

AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Patrick Madigan

## PREFACE

The following Oral History is the result of a recorded interview with Patrick Madigan conducted by Andrew O'Shaughnessy on June 12, 2020. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

Readers are asked to bear in mind that they are reading a transcript of spoken word, rather than written prose. The transcript has been reviewed and approved by the interviewee.

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Andrew O'Shaughnessy: My name is Andrew O'Shaughnessy, a JD candidate at the Duke University School of Law. I'm also a research assistant for the Global Financial Market Center's American Predatory Lending project. It is Friday, June 12th, 2020. I am speaking remotely with Patrick Madigan to conduct an oral history interview. Mr. Madigan, thank you for joining me today.

Patrick Madigan: Thank you for having me.

Andrew O'Shaughnessy: Right at the outset I'd like to start by establishing a little bit about your background. So I understand you attended the University of Iowa for both your undergrad and for law school. Are you a Hawkeye by birth or by adoption?

Patrick Madigan: By birth. I grew up in the state of Iowa. I was born in a small town called Atlantic, Iowa, but when I was five years old, we moved to an area that's referred to as Okoboji. The actual town is called Spirit Lake, Iowa, and that's where I grew up.

Andrew O'Shaughnessy: So what led you to the Attorney General's office?

Patrick Madigan: Well, I was in private practice in Denver, Colorado, and I was dissatisfied with my professional life and I kind of took a big leap of faith and I contacted the Iowa Attorney General's office to see if they had any openings and as it turned out, they did have one in consumer protection, which was the area that I wanted to work in. And I got the job. I was the first new hire into the division in seven years. Just to give you an idea of how the jobs don't come open all that often, or at least at that point in time. And also there was a desire to move back home. My wife is also from Iowa and we had started a family. And so the combination of family reasons and professional reasons led me to the Iowa Attorney General's office.

Andrew O'Shaughnessy: So how long did it take you to start encountering issues related to residential mortgage lending after you joined?

Patrick Madigan:

Not very long at all. I didn't know anything about mortgages when I joined the office, despite the fact that I was on my second mortgage. But I didn't know anything about mortgages and very early on I started working on a case against a company called Ameriquest Mortgage Company, who was at the time the largest subprime mortgage lender in America. And that took me down a path and on a journey that I could have never imagined.

Andrew O'Shaughnessy:

So when you first started working on Ameriquest, did you have a sense at the time, or have you learned since, that the mortgage crisis looked substantially different in Iowa? Or was the experience of Iowa pretty typical?

Patrick Madigan:

Well, one of the things that's really unique about working for Attorney General Tom Miller, is that he gives you a platform to work on where you really work on issues on a national level.

And so even though I am an Assistant Attorney General in Iowa, really from the get go my work has really been on a national level. But to answer your specific question, one of the things that was unique about the subprime crisis is that when it turned into a foreclosure crisis, some of the very early foreclosure data was very high in Iowa compared to other states. And that was something that we noticed because we followed the statistics very closely. I never did honestly get an explanation as to why that was, but in terms of the delinquency data that the MBA [Mortgage Bankers Association] would put out, it came early to Iowa.

Andrew O'Shaughnessy:

So how did the Ameriquest inquiry begin exactly?

Patrick Madigan:

So it had already been started, but it was fairly new when I joined the office. I joined the office April 1<sup>st</sup> of 2004. And at that point in time...There are many things that are understood today about what happened with subprime mortgages that people look back on and they say like, "Oh, it's just obvious that that would be problematic." Well, that was not the point of view in 2004, 2005, 2006, not at all. And so one thing I would just say is that what we were doing in terms of looking at the origination practices of subprime lenders was very unique and we were very much a voice in the wilderness and many people were highly critical of what we were doing. They were painting us as the bad guys. So there was a term that was common at the time called the democratization of credit. And it was this idea that we were spreading credit to other people and that this was a wonderful thing.

And of course it can be a wonderful thing if it's done correctly. And so we were very heavily criticized in that we were hurting people because we were going to make credit less available or more expensive.

Andrew O'Shaughnessy:

Who were these critics?

Patrick Madigan:

The industry, the industry trade groups, federal regulators. The federal banking regulators were not on the same page as the state Attorneys General. So we very much felt like we were fighting a battle that others were not seeing. I mean, obviously some others were...Center for Responsible Lending and others were aware of it, but it's remarkable to me upon looking back on it, just how much we were a voice in the wilderness at that point in time versus how these things are just accepted as common sense now.

Andrew O'Shaughnessy:

So you mentioned that all throughout this process, it was really multi-state in nature. When you say we, at this point, do you mean just the Iowa AG's office in the beginning stages, or was there already a coalition in place?

Patrick Madigan:

There was already a coalition in place. There had been a case that was before my time done against a company called Household International. I was not involved in that. And so because of that, some people had relationships and had worked together. So when I came on the scene there was....Minnesota was actually the leader of the Ameriquest case. Washington state was involved, both the state AG and the state banking department. I believe Texas was involved at that point in time, California. And then our coalition grew over time.

Andrew O'Shaughnessy:

So as that happened, as you built the case against Ameriquest and you started recruiting other AG offices, what were the dynamics like across different jurisdictions? I am interested to understand the relationship between that core group that was already invested from the Household work and new offices that came in.

Patrick Madigan:

Yeah. So one of the things that was interesting about it, and this was not exactly your question, but one of the things that you get from it is validation. So as I alluded to earlier, essentially people were telling us that we were crazy. What we were saying was incorrect, could not possibly be true, that the misconduct and the fraud that we were alleging could not possibly be occurring because of all of these various checks and balances. And so one of the things that was interesting about it is you talk

to somebody in a completely different part of the country than Iowa, and they have seen the same thing. That's a very powerful thing because it tells you that obviously you're not crazy, but that you're onto something. And so in a way that is the base dynamic, that is why it's a multi-state, that is why you're banding together, because you're seeing a commonality, you're seeing a common problem.

And then in terms of, you know, how state AGs work, is that even in these very ... large cases, there's always a core group who takes the rowing oar. I mean, it just makes sense. And so that's a different calculation in terms of "Who do you know, from other efforts? Who is interested in this subject matter?" And that's more of a one-on-one where you recruit people. And sometimes states...sometimes the state is strategic because of its size or its geographic location, or you want it to be a bipartisan effort, which we very much do want our efforts to be bipartisan. So their state AG is from the other party. So there's any number of factors that you might consider in who you would ask to join in what we call our executive committee, which is the States who are leading the effort.

Andrew O'Shaughnessy:

... You mentioned that people were describing your allegations as to the practices in the market were impossible because of "checks and balances." So what were those practices? And then what were the checks and balances that the industry was arguing precluded them?

Patrick Madigan:

Yeah, it's hard to take myself back there a little bit, but it's basically things that are all very well understood now. So one of the things that I worked on was appraisal fraud. Just the fact that appraisers were massively inflating home values in order to be able to justify the loan. And what people don't understand about the subprime crisis is that they often speak of it in terms of purchase money loans. But that really wasn't the case. The most common product by far was the debt consolidation refinancing. So it's an existing homeowner. They have other debt. They have credit card debt, they have medical debt, they have car loans, and the pitch is, "take that, wrap it all up into your mortgage loan. You're going to get a lower rate and, by the way, now it's tax deductible."

