MORTGAGE LENDING DISCRIMINATION
AND ITS ROLE IN THE SUBPRIME LENDING CRISIS

Testimony to the Committee on the Judiciary

Subcommittee on the Constitution, Civil Rights and Civil Liberties

Protecting the American Dream Part II: Combating Predatory Lending Under The Fair Housing Act

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The pervasiveness of toxic subprime[1] refinance[2] mortgage loans is destroying entire communities.[3] Minority communities are especially hard hit.[4] Record numbers of foreclosures are being driven by astronomical default rates on subprime loans, rates that exceed 20% on some portfolios.[5] More problems are anticipated as the bill comes due on certain forms of gimmicky products that defer interest by negative amortization, leading

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[1] *See* FATEN SABRY & THOMAS SCHOPFLOCHER, THE SUBPRIME MELTDOWN: A PRIMER 1 (2007), *available at* http://www.nera.com/publication.asp?p_ID=3209 (noting subprime loans are high interest loans made to borrowers who are perceived to present higher risk of default). Between 1995 and 2005 the percentage of subprime mortgage refinance loans increased from 5% to 20% of all mortgages made. *Id*. As of 2007, there is approximately $1.3 trillion in subprime mortgage loans outstanding. *Id*.

[2] Refinance loans are distinct from purchase-money loans in that the borrower already owns the home that will be security for the loan. Federal law recognizes this distinction and provides cancellation rights to homeowners who obtain refinance loans. 15 U.S.C. § 1635 (2006). As discussed below, these rights have proven insufficient to prevent a crisis grounded in predatory lending practices.

[3] *See* Alex Kotlowitz, *All Boarded Up – How Cleveland is Dealing With Mass Foreclosures*, N.Y. TIMES, Mar. 8, 2009, at MM28. *See also* Jennifer Steinhauer, *A Cul-de-sac of Lost Dreams and New Ones*, N.Y. TIMES, Aug. 22, 2009, at A1; George Packer, *The Ponzi State*, NEW YORKER, Feb. 9, 2009, at 81.

[4] William C. Apgar, and Allegra Calder. The Dual Mortgage Market: The Persistence Of Discrimination In Mortgage Lending. Joint Center for Housing Studies at Harvard University, Working Paper W05-11. (2005); http://www.jchs.harvard.edu/publications/finance/w05-11.pdf.; Kristopher S. Gerardi and Paul S. Willen, Subprime Mortgages, Foreclosures and Urban Neighborhoods, No. 08-6 Public Policy Discussion Papers (Federal Reserve Bank of Boston) http://www.bos.frb.org/economic/ppdp/2008/ppdp0806.htm; Daniel Immergluck, Measuring the Effect of Subprime Lending on Neighborhood Foreclosures, Urban Affairs Review, Vol. 40, No. 3, 362-389 (2005).

[5] According to the Federal Reserve Board, more than twenty percent of all subprime loans are seriously delinquent, as are one in ten securitized near-prime loans. Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Housing, Mortgage Markets, and Foreclosures, Speech at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008) (transcript available at http://www.federalreserve.gov/newsevents/speech/bernanke2008 1204a.htm). *See also, e.g.*, DAN IMMERGLUCK, FORECLOSED: HIGH-RISK LENDING, DEREGULATION, AND THE UNDERMINING OF AMERICA'S MORTGAGE MARKET 30 (Cornell University Press 2009). *See also* Vikas Bajaj & Louise Story, *Mortgage Crises Spreads Past Subprime Loans*, N.Y. TIMES, Feb. 12, 2008, at A1; Joe Nocera, Subprime and the Banks: Guilty as Charged – Executive Suite Blog, N.Y. TIMES (Oct. 14, 2009, 07:00 EST), *available at* http://executivesuite.blogs.nytimes.com/2009/10/14/subprime-and-the-banks-guilty-as-charged; Kotlowitz, *supra* note 3.

to significant payment increases two or three years into the loan term. These increases are virtually guaranteed to generate monthly obligations that are beyond many borrowers' ability to pay.[6]

Foreclosures are not just a catastrophe for individual homeowners, they also reduce tax rolls, lead to neighborhood deterioration resulting from property abandonment and vandalism, and generate a cycle of declining property values.[7] Indeed, the poor credit quality of subprime loan portfolios is a leading cause of the nation's current economic problems.[8]

Mortgage lending discrimination is one root of subprime lending problems and the resulting foreclosures. Vulnerable borrowers victimized by marked up interest rates and excessive costs and fees use more of their monthly income to make excessive mortgage payments than similarly situated white homeowners. In an economy still struggling with recession, the resulting foreclosures in minority neighborhoods threatens

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[6] As of December 2008, 28% of Payment Option Arm ("POA") Loans were delinquent or in foreclosure, according to LPS Applied Analytics, a data firm that analyzes mortgage performance. Ruth Simon, *Option Arms See Rising Defaults*, WALL ST. J., Jan. 30, 2009, at A1. Nearly 61% of POAs originated in 2007 will eventually default, according to a recent analysis by Goldman Sachs. *Id.* Goldman further estimates that more than half of all POAs originated in any year will default. *Id. See also* John Leland, *Loans that Looked Easy Pose Threat to Recovery*, N.Y. TIMES, Aug. 27, 2009, at A12.

[7] The City of Cleveland unsuccessfully pursued a lawsuit against a variety of subprime mortgage lenders in which the core claim was that lending practices constituted a public nuisance because of the resulting foreclosures and neighborhood deterioration. *See* City of Cleveland v. Ameriquest Mortgage Sec., Inc., 621 F. Supp. 2d 513, 516 (N.D. Ohio, 2009).

[8] *E.g.*, IMMERGLUCK, *supra* note 4 at 3; Kurt Eggert, *The Great Collapse: How Securitization Caused the Great Subprime Meltdown*, 41 CONN. L. REV. 1257, 1260-61 (May 2009). The national economic downturn reinforces the foreclosure problem as joblessness and underemployment lead to new rounds of defaults. Because many subprime borrowers have loans that require an extraordinary portion of their income, even small economic changes like loss of overtime income, divorce, or wage concessions can lead to default or foreclosure. *See* ELIZABETH WARREN & AMELIA WARREN TYAGI, THE TWO INCOME TRAP: WHY MIDDLE CLASS MOTHERS AND FATHERS ARE GOING BROKE 136-137 (2003).

the fabric of life for many minority neighborhoods.[9] Failure to aggressively modify mortgages exacerbates the problem.

FORMS OF MORTGAGE LENDING DISCRIMINATION AND LEGAL RESPONSES

Despite the Equal Credit Opportunity Act ("ECOA"), enacted to ameliorate discrimination in credit transactions,[10] and the Fair Housing Act ("FHA") designed to prevent discrimination in the housing industry more generally,[11] credit discrimination remains a widespread problem in America's mortgage lending industry.[12] Racial

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[9] Kristopher S. Gerardi and Paul S. Willen, Subprime Mortgages, Foreclosures and Urban Neighborhoods, No. 08-6 Public Policy Discussion Papers (Federal Reserve Bank of Boston) http://www.bos.frb.org/economic/ppdp/2008/ppdp0806.htm. See also Daniel Immegluck, Hypersegmentation and exclusion in financial services in the U.S.: The effects on low income and minority neighborhoods. Social Policy Journal 3: 25-44. (2004).

[10] *See* 15 U.S.C. § 1691 (1991); 12 C.F.R. § 202.6 (2003). The 1974 version of ECOA only prohibited discrimination on the basis of sex or marital status. The "Findings and Statement of Purpose" of the session law stated that "Congress finds . . . a need to insure that the various financial institutions . . . engaged in the extensions of credit exercise their responsibility to make credit available with fairness, impartiality, and without discrimination on the basis of sex or marital status." Equal Credit Opportunity Act of 1974, Pub. L. No. 93-495, § 502, 88 Stat. 1500 (1975) (amended 1976). In 1976, Congress amended the ECOA, significantly expanding its scope, to include anti-discriminatory acts on the basis of race, color, religion, national origin, and age. *See* Equal Credit Opportunity Act of 1976, Pub. L. No. 94-239, § 2, 90 Stat. 251 (1976) (current version at 15 U.S.C. § 1691(a)(1) (1991)).

