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PROTECTING THE AMERICAN DREAM (PART II): COMBATING PREDATORY LENDING UNDER THE FAIR HOUSING ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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PROTECTING THE AMERICAN DREAM (PART II): COMBATING PREDATORY LENDING UNDER THE FAIR HOUSING ACT

THURSDAY, APRIL 29, 2010

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE CONSTITUTION,
CIVIL RIGHTS, AND CIVIL LIBERTIES,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 1:45 p.m., in room 2141, Rayburn House Office Building, the Honorable Jerrold Nadler (Chairman of the Subcommittee) presiding.

Present: Representatives Nadler, Conyers, Scott, Johnson, and Chu.

Staff Present: (Majority) Michelle Millben, Counsel; Elliott Mincberg, Counsel; and Paul Taylor, Minority Counsel.

Mr. NADLER. This hearing of the Subcommittee on the Constitution, Civil Rights, and Civil Liberties will come to order. I am sorry we were delayed by the votes on the floor.

The Chair will begin by recognizing myself for an opening statement.

Today's hearing continuing the Subcommittee's review of the Fair Housing Act and its enforcement by the Department of Justice. In this hearing, we will be looking at predatory lending practices that have targeted minority communities and borrowers.

I am pleased that Assistant Attorney General for Civil Rights, Tom Perez, has joined us today to discuss the Civil Rights Division's enforcement initiatives in this area. It is really refreshing to have a seasoned civil rights lawyer who believes in the Division's mission at the helm again.

Years ago, minority communities were denied credit under a policy called redlining, in which individuals who lived in those communities were denied credit not on the basis of their creditworthiness but on the basis of their race. The term came from the practice of simply drawing a red line around the minority neighborhood and refusing to lend in that area.

In addition to being unfair to individual borrowers who were otherwise qualified for loans on an equal basis as White borrowers, redlining destroyed whole communities around the country. Fortunately, States and Federal Government enacted fair lending laws to outlaw this practice.

What we witness today, however, is something called reverse redlining, a mortgage brokerage or bank's practice of systematically singling out minority borrowers in neighborhoods for loans with inferior terms such as high up-front fees, high interest rates, or lax underwriting practices.

It seems that everything old is new again. Here we are again looking at the impact of discriminatory lending practices on families and communities, but what we are now looking at is not the refusal to lend in those areas or to those people, it is the refusal to give normal loans. It is steering people into subprime and more expensive loans with inferior terms in the areas in effect or the groups that used to be red lined.

What is most pernicious about the more recent practice is that the banks figured that they can make more money through predatory lending than they can by simply refusing to lend altogether. The geographic pattern is the same. Whether you look at a map of Memphis or Boston or Baltimore or Brooklyn, the pattern is disturbing; and anyone who knows his or her city knows exactly who is targeted.

We know the results of the wave of subprime lending: foreclosures, destroyed lives, destroyed credit, destroyed communities, and a destroyed financial system. These people are the human face of the unrestrained subprime lending spree. And what is most disgraceful is that it did not have to happen. Many people who were sold subprime mortgages could easily have qualified for conventional mortgages, but they were not offered conventional mortgages or they were steered into subprime mortgages because of their race or their location.

In addition to hearing about the problem and about how the courts and the Justice Department are attempting to address the harm, I hope to hear from our witnesses today what more we can do to provide the tools necessary to prevent this outrage from occurring in the future.

I want to welcome our distinguished panels of witnesses, and I look forward to your testimony.

I yield back the balance of my time.

In the interest of proceeding to our witnesses and the absence of the distinguished Ranking Member, mindful of our busy schedules, I ask that other Members submit their statements for the record.

Without objection, all Members will have 5 legislative days to submit opening statement for inclusion in the record.

[The prepared statement of Mr. Sensenbrenner follows:]

PREPARED STATEMENT OF THE HONORABLE F. JAMES SENSENBRENNER, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN, AND RANKING MEMBER, SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES

The Obama Justice Department has made it clear it intends to follow the Clinton Administration and file more lawsuits under what is called the "disparate impact" theory. Disparate impact lawsuits challenge practices that lead to statistically worse results for a particular group relative to other groups without alleging that the practice is actually discriminatory in its terms, design, or application. That is, disparate impact lawsuits claim there is discrimination when there is often no discrimination at all under any reasonable definition of the term.

Disparate impact theories arose out of Title VII of the Civil Rights Act of 1964, which was designed to protect individuals from intentional discrimination in employment. The Senate floor managers of Title VII, Senators Clifford Case and Joseph Clark, made clear that Title VII prohibited only intentional discrimination, and

that it did not require statistical parity in hiring. In their exhaustive memorandum distributed prior to Senate debate on the bill, the Senators wrote "There is no requirement in title VII that an employer maintain a racial balance in his work force." This was reiterated by Senator Hubert Humphrey, who said "If [a] Senator can find in title VII . . . any language which provided that an employer will have to hire on the basis of percentage or quota related to color, race, religion, or national origin, I will start eating the pages one after another, because it is not there."

But then Alfred Blumrosen, the Equal Employment Opportunity Commission's first chief of compliance, admitted in a law review article years later that he employed "[c]reative administration" to draft regulations under Title VII allowing disparate impact claims. He admitted that those regulations did not "flow from any clear congressional grant of authority." Subsequently, the courts often upheld disparate impact claims even without the grant of congressional authority, and different Congresses have from time to time codified them in one way or another in other contexts that require businesses that are not engaging in discriminatory treatment to ensure their products are sold in racially proportionate ways.

The abuse of the disparate impact theory in courts has had real-world consequences. There were many pressures on mortgage lenders to relax the standards under which loans were extended in the 1990's. But one factor was the Clinton Administration Justice Department's aggressive pursuit of disparate impact claims in which it sought to prosecute entities whose mortgage lending policies did not intentionally discriminate, but only had a disparate impact on one group or another.

In 1998, for example, Clinton Administration Housing Secretary Andrew Cuomo announced the results of a federal lawsuit settlement in which a bank was made to extend $2 billion in loans to people who posed a greater credit risk. Secretary Cuomo even admitted during a press conference televised on C-Span that "the 2.1 billion, lending that amount in mortgages, will be a higher risk and I'm sure there'll be a higher default rate on those mortgages than on the rest of the portfolio."

A leading article published in the *Banking Law Journal* at the time made clear that "Lenders relying on written standards and criteria in making decisions as to whether to grant a residential mortgage loan application run the risk of exposure to liability under the civil rights law doctrine known as disparate-impact analysis . . . Several underwriting guidelines that are fairly common throughout the mortgage lending industry are at risk of disparate-impact analysis [including] creditworthiness standards."

These lawsuits pressured lenders to bend traditional and time-tested accounting rules and extend more mortgages to many who could not afford them. These relaxed lending standards are now widely regarded as being a prime cause of the current financial crisis. Even the Washington Post editorialized that "the problem with the U.S. economy . . . has been government's failure to control systemic risks that government itself helped to create. We are not witnesses a crisis of the free market but a crisis of distorted markets . . . [G]overnment helped make mortgages a purportedly sure thing in the first place."

As one economist wrote recently in the *Wall Street Journal:*

> . . . [T]he focus on subprime [mortgages] ignores the widely available industry facts (reported by the Mortgage Bankers Association) that 51% of all foreclosed homes had prime loans, not subprime, and that the foreclosure rate for prime loans grew by 488% compared to a growth rate of 200% for subprime foreclosures ... The suggestions being put forward by the administration and most media outlets—more stringent regulation of subprime lenders—would not have prevented the mortgage meltdown regardless of their merit otherwise. Rather, stronger underwriting standards are needed ... But to do so political leaders must face up to the actual causes of the mortgage crisis, not fictitious causes that fit political agendas and election strategies.

In our efforts to enforce the nation's housing laws, I hope we do not repeat past mistakes. I look forward to hearing from all our witnesses today.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES

Compelling evidence demonstrates that banks and mortgage companies have committed prohibited practices of predatory lending and reverse redlining targeted at

minority communities across the country. The very same people victimized by redlining—the refusal to provide conventional loans in minority neighborhoods—are now victimized by reverse redlining—efforts to steer minority residents of those same neighborhoods towards high cost subprime or other predatory loans. These practices have played a key role in fueling the home foreclosure crisis and devastating communities of color across our nation.

For example, take my home state of Michigan. The NAACP has reported that 70.7% of subprime loans in Michigan in 2006 went to African-Americans.[1] In 2009 and the first quarter of 2010, Michigan had the sixth highest foreclosure rate in the country.[2] And as a 2009 study by the Applied Research Center found, Detroit neighborhoods with "high proportions of people of color have the highest foreclosure rates."[3]

Listen to what a Detroit attorney who has worked on foreclosure and predatory lending issues has to say. I would like to place in the record, with unanimous consent, the full statement of attorney Vanessa G. Fluker. She explains that:

"In my practice, which unfortunately now consists almost solely of predatory lending and foreclosure matters, the vast majority of my clients are the poor, minorities, and senior citizens over the age of 75 years old, who initially owned their home outright until steered into ARMs, despite the fact that they were on a fixed income, and now face foreclosure and homelessness."

As we will hear today and as Ms. Fluker states, there are real people behind these statistics and these concerns. For example, Mrs. Mallory, an African American grandmother on a fixed income in Detroit, wanted to take out a $4000 home equity loan to pay for a new furnace for her house. She had lived in that house for almost 20 years and had almost finished paying for it. But she was pushed by a loan company broker to instead take out a larger loan, which he insisted she would have no trouble paying back. That was true for six months, but then the rate jumped way up, as so many predatory loans do. Soon her house was put into foreclosure.[4]

We will hear today about more stories like Mrs. Mallory's, and about efforts to get justice for victims like her. As we listen to today's testimony, three important issues should be considered.

First, what is our federal Department of Justice doing about this serious problem? Previous hearings by our Committee have found that the Department was not vigorously and effectively enforcing fair housing laws, particularly with respect to predatory lending. We have all been gratified to hear the public announcements this year and last that the Department will take effective action. We look forward to hearing the details today from Assistant Attorney General Perez of the Civil Rights Division.

Second, I applaud the efforts of private attorneys and cities like Memphis to pursue fair housing claims against lenders charged with reverse redlining and predatory lending practices. But individual lawsuits are not enough. What can be done to better coordinate efforts at the federal, state, and local level to use the fair housing act to combat predatory lending?

Third, what can and should Congress do? Earlier this month, the Fair Housing Act, which I was proud to help through Congress in 1968, celebrated its forty-second birthday. Are any changes needed in the law? Would more hearings like this one be helpful? Are there particular programs that Congress should appropriate funds for to better combat predatory lending?

I join Chairman Nadler in welcoming all our witnesses today and look forward to their testimony and their answers to these questions.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF THE HONORABLE HENRY C. "HANK" JOHNSON, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA, AND MEMBER, SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES

Thank you, Mr. Chairman, for holding this hearing and giving Members the opportunity to examine the enforcement of the Fair Housing Act, the effect of subprime and predatory lending on the foreclosure crisis, and the work of the Justice Department's Civil Rights Division of its Fair Lending Unit.

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[1] NAACP, *Discrimination and Mortgage Lending in America* (March 2009) at 5.

[2] See "Foreclosure activity increases 7 percent in first quarter," *Realty Trac* (April 15, 2010); "Michigan foreclosure rate is nation's sixth highest," Detroit News (April 16, 2009).

[3] Applied Research Center, *Race and Recession* (May, 2009) at 39.

[4] See *Race and Recession* at 35.

All Americans have the right to be treated equally and free from discrimination. We must ensure that our fair housing laws are strictly enforced to protect everyone, especially the most vulnerable, in our society.

Although we have come a long way, many Americans still live in communities largely divided by race and ethnicity. Minorities have been disproportionately affected by the recent subprime mortgage crisis that has resulted in many families losing their homes, and their sense of well-being.

Minorities with much lower home ownership rates have been struggling to become part of the home-owning middle class. Unfortunately, subprime lenders have taken advantage of that want and desire.

Home Mortgage Disclosure Act data has shown that African-American and Latino borrowers were far more likely to receive subprime loans than white borrowers.

There is increasing evidence that the causes of the foreclosure crisis include mortgage fraud, predatory lending, discriminatory lending, and reverse redlining practices.

This issue is near and dear to my heart as Georgia ranks 8th in the nation for mortgage fraud. This is troubling as mortgage fraud played a big role in setting the housing crisis in motion, with mortgage professionals listing false income claims for borrowers, and overstating a home's appraised value.

I am especially appalled at the reverse redlining practice. In reverse redlining, banks have systematically singled out minority neighborhoods for loans with terms like high up-front fees, high interest rates, and lax underwriting practices.

I am anxious to hear from our witnesses today. The U.S. is already on course to lose more than a million homes to foreclosure this year, I want to know the steps that the Justice Department and HUD are taking to prevent predatory lending, and ensure that the Fair Housing Act is effectively enforced.

I look forward to hearing from our witnesses today and yield back.

Mr. NADLER. Without objection, the Chair will be authorized to declare a recess of the hearing, which I anticipate doing only if there are votes on the floor necessitating such action.

We turn to our first panel of witnesses numbering exactly one, one witness. As we ask questions of our witness, the Chair will recognize Members in the order of their seniority in the Subcommittee, alternating between the two parties, provided the Member is present when his or her turn arrives. The Chair reserves the right to accommodate a Member who is unavoidably late or only able to be with us for a short time.

Our first panel consists of the Assistant Attorney General for the Civil Rights Division, Tom Perez, who was nominated by President Obama to serve in that position and was sworn in on October 8, 2009. Mr. Perez previously served as Secretary of Maryland's Department of Labor, Licensing, and Regulation, which protects consumers through the enforcement of a wide range of consumer rights laws, including the mortgage setting. From 2002 until 2006, he was a member of the Montgomery County Council.

Earlier in his career, he spent 12 years in Federal public service, most of them as a career attorney with the Civil Rights Division. Mr. Perez later served as Deputy Assistant Attorney General for Civil Rights under Attorney General Janet Reno. He received a bachelors degree from Brown University, a masters of public policy from the John F. Kennedy School of Government and a juris doctorate from Harvard Law School.

I am pleased to welcome you. Your written statement in its entirety will be made a part of the record, and I would ask you summarize your testimony in 5 minutes or less.

And in case the members of the second panel are listening, I will ask them to do the same thing, and I will not repeat this boilerplate the second time.

To help you stay within your time, there is a timing light at your table. When 1 minute remains, the light will switch from green to yellow and then red when the 5 minutes are up.

Before we begin, it is customary for the Committee to swear in its witnesses. If you would please stand and raise your right hand to take the oath.

[Witness sworn.]

Mr. NADLER. Let the record reflect the witness answered in the affirmative. You may be seated, and you are recognized for 5 minutes for an opening statement.

TESTIMONY OF THE HONORABLE THOMAS E. PEREZ, ASSISTANT ATTORNEY GENERAL, CIVIL RIGHTS DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. PEREZ. Thank you, Mr. Chairman. It is always a pleasure to be in front of your Committee, and good afternoon to the other Members your Committee and Ranking Member Sensenbrenner.

We are all by now well aware that the nationwide housing crisis that has been a significant factor contributing to our Nation's economic unrest was fueled in large part by risky and irresponsible lending practices that allowed too many Americans to get unsustainable or unaffordable home loans. This crisis has overwhelmed families and communities of all kinds, but communities of color have been hit particularly hard.

A study of foreclosures in the New York region by the New York Times that looked at neighborhoods with mortgage default rates of at least twice the national average found that 85 percent of those neighborhoods have a majority of African American or Latino homeowners. The same study noted that an African American household in New York City making more than $68,000 a year was almost five times more likely to have a subprime loan than similarly situated White people.

Home Mortgage Disclosure Act data has shown that African American and Latino borrowers were far more likely to be put in subprime loans, often without correlation to their creditworthiness. The more segregated that a community of color is, the more likely it is that homeowners who live there will face foreclosure because the lenders who peddled the most toxic loans targeted those communities. The result is a large number of foreclosures in close proximity to each other, with devastating consequences to communities.

As a local elected official and then the State Secretary in charge of the department that oversaw the State-wide financial industry, I saw the realities of lending discrimination from the front row. I had the opportunity to work on solutions at the State level, and we did pass a sweeping package of reforms. But our reach was limited because large national players are not subject to State regulation.

Perhaps the biggest lesson learned as a local and State official trying to address this crisis was that Federal oversight and enforcement is absolutely critical to ensuring responsible, nondiscriminatory lending. It is for this reason that we have established a fair lending unit in the Civil Rights Division.

Both career attorneys, who have been there a while, and new hires will staff the unit, which will also have dedicated professional staff including economists and statisticians to assist in the work of

this unit. The unit is focusing on the entire range of discriminatory practices seen in the market.

We have currently have 39 open matters involving large, midsize, and small lenders, national lenders, regional lenders, local lenders. No single case will capture the full range of discriminatory conduct occurring in the mortgage market. However, what you see is a series of cases, each one targeted at specific discriminatory practices.

We expect to see cases, for instance, that examine the following: discrimination in the underwriting and pricing of loans such as discretionary markup and fees, redlining through the failure to provide equal lending services to minority neighborhoods, reverse redlining through the targeting of minority communities for predatory loans, steering minority borrowers into less favorable terms such as the case that I will describe later, marital status, gender, and age discrimination in lending.

Last month, we announced a settlement with two subsidiaries of AIG resolving a lawsuit that alleged that African American borrowers nationwide were charged higher fees on wholesale loans made by the lenders through contracted brokers. The $6.1 million settlement marked the largest amount for damages for identified victims in a fair lending settlement ever secured by the Division, and the case marked the first time that the Department has held a lender accountable for failure to monitor brokers' fees to insure that the fees are not being charged in a racially discriminatory manner.

Lenders had previously argued that they could not be held accountable for the discriminatory practices of brokers. That is incorrect, and this case sent an important signal of our direction in this area.

The unit's work will not focus solely on mortgage lending. We are committed to tackling discrimination in auto loans and other areas of consumer credit as well as in business lending.

Additionally, we are ramping up enforcement of the Servicemember's Civil Relief Act, which dictates that creditors may not take action to foreclose a lien against a servicemember on active duty without first obtaining a court order. We have two cases involving foreclosures against active duty servicemembers without a court order and also a number of cases involving unlawful repossession of cars belonging to servicemembers. This work is a part of a larger, Administration-wide effort to crack down on financial fraud so that we can eradicate those practices that helped lead to the financial meltdown.

The President's Financial Fraud Enforcement Task Force is fostering unprecedented interagency collaboration, a critical need in the face of this unprecedented crisis. I am a co-chair, along with the HUD and the Fed, of the Task Force's Nondiscrimination Working Group. Our relationship with HUD is especially critical to ensuring effective enforcement, and we have been working closely with our counterparts there. We have regular meetings that involve career staff in addition to political leaders so that the resulting collaboration will be institutionalized as part of our agencies' respective cultures.

We are also working with State officials. I spent a good part of last week with the Attorney General of Illinois working on a number of fair lending issues.

Referrals from banking regulatory agencies are a key component of our fair lending enforcement program, and through our relationships with these agencies we will continue to ensure that we receive a steady flow of referrals and that we collaborate so that problems identified in these referrals can be addressed expeditiously.

We also are working with our partners to identify potential fair lending violations where much of the lending is occurring today, and that is the mortgage modification context. We will be getting data soon from the Home Affordable Modification Program disaggregated by race and ethnicity, and our work group will be collaborating to analyze that and to hold wrongdoers accountable.

There are some who claim that aggressive enforcement of the civil rights laws in the fair lending context will hurt the very people that we are trying to help and dampen the business climate. I have heard that argument many times, and I must confess this has not been my experience. Common sense consumer protection and promoting a sound climate for lending go hand in hand. The absence of effective consumer protections and the dearth of meaningful Federal enforcement in recent years not only hurt communities but brought about staggering losses in the industry.

Through our efforts and partnerships, the Civil Rights Division will continue to ramp up fair lending enforcement to ensure that all Americans have equal access to credit without which the promise of equal opportunity remained unfulfilled.

Thank you, Mr. Chairman, for the opportunity to be here; and I welcome any questions that you or other Members of the Committee might have.

[The prepared statement of Mr. Perez follows:]

PREPARED STATEMENT OF THOMAS E. PEREZ

Department of Justice

STATEMENT OF

THOMAS E. PEREZ
ASSISTANT ATTORNEY GENERAL
DEPARTMENT OF JUSTICE

BEFORE THE

SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

ENTITLED

"PROTECTING THE AMERICAN DREAM PART II:
COMBATING PREDATORY LENDING UNDER THE FAIR HOUSING ACT"

PRESENTED

APRIL 29, 2010

Statement of
Thomas E. Perez
Assistant Attorney General
Department of Justice

Before the
Subcommittee on the Constitution, Civil Rights, and Civil Liberties
Committee on the Judiciary
United States House of Representatives

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

Presented
April 29, 2010

Good afternoon Chairman Nadler, Ranking Member Sensenbrenner and members of the Subcommittee. Thank you for calling this hearing on Fair Lending issues, which have become a top priority for the Civil Rights Division. I also want to thank you for the opportunity to testify before you today to tell about what the Division is doing to address these critical issues.

The nationwide housing crisis that has been a significant factor contributing to our nation's economic challenges, we now know, was fueled in large part by risky and irresponsible lending practices that allowed too many Americans to get unsustainable or unaffordable home loans. According to industry analysts between 8 and 13 million homes will be lost to foreclosure by the end of the crisis. About one in four borrowers are underwater and owe more on their loans than their homes are worth.

Communities nationwide have been devastated during the housing crisis. So many middle class Americans who worked hard to achieve the most basic building block of the American Dream – homeownership – have found themselves on the brink of disaster, facing the loss of their most important asset. The cost of foreclosures to our country is not limited just to the families that have lost their homes. Tens of millions of homeowners who have paid their mortgages on time will have their homes lose value because they are located near a home that has gone into foreclosure.[1]

[1] Center for Responsible Lending, *Soaring Spillover*, May 2009 available at http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf.

This crisis has overwhelmed families and communities of all kinds, but one fact is clear; while the foreclosure crisis has touched so many communities across America, communities of color have been hit particularly hard. A study of foreclosures in the New York region by the *New York Times* that looked at neighborhoods with mortgage default rates of at least twice the regional average, found that 85 percent of those neighborhoods have a majority of black or Latino homeowners. The same study noted that a black household in New York City making more than $68,000 a year was almost five times more likely to have a subprime loan than whites with similar or lower incomes. Home Mortgage Disclosure Act ("HMDA") data has shown that African-American and Latino borrowers were far more likely to receive a subprime loans than white borrowers. A 2004 Center for Responsible Lending study that supplemented HMDA data with data from a proprietary database concluded that African-Americans and Latinos received higher-priced subprime loans than white borrowers, even after controlling for creditworthiness and other underwriting factors. The Reinvestment Fund, in a series of foreclosure studies, found that as a community's percentage of African-American and Latino residents increases, so does that community's overall share of foreclosures.

The more segregated a community of color is, the more likely it is that the homeowners who live there will face foreclosure. In part, this is because some of the lenders who made the most toxic loans, which are the loans that are failing at the highest rates, targeted the residents of those communities. The result is a large number of foreclosures in close proximity to each other with devastating consequences for the community – many of the very same communities in which substantial investments have been made and that had begun to revitalize and flourish. I have now had the chance to see this crisis and its devastating impacts from the local, State and Federal levels.

As a member of the Montgomery County, Maryland, Council in the first half of the last decade, I saw the realities of lending discrimination at the ground level. Montgomery County, Maryland, is one of the wealthiest counties in the nation. It is also racially diverse. Even when we controlled for wealth, data showed us that African-American and Latino borrowers were disproportionately in subprime loans. The data in my home county showed that upper income African-Americans were as much as six times as likely to be in a subprime loan as upper income non-minorities.

In 2007, Governor Martin O'Malley asked me to be the Secretary of the agency that oversees financial regulation for the State of Maryland. In this position at the height of the crisis, I had the opportunity to work on solutions at the State level. We passed a sweeping package of reforms that extended the foreclosure process, cracked down on fraud, required lenders to verify a borrower's ability to repay a loan, and established a duty of care that requires brokers to offer the best products for which a borrower is eligible, rather than the one which will give the broker the highest fees. The Corporation for Enterprise Development's 2009-2010 Assets and Opportunity Scorecard cited Maryland as having the strongest law to curb predatory mortgage lending in the country, matched only by New Mexico.

Again, our reach was limited, because large, national players are not subject to State regulation. While we worked within our limited sphere of authority to combat the crisis, both at the front end, where loans were originated, and at the back end, where people were losing their homes, the Federal government was decidedly absent.

Perhaps the biggest lesson learned as a local and State official trying to address this crisis was that Federal oversight and enforcement is absolutely critical to ensuring responsible, non-discriminatory lending.

For this reason, President Obama has made mortgage fraud and homeownership preservation a top priority by establishing the Financial Fraud Enforcement Task Force and an array of programs to assist distressed homeowners and communities. To implement the President's mandate in civil rights Attorney General Holder and I have made fair lending a top priority. The Civil Rights Division is charged with enforcing the Fair Housing and Equal Credit Opportunity Acts. The Division receives referrals from banking regulatory agencies, which must refer cases to the Department when an agency believes a pattern or practice of discrimination may exist at a bank or other regulated financial institution. Today, we continue to open cases based on those referrals, but we are also making a concerted effort to take a more proactive approach to fair lending enforcement. The Division has created the necessary infrastructure to support and expand our fair lending work, begun to identify major targets for enforcement and started to fundamentally reshape our relationships with other Federal agencies and State partners, including State attorneys general.

We have created a Fair Lending Unit in the Division's Housing and Civil Enforcement Section in order to devote more resources to this critical work. Both current career attorneys and new hires will staff the unit, and we have hired several new attorneys to fill additional positions. The unit will also have three dedicated economists, a math statistician and dedicated professional staff to assist the attorneys. Initially, the unit will consist of more than 20 staff members who will devote a significant portion of their time to lending cases. Loosely modeled after the Human Trafficking Unit in the Division's Criminal section, which yielded tremendous results, this new unit will increase capacity, develop greater expertise and obtain significant results. The Division recently hired four new full-time lending attorneys to complement existing staff in the Housing Section. The Division has also hired a Special Counsel for Fair Lending, a senior career position in the Office of the Assistant Attorney General, to ensure that fair lending issues receive immediate attention and high priority.