Well, that's great if you do it once, but that's not what would happen. They would perpetually flip people into multiple loans. And in each instance, there's another round of origination fees as well. And in order to keep pushing all of that debt and those origination fees into these loans, you had to have a certain

home value. And the fact is that it just wasn't there in many instances. And so that equity was quite simply invented and it was invented by unethical appraisers. And so that was going on. Of course all of the origination fraud. So just making up income that people didn't have, inflating people's income, just basically anything that needed to be done in order to be able to close the loan, was being done.

Andrew O'Shaughnessy:

So just to close the loop on this, the appraisers are inflating the value. What incentives led them to do that?

Patrick Madigan:

Business. So what would happen is the loan originators would find out who the pliable appraisers were. Who are the appraisers that'll give them what they want, and then they use them over and over and over again. And so if you were an appraiser and you followed the rules and you did not do what they wanted, they didn't use you again. You were punished, you were left out in the cold. And so that was the incentive. And it was like word of mouth. Like, "Hey, these are the whatever five appraisers in the Des Moines area." And everybody knew who they were and they just used them repeatedly.

Andrew O'Shaughnessy:

And then the originators themselves at this point...Were we talking about predominantly bank or non-bank institutions, Iowa chartered or nationally chartered?

Patrick Madigan:

Yeah. One of the things that happened is, and you have to remember that this is before the licensing system that currently exists, so the NMLS<sup>1</sup> didn't exist until 2008, I believe. And so there were very, very different rules for people to be a mortgage loan originator. So one of the things that happened is a lot of people who had skills and sales [background], but had absolutely no knowledge about mortgages, migrated into the mortgage market. And so maybe before they sold cell phones, maybe they sold cars, but they can make so much money either as being a mortgage broker or as being a loan originator for a non-depository mortgage company like Ameriquest. And so these were not by and large banks. These were by and large non-depository mortgage originators that were almost exclusively state licensed.

Now that doesn't mean that there wasn't fraud in banks or other problems, but predominantly it was mortgage brokers and mortgage companies like Ameriquest.

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<sup>1</sup> The Nationwide Multistate Licensing System & Registry is an online licensing database set up by the Conference of State Bank Supervisors as the housing crisis began to crest.

Andrew O'Shaughnessy:

So returning to the narrative at a higher level, the multistate committee here. How did you understand your collective goal in investigating Ameriquest?

Patrick Madigan:

I don't know exactly if we knew at the beginning because that's why it's called an investigation, and what became apparent as we went along and at least to me, and remember I was new so I was brand new to the state AG world, but what became apparent to me is that this was a very widespread, very deep, very significant problem. And that was not generally believed at that point in time, obviously by either Ameriquest, the company itself, or the investors who purchased the loan[s], or basically anybody, and it became apparent that there really was something going on here and that there was going to be a day of reckoning from this.

And one of the things that was interesting -- I can remember this very clearly as we were in a meeting in Orange County, California, which is where the company was headquartered. And one of their attorneys said, "Well, if what you guys are saying is right, then why are the loans performing?" And we said, "Well, just wait." And the reason why the loans were performing is every time somebody got in trouble, they didn't go into foreclosure, they got flipped into a new refinancing. And so now you're starting fresh. And so it artificially masked the fraud and the delinquency rates because loans weren't actually going to delinquency status because they were just getting a new loan every time that there were problems. And so when finally, in 2007, like in a game of musical chairs, when the record stopped, it all collapsed.

Andrew O'Shaughnessy:

... [W]ould you say that you were looking for damages or other relief for borrowers or future regulation of their future conduct?

Patrick Madigan:

So first and foremost, we were looking for the truth. We were looking for the facts. I mean, there are two important functions that state Attorneys General play in these types of cases. One is that there's almost always restitution for borrowers. But the other, and what I would argue the much more significant, is the injunctive terms. So the reforms. If you look at that consent judgment, the Ameriquest consent judgment, you will find very, very detailed injunctive terms around origination practices. And that is, in my opinion, the true work of the state Attorneys General, and that's where we truly make a difference. The reforms that we are able to achieve in our settlements, the economic impact of those, the savings to consumers, the harm

that never occurs, will always far outstrip whatever money that you're able to recover in a settlement.

And we're often able to recover very significant amounts of money, but from my point of view, the reforms are the most important thing that we do.

Andrew O'Shaughnessy: In terms of the legal tools that you had in this investigation, what were they and did you feel that they were sufficient for ... the flipping fraud that you were seeing?

Patrick Madigan: State Attorneys General have extraordinary and unique tools. And so one of the things that we're able to do is we're able to engage in pre-complaint discovery. And that's really unique and we have extremely broad investigative authority under our UDAP statutes.

Andrew O'Shaughnessy: Will you define what a UDAP statute is?

Patrick Madigan: It's Unfair Deceptive Acts and Practices. It's the general term that's given to the statutes that state AGs enforce. Different nomenclature is used in different states and they're not all identical, but that's the general term that people use. I came from private practice and it was startling to me, the authority that state Attorneys General have in terms of their ability to gather information and to do so outside of normal discovery, as it's understood in civil litigation. It's an entirely different thing. And so we have very robust powers with which to gather information. I found it to be more than sufficient and we used it extensively.

Andrew O'Shaughnessy: I found your remarks about the power of injunctive enforcement to be quite interesting. Could you walk me through the process of how the terms are developed and negotiated when you're dealing with a coalition of States?

Patrick Madigan: It's a very difficult, very time consuming process and there are essentially multiple negotiations. So you have the negotiation with the company, of course, but you have negotiations on your own side of the table. And there are no shortcuts. One of the things that I personally believe in is trying to get it right. At least in the cases that I'm involved with, it is very much a negotiation with the company because after all, they're the ones who have to live with it at the end of the day. And so it does no good to come up with terms that they simply cannot perform. That is a worthless exercise. And so we do, and this is to the extent of how much do you trust the company you're dealing with, what

is your relationship with them, their counsel, their executives, I mean, these are all highly situational, but we do want to operate in the real world in terms of what is possible, what is not possible, what can be achieved. Negotiating a settlement that then they're just going to violate six months later is a pointless act. And so it's a very laborious, long process. And it's one of the reasons why our cases tend to take a long time is because of the injunctive terms. If it was just about money, the cases would be a lot quicker.

Andrew O'Shaughnessy:

So when you're negotiating with the AG's office on your side of the table about what the terms should be, is it all just about the staff's professional judgment or did you see things like different offices having different attitudes in terms of how quickly they would like to move...?

Patrick Madigan:

I mean first of all, there's a lot of cooks in the kitchen and that's just a difficult dynamic. You have people who are on just different ends of the spectrum in terms of their aggressiveness and just their personal philosophies. And then there is an interesting issue that you raised, which is time. Is there a time pressure? Is there a need to get this information into the marketplace? Is there a need to get these reforms out there? On any issue you can imagine there being disagreement. And so sometimes I find it somewhat extraordinary that we're able to do what we do. So go find twelve people and ask them where they want to go for lunch. See how long that takes you then after you go there, now you all have to order the same thing and you have to get the same salad dressing on your salad. I mean, it's just a very difficult process to reach this level of agreement with a very large and diverse group of people.