[11] 42 U.S.C. § 3601 et seq.

[12] *See* William C. Apgar & Allegra Calder, Joint Ctr. for Hous. Studies at Harvard U., *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending, in* THE GEOGRAPHY OF OPPORTUNITY: RACE AND HOUSING CHOICE IN METROPOLITAN AMERICA (Xavier de Souza Briggs ed., Brookings Inst. Press, 2005), *available at* http://www.jchs.harvard.edu/publications/finance/w05-11.pdf (finding that mortgage lending discrimination today is subtle but pervasive, with minority consumers continuing to have less-than-equal access to loans at the best price and on the best terms that their credit history, income, and other individual financial considerations merit more than three decades after the enactment of national fair lending legislation); Robert B. Avery, Kenneth P. Brevoort & Glenn B. Canner, *Higher-Priced Home Lending and the 2005 HMDA Data, in* FEDERAL RESERVE BULLETIN A124, A159 (2006), *available at* http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf (revealing that, according to HMDA data from both 2004 and 2005, "Blacks and Hispanic whites were more likely . . . to have received higher-priced loans than non-Hispanic whites . . . [which has] increased concern about the fairness of the lending process"); CALIFORNIA

redlining was a prevalent form of mortgage lending discrimination from the 1930's to the 1990's. It was ameliorated largely by aggressive fair housing advocacy for home purchase mortgages.[13] Reverse redlining—the practice of targeting minority communities and steering them into bad loans—emerged with the subprime lending boom.[14]

Deregulation allowed lenders to aggressively market unconventional mortgage loan products to borrowers with tarnished credit histories in the subprime market.[15] Loan origination volume contributed greatly to lenders' profitability. To maximize volume, mortgage lenders increasingly used brokers, which allowed them to market and process their loans nationally while maintaining a limited number of retail offices.[16] Prior to the economic downturn,[17] the wholesale market[18] was an immeasurably profitable channel for loan origination, for brokers, lenders and the secondary market.

Mortgage lenders controlled borrowers' access to their loan products by choosing

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REINVESTMENT COAL., ET AL., PAYING MORE FOR THE AMERICAN DREAM: A MULTI-STATE ANALYSIS OF HIGHER COST HOME PURCHASE LENDING 1 (2007), *available at* http://www.nedap.org/resources/documents/2007_Report-2005_HMDA.pdf.

[13] ALYS COHEN ET AL., NAT'L CONSUMER L. CTR., CREDIT DISCRIMINATION § 7.1, at 155 (5th ed. 2009) [hereinafter COHEN ET AL., CREDIT DISCRIMINATION].

[14] *See*, *e.g.*, *id*. (listing a number of cases challenging reverse redlining practices between the years 2000 to 2008).

[15] *E.g.*, Depository Institutions Deregulatory and Monetary Control Act of 1980, 12 U.S.C. § 1735f-7a(a)(1) (1981) (eliminating state rate and fee caps on residential real property).

[16] Lenders used wholesale brokers to solicit mortgages and who used high pressure tactics and targeted minority borrowers.

[17] *E.g.*, Chase, http://www.chaseb2b.com/Wholesale-Lending (last visited Sept. 30, 2009) (announcing that Chase shut down its wholesale lending business in March 2009); HSBC, http://www.hsbcusa.com/ourcompany/pressroom/2007/news_21092007_decision_one. html (last visited Sept. 30, 2009) (announcing that HSBC shut down its wholesale lending business in September 2007); Greenpoint, http://www.greenpointservice.com/ (last visited Sept. 30, 2009) (announcing that Greenpoint shut down its wholesale lending business in August 2007).

[18] Brokers earned fees on top of the loan costs. More, since they were paid based on volume, many brokers downplayed or avoided altogether concerns of prospective borrowers and, since the brokers themselves frequently filled out the applications, they often altered the applicants' information in order to sign them to loans they otherwise would not have been able to obtain.

certain communities for their full service, retail, brick-and-mortar offices, and other communities to originate loans through mortgage brokers.[19] Mortgage lenders rarely placed full-service retail operations in predominately minority neighborhoods.[20] Instead, mortgage lenders overwhelmingly used brokers to market and process their loans there.[21] As a result, minority borrowers did not have ready access to retail prime loans.[22] Wholesale lending, particularly subprime lending, is more expensive for the borrower.[23]

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[19] In 2003, the National Community Reinvestment Coalition ("NCRC") released a report on credit discrimination. *See* NAT'L CMTY. REINVESTMENT COAL., THE BROKEN SYSTEM: DISCRIMINATION AND UNEQUAL ACCESS TO AFFORDABLE LOANS BY RACE AND AGE 5 (2003), *available at* http://www.omm.com/omm_distribution/newsletters/client_alert_financial_services/pdf/ncrcdiscrimstudy.pdf (indicating that consumers living in areas with more minority residents are more likely to have mortgages with interest rates higher than the "prevailing and competitive" rates, often because of discrimination in lending). *See also* Remarks of Martin J. Gruenberg, Vice Chairman, FDIC, Inter-American Development Bank, October 18, 2006, http://www/fdic.gov/new/speeches/archives/2006/chairman/spsep1906.html ("[P]revious studies have also suggested higher-priced, subprime lenders are more active in lower income, urban areas and that minority access to credit is dominated by higher cost lenders."); CENTER FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 16 (2006), http://www.responsiblelending.org/mortgage-lending/research-analysis/unfair-lending-the-effect-of-race-and-ethnicity-on-the-price-of-subprime-mortgages.html (compared to their otherwise similarly-situated white counterparts, blacks were 31-34% more likely to receive higher rate fixed-rate loans and 6-15% more likely to receive adjustable-rate loans).

[20] *E.g.*, JONATHAN BROWN, RACIAL REDLINING: A STUDY OF RACIAL DISCRIMINATION BY BANKERS AND MORTGAGE COMPANIES IN THE UNITED STATES § I(C)(1) (1993), *available at* http://public-gis.org/reports/red1.html#C (reporting that "[t]he 62 worst case lending patterns identified in this report demonstrate that the 49 major mortgage lenders responsible for these patterns have excluded minority neighborhoods from their effective lending territories or substantially undeserved such neighborhoods").

[21] CALIFORNIA REINVESTMENT COAL., ET AL., PAYING MORE FOR THE AMERICAN DREAM: A MULTI-STATE ANALYSIS OF HIGHER COST HOME PURCHASE LENDING 1 (2007), *available at* http://www.nedap.org/resources/documents/2007_Report-2005_HMDA.pdf.; *See also* RICK COHEN, KIRWAN INST. FOR THE STUDY OF RACE AND ETHNICITY, A STRUCTURAL RACISM LENS ON SUBPRIME FORECLOSURES AND VACANT PROPERTIES 7 (2008), *available at* http://4909e99d35cada63e7f757471b7243be73e53e14.gripelements.com/pdfs/Rick_Cohen_paper.pdf.

[22] Because there is no broker involved in a direct lender, or retail, transaction, the borrower is not required to pay any brokers' related fees and costs.