The Fair Lending Unit is focusing its efforts on the entire range of abuses seen in the market, from traditional access to credit issues, such as redlining, to reverse redlining, pricing discrimination and other areas. No single case will capture the full range of discriminatory conduct occurring in the mortgage market. However, what you will see is a series of cases, each one targeted at specific discriminatory lending practices.

For example, last month we announced a settlement with two subsidiaries of AIG, resolving allegations that the lenders engaged in a pattern or practice of discrimination against

African-American borrowers. The Division's lawsuit alleged that the African-American borrowers nationwide were charged higher fees on wholesale loans made by the lenders through contracted brokers. The $6.1 million settlement marked the largest amount of damages for victims in a fair lending settlement ever secured by the Department of Justice, and the case marked the first time the Department has held a lender accountable for failing to monitor brokers' fees to ensure that the fees are not being charged in a discriminatory manner.

Addressing another type of discriminatory lending abuse, in September the Division reached a settlement with an Alabama bank, First United Security Bank, to resolve allegations of a pattern or practice of discrimination based on race. The complaint alleged that the bank charged African-American borrowers higher rates on mortgage-related loans than it charged to similarly situated white borrowers, and that it engaged in redlining by failing to offer its lending products and services on an equal basis in areas that are majority African-American. The bank agreed to open a new branch in an African-American neighborhood, to invest $500,000 in a special financing program for African-American borrowers and businesses and to spend more than $100,000 on outreach to potential customers and consumer financial education.

Also in September, the Division filed a lawsuit against a bank and two auto dealerships in Los Angeles, alleging that they violated the Equal Credit Opportunity Act by charging non-Asian American customers higher interest rate mark-ups. One of the three defendants, Nara Bank, agreed in a settlement to pay up to $410,000 to resolve the allegations.

These cases are just the beginning of what will be a robust enforcement effort to eradicate discriminatory lending practices from all markets. We currently have 39 matters open, including 17 investigations and an authorized lawsuit against a major lender involving allegations of discrimination based on marital status. We have identified seven national lenders as targets of enforcement efforts. While the current crisis necessitates that much of our focus will be on mortgage lending, the unit will address discrimination in all areas of lending including unsecured consumer lending, auto lending, and credit cards.

All of these efforts are part of a larger, Administration-wide effort to crack down on financial fraud so that we can eradicate those practices that led to the financial meltdown and ensure they don't happen again. The President's Financial Fraud Enforcement Task Force is fostering unprecedented inter-agency collaboration, a critical need in the face of an unprecedented crisis. I am a co-chair, along with HUD and the Federal Reserve, of the Task Force's Non-Discrimination Working Group, through which we are working with our partners at other agencies, as well as at the State level, to be able to address both existing and emerging issues. Last week we joined with the Illinois Attorney General, also a member of the Working Group, to host a Fair Lending Forum in Chicago to hear from experts on the ground about the issues.

Referrals from banking regulatory agencies are a key component of our fair lending enforcement program. Through the Task Force and our direct relationships with regulatory agencies we will work to ensure that we continue to receive a steady flow of referrals, and we

will collaborate with these agencies so that problems identified in the referrals are resolved as expeditiously as possible.

We are also working with our partners to identify potential fair lending violations where much of the lending activity is occurring today – at the back-end of the process – in mortgage modifications. We want to be sure homeowners are not again subjected to abusive practices as they attempt to get out from under unsustainable loans. We will be getting data soon from the Home Affordable Modification Program ("HAMP"), disaggregated by race and ethnicity, and the Non-Discrimination Working Group members are collaborating on methods to analyze the HAMP data. We will also be vigilant in looking at trends in the market as we continue to emerge from the recession, and as lending occurs once again at a more robust pace.

There are some who claim that aggressive enforcement of civil rights laws in the fair lending context will hurt the very people we are trying to help, and dampen the business climate. This has not been my experience. To the contrary, common sense consumer protection and promoting a sound climate for lending go hand in hand, and are inextricably intertwined. The absence of effective consumer protections and the dearth of meaningful Federal enforcement in recent years not only hurt communities across the country, but also brought about staggering losses in the industry and undermined the safety and soundness of so many lending institutions.

In addition to our fair lending efforts, our lending work also extends to the Servicemembers Civil Relief Act, which ensures that servicemembers will not be subject to certain civil actions while on active duty. Under the SCRA, creditors may not take action to foreclose a lien against a servicemember on active duty without first obtaining a court order. I have recently authorized lawsuits against two national mortgage servicers for violating the SCRA by improperly foreclosing on active duty service members. We will continue to diligently enforce the SCRA and make sure that the brave men and women who protect our country enjoy the full protection of the law.

In short, the Civil Rights Division is open for business across the board, and we have become a conspicuous presence in the fair lending setting. Through our efforts and our partnerships with other Federal agencies and State partners, we will continue to ramp up fair lending enforcement to ensure that all Americans have equal access to credit. Such access is the foundation of our economy and the root of families' ability to accumulate wealth from generation to generation – without it the promise of equal opportunity remains unfulfilled. In the Civil Rights Division, we are working once again to be sure that all individuals and all families have access to those resources that will allow them to achieve the promise of our great nation.

I look forward to answering any questions that Members of the Committee may have.

Mr. NADLER. I thank you, and I will begin the questions by recognizing myself for 5 minutes.

Mr. Assistant Attorney General, the Fair Housing Testing Program was established within the Civil Enforcement Section of the Civil Rights Division in 1992 to assist with the Department's fair housing enforcement activities. Testing, according to the Depart-

ment, can be a valuable tool to investigate housing market practices and to document illegal housing discrimination.

Two years ago, the Department of Justice testified that in 2006 they were improving and expanding the Fair Housing Testing Program; and they testified further 2 years ago that the tests were producing new cases and significant results. Can you describe the effectiveness of testing?

Mr. PEREZ. Our testing program has been very, very effective. There is a case in Atlanta involving Coldwell Banker in which we used testers to uncover steering by real estate agents. And, among other things, the real estate agent, when he first met the person, he had said that he wasn't sure where to take him to look at potential homes because: I couldn't tell—and I am quoting—I didn't know if you were a Caucasian or not over the phone. So he did not know where to take that person. And the testing——

Mr. NADLER. He said that out loud?

Mr. PEREZ. Oh, yes. And then we had another case in Alabama involving a rental in which the rental agent said to the White tester: You will love this place. There are no Black people here. Quote, unquote.

So our undercover testing is a very, very important tool to eradicate discrimination. And, regrettably, a lot of the discrimination we see is not very subtle. Those two cases are illustrations of the fact that it is not very subtle, and that is why we will continue to have a robust testing program. Because it does enable us——

Mr. NADLER. Have you expanded the testing program and can you cite improvements since the new Administration took over?

Mr. PEREZ. Yes, I think what we are trying to do and what we have succeeded in doing—first of all, we reestablished partnerships with fair housing groups. There was very little communication with fair housing groups. These are the boots-on-the-ground groups, and they enable us—for instance, I was in Birmingham, Alabama, about 2 weeks ago; and I heard from fair housing groups, here are some areas where we believe your testers should focus because this is what we have learned. What I found was that we were doing, frankly, a lot of testing, but I am not sure we were deploying our resources——

Mr. NADLER. In the right areas.

Mr. PEREZ [continuing]. As smart as possible because we didn't have those relationships with the frontline people who can help us.

So what we are doing I think better now is the strategic deployment of our resources in an evidence-based fashion so that we can yield better results from tests that we do.

Mr. NADLER. Thank you.

In the past, Members of this Committee have expressed concern over the types of cases being pursued by the Department. Data suggests that the Department of Justice's enforcement of traditional civil rights cases sharply declined during the previous Administration. In the context of fair housing enforcement, DOJ filed fewer fair housing cases in 2007 and 2006 in comparison to previous years: 35 fair housing cases in 2007, 31 in 2006, compared to 42 in 2005, and down from 53 in 2001.

In order to continue the rebuilding of the Civil Rights Division, can you talk very briefly about the professional credentials and

backgrounds of the attorneys and the individuals? For example, how many attorneys have extensive experience in complex litigation?

Mr. PEREZ. Sir, thanks to your leadership and the leadership of the President and the Attorney General, we have 102 new positions in the Civil Rights Division in fiscal year 2010. So your question is very timely, because the housing section is getting a significant complement of those new resources, and we have hired people who have extensive experience in fair lending. We are hiring people who have extensive experience in zoning. What we are finding is that a lot of the discriminatory barriers we are seeing in 2010 relate to zoning laws that are really subterfuges for discrimination.

And, frankly, the other thing we are doing, in addition to hiring remarkable people—and we have something like 500 applicants, Mr. Chairman, for roughly 8 or 10 attorney slots. And in addition to bringing in the new people we have got some remarkable people who were there throughout and done great work. And then, equally importantly, we are using every available tool in our arsenal.

The AIG case I described was a case in which we used our disparate impact theory, which is a theory that every circuit in the Nation that has ruled on has ruled is a viable theory. That theory was not allowed to be put forward in those cases, and now we are using all of our arrows in our quiver.

Mr. NADLER. Okay. Thank you.

My time is going to run out shortly. I want to ask one more question on the question of discriminatory lending practices.

In New York City, African American homeowners making more than $68,000—we are not taking about poor people here—were almost five times as likely to hold high-interest mortgages in comparison to Whites with similar or even lower incomes. An even greater disparity was reflected among Wells Fargo borrowers in New York, with subprime mortgages assigned to 16 percent of African Americans and 2 percent of Whites, again people making more than $68,000.

The Chicago Reporter found that, quote, African Americans earning $100,000 a year or more were three times more likely than their White counterparts to get high-cost loans, closed quote.

The Wall Street Journal reports that, of subprime loan borrowers generally, by the end of 2006 61 percent of such borrowers had credit scores that were high enough to qualify for conventional loans with better terms.

In your opening remarks, you discussed cases and investigations involving minorities paying more for loans than White borrowers or being steered into subprime loans. Can you discuss, first, why that would happen? Why are we seeing minority people who are capable financially, who have good credit scores and good incomes, who are capable of taking standard, relatively low-interest loans, why are they being steered into subprime loans and higher loans? And why is this happening and what can you do about it?

And, A, why is it happening; two, what can you do about it; and, three, do you have any recommendations about what Congress might do to enhance your enforcement capabilities?

Mr. PEREZ. Why is it happening? Because you can make more money by steering people into these toxic products that will give you a higher commission.

Mr. NADLER. Of course, if you are a major bank, you can make more money by steering people into toxic—into these products. But why the racial discrimination? I am out to exploit people. Why should I care if they are Black or White? Why don't I exploit everybody if I can get away with it?

Mr. PEREZ. Frankly, what we see in the lending context is we see behavior that that is predatory. Certain unscrupulous lenders are targeting everyone and anyone that they can bamboozle. We see behavior that is fraudulent. We see behavior that is discriminatory, that is targeting minority communities. So not all—when we talk about the wide panoply of abuses, some of the abuses are indeed predatory. They are equal opportunity.

Mr. NADLER. Equal opportunity terrible?

Mr. PEREZ. Yes, and some of the behavior is discriminatory, targeting low-income communities; and part of that targeting is you get somebody into a bad loan and then it is the gift that keeps on giving. Because a year later you come back to them and say, you know, that loan, I don't know if it is sustainable. Why don't we refinance? And then you get another set of fees. And given the securitization, the day after the loan is closed the broker has made their money; and it does not matter whether it is a sustainable loan. So that is part of the why.

The what are we doing? We are doing quite a lot. You saw the AIG case. We have investigations ongoing against large and small borrowers. We have the national, State, and local borrowers—lenders, I should say. We have the capacity to do the regression analyses.

Because what we often hear from critics is that, well, minority communities have problems with credit scores and things of that nature. And what we have found through the work that we have done is that when you control for all of those things, there is still discrimination at work.

Your point about upper-income African Americans, it is true in New York. It is true where I live in Montgomery County, which is one of the 10 or 12 wealthiest counties in the United States. And we did the same analysis when I was on the county council there. It is very troubling problem.

The last question about what to do, there are two issues I would like to bring to your attention, one of which relates to fair lending. When the alphabet soup of regulators, OCC, et al., are conducting reviews, they have the ability to subpoena documents. When HUD is conducting a review, they have the ability, pre-complaint, to subpoena documents. The only entity who has enforcement authority that does not have that similar subpoena power is the Civil Rights Division. So I would simply make that observation.

Second observation I would make relates to how technology has not kept pace—civil rights laws have not kept pace with technology. If you go on line—and a lot of people will now rent their apartments or try to get loans, et cetera, through the Internet or through Craigslist or all of those various entities, and we don't have authority under our tools to do that because the Communica-

tions Decency Act exempts them. And there are a couple of Court of Appeals cases that say that Craigslist—the Fair Housing Act doesn't apply to Craigslist.

Mr. NADLER. So we ought to amend the law to simply extend the jurisdiction of the Fair Housing Act and the Fair Credit Act to some of these other things?

Mr. PEREZ. That would enable us to have a level playing field to root out——

Mr. NADLER. We will be talking to you about this. Thank you very much. I have exceeded my time.

The gentleman from Virginia is recognized.

Mr. SCOTT. Good afternoon.

I would like to follow up briefly on Craigslist. Is there a threshold number of units you have to have—be renting to be under the Fair Housing Act?

Mr. PEREZ. Not for statements. So if you have a statement that says, no people with children need apply, it doesn't matter whether you have a 10-unit building or you have the garden apartment in the basement.

Mr. SCOTT. Okay. You mentioned testing for real estate agents. Do you test on loans? Have testers go in and try and get a loan, somebody else similarly situated, variable only being race with a credit score being virtually identical to see what the difference looks like?

Mr. PEREZ. We have authority to go in pre-application and test. If you attempt to do post-application testing, there are Federal laws that create barriers, in other words, the law being lying on an application. So that law does not prevent pre-application testing. In fact, pre-application testing can be very, very effective. It was used in the past in the Division, as I understand it; and it's one of the strategies that we are contemplating now in our fair lending work. But it has to be pre-application testing.

Mr. SCOTT. You mentioned mortgage fraud—or the fraudulent way they are doing business. One of the things about these no—these recourse loans where the mortgage broker does it and securitizes it and they get out of it, there is a period of time where the person who buys the mortgage does have recourse. If they don't pay it off right off the bat, the mortgage broker might get stuck with the loan, and it might come back.

One of the things they have done to get past this little period is to have these teaser rates where the borrower actually pays a teaser rate a couple of months, gets past the recourse, and then when it gets jacked up, obviously, they never could have paid it. Is there something inherently fraudulent about that practice?

Mr. PEREZ. I think every case is case specific, and I think the key to those situations is you need to qualify the person not at the teaser rate but at the rate that it will go up to.

Mr. SCOTT. They obviously don't qualify for the jacked-up rate, but they don't care. Because if they can get them past the period of time with the teaser rate during that period of time, then there is no recourse and it is not their problem. Isn't that inherently fraudulent?

Mr. PEREZ. I think it is irresponsible. And whether it rises to the level of fraudulent I think is a case-specific determination. But we

tried very hard in Maryland to ensure that when you are trying to qualify someone that you are not qualifying them at these teaser rates, because those are invitations for failure.

Mr. SCOTT. Does the mortgage broker have any fiduciary duty to the borrower?

Mr. PEREZ. It often depends on what State you live in. Some States have a duty of good faith and fair dealing. The various duties basically are a State-by-State issue. And one of the——

Mr. SCOTT. Is there any way we can do this federally? Because if the broker has no fiduciary duty, his incentive is just to rip them off the best you can. If there is a fiduciary duty, you can't do that.

Mr. PEREZ. We have seen a lot of activity vis-a-vis brokers, and the majority of brokers are responsible. But there are a sufficient number of bad apples. That I think is an area where regulation is appropriate.

Mr. SCOTT. Is there anything in Federal law, regulation, in terms of subprime loans that Congress encouraged in any way banks to get into this in such a way that it contributed to the economic collapse? There is some suggestion that because banks felt compelled to make these loans that were not getting paid back that that was the cause of the economic collapse.

Mr. PEREZ. Well, I have heard it often said, and I heard this as recently as a week ago, the Community Reinvestment Act is the main reason or one of the main reasons why we have seen the crisis that we have seen. And, frankly, the evidence doesn't support that. The Community Reinvestment Act was originally passed, I believe it was, in 1977; and if indeed that was the impetus then we should have seen a problem 10, 20 years ago.

In fact, the evidence shows that the loans that have been underwritten under the Community Reinvestment Act are some of the most solid loans we have seen. And, in addition, the large lenders, like Countrywide and others that were most responsible for the meltdown, are not even subject to the Community Reinvestment Act.

So that has really proven in my judgment, and I think the evidence demonstrates it, that that whole Community Reinvestment Act was the problem is the quintessential red herring.

Mr. SCOTT. Are Community Reinvestment Act loans set aside—can you tell which ones were made pursuant to the Community Reinvestment Act so they can be individually or as a category evaluated?

Mr. PEREZ. Yes, there have been studies that have looked at that and the Community Reinvestment Act—lenders covered by the Community Reinvestment Act—there was a study in 2006 by the Fed. Lenders covered by the Community Investment Act originated about 6 percent of the subprime loans that were made in the area where the lender was assessed for CRA compliance.

Again, the big dogs in this subprime mess, Countrywide, Wells Fargo, et cetera, they were not subject to CRA. And that is why I say—and Wells Fargo is slightly different because they are a bank. But they have so many operating subsidiaries that the operating subsidiaries that were doing the most toxic products were the operating subsidiaries that were not subject to CRA. So that is

really a red herring. And frankly, if we had more responsible CRA lending, I think we would be in a much better place.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. NADLER. I see the Chairman of the parent Judiciary Committee has arrived. Does the Chairman want to make an opening statement at this point?

Mr. CONYERS. No.

Mr. NADLER. Do you want to question him now?

Then I will recognize the gentleman from Georgia for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman.

Mr. Chairman, I have been in Congress now for about 3½ years. This is the first Subcommittee hearing that I have attended where there are no Members from the other side of the aisle present. If I had control of the video processes of this Committee, of this Subcommittee, I would order them at this time to just take a shot to see all of the folks on this side of the aisle that are here versus zero folks on the other side of the aisle. But since I don't have that power, perhaps my words will suffice. But I will say that I find it strange that the other side is not here.

I would ask, Mr. Perez, is it not true that the practices of various components of the financial services industry—fraudulent practices of various segments of the financial services industry are what led to the financial meltdown that we have suffered from in this country since 2008?

Mr. PEREZ. I think the fraudulent and at times predatory and at times discriminatory and at times all of the above practices and the failure to effectively regulate with the alphabet soup of Federal agencies that have authority to regulate were certainly factors—important factors that led to the crisis that we have been experiencing.

Mr. JOHNSON. So in addition to housing discrimination and housing—unfair housing practices directed toward minorities, i.e., predatory lending practices, we have had the same kinds of problems with respect to the automobile lending industry, the student loan industry, particularly the private student loan industry, consumer lending in general, credit cards. All of these excesses, fraudulent activity, discriminatory activity, predatory lending activity have contributed to this meltdown, isn't that correct?

Mr. PEREZ. Yes, sir.

Mr. JOHNSON. And I am happy to note that your unit inside the Justice Department will be focusing on all of these areas, in addition to fair housing practices; correct?

Mr. PEREZ. Yes, sir, especially—not especially, but including but not limited to protecting our men and women of the Armed Forces who are deployed abroad and then while they are deployed overseas they find that someone is trying to foreclose on their home or someone is trying to repossess their car and they haven't followed the proper process. When people are protecting our Nation, we owe it to them to protect their backs here at home, and that is precisely what we are doing through the tools that you have given us.

Mr. JOHNSON. Well, I am certainly proud to bestow more resources upon your unit to clean up what got us into this horrendous financial meltdown that we continue to suffer from today that has resulted in people losing their jobs and their homes.

But I do want to—in focusing on this fair housing situation that has—fair housing law that has been unenforced over the last decade, it has resulted in a number of children and families becoming homeless. So, in other words, as a result of these financial practices, one of the results is more homeless children and youth—2 million children, it has been reported, have been rendered homeless because of the foreclosure practice.

With so many families and children, especially families and children of color, suffering greater impact in the foreclosure practice, is the Department of Justice increasing its renting testing, especially with African American and Latino families with children of all ages?

Mr. PEREZ. We have a robust testing program. We test on issues of racial discrimination. We test on disability discrimination, ethnicity discrimination. And I described two cases that were the product of testing, and we have many others, and we will continue to do that, including family status, people who are losing their homes in many of the ways you described.

Mr. JOHNSON. Well, with many people losing their homes, becoming homeless, maybe getting back on their feet, they need to go into rental housing.

Mr. PEREZ. Correct.

Mr. JOHNSON. And you are focusing on rental housing and testing in that market?

Mr. PEREZ. We have a heavy focus in the rental market. In fact, the largest settlement in the history of the Fair Housing Act was a rental discrimination case in Southern California involving the owner of the Los Angeles Clippers, Donald Sterling, and that case involved discrimination in rental housing against African American and Latino would-be renters. And a big part of the settlement in that case in terms of compliance monitoring will be testing. Because it is one thing to reach a settlement, but then you have to got to make sure that you have truly stopped the discriminatory behavior. So we are not going away because we saw some serious pattern and practice problems in that particular area.

Mr. JOHNSON. And last thing I would like to speak on are the Federal insured—is the federally insured private student loan market where you get a lot of private institutions of higher learning which really have no accreditation and they end up being steered—or they end up steering students into that private student lending market, as opposed to the traditional student loan market.

That market is the subject of the legislation that Mr. Cohen out of Tennessee has proposed that would make those loans dischargeable in bankruptcy. In 2005, they were granted nondischargeability status; and I would want your unit to look into those types of lending practices within that market as well.

They feature high-cost loans, adjustable rates, and since they are not dischargeable, that means lenders are insisting upon strict repayment terms without regard to the debtor's ability to repay the loan. So I want you to take a close look at that. This legislation of Mr. Cohen is pretty important.

So I will close with that. Thank you, Mr. Chairman.

Mr. NADLER. Thank you.

I now recognize the gentlewoman from California.

Ms. CHU. Thank you, Mr. Chairman.

Well, I am particularly shocked by the blatant discriminatory practices of Wells Fargo Bank and their clear intent to steer Blacks to more expensive, riskier loans, despite the fact that there is a Fair Housing Act, and that they even instructed loan officers to place African American borrowers who had excellent credit into subprime mortgages and fired employees who didn't comply.

Now, the State of Illinois sued Wells Fargo for doing this; and, in their case, they state that Wells Fargo lacked policies to prevent borrowers from being purposefully steered into high-cost subprime and risky mortgages. Are banks required to have such policies in place?

Mr. PEREZ. Yes, ma'am.

Ms. CHU. What kind of actions can DOJ make to ensure that lending institutions do carry out these policies?

Mr. PEREZ. We have two primary tools, Congresswoman, and they are the Fair Housing Act and the Equal Opportunity Act. We have, again, a robust docket of cases involving large and small lenders alike; and we are looking at origination practices. Was there discrimination? Were people steered into high-cost loans on account of their race when they could have qualified for conventional loans that would have saved them a lot of money? Were the lending practices targeting minority communities, as we talked about before, the phenomenon of reverse redlining where the minority community is being targeted for these toxic products?

We have the capacity under the Equal Credit Opportunity Act and the Fair Housing Act to eliminate both intentional discrimination and policies and practices that may be neutral on their face but have the effect or a disproportionate adverse impact based on race. And we are actively looking at——

Again, I mentioned we have a docket of about 39 cases right now. And we just settled the AIG case that I talked about, which was a case about the relationship between lenders and brokers. That is one form of discrimination that we see, but we see many different forms, and I think what you will see in the months ahead as we move forward are cases that address varying aspects of the discrimination that we have seen.

Ms. CHU. Are you certain that every lending institution does in fact have a policy in place?

Mr. PEREZ. Well, I think it makes sense for a lending institution as a matter of safety and soundness and as a matter of sound compliance with both civil rights obligations and fair lending obligations relating to anti-predatory lending and consumer protection ordinances to ensure that every part of their process from soup to nuts is a process designed to ensure that there is no discrimination and that people—that you are lending to people who have the ability to repay and that you have taken steps to monitor your own internal practices.

I do a lot of police work, and it is really no different, making sure you have continuous internal quality control. And if those controls are not in place, you see in police departments and you see in lending institutions a lot of the excesses that we, from time to time, observe.

Ms. CHU. Well, I guess what I am wondering is how do you know that they have those internal mechanisms in place?

Mr. PEREZ. What we are finding in some of our investigations is those mechanisms are not in place. I am not here to contend that they are in every case. That is actually one of the critical factual questions that is often the focus of our investigations.

I apologize. I think I misheard your question.

Ms. CHU. It is monitoring.

Mr. PEREZ. I apologize.

Ms. CHU. You are actively looking at that?

Mr. PEREZ. Absolutely.

Ms. CHU. And providing some oversight on that?

I also have a question about HAMP. Of course, they are a large part of dealing with foreclosure issues, making sure that our Home Affordable Modification Program is addressing the needs of people out there that are facing foreclosure. The Treasury Department said that it will collect information to make sure that this program is not practicing discrimination, but so far none of this information has been released. Do you know whether this information is even being collected?

Mr. PEREZ. It is my understanding that the information is being collected, and I believe they began collecting the information as of December of 2009, the information disaggregated by race and ethnicity. We are working very closely with our partners at Treasury to access the data so that we can conduct an analysis to ensure that the program is being administered in a nondiscriminatory fashion.

We are also looking at other aspects that are perhaps not discrimination per se but are very problematic, practices such as entities who are examining somebody's application for a modification. Under the terms of the HAMP program, you are not allowed to initiate foreclosure proceedings during the pendancy of that review; and what we are finding anecdotally—and I heard this as recently when I was in Wisconsin and I heard it 2 weeks ago in Birmingham—that there are case after case after case where foreclosure proceedings are being initiated when the homeowner hasn't even gotten an answer to the question.