Andrew O'Shaughnessy:

I'm curious about two other factors that I imagine would operate during this process. One is the role of regulators. So presumably consumer protection units in AG offices have an existing relationship with their state banking regulator. In Iowa, were you talking with yours? Were your colleagues from other states talking about input or remarks from their regulators? And what was that like?

Patrick Madigan:

Yeah, that's a great question. We have a very strong relationship with the state banking departments and their umbrella organization CSBS [Conference of State Bank Supervisors]. And we had state regulators involved directly in the investigation and negotiation of the Ameritrust case. And so similar to us, there are people in those organizations who I would describe as national leaders who were involved. And so,

yes, I did talk to the Iowa Department of Banking, but California, Washington state, New York state, they were in the room with us, their state regulator. But my entire career, and this is one of the things that's somewhat unique about me, is that my entire career, I have worked not only with state Attorneys General, but I also work with other agencies. And so we were talking about cooks in the kitchen and trying to reach agreement. Well, not only am I working with state AGs, but I'm also working with the state banking departments and then later working with many different federal agencies as well. And so that presents just an entirely other dynamic, new dynamic to trying to reach consensus in these cases. But that has been my experiences, not only multi-state, but multi-agency.

Andrew O'Shaughnessy:

What was your experience with the federal regulators? I imagine many different agencies could be relevant, but who played the biggest role and what were their attitudes?

Patrick Madigan:

Well, no role in Ameriquest because they were state licensed. But my work with federal agencies came later with the National Mortgage Settlement and then the cases that followed on from that.

Andrew O'Shaughnessy:

... Before we move on to servicing issues, I am curious about one other dynamic that could inform this process of negotiation, which is not politics per se, but developments in the news cycle and public attention. You mentioned yourself that the other shoe dropped during this process. What effect did that have on negotiations?

Patrick Madigan:

It actually didn't drop during this process. So Ameriquest was announced in January of 2006. And we had a big press conference out in LA at the California Attorney General's office. In a rational world, that would have put an end to what was happening in subprime mortgage originations. This was the largest subprime mortgage originator by a wide margin. They were by far the most visible; they advertised on TV all the time. They'd sponsored the Super Bowl halftime show that year; they sponsored the Rolling Stones tour. They had blimps, Ameriquest blimps. They were a very well-known company and here comes the settlement with, I believe it was 50 state AGs, and you would think that that would put an end to the party and it did not. It did not put an end to the party. The party went on until August of 2007 when the entire subprime market collapsed seemingly overnight. And so that was one of the things that was the most surprising to me actually, was how the settlement did

not have the impact that I thought it would. And it was a tremendous lost opportunity in retrospect.

Andrew O'Shaughnessy:

When you say it didn't have the impact, do you mean that Ameriquest worked around the terms of its injunction or that the market didn't respond to the signal?

Patrick Madigan:

The market. Other companies weren't reined in. Investors continued to buy the loans, for example. That the market didn't take the signal. It wasn't about Ameriquest per se, because we had just filed a consent judgment with Ameriquest. It was about the market writ large, and that we still went through another eighteen months of damage after that fact that could have, and should have been avoided.

Andrew O'Shaughnessy:

And were your expectations also that regulators would apply some of the terms exemplified by the agreement with Ameriquest to the industries? What exactly were the opportunities that were missed?

Patrick Madigan:

That's a good question. And I think it's all of the above. Federal regulators could have stepped in and done some things and they did not. Investors. If you are putting very large sums of money into purchasing these securitized mortgage loans, that might've been a signal to you. One of the reactions, and I alluded to this earlier, was that we were irresponsible, was that we had done a bad thing, that this was political (which it was not in any way whatsoever), that this was done by these activist state Attorneys Generals who had just gone out and done this and that. This was bad because it was going to restrict access to credit. And that was a reaction from a number of segments in the industry which I've found extraordinary.

Andrew O'Shaughnessy:

When did you first start seeing servicing issues arise as opposed to origination?

Patrick Madigan:

March of 2007, I remember it well. Individual citizens contact our office, like they do all state AG offices. Because we're a smaller state, we're able to give a very high level of service to people who contact our office. I remember seeing a complaint, somebody saying, "I'm in trouble, I'm going to lose my house to foreclosure." And I did not remember seeing that before. And, again, we talked about it, well, why is that? And the reason was because before, anytime anybody got in trouble they were just put into a new loan. They were just refinanced. And so I was very struck by this and I started to look into it and I started to learn about mortgage servicing because I knew absolutely

nothing about mortgage servicing, even though I had spent three years at this point on origination.

And I had learned an awful lot about origination. Servicing was a completely different topic. And I remember distinctly with one of these early files, I called one of the companies and I talked to them and I said, "You know well, look, it seems to me that maybe you would want to work something out here on this loan instead of foreclosing on it because you're going to lose a massive amount of money." And one of the reasons why I knew that is because there was appraisal fraud on that actual file. And so in addition to the losses that are normally incurred in a foreclosure, then there was all of the other losses in the inflated equity that wasn't actually there. And I can tell you the reaction to that suggestion was as if I was from Mars. It was "What are you talking about? Why would we do that?" There was no culture of doing loss mitigation or loan modifications at that point in time. If they were to do it, they wanted to underwrite the loan to an extent that far exceeded how the loan was underwritten in the first instance, which was rather ironic. And so I started from zero point zero.

Andrew O'Shaughnessy:

So what was the nature of the servicers as businesses? Were these nationally chartered banks? Were they locally chartered non-bank institutions? Can you talk about that?

Patrick Madigan:

Yeah, so it's changed a lot over time, but a lot of servicing at that point in time was with banks. But then of course non-depository servicers existed as well, but they were much more of a niche and much more in the subprime loans. And at that point in time, in 2007, we believed it to be a subprime problem. Now it later grew beyond the subprime market, but it was believed by us to be contained just to the subprime market. But there was a lot more servicing with banks in 2007, 2008, than there is now.

Andrew O'Shaughnessy:

So how were the banks being compensated as part of the value chain of the mortgages? Because the originators get a fee, then the banks securitize the loans. So in their role as servicers, how do they get paid exactly?

Patrick Madigan:

They get paid in two ways. The main one is there's a float because they get all these payments and then before they have to distribute them to the various investors or wherever it has to go, to pay the property taxes or whatever it is that they have to do, they're able to earn [interest] for that period of time. But the main way that they do it is that they get a fee. They get a

servicing fee, which is often expressed as a percentage, or a number of basis points, of the loan, and that's what they get paid to service the loan.

Andrew O'Shaughnessy:

So you've described the problems that borrowers were running into. What was the legal basis of your emerging theory of the case at that point? What rules were being broken?

Patrick Madigan:

For servicing, that was something that we struggled with. For origination, it was pretty clear. If you're inflating appraisals, if you're lying about people's income, if you're forging documents, that's illegal pretty obviously. Servicing was a much more difficult topic because a lot of the laws that exist now because of the efforts of our group and others, did not exist then. And so that was actually something that we struggled with. And so one of the ways that we approached it, quite frankly, was as a public policy issue. I'm a government employee; I work for an elected official, and so one of the things that we came to was whether or not it's illegal to not give loss mitigation to these people. It doesn't make any sense from an economic standpoint.

