets with new and more profitable products. *See* Joseph William Singer, *Foreclosure and the Failures of Formality, or Subprime Mortgage Conundrums and How to Fix Them*, 46 CONN. L. REV. (forthcoming 2014).

⁵⁸ Peterson, *supra* note 48.

⁵⁹ *See* andré douglas pond cummings, *Racial Coding and the Financial Market Crisis*, 2011 UTAH L. REV. 141, 174–88 (2011).

⁶⁰ The increasing government liability for GSEs caused the government to rethink how to minimize its liability due to the rapid growth of the secondary market. *Id.* Thus, the government privatized the GSEs but still guaranteed the entities to assure confidence from investors who sold and bought mortgages on the secondary market. S. REP. NO. 90-1123, at 1871–76 (1968), *available at* <https://bulk.resource.org/gao.gov/90-448/000051A1.pdf>.

⁶¹ pond cummings, *supra* note 59.

⁶² *Id.*

⁶³ *See* Kristin N. Johnson, *From Diagnosing the Dilemma to Divining a Cure: Post-Crisis Regulation of Financial Markets*, 40 SETON HALL L. REV. 1299, 1306–07 (2010) [hereinafter Johnson, *Post-Crisis Regulation of Financial Markets*].

BFSI had seized homeownership policy and manipulated the foundation of the American dream for its own purposes.

In essence, the BFSI claimed control of American homeownership policy and, in the process, stripped away the stability of homeownership offered to Americans through the BFSI's risky gambling in the quest for profits. As of 2013, residential mortgage lending is stagnant, although lenders possess substantial capital to invest.⁶⁴ As a result of the 2007 financial collapse, housing prices in many areas of the country remain significantly devalued, holding existing citizen homeowners hostage because they are unable to sell homes with a lender-assisted short sale or are unable to refinance their mortgages despite the government's push for lenders to cooperate in loan restructuring.⁶⁵ For citizen homeowners whose mortgages are upside-down, meaning the value of the property is less than the remaining balance on the loan, any previously accumulated equity wealth has been lost. Before the 2007 financial crisis and the predatory loan era of 2004 to 2007, citizen homeowners had accumulated wealth through equity in their homes. Homeowners relied on such equity to fund future life events, such as retirement, education, emergencies, and other essential needs. Many existing citizen homeowners are still suffering from a substantial loss of equity in their homes, resulting in the inability to pay for life events using accumulated equity wealth. The loss is devastating for a substantial amount of citizen homeowners. In January 2012, the White House reported more than \$7 trillion in lost home equity wealth resulting from the 2007 residential finance market crisis,⁶⁶ while the BFSI captured more than \$11 trillion of the market value. This disparity makes it painstakingly clear that homeownership policy no longer provides citizen homeowners with a sense of empowerment, control, or inclusion in the social fabric of this nation.

II. FROM THE GREAT DEPRESSION TO THE GREAT RECESSION

The creation of government policies related to homeownership stems from the demand for adequate housing after the Great Depression. Due to this demand, the need for government intervention seemed reasonable to ensure citizens had access to mortgage products that otherwise would not be

⁶⁴ See generally Tracie R. Porter, *Managing Settlements for Consumers of the Mortgage and Foreclosure Crises*, 39 W. ST. U. L. REV. 301, 301 (2012) [hereinafter Porter, *Managing Settlements*]. In 2011, banks were financially well-endowed, so much so that five major financial institutions voluntarily agreed to settle a \$25 billion settlement with federal and state attorneys general related to the foreclosure crisis and robo-signing. *Federal Government and Attorneys General Reach Landmark Settlement with Major Banks*, NAT'L MORTG. SETTLEMENT, <http://nationalmortgagesettlement.com/> (last visited Dec. 31, 2013).

⁶⁵ See Cavanaugh, *supra* note 21.

⁶⁶ Obama, *supra* note 31; see *Corporate Profits After Tax*, *supra* note 17 (providing statistics on profits lenders made from 2000 to 2008, the time of greatest predatory lending leading up to the recession).

available. But in the late 1990s and early 2000s, the demand for housing was on a decline because housing starts were down and property price appreciation was slow.⁶⁷ Lenders with a huge pot of money, therefore, created a demand for housing and mortgages.⁶⁸ These lenders targeted new pools of borrowers who did not otherwise qualify for a mortgage, or these lenders also made it simple to gain access to mortgages. At least thirty percent of the mortgages in 2006 came from high-risk borrowers for whom lenders created high-risk mortgage products, such as subprime loans and alt-A mortgages,⁶⁹ in addition to already riskier, existing FHA loans.⁷⁰ Thus, in a market in which there was low (or no) demand and in which lenders had money to lend at favorable rates and terms, the campaign for homeownership spread nationwide. Most importantly, it appears from the demand that lenders facilitated the activity, with government cooperation, for their own gain and not due to consumers' demand for non-traditional mortgage loans, including subprime mortgages acquired through predatory lending practices.

For example, Countrywide Bank, once the nation's largest mortgage lender, but now owned by Bank of America, created the demand for non-traditional mortgages, or toxic mortgages. This demand would not have existed but for Countrywide purposefully creating and introducing these mortgages into the market. To market these toxic mortgages, Countrywide engaged mortgage brokers as paid, covert agents in its lending scheme. So, although several scholars have labeled mortgage brokers as the primary perpetrators of lending abuses,⁷¹ Countrywide was, in fact, the main supplier

⁶⁷ John A. Tatom, *The U.S. Foreclosure Crisis: A Two-Pronged Assault on the U.S. Economy* 4–5 (Networks Fin. Inst. Working Paper No. 2008-WP-10), available at <http://ssrn.com/abstract=1194975>.

⁶⁸ Porter, *Conflicts of Interest*, *supra* note 27.

⁶⁹ Tatom, *supra* note 67, at 4. Lenders created subprime loans for borrowers with relatively low credit scores and alt-A loans, also referred to as “no or low doc” loans for borrowers with prime credit scores. *Id.* Historically, these non-traditional sources of mortgage credit and these riskier products and categories of borrowers were unprecedented, and lenders ignored their performance success long-term. *Id.* at 5.

⁷⁰ *Id.* at 4.

⁷¹ See Gretchen Morgenson, *Inside the Countrywide Lending Spree*, N.Y. TIMES, Aug. 26, 2007, <http://www.nytimes.com/2007/08/26/business/yourmoney/26country.html>; see also Zachary B. Marquand, *Ability to Repay: Mortgage Lending Standards After Dodd-Frank*, 15 N.C. BANKING INST. 291, 291 (2011) (“Lenders pay brokers a percentage of the loan originated and an additional percentage for including high profit or risky features Brokers can increase their income by originating more loans, larger loans, and loans with riskier features A revenue maximizing broker would attempt to include as many high risk features as possible in the largest loan a borrower can afford and make as many of these loans as possible.”); Kale Gans, *Anatomy of A Mortgage Meltdown: The Story of the Subprime Crisis, the Role of Fraud, and the Efficacy of the Idaho Safe Act*, 48 IDAHO L. REV. 123, 125 (2011) (providing statistics that show that mortgage brokers and borrowers—but not bank employees—committed virtually all the mortgage fraud that precipitated the crisis); Charles W. Murdock, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: What Caused the Financial Crisis and Will Dodd-Frank Prevent Future Crises?*, 64 SMU L. REV. 1243, 1324 (2011) (stating that numerous factors coalesced to lead to the meltdown, including borrowers, mortgage brokers, and mortgage lenders combining to create unsound mortgages

of these toxic mortgages in the residential market. In order to sell them for large profits to the secondary mortgage securities market, Countrywide established a subsidiary, Countrywide Home Loans, specifically to originate toxic mortgages, known as subprime and alt-A mortgages. This was done solely to incentivize mortgage brokers to originate these mortgages.⁷² In so doing, the residential market became flooded with mortgages destined for default.⁷³

A. Pre-Depression Lending Standards—The “Safe Loan” Era⁷⁴

Prior to the Great Depression, banks originated and held mortgages locally. As a result, banks carefully assessed the risk of default on loans and offered products congruent with that risk.⁷⁵ In the two-party lending relationship between lenders and borrowers, lenders responsibly made loans because they held and served their own loans. Defaults on loans meant direct losses for the banks. Lenders, therefore, built relationships with borrowers. By dealing directly with borrowers, lenders were in the best position to assess the risk of doing business with them. Banks implemented lending standards commensurate with their risk-adverseness. For instance, lending standards were conservative, such as requiring large down payments of forty

that were candidates for default, liars’ loans, and “affordable” 2/28 mortgages with “manufactured” teaser rates); Ben Steverman & David Bogoslaw, *The Financial Crisis Blame Game*, BLOOMBERG BUS. WK. (Oct. 18, 2008), <http://www.businessweek.com/stories/2008-10-18/the-financial-crisis-blame-gamebusinessweek-business-news-stock-market-and-financial-advice> (offering a condensed version of the blame game; as markets crash and retirement dreams fade away, the media and the public are full of outrage at everyone from mortgage brokers and Wall Street CEOs to real estate investors to experts who failed to predict the crisis was coming).

⁷² A body of scholarship adequately addresses the role of mortgage brokers in causing the financial crisis and their involvement with mortgage lending. *See generally* Cassandra Jones Havard, “Goin’ Round in Circles” . . . And Letting Bad Loans Win: When Subprime Lending Fails Borrowers: The Need for Uniform Broker Regulation, 86 NEB. L. REV. 737, 775–76 (2008). This article, therefore, does not address mortgage brokers as “pawns.”

⁷³ Tatom, *supra* note 67, at 12; *see also* FCIC, *supra* note 9, at 20 (discussing the poor quality of loans, “which had the great likelihood of going sour”); RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 78 (stating that “[m]any subprime loans appear intended for default.”).

⁷⁴ “Safe Loans” is a reference to loans that banks felt were sound, especially when banks originated and kept loans in their own portfolios. *See* FCIC, *supra* note 9, at 7. Once banks began selling loans on the secondary market and taking them off their books and balance sheets, they cared less about loan quality, such as long-term performance and stability based on the borrowers’ ability to pay and the historic performance of the mortgage product, but instead, banks focused more on short-term profits from selling the loans. *Id.* at 44.

⁷⁵ pond cummings, *supra* note 59, at 34 nn.159–60; Peterson, *supra* note 48, at 2192. During this period, banks were local. National banks did not invest in the local residential mortgage market. Commercial lenders did not make mortgage loans in the early twentieth century because of the risk associated with such credit extensions and the lack of liquidity that banks face making such loans. *Id.*

percent of the purchase price, limiting loan maturity terms to three and six years with balloon payments for the balance at the end of the term, and lending only to borrowers that demonstrated the ability to repay the loan.⁷⁶ In other words, lenders made “safe loans,”⁷⁷ meaning loans with a low risk of default, assured profits for lenders, and heightened accountability to repay for borrowers who made such large initial equity investments. Unfortunately, such terms meant that wealthy citizens who had the financial means to borrow money benefited. Even with such safe loan practices in the residential mortgage market banks still suffered losses when borrowers, who also played the speculative stock market, defaulted. Following the crash, the government’s response was, in part, an effort to revive the national economy by stimulating construction in the residential housing market. Lenders at both local and national levels were instrumental to the government’s initiatives.⁷⁸

B. Post-Depression Residential Market Rescue

Banks’ lending practices transformed when the two-party lending relationship between lenders⁷⁹ and consumers evolved into a three-party relationship among lenders,⁸⁰ consumers, and the federal government.⁸¹ The three-party mortgage lending transaction eroded the “safe loan” model⁸² by shifting risk previously held by banks to the government.⁸³ As a result of President Franklin D. Roosevelt’s New Deal to rescue the economy after the Great Depression, the government guaranteed residential mortgage loans and created a secondary mortgage market. The government guarantee on

⁷⁶ Peterson, *supra* note 48, at 2192.

⁷⁷ The term “safe loans” is used by the author in the context of this article only. See FCIC, *supra* note 9, at 7.

⁷⁸ Local lenders dominated the residential finance market until after World War II. See Matthew Chambers et al., *Did Housing Policies Cause the Postwar Boom in Homeownership?* 1, 5 (Fed. Reserve Bank of St. Louis, Working Paper Series, Apr. 2012). However, under President Roosevelt’s New Deal Plan, national commercial banks would play a major role in financing residential construction, especially with government guarantees. See *generally id.* at 5. Prior to the 1930s, the federal government was only involved in residential housing as related to land trusts, but now became involved in residential housing and financing. *Id.*; see also Carliner, *supra* note 6, at 300.

⁷⁹ Lenders in the two-party relationship refers to those identified in the late 19th century, such as building and loans (also known as U.S. building societies, savings and loans, or thrifts), mutual savings banks, private lending firms, and some insurance companies. Peterson, *supra* note 48, at 2192.

⁸⁰ In the three-party relationship, the term lender includes commercial banks that were unwilling to lend in the mortgage market in the early 19th century, but became involved after the government began assuring repayment of FHA mortgage loans. *Id.* at 2192.

⁸¹ *Id.* at 2191–99.

⁸² “Safe loans” were primarily safe for lending because of the low risk of defaults by mortgages. See *generally* FCIC, *supra* note 9, at 7; see also Wenli Li & Michelle J. White, *Mortgage Default, Foreclosures and Bankruptcy* (Nat’l Bureau of Econ. Res., Working Paper No. 15472 Nov. 2009), available at <http://www.nber.org/papers/w15472>.

⁸³ In the three-party relationship, the government is the guarantor of the mortgage, placing very little risk on lenders. Peterson, *supra* note 48, at 2195.

mortgage loans aimed to alleviate banks' fears of risk related to property devaluation and borrower default. The government designed the secondary mortgage market for residential mortgages with the government's guarantee to resolve lenders' fears of losses due to devaluation and borrowers' defaults and to provide a solution to the liquidity problems due to significant losses from the previous downturn in the residential housing market.⁸⁴

To carry out its mission, the government established the Home Owners Loan Corporation (HOLC), the Federal Housing Administration (FHA), and the Federal National Mortgage Association (Fannie Mae).⁸⁵ The government created each entity to address the reluctance of local lenders to reenter the mortgage market after the Great Depression and to provide the capital necessary to aid in rebuilding communities and the economy. The newly created agencies aimed to establish a stable mortgage-lending infrastructure, encourage local lenders to get back into the residential lending business, and attract national commercial lenders that had not previously participated in the residential finance market.⁸⁶ The government guarantee created a three-party lending relationship that shifted risk away from lenders, and lenders were quick to partake in the potential new profits. Looking at each entity and its purpose helps understand how lenders exploited the government's policies for using homeownership to rebuild the economy for its citizens during the New Deal era and beyond.⁸⁷

First, Congress created the HOLC,⁸⁸ in 1933, with the sole purpose to buy mortgages owned by financially distressed borrowers.⁸⁹ After the government bought distressed mortgages⁹⁰ from lenders with taxpayer money, HOLC then refinanced borrowers' mortgages with terms that made the monthly payments more affordable and eliminated balloon payments.⁹¹ For example, the government extended the original three-to-six-year

⁸⁴ *Id.* at 2194–97.

⁸⁵ *Id.* at 2195.

⁸⁶ *Id.*

⁸⁷ See Steven A. Ramirez, *The Law and Macroeconomics of the New Deal*, 62 MD. L. REV. 515, 560 (2003) [hereinafter Ramirez, *The Law and Macroeconomics*].

⁸⁸ Home Owners Loan Act of 1933, 12 U.S.C. § 1461 (2012).

⁸⁹ Peterson, *supra* note 48, at 2195 n.46; see Ramirez, *The Law and Macroeconomics*, *supra* note 87, at 560; see *Roberson v. Home Owners' Loan Corp.*, 147 S.W.2d 952 (Tex. Civ. App. 1941); see also Annotation, *Home Owner's Loan Act*, 125 A.L.R. 809 (1940) (“The Home Owners Loan Act was created for the purpose of supplying direct relief to home owners, with respect to home mortgage indebtedness, to refinance home mortgages, to extend relief to owners of homes occupied by them, who are unable to amortize their debts elsewhere, and to pay, within limits, any accrued taxes, assessments, necessary maintenance, repairs and incidental costs.”).

⁹⁰ “Distressed mortgages” in this era were mortgages in which borrowers’ would default on repayment because of inability to pay the monthly payment or the principal balance upon maturity, especially for those borrowers who lost their wealth during the stock market crash and subsequent Great Depression in the late 1920s and early 1930s. See generally Peterson, *supra* note 48, at 2191–93.

⁹¹ Carliner, *supra* note 6, at 304. HOLC refinanced twenty percent of residential mortgages. *Id.*

repayment terms to up to thirty years. The longer repayment term meant the monthly payments were lower, making mortgages more affordable for financially distressed homeowners.⁹² As a result of HOLC refinancing an estimated one million mortgages, constituting approximately ten percent of the outstanding residential mortgages at the time,⁹³ borrower default rates declined. This meant that borrowers who made substantial deposits of equity when they purchased their homes were able to keep their homes and any accumulated equity wealth. It also meant that communities could rebound because families could stay in their homes. Additionally, it meant that lenders were freed from distressed or potentially distressed mortgages and enjoyed liquidity to make other investments.

Nevertheless, having suffered significant losses from the collapse of the economy and being skeptical of unstable property values in the residential market, lenders still refused to make mortgage loans, especially under terms borrowers could afford. By refusing to lend in the residential market, the liquidity for mortgages dried up. Driven by profit motivation, lenders needed additional incentives to make mortgage loans, and until they got one, they held the residential mortgage market hostage.

As a result, in 1934, Congress created the FHA⁹⁴ to complement the mission of HOLC. While HOLC had addressed the problem with existing distressed mortgages, the FHA addressed the lack of lender confidence in the residential market. The FHA's mission was to offer government-guaranteed repayment to lenders who made residential mortgage loans under FHA-established standards.⁹⁵ The quid pro quo between the government and lenders was that lenders had to offer more favorable loan terms to borrowers than they had in the past. For instance, the FHA set terms similar to those offered by HOLC, such as longer repayment terms of up to twenty or thirty years without balloon payments and lower down payments of between ten and twenty percent.⁹⁶ For lenders who agreed to make mortgage loans using FHA standards, the government agreed to pay lenders for the loss suffered if

⁹² See generally *id.* at 300.

⁹³ Peterson, *supra* note 48, at 2195 n.46 (citing Kenneth T. Jackson, *Race, Ethnicity, and Real Estate Appraisal: The Home Owners Loan Corporation and the Federal Housing Administration*, 6 J. URB. HIST. 419, 421 (1980)) (discussing the adverse role race played in the refinancing of loans in minority communities).

⁹⁴ The 1934 National Housing Act authorized the FHA insurance program. Carliner, *supra* note 6, at 305.

⁹⁵ Peterson, *supra* note 48, at 2195. The Veterans Administration (VA) functioned similar to FHA in that the VA guaranteed mortgages lenders made to veterans after World War II. *Id.* at 2197. The government provided insurance to lenders so that, in the event of default, lenders did not suffer any loss of the outstanding loan balance. *Id.*

⁹⁶ Peterson, *supra* note 48, at 2195 n.47; see Ramirez, *The Law and Macroeconomics*, *supra* note 86, at 560; see also Quinton Johnson, *Private Mortgage Insurance*, 39 WAKE FOREST L. REV. 783, 785 (2004). In the 1940s, twenty-year mortgages were common. Chambers, *supra* note 78, at 5. Eventually, in the 1960s, thirty-year mortgages became familiar to modern borrowers. See *id.*

the loan defaulted.⁹⁷ The loss suffered was measured by the difference between the price the property sold for at foreclosure and the outstanding mortgage balance. Lenders ultimately recouped the full value of their outstanding mortgages for any defaults under an FHA-standard mortgage. Such governmental risk absorption was necessary because lenders refused to reenter the residential mortgage market. Only with the risk shifted did lenders agree to reenter the market because of the profit potential.⁹⁸ Not only did lenders that invested in mortgage loans prior to the Great Depression take advantage of the government's new housing policy, but also lenders that had previously refused to participate in the residential mortgage market saw an opportunity to make unprecedented profits. Lenders took advantage of the government guarantees; and, without constant cash flow concerns and the risk of loans sitting on their books, they could reap windfall profits and greater liquidity through the secondary mortgage market provided through Fannie Mae.