At a minimum, if those facts are accurate, that is a breach of contract, because those who signed up in the HAMP program made a commitment not to do that. And that is one of the most frequent problems that we are seeing.

So we are doing our level best to, obviously, keep our radar up for the discrimination issues, but as we hear other concerns with the implementation of HAMP we are working closely with our partners at Treasury and HUD and elsewhere to address those situations.

Because people who are—people in trouble need four things: They need time, they need money, they need a good advocate, and they need government regulators who are actually doing the regulating that they are supposed to be doing. That is our role and what we are trying to do.

Ms. CHU. So you are saying you are getting the information from the Treasury in terms of the discriminatory practices. It is just that it has not been made public to——

Mr. PEREZ. The data—right—the data was collected beginning in December of 2009. That is my understanding. The data is still being scrubbed, and we hope to get the data that is being collected in the very near future. We have very regular conversations with our partners over at Treasury on this issue because we are, obviously, very interested in monitoring compliance.

Ms. CHU. Thank you.

Mr. NADLER. Thank you. And we thank the witness.

Mr. PEREZ. Thank you, Mr. Chairman. Always a pleasure to be here.

Mr. NADLER. We will now proceed with our second panel. I would ask the witnesses to take their place and, in the interest of time, I will introduce the witnesses while they are taking their seats.

A C Wharton, Jr., was elected the mayor of Memphis in a special election held on October 15, 2009—in other words, last October—to complete the term of the former mayor, Willie Herenton. Mayor Wharton previously served as the mayor of Shelby County, Tennessee. First elected in August of 2002 and reelected in August of 2006.

Mayor Wharton attended the Tennessee State University. He received a bachelor's degree in political science, and later earned his law degree from the University of Mississippi.

Roger Clegg is the President and General Counsel for the Center for Equal Opportunity. From 1982 to 1993, Mr. Clegg held a number of positions in the U.S. Department of Justice, including Assistant to the Solicitor General and the number two official in the Civil Rights Division and Environment Division. From 1992 to 1997, Mr. Clegg was the Vice President and General Counsel of the National Legal Center for the Public Interest. He is a graduate of Rice University and Yale Law School.

Gillian Miller is a single mother of three from Boston, Massachusetts. In 2005, she purchased a home, but, despite her good credit score, Mrs. Miller was only offered a subprime adjustable rate mortgage by her lender. Like many Americans in her position, Mrs. Miller eventually found herself unable to make the increasing payments on her loan, resulting in the loss of her home in 2006. She is currently a plaintiff in a discrimination lawsuit against Countrywide Financial Mortgages.

Gary Klein is currently a principal at the firm of Roddy, Klein & Ryan. He has litigated cases involving predatory lending and servicing and mortgage charging and wrongful foreclosure. From 1991 to 2000, Mr. Klein was a senior attorney at the National Consumer Law Center and Director of the Center of Sustainable Homeownership Initiative. He is a graduate of Yale University and Rutgers University Law School.

I am pleased to welcome all of you. Your witness statements will be made a part of the record in their entirety.

I would ask each of you to summarize your testimony in 5 minutes or less. To help you stay within that time, there is a timing light at your table. When 1 minute remains, the light will switch from green to yellow and then red when the 5 minutes is up. I trust you heard that when I said that to the first panel.

Before we begin, we will swear in the witnesses, which is our custom. If you would stand and raise your right hands to take the oath.

[Witnesses sworn.]

Mr. NADLER. Let the record reflect the witnesses answered in the affirmative, and you may be seated.

I recognize for 5 minutes the Honorable Mayor Wharton.

TESTIMONY OF THE HONORABLE A C WHARTON, JR., MAYOR, MEMPHIS, TN

Mr. WHARTON. Thank you, Mr. Chairman.

Again, Chairman Nadler, Ranking Member Sensenbrenner, and Members of the Subcommittee, I want to thank you for the opportunity to address you on this afternoon.

Also, I wish to extend a special thanks to my Congressman and friend, the Honorable Steve Cohen—who met me earlier and said that he had to be away from this hearing—for his graciousness and his fierce engagement on this most important issue.

I am indeed delighted to be present today. Although I am currently the mayor of Memphis, I feel that my words will not only represent the struggles of my own city and county with respect to this issue but they will also echo the frustrations of other mayors and local officials grappling with the serious consequences of predatory lending.

In his address before the signing of the landmark Civil Rights Act of 1968, President Lyndon Baines Johnson recognized Dr. Martin Luther King, Jr., and Dr. King's involvement on the subject of nondiscrimination in housing. This legislation, inclusive of Title VIII of the Fair Housing Act, as it is commonly known, was signed into law by President Johnson on that day, April 11, 1968. And while this event was historic and memorable, a truly seminal moment in civil rights, this signing ceremony was overcast by the long shadow of Dr. King's assassination in my home City of Memphis, Tennessee, exactly 1 week earlier. It is altogether befitting that Memphis, inspired by the legacy of Dr. King, has taken on the updated fight for nondiscrimination in housing with the reverse redlining lawsuit that our city and county filed against Wells Fargo on December 30, 2009.

We allege in that lawsuit that Wells Fargo targeted minority citizens and communities in Memphis for predatory loans that offered a fragile opportunity for homeownership that was essentially a financial house of cards.

As we have advanced this cause and found the voice for our grievance in the Fair Housing Act, we have been ever mindful of a larger context to be considered. Having taught law school for many years, I understand implicitly the sensitivity we all must have to the changing face of discrimination. The long and storied history of civil rights clearly shows us that one generation's Jim Crow is another generation's glass ceiling in corporate America. Outright police brutality was largely banished, only to be later repatriated under the identity of racial profiling.

Against the changing backdrop of political and social realities, we must continue to ensure that the principles of fairness and equity

do not fall victim to discrimination in new forms and with new names.

It is our contention that the discriminatory acts that once kept African Americans from renting or owning homes in certain neighborhoods is hardly different from blatant actions from financial institutions that singled out African Americans with noxious agreements that were rotten to the core. Simply put, predatory lending is to this generation what no lending to Blacks and Latinos was a generation before.

In Memphis, our reality is particularly unsettling as we see whole neighborhoods that have been picked apart and hollowed out by foreclosed properties. With State law that allows for nonjudicial foreclosures since the year 2000, foreclosures in Shelby County have increased by 180 percent.

Now you know Memphis to be the city of the blues. Some might say you are just singing the blues. We are not. We are simply crying foul. And if you look at Wells Fargo foreclosure rate in predominantly African American neighborhoods in Shelby county, it is nearly seven times as high as its foreclosure rate in predominantly White neighborhoods. It is particularly acute in minority neighborhoods in South Memphis, Hickory Hill, Orange Mound, and other neighborhoods with African American populations exceeding 80 percent.

As I sum up, I will simply go back to a few years back, a few decades back, when we, after the following of the many riots in our cities, we had the Kerner Commission that concluded that America was moving to two societies, one Black, one White. If this situation is not remedied, we will soon be moving to a different kind of dual society, one in which homeownership is a dream, the other in which it is a nightmare.

Thank you.

[The prepared statement of Mr. Wharton follows:]

PREPARED STATEMENT OF A C WHARTON, JR.

TESTIMONY OF A C WHARTON, JR.
MAYOR OF THE CITY OF MEMPHIS

BEFORE THE
SUBCOMMITTEE ON THE CONSTITUTION,
CIVIL RIGHTS, AND CIVIL LIBERTIES

COMMITTEE ON THE JUDICIARY

U.S. HOUSE OF REPRESENTATIVES

APRIL 29, 2010

PROTECTING THE AMERICAN DREAM PART II – COMBATING PREDATORY LENDING UNDER THE FAIR HOUSING ACT

I. Introduction

Chairman Nadler, Ranking Member Sensenbrenner and Members of the Subcommittee: My name is A C Wharton, and since 2009 I have had the privilege of serving the citizens of the City of Memphis, Tennessee as their Mayor. Before my election as Mayor of Memphis, I served as Mayor of Shelby County for almost eight years. I was elected to that position as Shelby County's first African American Mayor in 2002, and re-elected in 2006. My initial engagement with the issue that I will offer testimony on today started during my tenure as Mayor of Shelby County.

Leadership and public service have been the hallmark of my career. From my early life in Lebanon, Tennessee, in the foothills of the Cumberland Mountains, where it was assumed I was destined to be a farm laborer to my current status as Mayor of the largest municipality in the state of Tennessee, my life is an example of what anyone in our country can accomplish given the opportunity. With the help and encouragement of two student teachers and a scholarship, I was admitted to Tennessee State University, where I graduated with honors in 1962. Six years later I entered the University of Mississippi Law School, where I was one of the first African American students to serve on the Moot Court Board, and the first African American to serve on the Judicial Council. I graduated with honors in 1971, and then three years later became the University's first African American professor of law, a position I held for 25 years.

After law school I came to Washington, D.C. to work in the Office of General Counsel at the Equal Employment Opportunity Commission. Two years later I became head of the Public Employment Project at the Lawyers' Committee for Civil Rights under Law. In 1973 I moved to Memphis to serve as Executive Director of Memphis Area Legal Services, an organization facing

severe financial troubles. Under my leadership, Legal Services not only survived, but was recognized nationally for its innovative programs.

In 1980 I was appointed Chief Shelby County Public Defender. I am proud of my accomplishments in that position, which included creating a national model program for the mentally ill in the criminal justice system, and new ways to ease overcrowding in the jails without sacrificing public safety. In 1982 I wrote and passed one of the first state laws in the country to combat domestic violence, and at a national level worked for a special appropriation of one of the nation's first transitional living facilities for juveniles. At each post and position in my career I have sought to help those who need help, represent those who need representing and defend those who need defending. Therefore it should be no surprise that when I became aware of my citizens' treatment at the hands of predatory lenders, that I started the wheels into motion that resulted in the lawsuit filed this past December by the City of Memphis and Shelby County, Tennessee.

Following my election in 2002 as Mayor of one of the Southeast's largest county governments, I moved rapidly to turn around a county that was facing financial difficulty, which is all too common even today. I developed Shelby County's first long range financial plan, which has now decreased the County's debt payments; reduced the County payroll; kept critical hospital services open; expanded Head Start; developed the first smart growth and sustainability plan; initiated the first comprehensive crime-fighting plan in the County's history and limited our government to only one tax increase in seven years.

In October of 2009 I was elected Mayor of the City of Memphis, Tennessee. In the relatively short time that I have served as Mayor of Memphis, I have brought the same leadership and management skills to the challenges faced by our City. None of the challenges we face right

now, though, is greater than that posed by the current housing foreclosure crisis. As mentioned previously and discussed in detail below, I recognize that Memphis has been victimized by predatory lenders who have engaged in reverse redlining. These lenders targeted vulnerable minority home owners and minority neighborhoods to make a fast profit through abusive and discriminatory lending practices while the housing market was on the rise. My commitment to addressing this wrong has carried over into my new office and responsibilities. When the housing bubble broke, predatory lenders left Memphis and Shelby County with the ruins of their destructive practices – hundreds of vacant and foreclosed properties that now cost the City of Memphis, Shelby County and its residents dearly in terms of repairs, redressing code violations, and lost tax revenue.

Wells Fargo is one of the worst of these lenders. As discussed in detail below, Wells Fargo's foreclosure rate for loans in predominantly African American neighborhoods in Memphis and Shelby County is nearly seven times as high as its foreclosure rate for loans in predominantly white neighborhoods. We believe if Wells Fargo was properly and uniformly applying responsible underwriting practices in African American and white communities, it would have comparable foreclosure rates in both. Wells Fargo possesses sophisticated underwriting technology and data that allow it to predict with precision the likelihood of delinquency, default or foreclosure. The fact that Wells Fargo's foreclosure rate is so much higher in African American neighborhoods is not the product of chance events and is fully consistent with a practice of targeting African American neighborhoods and customers for discriminatory practices and predatory pricing and products. It is also consistent with a practice of failing to properly underwrite African American borrowers and of putting these borrowers into loans they cannot afford in order to maximize the company's profits.

Several former Wells Fargo employees who worked in the Memphis office and two who worked elsewhere but are knowledgeable about the Memphis market have given declarations setting out the practices they saw in the Wells Fargo offices. These former Wells Fargo employees have explained precisely how the company has used discretion in pricing and financial incentives to encourage its employees to target African-American customers and neighborhoods for deceptive, high priced loans that predictably result in unnecessary foreclosures. The former employees confirm that, among other things, Wells Fargo targeted African-Americans by developing lists of "leads" of people who made purchases at businesses in African-American neighborhoods; deceived African Americans by persuading them to consolidate non-housing debts into new subprime loans secured by their homes without telling them that their homes would be at risk; pushed high interest rate credit cards and other lines of credit that were secured by borrowers' homes; mailed live checks to the leads that became loans once cashed, and then tried to talk the new borrowers into refinancing such debt with subprime loans secured by their homes; made mortgage loans without regard for whether borrowers qualified for the loans or could repay them; failed to inform borrowers that their mortgages had adjustable interest rates and that their monthly payments could increase; charged borrowers for expensive add-on products and fees that did benefit them; gave loan officers broad discretion and large financial incentives to steer customers who qualified for prime and Federal Housing Administration ("FHA") mortgages into much more costly subprime products with increased interest rates, points, and fees that, in one declarant's words, put a "bounty" on African Americans targeted for subprime loans; deceived customers in order to give them subprime loans by, for example, telling them not to put any down payment on a property or not to submit full documentation for their loan, which would cause the loans to "flip" from prime to subprime;

deceived African Americans about the full range of more advantageous products that were available to them and that they qualified for; drafted subprime marketing materials on the basis of race by using software to "translate" the materials into what Wells Fargo literally defined as the "language" of "African American;" referred to subprime loans located in minority communities as "ghetto loans;" and generally fostered a discriminatory culture that was tolerated by management. These practices are described in greater detail below.

Wells Fargo's discriminatory practices have inflicted significant and substantial harm in the minority neighborhoods of Memphis and Shelby County. I describe these costs and harms in detail in the testimony below. Wells Fargo foreclosures cause homes to become vacant; and these vacancies result in very specific costs to our City and County, not just in property damage and repair, but in terms of lost tax revenue as well.

Faced with the overwhelming evidence of Wells Fargo's discriminatory conduct, both the City of Memphis and Shelby County decided to take legal action at the end of last year. We filed a lawsuit against Wells Fargo, alleging that its conduct violated the Fair Housing Act. The testimony that follows describes the facts underpinning our lawsuit, and what we hope to accomplish with this legal action. At a minimum, we want lenders like Wells Fargo to know that they cannot come into our community, exploit our citizens, City and County, cause enormous damage, and skate free with their ill-gotten profit. It is time for them to join with us in figuring out how to fix the damage that we face as caused in no small measure by their abusive practices. A just resolution of this lawsuit will require Wells Fargo's involvement in the creation of lending programs and victim funds designed to put our homeless residents back in homes, and keep those on the brink of foreclosure from losing their homes.

Other lenders who have engaged in similar practices in our City need to pay careful attention to this lawsuit. It is the first we have brought, but it is unlikely to be the last.

Time is of the essence. With each passing day, the crisis grows more acute and the damage done by Wells Fargo gets worse. All branches of government, whether it be the U.S. Department of Justice; State Attorneys General; municipalities like ours; or administrative agencies like HUD, need to come together to address these issues, ensure that violations of the law are fully redressed, and work together to make sure that lending institutions like Wells Fargo pay their fair share for the damage they have caused.

II. The Foreclosure Crisis Has Hit African-American Communities the Hardest In Cities around the Country

The impact of the foreclosure crisis is felt most acutely in minority communities. This is because of the prevalence of "reverse redlining." As used by Congress and the courts, the term "reverse redlining" refers to the practice of targeting residents in certain geographic areas for credit on unfair terms due to the racial or ethnic composition of the area. In contrast to "redlining," which is the practice of denying *prime* credit to specific geographic areas because of the racial or ethnic composition of the area, reverse redlining involves the targeting of an area for the marketing of deceptive, predatory or otherwise deleterious lending practices because of the race or ethnicity of the area's residents. This practice has repeatedly been held to violate the federal Fair Housing Act.[1]

A joint report on predatory subprime lending by the United States Department of Housing and Urban Development and the United States Department of the Treasury (the "HUD/Treasury Report") found that reverse redlining in subprime mortgage lending is a major problem: "Predatory lenders often engage in 'reverse redlining' – specifically targeting and aggressively soliciting homeowners in predominantly lower-income and minority communities

. . . ."[2] The report continues, "[t]estimony at the forums [held by the HUD/Treasury National Predatory Lending Task Force] strongly indicates that many predatory lenders may have engaged in reverse redlining, or targeting abusive practices to protected groups."[3]

There is a substantial body of empirical evidence that supports the HUD/Treasury finding and establishes that subprime mortgage lending and the predatory practices often associated with subprime lending are targeted at African Americans and African-American neighborhoods.

The Fannie Mae Foundation found that many borrowers who qualify for prime mortgage loans are instead given subprime loans, and that the problem is particularly acute for African-American borrowers.[4] Fannie Mae stated that "research by Freddie Mac reports that as much as 35 percent of borrowers in the subprime market could qualify for prime market loans" and that "Fannie Mae estimates that number closer to 50 percent."[5] Focusing on race, Fannie Mae concluded that "the level of subprime lending to black households and communities far exceeds the measured level of credit problems experienced by those households."[6]

A study by the National Community Reinvestment Coalition ("NCRC") reached the same conclusion.[7] The NCRC studied subprime mortgage loans in metropolitan areas across the country.[8] It combined data that lenders are required to release to the public under the federal Home Mortgage Disclosure Act ("HMDA") with credit scoring data on a census tract level that the authors obtained from one of the three major credit bureaus.[9] (Credit scores are not released under HMDA.) The NCRC controlled for differences in credit scores and found a statistically significant and positive correlation between the percentage of African Americans in a census tract and the percentage of subprime loans in the tract.[10]

HUD, though it did not have access to credit scores or other data about creditworthiness, studied 1998 HMDA data on almost 1 million mortgages and likewise concluded that the growth

of subprime lending was disproportionately concentrated in African-American neighborhoods. HUD also found that the disparity persisted across income lines and actually increased as neighborhood income increased and stated that the problem requires "closer scrutiny."[11] HUD observed with alarm that "only one in ten families in white neighborhoods [receive subprime loans and] pay higher fees and interest rates, but *five in ten families in African-American communities are saddled with higher rates and costs*."[12] Describing HUD's research in their subsequent joint report, HUD and Treasury stated that "the research consistently revealed that, controlling for income, predominantly non-white census tracts showed much higher subprime refinance penetration rates than predominantly white census tracts."[13]

A study of 2000 HMDA data covering every metropolitan statistical area in the country found a parallel racial disparity in the frequency of subprime loans.[14]

The studies discussed above show that African Americans and residents of African-American neighborhoods receive subprime loans at a much greater frequency than whites and residents of white neighborhoods, and that the disparity is much greater than legitimate underwriting factors can explain. The following studies provide empirical evidence that, after controlling for creditworthiness and other legitimate underwriting factors, there are likewise substantial disparities based on race in the terms and conditions of the subprime loans given to African Americans and residents of African-American neighborhoods.

A study by the Center for Responsible Lending ("CRL" or "the Center") found racial disparities in the pricing of loans. The study included loans made by Wells Fargo. The study found that African Americans receive higher-priced subprime mortgages than whites who are similarly situated with respect to credit and other underwriting criteria.[15] This study combined HMDA data with a proprietary database to determine whether race had a statistically significant

effect on the pricing of subprime loans in 2004.[16] The proprietary database covered 87% of the U.S. subprime market.[17] It included credit criteria such as the credit score and loan-to-value ratio for each loan; such data is not released under HMDA and is not publically available.[18] The CRL found that, after controlling for credit and other underwriting factors, the odds were 40% to 84% higher that an African-American borrower would receive a high-cost purchase loan than a similarly-situated white borrower.[19] The difference was statistically significant for most types of purchase loans.[20] Similarly, the study found that the odds were 4% to 62% higher that an African-American borrower would receive a high-cost refinance loan than a similarly-situated white borrower, also after controlling for credit and other underwriting factors.[21] The difference was statistically significant for refinance loans with prepayment penalties, which constituted nearly two-thirds of the refinance loans analyzed.[22]

Another study by the Center for Responsible Lending found that subprime borrowers in predominantly African-American and other minority neighborhoods are much more likely to be given loans with prepayment penalties than subprime borrowers in predominantly white neighborhoods who are similarly situated with respect to credit and other characteristics.[23] The Center analyzed proprietary data from The First American Corporation on 1.8 million subprime loans originated from 2000 to mid-2004. First American's proprietary database allowed the Center to control for a variety of underwriting factors, such as credit score, loan-to-value ratio, debt-to-income ratio, and more.[24] The study found that "[t]he odds of borrowers receiving prepayment penalties are consistently and positively associated with minority concentration, and the differences are statistically significant."[25] It concluded, "[i]n the simplest terms, the odds of avoiding a prepayment penalty on a subprime loan are significantly better for borrowers who live in predominantly white neighborhoods."[26]

Yet another study found racial disparities with respect to requiring borrowers to pay yield spread premiums.[27] The authors analyzed data on creditworthiness and other underwriting criteria, including credit scores and loan-to-value ratios, that was obtained in discovery in a mortgage lending lawsuit under the federal Real Estate Settlement Procedures Act, 12 U.S.C. § 2601, *et seq.*[28] They found that, after controlling for such criteria, African Americans (and Hispanics) paid substantially more in yield spread premiums than other borrowers, and that the disparity was statistically significant.[29] Moreover, they found that for every dollar paid by borrowers in yield spread premiums, the borrowers gained only 20 to 25 cents of value.[30]

III. Memphis Is No Exception to This National Pattern

Reverse redlining typically flourishes in cities where two conditions are met. First, the practice afflicts cities where minorities historically have been denied access to credit and other banking services. The legacy of historic discrimination, or redlining, often leaves the residents of minority communities without the means or resources required to identify loan products and lenders offering products with the most advantageous terms for which they might qualify. This makes them especially vulnerable to irresponsible subprime lenders who, instead of underwriting carefully to ensure that the loans they offer are appropriate for their customers, engage in an array of unscrupulous lending practices.

Second, reverse redlining arises in cities where there are racially segregated residential living patterns. This means that the people who are most vulnerable to abusive lending practices are geographically concentrated and therefore easily targeted by lenders.

Both of these conditions are present in Memphis and Shelby County. First, Memphis' and Shelby County's minority communities historically have been victimized by traditional redlining practices that persisted for decades.

Second, the City and County are highly segregated between African Americans and whites. As the map attached as Exhibit 1 shows, even though Memphis is 61% African-American and 34% white, and Shelby County is 52% African-American and 45% white, many neighborhoods have a much higher concentration of one racial group or the other.

IV. Wells Fargo Is a Big Part of the Problem in Memphis and Shelby County

Wells Fargo is one of the largest mortgage lenders in Memphis and Shelby County. It has made at least 1,000 mortgage loans in Shelby County in each of the last seven years for which data is available (2002-2008) with a collective value of more than $2 billion, and at least 400 mortgage loans a year with a collective value of more than $725 million in the City. Wells Fargo makes loans in both the white and African-American neighborhoods of Memphis and Shelby County.

Far from being a responsible provider of much-needed credit in minority communities, however, Wells Fargo is one of the leading causes of the disproportionately high rate of foreclosure in Memphis' and Shelby County's African-American neighborhoods. Its foreclosures since at least 2000 have been concentrated in South Memphis, Binghamton, Fox Meadows/Hickory Hill, Orange Mound, North Memphis, Whitehaven, and other neighborhoods with African-American populations exceeding 80%.

In the City, 54.2% of Wells Fargo's foreclosures from 2005 to 2009 were in census tracts that are predominantly African-American, but only 12.5% were in tracts that are predominantly white. In the County, 46.8% of Wells Fargo's foreclosures from 2005 to 2009 were in predominantly African-American census tracts but only 20.1% were in tracts that are predominantly white.

The figures are comparable for Wells Fargo's foreclosures in the City and County from 2000 to 2004. Half of the foreclosures in the City were in tracts that are predominantly African-American and only 7.1% were in tracts that are predominantly white. In the County 37.2% of the foreclosures were in tracts that are predominantly African-American and only 18.9% were in tracts that are predominantly white.

At the same time, Wells Fargo has the second largest number of foreclosures in Shelby County of any lender from 2000 to 2009. The map attached as Exhibit 2 represents the concentration of Wells Fargo's foreclosures in African-American neighborhoods.

The likelihood that a Wells Fargo loan from 2000 to 2008 in a predominantly African-American neighborhood will result in foreclosure is dramatically greater than the likelihood of foreclosure for a Wells Fargo loan in a predominantly white neighborhood. In the County, 17.7% of Wells Fargo's loans in predominantly African-American neighborhoods result in foreclosure, but the same is true for only 2.6% of its loans in neighborhoods that are predominantly white. In the City, 17.5% of Wells Fargo's loans in predominantly African-American neighborhoods result in foreclosure, but the same is true for only 3.3% of its loans in neighborhoods that are predominantly white. In other words, a Wells Fargo loan in a predominantly African-American neighborhood in Shelby County is almost seven times more likely to result in foreclosure as one in a predominantly white neighborhood. In Memphis, it is 5.3 times more likely to result in foreclosure.

Wells Fargo's failure to responsibly underwrite loans in minority and underserved communities has been the subject of public attention and concern for years. For example, its practices are the focus of a 2004 report from the Center for Responsible Lending. The report concluded that the company's customers "too often face the loss of their home or financial ruin

as a result" of its "predatory practices."[31] The predatory practices identified in the report include charging excessive fees; charging excessively high interest rates that are not justified by borrowers' creditworthiness; requiring large prepayment penalties while deliberately misleading borrowers about the penalties; using deceptive sales practices to wrap insurance products into mortgages; convincing borrowers to refinance mortgages into new loans that only benefit Wells Fargo; deceiving borrowers into believing that they are getting fixed rate loans when they are really getting adjustable rate loans, and more.