It doesn't make any sense from the investors who own these loans. And it certainly doesn't make any sense from a public policy perspective. And that was actually how we approached it at that point in time.

Andrew O'Shaughnessy:

So how did the multistate coalition start coming together? You're getting complaints, presumably from other jurisdictions. How'd that work?

Patrick Madigan:

So one of the interesting things is, as I started to educate myself and started to learn more about servicing and started to talk about servicing, I talked to my Attorney General, Tom Miller, and he said, "Hey, this is really interesting because this reminds me of a terrible crisis that happened in the state of Iowa in the 1980s, which was generally referred to as the Farm Crisis." And one of the things that was done here in the state of Iowa was a really innovative program was put in place that said you cannot foreclose on a farm unless you go through mediation first.

And he said, the same principles apply to what we think is about to happen here. And so my office actually put out a message to all 50 States and said, "Hey, we think something is about to happen. Please meet us in Chicago." In July of 2007, we had a meeting at a hotel near O'Hare airport. "We want to talk to you about foreclosures." And so we did that, and it was very well attended. And we put on a meeting; I spoke at the meeting and

a number of other people spoke at the meeting and we basically said a storm is coming. It turns out not only were we right, but we didn't know how right we were. One of the outgrowths of that meeting was the decision to create a group. And it was going to be a coalition of state AGs and state banking departments who are also at that meeting. And we created a formal group, which was called the State Foreclosure Prevention Working Group. And that group was created in August of 2007.

Andrew O'Shaughnessy: So it sounds like due to the paucity of legal tools you had, that it was fundamental to have the regulators on board from the beginning?

Patrick Madigan: Yeah, state regulators are extremely powerful and also just the depth of knowledge too. While we had worked with them on the Ameriquest case, this was more formal. This was a more formal partnership between the two state parties.

Andrew O'Shaughnessy: [D]o you think that you were able to convene everyone in the way that you did in large part because of the interpersonal ties, the social infrastructure that arose from that collaboration from the loan origination matters?

Patrick Madigan: Yeah and I think honestly the standing of my Attorney General Tom Miller, who is now the longest serving [state] Attorney General in United States history. Even in 2007, he had been Attorney General for a long time. And so I think all of the above.

Andrew O'Shaughnessy: [With regard to] the dynamic between the working group and federal regulators, what was the history of that relationship?

Patrick Madigan: Some of this was before my time, but in the early 2000s there was a move by the OCC [Office of the Comptroller of the Currency] and the OTS [Office of Thrift Supervision] to very aggressively preempt States and that was very controversial. We started our efforts in the fall of 2007 on foreclosures. One of the things we did is we developed what's referred to as a call report, which is just basically a way...

Andrew O'Shaughnessy: I'm sorry, a what report?

Patrick Madigan: Call, C-A-L-L. A call report. It is a term of art in the state banking department world, which is just basically a way to gather data every month in a consistent way from institutions. And so we developed one specific to mortgage delinquency and

foreclosure, and we sent it to, I believe, the top 20 subprime servicers.

A couple of things to say about it. One is that I believe that we were the first government actors to actually do this. I think we were ahead of all of the federal regulators in gathering this type of information, but many of the large servicers at that time were national banks. And so right away, we ran into a conflict where, if I remember correctly, the OCC instructed the national banks not to respond, not to give us that information. And so that was the beginning of several years of conflict between us and the federal regulators.

Andrew O'Shaughnessy: ...[W]hat was your understanding of the OCC and the OTS' rationale for that behavior?

Patrick Madigan: They had a very expansive view of preemption and in their view that included that entities that they charter did not have to respond to information requests from state regulators or state Attorneys General.

Andrew O'Shaughnessy: So was that a point of principle in itself, or do you think that they saw themselves as maintaining a kind of national market for banking services...?

Patrick Madigan: I can't speak for them, so I think I would let them answer that question.

Andrew O'Shaughnessy: ... So could you carry the story of the servicing investigations forward from there? So you had that big meeting and all your colleagues were brought in, what was your next move?

Patrick Madigan: So we created the group, we'd started to collect the information, and then we did two things. We had meetings in the fall of 2007 in Chicago with the top twenty subprime servicers, two different meetings. One was with ten servicers. The other was with the next ten. And that was very interesting. And then we began to take the information that we were gathering, and we started to write reports.

Andrew O'Shaughnessy: If I could interrupt for a second. What was interesting about those meetings? What were their initial responses like?

Patrick Madigan: Well, part of it is that in some circles, there was a belief that we were alarmist, that there was this so called foreclosure crisis, that there was not really a foreclosure crisis. And all of these things that we were saying or that what the Center for

Responsible Lending, who had put out a paper on this, was saying, were never going to come to pass. And that the issue just wasn't as bad as we were making it out to be. I can remember one executive telling me, "I understand what you guys are saying, but you don't need to modify these loans. Repayment plans work just fine. It's not necessary to actually change the terms of the loans and the modification." Then there was just a lot of discussion about just logistics. What are you doing, what's working, what's not working, how are you reaching borrowers, et cetera? Just the engagement, I guess. Because again, you have to remember that all of our work had been on the origination front prior to this time. And so this was really where the state AGs really first were getting their feet wet on mortgage servicing issues.

Andrew O'Shaughnessy:

Thanks for elaborating on that. You were saying that your next step was to start putting reports together?

Patrick Madigan:

We started writing these very comprehensive reports and they had a lot of data. They had a lot of analysis, charts and graphs and all of that good stuff. And policy suggestions. This is a very unique thing for state AGs to be a part of, and truth be told, some of our friends in the state regulator community were the primary authors of those reports, but we put them out and we put them out into the public and they were on websites and they were reported on. They were reported on in the industry press and people read them. I believed then and I believe now that we moved the industry, that those reports matter[ed].

Andrew O'Shaughnessy:

So what in particular were you disclaiming in your reports? What were you trying to accomplish with those publications?

Patrick Madigan:

I haven't read them in quite some time, but you have to go back again. This is just like origination. There are things now that are just accepted as common sense that were very hotly contested at that point in time. And just the basic concept of doing a loan modification was very much a contested topic at that point in time. And so there was a lot of people who said, "Look, loan modifications are a waste of time. People are just going to re-default. Housing values are going to drop even further. And then you're just going to get even less money when you liquidate the home." So in other words, you're just throwing good money after bad. And we said, "No, if you give a modification, a true modification, people will be able to pay. And that is better than the massive losses that you will suffer in a liquidation event."

So the industry early on, in the hopes that it wasn't as bad as we were saying, or that there would be a recovery right around the corner, took a bunch of baby steps, a bunch of half steps. And so what they would call a modification at that point in time is to take the arrearage and bring it back into the loan and recapitalize the loan so that you make the borrower current again. But the result of that is that, yes the person is now current again, but now their monthly payment is increased over what it was before. So the person who hypothetically couldn't afford a \$1,000 a month payment is now supposed to be able to afford a \$1,100 a month payment. And they called that a loan modification. And then when people re-defaulted, they would say, "See, we told you these things don't work."

And what we said is "That's not a loan modification. A loan modification has to actually provide payment relief to the borrower. The monthly payment is where the rubber meets the road, and if you achieve payment relief, whether it's by reducing the interest rate, extending the term, whatever it is that you're doing, then you will not see these high breakage rates, these high re-default rates. That was like a two year discussion, battling over that.