In 1938, Congress created Fannie Mae,⁹⁹ the third and last prong of the New Deal housing policies aimed at establishing viable residential mortgage lending infrastructure. Fannie Mae solved the cash flow problem for lenders that had historically held on to the mortgages they originated by creating a secondary market to purchase residential FHA-standard mortgages. At its inception as a government-owned entity, Fannie Mae acted as an assignee for FHA. Fannie Mae only purchased FHA-standard mortgages from lenders, for which it paid lenders a premium.¹⁰⁰ Lenders were guaranteed profits by either keeping the government-guaranteed FHA-standard mortgages on their books (thereby earning profits from the repayments) or assigning the FHA-standard mortgages to Fannie Mae for cash (thereby receiving the full value of the outstanding loan plus a premium). For the first option, keeping the loans on the lender's books meant some risk for the lender if the loan defaulted because the lender still had to initiate foreclosure to recover the government guarantee. This option also meant that the lender's available cash to make additional loans was limited.

⁹⁷ Peterson, *supra* note 48, at 2195 n.48. The government paid banks the difference between the amount of the loan collected from a foreclosure sale and the outstanding loan balance. *See id.* For example, a property valued at \$100,000 with a \$20,000 down payment of equity was subject to an \$80,000 mortgage loan. If the borrower defaulted on the mortgage with a balance of \$75,000 at the time of the default, a lender who could only get \$70,000 for the property at a foreclosure sale sought \$5,000 from the government. In the event the property sold for more than \$75,000 at the foreclosure sale, the borrower owed nothing to the lender or received any excess above the amount to pay off the mortgage, and the government owed nothing to the lender. In either case, the lenders received the full value of their mortgage from the government or from the proceeds from the sale of the property at a foreclosure sale. *Id.*

⁹⁸ *Id.* While lenders recouped the money from the mortgage whether or not the loan defaulted, the government gave borrowers no assurances against risk for loss of any equity they invested in the property if realty market prices declined. *Id.*

⁹⁹ *Id.* at 2196.

¹⁰⁰ *See generally* Peterson, *supra* note 48, at 2196 n.53.

The latter option was optimal for lenders because, by selling the loans to the FHA, lenders eliminated their risk of default and did not have to initiate foreclosure actions to collect any outstanding balances. This option also freed up lender cash flow to make additional FHA-standard loans, which then led to guaranteed short-term profits from selling their FHA loans, and the ability to make other more profitable investments.

The government policies enacted through the FHA and Fannie Mae gradually stimulated the mortgage market, and the overall economy, as intended. Eventually though, lenders saw the potential for unlimited and risk-free premiums through the sale of loans to the FHA. Thus, lenders used the third-party transaction among lenders, borrowers, and the government as a means for profit generation to the detriment of the government, borrowers, and the economy. Entrenched in the infrastructure of the growing residential market, government involvement grew but not solely of its own initiative. The government-owned and government-managed Fannie Mae fell into the hands of private investors in 1968 through the passage of new legislation, known as the Housing and Urban Development Act of 1968 (the HUD Act).¹⁰¹ The HUD Act created a means for lenders to expand their advantage in the residential secondary mortgage market through three GSEs, all of which came with the full faith and credit of the government. Private investors who ultimately took control over the GSEs and the secondary residential mortgage market, however, deviated from purchasing safer FHA-standard, government-guaranteed mortgages and began introducing riskier, non-FHA mortgages into the secondary market. Arguably, these risky mortgages ultimately led to the demise of the secondary market and that of the national economy as well.

C. Unraveling of the Mortgage Lending Market—The Secondary Mortgage Markets Under Self-Correcting Market Regime

Subsequent to the government's implementation of policies to support the residential finance market, mortgage lending on both the primary and secondary markets remained stable.¹⁰² Despite the Savings and Loan Crisis in the 1980s, the impact on citizen homeowners was marginal.¹⁰³

¹⁰¹ The HUD Act created the private GSE commonly known as Fannie Mae. See Carliner, *supra* note 6, at 308–09. The Government National Mortgage Association (Ginnie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) resulted from the passage of the HUD Act, respectively with other functions for the secondary market for government guaranteed FHA and VA mortgages and private-label securities issued by banks and financial services institutions. *Id.* at 309.

¹⁰² See generally Timothy A. Canova, *Financial Market Failure As a Crisis in the Rule of Law: From Market Fundamentalism to a New Keynesian Regulatory Model*, 3 HARV. L. & POL'Y REV. 369, 369 (2009).

¹⁰³ Moran, *supra* note 54, at 13, 19 (“The roots of the credit crisis stretch back to another notable boom-and-bust in recent history: the tech bubble of the late 1990s.”). Homeownership rose to 67.4% of U.S. households in 2000 from 64% by 1994. See U.S.

Beginning in the early 1990s, however, lenders in the mortgage market started to engage in risky behavior in their lending practices with borrowers, as well as with regard to the types of mortgage products they introduced into the residential market. Banks and non-banks (i.e., financial services firms) raised their investment risk by the increasing amount of MBSs in their asset pools.¹⁰⁴ In the early 2000s, lenders began using RMBSs as an essential tool for boosting profit revenues from domestic and global investors and bundled new, risky mortgage products into MBSs.¹⁰⁵ Because of these products, lenders fueled the primary—and ultimately the secondary—mortgage markets with unstable products that were instrumental in causing the financial crisis of 2007.¹⁰⁶ In addition to supplying the secondary mortgage market with these risky mortgage products, lenders engaged in deceptive and predatory lending practices to lure borrowers—who otherwise had not met established underwriting standards—into homeownership.¹⁰⁷

As early as 1994, abusive lending practices were on the rise because lenders began introducing risky mortgage products that ultimately proved to be unstable due to borrowers' inability to make mortgage payments.¹⁰⁸ Lenders also engaged in predatory lending by selling very sophisticated and complex mortgage products to less sophisticated borrowers.¹⁰⁹ In response to

CENSUS BUREAU, CENSUS BUREAU REPORTS ON RESIDENTIAL VACANCIES AND HOMEOWNERSHIP (Oct. 26, 2007), <http://www.census.gov/hhes/www/housing/hvs/qtr307/q307press.pdf>.

¹⁰⁴ Baradaran, *Separation of Banking and Commerce*, *supra* note 14, at 420 (citing Andrew G. Haldane & Piergiorgio Alessandri, BANKING ON THE STATE 2–4 (2009), <http://www.bis.org/review/r091111e.pdf>).

¹⁰⁵ *Id.*

¹⁰⁶ RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 128–29; FCIC, *supra* note 9, at xvii; Moran, *supra* note 54, at 13; Henry M. Paulson, Jr., Sec'y, U.S. Dep't of the Treasury, Statement on Comprehensive Approach to Market Developments (Sept. 19, 2008), *available at* <http://www.ustreas.gov/press/releases/hp1149.htm> (“As we all know, lax lending practices earlier this decade led to irresponsible lending and irresponsible borrowing. This simply put too many families into mortgages they could not afford.”).

¹⁰⁷ FCIC, *supra* note 9, at xxii; ENGEL & MCCOY, *supra* note 17, at 28.

¹⁰⁸ ENGEL & MCCOY, *supra* note 17, at 28–29.

¹⁰⁹ *Id.* at 30; Creola Johnson, *The Magic of Group Identity: How Predatory Lenders Use Minorities to Target Communities of Color*, 17 GEO. J. ON POVERTY L. & POL'Y 165, 168 (2010) [hereinafter Johnson, *The Magic of Group Identity*] (noting that lenders purposefully target consumers to influence their decision-making). The education level of the borrower does not denote the level of sophistication because both well-educated and less-educated borrowers took out risky mortgages without fully understanding the nature of the investment or the ultimate havoc the mass introduction of these mortgage products into the market would wreak on the national economy or on new and well-established citizen homeowners. John P. Relman, *Foreclosures, Integration, and the Future of the Fair Housing Act*, 41 IND. L. REV. 629, 634–35 (2008) (describing an increase in the subprime market and a corresponding increase in abusive lending practices); Charles L. Nier, III, & Maureen R. St. Cyr, *A Racial Financial Crisis: Rethinking the Theory of Reverse Redlining to Combat Predatory Lending Under the Fair Housing Act*, 83 TEMPLE L. REV. 941, 946 (2011) (“With the growth in subprime lending during the 1990s and early 2000s, predatory lending abuses also increased. Although subprime lending has come to a standstill in the wake of the financial

the urging of consumer advocates, Congress passed the Homeownership and Equity Protection Act (HOEPA),¹¹⁰ giving the Federal Reserve Board (FRB) authority to issue new mortgage lending standards and to investigate lenders' abusive lending practices, including seeking remedies for violations of any government regulations or standards as the FRB deemed necessary.¹¹¹ Nevertheless, the BFSI's influence over regulators and policymakers, through lobbying and other monetary means, stifled the FRB's enforcement of HOEPA. In addition, under Alan Greenspan's regime as the FRB Chairman from 1987 to 2006,¹¹² the long-standing policy was that any changes in mortgage lending practices would result from self-correction in the market, not from government regulation.¹¹³ Self-correction by the market was the FRB's governing framework, even though the FRB issued the standards for safety and soundness practices for the financial industry. As evidenced by their conduct, lenders failed to comply with such safety and soundness standards to keep the market stable and, residually, to protect consumers. A self-correction scheme was insufficient to dissuade the BFSI from extracting excess profits from the market, especially when the industry could borrow money from the FRB so cheaply and invest it with greater returns in the secondary mortgage market.¹¹⁴

By 2004, lenders not only ramped up their bad lending practices, but they also introduced toxic financial products into the market, such as derivative products that came with both high-risks to borrowers and investors, and high profit margins for the financial institutions that marketed them.¹¹⁵ These highly risky investment vehicles were an integral part of the

crisis, the harm from predatory subprime practices continues, most obviously in the form of foreclosure actions.”)

¹¹⁰ Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, 184 Stat. 2190 (codified as amended at 15 U.S.C. §§ 1601–1693s (2012)).

¹¹¹ 15 U.S.C. § 1639(l) (2012). “The Board may, by regulation or order, exempt specific mortgages or categories of mortgages from any or all of the HOEPA requirements, or prohibit additional acts or practices in connection with any mortgage that the Board determines are unfair, deceptive, or designed to evade HOEPA, or that are made in connection with a refinancing of a mortgage loan that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.” Raymond Natter, *Home Ownership Equity Protection Act of 1994*, BANKING L. COMMITTEE J., July 2007, at 5, available at <http://apps.americanbar.org/buslaw/committees/CL130000pub/newsletter/200708/natter.pdf>; see also FCIC, *supra* note 9, at 10.

¹¹² FCIC, *supra* note 9, at xviii. Greenspan, as a sympathetic regulator, encouraged the proliferation of complex financial instruments, such as derivatives. See also Canova, *supra* note 102, at 378.

¹¹³ FCIC, *supra* note 9.

¹¹⁴ Greenspan also kept the interest rate that banks used to borrow money from each other low. This meant that banks could borrow money cheaply and lend it out to other banks and consumers at higher rates to gain substantial returns and steady profit flows. Some argue that the Federal Reserve Bank's decision to keep the interest rate low fueled the rise in housing prices. Canova, *supra* note 102, at 379.

¹¹⁵ FCIC, *supra* note 9, at xxv–xxvii.

financial crisis.¹¹⁶ For example, in 2006, the BFSI created an estimated \$1.3 trillion in MBSs alone and another \$350 billion in CDOs tied to MBSs, from both U.S. and international investors.¹¹⁷ The losses from these investments were devastating to some of the companies that provided them as well as to the investors who purchased them. But the BFSI also created insurance for the risks that investors assumed in the form of CDSs, designed specifically to insure against the risk of investing in CDOs that failed.¹¹⁸ For example, AIG, formerly the nation's largest insurer, lost \$61.7 billion for guarantying the payment of \$440 billion in subprime mortgages through CDSs.¹¹⁹ CDSs were not subject to any government regulatory requirements because, while former FRB Chairman Greenspan had the authority to regulate such products, he again opted for the neoclassical theory of self-correcting markets to allow the BFSI to regulate itself.¹²⁰ After all, this theory relies on the BFSI engaging in practices that would protect, rather than harm, the profit potential for its investors and stakeholders,¹²¹ a premise that proved false.¹²² And, in addition to the harm caused to BFSI investors and stakeholders, American consumers suffered devastating losses.

The BFSI has historically been resistant to regulation of its business and consumer practices. In response to abusive lending practices, Congress introduced consumer protection laws in the late 1960s regulating lender consumer practices, particularly in mortgage transactions.¹²³ Consumer

¹¹⁶ *Id.* at 9; RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 54 (noting that Citigroup lost billions of dollars because of subprime lending practices).

¹¹⁷ Derivatives pooled millions of subprime mortgages into income streams in complex vehicles called CDOs. Johnson, *Post-Crisis Regulation of Financial Markets*, *supra* note 63; RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 54.

¹¹⁸ Johnson, *Post-Crisis Regulation of Financial Markets*, *supra* note 63.

¹¹⁹ *Id.*

¹²⁰ FCIC, *supra* note 9, at 18; DiLorenzo, *supra* note 39, at 24–25 (discussing a self-correcting market regime known as standard-based regulation which is suggested, versus rule-based regulation, which sets mandatory rules).

¹²¹ See *Dodge v. Ford Motor Co.*, 170 N.W. 668, 668 (Mich. 1919); RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 37–38; Ramirez, *The Law and Macroeconomics*, *supra* note 87, at 515; Schmudde, *supra* note 14, at 713–14.

¹²² See James Crotty, *Structural Causes of the Global Financial Crisis: A Critical Assessment of the New Financial Architecture*, 33 CAMBRIDGE J. ECON. 563, 563 (2009); Patricia A. McCoy, *Systemic Risk through Securitization: The Result of Deregulation and Regulatory Failure*, 41 CONN. L. REV. 1327, 1327 (2009) (arguing that deregulation and failures of regulators to address asset-backed securities markets led to a housing bubble and widespread fraud); Brian J.M. Quinn, *The Failure of Private Ordering and the Financial Crisis of 2008*, 5 N.Y.U. J.L. & BUS. 549, 549 (2009). Cf. RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 155–56 (inferring that profit drove banks, not charity); Johnson, *Exigent and Unusual Circumstances*, *supra* note 19.

¹²³ James R. Barth et al., *Redlining and Mortgage Markets: The Regulation of Financial Institutions, Financial Institution Regulations*, Conference Volume 21, FED. RES. BANK OF BOSTON (Apr. 1980). Barth states:

Prior to the 1970s, these institutions were subject to regulations governing entry into markets and mergers as well as numerous restrictions on interest rates that could be paid to depositors or charged to borrowers.

protective statutes, such as the Truth in Lending Act (TILA)¹²⁴ and the Residential Real Estate Settlement Procedures Act (RESPA),¹²⁵ slowly worked their way through Congress with resistance from the banking industry.¹²⁶ With the BFSI's powerful influence over the political process affecting passage of these consumer laws, Congress ultimately passed laws that simply mandated lenders disclose certain financial information to consumers and curbed some practices, such as kickbacks.¹²⁷ But, overall, lenders still operated in a self-regulatory industry with minimal penalties for non-compliance.¹²⁸ Lenders had successfully usurped influence over the legislative process.¹²⁹ Even now, despite some lending practices and mortgage products being curbed under the Wall Street Reform and Consumer Financial Protection Act, or the Dodd-Frank Act, lenders generally continue to operate in an otherwise unregulated manner in the residential mortgage market.¹³⁰

In the early 1970s, both major political parties came to see the government as intrusive and ineffective in managing general economic monetary matters.¹³¹ By the 1980s, the BFSI was the catalyst for

Recent major new regulations include: (1) the Equal Credit Opportunity Act; (2) the Fair Housing Act; (3) the Home Mortgage Disclosure Act; and (4) the Community Reinvestment Act. All of these new regulations are administered by organizations already established to enforce earlier statutes. But regulatory objectives of recent legislation differ substantially from previous ones. The Equal Credit Opportunity Act attempts to provide individuals with equal access to both consumer and mortgage credit. The Fair Housing, Home Mortgage Disclosure, and Community Reinvestment Acts are intended to improve the availability of mortgage credit to certain individual borrowers, and/or to certain neighborhoods.

Id.

¹²⁴ Truth in Lending Act, 15 U.S.C. § 102(a) (2012) (“It is the purpose of this title to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.”).

¹²⁵ Real Estate Settlement Procedures Act, 12 U.S.C. § 2601(2) (1974). “The Congress finds that significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information . . .” § 2601(2)(a).

¹²⁶ JOHN A. SPANOGLE ET AL., CONSUMER LAW: CASES AND MATERIALS, 134–35 (3d ed. 2007) (stating creditors wanted a degree of certainty to make it easier for creditors to comply, but it resulted in making it harder for consumers to sue for violation of the disclosure laws) (citing Ralph J. Rohner, *Truth in Lending “Simplified”: Simplified?*, 56 N.Y.U. L. REV. 999, 999 (1981)); *see also* Edward L. Rubin, *Legislative Methodology: Some Lessons From the Truth in Lending Act*, 80 GEO. L. J. 233, 233 (1991).

¹²⁷ Under TILA and RESPA, violations are penalized at a statutory maximum of \$2,000 per violation although plaintiffs may bring a private right of action for actual damages, including court costs and attorneys’ fees. 15 U.S.C. § 1640(a) (2012).

¹²⁸ *Id.*

¹²⁹ DiLorenzo, *supra* note 39, at 20; *see* Canova, *supra* note 101, at 380.

¹³⁰ DiLorenzo, *supra* note 39, at 376.

¹³¹ Canova, *supra* note 102, at 376.

deregulation of its industry. Lenders operated in a virtually deregulated market during the years between President Reagan and George W. Bush's terms.¹³² From the Clinton years through George W. Bush's presidency, the lending industry set its own practices and standards subject only to the safety and soundness standards recommended by the FRB. For instance, lenders established new mortgage lending standards for down payment requirements, which were eliminated by lenders in some cases through mortgages that financed one hundred percent of the purchase price of the home.¹³³ Lenders also determined what type of mortgage products to offer. Such products included high volumes of risky, new mortgage products, such as interest-only loans and hybrid loans tied to short-term, fluctuating interest rates that created payment shock for borrowers. In addition to the mortgage products, lenders took advantage of securitized investment vehicles created with these mortgages, such as derivatives and various CDOs sold to investors around the world.¹³⁴ Ultimately, in the BFSI's greedy quest for more profits, it not only resisted external, governmental regulation, but it also ignored the duties of self-regulation.

The BFSI managed to persuade politicians to abolish even the minimal regulatory oversight. The BFSI was the catalyst for Congressional repeal of the Garn-St. Germain Depository Institutions Act of 1982.¹³⁵ This Act was a pillar of consumer protection, designed to guard against banks collapsing because of too much diversified risk, especially after the government's experiences with the 1930s Great Depression crisis.¹³⁶ The bill, its full title: "An Act to revitalize the housing industry by strengthening

¹³² See *id.* at 377; see also Di Lorenzo, *supra* note 39.