[23] U.S. Department of Housing and Urban Development, Office of Policy Development and Research, A Study of Closing Costs for FHA Mortgages 53 (2008), *available at*

During the subprime lending boom, mortgage brokers infiltrated minority communities. In our practice, we have frequently spoken to minority homeowners who say they met a mortgage broker on the street in their neighborhood or at their church. For example, an African American Boston police officer described to us how he was approached by a mortgage broker while serving a police detail in Mattapan, Massachusetts (a predominantly African American neighborhood), who told him the could find him a mortgage loan at a lower interest rate. The broker ultimately received over $10,000 as compensation for arranging the subprime loan. An African American H&R Block customer service representative who arranged tax preparation service appointments began receiving cold calls from an H&R Block Mortgage loan officer at her workplace in her community, trying to convince her to refinance her mortgage. Despite explaining that she had no intention of refinancing her loan, the loan officer kept calling and eventually convinced her to do so. The resulting loan was a 2/28 adjustable loan with an APR of 11.759%. H&R Block Mortgage received a $6,982.50 loan origination fee. Many other borrowers have reported meeting loan brokers in their churches or by door-to-door solicitation.

A former Wells Fargo loan officer and current whistleblower submitted an affidavit in support of a racial redlining case brought by the City of Baltimore.[24] Among

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http://search.hud.gov/search?q=Woodward+study+closing+costs&btnG=Search&sort=date%3AD%3AL%3Ad1&output=xml_no_dtd&ie=UTF-8&oe=UTF-8&client=hud2009_frontend&proxystylesheet=hud2009_frontend&site=default_collection (finding that broker originated loans in the group of FHA loans reviewed in the study were more expensive by approximately $425 per loan with all borrower risk factors being equal).

[24] Affidavit of Elizabeth M. Jacobson ¶¶ 26-30, Mayor & City Council of Baltimore v. Wells Fargo Bank, N.A., 631 F. Supp. 2d 702 (D. Md. 2008) (No. 1:08-cv-00062) [hereinafter Jacobson Affidavit] (suit alleging FHA violation).

other things, the whistleblower revealed that Wells Fargo targeted African Americans through special events in African American communities called "wealth building" seminars and targeted African American churches. Wells Fargo steered minority borrowers with prime credit into subprime loan products, and it did so by incentivizing its loan officers to originate the highest volume of subprime loans possible. As Ms. Jacobson recalled in her affidavit, "[m]any of the customers who were referred to me [] came from Prince George's County. Some came from Baltimore. I would estimate that a large majority of my customers were African American. Subprime managers joked that Prince George's County was the 'subprime capitol of Maryland.' I remember managers saying that they felt 'so lucky to have P.G. County because it is the subprime capitol of Maryland."[25] Ms. Jacobson further stated, "I know that Wells Fargo Home Mortgage tried to market subprime loans to African Americans in Baltimore. I am aware from my own personal experience that one strategy used to target African-American customers was to focus on African-American churches. The Emerging Markets unit specifically targeted African American churches. Well Fargo had a program that provided a donation of $350 to the non-profit of the borrower's choice for every loan the borrower took out with Wells Fargo. Wells Fargo hoped to sell the African American pastor or church leader on the program because Wells Fargo believed that African American church leaders had a lot of influence over their ministry, and in this way would convince the congregation to take out subprime loans with Wells Fargo."[26]

Lenders also gave their brokers and loan officers discretion to mark up mortgage loans, which was then used to mark up loans made to minority borrowers more than loans

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[25] *Id*., at ¶26.
[26] *Id*., at ¶27.

made to whites.[27] Based on a number of objective credit criteria, lenders set par (i.e., no points) interest rates for its various loan products. Lenders gave their brokers and loan officers' discretion to increase a borrowers' par rate in return for increased compensation. In some cases, brokers and loan officers received tens of thousands of dollars for closing just a single mortgage loan.[28]

Under HMDA, lenders are required to report to the United States Department of Housing and Urban Development ("HUD") the number of high cost loans they originated, both by race and by year.[29] Data in the past ten years show that minority borrowers were substantially more likely to receive high cost loans than white borrowers.[30] While the HMDA data raises an eyebrow, it does not explain the reasons why minority borrowers received more high cost loans than white borrowers.[31] To understand whether this discrepancy occurred because of credit discrimination, experts have conducted further analysis of the relevant data.[32]

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[27] *See*, *e.g.*, Miller v. Countrywide Bank, N.A., 571 F. Supp. 2d 251, 255 (D. Mass. 2008); Ware v. Indymac Bank, FSB, 534 F. Supp. 2d 835, 840 (N.D. Ill. 2008); Hoffman v. Option One Mortgage Corp., 589 F. Supp. 2d 1009, 1011 (N.D. Ill. 2008); Zamudio v. HSBC N. Am. Holdings, Inc., No. 07-C-4315, 2008 WL 517138, at *1 (N.D. Ill. Feb. 20, 2008); Guerra v. GMAC, LLC, No. 2:08-CV-08-1297-LDD, 2009 WL 449153, at *5 (E.D. Pa. Feb. 20, 2009); Payares v. JPMorgan Chase & Co., No. CV 07-5540, 2008 WL 2485592 (C.D. Cal. June 17, 2008) (denial of defendants' motion for interlocutory appeal); Beaulialice v. Fed. Home Loan Mortgage Corp., No. 8:04-CV-2316-T-24-EAJ, 2007 WL 744646 (M.D. Fla. Mar. 6, 2007).
[28] *E.g.*, Jacobson Affidavit, *supra*, note 24, ¶ 6.
[29] Home Mortgage Disclosure Act ("HMDA"), 12 U.S.C. § 2803 (2006).
[30] HMDA data for 2006 revealed that black and Hispanic borrowers are more likely to obtain higher-priced loans than are white borrowers. The data indicated that black homeowners who received subprime mortgage loans were much more likely to be issued a higher-rate loan than white borrowers with the same qualifications. Federal Financial Institutions Examination Council, Home Mortgage Disclosure Act, http://www.ffiec.gov/hmda (last visited Oct. 3, 2009) same data for 2005, available at http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf (last visited Oct. 3, 2009).
[31] *See* COHEN ET AL., CREDIT DISCRIMINATION, *supra* note 13, § 4.4.5.4, at 91.
[32] *Id.*

In recent years, statistical experts have performed regression analyses on loan level account data, by which they controlled for objective credit factors such as credit score, debt to income ratio and loan to value ratio, and determined disparity levels based on purely subjective criteria.[33] Expert reviews of data produced in litigation, after regression analyses to control for business justifiable credit factors, find that minority borrowers received higher cost loans than whites. In one such case, the data showed that African American borrowers, as a group, were obligated to pay $102.5 million more than similarly credentialed white borrowers, in just the first five years of their loans.[34] This kind of credit discrimination is hard to identify without costly data analysis and as a result, there historically has been little remedial action under ECOA or similar statutes. However, as research and publicity bring this problem to light, public and private litigants have begun taking action.

In a recent effort to combat credit discrimination, private attorneys, Attorneys General and civil rights organizations have sued mortgage lenders under ECOA, FHA and state statutes, in their various representative capacities. Courts across the country adjudicating these cases have upheld plaintiffs' disparate impact theories in a series of

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[33] *See* Howell E. Jackson & Laurie Burlingame, *Kickbacks Or Compensation: The Case Of Yield Spread Premiums,* 12 STAN. J.L. BUS. & FIN. 289, 350 (2007); DEBBIE GRUNSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES (2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf.