Andrew O'Shaughnessy:

...[The] reluctance to perform loan modifications seems striking. What did you think? Why do you think they were so adamant?

Patrick Madigan:

Well, one is that there was a lot of pushback from the investor community. So you have to remember that the investor community got into subprime loans because of the incredibly high margins.

And the other thing is the structure of securitizations and then the mezzanine structure of those securities. And so when you say investor, it's not a monolith. There's people, depending on where they are in that pecking order, who have a very different opinion about what should or should not be done. And so one of the basic problems is that servicers were caught between a rock and a hard place because they had people telling them, "Modify that loan or else I'm going to lose all of my money." And they had other people telling them, "Don't you dare modify that loan because I'm going to then get less than what I thought I was going to get" and threatening to sue them. And there really was, I think, a real threat of litigation at that point in time.

Andrew O'Shaughnessy:

So what you're saying is there were people who held the AAA tranche of the CDO [Collateralized Debt Obligation],<sup>2</sup> who wanted to continue getting as high a payment as they possibly could from the investment? And then there were people holding the riskier tranches, who wanted modifications to protect their principal?

Patrick Madigan:

That's right. That's exactly right. And that's much more succinct. And the servicer is like, "What do I do?" So that was definitely part of the problem. And then part of the problem is almost what I would describe as cultural in that for years and years and years, we had this booming mortgage market that I have argued masked, hid, the fraud that that was in the market. And now it's been revealed, and there was no culture of doing loan modifications. And in fact, they weren't equipped to do loan modifications. So, I mean, servicing was viewed as kind of this back-office operation. It was a low touch or no touch money collection system. And now all of a sudden you have a flood of borrowers who are in default and who need help. And loss mitigation is a very intensive effort, especially how it was done at that point in time. And they were not equipped. They were not equipped from a volume standpoint, but they also just weren't equipped from a structural standpoint, like the big banks weren't built to do loss mitigation on a mass scale. So it was like a square peg in a round hole. And so that was another one of the big reasons why, that even if they wanted to do it, they couldn't.

Andrew O'Shaughnessy:

So to do a loan modification, you would need someone who will pick up the phone from the borrower and the banks just didn't have the thousands of loan officers you'd need to do it?

Patrick Madigan:

Yeah. You have to talk to these people for like 45 minutes and have them send in all these documents, and it's extremely labor intensive to go through and to get a solution that works. And they also weren't necessarily incentivized because they don't get paid more because they kept somebody in their house. They're paid their servicing fee. And so it was a whole combination of things that led to them being just extremely flatfooted when the foreclosure crisis came. And I'm talking about the early stages. This was before it spread into more of the market.

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<sup>2</sup> "Collateralized Debt Obligations are structured financial instruments that purchase and pool financial assets such as the riskier tranches of various mortgage-backed securities." See Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report 128 (2011).

Andrew O'Shaughnessy:

So you have published these reports and they are making a big splash. So what happened next?

Patrick Madigan:

This goes back to your question earlier about legal theory. And what I would say is we just continued to stay engaged. We continued to talk to servicers. We continued to meet with them. We continued to have dialogue with them. What we didn't do during that point in time was have any enforcement cases. And I think part of the reason why is there was a lot of uncertainty as to what would happen if we actually brought an enforcement case. And so we did a lot of what I would refer to as "jaw boning," using the bully pulpit of our offices to try to get certain outcomes, outcomes that we believed were better for everyone. I can't stress that enough. Sometimes it's seen as like this is engaging in some sort of charity or something like that.

And it's nothing of the sort, what we were advocating for was the most efficient economic outcome. We were advocating for what we believe was the right outcome, not only for the investors, but for the public policy. There really was that proverbial "win, win," out there. And so this went on for years, this kind of engagement until the next presidential election, where then there was a shift with the new administration.

Andrew O'Shaughnessy:

When you say you were trying to do what was most economically efficient, are you talking about the tension between money damages and negotiated loan forgiveness? What are you juggling?

Patrick Madigan:

What I'm talking about is doing a loan modification versus a foreclosure. That's what I'm talking about.

And one of the things that kind of developed in those two years is, as we had talked earlier about, where you are in your position and the trust [the legal entity that holds an interest in the mortgage loans for the benefit of investors] that greatly impacted your point of view as to what should or should not happen. It became kind of clear, and the timeframes escaped me a little bit now, that the servicer's duty was to service the trust as a whole, to the trust in the aggregate. And that was one of the breakthroughs that happened. And so the threat of investor litigation never occurred. It never really ever actually happened or certainly not on the scale as it was once threatened or feared.

Andrew O'Shaughnessy:

The duty to the trust that collectively owned the tranches of mortgages?

Patrick Madigan:

Right. So you service the trust in the aggregate, you did what was best for the trust in the whole, as opposed to an individual tranche. That was the principle that was established or re-established, or clarified, I guess is what I would say.

And so our argument was, "Look, if you take these homes to foreclosure, I think the term of art is loss severity, you're going to have very significant financial losses that will occur because housing prices were falling at that point in time." And so what we said is, "Look, just do the math. Do the math, and you will do better. Sure, you're not going to get what you thought you were going to get out of this loan because you had to reduce the interest rate to do a loan modification." So you're an investor and you thought you were going to get 9% or whatever, 14%. We're talking about subprime loans, just make something up. You're not going to get that. Now it's been reduced to 7%, but that's better than what you're going to get out of a liquidation of that. That's the argument that we were making.

Andrew O'Shaughnessy:

To double back briefly, you mentioned that you didn't really bring any actions? You were focused on your use of the bully pulpit during this time. And that was because you didn't know what would happen if you brought in an enforcement action? Do you mean you didn't know legally what would happen, or you didn't know what effect it would have on the marketplace?

Patrick Madigan:

I think the legal question, speaking only for myself, was very much an open question at that point in time, in terms of, is it an unfair, deceptive, act or practice not to give somebody a loan modification? Just at its most base level? Or what would be the actual assertion of where they have violated law? Now, maybe they're doing something that doesn't make a lot of sense. Maybe it's a bad outcome from our point of view, but is it actually illegal? That's a separate question.

Andrew O'Shaughnessy:

So you mentioned that this process took several years. Were there any disagreements about how best to proceed on the executive committee of the working group or even in the broader coalition? If so, what did that look like?

Patrick Madigan:

I'm sure that there were, and I think one of the debates we've just been discussing is, should we be doing something more or should we actually sue a mortgage servicer? And I think that was probably discussed quite a bit. But other than that, not really, because I think it was pretty clear to us what needed to be done. What needed to be done were loan modifications on a massive scale.

Andrew O'Shaughnessy: ... [W]hat happened next?

Patrick Madigan: So basically what happened next is the Obama Administration came in, and I want to say that none of my comments are meant to be political. I'm just recounting historical events, as I remember them. The Bush administration did not embrace loan modifications really at all, and I think that was a tremendous missed opportunity. But when the Obama Administration came in, they developed a program that became known as HAMP [Home Affordable Modification Program]. And that was really a sea change because that would really force the industry to do loan modifications. And it gave them financial incentives, actual financial payments to do modifications on a level that they just had previously not been done. And so HAMP was a very significant event in the response to the foreclosure crisis. So that was 2009. And then if you jump ahead, I would jump ahead all the way to September of 2010, when was the next really big event, which was when this new term "robo-signing" kind of came to the surface.