¹³³ Canova, *supra* note 102, at 377. Based on the author's years as a practitioner performing mortgage and real estate closings, some mortgages were in the form of one hundred percent of the property value, or two loans—one covering eighty percent of the property value and the other covering twenty percent. There were even loans for 125% of the property value.

¹³⁴ The toxic mortgage products that underpinned the MBSs that Wall Street investment firms placed in CDOs had no historical record of performance, and some bankers and investors even dubbed them as "toxic" from their introduction into the market. See ENGEL & MCCOY, *supra* note 17, at 9–10; Porter, *Conflicts of Interest*, *supra* note 27, at 624; FCIC, *supra* note 9, at 20 (stating "poison" was the word famously used by Countrywide CEO Angelo Mozila); RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 53–54 (stating as early as 2006, Countrywide CEO Angelo Mozila termed Countrywide's subprime loans as "poison" and "toxic," and likely to lead to bankruptcy).

¹³⁵ Garn-St. Germain Depository Institution Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982) (codified at 12 U.S.C. § 1701j-3(a)–3(g)). "The Act deregulated savings and loan associations and allowed banks to provide adjustable-rate mortgage loans. It is disputed whether the act was a mitigating or contributing factor in the savings and loan crisis of the late 1980s." *Garn-St. Germain Depository Institutions Act*, WIKIPEDIA, http://en.wikipedia.org/wiki/Garn%E2%80%93St._Germain_Depository_Institutions_Act (last visited Apr. 10, 2013). Congress repealed the Act mostly because lenders felt the law did not allow them to diversify their investments. See Canova, *supra* note 102, at 376–77.

¹³⁶ See RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 76 (stating that the home mortgage market functioned well for years after the Act's passage, suggesting that this law and others did not inherently destabilize finance).

the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans,” was an initiative of President Reagan’s administration.¹³⁷ The BFSI, however, saw the Garn-St. Germain Act as an impediment to profitability because the law placed restrictions on lending and capital requirements, as well as on the types of financial services banks could offer.¹³⁸ In seeking repeal of this Act, the BFSI, particularly commercial banks, wanted flexibility to offer products and services, which would maximize its competitive advantage in the national and global markets. The goal of the BFSI, again, was to allow the financial markets to remain self-correcting and to usurp all regulatory authority over its own operations. With the repeal of the Garn-St. Germain Act, deregulation enabled reckless market conduct that the BFSI never self-corrected. In addition, in order to keep regulators at bay, the BFSI deployed its financial resources by investing millions of dollars in lobbying efforts to influence policymakers and to infiltrate the regulatory infrastructure. For instance, between 1999 and 2008, lenders spent \$164 million on lobbying to forestall regulatory and oversight efforts over their lending practices.¹³⁹

The BFSI fought regulation not only at the federal level, where regulators actually had authority to regulate the industry under federal law, but the BFSI also warded off any state action aimed at deterring its lending practices. For example, for residential borrowers, lenders’ predatory lending practices had escalated so substantially that some state governments tried to take regulatory actions of their own, mainly because the federal government would not, or had not, taken action to stop such sharp practices by the BFSI. On one account, the Georgia legislature passed a law to expose lenders and investors in MBSs to liability for making predatory mortgage loans.¹⁴⁰ The Georgia act would have imposed unrestricted liability on assignees of mortgages (i.e., those investors who bought predatory mortgages on the secondary mortgage market) that were made to Georgia residents and

¹³⁷ See Garn-St. Germain Depository Institution Act of 1982.

¹³⁸ See Canova, *supra* note 102, at 377.

¹³⁹ FCIC, *supra* note 9, at xxvi, 41; see RAMIREZ, *LAWLESS CAPITALISM*, *supra* note 8, at 76; Matthew Sherman, *A Short History of Financial Deregulation in the United States*, CTR. FOR ECON. AND POL’Y RES., at *10 (July 2009), <http://www.openthegovernment.org/sites/default/files/otg/dereg-timeline-2009-07.pdf>. Sherman states:

The crumbling walls of Glass-Steagall received a final blow in 1999 when Congress passed the Financial Modernization Act, also known as the Gramm-Leach-Bliley Act. The act repealed all restrictions against the combination of banking, securities and insurance operations for financial institutions. The deregulation was a boon for national commercial banks, allowing for the formation of “mega-banks.” The Gramm-Leach-Bliley Act was the crowning achievement of decades and millions of dollars worth of lobbying efforts on behalf of the finance industry.

Id.

¹⁴⁰ See Georgia Fair Lending Act, GA. CODE ANN. §§ 7-6A-1–7-6A-13 (West 2002) (amended in 2003); see also Peterson, *supra* note 48, at 2243–45.

deemed predatory in nature.¹⁴¹ While the Georgia legislature passed the act to deter lenders' predatory behavior and protect its citizens, lenders saw the law as a threat to their profits on the secondary market. As a result, lenders influenced rating agencies to threaten to give poor rating to any MBSs that included Georgia mortgages because of the potential risk of liability to investors.¹⁴² The result would have been that lenders would have refused to offer mortgages to Georgia borrowers if they could not sell them on the secondary market, thereby driving lenders out of Georgia and leaving Georgia residents with a dearth of lending options. The Georgia legislature quickly repealed the law due to BFSI influence. Other states also tried to pass meaningful regulatory legislation to deter lenders' predatory behavior, only to find that they were insufficiently protective because of the high burden borrowers had to meet or because federal law preempted state law in regulating national banks and the financial services industry.¹⁴³

The BFSI was successful in its strategy to maximize profits primarily because it maintained a deregulated mortgage market, both politically and ideologically. The BFSI accomplished its short-term profit maximization¹⁴⁴ largely due to sympathetic regulators—most regulators had executive management roles in various institutions in the industry. With the flow of key regulatory officials through the revolving door between industry and government, in the position of the regulated and then regulator, the banking and financial services industry enjoyed the influential benefits of its own people regulating the industry. This revolving door within the “echelons of decision making, occurred especially between 2000 and 2007, the years leading up the financial crisis [of 2007].”¹⁴⁵ Prominent men who worked in the very industry that contested any government regulation have led the Treasury Department, the FRB, and the Securities and Exchange Commission (SEC), the three most important regulatory agencies for the BFSI. With the BFSI firmly in control of its industry and with its nearly complete influence over the regulatory regime, the greed for unprecedented profits left no room for protection of residential mortgage consumers, borrowers, and related institutions—the ultimate pawns of the BFSI.

¹⁴¹ Peterson, *supra* note 48, at 2243.

¹⁴² Lenders' influence over rating agencies results from lenders paying rating agencies for their services. The interconnectedness is necessary because mortgage lenders cannot bundle mortgages into MBSs, and, without high ratings, lenders cannot sell the mortgages for securitization. Ultimately, neither the lenders nor the rating agencies would make money from having no mortgages or from not having mortgages rated highly enough to attract investors. *See id.*; ENGEL & MCCOY, *supra* note 17, at 47–48.

¹⁴³ Peterson, *supra* note 48, at 2244–45 (referencing a comprehensive list of state and municipal acts and ordinances aimed at curbing predatory lending practices and punishing lenders for such practices.)

¹⁴⁴ FCIC, *supra* note 9, at xix.

¹⁴⁵ Canova, *supra* note 102, at 386.

III. PAWNS THE BFSI USED FOR ITS HIGHER GREED

This section discusses how the BFSI's profit strategy included using citizen homeowners and residential-mortgage-related institutions as pawns.¹⁴⁶ Residential mortgage lending institutions in the BFSI used the voluntary and coerced involvement of these essential pawns to their advantage, including, but not limited to consumers, politicians, regulators, and rating agencies.¹⁴⁷

A. Consumer Exploitation for Profit

The BFSI strategically shaped both the primary and secondary mortgage markets to its benefit because lenders needed a new pool of consumers to buy the new toxic, but profitable, mortgage products it introduced into those markets. Unfortunately, consumers were the most negatively impacted by the BFSI-created crisis. First, lenders targeted classes of unsophisticated consumers to place into toxic mortgage products. Second, the financial crisis resulted in historic foreclosures and the most devastating loss of equity wealth for citizen homeowners. Finally, consumers, through their congressional representatives, supported the largest bailout of the private BFSI in history following the 2007 financial collapse through the Troubled Asset Relief Program (TARP). The impact felt by taxpayers due to the financial crisis created economic losses both at the individual and national levels. As a result of capturing the regulatory and political regimes, the BFSI's exploitation of homeownership policy was especially detrimental to citizen homeowners.¹⁴⁸

¹⁴⁶ See *supra* note 1 (defining "pawn" in the context of this article).

¹⁴⁷ This article only focuses on what the author considers the most critical categories of pawns because the BFSI would not have been able to implement its profit goals without these categories. The author recognizes that there are many other categories of persons and institutions, including, but not limited to, mortgage brokers, in-house bank underwriters, appraisers, other banking and financial services institutions (e.g., thrifts and wholesale subsidiaries), and investors on the global market (i.e., private and governmental). See Elizabeth Devine, *The Collapse of an Empire? Rating Agency Reform in the Wake of the 2007 Financial Crisis*, 16 FORDHAM J. CORP. & FIN. L. 177, 188 (2011); see also Conrad P. Voldstad, Symposium Keynote Address, 18 FORDHAM J. CORP. & FIN. L. 235, 236 (2013) (providing the views of Voldstad, an executive in the derivatives market since the 1980s and a former hedge fund manager at Merrill Lynch, head of the derivatives group at J.P. Morgan Chase, and current chief executive of International Swaps and Derivatives Association, Inc.).

¹⁴⁸ Canova, *supra* note 102, at 380. Former borrowers who faced foreclosure lost their homes and equity wealth, but, with settlements reached between the government and lenders, these borrowers have only recouped a fraction of their losses. For citizen homeowners who have been unable to refinance, sell, or recapture equity, the losses they suffered are quantitatively irreparable in many cases. Moreover, citizen homeowners have seen no monetary restitution from the BFSI.

1. Toxic Mortgages and Related Products

Speculative, complex, and risky investment products, such as derivatives, CDOs, and CDSs, were the BFSI's tools for transforming the national residential finance market to capture lucrative profits attainable on the global level.¹⁴⁹ Because lenders desired to capture abundant foreign investment capital, lenders introduced new, toxic mortgage products into the residential market; such new products were needed because the pool of consumers eligible for less profitable, traditional products was already saturated.¹⁵⁰ Driven by greed, lenders could not overlook the guaranteed, short-term profits they would gain by investing more capital into MBSs that they could create with these toxic residential mortgages.¹⁵¹

In the mid-2000s, lenders used subprime mortgages to hedge their risks.¹⁵² In order to create the tsunami of mortgage products needed for MBSs, lenders deployed their minions comprised of mortgage originators, including wholesale subsidiary mortgage bankers and mortgage brokers, appraisers, rating agencies, and underwriters, among others. These minions rounded up consumers to place in subprime and alt-A mortgages that became the pipeline for MBSs. Critics who blame the crisis on consumer behavior often overlook and under-emphasize lenders' behavior in enticing consumers, who otherwise may not have qualified for mortgages or who were not actively seeking to refinance, into the mortgage market.¹⁵³ Moreover, consumers did not demand that lenders negligently create risky, toxic mortgage products or imprudently lower lending standards so that even the most financially vulnerable consumers could get mortgage loans. In addition, consumers were not involved in the placement of these questionable mortgage products into a cluster of risky mortgage-related security products, such as CDOs and CDSs. To the contrary, it was the duplicitous behavior of commercial banks and Wall Street investment firms that used the secondary mortgage market to exploit consumers for the BFSI's own ends.¹⁵⁴ Mortgage industry executives and employees, through

¹⁴⁹ FCIC, *supra* note 9, at 188 (finding that the three leading promoters of CDOs were Citigroup, Merrill Lynch, and UBS, which likely did not understand the risks inherent in the products they were creating); RAMIREZ, *LAWLESS CAPITALISM*, *supra* note 8, at 206 (explaining that CDOs were loaded with the riskiest mortgages in order to profit when the securities sold defaulted and created massive losses).

¹⁵⁰ FCIC, *supra* note 9, at 5.

¹⁵¹ *Id.*

¹⁵² ENGEL & MCCOY, *supra* note 17, at 53 n.47 (stating that at the top of the market in 2006 and 2007, banks issued over \$200 billion worth of CDOs backed by risky mortgage-backed securities.)

¹⁵³ See pond cummings, *supra* note 59 (comprehensively summarizing the various perspectives on who and what caused the financial crisis).

¹⁵⁴ Johnson, *The Magic of Group Identity*, *supra* note 109, at 168; Debra Pogrud Stark & Jessica M. Choplin, *A License to Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, 5 N.Y.U. J.L. & BUS. 617, 660–62 (2009); see also pond cummings, *supra* note 59, at 5; see also Porter, *Conflicts of Interest*, *supra* note 27, at 627

testimony and statements, have substantiated that lenders exploited borrowers by pushing them into toxic mortgages, misleading them with deceptive information, and making mortgages to borrowers destined for default because of the profits that the BFSI and its investors would realize.¹⁵⁵

In one instance, Ameriquest, a defunct mortgage lender¹⁵⁶ sued by forty-nine states and the District of Columbia for fraudulent loans, generated residential mortgages to ship to Wall Street investment banks so that such mortgages could then be sold to investors through private-label securities.¹⁵⁷ This example captures how lenders had “shifted the lending pattern.”¹⁵⁸ The result was more subprime mortgages packed into more faulty MBSs. In another instance, the nation’s then largest and most nefarious lender, Countrywide Financial, through its wholesale division Countrywide Home Loans, entered into the largest predatory lending settlement at \$8 billion,¹⁵⁹ with eleven states in 2008. Countrywide had misled borrowers about information regarding risky loan features, such as adjustable rate mortgages coupled with other volatile features.¹⁶⁰ Countrywide knew these risky mortgages were likely to go into default, but nonetheless generated large volumes of such mortgages to sell to private investors on the secondary market.¹⁶¹ The obvious need be stated, that lenders voluntarily made and enticed consumers into these risky mortgages; the government was unable or unwilling, because of BFSI influence and self-regulation, to force lenders to act in accord with prudent lending practices.

Several scholars have offered explanations about these influences on consumers’ behavior, especially the influences that led the consumers to take on such highly risky mortgages in the first instance.¹⁶² The congruence

(citing Lauren E. Willis, *Against Financial-Literacy Education*, 94 IOWA L. REV. 197, 202 (2008)).

¹⁵⁵ See generally FCIC, *supra* note 9, at 8.

¹⁵⁶ Ameriquest was a thrift institution regulated by the former government regulator, the OTS. As a thrift, Ameriquest only originated mortgages but was very lucrative in doing so. ENGEL & MCCOY, *supra* note 17, at 26 (stating that by 2006, Ameriquest profits allowed it to sponsor the Super Bowl XXXIX half-time show, although it shut down its retail mortgage shop by 2007 and sold the rest of the company to Citigroup).

¹⁵⁷ “Private-label securities” are those securities issued by Wall Street investment firms, as opposed to those securities GSEs generated. ENGEL & MCCOY, *supra* note 17, at 18.

¹⁵⁸ FCIC, *supra* note 9, at 12 (quoting Prentice Cox, interview by FCIC, Oct. 15, 2010). A former head of the fraud investigation department at Ameriquest told the Commission that he detected fraud right after he started working for Ameriquest but that senior management told him to ignore it. *Id.*

¹⁵⁹ RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 53.

¹⁶⁰ *Id.*

¹⁶¹ *Id.* at 80; see FCIC, *supra* note 9 (noting that GSEs only held a small percentage of toxic mortgages—about ten percent—but Wall Street investment firms generated the most private-label MBSs from these toxic mortgage products).

¹⁶² Stark & Choplin, *supra* note 154, at 600–62 (discussing the influence of salespersons on consumers); Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL’Y REV. 233, 234 (2002) (describing the levels of understanding of consumers based on educational levels and heuristics); Johnson, *The Magic of Group*

among these explanations lies, in part, in consumers' perceptions about homeownership and in lenders' control over those perceptions.¹⁶³ What could have made consumers invest in the riskiest, undiversified investment of their lives is the perceived social benefit of being homeowners.¹⁶⁴ While legal scholarship provides an excellent sounding board about the virtues of homeownership, at the grassroots level, lenders are not abstractly discussing these virtues, but rather are preying on consumers' identification with these virtues.¹⁶⁵ The fundamental perception that owning a home is part of the American dream likely drove consumers to mortgages lenders that offered to help attain this dream, without regard for the cognitive and fiscal analysis¹⁶⁶ or whether they should even own a home.¹⁶⁷ Some scholars have concluded that borrowers who became homeowners did not actually increase life satisfaction when they became homeowners because of the burdens associated with homeownership, such as the need for additional income to maintain the property or to pay for repairs as problems arose.¹⁶⁸ Aware of the social vulnerabilities consumers had in regard to homeownership, lenders used that knowledge to their most profitable advantage.¹⁶⁹ While lenders and

Identity, *supra* note 109, at 168 (identifying the types of schemes that lenders used to entice minority borrowers into homeownership).

¹⁶³ Willis, *supra* note 154, at 202; Johnson, *The Magic of Group Identity*, *supra* note 109, at 168; Stark & Choplin, *supra* note 154, at 662 (stating consumers are influenced by pitches from salespersons about the products they receive).

¹⁶⁴ Stephanie M. Stern, *Reassessing the Citizen Virtues of Ownership*, 111 COLUM. L. REV. 890, 891 n.4 (2011) (citing WILLIAM A. FISCHER, *THE HOMEVOTER HYPOTHESIS* 4–12 (2001)).

¹⁶⁵ *Id.* at 890 (exploring the psychological, historical, and economic factors underlying the variable citizenship effects from homeownership).

¹⁶⁶ A ten-year study by the National Institute of Health concluded that among U.S. students and adults, more than eighty percent of learning and reading problems were due to a cognitive skills weakness—mental skills absolutely necessary for successful learning. If skills are strong, learning comes naturally. If weaknesses remain hidden, a student will have to work too hard to learn or read. See *Top Ten Reasons to Test Cognitive Skills*, THE GIBSON TEST (Aug. 7, 2013) http://gcstest.com/Top_Ten_Reasons_to_Test_Cognitive_Skills.pdf; see also Willis, *supra* note 154, at 202.

¹⁶⁷ Stark & Choplin, *supra* note 154, at 668; Porter, *Conflicts of Interest*, *supra* note 27, at 627; Stern, *supra* note 164, at 891 n.4 (explaining that consumers are unlikely to assess the psychological factors that influence their decision to buy a home instead of continuing to rent, such as the benefits derived from citizenship virtues of homeownership discussed by property scholars); see also FISCHER, *supra* note 164, at 4–12.

¹⁶⁸ Stern, *supra* note 164, at 891 n.6; William M. Rohe, *The Social Benefits and Costs of Homeownership: A Critical Assessment of the Research* 11–22 (Harvard Univ. Joint Ctr. for Hous. Studies, Working Paper No. LIHO-01.12, 2001), available at <http://www.jchs.harvard.edu/publications/homeownership/liho01-12.pdf>.