[34] Ramirez, et. al. v. GreenPoint Mortgage Funding, Inc., Case No. 3:08-cv-00369-TEH (N.D. Cal. 2010), Class Certification Report of Howell E. Jackson, dated April 1, 2010 [Docket No. 181] (concluding that, based on a statistical regression analysis of GreenPoint's loan level account data, minority borrowers paid more for GreenPoint wholesale mortgage loans than whites with similar risk characteristics.)

cases brought by private attorneys.[35] That is, without alleging that lenders have intentionally discriminated against minority borrowers, these actions have challenged lenders' pricing policies, which, statistical data shows, result in minority borrowers receiving higher cost mortgage loans than white borrowers with the same credit qualifications. These actions seek, among other goals, to stop mortgage lenders from maintaining loan-pricing policies that cause discrimination and to provide restitution to minorities for the disparities in the costs of their mortgage loans.[36]

Attorneys General in several states have also launched investigations and brought enforcement actions to address the discriminatory effect of lenders' pricing practices.[37]

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[35] Miller v. Countrywide Bank, N.A., 571 F. Supp. 2d 251 (D. Mass. 2008); Ware v. Indymac Bank, FSB, 534 F. Supp. 2d 835 (N.D. Ill. 2008); Hoffman v. Option One Mortg. Corp., 589 F. Supp. 2d 1009 (N.D. Ill. 2008); Zamudio v. HSBC N. Am. Holdings, Inc., No. 07-C-4315, 2008 WL 517138 (N.D. Ill. Feb. 20, 2008); Newman v. Apex Financial Group, Inc., No. 07-C-4475, 2008 WL 130924 (N.D. Ill. Jan. 11, 2008); Martinez v. Freedom Mortg. Team, Inc., 527 F. Supp. 2d 827 (N.D. Ill. 2007); Guerra v. GMAC, LLC, No. 2:08-CV-08-1297-LDD, 2009 WL 449153 (E.D. Pa. Feb. 20, 2009); NAACP v. Ameriquest Mortgage Co., No. SACV-07-0794, 2008 WL 680898 (C.D. Cal. Jan. 12, 2009); Payares v. JPMorgan Chase & Co., No. CV 07-5540, 2008 WL 2485592, (C.D. Cal. June 17, 2008) (denial of Defendants' motion for interlocutory appeal); Ramirez v. GreenPoint Mortg. Funding, Inc., No. C08-0369, 2008 WL 2051018 (N.D. Cal. May 13, 2008); Garcia v. Countrywide Fin. Corp., No. 07-1161, slip op. at 7-11 (C.D. Cal. Jan. 17, 2008); Nat'l Cmty. Reinvestment Coal. v. Accredited Home Lenders Holding Co., 573 F. Supp. 2d 70 (D.D.C. 2008); Jackson v. Novastar Mortg. Inc., No. 06-2249, 2007 WL 4568976 (W.D. Tenn. Dec. 20, 2007); Rodriguez v. Nat'l City Bank, No. 08-2059, (E.D. Pa. Dec. 11, 2008); Beaulialice v. Fed. Home Loan Mortgage Corp., No. 8:04-CV-2316-T-24-EAJ, 2007 WL 744646 (M.D. Fla. Mar. 6, 2007).

[36] *Id.*

[37] *E.g.*, *Home Lender to Repay Minority Buyers*, N.Y. TIMES, Dec. 6, 2006, at C6, *available at* http://www.nytimes.com/2006/12/06/business/06settle.htm (then New York Attorney General Eliot Spitzer filed suit against Countrywide Home Loans); Office of the Attorney General, Media Center, Attorney General Cuomo Obtains Approximately $1 Million For Victims Of Greenpoint's Discriminatory Lending Practices (July 16, 2008), http://www.oag.state.ny.us/media_center/2008/jul/july16a_08.html; Paul Jackson, *Massachusetts AG Sues Option One, H&R Block*, HOUSINGWIRE.COM, June 4, 2008, http://www.housingwire.com/2008/06/04/massachusetts-ag-sues-option-one-hr-block.

The Department of Justice has also recently entered into a consent order with AIG to cover its residential mortgage lending practices.[38]

The National Association for the Advancement of Colored People ("NAACP") is pursuing a lawsuit against fifteen of the country's largest mortgage lenders, alleging claims under the FHA, ECOA and the Civil Rights Act with respect to the lenders' practices towards African Americans.[39] And recently a new concern has emerged: credit discrimination may be taking place in connection with loan modifications.[40]

The complexity of unregulated subprime loans has been fertile ground for discrimination. The balance of this testimony discusses how mortgage lending discrimination takes root.

CAUSES OF MORTGAGE LENDING DISCRIMINATION

1. The Illusion Of "Risk Based" Pricing

"Risk-based" mortgage pricing is a frequently overlooked contributing factor to discrimination in the mortgage marketplace. The proponents of risk-based pricing have asserted that a closer tie between credit risk and mortgage prices leads to more borrowing

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[38] http://online.wsj.com/article/BT-CO-20100304-714391.html; http://www.justice.gov/opa/pr/2010/March/10-crt-226.html

[39] *See* NAACP v. Ameriquest Mortgage Co., et al., 635 F. Supp. 2d 1096, 1098 (C.D. Cal. 2009).

[40] Eric Holder, Attorney General, Remarks as Prepared for Delivery at the Foreclosure Rescue Scams and Loan Modification Fraud Press Conference (Apr. 6, 2009), *available at* http://www.usdoj.gov/ag/speeches/2009/ag-speech-090406.html ("Already, we are hearing increasing concerns that not all distressed borrowers are receiving the same opportunities for loan modifications. We are also hearing that the terms and fees for such modifications are not being made available on a non-discriminatory basis.").

opportunities for borrowers with fewer resources or with checkered credit profiles.[41] Risk-based pricing has thus been closely linked with policies favoring expansion of homeownership.[42]

Another argument in favor of risk-based pricing is that it protects responsible borrowers with good credit scores from paying an interest rate premium justified by the expectation of higher default rates associated with loans to more risky borrowers.[43] Certainly, this is appealing, conceptually, because it implies that the mortgage industry can serve low-income borrowers' needs and assign the extra cost of doing so where it belongs–on those who generate additional risk.

In practice, however, risk-based pricing is a disaster for minority borrowers. There are three reasons for this. First and most obviously, charging higher interest rates to people with fewer resources leads to a self-fulfilling prophecy. When those facing economic pressures need more of their limited economic resources to service their mortgage debt, the default risk goes up.[44] Higher rate loans are, *de facto*, more expensive

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[41] CONSUMER FED'N OF AM., CREDIT SCORE ACCURACY AND IMPLICATIONS FOR CONSUMERS 4 (2002); Alan White, *Risk-Based Pricing: Present and Future Research*, 15 HOUS. POL'Y DEBATE 503, 504 (2004). *See generally*, JOHN C. WEICHER, THE HOME EQUITY LENDING INDUSTRY: REFINANCING LOANS FOR BORROWERS WITH IMPAIRED CREDIT (Hudson Institute 1997).
[42] CONSUMER FED'N OF AM., *supra* note 41, at 4.
[43] White*, supra* note 41, at 504.
[44] The problem is exacerbated because these same borrowers are also likely to be charged higher rates for car loans, credit cards, student loans, and, according to some studies, even for groceries. *See* WARREN & TYAGI, *supra* note 8, at 136-37.

and therefore harder for vulnerable homeowners to manage.[45] In short, default and foreclosure rates naturally increase as loan rates increase.[46]

Second, the idea that a lender can effectively assign risk based on credit factors is chimerical. In more than one study, credit reports have been found to be replete with errors.[47] A borrower whose profile includes a poor credit score may have been a victim of identity theft or simple error.[48] Further, even if credit reports were solely based on accurate information, people can have low credit scores for entirely benign reasons that are unconnected to future risk. A borrower whose low credit rating reflects a temporary period of unemployment due to a now-resolved family health need, for example, can have the same poor credit score as someone whose problems arose from an unresolved gambling addiction. Yet, in risk-based pricing models, both would receive the same subprime interest rate.

Third, and most problematically, unscrupulous lenders have seized on popular perceptions of risk-based pricing to manipulate some borrowers into accepting more profitable higher rate loans. In doing so, these lenders often manipulate the perceptions that minority borrowers have about themselves – i.e., that they cannot qualify easily for

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[45] ANNE KIM, TAKEN FOR A RIDE: SUBPRIME LENDERS, AUTOMOBILITY, AND THE WORKING POOR 9 (Progressive Policy Institute 2002), *available at* www.ppionline.org/documents/Automobility_1102.pdf (Table 2: Impact of Subprime Interest Rates shows a five year loan with a principal balance of $10,000).