Wells Fargo's pattern or practice of failing to follow responsible underwriting practices in Memphis' and Shelby County's African-American neighborhoods is evident from the type of loans that result in foreclosure filings in those neighborhoods. Approximately 65% of Wells Fargo's County loans that result in foreclosure, and 67% of its City loans that result in foreclosure, are fixed rate loans. For both the City and County, this ratio is nearly the same in African-American and white neighborhoods. This establishes that there is no legitimate reason for the stark difference in Wells Fargo's foreclosure rates by race.

Unlike adjustable rate loans, where the price may fluctuate with changing market conditions, the performance of fixed rate loans is relatively easy to predict using automated underwriting models and loan performance data because monthly payments do not vary during the life of the loan. Using these sophisticated risk assessment tools, and relying on traditional underwriting criteria such as FICO scores, debt-to-income ratios, loan-to-value ratios, and cash reserves, any lender engaged in responsible underwriting practices designed to identify qualified borrowers can predict with statistical certainty the likelihood of default and/or delinquency. Lenders engaged in marketing fixed rate loans in a fair and responsible manner should have no

difficulty sifting out unqualified borrowers, or borrowers whose loans would likely result in delinquency, default or foreclosure.

Because the percentage of fixed rate loans is so high and the same in both African-American and white neighborhoods, Wells Fargo should, if it properly underwrites, have comparable foreclosure rates in both communities. The fact that Wells Fargo's underwriting decisions result in foreclosure six to eight times more often in African-American neighborhoods than in white neighborhoods means that it is not following fair or responsible underwriting practices with respect to African-American customers.

The disparate foreclosure rates are instead consistent with the type of unscrupulous subprime lending practices described above. Wells Fargo engages in these and similarly inappropriate practices when making loans to African Americans and in African-American neighborhoods. This pattern or practice of targeted activities fully explains the disparate rates of foreclosure. The disparities are not the result of or otherwise explained by legitimate non-racial underwriting criteria.

A closer look at Wells Fargo's lending practices and the characteristics of its loans in Memphis and Shelby County demonstrates that Wells Fargo is engaged in a pattern or practice of reverse redlining with respect to the City's African-American neighborhoods. As described below, information from former Wells Fargo employees and examination of Wells Fargo's loans indicate it is engaged in unfair, deceptive and discriminatory practices in Memphis' and Shelby County's African-American neighborhoods that have the effect and purpose of placing underserved borrowers in loans they cannot afford and that require higher monthly payments than loans for which they qualify. Wells Fargo's unfair, deceptive and discriminatory practices maximize short-term profit without regard to the borrower's best interest, the borrower's ability

to repay, or the financial health of underserved minority neighborhoods. This targeted pattern or practice has resulted in the disproportionately high rate of foreclosure found in Memphis' and Shelby County's African-American neighborhoods. These discriminatory and predatory practices cause foreclosures and vacancies because they make it more difficult for borrowers to stay current on their payments and remain in their homes.

A. Former Wells Fargo Employees Explain How the Company Targets African Americans in Memphis and Shelby County for Subprime Loans and Abusive Subprime Lending Practices

Four people who worked for Wells Fargo in Memphis between 2002 and 2008 – Doris Dancy, Michael Simpson, Mario Taylor, and Camille Thomas – confirm that Wells Fargo engaged in a myriad of deceptive, unfair, abusive, and predatory subprime lending practices in Memphis and Shelby County. Their testimony is corroborated by two other former Wells Fargo employees, Tony Paschal and Elizabeth Jacobson, who state that Wells Fargo engaged in these practices nationally. Declarations from all six former employees are attached to this statement as Exhibits 3-9. Ms. Dancy, Mr. Paschal, Mr. Taylor, and Ms. Thomas further confirm that Wells Fargo targeted its abusive subprime lending practices at residents of African-American neighborhoods in Memphis and Shelby County. This constitutes reverse redlining.

Simpson worked at the Wells Fargo Financial branch office on Park Avenue from November 2002 until January 2008. Simpson was a credit manager for approximately 1½ years and was then promoted to branch manager. As a credit manager, he was responsible for soliciting current Wells Fargo customers and others to apply for new subprime loans. As a branch manager, he supervised credit managers and loan processors.

Thomas worked as a loan processor at the Wells Fargo Financial branch offices in Bartlett, Cordova, Collierville, and on Winchester Street from January 2004 until January 2008.

These offices only handled subprime loans. Thomas was responsible for all of the paperwork for the loans in her office and submitted the files to Wells Fargo underwriters for approval and funding. Thomas was very familiar with Wells Fargo's practices and underwriting rules and guidelines because of her responsibilities as a loan processor.

Taylor worked at the Wells Fargo Financial branch offices in Cordova and Quince and on Park Avenue from June 2006 until February 2008. He was a credit manager and was responsible for soliciting people to apply for Wells Fargo loans.

Dancy was a credit manager at the Wells Fargo Financial branch office on Park Avenue from July 2007 until January 2008. She was responsible for soliciting people to apply for Wells Fargo loans.

Paschal was a Wells Fargo loan officer from September 1997 to September 2007 (with a hiatus of approximately 2½ years beginning in June 1999). Paschal worked in Virginia and Maryland but his job was to solicit Wells Fargo borrowers from throughout the country to refinance their home mortgage with a prime or Federal Housing Administration ("FHA") loan. FHA loans have interest rates that are closer to prime than subprime rates. Paschal worked with many applicants from Memphis and Shelby County. Paschal referred the borrowers who did not qualify for a prime or FHA loan to the Mortgage Resources division, known as "MORE." MORE originates subprime loans exclusively and does so across the country, including in Memphis and Shelby County. Paschal worked on the same floor of the same building as MORE employees and communicated with them daily.

Jacobson worked for Wells Fargo as a loan officer and then as a Sales Manager from August 1998 until December 2007. Jacobson made subprime loans exclusively and was one of Wells Fargo's top three subprime loan officers nationally year after year, and in some years was

the company's top subprime loan officer in the country. She was based in Maryland but is familiar with Wells Fargo's policies and practices nationally, including in Memphis and Shelby County.

1. Targeting African Americans for Subprime Mortgage Loans

Wells Fargo targeted African Americans in Memphis and Shelby County in different ways. The branch offices' primary goal was to solicit new subprime business, and the former Wells Fargo Memphis employees explain that they targeted their efforts at lists of "leads" who were predominantly and disproportionately African-American. Wells Fargo developed these lists by obtaining information about people who financed purchases like furniture and jewelry at businesses in African-American areas of Memphis and Shelby County and by identifying African Americans who previously had loans with Wells Fargo. Even at branch offices in neighborhoods with many white residents, the vast majority of the leads were African-American.

Credit managers in the branch offices were instructed to contact these predominantly African-American leads to persuade them to apply for new subprime loans with Wells Fargo. Credit managers "cold-called" the leads repeatedly and even showed up at their homes.

Wells Fargo's Memphis branches targeted African Americans for subprime loans because employees held negative views of African Americans. Taylor explains that "[t]he prevailing attitude was that African-American customers weren't savvy enough to know they were getting a bad loan, so we would have a better chance of convincing them to apply for a high-cost, subprime loan."

Likewise, Thomas explains that "[i]t was generally assumed that African-American customers were less sophisticated and intelligent and could be manipulated more easily into a subprime loan with expensive terms than white customers." She heard employees joke about

customers' race and say things like, "You know that guy isn't so smart – is it because he's black?" Elderly African Americans were thought to be particularly vulnerable and so were frequently targeted for subprime loans with high interest rates.

Paschal confirms based on his nationwide lending responsibilities that Wells Fargo targeted its subprime lending in Memphis and Shelby County at African Americans. Paschal explains that Wells Fargo targeted subprime marketing at predominantly African-American zip codes in the City and County, but did not target white zip codes. Paschal also heard employees in the MORE division, which makes subprime loans nationally, comment that white areas are not good for subprime loans.

Another way in which Wells Fargo targeted African Americans was by tailoring its subprime marketing materials on the basis of race. Wells Fargo devised software to print out subprime promotional materials in different languages, one of which it called "African American." A computer screen shot from 2006 showing this option is attached as Exhibit 10. These promotional materials were available to loan officers across the country, including in Memphis and Shelby County. Wells Fargo did not remove the African American "language" option until Tony Paschal complained.

Like the branch employees in Memphis, Wells Fargo's subprime loan officers in the MORE division held derogatory stereotypes of African Americans. This contributed to their targeting of African Americans in Memphis and Shelby County for subprime loans. Paschal heard subprime loan officers from MORE describe African-American and other minority customers as "mud people" and say that "those people have bad credit" and "those people don't pay their bills." They referred to loans in minority communities as "ghetto loans." Paschal's

manager, Dave Zoldak, was promoted even after Paschal complained to management about Zoldak's use of the slur "nigger."

2. Steering Customers into Subprime Loans They Cannot Afford

The former Wells Fargo Memphis employees state that Wells Fargo steered its customers into high-cost subprime loans they could not afford. These loans caused borrowers' financial conditions to deteriorate and needlessly increased the risk that borrowers would lose their homes. The branch offices in Memphis used a range of tactics to steer potential customers into bad subprime loans that the customers could not afford. Each of the former Memphis employees describes these practices as unethical. Employees were pressured to engage in these unethical and predatory practices by upper management even though it was apparent that the practices would cause people to lose their homes.

The leads were the starting point for many of Wells Fargo's predatory practices in Memphis. Credit managers were instructed to focus on leads for whom Wells Fargo had information regarding the value of their house and to get as many of the leads as possible to apply for loans. The managers worked to persuade these potential customers to consolidate different existing debts – such as credit cards, student loans, car loans, and loans for product purchases – into a new high-cost subprime loan secured by their house. Although the existing consumer debt did not place the customers' homes at risk, by consolidating debt in this manner and using the house as collateral, the borrowers now stood to lose their homes should they default on the loan. Employees would deceive customers about these loans by telling them that they were "getting rid of" the existing debts when they were really just refinancing and combining the debts into an expensive subprime loan, but now with the house at risk.

The managers likewise worked to persuade their potential customers to refinance any existing mortgage debt into the new high-cost subprime loan.

In addition to consolidating and refinancing existing debts in a subprime loan, the Memphis branches also jammed new high-cost debts onto their customers' homes. The Memphis employees confirm that Wells Fargo's goal was to get their customers to take on as many loans as possible. If employees convinced someone to consolidate their debts with a subprime home equity loan, for example, they would then try to persuade the borrower to take out an auto loan, too. Both the subprime home equity loan and the auto loan would be secured by the house.

Employees likewise pushed on borrowers new high interest rate credit cards that were secured by the borrower's house. They would bring all the credit card paperwork to the closing on another loan and say that the customer had "qualified" for a "preferred line of credit" as part of a "package deal."

Similarly, employees encouraged borrowers to take cash out of their homes. This would increase the size of their mortgages and make the mortgages more difficult to pay back.

Employees would also pressure borrowers to open a line of credit secured by their home. Some credit managers lied to customers about using the house as collateral, telling them that the line of credit was like an ordinary credit card and not telling them that it was actually a second mortgage secured by the customer's home.

Wells Fargo also solicited customers in the Memphis area by mailing live checks to leads. When deposited, the checks instantly became high interest loans, often with a rate of 20-29%. Wells Fargo would then pursue the people who deposited the checks to talk them into refinancing this loan. The new loan would be yet another subprime loan with an interest rate that

was only marginally lower, and this time the new customer's house would be placed at risk because it would be used as collateral.

The Memphis branches loaded all of this expensive subprime debt onto their customers without regard for whether their customers qualified for the loans or had the capacity to sustain them. Employees affirmatively and aggressively pushed unaffordable loans on customers. Customers were given high-priced subprime loans when they should not have been given any loan. Doris Dancy states that she saw Wells Fargo give subprime loans – sometimes with rates as high as 17% – to people with very poor credit scores and very high debt-to-income ("DTI") ratios. Dancy says that she "would shake my head in disbelief and ask myself, 'how could this happen?'"

Even though Wells Fargo's own rules prohibited loans with a DTI ratio above 50%, it violated these rules to make loans to customers with higher DTI ratios, even to customers with low credit scores. Mario Taylor was told to disregard customers' ability to repay loans and just "get the documents from them so we can send the deal up."

Likewise, the Memphis branches made loans with exorbitant loan-to-value ("LTV") ratios. First mortgage LTV ratios went as high as 110% and second mortgage LTV ratios went as high as 132%. Auto loan LTV ratios went as high as 160% because customers were not required to make any down payment and were given a large portion of the loan as a cash payment. These auto loans were secured by customers' homes.

Employees would deceive customers into believing they could repay these loans. One way was by only telling customers what their monthly payment would be under an initial "teaser rate." Rates on loans with teaser rates were adjustable and could go up significantly and become

unaffordable, but employees were instructed not to tell customers that the rate was adjustable. They would simply say, "This is your monthly payment."

The loans became even more harmful to Wells Fargo's customers – and more profitable for Wells Fargo – because employees included expensive add-ons that only benefited the company. For example, employees were instructed to include a "Home/Auto Security Plan" with many loans. This costly insurance product did not benefit the customer but drove up the price of the loan. Wells Fargo presented it as a necessary part of the loan even though it was actually optional.

Employees likewise pressured customers to buy other insurance products, such as life and health insurance, even if they already had sufficient insurance. Simpson states that the district manager, to whom he and the other branch managers reported, told subordinates to include as many features as possible with every loan, no matter what.

Many loans also included an exorbitant fee of four points, or 4% of the loan amount, as part of the closing costs. These points were profit for Wells Fargo.

The Memphis branches made these high-cost subprime loans without regard to whether their customers qualified for better loans. Even if a customer could qualify for a lower-priced loan, it was not offered. Wells Fargo had software that was supposed to filter loans to make sure applicants were offered the best loans for which they qualified, but the filters were regularly evaded and did not work. Employees knew how to manipulate the application data so that the filters would allow them to sell the higher-priced subprime loans instead.

The managers also misled their customers so they could sell them costly subprime loans instead of better loans for which they qualified. One way they did this was by encouraging borrowers to apply for "stated income" loans instead of submitting income documentation, even

though the borrowers were willing and able to provide the documentation. They did not tell borrowers this would disqualify them from getting a less expensive loan. Thomas explains that another technique used by managers to conceal what they were really doing from their clients was to talk quickly and shuffle lots of paper.

In addition to deceiving customers, employees in the Memphis branches deceived underwriters by falsifying documents. For example, white-out was used on pay records to change borrowers' incomes. When Thomas objected to the practice of falsifying income records, a branch manager responded, "we gotta do what we gotta do." Similarly, managers deliberately used inflated appraisals that they knew were not accurate to manipulate LTV calculations. Some managers falsified the mileage on car loan applications. These practices made it look like loans satisfied eligibility requirements when, in fact, they did not.

The Wells Fargo Memphis employees further state that Wells Fargo employees engaged in these abusive, predatory practices because they were both incentivized and pressured into doing so. Managers received large commissions and bonuses of up to $10,000 a month for meeting Wells Fargo's quotas for subprime loans. Managers who failed to meet their quota were put on probation or written up. District managers used this system to pressure credit managers into making loans that should not have been made. Wells Fargo created an atmosphere in the Memphis branch offices in which unethical practices were condoned and encouraged.

Some Memphis employees objected to Wells Fargo's predatory subprime lending practices, refused to engage in them, and raised their concerns with upper management. Nonetheless, the practices and the pressure to perpetrate them remained. Employees who objected to the practices were disfavored for promotion.

Based on their national and local experience, Jacobson and Paschal confirm that Wells Fargo engaged in predatory practices in Memphis and Shelby County, including steering borrowers who qualified for prime loans into subprime loans. They explain that Wells Fargo gave loan officers substantial financial incentives and the discretion to steer borrowers in this manner. Paschal was instructed by management to refer borrowers who could have qualified for more advantageous prime or FHA loans to the subprime unit. He was even reprimanded for giving too many people FHA loans instead of referring them for subprime loans.

One of the borrowers who Paschal was instructed to steer into a subprime loan was an African American from Memphis. The borrower had excellent credit but had been given a subprime 2/28 adjustable rate loan by Wells Fargo two years earlier. He wanted to refinance that loan to keep his monthly payment from suddenly rising. He qualified for a prime fixed-rate refinance loan, but Paschal's manager instructed him to give the borrower another adjustable rate subprime loan instead. Paschal refused and was disciplined as a result.

Although Jacobson was based in Maryland, she regularly communicated with and traveled to meet with Wells Fargo employees from across the country. She is knowledgeable about Wells Fargo's mortgage policies and practices nationally, including their application in Memphis and Shelby County. Jacobson states that Wells Fargo created very substantial financial incentives to steer people into subprime loans. "A reps," who made prime loans, generally made more money in referral fees by referring a person with prime credit to a subprime loan officer than by originating a prime loan. Subprime loan officers, whose pay was based on commissions and fees, likewise made more money by originating loans with higher interest rates and fees. Paschal describes the effect of Wells Fargo's compensation system for subprime loans as putting "bounties" on minority borrowers.

Wells Fargo also gave lavish gifts and trips to successful subprime loan officers, even as foreclosures increased in recent years. This was part of a culture, confirmed by Paschal and Jacobson, that focused only on making the most money possible and not on putting borrowers in loans that were appropriate for them.

Jacobson and Paschal also confirm that loan officers were able to steer people with good credit into subprime loans because Wells Fargo gave them broad discretion. Jacobson knows from regularly communicating with Wells Fargo employees around the country that in Memphis and Shelby County, Wells Fargo's underwriting guidelines and pricing rules gave ample discretion to A reps to allow them to steer customers who qualified for prime loans into subprime loans by referring them to subprime loan officers. She confirms that the subprime loan officers then had discretion to offer the customers higher-priced products.

Jacobson and Paschal explain that Wells Fargo loan officers developed a multitude of unscrupulous ways to apply their discretion to get away with steering subprime loans to people who qualified for prime or FHA loans. One method was to intentionally mislead customers by, for example, giving "stated income" loans to customers who could document their income (a practice also described by Camille Thomas), or telling customers not to make a down payment or to take more cash from their home equity, which would automatically cause a prime loan to "flip" into a subprime loan. Another was to intentionally mislead underwriters by saying that the customer chose not to provide documentation in support of a loan application, did not have verified assets, or wanted to close the loan quickly. Loan officers used such techniques to increase their commissions while discriminating against minority applicants. These techniques were applied by loan officers responsible for serving Memphis and Shelby County.

In 2004 Wells Fargo responded to public criticism by creating the "filters" discussed above that were supposed to prevent the steering of prime customers into subprime loans. Jacobson and Paschal confirm the former Memphis employees' statements that it was widely understood that the filters were not effective. Loan officers learned many ways to work around the filters by using the broad discretion they were afforded by Wells Fargo. These techniques were widely used. Senior managers were aware of their use and eventually made certain changes in response, but the loan officers continued to easily undermine the filters. The filters were also ineffective because Wells Fargo did not create disincentives to steering prime customers into subprime loans. To the contrary, employees continued to have substantial financial incentives to engage in such steering and continued to do so.

Wells Fargo's steering practices and techniques were applied regularly in Memphis and Shelby County and caused many customers who qualified for prime or FHA loans to receive subprime loans. Borrowers who were steered in this manner could be identified by reviewing Wells Fargo's loan files for loans in Memphis and Shelby County.

3. Other Abusive Subprime Lending Practices Engaged in by Wells Fargo

The former Wells Fargo employees further state that Wells Fargo routinely misled and deceived its customers in order to raise the cost of their loans. Dancy, Simpson, Taylor, and Thomas all explain the many ways this was done by the Memphis branches.

One way was by failing to inform borrowers that their loans had adjustable rates, which could cause their monthly payments to increase dramatically. When borrowers knew their rate was adjustable, credit managers would promise that the loan could be refinanced before the rate increased, even though they knew there was a good chance that the borrower would not be able to refinance the loan.

Memphis employees were also instructed to deceive customers about the addition of sizable closing costs and fees to their loans. These were added to increase Wells Fargo's profit, not to benefit the borrower.

Credit managers at Memphis branches also told borrowers that interest rates were locked prior to closing when they were not. This prevented borrowers from taking advantage of declining interest rates.

Employees were not supposed to inform customers about the details of their loans, telling them instead only the bottom-line monthly payment. For example, borrowers were not informed about the inclusion and significance of onerous prepayment penalties in the terms and conditions of their loans. Prepayment penalties typically made it difficult for borrowers to refinance into new and better loans. When the subject was raised, borrowers were told that prepayment penalties could be waived, even though this was not true.

The former Wells Fargo employees confirm that employees were given substantial discretion to increase the costliness of subprime loans and that they regularly used this discretion at the expense of subprime borrowers. Credit managers and loan officers had broad discretion to set the pricing, points, and fees for subprime loans. Even when Wells Fargo created some limits in 2007, employees retained significant discretion. Employees had strong financial incentives to increase the pricing, points, and fees because it would increase their commissions.

Employees also used their discretion to discriminate against minority borrowers in Memphis and Shelby County by not offering them Wells Fargo's newer and better loan products. Those products had lower fixed interest rates and fees than the products that were offered to minority borrowers.

Wells Fargo also qualified adjustable rate subprime loans in Memphis and Shelby County as if the borrower would be paying the teaser rate for the life of the loan instead of just the first two or three years. This means that it was or should have been apparent to Wells Fargo from the outset that many of the people to whom it gave adjustable rate mortgages did not have the ability to repay those loans. Foreclosures are a predictable result of this practice.

Dancy, Simpson, Taylor, and Thomas all found Wells Fargo's subprime lending practices to be unethical and all quit their jobs voluntarily to find other employment. Dancy explains that the practices were so bad that she would cry at the end of the day. She left to find a job "where I could feel good about what I was doing."

B. Publicly Available Home Mortgage Disclosure Act Data Shows that Wells Fargo's High-Cost Loans Are Disproportionately Located in African-American Neighborhoods in Memphis and Shelby County

Publicly available data reported by Wells Fargo to federal regulators pursuant to the Home Mortgage Disclosure Act ("HMDA") shows that from 2004 to 2008, Wells Fargo made high-cost loans (*i.e.*, loans with an interest rate that was at least three percentage points above a federally-established benchmark) to 51% of its African-American mortgage customers in Shelby County, but only 17% of its white customers in the County. In Memphis, it made high-cost loans to 63% of its African-American customers but to only 26% of its white customers. (HMDA data for 2009 is not yet available.)

Racial disparities in the pricing of Wells Fargo's mortgage loans are confirmed by a study released last year.[32] The study found that the disparity actually increased at higher income levels.[33]

The map attached as Exhibit 11 shows the geographic distribution of high-cost loans in African-American and white neighborhoods in Memphis and Shelby County. The map

demonstrates that Wells Fargo's high-cost loans are disproportionately located in Memphis' and Shelby County's African-American neighborhoods. The fact that Wells Fargo's high-cost loans are more heavily concentrated in Memphis' and Shelby County's African-American neighborhoods is consistent with the practice of reverse redlining and, upon information and belief, has contributed significantly to the disproportionately high rate of foreclosure in Memphis' and Shelby County's African-American communities.

The stark disparity in the location of Wells Fargo's high-cost or subprime mortgage loans in Memphis and Shelby County is especially disturbing when one considers the location of Wells Fargo's low-cost or prime mortgage loans. Almost 70% of those loans are located in predominantly white neighborhoods, which encompass 38.3% of the County's households, while only 6.9% of the loans are in predominantly African-American neighborhoods, which encompass 30.2% of County households. In other words, while Wells Fargo is targeting African-American neighborhoods for predatory subprime loans that disproportionately lead to foreclosure, it is also failing to allow residents of African-American neighborhoods to have access to prime loans. Wells Fargo is simultaneously engaged in reverse redlining and redlining of minority neighborhoods, exacerbating the harm caused by each unlawful practice. The map attached as Exhibit 12 demonstrates Wells Fargo's failure to make prime credit available in African-American neighborhoods.[34]

V. The Nature of the Injuries Suffered by Memphis

The foreclosures caused by Wells Fargo's discriminatory reverse redlining practices have caused, and continue to cause, multiple types of injuries to Memphis and Shelby County, including:

a. A significant decline in the value of homes that are in close proximity to the Wells Fargo foreclosure properties, resulting in a decrease in property tax revenue;

b. Increased expenditures for police and fire responses to Wells Fargo foreclosure properties that have become vacant and have turned into centers for squatting, drug use, drug distribution, prostitution, and other unlawful activities;

c. Increased expenditures to secure, stabilize, clean, acquire, and rehabilitate Wells Fargo foreclosure properties;

d. Additional expenditures for administrative, legal, and social services in connection with notices of foreclosure at Wells Fargo properties.

A. Memphis and Shelby County Have Been Injured by Having to Provide Costly Municipal Services at Properties in African-American Neighborhoods as a Direct Result of Discriminatory Loans Originated by Wells Fargo

Wells Fargo foreclosure properties that become vacant result in injuries that are especially costly to Memphis and Shelby County. Vacancies cause, among other harms, squatters, increased risk of crime and fire, and infrastructure damage such as burst water pipes and broken windows. Expensive responses by Memphis and Shelby County are required to address these harms at Wells Fargo foreclosure properties. The costs incurred by the City and County are the direct result of the foreclosures on Wells Fargo loans.

Even when a house is not vacant, foreclosures cause serious housing code violations. These violations likewise require expensive responses by the City and County. The costs of responding to these violations are also the direct result of the foreclosures on Wells Fargo loans. Housing code violations caused by Wells Fargo foreclosures occur disproportionately in predominantly African-American neighborhoods. These violations include environmental

problems, properties in need of repair, properties with structural damages, and properties that are extremely dilapidated. The City and County must respond to all of these problems.

The costs of taking these actions for each Wells Fargo foreclosure property constitute specific damages caused by Wells Fargo's illegal lending practices. Memphis and Shelby County will have to continue to provide increased municipal services at these properties in the future, particularly with respect to the many that remain vacant. Damages suffered by Memphis and Shelby County as a result of vacancies resulting from Wells Fargo's foreclosures at Wells Fargo properties are fully capable of empirical quantification.