¹⁶⁹ Stern, *supra* note 164, at 891 n.5; Denise DiPasquale & Edward L. Glaeser, *Incentives and Social Capital: Are Homeowners Better Citizens?*, 45 J. URB. ECON. 354, 374 (1999) (explaining that empirical scholars have concluded from their findings that only modest differences exist between owners and renters in the context of psychological and citizenship benefits).

their investors were making profits, homeowners were losing their accumulated equity wealth into the trillions of dollars by early 2012.¹⁷⁰

2. *Loss of Equity Wealth*

Homeownership has been traditionally tied to the ideology of wealth building and community stability, bringing about better citizenry and stronger communities.¹⁷¹ The years leading up to the 2007 financial crisis created a misconception related to the ideology of homeownership as a wealth-building investment because of the enormous amount of indebtedness associated with obtaining homeownership, particularly a very large mortgage.¹⁷² The wealth-building benefit of homeownership occurs when, over time, the mortgage decreases and the property value increases. This equity value is what creates wealth for homeowners. However, when lenders introduced equity-depleting mortgage products into the residential market, the result was not only a lack of equity-building, but also substantial equity loss for many citizen homeowners. When the mortgage feature of an adjustable rate required front-loading the payments with interest, or required no equity down payment at origination, equity was non-existent, especially in the first several years (or almost first decade), of the mortgage term.¹⁷³ In addition, when lenders introduced mortgages with volatile monthly payments that increased due to interest rate increases, borrowers who lenders steered into these risky mortgages found that they could no longer afford the mortgage payments and defaulted—defaults that some lenders admit they anticipated upon initially making such mortgages. Thus, homeownership resulted in community instability because of the toxic mortgages lenders eventually foreclosed on in the wake of the financial crisis—in some cases, creating foreclosure ghost towns.¹⁷⁴ The psychological impacts on citizen

¹⁷⁰ Obama, *supra* note 31; *see generally* Carliner, *supra* note 6.

¹⁷¹ Stern, *supra* note 164, at 890.

¹⁷² Mortgages are the largest debt obligation most citizens will ever make in their lifetimes. *See id.* at 891.

¹⁷³ Some mortgages were interest-only with no principal reduction. These mortgages were often adjustable rate mortgages with interest rates locked in for one to ten years by some lenders. As a norm, many lenders offered interest-only loans for two to five years so that equity building would not start until borrowers paid down the principal because the initial monthly payment only paid for the interest on the loan. The initial perceived equity in property was due to the inflated property values lenders used to make the mortgages, which dropped by as much as fifty percent in some communities after the 2007 financial collapse. John Yedinak, *Home Equity Declines More Than 60% During Great Recession Says Fed Report*, REVERSE MORTG. DAILY (Feb. 13, 2011), <http://reversemortgagedaily.com/2011/02/13/home-equity-declines-more-than-60-during-great-recession-says-fed-report/>. The author's experiences as a loan originator with mortgage brokers and as a real estate attorney conducting hundreds of closings between 2000 and 2006 and her non-empirical research talking with lenders and practitioners provide the basis for many of these statements.

¹⁷⁴ Harry Bradford, *Images of America's Foreclosure Ghost Towns*, HUFFINGTON POST (Mar. 30, 2011), http://www.huffingtonpost.com/2011/03/30/foreclosures-ghost-towns_n_840663.html#s258761&title=Las_Vegas_Nevada; Paul Toscano, *Ghost Towns Seeing*

homeowners who faced foreclosure are significant because they and their families were uprooted from their communities.¹⁷⁵ Lenders who made these mortgages, however, had little, if any, conversation with borrowers at the outset about weighing the perceived benefits of homeownership versus the burdens of such a debt obligation, as doing so would have been contrary to lenders' own interests. Thus, lenders ignored the policy of homeownership as an equity, wealth-building means for citizens, but instead used homeownership as a profit-building means for themselves.

The economic losses to citizen homeowners are substantial relative to the profits still enjoyed by the BFSI. By the end of 2007, the estimated amount of foreclosed mortgages¹⁷⁶ equaled \$400 billion.¹⁷⁷ Between 2007 and 2009, citizen homeowners had lost sixty percent of their equity wealth.¹⁷⁸ By January 2012, the White House reported an estimated \$7 trillion in lost equity wealth.¹⁷⁹ Although some 2013 reports indicate an increase in property values of around ten to twenty percent in some major metropolitan areas where property values did not see the most significant declines, most citizen homeowners are still suffering from significant equity loss.¹⁸⁰ Yet, by June 2009, the FRB reported that commercial banks were on

Signs of Life, CNBC (Nov. 17, 2010), <http://www.cnbc.com/id/40220424>; Azam Ameer & Darnell Little, *Foreclosures Spur Neighborhood Ghost Towns*, CHI. TRIB., Feb. 22, 2009, http://articles.chicagotribune.com/2009-02-22/news/0902210271_1_ghost-towns-foreclosures-last-year-neighborhood-stabilization-program.

¹⁷⁵ Tatom, *supra* note 67, at 10 (discussing the “psychic costs” associated with foreclosure that result when consumers can no longer afford the costs of homeownership, including: embarrassment; loss of self-confidence and esteem for both parents and their children; and damage to credit ratings impacting the ability to find work, to secure a new residence, to obtain insurance, and to get credit for other goods and services).

¹⁷⁶ *Id.* at 14. The loss of equity to citizen homeowners caused by reduced housing prices is significant. *Id.*

¹⁷⁷ Peter S. Goodman, *Homeowners Feel the Pinch of Lost Equity*, N.Y. TIMES, Nov. 8, 2007, <http://www.nytimes.com/2007/11/08/business/08borrow.html?pagewanted=all>. When home prices began to fall in 2007, owners' equity in their real estate fell from almost \$13.5 trillion in the first quarter of 2006 to a little under \$5.3 trillion in the first quarter of 2009. Yedinak, *supra* note 173. In that three-year period, the decline in total home equity exceeded sixty percent, according to the report. *Id.* At the end of 2009, owners' equity bounced back a bit and was an estimated \$6.3 trillion. *Id.* Nevertheless, the equity as of late 2009 was still more than fifty percent below its 2006 peak. *Id.*

¹⁷⁸ *Id.* There was a decline in total home equity of more than sixty percent. *Id.*

¹⁷⁹ Obama, *supra* note 31. By early 2012, former and current homeowners lost equity wealth of about \$7 trillion since the peak of the housing bubble in 2005. *Id.*

¹⁸⁰ Ken Harney, *Homeowners' Equity Jumps 20 Percent After a Years-long Slump*, WASH. POST, Jan. 4, 2013, http://articles.washingtonpost.com/2013-01-04/news/36210883_1_home-equity-rebound-in-home-prices-real-estate. Some of the most impressive gains in values were in areas that suffered the deepest price plunges—and the most painful losses in owners' equity—between 2007 and 2011. *Id.* According to a study by Realtor.com, list prices of houses in Phoenix were 21.4% higher in November than they were twelve months earlier. *Id.* In Riverside-San Bernardino, California, prices were up 13.3%; in Las Vegas, 10.6%; and in Miami, 10%. *Id.*

target for estimated profits and that stock values remained stable.¹⁸¹ As of early 2013, the nation's six largest banks reported record profits of \$23 billion in the second quarter.¹⁸² The disparity in losses to citizen homeowners is staggering, especially in light of the ongoing profits of the BFSI.

While lenders recouped their losses over a relatively short period time between 2007 and 2013,¹⁸³ citizen homeowners who still own their homes today are not likely to see the same recovery of lost equity. Many borrowers lost their wealth to foreclosure, and many of the remaining homeowners will take substantially longer to recover the equity that would have accrued in their property if self-regulated lenders had not caused unrealistic home value inflation to feed the secondary mortgage market.¹⁸⁴ While the BFSI prospered from securitization of toxic mortgages and related products, citizen homeowners fared poorly.¹⁸⁵ The residual effect of the

¹⁸¹ Morten L. Bech & Tara Rice, *Profits and Balance Sheet Developments at U.S. Commercial Banks in 2008*, 95 FED. RES. BULL., at A86 (June 2009), available at <http://www.federalreserve.gov/pubs/bulletin/2009/articles/bankprofit/default.htm>. The bulletin states:

By the middle of April, about one-half of banking organizations had reported their earnings for the first quarter of 2009. While earnings per share (EPS) results were *better than expected* at some (especially large) banking organizations, about one-third of the firms reported losses, and about two-thirds fell short of analysts' expectations Their earnings results, coupled with analysts' estimates available through mid-April, indicated that banking firms will earn in the first quarter of 2009, on average, about one-fourth of their EPS in the same quarter last year and just slightly more per share than in the fourth quarter of 2008.

Id. (emphasis added).

¹⁸² Peter Eavis, *Big Banks, Flooded in Profits, Fear Flurry of New Safeguards*, N.Y. TIMES, July 18, 2013, http://dealbook.nytimes.com/2013/07/18/big-banks-flooded-in-profits-fear-flurry-of-new-safeguards/?_r=0.

¹⁸³ Global investors in American MBSs included foreign nations. See generally Kerri Ann Panchuk, *Hidden Foreign Investor Risk Legacy in RBMS*, HOUSINGWIRE (Nov. 26, 2012), <http://www.housingwire.com/blogs/1-rewired/post/hidden-foreign-investor-rmb-debacle>. Now, the investors who hold interests in the secondary market tranches bear most the losses from the banks' risky mortgage originations. According to various economic reports, the FDIC, the Lex 2008, the International Monetary Fund, the Organisation for Economic Co-operation and Development, and Greenlaw, Hatzius, Kashyap, and Shin, the conclusion drawn is that most banks were aggressively raising new capital, offsetting the lion's share of write-downs by the end of 2007 because they sold them on the secondary mortgage market where those mortgages were securitized and then sold to private domestic and global investors. *Id.*

¹⁸⁴ Some argue that this is not likely to occur because many borrowers purchased the property at an inflated value or, in other words, paid more than the house was actually worth. *Id.*

¹⁸⁵ The lost equity wealth relates largely to the unprecedented foreclosure rates, resulting from lenders' abusive lending practices. See Gretchen Morgenson, *Audit Uncovers Extensive Flaws in Foreclosures*, N.Y. TIMES, Feb. 15, 2012, http://www.nytimes.com/2012/02/16/business/california-audit-finds-broad-irregularities-in-foreclosures.html?_r=0. The Assessor-Recorder of San Francisco, through examining files of property recorded in the county from January 2009 through November 2011, determined that about eighty-four percent of the files contained clear violations of the foreclosure laws and about two-thirds had violations and other irregularities, such as failure to warn borrowers of default, entities with

financial crisis and the resulting mortgage and foreclosure crises is that the citizen homeowners who kept their homes suffered a significant decline in household wealth, which resulted in consumers' attempt to boost savings and cut spending in order to rebuild wealth—an impact felt by the entire American economy.¹⁸⁶ Wealth recovery for citizen homeowners is still lacking from the government and the BFSI, even though the government aided the BFSI in restoring its wealth with taxpayer funds—the same taxpaying citizen homeowners who deserve restoration of their wealth.

3. BFSI Bailout Through the Troubled Asset Relief Program

Citizen homeowners received no government assistance after the financial collapse in 2007, but the government allocated \$700 billion of taxpayer funds to provide relief to troubled banks and Wall Street investment firms—the largest bailout of private financial companies in American history.¹⁸⁷ Specifically, in 2010, Congress passed the TARP¹⁸⁸ to deal with the too-big-to-fail problem, which was rooted in BFSI's excessive greed, deficient self-regulation, lack of transparency, and incestuous interconnectedness. This lack of transparency related particularly to the residential secondary mortgage market of MBSs, and it included the related issue of how heavily BFSI institutions were invested in each other.¹⁸⁹ As a result, if one large financial institution failed, then all BFSI institutions financially connected to that large institution would also fail, and the American economy would suffer.¹⁹⁰ The lack of BFSI transparency about its level of interconnected investments and the true nature of the risk that the prominent insurance company AIG guaranteed for those interconnected investments left the government and its regulators uncertain of what would happen to the national economy if one firm's collapse led to a domino-effect collapse within the BFSI. For instance, with the collapse of Lehman Brothers Holdings Inc., a global investment firm, the stock market fell significantly and global markets experienced declines. The BFSI and foreign powers warned the government not to allow another BFSI institution to fail because the effects would be devastating nationally and globally.¹⁹¹ The government

no right to assignment of loans in the chain of title, and mortgages bought back at auction by lenders who had not proven ownership. *Id.*

¹⁸⁶ Tatom, *supra* note 67, at 9.

¹⁸⁷ Marc Davis, *Top 6 U.S. Government Financial Bailouts*, INVESTOPEDIA (July 12, 2009), <http://www.investopedia.com/articles/economics/08/government-financial-bailout.asp>.

¹⁸⁸ Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, §§ 1–303, 122 Stat. 3765 (2008).

¹⁸⁹ BAIR, *supra* note 27, at 67–68, 176, 317–18. As former chairman of the FDIC, Bair discussed the troubles that loomed over the largest commercial banks under her agency's control, as well as action taken by the Federal Reserve Board under Chairman Paulson's leadership in relation to the largest Wall Street investment firms. *Id.*

¹⁹⁰ *Id.* at 107–08.

¹⁹¹ TOO BIG TO FAIL, *supra* note 22.

realized that without knowing the full level of BFSI interconnectedness, the collapse of a major BFSI player could be economically catastrophic; as a result, the BFSI had cornered the government into rescuing the industry.¹⁹² Thus, the government, through taxpayer funds, rescued all of the largest commercial banks and investment firms from their bad investments and potential losses. The bad investments, also referred to as toxic assets, were mostly real estate assets, namely RMBSs. Unfortunately, BFSI institutions received TARP funds without restrictions on how the funds could and should be used to aid economic recovery and without any level of accountability beyond repayment of the funds. Moreover, the rate the government charged for repayment was very favorable to the BFSI. The infusion of cheap capital had a low five percent interest rate, and the government guaranteed the debts of many BFSI institutions, allowing those institutions to pay large bonuses and compensation packages to executives and dividends to shareholders, while remaining solvent nevertheless.¹⁹³ In the interim, taxpayers suffered the worst individual and national economic loss of wealth in U.S. history.

Arguably, the most significant and detrimental loss to taxpayers and those citizen homeowners was that the government did not require the BFSI to make restitution to borrowers for equity losses caused by the BFSI. Lenders further dried up lending and refused to refinance mortgages that citizen homeowners found themselves unable to repay because of steep interest rate increases. This lender conduct following the 2007 financial crisis was reminiscent of lender conduct following the Great Depression, when lenders also refused to make loans prior to the advent of government guarantees. This time, however, lenders had already captured the existing regulatory regime, eliminated meaningful regulation that would have curbed the conduct leading to such economic crisis, and salvaged itself and its profits through TARP. The BFSI had successfully facilitated the rescue of its industry, while citizen homeowners and taxpayers received scant, if any, relief, no guarantee to prevent their losses, and little meaningful assurance that the BFSI would aid them or the national economy.¹⁹⁴ Citizen homeowners need recovery for their losses akin to the governmental nationalization of BFSI private firms under TARP.¹⁹⁵ For such recovery to

¹⁹² BAIR, *supra* note 27, at 117–19 (detailing that Citicorp needed repeated allocation of bailout funds because of many bad investments).

¹⁹³ RAMIREZ, *LAWLESS CAPITALISM*, *supra* note 8, at 86–87.

¹⁹⁴ See generally Symposium, *Four More Years? Looking Backward and Looking Forward Regarding the Great Recession and the Law*, 39 W. ST. U. L. REV. 281 (2012) (providing panel discussions among Professors David Groshoff, Reza Dibadj, and Tracie R. Porter).

¹⁹⁵ Both state and federal governments have entered into several settlements with banks and thrifts that committed fraud against borrowers. Nevertheless, many of the settlements do not guarantee that banks pay anything directly to victimized borrowers. For example, the Ameriquest settlement was for loan modifications for existing borrowers who were required to apply and qualify under standards set by the bank for proving injury. FCIC, *supra* note 9, at 12. Furthermore, during the period of investigation into Ameriquest's dealings, the bank's revenues totaled \$217.9 billion in loans, but the settlement was for \$325

occur, Congress first must address the BFSI usurpation of federal policy and regulatory capture.

B. BFSI's Influence on Policymakers and Politicians

American homeownership policy, as it relates to the government's lack of regulation of the BFSI, is a symptom of influence and control that the industry has over the legislative process and policymakers. The regulators and legislators should have provided optimal consumer protection to residential borrowers by mandating that lenders follow prudent lending standards. The FRB and Federal Deposit Insurance Corporation (FDIC)¹⁹⁶ established safety and soundness standards that lenders were to implement as a self-regulating industry. Congress authorized the FRB to regulate and enforce those standards against any violators.¹⁹⁷ For example, in 1994, the FRB had authority under HOEPA¹⁹⁸ to set prudent lending standards that addressed the predatory lending practices that plagued many low-income and minority communities.¹⁹⁹ The mortgage lenders originated in these communities contained onerous terms that many borrowers could not meet, thus they ultimately defaulted on the mortgages. With FRB Chairman Greenspan's neoclassical economic policy in place and the influence of the

million. *Id.* The \$25 billion settlement among the forty-nine state attorneys general, the U.S. Attorney General, and five banks benefitted former borrowers and homeowners. *See* NAT'L MORTG. SETTLEMENT, *supra* note 20. However, borrowers indirectly benefit from the settlement because they must make these requests for funds directly to the banks that determine if borrowers qualify for settlement funds. *Id.* In the meantime, the banks control the \$22 billion of the settlement funds and hold it in their accounts. *Id.* Borrowers may also apply for relief programs from their states because the state attorneys general directly received \$3 billion. *Id.*; *see also* Porter, *Managing Settlements*, *supra* note 64, at 309. The nation's former largest mortgage lender and biggest federal lobbying force, Countrywide, settled an allegation of fraud for \$8 billion in loan modifications. *Payments to Borrowers Who Lost Their Homes to Foreclosure*, NAT'L MORTG. SETTLEMENT (May 13, 2013), <http://www.nationalmortgagesettlement.com/>. Approximately \$1.5 billion of the \$22 billion (about 6.67%) banks agreed to pay borrowers in the national settlement is being used to compensate borrowers who lost their homes to foreclosure during the period of January 1, 2008 to December 31, 2011. *Id.*

¹⁹⁶ 12 C.F.R. § 170.1(b) (2011) ("Section 39 of the FDIC Act requires the OCC to establish safety and soundness standards.").

¹⁹⁷ 12 C.F.R. § 170.2 (2011). The regulation provides:

(a) Determination. The Office of Comptroller of the Currency may, based upon an examination, inspection, or any other information that becomes available to the OCC, determine that a Federal savings association has failed to satisfy the safety and soundness standards contained in the Interagency Guidelines Establishing Standards for Safety and Soundness as set forth in appendix A to this part or the Interagency Guidelines Establishing Information Security Standards as set forth in appendix B to this part.

Id.

¹⁹⁸ DEP'T OF HOUS. AND URBAN DEV., *supra* note 52.

¹⁹⁹ FCIC, *supra* note 9.

BFSI's lobbying efforts, Congress did not question the FRB's failure to regulate lenders' conduct, which it could have done by mandating that the agency promulgate rules to address the issue.²⁰⁰ However, the influence of the BFSI over politicians and, therefore, the legislative policy process affected how policymakers enforced existing laws.

Prior to the 2007 financial crisis, the BFSI's financial power made it difficult for politicians to say "no" to the industry.²⁰¹ The influence on and control over policymakers came from the biggest and most influential institutions in the BFSI,²⁰² such as the growing financial giant Countrywide, that regularly kept a presence in the nation's capital to watch over the legislative process to ensure that laws did not interfere with their profits.²⁰³ The BFSI used its influence and money to control whom was elected to legislative positions and what decisions politicians and other policymakers made while holding those positions.