[46] Alan M. White, *The Case for Banning Subprime Mortgages,* 77 U. CIN. L. R. 617, 618 (2008).

[47] CONSUMER FED'N OF AM., *supra* note 41 at 6-7; ROBERT B. AVERY ET AL., AN OVERVIEW OF CONSUMER DATA AND CREDIT REPORTING 50 (2003).

[48] C. WU & E. DEARMOND, NAT'L CONSUMER L. CTR., FAIR CREDIT REPORTING, §§ 7, 14.8 (6th ed. 2006 and 2009 supp.). One survey concluded that more than 8.9 million people were victims of identity theft in 2009. Council of Better Business Bureaus, 2006 Identity Fraud Survey Report, *available at* http://www.bbbonline.org/idtheft/safetyQuiz.asp.

prime credit.[49] As described elsewhere in this testimony, loan officers and mortgage brokers have long been incentivized to mark-up borrowers' interest rates. A popular way of getting a minority borrower to accept a marked-up rate is to tell that borrower that her credit score was lower than anticipated, whether that information is true or not, or that some other perceived blemish mandates a mark-up. Often this occurs at the closing table, to justify a rate higher than originally promised. At the end of the day, there is little evidence that prices on subprime loans accurately reflect their risk.[50]

The psychology that allows the latter abuse is grounded in the perceptions that lenders' pricing models are effectively objective and that credit scores do not lie. The reality, however, is not only that credit scores do not accurately reflect risk, but also that loan officers and mortgage brokers have lied and have done so often. This opportunity to manipulate works to the disadvantage of minority borrowers – when conscious or unconscious bias enters the equation.[51]

2. Excessive and Confusing Origination Costs and Fees Provide Ample Opportunities to Discriminate

Although for many years a lender's main profit center was the resale of mortgages to investors on the secondary market, those profits have long been enhanced by virtually unfettered access to fee-based origination income. This income takes many forms.

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[49] IAN AYRES, PERVASIVE PREJUDICE?: NON-TRADITIONAL EVIDENCE OF RACE & GENDER DISCRIMINATION (University of Chicago Press 2002).
[50] *See* White, *supra* note 41, at 506.
[51] See, e.g., Eric J. Vanman et al., The Modem Face of Prejudice and Structural Features That Moderate the Effect of Cooperation on Affect, 73 J. Personality & Soc. Psychol. 941, 944-45 (1997); Yolanda F. Niemann et al., Intergroup Sterotypes of Working Class Blacks and Whites: Implications for Stereotype Threat, 22 Western J. Black Stud. 103 (1988); John F. Dovidio et al, Racial Stereotypes: The Contents of Their Cognitive Representations, 22 J. Experimental Soc. Psychol. 22 (1986); Mark Chen & John A. Bargh, Nonconscious Behavioral Confirmation Processes: The Self-Fulfilling Consequences of Automatic Stereotype Activation, 33 J. Experimental Soc. Psychol. 541 (1997).

Lenders typically charge application fees, underwriting fees, processing fees, origination points, and a host of other mystifying and often unexplained settlement charges. These fees are typically financed from the proceeds of the loan and add to a borrower's loan costs.[52] Additionally, the fees are often duplicative such that, for example, many borrowers pay application fees to both lenders and brokers. In other cases, fees are charged for work that is not actually performed.[53] Moreover, fees can be in amounts that bear no relation to the value of the service provided.[54]

Origination points are often the largest single source of fee-based income. These points are calculated as a percentage of the loan balance, and one to five origination points are common in subprime transactions.[55] These amounts come off the top of the borrower's loan. For example, a subprime borrower with a loan of $200,000 paying three "origination points" really receives only $194,000 in loan proceeds, but pays interest for the life of the loan on the full $200,000. Not only does the borrower never have real use of $6,000, but, to add insult to injury, she pays interest for use of that amount. Other loan fees financed in the transaction have the same effect.[56]

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[52] The Truth in Lending Act and its implementing regulations contain a basic definition of finance charge such that it includes fees that add to the cost of credit. 15 U.S.C. § 1605 (1995); 12 C.F.R. § 226.4 (2009). Unfortunately, many consumers still look only at the interest rate without recognizing these additional credit costs.

[53] *E.g.*, Jenkins v. Mercantile Mortgage Co., 231 F. Supp. 2d 737, 749-50 (N.D. Ill. 2002) (charges for which no benefit was provided may violate state unfair trade practice law).

[54] *See* ELIZABETH RENUART ET AL., NAT'L CONSUMER L. CTR., COST OF CREDIT (4th ed. 2009), § 12.2.1.7 (discussing excessive, unearned and duplicative fees).

[55] One point represents 1% of the loan amount. *E.g.*, BLACK'S LAW DICTIONARY 1275 (9th ed. 2009).

[56] The interest rate can thus effectively mislead borrowers about the real cost of borrowing. *See* ELIZABETH RENUART ET AL., NAT'L CONSUMER L. CTR., TRUTH IN LENDING (6th ed. 2007) § 3.2.3.

When charged, the effect of such points on a borrower's effective rate can be profound. If the borrower finances the additional $6,000 in points over thirty years at 8% interest, the total carrying costs for money that the borrower never really received is nearly $16,000. Even more perniciously, if the loan is paid back early by refinancing, the points (and other prepaid finance charges) act as a *de facto* prepayment penalty.[57] The borrower must repay the fees in full from the proceeds of the refinancing as, unlike interest, prepaid finance charges come due in full as of the date the loan is closed. The new refinance loan thus effectively capitalizes these finance charges and the borrower is obligated to pay additional fees and interest to repay sums that she never actually received.

Another common problem involves payment of points to receive a purported rate buydown or discount. Some lenders charge discount points that do not provide a real discount—thus charging borrowers but providing nothing in return.[58] Other lenders load the dice by providing discounts that are not a fair exchange for the number of points charged.

Consumers are rarely able to do the necessary calculations to evaluate the costs and fees on their loans. They are misled by the idea that they are receiving a "discount" without understanding what they pay for that perceived privilege.[59] The benefit of the discount, if any, can only be achieved by staying in the loan long enough that lower

[57] *Id.* § 3.8.3; RENUART ET AL., COST OF CREDIT, *supra* note 54, §§ 6.3, 7.2.2.
[58] WASH. ADMIN. CODE § 208-660-500(3)(e) (2009) (enumerating prohibited practices of loan originators); 209 MASS. CODE REGS. 40.02 (2009) (defining "bona fide" discount points). *See* Gunter v. Chase Bank U.S.A., N.A., No. 07-00403-KD-M, 2008 WL 3211293, at *1 (S.D. Ala. Aug. 6, 2008) (claiming that borrowers received no discount).
[59] Lenders are not required to inform consumers of the amount of the rate discount they are paying for. Unsophisticated consumers are unlikely to ask.

monthly payments attributable to the lower rate exceed the amount paid in points.[60] Because consumers do not understand this trade-off and can rarely calculate the latter crossover point, many have paid thousands (or tens of thousands) in discount points with little or no benefit in return. One of our African American clients, for example, paid $12,717.00 in discount points - many times more than what an average borrower would pay in total for settlement costs on a mortgage loan. In the boom years of refinancing, consumers rarely kept the loan long enough to receive sufficient benefit. And lenders exacerbated the problem by touting the chimerical benefits of early refinancing, which often imposed a new set of points and fees.[61]

Current literature suggests that where such fees are discretionary with lenders and brokers, minority borrowers pay more. That is discretionary fee mark-ups and costly points are charged more aggressively to minority borrowers.[62] Again, discretion in the amount of such fees becomes an opportunity for conscious and unconscious bias.[63]

3. Incomprehensible Disclosures

In the last twenty years, regulation of subprime lending has largely been through disclosures of loan terms to consumers.[64] The working legislative and regulatory

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[60] One financial reporter illustrates the complications of calculating the benefits associated with payment of discount points. Among other things, the calculations are complicated and require the homeowner to make an assumption about how long he or she is likely to stay in the home—an issue that depends on life events and planning that is far beyond the average homeowner's capacity to control. Terri Ewing, *Discount Point*, MORTGAGE INSIDER, Aug. 1, 2008, http://themortgageinsider.net/glossary/discount-points.html.