Andrew O'Shaughnessy: So what was robo-signing?

Patrick Madigan: So I got a call from a reporter in September of 2010, and they were asking me about this. I was not aware of it at that point in time, but essentially the assertion is that mortgage servicers were signing documents that required personal knowledge of some facts and the people who were signing them did not have that personal knowledge or maybe didn't even work for the entity that was supposedly signing the document that essentially these were false documents, or improperly executed documents might be a better way of saying it, and that it was being done on a mass scale.

Andrew O'Shaughnessy: So this provided a more robust legal basis for you all in the state AGs offices because you're getting causes of action in state law at that point? Is that what's happening?

Patrick Madigan: Exactly. This gave us a legal hook that was very clear. It was clearly illegal. It was clearly state law. It had clearly happened and that was a game changer.

Andrew O'Shaughnessy: You mentioned the first call was from a reporter and that robo-signing was a term that gained wide use. So did the fact that it was front page news help the case at all?

Patrick Madigan: Yes. This was one of the remarkable things about it. As we've been discussing, I had been working on mortgage servicing since

2007, and myself and my colleagues had put tremendous effort into the issue. Written reports, published reports, we had done all these things trying to bring attention to the issue. And there was something about robo-signing that captured the public's imagination and the press' imagination. I don't know if it was just because people could understand it, that people understand this concept of execution of these documents. But it took this issue that had been out there for years, and it just sent it on a rocket ship to the moon. And it was unbelievable to me. I think it was around the third week of September when I got that call and the sequence of events that happened after that were extraordinary and the pace at which they happened was extraordinary.

Andrew O'Shaughnessy:

So can you tell me a little bit about that?

Patrick Madigan:

Just the attention. So again, these were not new issues to me. The actual robo-signing allegation itself was new, but not mortgage servicing writ large and all of a sudden it became like front page news, as you said. And so just the attention that was put on it was extraordinary. The number of calls from reporters that we started fielding was extraordinary. We made the decision that this was the time for an enforcement action and I would have to go back and look, but I think within about a month of that first phone call, we had a 50 state group put together and everybody had signed-up and said, "We're doing this." And we were off and running.

I'm used to working on high profile matters. I worked for an elected official, a pretty well-known one in the AG world. I have never seen anything before or since that had this much attention focused on it that intensely.

Andrew O'Shaughnessy:

So when that 50 state group came together, when exactly was this?

Patrick Madigan:

Probably like October of 2010.

Andrew O'Shaughnessy:

Okay. So it seems like at this point, on the one hand, with a state law cause of action the role of federal regulators is going to become less important, but also you've had a couple of years of a Democratic administration. Had there been enough or any turnover at the regulators you mentioned? That their positions had changed much or was that not the case?

Patrick Madigan:

So what basically happened is that we had worked with the Department of Justice and the Obama Administration under

something called the FFETF, the Financial Fraud Enforcement Task Force. And so we had developed a very good relationship with the Department of Justice, which is somewhat unusual to my understanding, that it's not always common for what's referred to as "Main Justice" to work with state Attorneys General. And so "Main Justice" reached out to us, and HUD [United States Department of Housing and Urban Development] reached out to us. And that's actually who we worked with. We did not work with the regulators. We did not work with the OCC and the OTS. I think they had a different point of view than we did.

Andrew O'Shaughnessy:

So there's all of this attention, and you've initiated an action. How do you get from there to the National Mortgage Settlement?

Patrick Madigan:

Those were the most intensive 18 months of my life, and again it was extraordinary because not only is it multi-state, but it's multi-agency and state and federal. And so one of the things that had happened was the passage of the Dodd Frank Act. And one of the really important things that happened with Dodd-Frank is that it addressed preemption. To this day, I don't think anybody really knows exactly where the lines are when it comes to preemption, but we know that they were different than what they were before, or at least what they were asserted to be before. And so one of the really important things is that we contacted national banks. The four largest servicers in America at that time were national banks. And they had to make a decision as to how they were going to respond to state Attorneys General.

And they made, what I think was the correct choice. They decided to engage with us. But we didn't know how they were going to respond when we first contacted them, which is not well understood. People don't understand those dynamics. They think that we just have omnipotent power, which we don't. And so what ultimately ended up happening is there was a decision of, well this is an industry wide issue, so how do you tackle it? Where do you draw the line? What do you do? How many entities do you engage? Do you do them one at a time? You have all of these issues. And it ultimately was decided that the top five would be where we would draw the line, which ended up being about 68% of the market if I remember correctly. And it was four national banks and then one state licensed entity,

which was GMAC [General Motors Acceptance Corporation] or Ally, as they were known.<sup>3</sup>

Andrew O'Shaughnessy:

...Would it be a[n]... accurate characterization to say that the General Counsels at these banks were making prudential judgments about what would happen in court? Did you have a mental model of how they were making their decisions at the time?

Patrick Madigan:

It's a really interesting question. I called some of them personally. And I was the person who called and asked them to engage with us. And I'm sure that they thought of any number of different things, legal and non-legal. Look, they have business reasons for what they do. They have reputational reasons. There's all kinds of things that go into their calculus. I don't know what all went into their calculus, but it's more than just the law. That's for sure.

Andrew O'Shaughnessy:

So you zero in on these institutions and what was the process of opening negotiations like?

Patrick Madigan:

One of the things is we had to decide what our goals were and what the scope was. And there's this view out there in some circles that the National Mortgage Settlement was timid. It was the exact opposite. It was extremely robust and aggressive from my point of view. And so what we decided was we weren't going to just address robo-signing. We were going to address everything. We were going to address all of the issues that we were aware of, all of the issues that we are working on for the past three years, that this was where we were going to make a difference in mortgage servicing. And that was a fundamental decision. And so one of the things was just, "Okay, fine, what do you want?" Like, what do you want to change? We started with a blank piece of paper, literally. So what are the reforms? And that's a monumental effort in terms of just trying to figure out that question and then have this incredibly diverse coalition of states and federal agencies reach agreement upon that. So that was an enormous part of the effort.

Andrew O'Shaughnessy:

So the processes you're describing sounds very difficult and time intensive in any situation, just getting all that number of actors on the same page. Did you feel that it was more complicated because of divergent views about what the goals should be? Were there camps? Even if you can't identify any

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<sup>3</sup> In May 2010, GMAC re-branded itself as Ally Financial.

individuals, were there different views that led people to different conceptions of what the goal should be?

Patrick Madigan:

What I would say at a high level is that early on we were attacked from the Right. That this was all overblown, that nobody was actually hurt by this, that we were overstepping our bounds. Initially the blow back on the political spectrum came from the Right, and then amazingly, three months later after that, it came from the Left, that this was a sellout and that this was a terrible, and that we weren't nearly aggressive enough. And so basically we were getting it from all sides, depending on where we were in this process. And again, the attention that was being put on this was extraordinary. From a press perspective, just almost unending contacts from the press, which we were not seeking by the way. It just makes your job more difficult. Whenever you're trying to do something important, and this was definitely important, everybody's mad at you. And so I would say that we got it from all sides.