The BFSI's financial power affects whether policymakers win or lose elections, or re-elections, particularly at the federal level.²⁰⁴ The relationships the BFSI had with influential political leaders in federal legislative positions and those who wanted to be elected to office directly affected homeownership policymaking and regulation. During the years when mortgage lending was at its most profitable for lenders, roughly between 2004 and 2007, the most prevalent of these relationships seemed to be the non-bank mortgage lenders in the BFSI,²⁰⁵ such as Countrywide Home Loans²⁰⁶ and Ameriquest,²⁰⁷ also known as thrift institutions. These types of

²⁰⁰ BAIR, *supra* note 27; RAMIREZ, LAWLESS CAPITALISM, *supra* note 8; FCIC, *supra* note 9.

²⁰¹ Issa, *supra* note 11.

²⁰² RAMIREZ, LAWLESS CAPITALISM, *supra* note 8; FCIC, *supra* note 9.

²⁰³ Issa, *supra* note 11, at 413.

²⁰⁴ *Top Contributors*, OPEN SECRETS, <http://www.opensecrets.org/pres12/contrib.php?id=N00000286> (last visited Nov. 13, 2013). For example, the largest contributions from financial institutions, including national banks and investment companies, to Mitt Romney's Campaign during the 2012 Presidential Election are as follows: (1) Goldman Sachs donated \$1,033,204; (2) Bank of America donated \$1,013,402; (3) Morgan Stanley donated \$911,305; (4) J.P. Morgan Chase & Co. donated \$834,096; (5) Wells Fargo donated \$677,076; (6) Credit Suisse Group \$643,120; and (7) Citigroup donated \$511,199, among others who donated various smaller amounts. *Id.*; see also Issa, *supra* note 11, at 412.

²⁰⁵ The term "non-bank mortgage lenders" is used here in reference to financial institutions that did not engage in depository banking, but solely originated mortgages. Subsidiaries of banks, thrifts, and Wall Street investment firms all engaged in mortgage lending but not traditional retail banking, unlike Bank of America or J.P. Morgan Chase, which provided both depository and mortgage lending services. See generally CORRIGAN, *supra* note 5.

²⁰⁶ The former CEO of Countrywide Angelo Mozilo characterized Countrywide's subprime loans as "poison" and "toxic," and likely to lead to bankruptcy. RAMIREZ, LAWLESS CAPITALISM, *supra* note 8, at 53–54 (citing FCIC, *supra* note 9, at 20). Countrywide Homes Loans, as a subsidiary of Countrywide Bank, reigned supreme as the nation's largest mortgage lender during the real estate boom from 2000 to 2007. *Id.*

²⁰⁷ Issa, *supra* note 11, at 413. Ameriquest was a thrift created for the purpose of originating residential mortgages, and it collapsed during the financial crisis. RAMIREZ,

mortgage lenders led the charge in creating a roadblock that closed off regulatory intervention in the new, risky lending practices. This roadblock to regulation came from assuring sitting members of Congress political contributions through political action committees and individual employee contributions,²⁰⁸ as well as financial support in the jurisdictions where members wanted to maintain political control.²⁰⁹

Once policymakers won elections, the BFSI created a powerful coalition of political allies in Congress.²¹⁰ For instance, in the secondary market, a federal legislator recounts how privately owned Fannie Mae and Freddie Mac blocked legislative reform that would affect their preferential treatment as GSEs and remove their autonomy as self-regulated entities within the BFSI.²¹¹ For the GSEs, this meant that they would have had to operate more conservatively without the government guarantee because of the lack of assurance of funding from taxpayer money if they got into financial trouble. In some instances, any policymaker who attempted to expose the BFSI's scandals, which other key policymakers allowed to fester, was committing political suicide. In a reported instance, Congressman Paul Ryan (R-WI) sought to increase regulatory oversight over GSEs, but he found that GSE and BFSI lobbyists reported to his constituents that he was promoting efforts to increase their mortgage rates.²¹² When Congressman Christopher Shays (R-CT) introduced new legislation to Congress that the BFSI lobbyists had not first vetted, lobbyists pressured the Congressman to withdraw the bill by questioning his judgment and pulling resources that promoted homeownership from his district.²¹³

After the 2007 financial crisis emerged, and with the BFSI's siege of control over the policy-making process and its regulatory authorities, Congress compromised with the BFSI by creating and passing the Wall Street Financial Reform Act and Consumer Financial Protection Bureau,

LAWLESS CAPITALISM, *supra* note 8. Through strategic agreements between non-bank mortgage lenders and both GSEs and Wall Street private-label investment institutions to deliver mortgages to the secondary market institutions to create MBSs, the BFSI assured its success in profiting from loan originating and securitization. *Id.*

²⁰⁸ Issa, *supra* note 11, at 414. GSE employees contributed over \$15 million between 1998 and 2008 to campaigns of key members of Congress who served on committees responsible for their oversight. *Id.*

²⁰⁹ See generally *id.* at 413. See also RAMIREZ, LAWLESS CAPITALISM, *supra* note 8.

²¹⁰ Issa, *supra* note 11, at 412.

²¹¹ *Id.* The GSEs Fannie Mae and Freddie Mac spent as much as \$176 million in lobbying expenses between 1998 and 2008. *Id.*

²¹² *Id.* at 414. By the 1960s, the government no longer owned GSEs, but private investors took ownership while the government acted as a guarantor for GSEs. As a result of the financial crisis in 2007, the government placed Fannie Mae and Freddie Mac in receivership because of the losses suffered from investments in toxic mortgages and subprime products. It was under private ownership that the GSEs collapsed, but only after the owners made substantial profits from them. Bech & Rice, *supra* note 181; pond cummings, *supra* note 59.

²¹³ Issa, *supra* note 11, at 414.

commonly referred to as the Dodd-Frank Act.²¹⁴ This Article is not a critique of the effectiveness of the Dodd-Frank Act and its potential to prevent future financial crisis. However, the Dodd-Frank Act, in its current form, is not likely to provide the originally envisioned level of effective, meaningful, and consumer-focused homeownership policy²¹⁵ because of the BFSI's effort to undermine the Act.²¹⁶ With the new policy in place and even with laws establishing new regulatory and oversight policy, the BFSI's revolving door into the offices of its various regulators will likely keep enforcement at a minimum or non-existent level, as was the case in the years preceding 2007. Regulators hold the role of enforcers of law, and, therefore, Congress should mandate regulators pursue and enforce action under the law.

²¹⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of 12 U.S.C.). This act creates the Consumer Financial Protection Bureau (CFPB) to provide major structural changes to the regulation and enforcement of financial consumer protections. *Id.* at § 1011; *see also* CONSUMER FIN. PROT. BUREAU, www.cfpb.gov (last visited Nov. 13, 2013); *see also* Obama, *supra* note 31.

²¹⁵ Furthermore, while Congress got the industry to agree to eliminate the riskiest loans, such as no- and low-documentation loans, the most profitable ones are still available to lenders, such as a variety of adjustable rate mortgages used during the subprime crisis, such as 2/28 and 3/27 mortgages. Dodd-Frank Act; Christopher K. Seide, *Consumer Financial Protection Post Dodd-Frank: Solutions to Protect Consumers Against Wrongful Foreclosure Practices and Predatory Subprime Auto Lending*, 3 U. P.R. BUS. L.J. 219, 236 (2012) (“Title XIV, known as the Mortgage Reform and Anti-Predatory Lending Act . . . creates new substantive changes for a variety of consumer financial products, most notably of which are mortgage loans.”).

²¹⁶ Matt Taibbi, *How Wall Street Killed Financial Reform*, ROLLING STONE MAG. (May 10, 2012), www.rollingstone.com/politics/news/how-wall-street-killed-financial-reform-20120510; Arthur E. Wilmarth, Jr., *The Financial Services Industry's Misguided Quest to Undermine the Consumer Financial Protection Bureau*, 31 REV. BANKING & FIN. L. 881, 889 (2012) (“The Industry's Post-Dodd-Frank Campaign to Weaken CFPB”); *see* Seide, *supra* note 215, at 235–36. Seide states:

The Dodd-Frank Act addresses a wide range of topics, including key provisions such as: (1) consumer protections; (2) systemic risk oversight; (3) executive compensation regulation; (4) bank capital requirements; (5) ending “too big to fail” bailouts; (6) transparency and accountability relating to complex financial instruments; (7) enforcement of current regulations; (8) reform of the Federal Reserve; (9) mortgage lending reform; (10) hedge fund oversight; (11) control over credit rating agencies; (12) reform of insurance regulations and investor protections; and (13) addressing securitization and municipal securities.”As new legislation, most of the provisions of the Act will not be until 2014; rulemaking also has not, or has recently, been concluded. In the meantime, lobbyist efforts through political influence will likely gut the most important provisions of the DFA before it even becomes effective and enforceable. For law to be most effective, it has to be enforced, and enforceability of the law was the essential missing component in the events that result in the financial crisis.

Seide, *supra* note 215, at 235–36.

C. One-Eye-Open Federal Regulators²¹⁷

Due to federal preemption law, state regulators have little to no way of regulating the BFSI, unless the institutions locally charter in their states. Thus, the line of defense for citizen homeowners against the BFSI lies within the control of federal regulators, who are unfortunately under the BFSI's influence.²¹⁸ Specifically, the federal government has sole authority over all of the nationally-chartered institutions. Federal homeownership policy, as it relates to the regulatory oversight and enforcement of the lending practices of the BFSI, falls under the authority of several agencies. The FDIC insures consumer deposits and oversees national banks' safety and soundness, but the FDIC lacks enforcement authority over bank lending practices. The SEC has authority over institutions that introduce securities products into the residential secondary mortgage market, such as MBSs and CDOs.²¹⁹ The primary regulators of the BFSI, however, are the FRB and the Office of the Comptroller of the Currency (OCC).²²⁰ The FRB regulates the financial services industry generally, but particularly national banks and Wall Street investment firms, whereas the OCC regulates national banks.

1. The Federal Reserve Board

Congress authorized the FRB to enforce policy affecting monetary and lending practices of the BFSI. Under its authority, the FRB can set standards for the BFSI to follow, such as those governing mortgage lending. The FRB has declined to use its regulatory authority to oversee or enforce

²¹⁷ *Eyes Wide Shut*, FIN. TIMES, May 23, 2008, www.ft.com/intl/cms/s/0/bf30c3d2-2877-11dd-8f1e-000077b07658.html#axzz2pk1M9iRp. This title is coined from article's title in the Lex Column, but the author plays on the words because in some ways the regulators had at least one eye open and knew fraud was occurring—the open eye. In other ways, regulators really did not know what the BFSI was doing or how interconnected the industry's toxic mix of products were until it was too late—the shut eye. See BAIR, *supra* note 27 (commenting on interconnectedness); see also FCIC, *supra* note 9, at xvi (discussing toxic mortgages); see generally RAMIREZ, LAWLESS CAPITALISM, *supra* note 8 (on corporate irresponsibility and lack of transparency to the markets).

²¹⁸ BAIR, *supra* note 27.

²¹⁹ While scholars have identified that the toxic derivatives market, fueled by atomic mortgage-backed securities, caused the systemic collapse on the national and global level, the SEC is not in the best position to address the past injury or the next future harm, from issuance of securities tied to residential mortgages. The BFSI created and engaged in a quagmire of derivatives tied to CDOs and credit default swaps stocked with subprime mortgages destined to default. The SEC was not privy to these practices as they arose. See generally Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 463 (2009) (accounting for the role of all the regulatory agencies, including the SEC, during the government's bailout of financial institutions and the SEC's role as facilitator in various mergers of institutions).

²²⁰ The FDIC has authority over banks when depository banks fail. The SEC is the primary regulator for the residential secondary securities market, but does not have authority over the general lending practices of the BFSI, such as mortgage lending.

actions against the BFSI. Arguably, the policies, set between 1987 and 2006 by former FRB Chairman Alan Greenspan, aided lenders in increasing mortgage loans and related securitized investments, allowing both the toxic assets to arise and the troublesome interconnectedness among depository institutions to flourish. Some scholars attribute the 2007 financial crisis to the BFSI's imprudent interconnectedness of loaning funds to each other. For example, by keeping the federal funds rate low, the FRB reduced the value of the dollar, thus pervasively boosting investments.²²¹ The low funds rate benefited lenders that engaged in mortgage lending because the federal funds rate is the rate at which depository institutions (i.e., banks) lend funds or borrow funds from each other.²²² The FRB and institutions that wish to lend funds (i.e., lender institutions) agree to this rate on individual loan transactions, which generally are overnight in term.²²³ The borrowing institution then borrows money at a very low rate (e.g., two percent) from the lender institution, and then, in turn, the borrowing institution makes loans at higher interest rates to consumers (e.g., five percent), for example in the form of mortgages. The borrowing institution profits from the difference between the rate at which it borrows and the rate at which it lends. For example, Lender A, the lender institution, loans money out to Lender B, the borrowing institution, at the federal fund rate of two percent (effective as of April 30, 2008).²²⁴ Lender B then sells consumer mortgages at five percent. Lender B then pays back Lender A at two percent and keeps a profit of three percent. The lower the federal funds rate, the cheaper it is for borrowing institutions to obtain money and the greater the likelihood that they can loan money out at higher rates. This practice was prevalent among those institutions engaged in the RMBSs market. For example, Citicorp, the bank that obtained the largest amount of TARP funds because of its massive amount of toxic real estate investments, found itself unable to repay its loans to other financial institutions. Thus, if the government had not bailed out Citicorp, the various other lending institutions that loaned it funds would have suffered from the ripple effect.²²⁵ Thus, the FRB is responsible, to some degree, for facilitating the BFSI's greed-motivated behavior by failing to act as a proactive regulator.²²⁶

²²¹ Tatom, *supra* note 67, at 9.

²²² *Id.* at 19. This is distinguishable from the "primary credit rate," also known as the "discount rate," in which qualifying depository institutions (likely members of the Federal Reserve Bank) borrow funds directly from the Federal Reserve Bank, generally overnight. *Id.* Nevertheless, borrowing from the Federal Reserve Bank is not common or frequent for banks that generally lend and borrow from each other at the federal funds rate explained above. *Id.*

²²³ *Id.*

²²⁴ For the same effective date, the primary credit rate (or discount rate) was 2.25%, generally signaling to lenders that credit was easy for them to obtain. *Id.* at 20 (referring to statistics from the Federal Reserve Bank of St. Louis).

²²⁵ BAIR, *supra* note 27; FCIC, *supra* note 9.

²²⁶ The behavior of the Federal Reserve Bank has been more like a commercial bank than a central bank. Tatom, *supra* note 67, at 24, 26. A commercial bank is one that is constrained by liabilities and funding requirements. When a commercial bank is in crisis, it

The FRB's mindset, however, was reactive, not proactive. Under former Chairman Greenspan for two decades and then under his successor, former Chairman Ben Bernanke, the FRB held the regulatory position that the markets should take care of policing themselves as that was not—and should not—be the job of government.²²⁷ This reactive regulatory mindset led to the FRB's failure to use its authority as the only government agency with the power to prescribe mortgage-lending standards for all BFSI institutions, which, if exercised, could have stopped the subprime lending abuses, and ultimately, the resulting financial crisis built upon those abuses.²²⁸

It was only after the 2007 financial crisis and the Congressional appointment of the Financial Crisis Inquiry Commission (FCIC) to investigate what led to the crisis that the nation learned about the “pervasive permissiveness [and] little meaningful action . . . by the Federal Reserve Bank that failed to stem the flow of toxic mortgages.”²²⁹ It was not until 2009, after the financial and resulting mortgage and foreclosure crises erupted, that former Chairman Bernanke publicly acknowledged that the FRB failed to act earlier in promulgating lending standards under HOEPA.²³⁰ The rules that the FRB did promulgate did not go into effect until after the crisis—much too late to help affected citizen homeowners from devastating foreclosures and substantial equity wealth losses.²³¹

2. *The Office of the Comptroller of the Currency*

Congress empowered the OCC to charter and supervise national commercial banks, such as Citicorp, J.P. Morgan Chase, Bank of America, and Wells Fargo. The OCC's supervision of banks included regulating mortgage-lending standards and mortgage products. Yet, the largest institutions the OCC regulated influenced its regulatory decision-making. An account from Sheila Bair, former Chairman of the FDIC, stated that when regulatory guidance designed to address the increasing risks of non-traditional mortgages (or toxic mortgages) and to tighten mortgage-lending standards originated from OCC regulators, the BFSI criticized the regulators' actions in the media.²³² The BFSI also successfully encouraged members of

must reduce its liabilities and increase its capital assets. A central bank, however, is one that can print its own money. A central bank, having a demand for credit that it wishes to meet, can simply print money—rather than selling or reducing other assets. Some scholars point out that the great error of the Federal Reserve Bank is that it has acted like a private commercial bank and not a central bank, such as during the Great Depression and now during the Great Recession. *Id.*

²²⁷ BAIR, *supra* note 27.

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ *Id.*

²³¹ FCIC, *supra* note 9.

²³² BAIR, *supra* note 27.

Congress to criticize the actions of the regulators.²³³ Under the pressure of both the BFSI lobby and policymakers, the OCC compromised its position so that tougher regulatory standards would not be placed on national banks, but only on thrift institutions then regulated by the former OTS.²³⁴ For the largest national banks, such as Citicorp, this kept the OCC from interfering in the banks' risky lending and investment practices, which ultimately resulted in Citicorp receiving two TARP fund distributions.

In the case of regulation of mortgage products, such as non-traditional²³⁵ and subprime mortgages,²³⁶ the OCC argued that thrifts, such as Washington Mutual, Countrywide, and Golden West, primarily pushed these prevalent mortgage products, not national banks. Some argue that national banks did not routinely make subprime and predatory loans,²³⁷ albeit they allowed their subsidiaries to do so. Even if national banks did not make such mortgages, they did heavily invest in RMBSs that securitized those mortgage loans. Nevertheless, the BFSI's lobby once again used its financial and political power to influence regulators either to abandon any subprime mortgage lending guidelines or to shape the guidelines in the industry's favor.²³⁸ The compromise between regulators and the industry was that the OCC agreed to guidelines that required the BFSI to provide disclosures to consumers as to the features of certain types of toxic and subprime mortgages.²³⁹ Still, such regulation came too late to have any impact on the subprime and predatory mortgages lenders had made prior to 2007. Those types of mortgages led to the national and global market collapse because they had been bundled into securities and sold to investors on the secondary market. Investors relied on the quality of the MBSs based on the ratings of

²³³ *Id.*

²³⁴ Abolished by Congress in 2011, the OTS was the primary regulatory agency of major thrift institutions, such as New Century and Ameriquest. *Id.* OTS chartered and regulated thrifts, which are institutions that hold no deposit accounts, but primarily generate revenue from mortgage lending. *Id.* Thrifts grew mortgage loan balances from \$727 billion at the end of 2006 to \$795 billion by the third quarter of 2007. *Id.* By 2007, all the high-risk mortgage lenders regulated by OTS failed or were acquired by other institutions. *Id.*

²³⁵ NTMs include predatory mortgages that target borrowers with riskier credit credentials and great potential of default. *Id.*

²³⁶ Subprime loans are made to persons with good credit credentials and income, but, under these loans, borrowers are offered higher interest rates and terms when they qualify for better rates and terms. *Id.*

²³⁷ Some of the biggest national banks generated substantial numbers of subprime loans, including hybrid adjustable rate mortgages that offered an introductory teaser rate to qualify borrowers for mortgages. After the teaser rate expired, the monthly mortgage increased, surpassing borrowers' ability to pay. The prior standards only required lenders to qualify borrowers under the teaser rate and not disclose the fully indexed rate once the teaser rate expired. See generally FCIC, *supra* note 9; ENGEL & MCCOY, *supra* note 17.