[61] Besta v. Beneficial Loan Co. of Iowa, 855 F.2d 532, 534 (8th Cir. 1988); *In re* Milbourne, 108 B.R. 522, 528-529 (Bankr. E.D. Pa. 1989); RENUART ET AL., COST OF CREDIT, *supra* note 54, § 6.3.2.

[62] See note 34, *supra*.

[63] See notes 34, 49-51 *supra*.

[64] *See generally* NAT'L CONSUMER L. CTR. ET AL., COMMENTS FROM THE NATIONAL CONSUMER LAW CENTER, AND CONSUMER ACTION, CONSUMER FEDERATION OF AMERICA, CONSUMERS UNION, LEADERSHIP CONFERENCE ON CIVIL RIGHTS, NATIONAL ASSOCIATION OF CONSUMER

assumption has been that if a consumer is told about various loan features, even if predatory, the consumer has sufficient information to make an informed choice.[65]

One problem with a disclosure approach to consumer protection in mortgage lending is the sheer amount of paperwork associated with a given loan. Most loans involve hundreds of pages of documents at the closing table. For some, finding the most relevant disclosures is like locating a needle in a haystack.[66] When English is not a borrower's first language, there is no needle to find.

A second problem is that mortgage loans are increasingly complicated.[67] Variable rate loans typically contain references to obscure interest rate matrices that are both unavailable and incomprehensible to the average consumer. The problem is exacerbated by gimmicky loan features that are designed to obscure the real cost of the loan, sometimes by overshadowing the true price of the loan with an initial rate that will only

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ADVOCATES, NATIONAL FAIR HOUSING ALLIANCE, AND THE EMPIRE JUSTICE CENTER TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM REGARDING PROPOSED REGULATIONS RELATING TO UNFAIR TRADE PRACTICES IN CONNECTION WITH MORTGAGE LENDING (2008), *available at* http://www.consumerlaw.org/issues/predatory_mortgage/content/HOEPACommentsApril08.pdf (describing the failure of the disclosure regime).

[65] *See* 15 U.S.C. § 1601 (2006) (statement of legislative purpose and congressional findings).

[66] Even lending industry advocacy groups recognize that consumer disclosures are complicated and often insufficient in the face of complex loan products. *See*, *e.g.*, Letter from Steve Bartlett, President and CEO, The Financial Services Roundtable, et al., to Senators Christopher J. Dodd and Richard C. Shelby (June 27, 2007), *available at* http://www.americansecuritization.com/uploadedFiles/LetterToSenateReSubprime062706.pdf.

[67] Emery v. Am. Gen. Fin., Inc., 71 F. 3d 1343, 1346 (7th Cir. 1995) (describing ineffectiveness of TILA in conveying relevant information in a complex refinancing transaction and concluding, "[s]o much for the Truth in Lending Act as a protection for borrowers"). *See also* BD. OF GOVERNORS OF THE FED. RESERVE SYS. & DEP'T OF HOUS. AND URBAN DEV., JOINT REPORT TO THE CONGRESS CONCERNING REFORM TO THE TRUTH IN LENDING ACT AND THE REAL ESTATE SETTLEMENT PROCEDURES ACT 9, 17, 62 (1998), *available at* http://www.federalreserve.gov/boarddocs/RptCongress/tila.pdf (noting consumers' difficulty in understanding mortgage terms with or without disclosure).

be in effect for a matter of days.[68] Similarly, deregulation has led to increasingly complex loan provisions, including confusing prepayment penalty terms,[69] complex provisions for negative amortization and payment changes,[70] holdbacks from loan proceeds,[71] and mysterious fees and costs. Thus, as loans themselves become more complex, disclosures become increasingly inadequate.[72]

The sheer complexity of loan terms makes it virtually impossible for minority borrowers to understand the terms of their loans in order to protect themselves from inappropriate steering and other forms of discrimination. Lenders often take advantage of

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[68] One loan recently reviewed, given to a minority borrower with a high school education, had a low fixed teaser rate in effect for just sixty days followed by the following provision for biannual payment changes: "At least 30 days before each Payment Change Date, the Note Holder will calculate the amount of the monthly payment that would be sufficient to repay the unpaid Principal that I am expected to owe at the Payment Change Date in full on the maturity date in substantially equal payments at the interest rate effective during the month preceding the Payment Change Date. The result of this calculation is called the 'Full Payment.' Unless Section 3(F) or 3(G) apply, the amount of my new monthly payment effective on a Payment Change Date, will not increase by more than 7.500% of my prior monthly payment. This 7.500% limitation is called the 'Payment Cap.' This Payment Cap applies only to the Principal and interest payment and does not apply to any escrow payments Lender may require under the Security Instrument. The Note Holder will apply the Payment Cap by taking the amount of my Minimum Payment due the month preceding the Payment Change Date and multiplying it by the number 1.075. The result of this calculation is called the 'Limited Payment.' Unless Section 3(F) or 3(G) below requires me to pay a different amount, my new Minimum Payment will be the lesser of the Limited Payment and the Full Payment." Amended Class Action Complaint at 8, Hart v. Bank of Am. Home Loans, Inc., No. 09-11096-RWZ (D. Mass. July 13, 2009) [hereinafter Hart Complaint]. Importantly, the loan included complicated provisions making it virtually certain that the loan principal would increase over time triggering significant and unaffordable payment changes to amortize the balance. *See generally id.*

[69] *See* RENUART ET AL., THE COST OF CREDIT, *supra* note 54, § 5.8.

[70] *Id*. § 4.3.1.2.

[71] Prepaid payments are regulated only for very high rate loans. *See* 15 U.S.C. § 1639(g) (2006). *See generally* Therrien v. Resource Fin. Group, Inc., 704 F. Supp. 322 (D.N.H. 1989).

[72] *See* MICHAEL BARR ET AL., HARVARD UNIV. JOINT CTR. FOR HOUS. STUDIES, BEHAVIORALLY INFORMED HOME MORTGAGE REGULATION 3 (2008). *See also* Michael Barr et al., *A One Size Fits All Solution*, N.Y. TIMES, Dec. 26. 2007, at A31. The Federal government has preempted almost all substantive state regulation of mortgage terms, without substituting commensurate consumer protections. *See*, *e.g.*, The Alternate Mortgage Transactions Parity Act, 12 U.S.C. §§ 3801-05 (2006).

their superior knowledge of the mathematics of complex loan transactions to steer unwitting borrowers into loans with discriminatory terms.