Andrew O'Shaughnessy:

... What were, as you recall, some of the main specific things that you were looking for the banks to agree to?

Patrick Madigan:

That's actually a really interesting question because what we ended up with was what we called the Servicing Standards, which were 41 pages, single-spaced, of reforms. You shall do this, you shall not do that. You shall do this within five days. You shall do this within 30 days, extremely granular. And what's significant about this is it did not exist previously. And so we put in place a framework of rules around mortgage servicing that was new, that had not previously existed, and that's an incredibly important event. So what is it that we wanted to achieve? If you would go and read those servicing standards, it is a breathtakingly diverse number of issues across any number of different things. And so it's actually really difficult to summarize, not only because of the breadth of it, but also the detail.

I mean these are not high-level aspirational statements. These are like operational details about how you run a business. And that's where it was really important that it be a negotiation with the industry, like we talked about before. And that the industry agreed to it and buys in on it and says, "Yeah, we can actually do this in the real world." And I remember I talked to one of the executives who was a major negotiator in that years later, and said, "Well, what's your view on it now? What do you think?" And I think at the risk of saying this wrong, I think he said that, about like 85% of it was good and that he agreed with it, and

that there was maybe another 15% where we missed the mark or it was too aggressive or didn't work or what not. But that's a great outcome from my point of view.

Andrew O'Shaughnessy:

So what you were negotiating about was a very complex body of specific terms. And so it would probably be difficult to summarize what the banks felt were the most egregious asks, what they resisted most strongly, but does anything stand out in your mind?

Patrick Madigan:

Not really, and in part that's because of the passage of time and because of the detailed nature of it. We were trying to do a paradigm shift though. These were not changes on the margins. We were trying to say that mortgage servicing matters and that it needs to be done in a certain manner. And it created a shift culturally to one of loss mitigation, when appropriate. I want to stress that point. Again, we have never, ever advocated for doing loss mitigation where it's not appropriate. There are certain situations where the foreclosure should happen. You are not doing the borrower a favor by trying to keep them in a home that they can no longer afford. And you're certainly not doing the bank or the investors a favor in that situation either, or I think the market writ large.

So we're only talking about trying to avoid unjustified foreclosures, avoidable foreclosures. One of the things that happened in the last crisis is a whole lot of people got foreclosed upon not because it was the right economic decision, but because of a process failure. Because the servicers were overwhelmed, they didn't have the staff, they were losing documents, documents were going stale, they weren't designed to do this as we discussed earlier. And so what we wanted to achieve was that if somebody is going to be foreclosed upon, it is because it's the right thing to happen, not because they fell through the cracks because of a process failure.

Andrew O'Shaughnessy:

How do you feel like the settlement has held up over time?

Patrick Madigan:

Well, the settlement wasn't just servicing standards. There was also a lot of money involved in that. So we had \$5 billion, with a "B" in cash, involved. And then there were a number of commitments that the servicers had to make, which we referred to as the "menu." It's not the official name. And the "menu" was that if you take these various actions, depending on what it is, then you'll get credits of 50 cents on the dollar or 25 cents on the dollar or 80 cents on the dollar. And it was argued by some that the banks were just going to do all that stuff anyway. I beg

to differ. They were not going to just do those things anyway, not from my perspective and not from the prior three years that I had spent on the issue.

And they ended up doing, I think about 50 billion dollars worth of efforts through the menu, if I remember correctly. And so I think that the settlement, and this is going to sound self-serving, but I think it was a tremendous success. I think that it helped put a floor, to some extent, under the foreclosure crisis at that point in time. But much more importantly, it was about the future. So one of the things that happened is our servicing standards became the basis for rulemaking by the CFPB [Consumer Financial Protection Bureau]. We knew that this was going to happen, but the CFPB did rulemaking several years later, where then they applied for the first time to everybody. Because the national mortgage settlement was only to the five entities, even though they were five, very large entities.

Under everybody, these were the rules. And if you compare those rules with our servicing standards, you're going to see a lot of commonality. It's not the same. There are things that are different, but there's no question in my mind that what we did in that settlement was the basis, the starting point, for that rulemaking. That is a seismic shift in mortgage servicing. If you go back to 2007, when I first started and I very first started talking to services, it is a sea change to where we are now. It is hard to overstate how much different it is now. And I think that is one of the great legacies of the settlement. I think the settlement is misunderstood. I think it's underappreciated because it became very political, and a lot of people criticized it without really understanding where we were starting from and where we ended up. Also understanding things like preemption and state AGs interacting with national banks and various other issues.

So clearly as one of the leaders of that effort, I'm going to support it. But I think that it was an extremely important event in mortgage servicing.

Andrew O'Shaughnessy:

[T]here was a little bit in the press about how at the political level of the offices, there was some disagreement about how to proceed in the NMS. So as an outside observer, it's hard to tell what exactly the disagreements were at the staff level versus the political level. I am curious about what your recollection is on the different perspectives people wanting to take were?

Patrick Madigan:

Well, this is a sensitive topic, but I'd say for staff, there was no disagreement in staff. And what I would say is essentially an alternate reality was created in certain circles and in the press that did not reflect what was actually happening.

Essentially, the issue was around the issue of securitization. And there was an assertion that through this settlement, we were going to release all securitization claims. That was not true at any point ever. It was a false assertion, that essentially we were engaged in this massive giveaway and only because of this opposition were we stopped from doing that. It was false. It was false then, it's false now. That was the assertion and those claims were not released. Those claims were never going to be released. After the NMS, there were a number of actions by state AGs specifically about the process of securitizing loans and many hundreds of millions, if not billions of dollars, were recovered through those actions. And so at the staff level, I can just tell you it was nothing but frustration because none of it was true and we knew it wasn't true because we were the ones actually doing the work.

That was very, very difficult and it was very disheartening to see that happen because the state Attorneys General should be working together, not fighting each other in the press.

Andrew O'Shaughnessy:

I understand there were a number of settlements that followed the National Mortgage Settlement. What, if anything, did you think was remarkable about those? Or do you think they were just more so trying to get more parties under the same settlement framework?

Patrick Madigan:

Part of it that was amazing was, as I described, how for years and years and years we had to fight and scratch and claw and how we really started from zero, again, which I think was not understood by a lot of the critics. And after the NMS, that was not true. So we came in on a different basis, on a different standing and so those engagements were different because of that. We had done the NMS.

Not that I would want to say anything was easy because nothing that we do is easy, but that we started at a different point is one observation that I would make. And so on some level it was just getting more parties into the settlement. But the other thing that happened post-National Mortgage Settlement is that a big shift occurred where a whole lot of servicing, what are called mortgage servicing rights or MSRs, were transferred from banks, typically national banks, to non-depository state licensed

servicers. And so some of these servicers, who we had met with in 2007 and were kind of niche players, got really big really fast. So you had companies that, and I'm just making this up, but let's say they were the 25th largest servicer in America. And now all of a sudden, they're the seventh largest servicer because they got a massive transfer of MSRs from say, Bank of America. That presented a whole new set of challenges that we worked on in those years, and we're still working on dealing with now, a whole entirely different type of company with an entirely different business model than say a large depository national bank.