²³⁸ BAIR, *supra* note 27. Regulators wanted a definite ability to pay according to the fully indexed rate, while lenders wanted, as argued through the OCC, a more vague ability-to-pay standard. *Id.*

²³⁹ Regulators reached a compromise but not until June 2007, at the beginning of the real estate bubble's bursting, which was too late to help borrowers. *Id.*

the underlying mortgages—a vast amount of which lenders knew at origination was toxic and likely to default. Thus, the BFSI needed the services of rating agencies to give high ratings to these investments, so they could be sold as part of the BFSI's quest for more profits.

D. Ready-to-Rate Rating Agencies

Essential for generating maximum profits through the sale of RMBSs on the national and global markets were the highest ratings available from the rating agencies. The ratings for securities investments are similar to consumer credit scores in that the ratings inform investors of the risk associated with the investment, just as in the consumer context a credit score dictates whether and at what rate a creditor will extend credit based on the credit score, which serves as a proxy for the potential for default.²⁴⁰ Thus, the higher the rating, the less risk involved in the investment, and vice versa. Investors used ratings to assist them in their decisions to invest in RMBSs the BFSI offered. However, investors were either ignorant to or ignored the fact that rating agencies were paid by the BFSI institutions that sought the ratings.²⁴¹ This meant that the BFSI wielded great influence over ratings through both the information provided to the rating agencies and by directing substantial business to these agencies.

Investors used the report-card-like letter ratings to assess the risk of the investment. For example, the AAA rating is the highest rating and a BBB rating is the lowest rating.²⁴² An investment with the AAA rating would lead an investor to presume that the investment was of the highest quality and would yield a favorable return with low risk, whereas an investment with the BBB rating would signal to the investor that the investment was highly risky and that investment in that vehicle should either be avoided or that extreme caution should be taken in investing due to the high risk of loss. Without the positive rating given to the RMBSs the BFSI sold, investors might not have bought in, and the BFSI would not have been able to garner such substantial profits.²⁴³

Some commentators, as well as the federal government, take the position that the financial crisis resulted, in part, from irresponsible ratings by rating agencies, which misled investors.²⁴⁴ In order to rate investments, however, the BFSI purchased the rating agencies' services for the rating of the investment products that were riddled with toxic mortgages destined for

²⁴⁰ Three primary rating agencies provided those designations for BFSI investments: Standard and Poor's, Moody, and Fitch. See ENGEL & MCCOY, *supra* note 17.

²⁴¹ See Porter, *Conflicts of Interest*, *supra* note 27.

²⁴² FCIC, *supra* note 9; ENGEL & MCCOY, *supra* note 17.

²⁴³ The 2007 financial crisis disclosed that not only private investors but also foreign governments made substantial investments in residential MBSs based on the ratings. The collapse of the United States market had a startling negative impact at the global level. Panchuk, *supra* note 183.

²⁴⁴ *Id.*

default, a fact only the BFSI originators knew.²⁴⁵ Much like the federal and state politicians and the federal regulators that the BFSI captured with its power and influence, rating agencies could only rely on the BFSI. Under the BFSI's robust creation of investment products, the rating agency industry rated what the BFSI presented to it, and the presentation by the BFSI failed to disclose adequately the inherently toxic nature of the products it packaged for rating and subsequent investment.

The BFSI institutions that employed the rating agencies used their powerful influence over the rating agencies to the industry's advantage. In some instances, it used the rating agencies to influence state legislative action to maintain profitable creation of investments. In another instance, it used the federal government to attack and blame the rating industry for the BFSI's irresponsible lending and investment practices. In both instances, the BFSI avoided regulation, made money, and escaped blame for its reckless conduct.

Take, for example, the State of Georgia outlined in Section II.C above. In that instance, the legislature received pressure from lenders and Wall Street investment banking firms, which refused to provide residential lending if the legislature passed a law exposing the industry and its investors to liability at the secondary market level. Specifically, BFSI lenders exerted their influence through the Standard and Poor's (S&P) rating agency, which announced it would refuse to rate any securities that included mortgages originated in Georgia.²⁴⁶ Because the BFSI clearly understood that investors would not buy investments without favorable ratings,²⁴⁷ lenders simply would not originate mortgages they could not sell on the secondary market.²⁴⁸ This meant that mortgage funds would dry up for Georgia consumers, making it difficult, at best, to buy or refinance homes. The BFSI pipeline to profits simply would not tolerate any hindrances from state legislatures, and thus, Georgia state politicians repealed the law.

At the federal level, the U.S. government took action against rating agencies by suing S&P for its rating of CDOs, based on alleged fraudulent behavior.²⁴⁹ The government's position is that rating agencies provided

²⁴⁵ See Porter, *Conflicts of Interest*, *supra* note 27.

²⁴⁶ See Peterson, *supra* note 48, at 2243–44.

²⁴⁷ *Id.* at 2243.

²⁴⁸ The most profitable aspect of residential mortgage lending was the ability to sell the mortgages on the secondary market bundled as MBSs and then eventually into CDOs insured by Credit Default Swaps. Johnson, *Post-Crisis Regulation of Financial Markets*, *supra* note 63.

²⁴⁹ *United States v. McGraw-Hill Cos.*, No. CV13-00779-DOC, 2013 Westlaw 416293 (C.D. Cal. Feb. 4, 2013); see also Sakthi Prasad, *U.S. Asks Judge to Deny S&P's Motion to Dismiss Fraud Lawsuit*, REUTERS (May 21, 2013), <http://www.reuters.com/article/2013/05/21/us-sandp-fraud-lawsuit-idUSBRE94K07T20130521> (a copy of the filed complaint is on file with the author). The federal government's lawsuit is based on a violation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) and alleges that the rating agency industry misled Citicorp, among other banks, by giving imprudent ratings on investments that the industry should have known were misleading to

fraudulent or misleading information that led to the crisis. In February 2013, the government filed a \$5 billion lawsuit accusing S&P, owned by McGraw-Hill Companies, Inc., of fraud for issuing inflated ratings on faulty products to drum up business.²⁵⁰ The government alleges that the S&P ratings were more than mere “puffery” and that S&P made ratings knowing investors would rely on them.²⁵¹ In response to the lawsuit, S&P filed a motion to dismiss the action arguing that S&P made ratings based on the same subprime mortgage data available to the rest of the market—including U.S. government officials, who publicly stated in 2007 that problems in the subprime market appeared to be contained.²⁵² Arguably, the rating agency relied on information that the BFSI presented to it. S&P also argues that it acted in good faith and published, between 2006 and 2007, a report on the state of the U.S. housing market and on U.S. RMBSs based on the good faith efforts of S&P’s professionals.²⁵³ The report contained information that was readily available from the BFSI to the market. The government action against S&P in this lawsuit is questionable, especially in light of the findings of the FCIC Report that faulted lending institutions, both commercial and Wall Street firms, for imprudent, negligent, and fraudulent lending practices that lenders often actively hid from discovery.²⁵⁴ In addition, as of the filing of the government action against S&P, no BFSI institution has been sued by the government based on fraudulent practices.²⁵⁵ “Now banks are the victims,” particularly Citigroup and Bank of America,²⁵⁶ stated one *Wall Street Journal* writer.²⁵⁷ The lawsuit against the rating agency is just another example of how the BFSI’s influence, which captured consumers, politicians, regulators, and related companies to act for its benefit. Instead of

investors. *Id.* Citicorp was the largest institution bailed out with TARP funds, and it had invested heavily in MBSs, including originations. *Id.*

²⁵⁰ *Id.*

²⁵¹ See Prasad, *supra* note 249.

²⁵² *Id.*

²⁵³ *S&P’s Response to the DOJ’s Meritless Lawsuit*, STANDARD & POOR’S RATINGS SERVS., <http://ratings.standardandpoors.com/changes/company/SPs-Response-To-The-DOJ-Complaint.html> (last visited June 6, 2013).

²⁵⁴ *Id.*

²⁵⁵ The OCC and FRB announced in early 2013 that as a result of an enforcement action regarding *deficiencies in mortgage servicing and foreclosure processes*, the regulators had settled with four large mortgage servicers—GMAC Mortgage, HSBC Finance Corporation, SunTrust Mortgage, and EMC Mortgage Corporation, among others. See *generally Independent Foreclosure Review*, BD. OF GOVERNORS OF THE FED. RES. SYS., <http://www.federalreserve.gov/consumerinfo/independent-foreclosure-review.htm> (last visited Dec. 19, 2013) [hereinafter FRB INDEP. FORECLOSURE REVIEW] (emphasis added). The enforcement action did not relate to fraud in the origination of those mortgages, upon which banks foreclosed. *Id.*

²⁵⁶ These banks are the two biggest benefactors of TARP funds, although Wall Street investment firms were the major benefactors of the ratings for their MBSs. ENGEL & MCCOY, *supra* note 17.

²⁵⁷ *Suddenly, Banks are Victims*, WALL ST. J., Apr. 24, 2013, <http://online.wsj.com/article/SB10001424127887323951904578291910513633152.html#>.

suing the rating agencies, federal policymakers should focus on using taxpayer dollars to sue and recover restitution from those BFSI institutions for the citizen homeowners harmed by their fraudulent and reckless conduct.

IV. NO HELP FOR CITIZEN HOMEOWNERS

Former and existing homeowners are the group most victimized by the BFSI's conduct, especially existing homeowners who lost the equity wealth in their homes when the BFSI pillaged the housing market.²⁵⁸ The \$700 billion in TARP funds²⁵⁹ that the U.S. Department of Treasury convinced Congress to approve to bail out the BFSI was an abuse and misuse of taxpayer dollars. Institutions in the BFSI used those funds to minimize their losses from the financial crisis that the industry created while citizen homeowners are desperately trying to recover from lost equity wealth in excess of \$1 trillion. Citizen homeowners, especially those who still own their homes, have suffered the greatest loss from the 2007 financial crisis and have received scant assistance from the U.S. government or the BFSI.²⁶⁰ Even if citizen homeowners initiate their own actions against institutions in the BFSI, the private remedies available to them are limited and often difficult to pursue given the BFSI infiltration into policy that prohibits action by private individuals against BFSI institutions, and under some laws, by the government.²⁶¹ Unless Congress enforces existing laws or creates new laws²⁶² allowing homeowners to pursue private actions against institutions in the BFSI or seeks recourse for existing homeowners who have received no meaningful assistance during this financial crisis, justice will not be served, and the BFSI will remain unaccountable for its egregious actions.

²⁵⁸ For purposes of the rest of the article, all references to "citizen homeowners" mean those homeowners who have not lost their homes to foreclosure, but who have suffered a significant loss of equity in their homes.

²⁵⁹ See generally TOO BIG TO FAIL, *supra* note 22 (referring to how the government bailed out Wall Street's gambling problem).

²⁶⁰ HAMP is a program the government promoted, but it was at BFSI members' discretion as to whether to participate in HAMP. *Home Affordable Modification Program*, MAKING HOME AFFORDABLE, http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx?gclid=CNyAyZLIw7kCFaN_Qgod-SUAdA (last updated May 28, 2013). Many of the modifications eventually led to foreclosure because of the impact of the financial crisis on employment that caused many homeowners to lose their jobs and the ability to pay their mortgages. *Id.*; *The Latest HAMP Statistics: What Do The Numbers Tell Us?*, HOUSE KEEPING REPORT: OREGON MORTG. & FORECLOSURE NEWS (Jan. 12, 2013), <http://www.housekeepingreport.com/the-latest-hamp-statistics-what-do-the-numbers-tell-us/>.

²⁶¹ Federal Trade Commission Act, 15 U.S.C. § 46(a) (2012) ("[E]xcepting banks, savings and loan institutions . . ." from enforcement action for unfair and deceptive practices affecting commerce).

²⁶² In the wake of the 2007 financial crisis, Congress expediently created TARP in an attempt to mitigate losses to the BFSI and the market as a whole. See Davidoff & Zaring, *supra* note 219. The indirect benefit to citizen taxpayers was to avoid a collapse of the financial markets, but arguably, citizen homeowners still have not seen true, tangible, direct benefits.

The next section analyzes some relevant existing state and federal laws that would: (1) provide the legal basis for creating new legal remedies for citizen homeowners to employ against BFSI institutions; and (2) allow the government to seek restitution from BFSI institutions for citizen homeowners. This section further critiques whether existing federal law provides the legal authority for the federal government to take action on behalf of citizen homeowners against the BFSI, much like the action the government has taken against the rating agencies. This section concludes with a proposal for how the federal government can use its policy-making power to design a remedy that provides adequate financial relief for citizen homeowners.²⁶³

A. State Law Claim Basis

Federally chartered banks and financial institutions have never been subject to state tort or property law.²⁶⁴ In either case, federal law preempts any actions by private individuals against federally chartered banks and financial institution.²⁶⁵ Moreover, the FCIC Report, congressional testimony, and other reports substantiate how BFSI lenders cleverly engaged in negligent and reckless business practices that may have complied with the letter of the law, but not the spirit of state statutes regulating consumer protection, deed recordings, foreclosure procedure, and negotiable instruments.²⁶⁶ As further evidence of the chaos lenders caused as result of the financial crisis, state court dockets are filled with lawsuits that expose the marketing and titling mechanisms mortgage lenders invented that did *not* comply with state property laws.²⁶⁷ While state property law does not provide a viable cause of action for recovery, state tort law may offer some basis for establishing new federal law upon which the government may seek restitution for citizen homeowners.

The conduct by the BFSI fits the textbook definition of a state negligence per se tort action. However, such action is unavailable to harmed consumers, and no federal tort law exists. Under a negligence per se claim, one must prove that: (1) there is a statutorily imposed duty, (2) the

²⁶³ The recent settlements between federal regulators and the BFSI have been for former homeowners, who lost their homes to foreclosure. NAT'L MORTG. SETTLEMENT, *supra* note 20; FRB INDEP. FORECLOSURE REVIEW, *supra* note 255.

²⁶⁴ The BFSI treated state property law as an obstacle to get around rather than as a foundation on which to build responsible lending practices—practices that would have protected citizen borrowers. Singer, *supra* note 57.

²⁶⁵ *Id.*

²⁶⁶ *Id.*

²⁶⁷ *Id.*; see generally Heather Hill Cernoch, *Illinois Supreme Court Establish Foreclosure Committee*, DSNEWS.COM (Apr. 12, 2011), <http://www.dsnews.com/articles/illinois-supreme-court-forms-committee-to-assist-families-in-foreclosure-2011-04-12> (noting that by the end of 2010, more than 70,000 foreclosure actions were pending in Cook County alone, with expectations of future increase).

wrongdoer breached that duty, (3) the breach caused some injury, and (4) the injury rises to more than monetary damages to the plaintiff.²⁶⁸ On the basis of the elements of this claim, regulators using existing laws and standards could impose liability on BFSI institutions for their conduct leading to the financial crisis and the financial losses they caused to citizen homeowners.²⁶⁹

First, the FRB's policy promulgated under existing law that allowed the BFSI to operate under a neoclassical economic model of self-regulation created a statutory-like duty on the BFSI.²⁷⁰ Under the FRB's safety and soundness standards, promulgated under the 1992 Federal Housing Enterprises Financial Safety and Soundness Act, institutions that engaged in mortgage lending owed a duty to American consumers to engage in prudent lending practices, which protected the market and consumers.²⁷¹ Even though the standards were suggestive and not mandatory, the BFSI was held accountable for ensuring its practices complied with these standards. The evidence of the BFSI's intentional or negligent conduct demonstrates that many institutions within the BFSI did not comply with these standards and, in some cases, even purposefully disregarded the standards. Thus, the law created a duty regarding mortgage lending and securitization of mortgages that the BFSI ultimately breached. For private individuals, a state law claim establishing that a mandated duty was owed to them would be a huge hurdle given the traditional creditor-debtor relationship that courts have established exists between lenders and borrowers.²⁷² Thus, only Congress is in the position to establish that such duty exists and could take action on behalf of

²⁶⁸ In order for this to occur, a judge would first determine that the statute applies and then determine if the applicable statute was designed to protect the class of persons in which the victim falls. If the statute is designed to protect against the type of harm suffered, then victims may have a remedy. At the state level, different jurisdictions have different procedural implications for negligence *per se*, which is not very helpful for plaintiffs. However, if federal courts established that the statute was applicable to the BFSI and set a uniform procedural process, then such a process might be more helpful to plaintiffs who bring lawsuits. See Barbara Kritchevsky, *Tort Law is State Law: Why Courts Should Distinguish State and Federal Law in Negligence-Per-Se Litigation*, 60 AM. U. L. REV. 71, 73–74 (2010).

²⁶⁹ If Congress passed new legislation, it would be *ex post facto* and not applicable retrospectively. Regulators, however, can use existing legislation to enforce against violators and recover on behalf of the injured.

²⁷⁰ See DiLorenzo, *supra* note 39. Under the self-regulatory regime the BFSI created for itself, it was arguably its own regulator and bound to follow federally imposed guidelines. *Id.* Under the FRB-proposed standards for lending practices, the BFSI agreed to conduct lending in a manner that would not jeopardize the financial stability of the markets and would comport with standards that responsibly assessed the risks of its products, services, and investments. *Id.*

²⁷¹ Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Pub. L. No 102-550, 106 Stat. 3941 (codified at 12 U.S.C. §§ 4501–641 (2012); see Carliner, *supra* note 6, at 310.

²⁷² Porter, *Conflicts of Interest*, *supra* note 27. If the courts were to establish that a special relationship exists between lenders and, particularly, mortgage consumers, then, by virtue of such a fiduciary relationship, lenders would owe borrowers a duty of loyalty and care. *Id.* Otherwise, borrowers must establish that either lenders owed them a duty in contract or statutorily, both of which courts typically have found to be absent. *Id.*

borrowers or create new law that allows individuals to file a private right of action.

Second, with an established duty under federal law for safety and soundness, there exists ample evidence that the BFSI breached that duty. The breach is evidenced by the BFSI's failure to lend responsibly and by introducing highly risky mortgage products into the residential market for its own profitable gain. An example of irresponsible lending practices was the introduction of highly risky products that failed to meet safety and soundness standards, such as the low- and no-documentation mortgages, often referred to as "liar loans." Under these loans, lenders failed to verify the reliability of financial information of borrowers or borrowers' ability to repay the loans before making the mortgages. Predatory and subprime mortgages²⁷³ are further evidence of lax lending standards created to place borrowers into risky mortgages that some lenders admitted were destined to default, such as mortgages with adjustable teaser interest rates.²⁷⁴ Thus, these types of lending practices and standards failed to meet the regulatory safety and soundness standards, and they resulted in a breach by lenders of their statutory obligations.

Third, the evidence of causation of the financial crisis is established by the federal government's own inquiry into and conclusions about the lending practices that triggered the financial crisis, which were contrary to prudent safety and soundness practices. The FCIC's Report established that the BFSI knew or should have known (1) that its conduct would result in residential mortgage defaults;²⁷⁵ (2) that certain mortgage products posed a unreasonable risk to residential borrowers²⁷⁶ and, ultimately, investors in residential mortgage-backed securities; and (3) that the industry imposed unproven underwriting standards that exposed the national and global markets to inevitable risks.²⁷⁷ The FCIC's report also provides uncontroverted evidence that the financial crisis could have been avoided but for lending practices that occurred in the U.S. residential real estate market and the related secondary securities market.²⁷⁸

Lastly, the result of the financial crisis adequately establishes the injury citizen homeowners suffered. Although the injury to citizen homeowners appears purely monetary, particularly looking at the \$1 trillion in lost equity wealth, it was the BFSI that endured purely monetary losses,

²⁷³ Predatory lending practices—especially targeting the elderly, low-income individuals, and minorities—that lenders created to persuade new and existing borrowers to enter into unaffordable mortgages are *the* most egregious among the BFSI's lending practices. See Johnson, *The Magic of Group Identity*, *supra* note 109; pond cummings, *supra* note 59.