4. Lending Industry Compensation Structures Have Contributed to Discrimination

Lenders incentivized their loan officers and brokers to sell as many subprime loans as possible for higher compensation. Minority communities were seen as easy targets.[73] Loan officers have described their offices as "boiler rooms,"[74] where they would "work the phones hour after hour . . . trying to turn cold calls into lucrative 'subprime' mortgages."[75] As one news article reported, "[loan officers] described 10- and 12-hour days punctuated by 'power hours'—nonstop cold-calling sessions to lists of prospects burdened with credit card bills; the goal was to persuade these people to roll their debts into new mortgages on their homes."[76] Lenders provided their loan officers with scripts designed to convince unwitting borrowers to take unaffordable and unfavorable loans, and to avoid borrowers' questions and concerns.[77] This marketing strategy targeted financially struggling homeowners in immediate need of capital and those with equity in their homes.[78] While lenders trained their loan officers how to sell

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[73] See *supra*, notes 24-25.
[74] Mike Hudson & E. Scott Reckard, *Workers Say Lender Ran "Boiler Rooms,"* L.A. TIMES, Feb. 4, 2005, at A1. *See also* Dean Starkman, *Boiler Room: The Business Press is Missing the Crooked Heart of the Credit Crisis*, 47 COLUM. JOURNALISM REV. 48 (2008).
[75] Hudson & Reckard, *supra* note 74, at A1.
[76] *Id*.
[77] *See supra* note 74; Williams v. Ameriquest Mortgage Co., No. 1:05-CV-06189-LTS (S.D.N.Y. July 1, 2005).
[78] Press Release, Fed. Trade Comm'n, FTC Charges One of Nation's Largest Subprime Lenders with Abusive Lending Practices (Mar. 6, 2001), *available at* http://www.ftc.gov/opa/2001/03/associates.shtm.

the most loans possible, they failed to provide loan officers any meaningful training on mortgage lending laws and regulations.[79]

Loan officer compensation in the subprime boom was in part volume based–the more loans originated, the higher the loan officer's commission.[80] Furthermore, lenders provided additional incentives to increase loan volume by rewarding successful loan officers with extravagant gifts such as vacations, cars and sports tickets.[81] Because management level employees received commissions based in part on revenue earned by their subordinates, they trained loan officers to convince homeowners to borrow more often, and in larger amounts.[82]

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[79] *See In re* First Alliance Mortgage Co., 471 F.3d 977, 985 (9th Cir. 2006) ("First Alliance trained its loan officers to follow a manual and script known as the 'Track,' which was to be memorized verbatim by sales personnel and executed as taught. The Track manual did not instruct loan officers to offer a specific lie to borrowers, but the elaborate and detailed sales presentation prescribed by the manual was unquestionably designed to obfuscate points, fees, interest rate, and the true principal amount of the loan. First Alliance's loan officers were taught to present the state and federal disclosure documents in a misleading manner."). *See*, *e.g.*, REPORT OF THE MORTGAGE SUMMIT WORKING GROUPS 12 (2007), *available at* http://www.mass.gov/Eoca/docs/dob/Mortgage_Summit_Final_20070409.pdf (noting that in Massachusetts there was no testing or education requirements for loan officers to ensure they were fully informed on all of the obligations in Massachusetts).

[80] CENTER FOR RESPONSIBLE LENDING, CLR POLICY BRIEF: NEGLECT AND INACTION: AN ANALYSIS OF FEDERAL BANKING REGULATORS' FAILURE TO ENFORCE CONSUMER PROTECTIONS (JULY 13, 2009), http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/regulators-failure-to-enforce-consumer-protections.html (citing a 2005 OCC survey of credit underwriting practices acknowledging that "ambitious growth goals in a highly competitive market can create an environment that fosters imprudent credit decisions"). *See also* OFFICE OF ATTORNEY GENERAL MARTHA COAKLEY, COMMONWEALTH OF MASSACHUSETTS, THE AMERICAN DREAM SHATTERED: THE DREAM OF HOME OWNERSHIP AND THE REALITY OF PREDATORY LENDING 11 (2007).

[81] Tellin' Stories, a media production company, filmed a video advertisement for Ameriquest's 2005 annual sales meeting that took place in Las Vegas. The video opener can be found on its website under the link "Portfolio," entitled "Ameriquest Big Spin." The video explains that the "Big Spin" includes prizes and a free concert for Ameriquest's employees who have exceeded their loan quotas. Tellin' Stories, http://www.tellinstories.com (last visited Oct. 17, 2009). *See also* Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A., 631 F. Supp. 2d 702 (D. Md. 2008).

[82] *See* Press Release, Wash. State Office of the Att'y Gen., Washington Homeowners to Receive Millions in Ameriquest Settlement (Jan. 23, 2006), *available at*

Similarly, lenders compensated mortgage brokers by allowing them to mark up interest rates with yield spread premiums.[83] The yield spread is the difference between the par rate (the lowest interest rate for which a borrower could qualify) and the marked-up interest rate, expressed as a percentage.[84] Thus, the dollar amount brokers received as a premium correlated with the size of the mark-up on the interest rate. The higher interest rate would remain in effect for the entire term of the loan and could continue long after the lender recouped the broker's compensation through the borrower's higher interest payments.[85] Not privy to lenders internal underwriting standards, minority borrowers did not know the lowest interest rate for which they could qualify independent of brokers' representations.[86] They therefore had no basis with which to challenge the mark-up on their interest rate.

5. The Secondary Market And Its Facilitation Of Discriminatory Practices

In response to the collapse of the housing market during the Great Depression,[87] Congress passed three acts intended to stabilize the housing industry: the Federal Home Loan Bank Act of 1932, the Home Owners' Loan Act of 1933, and the National Housing

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http://www.atg.wa.gov/pressrelease.aspx?&id=16354 (Ameriquest required to revise its compensation system to eliminate employee incentives for prepayment penalties or other fees as part of a $295 million dollar settlement with state's attorney general).

[83] JONATHAN SHELDON ET AL., UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 6.3.4.1 (7th ed. 2008), § 6.2.3, at 331.

[84] *Id*.

[85] *Id*.

[86] *Id*.

[87] During the Great Depression 40% of the United States' $20 billion in home mortgages fell into default and about 1,700 of the United States' approximately 12,000 savings institutions failed. U.S. v. Winstar Corp., 518 U.S. 839, 844 (1996) (citing H.R. REP. NO. 101-54, pt. 1, at 292-93 (1989)).

Act of 1934.[88] This legislation provided, for the first time, for direct federal government involvement in the mortgage market.[89] Among other purposes, the National Housing Act, through the creation of the Federal Housing Administration,[90] was designed to free up capital for lenders to extend more mortgage loans by enabling them to sell their loans to investors.[91] Rather than holding loans and having to wait for full repayment until the end of the loan term,[92] the ability to sell loans on the secondary market allowed lenders to obtain repayment immediately and use the returned capital to originate more loans. These rational policy choices were turned on their head as big investment banks set up a private secondary market for subprime and other non-conforming loans.[93]

Investors' demand for mortgage-backed securities skyrocketed in the mid-2000s. According to Ginnie Mae, the cumulative total of the dollar amount of mortgage-backed

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[88] *See* IMMERGLUCK, *supra* note 4, at 27-34. *See also* Globe Sav. Bank, F.S.B. v. U.S., 55 Fed. Cl. 247, 248 (Fed. Cl. 2003) (discussing the origins of the modern regulatory regime for the thrift industry, specifically as it stemmed from the aforementioned Congress acts of the Great Depression Era); Federal Home Loan Bank Act of 1932, Pub. L. No. 72-304, 47 Stat. 725 (codified as amended at 12 U.S.C. §§ 1421-49 (2006)); Home Owners' Loan Act of 1933, Pub. L. No. 73-42, 48 Stat. 128 (codified as amended at §§ 12 U.S.C. 1461-70 (2006)); National Housing Act of 1934, Pub. L. No. 73-479, 48 Stat. 1246 (codified as amended at 12 U.S.C. §§ 1701-50g (2006)).

[89] IMMERGLUCK, *supra* note 4, at 27-29.

[90] Federal Housing Administration, About the Federal Housing Administration, http://portal.hud.gov/portal/page/portal/FHA_Home/about (last visited Oct. 17, 2009). The Federal Housing Administration ("FHA") insures mortgages and has insured over 37 million home mortgages since 1934. *Id.*

[91] 12 U.S.C. § 1719(d) (2006) ("To provide a greater degree of liquidity to the mortgage investment market and an additional means of financing its operations . . . the corporation is authorized to set aside any mortgages held by it . . . and, upon approval of the Secretary of the Treasury, to issue and sell securities based upon the mortgages so set aside.").

[92] The Federal Home Loan Bank Act standardized the thirty-year fixed mortgage product. *See* Federal Home Loan Bank Act of 1932, Pub. L. No. 72-304, 47 Stat. 725 (codified as amended at 12 U.S.C. §§ 1421-49 (2006)).