Examples of the City and County's injuries related to specific representative properties are described in greater detail in paragraphs 149-198 of Memphis and Shelby County's First Amended Complaint against Wells Fargo.

B. Memphis and Shelby County Have Been Injured by a Reduction in Property Tax Revenues Caused by Wells Fargo Foreclosures

Wells Fargo foreclosure properties, and the problems associated with them, likewise cause especially significant declines in property values because the neighborhoods become less desirable. This reduces the property tax revenues collected by the City and County. Property tax losses suffered by Memphis and Shelby County as a result of vacancies resulting from Wells Fargo's foreclosures are fully capable of empirical quantification.

Routinely maintained property tax and other data allow for the precise calculation of the property tax revenues lost by Memphis and Shelby County as a direct result of particular Wells Fargo foreclosures. Using a well-established statistical regression technique that focuses on effects on neighboring properties, the City and County have isolated the lost property value attributable to each individual foreclosure or vacancy from losses attributable to other causes, such as neighborhood conditions. This technique, known as hedonic regression when applied to

housing markets, isolates the factors that contribute to the value of a property by studying thousands of housing transactions. Those factors include the size of a home, the number of bedrooms and bathrooms, whether the neighborhood is safe, whether neighboring properties are well-maintained, and more. Hedonic analysis determines the contribution of each of these house and neighborhood characteristics to the value of a home.

The number of foreclosures in a neighborhood is one of the neighborhood traits that hedonic analysis can examine. Hedonic analysis allows for the calculation of the impact of the first foreclosure in close proximity (*e.g.*, ⅛ or ¼ of a mile) on a property's value, the average impact of subsequent foreclosures, and the impact of the last foreclosure.

Foreclosures attributable to Wells Fargo in Memphis and Shelby County have been analyzed through hedonic regression to calculate the resulting loss in the property values of nearby homes. This loss has been distinguished from any loss attributable to non-Wells Fargo foreclosures or other causes. The loss in property value in Memphis and Shelby County attributable to Wells Fargo's unlawful acts and consequent foreclosures has been used to calculate Memphis' and Shelby County's corresponding loss in property tax revenues.

Recent studies establish that hedonic regression can be used for this purpose. A study published by the Fannie Mae Foundation, using Chicago as an example, determined that each foreclosure is responsible for an average decline of approximately 1.1% in the value of each single-family home within an eighth of a mile.[35]

Other studies have focused on the impact of abandoned homes on surrounding property values. A recent study in Philadelphia, for example, found that each home within 150 feet of an abandoned home declined in value by an average of $7,627; homes within 150 to 299 feet declined in value by $6,810; and homes within 300 to 449 feet declined in value by $3,542.[36]

Application of a hedonic regression methodology like the methodologies employed in these studies to data regularly maintained by Memphis and Shelby County has been used to quantify precisely the property tax injury to the City and County caused by Wells Fargo's discriminatory lending practices, including but not limited to those described above, and the Wells Fargo foreclosures that are the direct result of those practices.

VI. What Memphis and Shelby County Hope to Accomplish with Their Lawsuit against Wells Fargo

The City of Memphis filed a lawsuit on December 30, 2009, against Wells Fargo Bank, N.A., and two Wells Fargo subsidiaries to recover damages caused by Wells Fargo's discriminatory lending practices. The City's co-plaintiff is Shelby County. The lawsuit is captioned *City of Memphis v. Wells Fargo Bank, N.A.*, No. 2:09-cv-02857-STA-dkv (W.D. Tenn.). Memphis and Shelby County filed a First Amended Complaint on April 7, 2010, adding detailed information provided by the former Wells Fargo Memphis employees discussed above and detailed information about damages.

The lawsuit includes two causes of action. First, Memphis and Shelby County allege that by engaging in a pattern or practice of targeting deceptive, predatory, or otherwise unfair lending practices at African-American neighborhoods in the City and County – that is, by engaging in reverse redlining – Wells Fargo has violated the federal Fair Housing Act, 42 U.S.C. § 3601 *et seq.* Second, the suit alleges that these lending practices themselves violate the Tennessee Consumer Protection Act of 1977, Tenn. Code Ann. § 47-18-101 *et seq.*

It is our hope that this lawsuit will result in compensation for the damage Wells Fargo's predatory practices have caused our City and County, and create a catalyst for new lending programs and initiatives that will benefit our hardest hit neighborhoods and citizens.

Wells Fargo must begin by providing compensation to the City and County for the specific property costs we have incurred at Wells Fargo foreclosed properties. We also seek compensation for lost tax revenue that is directly and provably attributable to concentrations of Wells Fargo foreclosures in minority neighborhoods across Memphis and Shelby County. These funds will work to the benefit of our residents by restoring costs that the City and County have been forced to bear as a result of Wells Fargo's illegal lending practices. Shouldering these costs has depleted much needed funds that would otherwise have been spent to improve the lives of our residents in many necessary and important ways. We will use the funds we recover to help those residents who have lost their homes, or are in imminent danger of losing their homes.

But this case is about a lot more than recovering damages. If Wells Fargo is going to become a true partner with us in repairing the damage it has caused, new lending programs are required. The steps we would like to see Wells Fargo take as part of a just resolution of our lawsuit include the following:

- Make low cost home mortgage loans available across the City and County, with special focus on marketing these affordable loans in our hardest hit minority neighborhoods. This will create new housing opportunities for those who have lost their homes as a result of predatory practices.

- Modify existing loans for select borrowers who are in danger of losing their homes to foreclosure by writing down principal, adjusting loan terms, and reducing interest rates.

- Provide support for financial literacy programs at housing advocacy organizations that work in our underserved neighborhoods.

- Rehab Wells Fargo foreclosed properties and donate them to the City and County to provide housing to residents who have lost their homes.

- Construct new Wells Fargo storefronts in underserved neighborhoods to serve as "Loan Modification Centers" where borrowers in need of assistance in preventing foreclosure can obtain counseling and assistance.

These programs are just a few of the steps that Wells Fargo can and should take to help redress the damage that its actions have caused the City, County and its residents. Going forward we hope that this lawsuit will lead to a true partnership not just between Wells Fargo and the City and County, but also with other lenders who have profited from our community at the expense of our residents.

I hope this lawsuit will also serve to spur much needed enforcement action against predatory lenders who have targeted minority communities for abusive practices. Cities like Memphis need assistance from Assistant Attorney General Tom Perez at the Justice Department, as well as State Attorneys General with jurisdiction over the activities of lenders like Wells Fargo. Working together, we have the ability to ensure that homeowners are protected, new programs enacted, and compensation paid to those who have been wronged.

Finally, I hope our efforts will spur action by the United States Congress, after these hearings, on behalf of Americans in my city and across America who have been made to suffer and endure as the American Dream of "home ownership" is ripped from their grasp by unscrupulous and predatory lenders. Many families, many Memphians, and many Americans have been forced out of their homes by unfair loans with unreasonable terms that in the end virtually guaranteed failure and foreclosure. Congress has the power and the duty to fashion a remedy for these victims because they personify an American Dream that is truly too important to let fail.

Time is of the essence. Every day that we delay the effect of the damage inflicted by lenders like Wells Fargo gets worse. We filed our lawsuit because we believe the time for action is now. We hope others will follow our lead.

Thank you for allowing me to share these views with the Subcommittee.

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[1] *See, e.g.*, *Barkley v. Olympia Mortgage Co.*, No. 04-cv-875, 2007 WL 2437810 (E.D.N.Y. Aug. 22, 2007); *Hargraves v. Capital City Mortgage Corp.*, 140 F. Supp. 2d 7 (D.D.C. 2000).

[2] HUD & Treasury, *Curbing Predatory Home Mortgage Lending* (2000) at 72 (available at http://www.huduser.org/Publications/pdf/treasrpt.pdf).

[3] *Id.*

[4] James H. Carr & Lopa Kolluri, Fannie Mae Foundation, *Predatory Lending: An Overview* (2001) (available at http://www.cra-nc.org/financial.pdf).

[5] *Id.* at 37.

[6] *Id.*

[7] National Community Reinvestment Coalition, *The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age – Subprime Lending in Ten Large Metropolitan Areas* (2003) (available at http://www.ncrc.org/images/stories/pdf/research/ncrediscrimstudy.pdf).

[8] *Id.* at 6, 24-25.

[9] *Id.* at 19-20, 25.

[10] *Id.* at 31-34.

[11] HUD, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (2000) at 4-5 (available at http://www.huduser.org/Publications/pdf/unequal_full.pdf).

[12] *Id.* at 4 (emphasis in original).

[13] HUD/Treasury Report at 105.

[14] Calvin Bradford, Center for Community Change, *Risk or Race? Racial Disparities and the Subprime Refinance Market* (2002) at vii-ix (available at http://www.knowledgeplex.org/redir.html?id=1032&url=http%3A%2F%2Fwww.knowledgeplex.org%2Fkp%2Freport%2Freport%2Frelfiles%2Fccc_0729_risk.pdf).

[15] Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* (2006) (available at http://www.responsiblelending.org/mortgage-lending/research-analysis/rr011-Unfair_Lending-0506.pdf).

[16] *Id.* at 3, 9.

[17] *Id.* at 9.

[18] *Id.*

[19] *Id.* at 16.

[20] *Id.*

[21] *Id.* at 17.

[22] *Id.*

[23] Center for Responsible Lending, *Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans* (2005) (http://www.responsiblelending.org/mortgage-lending/research-analysis/rr004-PPP_Minority_Neighborhoods-0105.pdf).

[24] *Id.* at 5, App.-1.

[25] *Id.* at 1-2.

[26] *Id.* at 7.

[27] Howell E. Jackson & Jeremy Berry, "Kickbacks or Compensation: The Case of Yield Spread Premiums" (2002) (available at http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf).

[28] *Id.* at 7, 122-23 & n.147.

[29] *Id.* at 9, 125.

[30] *Id.* at 127.

[31] Center for Responsible Lending, *A Review of Wells Fargo's Subprime Lending* (Apr. 2004) at 10 (available at http://www.responsiblelending.org/mortgage-lending/research-analysis/ip004-Wells_Fargo-0404.pdf).

[32] National People's Action, *The Truth About Wells Fargo: Racial Disparities in Lending Practices* (2009) at 2 (available at http://www.npa-us.org/downloads/truthaboutwellsfargo.pdf).

[33] *Id.*

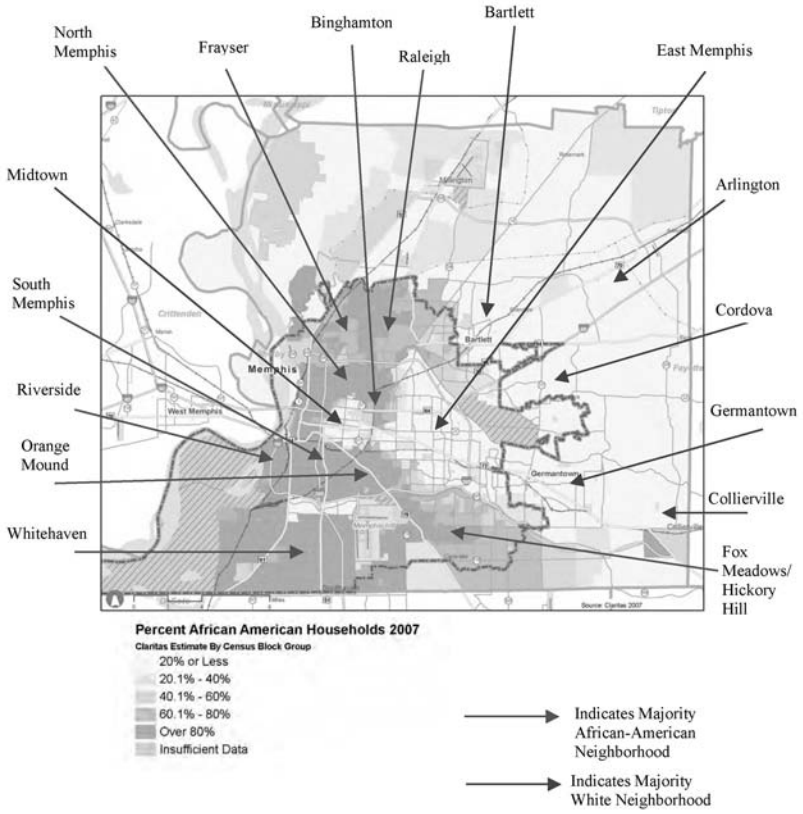
[34] There is substantial additional evidence that Wells Fargo has been engaged in reverse redlining in Memphis and Shelby County. This includes evidence concerning Wells Fargo's pricing sheets, pricing practices in Philadelphia, use of adjustable rate mortgages with "teaser" rates, and interest rate caps on adjustable rate mortgages, as well as the length of time between origination and foreclosure on Wells Fargo loans. This evidence is described in Memphis and Shelby County's First Amended Complaint against Wells Fargo, which is discussed in section VI of this statement.

[35] *See* Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 Housing Policy Debate 57 (2006) at 69.

[36] Anne B. Shlay & Gordon Whitman, *Research for Democracy: Linking Community Organizing and Research to Leverage Blight Policy*, (2004) at 21.

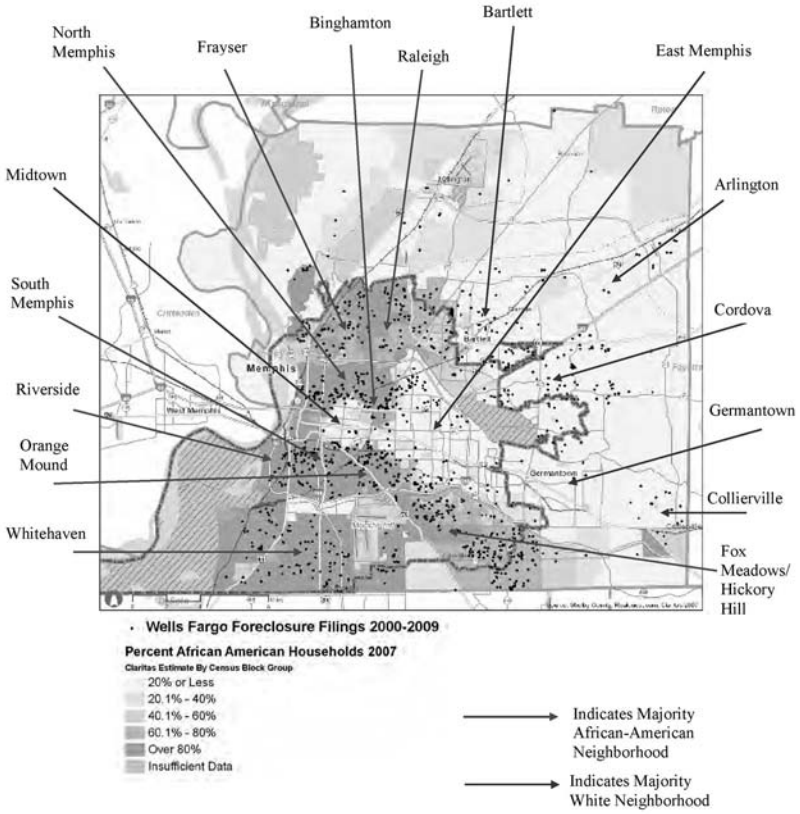
EXHIBIT

1


North Memphis
Frayser
Binghamton
Raleigh
Bartlett
East Memphis
Midtown
Arlington
South Memphis
Cordova
Riverside
Germantown
Orange Mound
Collierville
Whitehaven
Fox Meadows/ Hickory Hill
Memphis
Bartlett
Germantown
Percent African American Households 2007
Claritas Estimate By Census Block Group
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Insufficient Data
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

EXHIBIT

2


North Memphis
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East Memphis
Midtown
Arlington
South Memphis
Cordova
Riverside
Germantown
Orange Mound
Collierville
Whitehaven
Fox Meadows/ Hickory Hill
Memphis
Wells Fargo Foreclosure Filings 2000-2009
Percent African American Households 2007
Claritas Estimate By Census Block Group
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Insufficient Data
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

EXHIBIT

3

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

CITY OF MEMPHIS and SHELBY COUNTY, Plaintiffs, v. WELLS FARGO BANK, N.A., WELLS FARGO FINANCIAL TENNESSEE, INC. and WELLS FARGO FINANCIAL TENNESSEE 1, LLC, Defendants.	)	Case No. 2:09-cv-02857-STA-dkv

DECLARATION OF DORIS DANCY

1. I, Doris Dancy, hereby attest that I am over the age of eighteen and I am competent to testify with respect to the matter below.

2. In July 2007, I was hired by Wells Fargo Financial ("Wells Fargo") as a credit manager. I worked in that capacity for Wells Fargo until January 2008 when I voluntarily left the company to seek other employment.

3. I worked at the branch office located at 5041 Park Avenue in Memphis for the entire time that I was employed at Wells Fargo.

4. As a credit manager, my job was to find as many potential borrowers for Wells Fargo as possible. I spent almost all of my time calling people from a list of "leads" provided to me. We were put under a lot of pressure to call these individuals repeatedly and encourage them to come into the office to apply for a loan.

5. Most (eighty percent (80%) or more) of the leads on the lists I was given were African American. I know this both from meeting these individuals, and from talking with them on the telephone. The people on the list of leads did not represent a random cross-section of the people who lived in the area around the branch office, because our office was located in an area where a lot of white people lived.

6. I know that Wells Fargo got many of these leads from lists of their previous borrowers who had car loans, home equity loans, or credit cards with Wells Fargo. We were supposed to try and refinance these individuals into new, expensive subprime loans with high interest rates and lots of fees and costs. The way we were told to sell these loans was to explain that we were eliminating the customer's old debts by consolidating their existing debts into one new one. This was not really true – we were not getting rid of the customer's existing debts; we were actually just giving them a new more expensive loan that put their house at risk.

7. Many of the leads had files that contained a fair bit of information about the borrower. I remember that my aunt, who had a home equity loan with Wells Fargo, once showed up on a call list in my office. When I typed her name into my computer, I was able to see all kinds of information about her, including the value of her home, her credit score, place of employment, and address.

8. Our district manager pressured the credit managers in my office to convince our leads to apply for a loan, even if we knew they could not afford the loan or did not qualify for the

loan. I was pressured into trying to get customers with credit scores as low as 504, and debt-to-income ("DTI") ratios of well above 50%, to apply for loans that I knew they could not afford and would not be able to pay back. I knew all this information about the customer before I even called them. I thought this was an unethical and dirty practice because I knew it was going to cause folks to lose their homes. To my shock, many of the people whom I saw with very bad credit scores and high DTI ratios walked out of the office with approved subprime loans at interest rates of 11% or 12% or even 13%. Some interest rates went as high as 17%. I would shake my head in disbelief and ask myself, "how could that happen?"

9. I was particularly upset at seeing customers with low credit scores and debt-to-income ratios above 50% being put into high interest rate subprime loans. I know that Wells Fargo violated its own underwriting guidelines in order to make loans to these customers. According to Wells Fargo's own rules, loans were not supposed to exceed a DTI ratio of 50%, and credit scores were supposed to be at least in the 580 to 600 range.

10. We were told to make as many loans to a customer as we could. Even if we were able to get the customer to apply for a home equity loan, we were also supposed to try to sell them a car loan. I saw customers placed in car loans with very high interest rates. Some of the car loans were at 100% LTV (no down payment) and the customers were given cash back on top of that. And in some cases, even after consolidating a customer's existing debt (including credit card debt) with a new high interest rate home equity loan, we were told to give the customers a *new* Wells Fargo credit card with a high interest rate on top of all the other loans. I thought this was a particularly dirty practice because it meant the customer was destined to get behind once again with revolving debt – this time from the Wells Fargo credit card – and now their home would be put at risk.

11. Another practice that I thought was especially unethical was the use of "live" draft checks. Wells Fargo would mail checks in the amount of $1,000 or $1,500 to leads. Once these checks were deposited or cashed, they instantly became loans with Wells Fargo at very high interest rates. Individuals who cashed these checks became an instant "lead" target for a home equity refinance loan, which of course would end up placing the borrower's home at risk.

12. Although I never witnessed it myself, I heard from other employees that some branch managers falsified information in order to get customers to qualify for subprime loans.

13. Many customers were told that they needed to purchase a Home/Auto Security Plan ("HASplan"), which added extra costs on to their loan. Wells Fargo told us to do this because it made the bank more money. The customers were not told that the HASplan was actually optional, and that it offered the borrower no additional value.

14. Many of the mostly African American customers who came into the office were not experienced in applying for loans. They did not understand a lot of the terms of the loans that managers wanted us to get them to apply for. Our district manager told us to conceal the details of the loan. He thought that these customers could be "talked into anything." The way he pressured us to do all of these unethical things was as aggressive as a wolf. There was no compassion for these individuals who came to us trusting our advice.

15. I tried to do right by my customers and would be honest with them about what they were getting themselves into. My district manager did not like this. He used the bonus system to pressure me to make loans that I thought should not be made. I received only one bonus, and that was for just $175. I know other managers made much bigger bonuses than this.

16. After six months working at Wells Fargo I decided that the practices were too unethical for me to participate in any longer. I hated to go to work, and found myself crying at

the end of the day. In January 2008 I voluntarily left Wells Fargo to find different employment where I could feel good about what I was doing.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: February 17, 2010

BY: Doris Dancy
Doris Dancy

EXHIBIT

4

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

CITY OF MEMPHIS and SHELBY COUNTY, Plaintiffs, v. WELLS FARGO BANK, N.A., WELLS FARGO FINANCIAL TENNESSEE, INC. and WELLS FARGO FINANCIAL TENNESSEE 1, LLC, Defendants.	)	Case No. 2:09-cv-02857-STA-dkv

DECLARATION OF MICHAEL SIMPSON

1. I, Michael Simpson, hereby attest that I am over the age of eighteen and I am competent to testify with respect to the matter below.

2. I was hired by Wells Fargo Financial ("Wells Fargo") in November 2002 as a credit manager. After approximately a year and a half I was promoted to branch manager. I worked in that capacity for Wells Fargo until January 2008 when I voluntarily left the company to seek other employment.

3. I worked at the branch office located at 5041 Park Avenue in Memphis for the entire time that I worked at Wells Fargo.

4. I decided to go into the lending business because I wanted to help people and I thought this would be a good way to do it. Around the time that I was promoted to branch manager, I began to feel a lot of pressure from managers above me to participate in what I thought were unethical lending practices. I resisted this pressure as best I could, and in many instances refused to engage in practices that I thought were wrong. I know that others in the company went along with what the management wanted and participated in what I considered were unethical and deceptive lending activities.

5. We generated new potential customers by cold calling people from lists of "leads." Leads were generated by buying lists of customers who had financed the purchase of goods, like furniture or jewelry, at area stores. We would contact these individuals to see if we could get them to refinance their loans with us. We were encouraged to try and get these customers to consolidate all of their existing debt – credit card, auto loans, and other small loans on product purchases – with a new subprime loan through Wells Fargo. In many cases these new loans would be done through a home equity product that used the borrower's house as collateral for the loan.

6. The leads were inputted in a system called "E-leads." This was an electronic database of previous or existing Wells Fargo customers who already had a credit card, an auto loan, or some other type of loan with us. We would cold call these customers as well for the purpose of trying to get them to refinance their loans and consolidate their debt.

7. Credit managers were instructed to pursue customer leads with credit scores in the 500 to 680 FICO range, and for whom there was file information about the value of their house.

The assumption was that these would be ideal subprime loan customers. Based on my experience and observation, I would not be surprised if the customer leads in this FICO range were disproportionately African American.

8. There were a number of loan products and practices that I did not like and thought were wrong. While I was at Wells Fargo, the company was very aggressive about pushing an auto loan product that permitted the customer to borrow up to 160% of the car's value (e.g., 160% loan-to-value ratio or "LTV") at interest rates as high as 24%. I felt this product offered no benefit to the customer, and I refused to offer it. My objection to this product may have prevented me from being promoted above branch manager. We would later refinance these extremely high interest rate car loans at marginally lower subprime rates, many times using the borrower's house as collateral. This, of course, put the borrower's house at risk if the borrower got behind on loan payments.

9. I know that some Wells Fargo managers falsified the mileage on car loan applications so that the loan would be approved. This was done by listing the mileage on the car as lower than it actually was, and putting that false information in the loan file. This allowed the car loan to be both approved, and approved for a larger loan amount. Managers did this because they could get a bigger bonus if they completed more car loans. Twenty to thirty percent of the upper management (branch managers and district managers) knew that mileage records were being falsified. They just turned the other way. I know that one of my district managers knew that this was going on.

10. Wells Fargo was very aggressive in its mortgage lending. We were encouraged to make 110% LTV loans to customers with 680 FICO scores with interest rates between 10 and 13%. Debt-to-income ("DTI") ratios for these borrowers went as high as 55%. Some of our

second lien loans allowed LTVs as high as 132%. With credit profiles like this, it was not surprising to me that many borrowers would eventually default on their loans, given their existing debts. Wells Fargo turned a blind eye and made the loans anyhow. Often it was not just a matter of consolidating the borrower's existing debts and putting their house at risk, the sales process also involved jamming new debt on the borrower by getting them to take cash out or giving them a new credit card. In my view, this was like giving an alcoholic a beer. Wells Fargo did it because the loans were very profitable. We made an automatic 4 points (or four percent of the loan amount) as a fee at the time of closing.

11. My district manager instructed us to run every loan with as many features as possible, no matter what. This meant more profit for the company on each loan we made. For example, we were instructed to add the Home/Auto Security plan ("HASplan") on every car loan. This was a gimmick product and a rip-off. A large portion of the cost of the HASplan was profit for Wells Fargo. Managers were instructed to tell the customer that the HASplan came with the loan, when the truth was it was both optional and an unnecessary expense for the borrower.

12. We were also instructed to sell insurance plans, such as life and health insurance, with the loans we made. There was a lot of pressure to sell these plans, regardless of whether the customer needed them or not. I objected to the fact that many of these plans were pushed on customers who already had perfectly good insurance. Management made clear that branch managers would not advance unless they aggressively pushed these insurance plans on every customer.