²⁷⁴ See generally Depository Institutions and Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980) (allowing financial institutions and banks to charge any interest rate in lending); Canova, *supra* note 102.

²⁷⁵ FCIC, *supra* note 9.

²⁷⁶ *Id.*

²⁷⁷ *Id.*; RAMIREZ, *LAWLESS CAPITALISM*, *supra* note 8.

²⁷⁸ RAMIREZ, *LAWLESS CAPITALISM*, *supra* note 8.

from which it was ultimately rescued.²⁷⁹ For citizen homeowners, the after-effects of the financial crisis also produced other intangible losses, such as the avalanche of foreclosures that caused blighted communities and the uprooting of families that created a drain on local and state government resources to aid them. Additionally, it produced the loss of jobs for those in the banking, real estate, and mortgage industries. In the most disturbing cases, the crises led to the loss of life for those who could not bear the loss of their life savings (in the form of equity wealth in their homes.) While recoverable personal financial losses for citizen homeowners includes equity wealth, the devastation of the financial crisis to the lives and communities is impactful.

The loss of equity wealth also resulted in losses in other areas. For example, home repairs stifled because financial resources in households dropped or dried up. Historically, homeowners have relied on equity lines of credit for major repairs, such as roof work, windows, and general maintenance. With property values already significantly devalued, homes in significant disrepair are even more devalued. Many homeowners suffered emotional distress because of the loss of their equity wealth or even their homes. Some scholars have even identified the emotional toll on children who were impacted during financial crisis, especially when they were forced to leave their homes due to foreclosures or when they were privy to the stressful financial circumstances resulting in the necessity to sell their homes—displacing them from their communities.²⁸⁰ The injuries citizen homeowners suffered were primarily monetary, but the impact of those monetary losses resulted in real, tangible injuries. As the cause of these injuries, the BFSI must be forced to make restitution because of its blatant disregard for anyone or anything but its own greed.

While no federal tort claim exists for citizen homeowners, the federal government, through the regulatory agencies charged with enforcing existing laws, may arguably pursue action based on the spirit of a tort negligence per se claim for harm the BFSI caused consumers. Furthermore, to deter future negligent behavior, Congress could promulgate new laws to seek restitution for citizen homeowners or to allow consumers to file a

²⁷⁹ Despite banks that received TARP funds making full repayment and allowing their institutions to recover from perceived losses because of the financial crisis they caused, American homeowners did not get the chance to receive similar assistance to avoid a collapse of their households. The financial industry's drain of \$700 billion in taxpayer resources that could have been used to bailout Americans, not banks. Matt Egan, *Bank Crisis is Over, But TARP Bailout is Still Alive and Kicking*, FOXBUSINESS (July 16, 2013), <http://www.foxbusiness.com/industries/2013/07/15/banking-crisis-is-over-but-tarp-bailout-is-still-alive-and-kicking/>. While big banks like J.P. Morgan, Chase, and Citigroup could not return their TARP funds fast enough, dozens of publicly-traded lenders and thrifts are still sitting on nearly \$5 billion in bailout cash some four years after the Great Recession ended. *Id.*

²⁸⁰ Phillip Lovell & Julia Isaacs, *The Impact of Mortgage Crisis on Children*, FIRST FOCUS, May 2008, <http://nhcsl.org/demo2013/pdf/HousingandChildren-%20First%20Focus.pdf> (discussing how physical and mental health and well-being have impacted homeowners, their children, and their communities).

private right of action to seek redress. Congress must act because it has the power to establish the legal basis upon which restitution can be made to citizens.

B. Federal Law Claims Basis

The federal government enacted statutes and agencies that govern the conduct of businesses, including banks and financial services institutions, in relation to American consumers. The most relevant among those statutes are the FTCA and, most recently, the Dodd-Frank Act.²⁸¹ Congress has the authority to hold the BFSI accountable for its negligent, deceptive, and egregious acts toward citizen homeowners, and it can mandate that authority be enforced through the FRB, which has statutory authority over banks and financial institutions.

1. The Federal Trade Commission Act

Under the FTCA, the FTC prescribes rules defining the types of acts or practices in or affecting commerce that are unfair or deceptive to consumers given the current activity of business in relation to consumers.²⁸² The FTC periodically publishes rules depending on the need for consumer protection, such as in 2003 when it promulgated rules on unsolicited bulk electronic mails, or spam, in part because spam serves as a vessel for deceptive practices. Using those rules as a guideline, the FTC may enforce violations against businesses that contravene its rules.²⁸³ The FTCA, however, specifically exempts banks from coverage, but not other investment firms and financial institutions that engage in bank-like activities.²⁸⁴ Therefore, regulators should enforce existing law, including claims for fraud, and even criminal charges (as necessary), against those entities that are not exempt. In addition, Congress should amend the FTCA to allow the FTC to rely on its 1983 Policy Statement on Deception to seek recourse in the future against banks and all financial institutions in the BFSI that engaged in prohibited deceptive practices.²⁸⁵

²⁸¹ 15 U.S.C. §§ 41–58 (2012).

²⁸² 15 U.S.C. § 57a (2012).

²⁸³ The rules set forth by the FTC, referred to as Trade Regulation Rules, define unfair and deceptive practices on specific topics. CONSUMER PROTECTION HANDBOOK 27, 48 (Am. Bar Ass'n, Section of Antitrust Law 2004).

²⁸⁴ Although 15 U.S.C. § 46(a) gives power to the Commission to investigate persons, partnerships, or corporations, it excepts banks and savings and loan institutions described in Section 57a(f)(3) in the Act. Nonetheless, Congress, which has the authority to amend existing laws or create new laws, could make banks and financial service institutions subject to the FTC and deter future behavior.

²⁸⁵ The retrospective impact of the law on banks makes it impossible to seek redress against them because of the exemption. The overall objective is to deter fraudulent behavior that harms consumers.

Looking at the manner in which lenders used advertising, among other marketing practices, to lure borrowers into mortgage transactions during the residential real estate boom from 2004 to 2007, Congress is well justified in amending the FTCA, or otherwise promulgating new law, to allow the FTC to enforce the deceptive practices laws under the FTCA against institutions in the BFSI industry. Bringing the BFSI under the enforcement authority of the Commission would allow the agency to maximize consumer protection and prevent future abuses in residential mortgage transactions against all institutions, especially given the failure of the FRB to act in the years leading up to the 2007 financial crisis.

The FTC is well suited to use precedent to apply its 1983 Policy Statement on Deception, particularly as it relates to the advertising context, to prohibit businesses from engaging in practices that are likely to mislead consumers.²⁸⁶ The FTC policy does not require actual deception to hold that a violation has occurred, but rather it looks at the act or practice from the perspective of the consumer acting reasonably in the circumstances.²⁸⁷ The materiality of the practice is also important if it involves providing information that would likely affect consumers' choices or conduct regarding the product.

If the FTC applied its policy by looking through the lens of consumers, it would see that non-exempt BFSI lenders actively engaged in conduct, particularly through advertising and third parties, that misled residential mortgage consumers to enter into the most risky and unsuitable mortgage products. In a substantial amount of transactions, the information lenders in the BFSI provided to consumers was deceptive and misleading.²⁸⁸ These transactions are the basis upon which the state attorneys general have sued those lenders that conducted themselves in the most egregious manner in order to recover restitution on behalf of former citizen homeowners in their state who had no remedy under state or federal law.²⁸⁹ Given the egregious predatory lending practices of lenders and the gross amount of foreclosures in their jurisdiction, the state attorneys general's lawsuits are based on the premise that the spirit of the FTCA was violated because those institutions engaged in unfair and deceptive practices.²⁹⁰ Congress should

²⁸⁶ See *In re Cliffdale Assocs.*, 103 F.T.C. 110, 110 (1984). The Commission, using the Policy Statement on Deception that was issued October 14, 1983, found an act or practice to be deceptive if the representation, omission, or practice is likely to mislead consumers acting reasonably under the circumstances. and the representation, omission, or practice is material. *Id.*

²⁸⁷ SPANOGLE ET AL., *supra* note 126, at 41.

²⁸⁸ FCIC, *supra* note 9.

²⁸⁹ See Porter, *Managing Settlements*, *supra* note 64.

²⁹⁰ 15 U.S.C. § 45(a)(1) (2012) (declaring that "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful"). Every state has promulgated an unfair and deceptive practices act, which are known as "little FTCs."

also enforce the FTCA against all non-exempt institutions and ultimately allow for such enforcement against banks.

Within its authority, the FTC may seek a cease and desist order or, as historically sought, fines. The FTC, however, should further consider other equitable relief, such as restitution.²⁹¹ Taking into account the conduct of the BFSI, the federal government established evidence through the FCIC Report, which included the uncontroverted admissions of industry executives who testified before the FCIC, that institutions in the BFSI engaged in unfair and deceptive practices that caused harm to consumers.²⁹² In addition, lenders engaged in egregious and predatory lending practices involving deceptive marketing to draw consumers into their mortgage products, particularly low-income, elderly, and minority consumers.²⁹³ Lenders also engaged mortgage brokers to put borrowers into the riskier, higher-cost mortgages by paying them a yield spread premium, or a commission, which neither lenders nor mortgage brokers disclosed to borrowers.²⁹⁴ Relying on the FCIC's report, findings, and gathered evidence, the FTC may take such other investigatory action it deems necessary to discover specific unfair or deceptive practices that lender institutions engaged in that resulted in harm to citizen homeowners during the housing boom from 2004 through 2007.²⁹⁵

Thus, to deter future bad lending practices, Congress should amend the FTCA to include the BFSI's practices in the residential mortgage market. In addition, Congress should authorize the FTC to commence an action against the most culpable financial institutions who currently exist or who acquired through mergers those financial institutions that committed unfair and deceptive practices against citizen consumers during the height of the subprime herding from 2004 through 2007. The funds the FTC recovers from

²⁹¹ 15 U.S.C. § 45(1)–(m).

²⁹² See generally FCIC, *supra* note 9, at 230. The FCIC concluded that the private-label securities that Wall Street financial firms bundled and sold had high delinquency rates, but investors purchased and guaranteed them nonetheless. *Id.* Taking into account the BFSI's conduct, the BFSI engaged in risky mortgage lending through lax mortgage standards instituted for the sake of lucrative, short-term profits, despite the knowledge that many of those mortgages were likely to default. *Id.* Lenders, especially those like Countrywide Homes Loans, used their wealth and influence to keep regulators at bay. *Id.* at xxii; Issa, *supra* note 11. Even the securitizers knew that a significant percentage of the mortgages they acquired did not meet sound underwriting standards, either their own standards or those of the industry in general. FCIC, *supra* note 9, at xxii.

²⁹³ Johnson, *The Magic of Group Identity*, *supra* note 109; pond cummings, *supra* note 59.

²⁹⁴ FCIC, *supra* note 9, at xxii. The Commission concluded that there was a systematic breakdown in mortgage lenders' accountability to both consumers and the financial markets, ultimately eroding the public's trust in those markets. *Id.* Under lax lending standards and a non-regulatory environment, lenders reported a twenty-fold rise in financial crimes related to mortgage fraud between 1996 and 2005; that rate again doubled between 2005 and 2009—to the tune of \$112 billion. *Id.*

²⁹⁵ Between the summer of 2006 and late 2007, the percentage of borrowers who defaulted on their mortgages nearly doubled, while lenders' profits rose substantially. See *Corporate Profits After Tax*, *supra* note 17.

equitable relief, such as fines and settlement funds from those institutions, should be used to make financial restitutions to existing citizen homeowners.²⁹⁶

2. *The Federal Reserve Board*

Arguably, the FRB has the authority to bring action against BFSI institutions, but the FRB's track record with regard to enforcement actions against banks is poor, with only one such action being filed against banks because of the financial crisis.²⁹⁷ The basis of such action would be the breach of the safety and soundness standards that the BFSI disregarded for the sake of profit.²⁹⁸ However, by allowing the BFSI to become a self-regulating industry, the FRB left itself with little basis for enforcing its non-mandatory safety and soundness standards. In fact, the primary action the FRB has taken is to re-promulgate the non-mandatory safety and soundness standards, which hardly bring the BFSI to account for its practices.²⁹⁹ Furthermore, the influence of the BFSI over the FRB is prominent. The BFSI has used its lobbying influence and political capital to ensure minimal regulation by its regulators. This is clear from the FRB's failure to regulate or investigate BFSI institutions in the BFSI during the height of BFSI activities leading to the financial crisis.³⁰⁰

²⁹⁶ Any settlement lenders make to citizen homeowners must allow the homeowners to either: (a) pay down the principal on the mortgage to recapture loss equity, or (b) obtain no-cost grants to make major home repairs that they have been unable to access equity to make. In both instances, the restitution would need to be without tax repercussions, similar to the exception under the Mortgage Forgiveness Debt Relief Act (MFDRA) that allowed for homeowners who sold their homes through lender short sale programs to avoid a taxable event. *See* Mortgage Forgiveness Debt Relief Act of 2007, Pub. L. No. 110-142, 121 Stat. 1803 (2007). For further discussion of the MFDRA, reference the author's forthcoming article on mortgage short sales, currently entitled *Corporate Abuse of Residential Short Sales and the Negative Tax and Financial Impact on Consumers*. (A copy of the manuscript is on file with the author).

²⁹⁷ RAMIREZ, *LAWLESS CAPITALISM*, *supra* note 8.

²⁹⁸ This argument is arguably akin to a negligence *per se* claim because statutorily, or in this case according to recommended regulatory guidelines, members of the BFSI disregarded the law, which was the standard and caused harm as a result.

²⁹⁹ Reiss, *Message in a Mortgage*, *supra* note 31, at 3. "Payment shock" mortgages were those in which borrowers saw a dramatic rise in their monthly mortgage payment after an earlier period, usually two years, of lower monthly payments. *Id.* at 6. With a trillion-dollar market in their sight, banks offered products that contradicted soundness and safety standards, such as mortgages with "payment shock," negative amortization, and no document verification. *Id.*

³⁰⁰ *See* Porter, *Managing Settlements*, *supra* note 64 (citing Vincent DiLorenzo, *The Federal Financial Consumer Protection Agency: A New Era of Protection or More of the Same?* 7, 9 (St. John's Legal Studies Research Paper No. 10-0182, Sept. 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1674016). Banks are regulated by various governmental agencies, including the FRB. *Id.*; *see also* BD. OF GOVERNORS OF THE FED. RES. SYS., <http://www.federalreserve.gov/bankinforeg/reglisting.htm> (last visited Dec. 31, 2013) [hereinafter FRB]; *see also* OFFICE OF THE COMPTROLLER OF THE CURRENCY, [Published by DigitalCommons@Hamline,](http://www.</p>
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Congress could use its authority over the FRB to force an action against the national banks and investment banks that took advantage of TARP funds to cover their economic losses. Recovery funds these institutions pay would directly assist in the economic recovery of citizen homeowners, especially those still suffering from significant devaluation of their residential property. After-the-fact oversight by the FRB could still provide relief for citizen homeowners, through monetary restitution paid by institutions in the BFSI. Institutions in the BFSI can amply afford to repay citizen homeowners for their losses. Congress is citizen homeowners' only hope.

3. The Wall Street Reform Act and Consumer Financial Protection Bureau (Dodd-Frank Act)³⁰¹

In response to the 2007 financial crisis, Congress' 2010 passage of the Dodd-Frank Act was a reactive attempt to regulate the BFSI. Due to the economic collapse, the unprecedented use of taxpayer funds used to bailout the BFSI, and the public call for accountability, the Dodd-Frank Act was enacted to make changes in how federal regulators oversee the BFSI in hopes of preventing future financial crises of the magnitude realized in 2007. This article is not an analysis or critique of the substantive provisions of the Dodd-Frank Act,³⁰² but this article does analyze the potential regulatory impact of the law given the BFSI's powerful influence over regulatory and enforcement activities.³⁰³ The regulatory impact is still unknown given that most provisions of the Dodd-Frank Act do not become effective until after the comment period expires in 2014.

In the meantime, legions from the BFSI's lobby immediately began their charge to minimize the impact of policy changes under the law on the industry shortly after Congress passed the law.³⁰⁴ Policymakers, likely influenced by the BFSI, have introduced various laws or stalled rulemaking to mitigate the law's impact on the industry.³⁰⁵ As early as 2010, Republican

occ.treas.gov/ (last visited Dec. 31, 2013) [hereinafter OCC]; see also SEC, <http://www.sec.gov/about/laws.shtml> (last visited Dec. 31, 2013).

³⁰¹ See generally Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of 12 U.S.C.).

³⁰² The law requires that regulators create 243 rules, conduct 67 studies, and issue 22 periodic reports. *Id.*

³⁰³ As with other major financial reforms, critics have attacked the law. Some argue that it was not enough to prevent another financial crisis or more "bailouts," and others argue it went too far and unduly restricted financial institutions. See generally Michael Simkovic, *Competition and Crisis in Mortgage Securitization*, 88 IND. L.J. 213, 213 (2011).

³⁰⁴ "In a furious, below-the-radar effort at gutting the law—roundly despised by Washington's Wall Street paymasters—a troop of water-carrying Eric Cantor Republicans are speeding nine separate bills through the House, all designed to roll back the few genuinely toothy portions left in Dodd-Frank." Taibbi, *supra* note 216.

³⁰⁵ "This stuff doesn't get any better with time," said former FDIC chairman Sheila Bair, a key figure in the Dodd-Frank approval process prior to leaving office. "The

policymakers were leading the charge, but it is likely that Democratic policymakers also aided in what one commentator referred to as “[q]uisingian covert assistance,”³⁰⁶ in order to eliminate any meaningful debate about the Dodd-Frank Act’s fate.³⁰⁷ As of June 2013, the rulemaking process under the Dodd-Frank Act met with little success. One commentator blamed the delay on the well-funded finance-industry lobby, as well as the legal battles and resistance in Congress.³⁰⁸ The lag in implementing meaningful regulations is also due, in part, to a regulatory system in which multiple federal agencies, with irreconcilable views, are tasked with shepherding the complex legislation into final rules.³⁰⁹

Regulatory agency enforcement of the law is also a quagmire.³¹⁰ With eleven agencies charged with rulemaking authority, the potential for confusion, loopholes, and conflict is likely, especially given the lack of cooperation among regulatory agencies leading up to the financial crisis. As Sheila Bair, former FDIC Chairman, accounted, the powerful leaders of the Treasury Department, responsible for suggesting the TARP, and the FRB, responsible for primary oversight and consolidation of BFSI institutions during the financial crisis, proved most influential in serving the needs of and protecting the economic losses of the BFSI.³¹¹ The unprecedented assistance these agencies provided to the BFSI may likely be tied to the fact that the heads of these key agencies were former executive-level managers in BFSI institutions prior to taking their public positions. In some cases, heads of these and other regulatory agencies either remained closely connected to the industry or returned to the industry upon leaving public office.³¹² Ultimately, the BFSI’s influence over regulators remains intact and will likely dominate future regulatory relationships given the new, broad spectrum of regulatory control across a vast number of agencies.³¹³ For instance, the power of the

longer you wait to finalize the rules, the more they get watered down, the more exceptions that get built in, people’s memories about the crisis start to fade and the pressure isn’t there.” Kevin McCoy, *Dodd-Frank Act: After 3 Years, A Long To-Do List*, USA TODAY <http://www.usatoday.com/story/money/business/2013/06/03/dodd-frank-financial-reform-progress/2377603/> (last updated Sept. 11, 2013).