[93] For an entertaining description of the origins of the secondary market for non-conforming mortgages, see MICHAEL LEWIS, LIAR'S POKER: RISING THROUGH THE WRECKAGE ON WALL STREET (Penguin 1990).

securities increased exponentially from about $5 billion in 1975 to approximately $2,660 billion in 2007.[94]

Securitization freed up capital for lenders to originate more loans.[95] With high demand from investors, lenders had easy opportunities to sell their loans. Lenders became mere pass-through agents—originating loans and flipping them to investors—while making enormous profits on origination-related fees and shifting the risk of default onto investors.[96] All of these factors, coupled with a deregulated market,[97] incentivized lenders to aggressively market and originate large volumes of new high-cost loans in the low-income minority community.[98]

For many minority borrowers, the expansion of the secondary market meant exposure to relentless predatory lenders and an increased risk of foreclosure from falling prey to bad loans. Lenders targeted unsophisticated borrowers with subprime credit with promises of lower interest rates, lower monthly payments or cash out if they refinanced their loans.[99] The lender knew that these loans could be sold profitably on the secondary market. The purchasers now claim, that though their actions facilitated the loans

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[94] GINNIE MAE, ANNUAL REPORT: BRINGING WALL STREET TO MAIN STREET 5 (2007), *available at* http://www.ginniemae.gov/about/ann_rep/annual_report07.pdf.
[95] Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1273-74 (2002).
[96] *In re* Countrywide Fin. Corp. Sec. Litig., 588 F. Supp. 2d 1132, 1151 (C.D. Cal. 2008).
[97] *See In re* Novastar Fin. Inc., Sec. Litig., 579 F.3d 878, 880 (8th Cir. 2009) (explaining that a subprime lender can "raise[] additional capital by bundling groups of loans into mortgage-backed securities and selling the rights to the income generated by these securities"); IMMERGLUCK, *supra* note 4, at 41.
[98] *See* Eggert, *supra* note 8, at 1292 (citing John Kiff & Paul Mills, *Money for Nothing and Checks for Free: Recent Developments in U.S. Subprime Mortgage Markets*, *in* INT'L MONETARY FUND, IMF COUNTRY REPORT NO. 07/265, UNITED STATES: SELECTED ISSUES 45 (2007)).
[99] THE AMERICAN DREAM SHATTERED, *supra* note 80, at 1.

containing discriminatory terms, they cannot be held liable because they did not participate in the discriminatory practices. Some courts have found otherwise.[100]

CONCLUSION

In addition to preventing discriminatory practices going forward, effective remedies for existing victims struggling to keep their homes are essential. The social and economic consequences of the foreclosure crisis in the minority community continue to be catastrophic, as the foreclosure rate shows no sign of abatement.[101] Foreclosures have now become a significant cause of homelessness.[102] The best remedy to address this crisis is affordable loan modifications.[103] Immediate modification of subprime loans is crucial because these loans have the highest delinquency rates.[104]

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[100] In re First Franklin Financial Corp. Litigation, No. C08-01515JW (HRL) (N.D. Cal. May 6, 2009) Order Granting Plaintiffs' Motion for Leave to File an Amended and Consolidated Class Action Complaint p. 4 [Docket No. 73] ("… Plaintiffs may be able to state a claim against Merrill Lynch Defendants [for participation in a discriminatory loan pricing policy])."

[101] Les Christie, *Worst Three Months of All Time*, CNNMoney.com, Oct. 15, 2009, http://money.cnn.com/2009/10/15/real_estate/foreclosure_crisis_deepens/?postversion=2009101507 (finding that one in every 136 U.S. homes were in foreclosure in the third quarter of 2009, representing a 5% increase from the second quarter and a 23% jump over the third quarter of 2008).

[102] NAT'L COAL. FOR THE HOMELESS ET AL., JOINT REPORT: FORECLOSURE TO HOMELESSNESS 2009: THE FORGOTTEN VICTIMS OF THE SUBPRIME CRISIS 5 (2009), *available at* http://www.nationalhomeless.org/advocacy/ForeclosuretoHomelessness0609.pdf (estimating that more than 10% of homeless people that social services agencies have assisted over the last year became homeless because of foreclosure).

[103] *Foreclosure Prevention and Intervention: The Importance of Loss Mitigation Strategies in Keeping Families in Their Homes*: *Hearing Before the H. Subcomm. on Hous. and Cmty. Opportunity*, 110th Cong. 4 (2007) (written testimony of Tara Twomey); U.S. DEP'T OF HOUS. AND URBAN DEV., OFFICE OF POL'Y DEV. AND RESEARCH, INTERIM REPORT TO CONGRESS ON THE ROOT CAUSES OF THE FORECLOSURE CRISIS 44 (2009), *available at* http://www.huduser.org/Publications/PDF/int_foreclosure_rpt_congress.pdf ("Loan modifications that include interest rate and/or principal reductions represent the mot powerful tool for keeping borrowers in their homes . . .").

[104] David A. Graham, *Fixing Troubled Mortgages for the Elderly*, WALL ST. J., Oct. 21, 2009, at D1 (referring to an industry expert's findings that as of August 31, 2009 48% of subprime loans were delinquent or in foreclosure).

Private loss mitigation and government programs have not achieved the necessary level of loan modifications to curb the rate of foreclosures.[105] Despite promises and bailout funds, the country's biggest mortgage servicers have not delivered.[106] The government's Home Affordable Modification Plan ("HAMP") was not effectuated swiftly enough and has not produced its desired results.[107] These problems exist primarily because the HAMP lacks a clear enforcement mechanism.[108]

Significant attention must be paid to availability of these remedies in low-income minority communities. Failure to do so, in the best case scenario will lead to unnecessary foreclosures followed by reduced property values in connection with resale of property, at a loss, by the nation's remaining lending institutions. In the worst case scenario, failure to modify loans will lead to property abandonment, further reduction in property tax collection and irremediable deterioration of the nation's inner cities.

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[105] *See* CONG. OVERSIGHT PANEL, OCTOBER OVERSIGHT REPORT: AN ASSESSMENT OF FORECLOSURE MITIGATION EFFORTS AFTER SIX MONTHS 48 (2009) (finding that only 1.26% of HAMP modifications had become permanent after a three month trial period); Carrie Bay, *Wells Fargo Under Fire for Denied Modifications*, DSNEWS.COM, Sept. 8, 2009, http://www.dsnews.com/articles/wells-fargo-under-fire-for-denied-modifications-2009-09-08; John Collins Rudolf, *Judges' Frustration Grows With Mortgage Servicers*, N.Y. TIMES, Sep. 3, 2009, at B1 (discussing a recent bankruptcy case where the judge summoned a Wells Fargo senior executive to answer questions about Wells Fargo's failure to properly process the debtors' loan modification application); Dawn Kopecki, *Bank of America Among Worst for Loan Modifications*, BLOOMBERG.COM, Aug. 4, 2009, http://www.bloomberg.com/apps/news?pid=20601087&sid=aoO9FGsvnJOk.

[106] CTR. FOR RESPONSIBLE LENDING, MORTGAGE REPAIRS LAG FAR BEHIND FORECLOSURES (2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/mortgage-repairs-lag-far-behind-foreclosures.html.

[107] *See* CONG. OVERSIGHT PANEL, *supra* note 105; Nick Carey & Al Yoon, Home Rescue Plan Delaying, Not Solving Crisis, Reuters (Oct. 13, 2009), http://www.reuters.com/article/topNews/idUSTRE59C00620091013.

[108] *See,* Williams v. Timothy F. Geithner, No. 09-1959 ADM/JJG, 2009 WL 3757380, at *6 (D. Minn. Nov. 09, 2009) (finding, "…[HAMP] does not create an absolute duty on the part of the Secretary to consent to loan modifications; it is not "language of an unmistakably mandatory character.")