Andrew O'Shaughnessy: So these are the Ocwen Financials and the SunTrust mortgages?

Patrick Madigan: So Ocwen definitely. SunTrust is a bank. But Ocwen is the perfect example of that niche subprime servicer who specialized in default servicing. So for borrowers who are in trouble and need loss mitigation. Ocwen got really big, really fast.

Andrew O'Shaughnessy: So you mentioned that they had different business models. How is Ocwen compensated for servicing?

Patrick Madigan: Well, they're compensated the same, but one of the big differences is they're not a bank. So banks are able to use deposits, people's checking and savings accounts, to fund other operations of the bank.

A non-depository doesn't have that. And so they have to go out into the capital markets and they have to, through warehouse lines, access tens or hundreds of millions of dollars from the capital markets in order to run their business, in order to front the advances that they have to make when a borrower doesn't make a monthly payment. And so they're just different. They're just different animals. They're different in their financial structure, but they're just different in general because they're not a bank with 5,000 branches across the United States.

Andrew O'Shaughnessy: So what are some of the legal differences in going after an Ocwen as opposed to a bank?

Patrick Madigan: None, other than you don't have any potential preemption issues, but it's all the same legally. It's all still mortgage servicing. It's all still giving borrowers misleading information or are you engaged in robo-signing, whatever it might be. It's the same. The legal part of it is the same. It's just that the entity is just such a different entity and it's at such a different scale than a very large bank.

Andrew O'Shaughnessy:

[T]here are some broader questions that we ask in closing. One of them is that over the past ten years or so since some of these events, a number of different narratives have emerged to explain the financial crisis. So we have made a habit of asking everyone we talk to about what their view of the origins were.

Patrick Madigan:

First of all, I'm a lawyer. I'm not an economist or, so I know what I don't know, but from my point of view, the origin was mortgages. It was what was occurring in the subprime market, in particular. It was the decision by private equity to get involved in mortgages in which to get a higher return. Some people say like, "Oh my gosh, it was because of the CRA," the Community Reinvestment Act. Well, that's crazy. CRA was passed in what, 1977? And then somehow amazingly in 2005 to 2007, it causes all these problems. No, that wasn't it.

Andrew O'Shaughnessy:

That the CRA encouraged home ownership?

Patrick Madigan:

Right. And this is part of the narrative that it was all about people who bought more houses than they could afford, which is also false because obviously there were purchase money loans that were problematic, but the problem with Ameriquest was not purchase money loans. It was debt consolidation refinancing. That was the problem. And so the issue was that there became a demand to get a higher level of return from an investment standpoint. And so Wall Street, investment banks, went out and fostered that demand. They actually went out and purchased mortgage companies basically to have vertical integration in order to have that constant flow of these loans that would then fill those securitizations. And they created this insatiable demand such that then people went out and they did whatever they had to do in order to close that loan, in order to meet that demand, in order to fulfill that securitization that they needed to fill by the end of the month.

You would see where you'd hit the 27th, the 28th, the 29<sup>th</sup>, and then all of a sudden all these loans would get closed because there was an obligation that it would be done. That was what the difference was. The gatekeepers stopped being gatekeepers. There was a big movement back then to blame borrowers. Well, borrowers can't commit fraud unless the bank allows them to commit fraud. And the banks, originators, were not only allowing them to commit fraud, they were encouraging it. So I can tell you that in our interviews of borrowers in the Ameriquest case, they would say, "I'm just trying to get a loan, and then this guy, this loan originator would suggest to me that,

'Hey, maybe you've got a business that you run out of your basement.'"

Maybe you have this side business, which is completely fictitious. Now, if that borrower went along with it, they should not have done that. But the impetus came from the originator. It did not come from the borrower. Why is that? Because that loan originator was incentivized to close the loan. Why is that? Because they didn't own the loan. They didn't keep it on their books. They sold it. They securitized it. And at the C-suite of that company, they're trying like crazy to meet all of the obligations that they promise in order to fill these securitizations so that a Wall Street investment bank can continue to have these investments that have an 11% interest return instead of a 5% interest return. That's what happened. This was a market failure. That's what happened.

Andrew O'Shaughnessy:

So just to be clear, you mentioned the originators having obligations to the banks to originate these loans. You mean they were being paid and incentivized under contract to produce them?

Patrick Madigan:

Yeah. I haven't looked at these things in a long time, but my understanding is that they would often do these deals and then it wasn't like, "Hey, we have all of these loans, so now let's securitize them." Sometimes the deals would be done, and then now you've got to go find the loans in order to meet the terms of that deal. There wasn't a rash of irresponsible borrowers that just magically existed in the early 2000s that no longer exist anymore. It was a failure at the gatekeeper level. And in particular, it was a failure of origination. And that was because of what had happened from basically a private equity standpoint. And that is what happened because otherwise, why then? Why isn't it happening now? Why didn't it happen 10 years earlier? All of the other explanations don't hold water.

Andrew O'Shaughnessy:

So based on your experience, what would you say state level policymakers should learn from the mortgage crisis and its effects?

Patrick Madigan:

State Attorneys General matter. We can have a tremendous impact on the world. I think we were without a doubt, the driving force behind what happened with loan servicing and loss mitigation. That's not to diminish our federal partners who were tremendous in the National Mortgage Settlement, but it was the states from 2007, 2008, 2009, who were the ones who were beating the drum and who were saying we need to do

something here. And it was the States who did Household and who did Ameriquest. Housing issues are a local issue. It's city government, county government, state government, that gets devastated by foreclosures. People contact their state Attorney General's office. We're closer to the issues. And so there's a tendency to try to federalize everything and think about federal agencies as being the solution. And what I would say is that state Attorneys General have made an enormous difference in the issues of mortgages.

Andrew O'Shaughnessy:

... Given again our focus on state level policymaking, is there anything that I should have asked about or that you would have liked to talk about?

Patrick Madigan:

I don't know. On any one of these topics, we could go into a lot of depth. Not that this has been superficial because it hasn't. That's just really difficult, but no, because we've done the chronology. We've kind of done my history with this issue. And so it's just a question of whether you want to explore any aspect of it more fully.

Andrew O'Shaughnessy:

Sure, and I'll be reviewing and processing the transcripts, so more questions may well occur to me. I'm just curious, are you seeing any widespread issues related to mortgage lending today?

Patrick Madigan:

Well, that's a really interesting question. Delinquencies were at a very low level in March of this year. Then COVID happened. And so COVID has introduced a lot of really interesting issues from a mortgage perspective, including of course what happened with the CARES [Coronavirus Aid, Relief, and Economic Security] Act and what I call "forbearance on demand." And so my group, not that we were inactive, but we became a lot more active several months ago. And we're very concerned about what's going to happen with mortgages, what's going to happen with foreclosures. I mean, my goodness, look at the unemployment numbers in this country right now. And the future is very unclear, but what I would say is we are very engaged, and we are talking to the industry and it remains to be seen with what what's going to happen.

Andrew O'Shaughnessy:

Well, terrific. Mr. Madigan, thank you for being so generous with your time. We've talked just about two hours at this point, and it has been fascinating. Thank you so much.

Patrick Madigan:

Thank you for having me. I appreciate that.

[END OF SESSION]