³⁰⁶ This term “quising” is defined as: “A traitor who serves as the puppet of the enemy occupying his or her country.” WEBSTER’S NEW COLLEGE DICTIONARY 931 (3rd ed. 2008).

³⁰⁷ Taibbi, *supra* note 216.

³⁰⁸ McCoy, *supra* note 305.

³⁰⁹ The chances of all agencies coming to an agreement on an 848-page bill is more than challenging. *Id.*

³¹⁰ See generally DAVID POLK & WARDWELL, LLP, SUMMARY OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT, ENACTED INTO LAW ON JULY 21, 2010 (2010), available at http://www.davispolk.com/sites/default/files/files/Publication/7084f9fe-6580-413b-b870-b7c025ed2ecf/Preview/PublicationAttachment/1d4495c7-0be0-4e9a-ba77-f786fb90464a/070910_Financial_Reform_Summary.pdf.

³¹¹ BAIR, *supra* note 27.

³¹² *Id.*; Davidoff & Zaring, *supra* note 219.

³¹³ In August 2013, in the author’s personal interaction and account with a practitioner who works for a large, east coast law firm as partner handling federal regulatory

BFSI was successful in blocking the appointment of Congresswoman Elizabeth Warren, formerly a Harvard Law Professor who developed the notion of the Consumer Financial Protection Bureau (CFPB), from heading the newly created agency,³¹⁴ as well as blocking its ability to address the enforcement activities of the BFSI that led to the financial crisis.

The congressional mandates for the CFPB seriously hindered its enforcement activity *vis à vis* the BFSI. While the CFPB came into existence immediately upon passage of the Dodd-Frank Act with a strong statement about its enforcement-action authority related to credit card violations,³¹⁵ the paramount issues related to MBSs, CDOs, and other securitization-related transactions, which caused the financial market collapse, were, and arguably still are, beyond the reach of the CFPB.³¹⁶ The numerous advisements and inquiries the agency must make through other bank regulators are likely to hinder the enforcement effectiveness of the agency. For example, before issuing any regulatory recommendations against banking and some non-banking institutions, the CFPB must coordinate with other regulators to prevent undue regulatory burden on banks.³¹⁷ Bank regulators may also appeal, or challenge, the CFPB's proposal to take enforcement action if the other bank regulators deem the regulations put the safety and soundness or stability of the bank or BFSI at risk.³¹⁸

It is, and will be, a turf war between the CFPB and ten other regulatory agencies charged with regulation of the BFSI, especially given powerful allegiances of the leadership at the Treasury Department, FRB, FTC, and SEC, as well as the roles of these four agencies on the Financial Stability Oversight Council (FSOC), created by the Dodd-Frank Act.³¹⁹ The FSOC is charged with identifying and responding to emerging risks throughout the financial system. The most powerful influence on the FSOC is the Treasury Secretary, who chairs the FSOC. The other federal regulator

enforcement actions for the firms' clients, this person shared personal experiences with federal regulators. The person stated that, in dealing with institutions in the BFSI, regulators are very cooperative with BFSI institutions because of regulators' prior employment relationships in the BFSI or their future ambitions to join or return to the BFSI upon leaving public service.

³¹⁴ "With Geithner and Republicans in Congress blocking her once-inevitable appointment, we no longer had Warren playing watchdog to Federal Reserve chief Ben Bernanke—instead we had new CFPB head Richard Cordray, a former Ohio attorney general who enjoys far less of a popular mandate than Warren, forced to operate within the bureaucracy of Bernanke's Fed." Taibbi, *supra* note 216.

³¹⁵ This statement relates to its action against Capital One for credit card violations and the fines it issued. See *Probe Into Capitol One Credit Card Marketing Results in \$140 Million Consumer Refund*, CONSUMER FIN. PROT. BUREAU, July 18, 2012, <http://www.consumerfinance.gov/pressreleases/cfpb-capital-one-probe/>.

³¹⁶ DAVID POLK & WARDWELL, LLP, *supra* note 310.

³¹⁷ *Id.*

³¹⁸ See S. COMM. ON BANKING, HOUS., & URBAN AFFAIRS, *Brief Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act* http://www.banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf (last visited Dec. 19, 2013) [hereinafter *Dodd-Frank Summary*].

³¹⁹ BAIR, *supra* note 27; TOO BIG TO FAIL, *supra* note 22.

members include the heads of the FRB,³²⁰ SEC,³²¹ Commodity Futures Trading Commission,³²² OCC,³²³ FDIC,³²⁴ Federal Housing Finance Agency,³²⁵ National Credit Union Association,³²⁶ and CFPB.³²⁷ The effectiveness of the new regulatory regime, placed in the auspices of these agencies, remains to be seen.

Yet, the Dodd-Frank Act's after-the-fact regulatory attempt does not deal with past harms to consumers. The law was arguably a prime opportunity to do so. However, the law does not mandate that any regulators take retrospective enforcement action against the BFSI, which is action Congress should pursue against the egregious behavior of institutions in the BFSI that harmed citizen homeowners.

V. THE ECONOMIC RECOVERY FOR EXISTING CITIZEN HOMEOWNERS FUND

In the height of the aftermath of the financial crisis, citizen homeowners lost in excess of \$7 trillion in equity wealth. Some citizen homeowners will never recover their lost equity due to the loss of their property to foreclosure or short sales.³²⁸ Other citizen homeowners who still own their homes are not likely to see property values increase significantly

³²⁰ FRB, *supra* note 300.

³²¹ SEC, *supra* note 300.

³²² Congress created the Commodity Futures Trading Commission in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States. The agency's mandate has been renewed and expanded several times since then, most recently by the Dodd-Frank Wall Street Reform and Consumer Protection Act. COMMODITY FUTURES TRADING COMM'N, <http://www.cftc.gov/About/index.htm> (last visited Dec. 31, 2013).

³²³ OCC, *supra* note 300.

³²⁴ See BAIR, *supra* note 27.

³²⁵ The Federal Housing Finance Agency (FHFA) was created on July 30, 2008, when President Obama signed into law the Housing and Economic Recovery Act of 2008. The Act gave FHFA the authority necessary to oversee vital components of the country's government-sponsored entities on the secondary mortgage markets, namely Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. See FED. HOUS. FIN. AGENCY, <http://www.fhfa.gov/Default.aspx?Page=4> (last visited Dec. 31, 2013).

³²⁶ The National Credit Union Administration (NCUA) is the independent federal agency that regulates, charters, and supervises federal credit unions. With the backing of the full faith and credit of the U.S. government, NCUA operates and manages the National Credit Union Share Insurance Fund, insuring the deposits of nearly ninety-four million account holders in all federal credit unions and the overwhelming majority of state-chartered institutions. NAT'L CREDIT UNION ADMIN., <http://www.ncua.gov/about/Pages/default.aspx> (last visited Dec. 31, 2013).

³²⁷ The FSOC also has five non-voting members, including representatives from the Office of Financial Research, the Federal Insurance Office, state banking, insurance, and securities regulators, plus an independent appointee with insurance expertise as a voting member. See *Dodd-Frank Summary*, *supra* note 318.

³²⁸ For a discussion of the effect of short sales on borrowers, contact the author for her work-in-progress. MFDRA, *supra* note 296.

enough to recapture much of the lost equity.³²⁹ Without any direct recourse against lending institutions that held or hold mortgages, citizen homeowners are at the mercy of Congress, which is in the best position to assist them in recovering their losses. Congress has made that effort for former citizen homeowners. In 2013, former citizen homeowners received direct, partial restitution,³³⁰ although in very modest amounts, from a fund paid into by ten of the nation's largest lenders as the result of a rather covert settlement between regulators and financial institutions for foreclosure abuses.³³¹ For existing homeowners, however, other than refinancing programs that have been painfully ineffective for most, Congress has not taken any meaningful action to construct an enforcement or settlement action. Congress, therefore, should use its authority through existing laws or enact new laws to seek recovery from the BFSI that directly benefits existing citizen homeowners for lost equity wealth.

This proposed Economic Recovery for Existing Homeowners Fund is not a fund that would be uncommon to Congress. Similar to other recovery

³²⁹ For a common example, one borrower paid \$723,500 for his three-bedroom house in July 2006, taking out \$651,000 in mortgages to buy the property, which equated to a ten percent equity down payment. As of January 2013, the borrower estimated his home was worth about \$440,000, or about a forty percent less than he paid. The down payment is a direct loss to the borrower, and the thirty percent property devaluation is an indirect loss of his equity wealth. See Richard Clough & Jeff Collins, *Foreclosure Settlement Cash a Few Months Away*, ORANGE COUNTY REG., Jan. 9, 2013, <http://www.ocregister.com/articles/foreclosure-382857-homeowners-loan.html>.

³³⁰ This article does not discuss the settlement in detail, as the issue of the effectiveness of settlements is a topic for the author's work-in-progress, currently entitled *A Slap on the Hands for Banks—Consumers Settlement in the Great Recession*. (A copy of the forthcoming manuscript is on file with the author). See generally *id.* The FRB negotiated an \$8.5 billion foreclosure-abuse settlement with ten large banks. Nearly four million former and existing homeowners who were foreclosed upon or who were in the foreclosure process will receive compensation without being required to prove wrongdoing related to their mortgages or take any action to obtain the funds, even if they did not apply for a foreclosure review, as previously announced by regulators. Under the settlement agreement, which ended a nationwide foreclosure review program, the banks will collectively pay as much as \$3.3 billion directly to 3.8 million affected borrowers. The deal also designates \$5.2 billion for loan modifications and other assistance to borrowers but for which borrowers will have to apply to obtain relief. *Id.*

³³¹ Eleazor D. Melendez & Ben Hallman, *Foreclosure Review in New Settlement Leaves Homeowners in Banks' Hands*, HUFFINGTON POST (Jan. 8, 2013), www.huffingtonpost.com/2013/01/07/foreclosure-review-settlement-banks_n_2426437.html (providing a statement from Rep. Elijah E. Cummings (D-Md.), ranking member of the House Committee on Oversight and Government, who said that he was "deeply disappointed" that the regulators decided to proceed "before providing Congress answers to serious questions about how this settlement amount was determined, who these funds will go to, and what will happen to other families who were abused by these mortgage servicing companies"). Cummings went on to say, "I believe that borrowers deserve more answers and transparency than the Federal Reserve and the OCC are currently willing to provide." *Id.*; see also Ben Hallman, *Recent Foreclosure Settlement Was a Win for Big Banks*, HUFFINGTON POST (Jan. 25, 2013), http://www.huffingtonpost.com/2013/01/25/foreclosure-settlement-big-banks_n_2551727.html.

funds created as a result of settlements with banks, the federal government would collect the money and designate a regulatory agency or an independent third party to distribute the funds to citizen homeowners. An enforcement action would seek recovery from the most egregious lenders in the BFSI, not only banks but also Wall Street firms. Much like the foreclosure abuse settlement of 2013, direct restitution would be paid to existing citizen homeowners who took out or refinanced their loans with, but not limited to, any of the following lenders between 2002 and 2007: Citigroup,³³² Bank of America (which acquired Countrywide, which in turn acquired Merrill Lynch),³³³ JP Morgan Chase Bank (which acquired Bear Sterns with government assistance and Washington Mutual), Wells Fargo (which acquired Wachovia Bank), Bank of New York, and State Street Corporation. Recovery would also be sought from the following investment banks: Goldman Sachs (in which Warren Buffett infused \$5 billion in capital) and Morgan Stanley (in which Mitsubishi Bank, a Japanese company, infused capital).³³⁴ These institutions either acted directly or acquired financial institutions whose actions significantly contributed to the financial crisis and which took out the largest TARP funds to minimize their economic losses during the financial crisis.³³⁵ Just nine banks and financial service institutions in the BFSI own \$9 trillion in assets and comprise more than seventy percent of the U.S. financial system. They can afford to help existing citizen homeowners recover their lost equity. They can also use some of the profits gained during the years leading up to the financial crisis and the \$700 billion in taxpayer funds³³⁶ that bailed them out to repay existing citizen homeowners.

When the government utilized TARP funds to aid BFSI institutions, none of those institutions needed to prove their losses in order get help; in other words, the government eliminated bureaucracy. Even more startling,

³³² Citigroup received TARP funds at least twice after the financial crisis began. See BAIR, *supra* note 27.

³³³ Shannon D. Harrington & Hamish Risk, *Bank of America Credit Risk Increases on Countrywide Purchase*, BLOOMBERG (Jan. 11, 2008), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=adjOxU6pIVyY&refer=home>; Steven Sloan, *When a Job Becomes a Policy Lever*, FIN. PLANNING (July 17, 2009), <http://www.financial-planning.com/news/paulson-merrill-lewis-2663309-1.html>.

³³⁴ Davidoff & Zaring, *supra* note 219.

³³⁵ See *Latest TARP Reports*, U.S. DEP'T OF TREASURY, <http://www.treasury.gov/initiatives/financial-stability/reports/Pages/default.aspx> (last visited Nov. 13, 2013).

³³⁶ TARP funds were allocated to banks as follows: \$25 billion each to Citigroup and Wells Fargo; \$15 billion to JP Chase Bank; \$10 billion to Merrill Lynch, Goldman Sachs, and Morgan Stanley; \$3 billion to Bank of New York; and \$2 billion to State Street Corporation. Citigroup also receive two additional infusions of capital from TARP funds when no other banks did. All institutions repaid the TARP funds with money left over to pay elaborate bonuses to executives. The rate of return on the funds was only a five-percent dividend on non-voting preferred stock held by the government, making it the cheapest capital and debt guarantee any bank would ever receive. *Id.*; see BAIR, *supra* note 27 (giving her perspective about the decisions made by the Treasury as to which institutions received TARP funds).

BFSI institutions were under no mandate as to how they could use the funds they received. Similar to the flexibility offered to institutions in the BFSI, a recovery plan and funds distribution, very similar in protocol and process, should exist for existing citizen homeowners who borrowed money from any of these institutions. Once regulators determine the egregious nature of the institutions' conduct, potentially based on the default rates of predatory and subprime loans held by or acquired by lenders, the institutions then would make a direct credit to borrowers' mortgage accounts. This direct credit would create a new escrow account that borrowers could either use to pay down the mortgage principal (in lieu of loan modification)³³⁷ or to pay down established impounds for current or retrospective real estate taxes and insurances on the account (if any).

Congress also must ensure that the Internal Revenue Service (IRS) would not treat these funds as income taxable to borrowers, much like the exemption the IRS recognizes under the Mortgage Forgiveness Debt Relief Act.³³⁸ Citizen homeowners should not be penalized. If the government allowed these funds to be taxable income, the program would become an additional blow to existing citizen homeowners who have been economically crippled by the actions of the BFSI.

Some commentators argue against blaming the BFSI for the financial crisis and resist any regulation or any additional regulation.³³⁹ Other commentators place the burden and blame on consumers who invested in the risky products and services the BFSI offered.³⁴⁰ Ultimately, the public confidence in the market is what allows the BFSI to operate, and the social contract proposed by some scholars obligates the BFSI to honor the relationship it has with the government and consumers by acting prudently in its practices.³⁴¹

On the one hand, some commentators argue that borrowers were not so unsophisticated and that they even aided in the financial crisis by taking out mortgages they knew they were unable to repay.³⁴² Borrowers of certain socio-economic status and ethnicity are even blamed as a primary cause of the financial crisis.³⁴³ These commentators do not advocate for industry-wide

³³⁷ Loan modifications that include principal reductions can invoke a federal tax liability for forgiveness of debt or create a taxable event. *See* MFDRA, *supra* note 296. If lenders apply credit to the account, borrowers would, once again, have some options about how they want to use their equity, as they did in the past by taking out equity to pay other obligations. In this case, however, the credits would be used to aid the borrowers with the loss of equity, which was the most significant loss to homeowners from the financial crisis.

³³⁸ *Id.*

³³⁹ *See generally* pond cummings, *supra* note 59 (discussing the various perspectives of commentators).

³⁴⁰ *Id.*

³⁴¹ *See* Mehrsa Baradaran, *Banking and the Social Contract*, NOTRE DAME L. REV. (forthcoming) [hereinafter Baradaran, *Banking and the Social Contract*], available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2227060.

³⁴² pond cummings, *supra* note 59.

³⁴³ *Id.*

regulatory changes, but rather they place the burden back on consumers, who they argue should better inform themselves through the disclosures the industry provides.³⁴⁴ This consumer-investor-burdened perspective fails to take into account that the industry created and placed into the market products and services that even the most sophisticated, prudent consumer-investors would have difficulty deciphering. In addition, institutions that offered these products marketed and sold them to consumers regardless of consumers' understanding or lack thereof. To address this problem of whether or not consumers should decide to invest in a mortgage or securities transaction, one executive-level member of one of the large financial institutions told a crowd of lawyers that if consumers of those products take the risk, then they should bear the responsibility of the decisions they made because the financial institutions should be able to offer whatever products they want into the market, despite their level of complexity.³⁴⁵

And yet, others argue that there is too much regulation, especially given that the BFSI is not a nationalized industry. Some scholars argue that, even if the government regulates the industry, it may regulate too much because the government already struggled to create regulation that could take into account all possible outcomes.³⁴⁶ Even if the government could take into account all possible scenarios, the ever-changing, complex business products, services, and structure would leave the government traversing areas of corporate business that the government does not understand.³⁴⁷

Moreover, some commentators argue that the banks, which are a part of the BFSI, breached their social contract with the public (through the state), in that banks obligated themselves to operate prudently given the high level of public trust offered to them in order for them to competitively function in the markets.³⁴⁸ Some scholars assert that there exists today, and has always existed, an interdependent relationship between banks and the state, a mutual-benefits-and-responsibilities connection, or social contract. This social contract has existed since the inception of banking in the United States and has been reinforced over time, but it recently has weakened due to the growing size and political power of a few banks.³⁴⁹ Some argue that given the transformed banking landscape, the social contract needs to be re-established to meet the three main needs of the public: (1) bank safety, (2) consumer protection, and (3) access to credit.³⁵⁰

³⁴⁴ See 15 U.S.C. § 102(a) (2012); see also 12 U.S.C. § 2601(2) (2012).

³⁴⁵ This is based on the author's personal experience in July 2013 as an attendee at a conference that included panelists from Bank of America, Wells Fargo, Financial Industry Regulatory Authority, and the Office of the U.S. Attorney.

³⁴⁶ See generally Baradaran, *Separation of Banking and Commerce*, *supra* note 14, at 385, 419.

³⁴⁷ *Id.*

³⁴⁸ Baradaran, *Banking and the Social Contract*, *supra* note 341.

³⁴⁹ *Id.*

³⁵⁰ *Id.*

The diverging opinions are not likely to be resolved given the ongoing neoclassical economic perspective still in effect for the BFSI, even after enactment of the Dodd-Frank Act. If regulators and politicians continue to harbor the notions that regulation is best left to the market and that the BFSI is in the best position to regulate its own conduct, the practices of the BFSI will not change. Government safety and soundness standards for the BFSI will continue to serve only as a benchmark for practices, but the ultimate control and management of corporate entities will remain with powerbrokers in the industry and will lord over homeownership policy.

VI. CONCLUSION

In summary, the BFSI's financial supremacy and political capital are roadblocks to any meaningful government action. The BFSI's influence both internally and externally on government policy is too great to underestimate, and to think otherwise is foolish. Until money and power no longer rule the world, those without it will forever remain subject to those who do. Thus, most will remain mere pawns of those with a higher greed; and, in the case of the 2007 financial crisis, the banking industry has checkmate.