13. I told my team to disclose all fees that the customer would have to pay at closing on the loan. I know, however, that managers were encouraged to tell customers that there were

no out-of-pocket fees, and no closing costs. Of course, this was not true. Many loans had an automatic fee of 4 points, or 4% of the loan amount, attached as a closing cost. This was highly profitable for Wells Fargo.

14. Credit managers and assistant managers were encouraged to tell customers with high interest rate loans that they should not worry because they could apply to refinance their loan later at a lower rate. This practice could be very deceptive.

15. Managers, including my district manager, instructed us to push "package deals." This meant, for example, that we were supposed to have the paperwork for a new high interest rate Wells Fargo credit card all done and set to go at the time we closed the loan. Then we were to tell the customer at closing that they had "qualified" for a "preferred line of credit" to encourage them to sign up for the card.

16. I know that some managers falsified information in the loan files, such as income documentation, in order to get loans approved. I have personal knowledge of managers who participated in this type of fraud.

17. From the time I came to Wells Fargo until about 2007, the company targeted customers in the 500 to 600 FICO range for "draft checks." These were checks that were mailed directly to customers, and once cashed, became a loan at rates as high as 29%. Cashing the check allowed us to identify the individual. We would then target these individuals for refinance loans at new, marginally lower subprime rates. These refinance loans would use the borrower's house as collateral for the loan and put the house at risk if the borrower could not make the payments on the loan. I know of instances where individuals other than the intended recipient cashed the check, leaving the unknowing addressee of the check on the line for the high interest loan.

18. The culture at Wells Fargo supported managers, like my district manager, who promoted aggressive and unethical practices. The culture was completely results driven. The attitude was that the ends justified the means. I think that money corrupted Wells Fargo, and clouded the judgment of upper management. Wells Fargo Financial was responsible for the majority of the bank's overall profits, and the enormous amounts of money coming in from subprime loans meant that unethical and dirty managers like my district manager were supported and rewarded.

19. I was constantly butting heads with my district manager. I told him repeatedly about the practices I objected to. He knew that loans were being falsified; and he knew that many of the aggressive practices he instructed us to follow were causing borrowers to get behind on their loans. Yet he still pressured us to engage in the most aggressive loan practices and threatened employees with their jobs if they did not do things his way. The bonus system was lucrative, so there was plenty of financial incentive to engage in high pressure and deceptive sales practices, even if one knew they were wrong.

20. I was not the only one who objected to Wells Fargo's practices. Mario Taylor worked under my supervision as a credit manager. He is a truthful and credible person whom I trust. I know he also refused to follow a lot of the practices that our district manager asked us engage in.

21. I left the company voluntarily in January 2008 to pursue other employment. At the time I left, I sent a lengthy email to much of the upper management discussing many of the concerns that I had about the Wells Fargo's practices and that I had raised with my district manager on many prior occasions.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: March 3, 2010

BY: _____
Michael Simpson

EXHIBIT

5

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

CITY OF MEMPHIS and SHELBY COUNTY, Plaintiffs, v. WELLS FARGO BANK, N.A., WELLS FARGO FINANCIAL TENNESSEE, INC. and WELLS FARGO FINANCIAL TENNESSEE 1, LLC, Defendants.	)	Case No. 2:09-cv-02857-STA-dkv

DECLARATION OF MARIO TAYLOR

1. I, Mario Taylor, hereby attest that I am over the age of eighteen and I am competent to testify with respect to the matter below.

2. In June 2006 I was hired by Wells Fargo Financial ("Wells Fargo") as a credit manager. I worked in that capacity for Wells Fargo until February 2008 when I voluntarily left the company to seek other employment.

3. During the time I was employed by Wells Fargo I worked at three different locations in the Memphis area. I primarily worked at the Cordova office, which is located at

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1785 North Germantown Parkway. I also worked at the Quince office and at an office on Park Avenue.

4. As a credit manager, my job was to find as many potential borrowers as I could for Wells Fargo and get them to apply for a loan. Credit managers were given a list of what were called "leads." These were names of people we were supposed to call to encourage them either to come into the office so we could get them to apply for a loan, or to apply directly over the telephone. We were instructed to make as many as 35 calls an hour and to call the same borrower multiple times each day.

5. Many of the people who were on the list of leads were individuals who already had loans with Wells Fargo. Some had auto loans; some had other types of home equity loans. I was supposed to try and get them to refinance their existing loan. Other names that we pursued from the list of leads were individuals for whom we were trying to consolidate their existing debt into one loan, for which the collateral would be their home. In these cases, we would typically try to get a person who had credit card debt, a car loan or a student loan, and convince them to consolidate all of these debts into one subprime loan with Wells Fargo at a high interest rate. We would tell these borrowers that we were "getting rid of" their existing debts when in fact all we were really doing was giving them a new subprime loan, this time with their house at risk.

6. Approximately 80-90 percent of the leads I was given turned out to be individuals who were African American. Although I don't know exactly how Wells Fargo came up with the leads, I believe that Wells Fargo targeted African Americans for these subprime loans. The prevailing attitude was that African-American customers weren't savvy enough to know they were getting a bad loan, so we would have a better chance of convincing them to apply for a high-cost, subprime loan.

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7. While I was at the Cordova office, I was put under pressure from the branch manager to do all kinds of things that I thought were unethical or just plain dirty. I know that a lot of this pressure came directly from a district manager.

8. The branch manager wanted us to get as many people to apply for loans as possible, regardless of whether they were qualified for the loan or could pay back the loan. I was told to just "get the documents from them so we can send the deal up." This meant that many individuals got high priced, subprime loans when they never should have gotten a loan. In some instances customers were given higher priced subprime loans when they could have qualified for a lower priced loan. Many people were taken advantage of just to satisfy the branch manager's insistence on reaching monthly quotas.

9. The branch manager directed us to make as many different loans to people as we could. For example, if we convinced someone to apply for a home equity loan, we were then supposed to try to get them to apply for an auto loan as well. On top of that, we would also try to give customers a Wells Fargo credit card with a very high interest rate.

10. I saw people turned "upside down" in auto loans. By that I mean they were put into auto loans at interest rates above twenty percent with no down payment and with a cash-out payment on top of that. Some of these auto loans were effectively at 160 percent loan-to-value ("LTV") ratios because there was no down payment required; the borrower was loaned the full amount of the car; and got an additional 50 percent of the loan amount again as a cash payment. These auto and home equity loans would be put together in consolidated packages so that the borrower's home was at risk if they couldn't make the payment.

11. I objected to many of these loans because I knew the borrower wouldn't be able to make the payments. I thought it was particularly unethical to take advantage of a borrower by

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turning a car loan into a home equity loan and placing their home at risk. Even though I made it known that I didn't want to take part in these practices, my branch manager pressured me relentlessly to get borrowers to apply for these types of loans.

12. Some branch managers told us how to mislead borrowers. For example, we were told to make "teaser rate" loans without informing the borrower that the loan was adjustable. Managers also promised borrowers that an adjustable rate loan would be refinanced, even if they knew this might not be possible.

13. Credit managers were supposed to only tell borrowers the bottom-line monthly payment without any other details. We were told not to tell the customer what was in the fine print.

14. In many cases income documents were falsified in order to qualify a borrower for a loan. I know that some managers, including one of my branch managers, changed pay stubs and used white-out on documents to alter the borrower's income so it would look like the customer qualified for the loan.

15. Borrowers were not told about prepayment penalties.

16. Borrowers were also not told about astronomical fees that were added to the loan and that Wells Fargo profited from. I remember that one of my branch managers specifically told me not to disclose these fees to borrowers.

17. Managers sometimes told borrowers that rates were locked prior to closing, when they were not.

18. Managers often misled borrowers by failing to tell them how to pay taxes and insurance as part of their monthly payments.

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19. Each office had what was called a "loan optimizer." This was a type of filter that was supposed to be used to make sure that the borrower qualified for the best loan available. Managers knew exactly how to manipulate the loan applicant's information, such as tweaking the value of the home, so that the borrower would qualify for a subprime loan.

20. Managers added expensive "extras" to loan applications even when the borrower did not need them. For example, I was instructed to tell every borrower that the Home/Auto Security Plan ("HASplan") came with their loan when in fact it was an unnecessary type of insurance that increased monthly payments. If I sent a loan to the underwriters without a HASplan, my branch manager would ask why I had not added the plan.

21. Managers discouraged customers from going to another bank to apply for a loan by telling them that their credit score had been pulled and their credit would be hurt if they applied again somewhere else. This was a pressure tactic designed to keep customers from comparative shopping for a better priced loan.

22. Managers had financial incentives to put borrowers into subprime loans. Managers were given large bonuses if they met quotas set by Wells Fargo. I remember one borrower, Edna Word, whose paystubs were falsified so that the manger could close the loan and make her bonus. If a manager met the monthly requirements for the number and size of loans closed, the bonus could be as much as $10,000 a month.

23. If a manager didn't make their monthly quota, they could be punished. Many managers were put on probation or written-up if they didn't make enough loans.

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I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: February 17, 2010

BY: Mario Taylor
Mario Taylor

EXHIBIT

6

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

CITY OF MEMPHIS and SHELBY COUNTY, Plaintiffs, v. WELLS FARGO BANK, N.A., WELLS FARGO FINANCIAL TENNESSEE, INC. and WELLS FARGO FINANCIAL TENNESSEE 1, LLC, Defendants.	)	Case No. 2:09-cv-02857-STA-dkv

DECLARATION OF CAMILLE THOMAS

1. I, Camille Thomas, hereby attest that I am over the age of eighteen and I am competent to testify with respect to the matter below.

2. In January 2004 I was hired by Wells Fargo Financial ("Wells Fargo") as a loan processor. I worked in that capacity for Wells Fargo until January 2008 when I voluntarily left the company to seek other employment.

3. During the time that I was employed by Wells Fargo I worked at four different locations in the Memphis area. I primarily worked at the Cordova office, which is located at

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1785 North Germantown Parkway. I also worked at the Bartlett office, an office on Winchester Street, and at the Collierville office.

4. In each of the offices where I worked there was one loan processor, several credit managers, and a branch manager. As a loan processor, I was responsible for handling all the paperwork. Customers would initially speak to a credit manager to apply for a loan. Credit managers also solicited customers for loans. Then the loan would be reviewed and approved by the branch manager. After that I would receive and process the file so that it could be submitted to Wells Fargo underwriters for approval and funding.

5. In order to do my job, I had to be familiar with all of the underwriting rules and guidelines that Wells Fargo was supposed to use to qualify borrowers for loans. I worked very closely with the credit managers and became familiar with the different things they did to qualify borrowers for loans.

6. At each of the offices where I worked, Wells Fargo Financial only made refinance loans. All of the loans that Wells Fargo Financial made at the branches where I worked were subprime loans.

7. It was the practice at the Wells Fargo offices where I worked to target African Americans for subprime loans. It was generally assumed that African-American customers were less sophisticated and intelligent and could be manipulated more easily into a subprime loan with expensive terms than white customers. I heard employees joking with one another about the race of customers, saying things like: "You know that guy isn't so smart – is it because he's black?"

8. Elderly African-American customers were thought to be particularly vulnerable and were frequently targeted for subprime loans with high interest rates. I remember one instance where an elderly African-American woman who was over 65 could not qualify for a

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subprime loan that a credit manager wanted to put her into, so the credit manager convinced her to transfer the property to her son so the subprime loan could be made in the son's name.

9. Credit managers targeted African-American borrowers in several different ways. One way was to partner with local businesses that were located in African-American areas, such as Royal Furniture and Flemings, to identify customers who had financed purchases at these stores. Credit managers would "cold-call" people off of these lists or simply show up at these individuals' homes or businesses. Managers identified African-American customers by talking to them over the telephone, or by meeting them in person. Most of the leads on the lists that managers were given to call were African-American.

10. Another way that credit managers targeted African-American customers was by working off of lists of borrowers who had previously had a loan with Wells Fargo. The race of these borrowers could be determined from information contained in the loan file. Managers would try to get these borrowers to re-finance their loans with higher interest rates and other fees and costs, or consolidate their debts at subprime rates using their house as the collateral for the loan. Wells Fargo used these same lists to solicit African-American borrowers with "draft checks." These checks were live, and when cashed instantly became a loan, usually at a very high interest rate, many times at or over 20 percent. When customers deposited these draft checks into their account, we would receive notice and would pursue them in an effort to refinance them with another subprime loan.

11. The higher-ups at Wells Fargo, including the branch managers, put a lot of pressure on credit managers to close loans with the highest possible interest rates and most expensive terms. This led to an environment in which unethical practices were condoned and encouraged. Credit managers and branch managers pushed African-American customers into

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loans they really could not afford. This was possible to do because the underwriting rules gave the managers lots of discretion that allowed them to engage in predatory practices. I know this happened, because I processed the paperwork and saw the loan files.

12. Many different practices were used to steer African-American customers into subprime loans. Many of these customers could have qualified for less expensive or prime loans, but because Wells Fargo Financial only made subprime loans, managers had a financial incentive to put borrowers into subprime loans with high interest rates and fees even when they qualified for better priced loans. Managers received commissions or a bonus based on how many loans they made during a month and whether they met quotas set by the company. Branch and district managers put a lot of pressure on credit managers to meet these goals. Credit managers would not get their bonus and would be written up if they failed to meet the goals. Branch managers used this threat to pressure credit managers into making loans that in many instances should not have been made.

13. There were lots of schemes used to steer African-American customers into subprime loans. For example, credit managers and branch managers made "teaser rate" loans without informing the borrower that the loan had an adjustable rate. They would just say: "this is your monthly payment." Managers also told borrowers that the teaser rate loans would be refinanced in 3 years to avoid paying a higher rate, even when they knew there was a significant risk that it couldn't be done.

14. Managers manipulated loan-to-value ("LTV") calculations in order to qualify borrowers for loans that were larger than they could afford by using inflated appraisals for homes that they knew were not accurate.

CH

15. In many cases documents were actually falsified to inflate a borrower's income so that the borrower would appear to meet debt-to-income ("DTI") requirements. I know that at least one branch manager engaged in this practice. On one occasion I objected to a falsification of income documents and the branch manager told me, "we gotta do what we gotta do."

16. Borrowers were encouraged to apply for "stated income" loans even when they had the necessary income documentation to qualify for a prime loan. By applying for a stated income loan, the borrower would qualify for a more expensive subprime product. Managers did not tell borrowers that if they submitted income documentation, they could get a less expensive loan.

17. Managers encouraged borrowers to increase the size of their loans by taking additional cash out of their homes when applying for a home equity loan. These "cash-out" refinance loans inflated the size of the loan beyond what the borrower needed, making it more expensive and more difficult to pay back.

18. Borrowers were not told about prepayment penalties.

19. In some instances managers told borrowers that rates were locked prior to closing, when they were not.

20. Managers often misled borrowers about the cost of their loan by failing to tell them that they would have to pay taxes and insurance as part of their monthly payments.

21. Each office had what was called a "loan optimizer." This was a type of filter that was supposed to be used to make sure that the borrower qualified for the best loan available. Managers knew exactly how to manipulate the loan applicant's information so that the borrower would qualify for a subprime loan.

CT

22. Managers added expensive "extras" to loan applications even when the borrower did not need them. For example, credit managers told borrowers that the Home/Auto Security Plan ("HASplan") came with the loan when in fact it was an unnecessary additional type of insurance that increased monthly payments. The only thing this extra did was drive up the cost of the loan. Wells Fargo made money by adding this extra on to the loan.

23. Managers even went so far as to lie to borrowers about whether their house would become the collateral for a debt consolidation. They told the borrower that they were simply applying for a line of credit, like a credit card, not that they were taking out a loan on their house. For example, managers pushed what we called the "NowLine" of credit without telling the borrower that this would be a second mortgage on their home.

24. In doing all of these things to manipulate African-American borrowers into subprime loans, managers would talk quickly and shuffle lots of papers to conceal what they were doing from the borrower and push the deal through faster.

25. Whenever I saw something that I thought was not right, I did my best to get it fixed. I remember one African-American borrower, Tyrone Banks, Sr., who came into the office to make payments on a debt consolidation loan. I became familiar with his situation, and at one point tried to help him modify his loan when he could no longer afford to make payments. I came to learn that his income documents were falsified in order to qualify him for the subprime loan that he could no longer make payments on. I also learned that Mr. Banks was never told that his loan was an adjustable loan, and that his payments could go up. Mr. Banks has had to file for bankruptcy in order to prevent his home from being foreclosed on.

CT

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: February 4, 2010

BY: Camille Thomas

Camille Thomas

EXHIBIT

7

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, Plaintiff,	)	
v.	)	No. 1:08-cv-00062-BEL
WELLS FARGO BANK, N.A. and WELLS FARGO FINANCIAL LEASING, INC., Defendants.	)	

1. I, Tony Paschal, hereby attest that I am over the age of 18 years and that I am competent to testify with respect to the matter below.

2. Between September, 1997 and September, 2007, during two separate periods of employment and for a total of eight years, I worked as a home mortgage consultant, or loan officer, in the Annandale, Virginia office of Wells Fargo Home Mortgage ("Wells Fargo").

3. My first period of employment with Wells Fargo was from September, 1997 to June, 1999. I was initially hired by Norwest Mortgage which merged with Wells Fargo in the middle of 1998. As a loan officer in Wells Fargo's Sales and Marketing section, my duties included contacting existing Wells Fargo borrowers in forty-eight (48) states to solicit them to refinance their home mortgage loan. Other Wells Fargo loan

officers also referred to me mortgage loan applicants that they were unable to qualify for "prime" loans because the applicants had blemished credit. I worked with these applicants to see if they would qualify for a prime conventional loan or a Federal Housing Administration ("FHA") loan. As loans insured by the federal government, FHA loans have interest rates that are a little higher than the prime rate, but are significantly less expensive than subprime loans.

4. I also worked during much of this period as a Community Development Representative. In this capacity, I contacted and worked with community groups with the goal of expanding Wells Fargo's business, particularly in minority communities. I am African American.

5. In June, 1999, I left Wells Fargo to take a position with Ardent Communication, a telecommunications business. I left Wells Fargo for two reasons. First, I was uncomfortable with how Wells Fargo treated its minority employees and customers. Wells Fargo's managers were almost entirely White and there was little to no opportunity for advancement for minorities. Wells Fargo also discriminated against minority loan applicants by advising them that the interest rate on their loan was "locked", when in fact, Wells Fargo had the ability to lower the interest rate for the applicant if the market rates dropped prior to the loan closing. I believe this was deceptive and discriminatory, particularly since Wells Fargo loan officers lowered interest rates for White loan applicants when market rates dropped after the application but prior to a loan closing. Even though I complained about this differential treatment of minorities to the branch manager, Jennifer Bowman, Wells Fargo did nothing to change

the practice. I also left Wells Fargo because Ardent Communications offered me a higher salary and more opportunities as a minority employee for advancement.

6. After Ardent Communications went out of business, in November 2001, I returned to work as a loan officer in the Sales and Marketing section of Wells Fargo's Annandale, Virginia office. Although I still had concerns about Wells Fargo's treatment of minority employees and customers, I thought that because there was a new branch manager, Dave Margeson, in the Annandale office, the working environment may have improved.

7. By the time I returned to Wells Fargo, the company was targeting existing customers for refinance loans to a much greater extent than it had during my first period of employment. As during my first period of employment, I contacted existing Wells Fargo borrowers nationally to solicit them to refinance their loans into a prime or FHA loan. When the borrower did not qualify for those loans, I would refer the borrower to the Mortgage Resource division, which is known by the acronym MORE and exclusively originates higher interest rate subprime loans. The employees working for MORE were located on the same floor as I was and I communicated with them every day.

8. In addition to taking referrals from other loan officers, MORE employees in the Annandale office targeted minority consumers for both purchase and refinance subprime loans. The MORE division targeted zip codes in Washington, D.C. east of the Anacostia River, Prince George's County, Maryland and the City of Baltimore with predominantly African-American populations. I heard employees in the MORE division comment that Howard County was not good for subprime loans because it has a predominantly White population. I also heard MORE employees on several occasions

mimic and make fun of their minority customers by using racial slurs. They referred to subprime loans made in minority communities as "ghetto loans" and minority customers as "those people have bad credit," "those people don't pay their bills," and "mud people."

9. In 2002, Dave Johnson, a former colleague with whom I had worked at Wells Fargo in 1997 and 1998, asked me if I could help him return to Wells Fargo. Mr. Johnson left Wells Fargo in 1998 to work at another mortgage lender. I spoke with Dave Margeson, my branch manager, and suggested that he hire Dave Johnson. Wells Fargo hired Mr. Johnson as a manager in the MORE division. Although I had also applied for a management position, Wells Fargo hired Mr. Johnson, who is White, instead of promoting me. I believe that Wells Fargo did not promote me for two reasons. First, Wells Fargo's management culture was White. Mr. Margeson is White and so is his immediate supervisor, area manager John Goulding. Indeed, I know of only one Wells Fargo African-American manager. Second, Wells Fargo management knew that I treated Wells Fargo customers well by offering to refinance them to prime and FHA loans when they qualified for those products. Wells Fargo management did not believe that I was doing enough to promote the subprime business, which was far more profitable because of the higher interest rates and fees. John Goulding told me that I was not doing enough to promote subprime loans and managers told me and others in the Sales and Marketing section that if we could not initially qualify a borrower for an FHA loan, we should refer them to the MORE division for a subprime loan even if with additional time or assistance the borrower would qualify a prime or an FHA loan.

10. Wells Fargo promoted its subprime business by targeting subprime loans to minorities. It did so in two ways, first, by sending marketing materials to minority

communities; second, by using minority subprime loan officers to solicit loans in those same communities. Wells Fargo targeted marketing materials to zip codes with predominantly minority populations. Wells Fargo's Annandale office targeted African American zip codes in Washington, D.C., Prince George's Country and Baltimore.

11. Wells Fargo even had software to generate marketing materials to minorities. For example, if a Wells Fargo loan officer anywhere in the United States wanted to send a flyer to consumers in an African-American neighborhood soliciting subprime loans, he could access software on his computer that would print out a flyer to persons speaking the language of "African American." I discovered this practice and attach a screen shot from my computer as an illustration of how a Wells Fargo employee could generate a flyer targeting African Americans. The document attached as Exhibit A is a true and accurate copy of the screen shot I printed on January 17, 2006. Only after I complained about this practice, did Wells Fargo agree to remove the African American option from the menu of languages.

12. Wells Fargo also marketed subprime loans to minorities by hiring minority employees to solicit these higher cost loans. Wells Fargo hired African-American loan officers exclusively from other subprime lenders. In the Annandale office, all the MORE loan officers were African-American, even though their two managers were White. In Silver Spring, Maryland, Wells Fargo had an "Affinity Group Marketing" section which consisted entirely of African-American employees. The Affinity Group targeted African-American churches and their members for loans. The Affinity Group Marketing section also hired an African-American employee specifically for the purpose of targeting African-American churches. Because the MORE group only had authority to make

subprime loans, they regularly originated subprime loans to African Americans and other minority borrowers who could have qualified for a lower cost prime loan or FHA loan. I had access to Wells Fargo customers' loan records and application files for my work in the Sales and Marketing division and regularly saw minority customers who had good credit scores and credit characteristics in subprime loans who should have qualified for prime or FHA loans.

13. Because Wells Fargo made a higher profit on subprime loans, the company put "bounties" on minority borrowers. By this I mean that loan officers received cash incentives to aggressively market subprime loans in minority communities. If a loan officer referred a borrower who should have qualified for a prime loan to a subprime loan, the loan officer would receive a bonus. Loan officers were able to do this because they had the discretion to decide which loan products to offer and to determine the interest rate and fees charged to the borrower. Since loan officers made more money when they charged higher interest rates and fees to borrowers, there was a great financial incentive to put as many minority borrowers as possible into subprime loans and to charge these borrowers higher rates and fees. I knew many loan officers who made more than $600,000 a year and a few who made more than $ 1 million.

14. Wells Fargo discriminated against minority loan applicants by not offering them its better or newer products which had lower fixed interest rates and fees. Instead, Wells Fargo offered its higher cost loan products, including its adjustable rate mortgage (ARM) loans to minority applicants. Wells Fargo's loan officers also discriminated against minority refinance applicants by encouraging them to take out more cash from their home equity. By taking out more cash, the borrower would unwittingly increase the

commission the loan officer received on the loan, while at the same time eliminating his ability to qualify for a prime or FHA loan. By encouraging the borrower to take out more cash, the loan officer knowingly increased the borrower's risk of foreclosure because of the higher loan amount.

15. In trainings, Wells Fargo loan officers were encouraged to omit pertinent information about a subprime loan in talks with applicants because discussing loan terms could cost a loan officer a sale. For example, it was implied in trainings that Wells Fargo loan officers should not mention that subprime loans included a prepayment penalty if the borrower paid off or refinanced his loan before the prepayment penalty period ended or that the monthly payments on ARM loans would substantially increase. When an applicant asked a loan officer about prepayment penalties or monthly payment increases, the loan officer would tell the applicant not to worry because Wells Fargo would later be able to refinance him into a prime or an FHA loan.

16. Wells Fargo's management also tolerated a culture of discrimination. In addition to being almost entirely White, the company promoted at least one manager who used racial slurs. Dave Zoldak, who succeeded Dave Margeson as my branch manager in 2005, used the word "nigger" at the office. Although Wells Fargo knew Mr. Zoldak used racial slurs, it promoted him to area manager after I complained about his discriminatory comments. On October 21, 2005, I complained by email to Mr. Zoldak directly about his use of the word "nigger" and speaking about how African Americans lived in "'hoods" and "slums." Mr. Zoldak replied that he had used the slurs in a humorous way, just as the African-American comedian Dave Chapelle did on television and thought that I would find the use of these terms humorous. I attach as Exhibit B a true and accurate

copy of my October 21, 2005 email to Mr. Zoldak and his response later the same day. On December 9, 2005, I complained by email to Joe Rogers, an Executive Vice President, and two Human relations employees at Wells Fargo about the use of the word "nigger" and other slurs by Wells Fargo employees. I also verbally informed Mr. Rogers's of Mr. Zoldak's racial slurs, including the use of the word "nigger." Although Mr. Rogers agreed with me by email that racial epithets were unacceptable, he questioned why I was raising the issue with him. I attach as Exhibit C a true and accurate copy of my December 9, 2005 email to Mr. Rogers and others, and his December 12, 2005 response. Despite these complaints, Wells Fargo promoted Mr. Zoldak.

17. Even the underwriting of subprime loans fostered their discriminatory impact on minorities. The subprime underwriting group was located in a different city than the prime underwriting group. The subprime underwriters were located initially in Baton Rouge, Louisiana and later Ft. Mill, South Carolina. Subprime loan officers with MORE and elsewhere within Wells Fargo pressured underwriters to approve subprime loans.

18. In late 2004 and early 2005, in response to the complaints of discrimination by such groups as ACORN (the Association of Community Organizations for Reform Now) and the Center for Responsible Lending, Wells Fargo implemented so-called "filters" in their lending programs that purportedly would discourage loan officers from steering minorities to subprime loans. Wells Fargo implemented these filters for public consumption only and not to actually restrict discriminatory practices. The filters were ineffective because they did not have any "teeth" (no punishment for violating) and because they were easy for loan officers to circumvent. I do not believe these filters had

any impact on steering because subprime loan officers continued to receive large financial incentives for making subprime loans to minority borrowers and were encouraged by their managers to do so because these loans were profitable. These filters also did not have an impact on steering because, notwithstanding any written rules, loan officers had discretion to make decisions about products and pricing.

19. Wells Fargo ultimately fired me in September, 2007 asserting that my loan production was low. My loan production was lower than many other loan officers because I tried to do the right thing by Wells Fargo customers by putting them in loans they could afford. If a customer did not qualify for a loan or could not afford an estimated monthly payment, I did not originate the loan. I was verbally reprimanded by John Goulding, my indirect supervisor, for placing too many customers in FHA loans, when the company wanted me to refer them to a subprime loan officer, for example in the MORE group, so that the company could make a greater profit on the loan.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief.

EXECUTED WITHIN THE UNITED STATES ON: April 9, 2009

BY: _____
Tony Paschal

Exhibit A

Search for Items

Standard Search (* You must at least select a Type of Item or enter a Subject)

* What Type Of Item Are You Looking For?	Fast Flyer
* What Subject Are You Looking For?	
Personalized	Yes, Personalized
Strategy	Special Programs
Language	African American
Item Size	--Select One--
Item Color	--Select One--
Audience	--Select One--
Product / Program / Feature	--Select One--
High Trust Sales and Marketing	--Select One--
SALE ITEMS	--Select One--

Search

Searching Hints

Here are some helpful searching hints t
you find the items you're looking for.

> For the fastest results, if you know the
number, enter it in the Quick Search sect

> For best results using Standard Searc
minimum, select a Type of Item AND a St
such as "FAST Flyer - Consumer" and "F
Homebuyer".

> For more targeted results, also include
search criteria as appropriate, such as a
language, etc. At a minimum, you must
either a Type of Item or enter a Subject.

Quick Search (Use This When You Know the Item ID)

Item ID (do not include NMFL#, etc.)

Search

Custom Requests

For custom design requests, click on the button below. Please note that custom requests are not tracked as orders through Easy O
should contact Ad Services directly at 515-213-4006 or by email at adservices@wellsfargo.com for questions regarding custom req

Custom Requests/Reviews

Exhibit B

Paschal, Tony

From: Zoldak, David
Sent: Friday, October 21, 2005 8:47 AM
To: Paschal, Tony
Subject: RE: Workflow

I'm only trying to provide you options to help lessen an obviously frustrating situation. I would rather suggest as many resources I know of to help you be proactive with your loans instead of making excuses to let those loans go to the wayside. As far as the rest of your comments are concerned, I believe you are referring to our many rehashings of the Dave Shappel(spelling) show...which, I assumed you enjoyed. If something I said had ever offended you, I'm sorry. They next time I say something that you feel is offensive to you or anyone, I would encourage you to address it at that time. I would like you to focus on working with me and our team in Ohio to resolve your loan problems instead of wasting your time and energy in some other direction.

David J. Zoldak
Branch Manager
Wells Fargo Home Mortgage
MAC M8602-031
7620 Little River Turnpike, Ste. 300
Annandale, VA 22003
703.333.5555 Tel
866.333.5540 ext. 5555 Toll Free
703.333.5590 Fax
david.zoldak@wellsfargo.com

For your protection, we remind you that this is an unsecured email service, which is not intended for sending confidential or sensitive information. Please do not include your social security number, account number, or any other personal or financial information in the content of the email. To see our privacy policy regarding how we use and protect customer information, please select the following link: http://www.wellsfargo.com/privacy/privacy.jhtml. To discontinue receiving all emails containing solicitation materials from Wells Fargo Bank N.A., including Wells Fargo Home Mortgage, please send an email to NoEmailRequest@wellsfargo.com with your name and email address.

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Wells Fargo Home Mortgage-2701 Wells Fargo Way-Minneapolis, MN 55467-8000

From: Paschal, Tony
Sent: Friday, October 21, 2005 6:49 AM
To: Zoldak, David
Subject: Workflow
Importance: High

As soon as my email functionality is restored I will forward the email I sent to Ms. Noble over a week ago informing her about my computer situation. If I were able to access the information she has been requesting in her email, (cell phone numbers, work numbers, etc) I would have used loan status not LIS to get that information. Since neither of those systems has been available on a consistent basis for the past two weeks, and since loans in appraiser are reciprocally linked to loan status, getting back to Ms. Noble has been difficult at best. I feel her emails have been returned in a timely fashion, however if this situation is being approached as Shirley Temple and Bill (Bojangles) Robinson we have a problem. Speaking of problems, since you were comfortable enough to use a quote in front of me several months ago using the word "nigger" you'll understand when I say that I am nobody's "nigger" and I do not live in anyone's "hood" and I am not from anyone's slums. If you have any questions feel free to contact me. Thank's

Tony Paschal
Home Mortgage Consultant
Wells Fargo Home Mortgage
M8602-031
7620 Little River Turnpike Suite 300
Annandale, Virginia 22003
703.333.5549 Office
866.333.5540 ext.5549 Toll Free

Exhibit C

Paschal, Tony
From: Rogers, Joe
Sent: Monday, December 12, 2005 10:34 AM
To: Paschal, Tony
Cc: White, Julie M. - HR; Williams, Mark S (HR)
Subject: RE:

Tony,

I believe all on this chain would agree with you. My question is one of context. What prompts you to ask that question at this time. While I would want to send an across the board agreement, questions like yours below, could be an example of the use of this word. In other words, indicating a totally unacceptable practice.

Joe Rogers
Ph: (410) 872-1935

-----Original Message-----
From: Paschal, Tony
Sent: Friday, December 09, 2005 4:03 PM
To: Rogers, Joe
Cc: White, Julie M. - HR; Williams, Mark S (HR)
Subject:
Importance: High

Is there any time when it is appropriate to use the word "Nigger" in the workplace? Is it ever appropriate to reference where an African American employee and his family live as the "slums" or the "hood"? This word is so vile and filthy that our email system will not allow it to leave our own network. After reading every employee handbook since Wells Fargo Home Mortgage was Norwest Mortgage, I cannot find any instance where any racial epithet is allowed at Wells Fargo. At least that what the handbook says.

Tony Paschal
Home Mortgage Consultant
Wells Fargo Home Mortgage
M8502-031
7820 Little River Turnpike Suite 300
Annandale, Virginia 22003
703.333.5549 Office
866.333.5540 ext.5549 Toll Free
703.333.5590 Fax
tony.paschal@wellsfargo.com

For your protection, we remind you that this is an unsecured email service, which is not intended for sending confidential or sensitive information. Please do not include your social security number, account number, or any other personal or financial information in the content of the email. To see our privacy policy regarding how we use and protect customer information, please select the following link: http://www.wellsfargo.com/privacy/privacy.html. To discontinue receiving all emails containing solicitation materials from Wells Fargo Bank N.A., including Wells Fargo Home Mortgage, please send an email to NoEmailRange@wellsfargo.com with your name and email address.

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Wells Fargo Home Mortgage-2701 Wells Fargo Way-Minneapolis, MN 55467-8000

EXHIBIT

8

DECLARATION OF TONY PASCHAL

1. I, Tony Paschal, hereby attest that I am over the age of 18 years and that I am competent to testify with respect to the matter below.

2. On April 9, 2009, I signed and submitted a declaration in the case of *Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A.*, Civ. No. 08-00062 (D. Md.). ("April 9, 2009 Declaration"). My April 9, 2009 Declaration is attached as Exhibit A hereto.

3. In my April 9, 2009 Declaration, I described the work I did with Wells Fargo Home Mortgage ("Wells Fargo") between September 1997 and June 1999, and between November 2001 and September 2007, and the discriminatory practices I observed. During both periods of employment, I worked as a loan officer in Wells Fargo's Sales and Marketing Section in Annandale, Virginia. As a loan officer, my duties included contacting existing Wells Fargo's borrowers in forty-eight (48) states, including Tennessee, to solicit them to refinance their home mortgage loans. April 9, 2009 Declaration at ¶¶ 3-7.

4. Many of Wells Fargo's practices in the City of Memphis and Shelby County were the same as the company's practices in Baltimore that I described in my April 9, 2009 Declaration. For example, just as Wells Fargo targeted zip codes with African-American populations for high cost subprime loans in Baltimore (April 9, 2009 Declaration at ¶ 8), it targeted zip codes with African-American populations for these same products in the City of Memphis and Shelby County.

5. Wells Fargo used the same software to generate marketing materials to

Minorities in both Baltimore and Memphis. For example, if a Wells Fargo loan officer anywhere in the United States wanted to send a flyer to consumers in an African-American neighborhood soliciting subprime loans, he or she could access the same software on his computer that I have described in my April 9, 2009 Declaraion. This software included an option for printing flyers in the so-called language of "African American." I attached a true and accurate copy of a screen shot I printed on January 17, 2006 from my computer to my April 9, 2009 Declaration as an illustration of how a Wells Fargo employee could generate a flyer targeting African Americans. Wells Fargo only agreed to remove the African American option from the menu of languages after I complained about this practice.

6. As in Baltimore, Wells Fargo discriminated against minority loan applicants in the City of Memphis and Shelby County by not offering them its better or newer products which had lower fixed interest rates and fees. Instead, Wells Fargo offered its higher cost loan products, including adjustable rate mortgage (ARM) loans, to minority applicants. These ARM loans included loan products known as 2/28s and 3/27s which had a lower "teaser rate" during the first two or three years of the loan, but then the interest rate of the loan would reset to a much higher rate that can continue to rise based on market conditions.

7. Wells Fargo's loan officers also discriminated against minority refinance applicants in the City of Memphis and Shelby County by encouraging them to take out more cash from their home equity. By taking out more cash, the borrower would unwittingly increase the commission the loan officer received on the loan, while at the same time damaging his ability to qualify for a lower cost prime or Federal Housing

Administration ("FHA") loan. By encouraging the borrower to take out more cash, the loan officer increased the borrower's risk of foreclosure.

8. In my duties as a Wells Fargo loan officer, I worked with many loan applicants in the City of Memphis and Shelby County to see if they were qualified for a prime conventional loan or an FHA loan. FHA loans are insured by the federal government and have lower interest rates than subprime loans and are fixed. If a borrower was not qualified for a prime or FHA loan, I would refer the borrower to the Mortgage Resource division, which is known by the acronym MORE and exclusively originates higher interest rate subprime loans.

9. In 2006, I worked with a borrower in the City of Memphis to refinance his Wells Fargo ARM loan; to the best of my belief this borrower was African-American. The borrower had a 2/28 subprime ARM loan that was almost two years old and was seeking to refinance his loan before his "teaser rate" expired and reset to a much higher interest rate. I determined that the borrower qualified for a prime loan. The borrower had an excellent credit score, and for this reason I suspected that he had previously qualified for a prime loan in 2004 but had been inappropriately placed by Wells Fargo into a subprime ARM loan at that time. In working with the borrower in 2006, I informed my branch manager, Dave Zoldak that the borrower qualified to refinance into a prime fixed-rate loan. Mr. Zoldak told me that I should instead refinance the borrower into another subprime ARM loan. I refused to do this because I thought it was both unfair and discriminatory. After I refused, Mr. Zoldak "wrote me up" by putting a negative performance evaluation in my personnel folder.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief.

EXECUTED WITHIN THE UNITED STATES ON: December 17, 2009

BY:_____
Tony Paschal

EXHIBIT

9

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE,	)	
Plaintiff,	)	
v.	)	No. 1:08-cv-00062-BEL
WELLS FARGO BANK, N.A.	)	
and	)	
WELLS FARGO FINANCIAL LEASING, INC.,	)	
Defendants.	)	

DECLARATION OF ELIZABETH M. JACOBSON

1. I, Elizabeth M. Jacobson, hereby attest that I am over the age of eighteen and I am competent to testify with respect to the matter below.

2. In 1998, I was hired by Wells Fargo Home Mortgage as a "Home Mortgage Consultant" or loan officer. I worked for Wells Fargo Home Mortgage ("Wells Fargo") until December, 2007. After a period of time, I was promoted to Sales Manager.

3. For much of the time that I worked for Wells Fargo my office was located in Federalsburg, Maryland. I worked directly with loan applicants to make subprime loans. The geographic area that I covered was known as Region 12. This area included Northern Virginia, Baltimore, and Prince George's County, among other places. Much of my business came from referrals from Wells Fargo loan officers who were on the prime

side of the business. That means that they dealt with prime loan customers. These loan officers were known as "A reps." Many of these referrals came to me over the telephone from the A reps. Once I got the referrals, I would work directly with the loan customer to get them a subprime loan.

4. I was very successful in making subprime loans. I received many awards from Wells Fargo for originating a very high volume of subprime loans. For several years I was the top subprime loan officer at the company. In 2004 I made more subprime loans than any other loan officer at Wells Fargo anywhere in the country. I was always one of the top three Wells Fargo subprime loan producers in the country.

5. Between 2003 and 2007 I completed approximately $50 million in subprime loans per year. This translated to about 180 loans per year.

6. My pay was based on commissions and fees I got from making these loans. Fees and commissions were based on the size of the loan and the interest rate. In 2004, I grossed more than $700,000 in sales commissions. In 2005 I grossed more than $550,000 in commissions and pay. I was happy to remain a sales manager and not move any higher up at Wells Fargo because I could make more money working directly with customers to originate loans.

7. Because of the high volume of subprime loans that I made and the length of time that I worked at Wells Fargo, I learned all of the "ins and outs" of the subprime loan process at the company. I used this knowledge to find ways to qualify customers for subprime loans.

8. The commission and referral system at Wells Fargo was set up in a way that made it more profitable for a loan officer to refer a prime customer for a subprime

loan than make the prime loan directly to the customer. The commission and fee structure gave the A rep a financial incentive to refer the loan to a subprime loan officer. Initially, subprime loan officers had to give 40% of the commission to the A rep who made the referral; later on A reps received 50 basis points of the available commission. Because commissions were higher on the more expensive subprime loans, in most situations the A rep made more money if he or she referred or steered the loan to a successful subprime loan officer like me. A reps knew about my success in qualifying customers for subprime loans; as a result, I received hundreds of referrals.

9. When I got the referrals, it was my job to figure out how to get the customer into a subprime loan. I knew that many of the referrals I received could qualify for a prime loan. If I had access to Wells Fargo's loan files right now and could review these files, I could point out exactly which of these customers who got a subprime loan could have qualified for a prime loan.

10. Because I worked on the subprime side of the business, once I got the referral the only loan products that I could offer the customer were subprime loans. My pay was based on the volume of loans that I completed. It was in my financial interest to figure out how to qualify referrals for subprime loans. Moreover, in order to keep my job, I had to make a set number of subprime loans per month.

11. Wells Fargo, like any other mortgage company, had written underwriting guidelines and pricing rules for prime and subprime loans. There was, however, more than enough discretion to allow A reps to steer prime loan customers to subprime loan officers like me. Likewise, the guidelines gave me enough discretion to figure out how to qualify most of the referrals for a subprime loan once I received the referral.

12. In many cases A reps used their discretion to steer prime loan customers to subprime loan officers by telling the customer, for example, that this was the only way for the loan to be processed quickly; that there would be less paperwork or documentation requirements; or that they would not have to put any money down. Customers were not told about the added costs, or advised about what was in their best interest.

13. Once I received a referral from an A rep, I had discretion to decide which subprime loan products to offer the applicant. Most of the subprime loans I made were 2/28s. A 2/28 loan allowed the borrower to pay a lower fixed rate of interest for the first two years of the loan (the "teaser rate") and then the interest would reset periodically with the market for the remaining 28 years of the loan. These loans typically included a prepayment penalty for two or three years which ultimately made it more difficult for the borrower to refinance later out of the loan. For those loans where the prepayment penalty extended beyond the teaser rate period, the borrower would be unable to refinance her loan even after her interest rate re-set because she could not afford to pay the prepayment penalty. I know that some loan officers encouraged customers to apply for these loans by telling them that they should not worry about the pre-payment penalty because it could be waived. This was not true – the pre-payment penalty could not be waived.

14. According to company policy, we were not supposed to solicit 2/28 customers for re-finance loans for two years after we made a 2/28 subprime loan. Wells Fargo reneged on that promise; my area manager told his subprime loan officers to ignore this rule and go ahead and solicit 2/28 customers within the two year period, even though this violated our agreement with secondary market investors. The result was that Wells

Fargo was able to cash in on the pre-payment penalty by convincing the subprime customer to re-finance his or her 2/28 loan within the initial two year period. I complained to senior managers about this practice. I am not aware of any corrective action that was taken.

15. In addition to 2/28 loans, we had at least three types of low or no document subprime loan products that we marketed to customers: (1) "stated income" loans; (2) no income, no asset loans; and (3) no ratio loans. Stated income loans were ones in which the customer did not have to show what his or her income was with verifying documentation, but could merely say he or she made a certain amount of money. No income, no asset loans did not require the customer to list any employment. For a no ratio loan, the loan officer only had to put down the borrower's job title and did not have to list any income or debt-to-income ratio. Although the underwriting guidelines with respect to these products changed from time to time, loan officers always had discretion to use different compensating factors to get the customer into one of these subprime loan products. If, for example, a customer had a high credit score that would make them a good candidate for a prime loan, it was a simple matter to get them qualified for a subprime loan by telling the underwriting department that the customer did not want to provide documentation for the loan, had no source or seasoned assets, or needed to get the loan closed quickly.

16. Wells Fargo loan officers encouraged loan applicants to apply for stated income loans, no income – no asset loans, and no ratio loans because these loans had higher interest rates and fees and would allow the loan officer to receive a higher commission. Wells Fargo qualified borrowers for subprime loans by underwriting all

adjustable rate mortgage (ARM) loans, including 2/28 loans, with the assumption that the borrower would pay the teaser rate for the full life of the loan even though this lower rate only applied during the first two or three years of the loan. Wells Fargo also did not require subprime borrowers to escrow for taxes and insurance and most subprime borrowers did not.

17. There were various techniques that were used to qualify the A rep referrals for subprime loans. Each of the techniques involved taking advantage of the discretion we had in applying the underwriting guidelines. One way was to tell customers not to put any money down on the loan and borrow the entire amount, even if they could afford a big enough down payment to qualify for a prime loan. As soon as the loan was submitted without a down payment, it would "flip" from prime to subprime and a subprime loan officer would be able to get the loan qualified as a subprime loan. Another technique would be to tell the customer that the only way to get the loan closed quickly would be to submit it as a subprime loan. A third technique would be to put a person into a "stated income" loan, even if they had a W-2 statement that verified their income. By doing this, the loan was flipped from a prime to a subprime loan. I know that through some of these techniques borrowers with credit scores as high as 780 were steered into expensive subprime loans with as many as four points, even though they could have qualified for a prime loan.

18. I also know that there were some loan officers who did more than just use the discretion that the system allowed to get customers into subprime loans. Some A reps actually falsified the loan applications in order to steer prime borrowers to subprime loan officers. These were loan applicants who either should not have been given loans or who

qualified for a prime loan. One means of falsifying loan applications that I learned of involved cutting and pasting credit reports from one applicant to another. I was aware of A reps who would "cut and paste" the credit report of a borrower who had already qualified for a loan into the file of an applicant who would not have qualified for a Wells Fargo subprime loan because of his or her credit history. I was also aware of subprime loan officers who would cut and paste W-2 forms. This deception by the subprime loan officer would artificially increase the creditworthiness of the applicant so that Wells Fargo's underwriters would approve the loan. I reported this conduct to management and was not aware of any action that was taken to correct the problem.

19. Prior to 2004, Wells Fargo did not make any effort to determine if subprime loans were being made to customers who qualified for prime loans. In 2004 a "filter" was put in place that was supposedly to help keep subprime loans from being made to prime customers. The filter did not work, and everyone knew it. There were lots of ways for loan officers to get around the filter because of the discretion that we had. If a subprime loan was flagged by the filter as one that had gone to a customer who qualified for a prime loan, the loan officer would simply give the underwriting department one of a set of stock responses, such as "the customer has no assets," or the customer's assets were not "sourced and seasoned." ("Sourced and seasoned" refers to verification of where the money comes from for the down payment and whether it has been in the customer's bank account long enough). These responses were widely used, and as soon as they were given to the underwriter, he or she would just override the filter and approve the subprime loan.

20. High ranking Wells Fargo managers knew that this practice was going on, because after about a year of these standby explanations being given, underwriters in the underwriting department were told to call the customers directly rather than contact the loan officer who was working with the customer. The loan officers quickly figured out how to work around this by warning customers that underwriters might call them and then coaching the customers about what to say. For example, customers were told that they should just tell the underwriter that they did not have much in the way of assets or documentation for their income, because otherwise the underwriter would deny their loan or force them to fill out additional paperwork to document their financials. The point was to get the customer to say whatever would allow them to qualify for a subprime loan, even if it was not true. The customers went along with this because they thought it would expedite the process of getting them the loan that they had been told was the right one for them.

21. Underwriters, like loan officers, had a financial incentive to approve subprime loans than, even if the customer could qualify for a prime loan, because they too got paid more if a subprime loan went through.

22. Wells Fargo charged higher interest rates and fees not only on its 2/28 and 3/27 subprime loans, but also on its subprime fixed-rate loans, than it did for prime loans. Subprime loan officers had discretion to decide what interest, points and fees to charge a borrower. For example, for approximately the first five years that I worked at Wells Fargo, I could charge as many points on a loan as I decided. Pricing sheets included different "add-ons" or fees that might be added to the price of the loan depending on the circumstances of the loan.

23. Federal Housing Administration (FHA) loans, like other government-insured loans, offered lower interest rates that are closer to prime rates. Subprime loan officers were required to have a subprime borrower sign a "Benefit to Borrower" Statement that stated that the borrower may qualify for a government-insured loan, but did not want it because it was too much paperwork. In fact, subprime loan officers were never trained in how to make FHA or government-insured loans. We asked for this training, but Wells Fargo refused to provide it.

24. For most of my employment, Wells Fargo did not restrict or regulate the fees that loan officers could charge. Only in 2007 did Wells Fargo begin to regulate and set the amount of fees such as processing fees and underwriting fees. Despite this regulation, subprime loan officers still had discretion to determine which fees to include as costs to the borrower and had a financial incentive to add fees because doing so increased their commission. There was always a big financial incentive to make a subprime loan wherever one could.

25. Once the subprime loan transaction with the customer was closed and we and Wells Fargo received our fees, closing costs and commissions, the loans were sold on the secondary market. This meant that Wells Fargo was no longer exposed to any risk of default or delinquency in payment on these subprime loans. In many cases, Wells Fargo continued to service these same subprime loans, and was paid a fee for doing that, but to my knowledge that did not expose the company to any risk beyond the first three months if the loans went bad. The risk of default rested with the companies that bought the loans from Wells Fargo, such as Fannie, Freddie, and Wall Street investment banks.

26. Many of the customers who were referred to me by A reps 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."

27. 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 black churches. Wells 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.

28. I remember being part of a conference call that took place in 2005 where Wells Fargo sales managers discussed the idea of going into black churches in Baltimore to do presentations about our subprime products. Everybody on that call was a subprime loan officer. Two of the individuals on the call were branch managers. On that call we were told that we "have to be of color" to come to the presentation. The idea was that since the churchgoers were black Wells Fargo wanted the loan officers to be black. I was

told that I could attend only if I "carried someone's bag." The point was clear to me: Wells Fargo wanted black potential borrowers talking to black loan officers.

29. Wells Fargo also targeted African Americans through special events in African-American communities called "wealth building" seminars. At some point in 2005 before the conference call discussed above, I remember preparing to participate in a wealth building seminar that was to be held in Greenbelt, Maryland. It was understood that the audience would be virtually all black. The point of the seminar was to get people to buy houses using Wells Fargo loans. At the seminar, the plan was to talk to attendees about "alternative lending." This was code language for subprime lending, but we were not supposed to use the word "subprime." I was supposed to be a speaker at this seminar, but was told by the Emerging Markets manager that I was "too white" to appear before the audience. I was offended by these statements and complained to several higher ranking managers about what had been said. The company did not respond to my complaints and no action was taken.

30. Subprime loan officers did not market or target white churches for subprime loans. When it came to marketing, any reference to "church" or "churches" was understood as a code for African-American or black churches.

31. I complained many times about what I thought were unethical or possibly predatory loan practices that Wells Fargo was engaged in. Managers never took any action to respond to my concerns. In my office we morbidly joked that we were "riding the stagecoach to Hell."

32. The culture at Wells Fargo was focused solely on making as much money as possible. Even as foreclosures were increasing in recent years, the company continued

to lavish expensive trips and gifts on successful subprime loan officers. I attended all expense paid trips to Cancun, Orlando, Palm Springs, Vancouver and the Bahamas where we were entertained by Aerosmith, the Beach Boys, the Eagles, Cheryl Crow, Elton John, Jimmy Buffett and James Taylor. When we would return to our rooms at night we would find gifts of artwork, crystal platters, steak of the month club memberships and IPODs left for us.

33. Although I did not work in the part of the company known as Wells Fargo Financial ("Financial"), I am aware that Financial did mainly re-finances, not home purchase loans. Many of Financial's loans were extremely high priced with lots of points and fees. Wells Fargo management did not allow loan officers to solicit customers with high-priced Wells Fargo Financial loans for purposes of refinancing, even though this would have been in the borrower's best interest.

34. I left Wells Fargo in December 2007 because at that time the subprime market was contracting and I was getting fewer referrals. I wanted to move from Federalsburg to Easton, Maryland, but Wells Fargo said it wasn't opening any new offices. I gave my notice to the company at that point.

35. There are many other current and former Wells Fargo employees who have knowledge of the practices that I have discussed in this Declaration and, if compelled to testify, would, I believe, agree with what I have said. Many current and former Wells Fargo employees may well be reluctant to come forward voluntarily to tell what they know for fear of retaliation, reprisal or other actions that could adversely affect their future careers in the lending industry.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: April 20, 2009

BY:_____
Elizabeth M. Jacobson

EXHIBIT

10

WHOLESALE - ALTERNATIVE LENDING/ SUBPRIME RATE SHEET
15 Day Best Effort Pricing - 7/13/05
Loan Programs with Prepayment Penalties
Fax on Demand: 888/268-7177 Doc #302

WELLS FARGO HOME MORTGAGE

	Credit Grade	LTV	Cap 5/1/6 PAR	Term 2/28 ARM 2 Year Prepay Penalty <1.00>	<0.50>	<0.00>	Index LIBOR 3.750 Margin	Cap 5/1/6 PAR	Term 3/27 ARM 3 Year Prepay Penalty <1.00>	<0.50>	<0.00>	Index LIBOR 3.750 Margin	Term 30 Year Fixed 3 Year Prepay Penalty <1.00>	<0.50>	<0.00>
Y9	Credit Score 680+	70%	5.250	5.750	6.250	6.750	3.000	5.500	6.000	6.500	7.000	3.250	6.875	7.375	7.875
	Mtg. History 0x30	75%	5.375	5.875	6.375	6.875	3.125	5.625	6.125	6.625	7.125	3.375	6.500	7.000	7.500
	BKFC 4/3	80%	5.500	6.000	6.500	7.000	3.250	5.750	6.250	6.750	7.250	3.500	6.625	7.125	7.625
	Debt Ratio <=50%	85%	5.750	6.250	6.750	7.250	3.500	6.000	6.500	7.000	7.500	3.750	6.875	7.375	7.875
		90%	5.875	6.375	6.875	7.375	3.625	6.125	6.625	7.125	7.625	3.875	7.000	7.500	8.000
		95%	6.500	7.000	7.500	8.000	4.250	6.750	7.250	7.750	8.250	4.375	7.625	8.125	8.625
		100%	7.125	7.625	8.125	8.625	4.875	7.375	7.875	8.375	8.875	5.125	8.250	8.750	9.250
Y8	Credit Score 640-679	70%	5.375	5.875	6.375	6.875	3.125	5.625	6.125	6.625	7.125	3.375	6.500	7.000	7.500
	Mtg. History 1x30	75%	5.500	6.000	6.500	7.000	3.250	5.750	6.250	6.750	7.250	3.500	6.625	7.125	7.625
	BKFC 3/3	80%	5.625	6.125	6.625	7.125	3.375	5.875	6.375	6.875	7.375	3.625	6.750	7.250	7.750
	Debt Ratio <=50%	85%	5.875	6.375	6.875	7.375	3.625	6.125	6.625	7.125	7.625	3.875	7.000	7.500	8.000
		90%	6.000	6.500	7.000	7.500	3.750	6.250	6.750	7.250	7.750	4.000	7.125	7.625	8.125
		95%	6.625	7.125	7.625	8.125	4.375	6.875	7.375	7.875	8.375	4.625	7.750	8.250	8.750
		100%	7.250	7.750	8.250	8.750	5.000	7.500	8.000	8.500	9.000	5.250	8.375	8.875	9.375
Y7	Credit Score 620-639	70%	5.500	6.000	6.500	7.000	3.250	5.750	6.250	6.750	7.250	3.500	6.625	7.125	7.625
	Mtg. History 1x30	75%	5.625	6.125	6.625	7.125	3.375	5.875	6.375	6.875	7.375	3.625	6.750	7.250	7.750
	BKFC 3/3	80%	5.750	6.250	6.750	7.250	3.500	6.000	6.500	7.000	7.500	3.750	6.875	7.375	7.875
	Debt Ratio <=50%	85%	6.000	6.500	7.000	7.500	3.750	6.250	6.750	7.250	7.750	4.000	7.125	7.625	8.125
		90%	6.125	6.625	7.125	7.625	3.875	6.375	6.875	7.375	7.875	4.125	7.250	7.750	8.250
		95%	6.750	7.250	7.750	8.250	4.500	7.000	7.500	8.000	8.500	4.750	7.875	8.375	8.875
		100%	7.500	8.000	8.500	9.000	5.250	7.750	8.250	8.750	9.250	5.500	8.625	9.125	9.625
Y6	Credit Score 610-619	70%	5.750	6.250	6.750	7.250	3.500	6.000	6.500	7.000	7.500	3.750	6.875	7.375	7.875
	Mtg. History 2x30	75%	5.875	6.375	6.875	7.375	3.625	6.125	6.625	7.125	7.625	3.875	7.000	7.500	8.000
	BKFC 3/2	80%	6.000	6.500	7.000	7.500	3.750	6.250	6.750	7.250	7.750	4.000	7.125	7.625	8.125
	Debt Ratio <=50%	85%	6.250	6.750	7.250	7.750	4.000	6.500	7.000	7.500	8.000	4.250	7.375	7.875	8.375
		90%	6.375	6.875	7.375	7.875	4.125	6.625	7.125	7.625	8.125	4.375	7.500	8.000	8.500
		95%	7.000	7.500	8.000	8.500	4.750	7.250	7.750	8.250	8.750	5.000	8.125	8.625	9.125
		100%	7.625	8.125	8.625	9.125	5.375	7.875	8.375	8.875	9.375	5.625	8.750	9.250	9.750
Y5	Credit Score 580-609	70%	5.875	6.375	6.875	7.375	3.625	6.125	6.625	7.125	7.625	3.875	7.000	7.500	8.000
	Mtg. History 2x30	75%	6.000	6.500	7.000	7.500	3.750	6.250	6.750	7.250	7.750	4.000	7.125	7.625	8.125
	BKFC 2/2	80%	6.125	6.625	7.125	7.625	3.875	6.375	6.875	7.375	7.875	4.125	7.250	7.750	8.250
	Debt Ratio <=50%	85%	6.375	6.875	7.375	7.875	4.125	6.625	7.125	7.625	8.125	4.375	7.500	8.000	8.500
		90%	6.750	7.250	7.750	8.250	4.500	7.000	7.500	8.000	8.500	4.750	7.875	8.375	8.875
		95%	7.500	8.000	8.500	9.000	5.250	7.750	8.250	8.750	9.250	5.500	8.625	9.125	9.625
		100%	8.125	8.625	9.125	9.625	5.875	8.375	8.875	9.375	9.875	6.125	9.250	9.750	10.250
Y4	Credit Score 560-579	70%	6.000	6.500	7.000	7.500	3.750	6.250	6.750	7.250	7.750	4.000	7.125	7.625	8.125
	Mtg. History 1x60	75%	6.125	6.625	7.125	7.625	3.875	6.375	6.875	7.375	7.875	4.125	7.250	7.750	8.250
	BKFC 1/1	80%	6.375	6.875	7.375	7.875	4.125	6.625	7.125	7.625	8.125	4.375	7.500	8.000	8.500
	Debt Ratio <=50%	85%	6.875	7.375	7.875	8.375	4.625	7.125	7.625	8.125	8.625	4.875	8.000	8.500	9.000
		90%	7.625	8.125	8.625	9.125	5.375	7.875	8.375	8.875	9.375	5.625	8.750	9.250	9.750
		95%	8.250	8.750	9.250	9.750	6.000	8.500	9.000	9.500	10.000	6.250	9.375	9.875	10.375
Y3	Credit Score 540-559	70%	6.875	7.375	7.875	8.375	4.625	7.125	7.625	8.125	8.625	4.875	8.000	8.500	9.000
	Mtg. History 2x60/1x90	75%	7.000	7.500	8.000	8.500	4.750	7.250	7.750	8.250	8.750	5.000	8.125	8.625	9.125
	BKFC 1/0	80%	7.250	7.750	8.250	8.750	5.000	7.500	8.000	8.500	9.000	5.250	8.375	8.875	9.375
	Debt Ratio <=50%	85%	8.000	8.500	9.000	9.500	5.750	8.250	8.750	9.250	9.750	6.000	9.125	9.625	10.125
		90%	8.625	9.125	9.625	10.125	6.375	8.875	9.375	9.875	10.375	6.625	9.750	10.250	10.750
		95%	9.875	10.375	10.875	11.375	7.125	9.625	10.125	10.625	11.125	7.375	10.500	11.000	11.500
Y2	Credit Score 500-539	70%	7.875	8.375	8.875	9.375	5.625	8.125	8.625	9.125	9.625	5.875	9.000	9.500	10.000
	Mtg. History 0x	75%	8.000	8.500	9.000	9.500	5.750	8.250	8.750	9.250	9.750	6.000	9.125	9.625	10.125
	BKFC <1 Year	80%	8.625	9.125	9.625	10.125	6.375	8.875	9.375	9.875	10.375	6.625	9.750	10.250	10.750
	Debt Ratio <=50%	85%	9.875	10.375	10.875	11.375	7.125	9.625	10.125	10.625	11.125	7.375	10.500	11.000	11.500
Y1	Credit Score 500-515	70%	8.500	9.000	9.500	10.000	6.750	8.750	9.250	9.750	10.250	7.000	10.125	10.625	11.125
	Mtg. History 0x	75%	9.125	9.625	10.125	10.625	6.875	9.375	9.875	10.375	10.875	7.125	10.250	10.750	11.250
	BKFC <1 Year	80%	9.500	10.000	10.500	11.000	7.250	9.750	10.250	10.750	11.250	7.500	10.625	11.125	11.625
	Debt Ratio <=70%														

ARM Floor Rate = 5.00% | **Fixed Floor Rate = 5.95%**

Note: Rate may be higher than floor rate. Floor rate, after all adjustments, including cap/margin, must be at or above the floor rate.

General Notes
- Rates may be hedged upon assurance of all pass-through conditions.
- Maximum margin is posted - No further margin buyup available.
- No Section 32 or state-specific high cost loans
- Lender Fees: $495 + Tax Service (State Specific)

Maximum Broker Compensation:
- Broker Compensation is capped at a total of 5%
- 0.00 Libor, 3/27 ARM & Fixed rate (equal to/plus penalty) =<1.00>
- 1 Year ARM(without prepay penalty) = PAR

Prepayment Penalty Adjustments:

	Rate and Margin			
	1 Yr ARM	2/28 ARM	3/27 ARM	All Fixed
No Prepay	0.50	0.00	0.00	0.75
2 Years Prepay	n/a	0.00	0.25	0.25
3 Years Prepay	n/a	n/a	0.00	0.00

Adjustments:

	Rate/Margin
Stated Only Program	+.250
Piggyback	-.125
Site Doc	+.250
Second Home	+.250
Non-Owner Occupied	+.500
2-4 Units	+.500
High-Rise Condo	+.250
Loan Amounts <= $75,000	+.500
Loan Amounts $75,001 - $149,999	As Posted
Loan Amounts $150,000 - $400,000	-.100
Loan Amounts >= $400,001	-.250

Loan Programs:
30/15 Balloon or 15 Year Fixed
1 Year ARM

Refinancing:
Reduce 30 yr Fixed by .25
Reduce 2/28 ARM by .125

SUBPRIME MORTGAGE REWARDS
Credit Grades Y2, Y3 & Y4 only

0 x 30 last 24 mos.	Reduce rate by 37.5 bps
0 x 30 last 12 mos.	Reduce rate by 25 bps
1 x 30 last 24 mos.	Reduce rate by 25 bps

Refer guidelines for additional information and restrictions.

Title Policy Based solely for the indicated states, and including:

ARM Notes:
AL, AK, AZ (min loan: $6,000), AR, CA, CO, CT, DE, DC, FL
GA (sfo min loan: $200,000, invest-ARM, 2nd home), HI, ID, IN, IL
IA, KS, KY, LA, MD, MA (2nd home purchase & investment)
MI, MN, MS, MO, MT, NE, NH, NC (min loan: $100,001)
NJ (sfo purchase min loan: $355,673; investment, 2nd home)
NM (min loan: $259,650), ND, NV, NY, OH, OK, OR, PA, RI
SC (sfo min loan: $200,000; 2nd & investment min loan: $150,001)
SD, TN, TX, UT, VA, VT, WA, WI, WV, WY

Fixed Rate loans and 30/15 Balloon in:
AL, AZ (min loan: $6,000), AR, CA, CO, CT, DE, DC
FL, GA (sfo min loan: $200,000, investments, 2nd home), HI, ID, IN, KY
LA (min loan: $20,000), MA (2nd home purch & inv), MD, ME, MI, MN, MO, MT
NE, NH, NV, NY (2yr max; Max YSP <2.00%), *NC (2yr max; min loan $150,001)
ND, OH, OK, OR, PA (min loan: $30,001), RI (refinances)
SC (sfo min loan: $200,000; 2nd & investment min loan: $150,001)
SD, TN, TX (< 12%), UT, VA, WA, WV (purchases), WI, WY
*30/15 Balloon not available for loans in NC and MA (2nd homes)

Alternative Lending/Subprime Operations Centers:

Baton Rouge (800) 209-7574	4041 Essen Lane, Suite 300, Baton Rouge, LA 70809
Fort Mills (888) 435-5443	3400 Statesville Blvd, Fort Mills, SC 29715
Duluth (800) 474-2544	1401 Willow Pass Road, Concord, CA 94520
Des Moines (888) 640-6110	One Home Campus, West Des Moines, IA 50328

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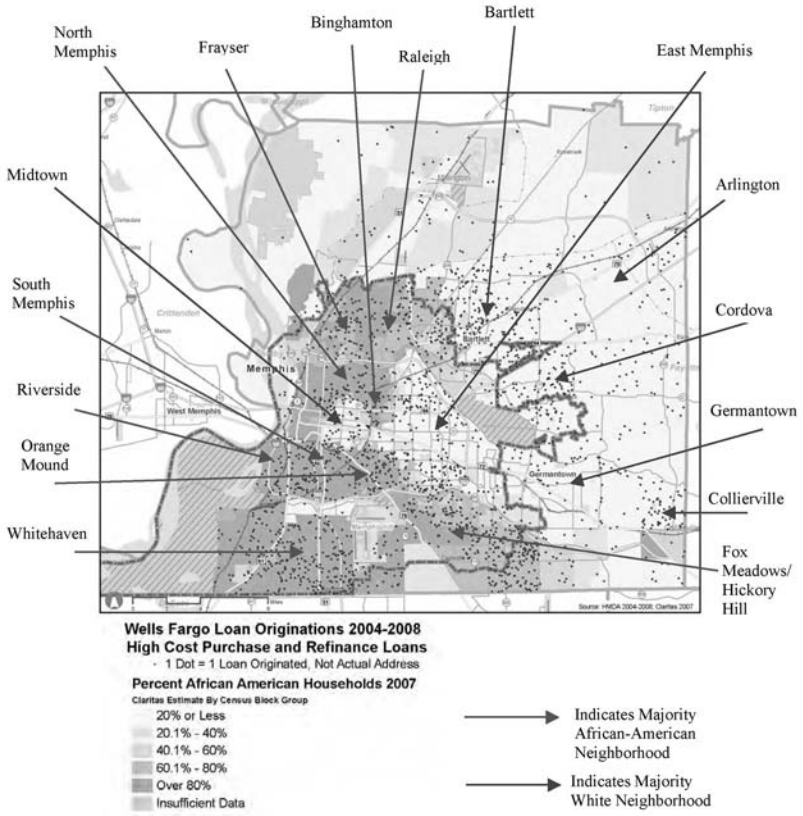
EXHIBIT

11


North Memphis
Frayser
Binghamton
Raleigh
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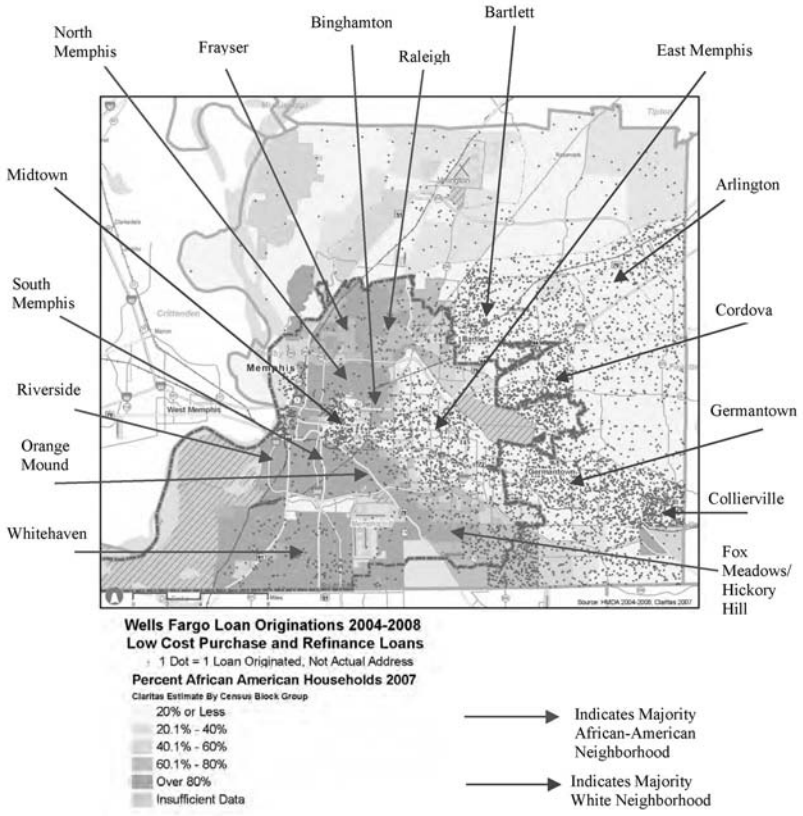
Midtown
Arlington
South Memphis
Cordova
Riverside
Germantown
Orange Mound
Collierville
Whitehaven
Fox Meadows/ Hickory Hill
Memphis
West Memphis
Germantown
Wells Fargo Loan Originations 2004-2008
High Cost Purchase and Refinance Loans
1 Dot = 1 Loan Originated, Not Actual Address
Percent African American Households 2007
Claritas Estimate By Census Block Group
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Insufficient Data
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

EXHIBIT

12



Mr. NADLER. I thank you.

I recognize Mr. Clegg for 5 minutes.

TESTIMONY OF ROGER CLEGG, PRESIDENT AND GENERAL COUNSEL, CENTER FOR EQUAL OPPORTUNITY

Mr. CLEGG. Thank you very much, Mr. Chairman, for the opportunity to testify this afternoon before the Subcommittee.

My name is Roger Clegg. I am President and General Counsel of the Center for Equal Opportunity. I should also note that I was a Deputy in the Justice Department's Civil Rights Division from

1987 to 1991, and during part of that time I supervised the housing and public accommodations section.

My written statement today, Mr. Chairman, makes four points. Just briefly, it is and should be illegal for lenders to treat people differently on the basis of race or ethnicity.

Second, lending practices that do not discriminate in their terms, application, or intent on the basis of race or ethnicity but simply have disproportionate effects on that basis are not and should not be illegal.

Third, I have no opinion on whether bans on subprime lending are a good idea as a matter of macroeconomic policy, but I would note that one likely effect of such a ban is to make loans of any kind unavailable to people who will be viewed by lenders as unacceptable default risks unless they are charged higher interest rates.

Fourth, nobody knows exactly what role racial and ethnic discrimination played in the mortgage meltdown, but it is at least as likely that politically correct rather than politically incorrect discrimination played a serious role; and, accordingly, it would be quite foolish for the Federal Government to repeat its policies during the Clinton and Bush administrations of pressuring lenders to make more home loans to people whose creditworthiness is marginal.

In that regard, Mr. Chairman, I want to commend to the Subcommittee's reading a report that was put out by the United States Commission on "Civil Rights last year on Civil Rights and the Mortgage Crisis." It is quite evenhanded. In fact, it is so evenhanded that in many respects it does not draw conclusions. But it is, nonetheless, I think a very useful compilation of information in a disinterested way on the role that race and ethnicity may have played in mortgage policies and in the mortgage crisis.

For the balance of my time I would like to make a few other points that are not in my written statement but that are prompted by the statements that the other witnesses have made; and, of course, I didn't get those statements until after my own statement was due, so that's why I'm playing catch-up here.

One point I would make is something that, Mr. Chairman, I think you've already sort of, you know, hinted at. And that is that even if subprime loans were evenly spread among racial groups there would still be a problem if they were unfair or if they had dangerous macroeconomic effects. That's one reason why I think that, in looking at this issue, it's important to bear in mind that, in some instances, there might be problems whether or not there is discrimination on the basis of race and ethnicity.

Reading the other witnesses' narratives, the basic point seems to be that there are these evil moneylenders out there that are targeting African Americans and African American communities for subprime loans because they are gullible enough to accept them. I'm skeptical that most lenders are deliberately deciding to charge higher interest rates on the basis of race rather than on the basis of creditworthiness. I don't think that most lenders like to make loans that are going to be defaulted on, and there are plenty of lenders out there so that competition among them will keep interest rates at a reasonable level.

Even if this is true, even if African Americans or other groups are being targeted, I want to go on and offer one other observation. This is not a new claim, and it's not limited to the home loan area. In fact, we've already heard that this is a problem or an allegation that's made in other areas, too—auto loans and so forth.

In our economy, it is not very efficient to say that the government has to go around and investigate every business that has price variations from day to day, from place to place, and from customer to customer. And I hasten to stress that racial discrimination in lending is wrong, and it is illegal. But, ultimately, the best way for customers, for consumers to protect themselves is by shopping around and by maybe making the decision that they should not buy. Don't buy a car at the first dealership that you walk into. Check the newspaper, the real estate section, every day as to what the going rate is for real estate loans. Don't validate the Black-people-are-gullible stereotype.

I know I'm going to be accused of blaming the victim, but sometimes the victim does have to shoulder some of the blame. I'm happy for the government to bring race discrimination cases if it can really show race discrimination. But part of the solution is for consumers to be more careful, more skeptical. They need to shop around, and they may decide that they really can't afford to buy a house right now.

Thank you.

[The prepared statement of Mr. Clegg follows:]

PREPARED STATEMENT OF ROGER CLEGG

TESTIMONY OF

ROGER CLEGG,

PRESIDENT AND GENERAL COUNSEL,

CENTER FOR EQUAL OPPORTUNITY

BEFORE THE

HOUSE JUDICIARY COMMITTEE'S

SUBCOMMITTEE ON THE

CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES

REGARDING

"PROTECTING THE AMERICAN DREAM, PART II:
COMBATING PREDATORY LENDING UNDER THE FAIR HOUSING ACT"

April 29, 2010
2141 Rayburn House Office Building

Introduction

Thank you, Mr. Chairman, for the opportunity to testify this afternoon before the Subcommittee.

My name is Roger Clegg, and I am president and general counsel of the Center for Equal Opportunity, a nonprofit research and educational organization that is based in Falls Church, Virginia. Our chairman is Linda Chavez, and our focus is on public policy issues that involve race and ethnicity, such as civil rights, bilingual education, and immigration and assimilation. I should also note that I was a deputy in the U.S. Department of Justice's Civil Rights Division for four years, from 1987 to 1991, and that during part of that time I supervised the Housing and Public Accommodations Section.

I would like to make four points in my testimony today, Mr. Chairman. (1) It is, and should be, illegal for lenders to treat people differently on the basis of race or ethnicity (in my testimony today, I am going to focus on racial and ethnic discrimination, although of course of the Fair Housing Act forbids other kinds of discrimination, too). (2) Lending practices that do not discriminate in their terms, application, or intent on the basis of race or ethnicity, but simply have disproportionate effects on that basis, are not and should not be illegal. (3) I have no opinion on whether bans on subprime lending are a good idea as a matter of macroeconomic policy, but I would note that one likely effect of such a ban is to make loans of any kind unavailable to people who will be viewed by lenders as unacceptable default risks unless they are charged higher interest rates. (4) Nobody knows exactly what role racial and ethnic discrimination played in the mortgage meltdown, but it is as least as likely that politically correct rather than politically incorrect discrimination played a serious role—and, accordingly, it would be quite foolish for the federal government to repeat its policies during the Clinton and Bush administrations of pressuring lenders to make more home loans to people whose creditworthiness is marginal.

Disparate Treatment, Disparate Impact, and Federal Policy on Lending

Disparate treatment in lending on the basis of race and ethnicity. If a lender refuses to make home loans to people on the basis of race or ethnicity, or makes such loans only under different terms and conditions, this violates federal law, including the Fair Housing Act. So, for example, if a lender refused to make home loans to African Americans, or charged them higher interest rates, because of their race, this would be illegal. I don't believe there is anyone who would disagree with this statement, and there are few who would wish it otherwise and who would push to see the law changed.

Disparate impact in lending on the basis of race and ethnicity. Suppose, however, that a lender has a policy that does not discriminate by its terms on the basis of race or ethnicity, nor is it applied unequally on that basis, nor was it adopted with discriminatory intent – but nonetheless it turns out that the policy has a disproportionate effect on some racial and ethnic groups versus other racial and ethnic groups. That is, suppose that a lender will not make loans to individuals with a poor credit history or work

history, or requires a certain down payment, or will not make loans on homes that are priced below or above certain values – and these practices turn out to have disproportionate effect on a particular racial or ethnic group. Is this illegal?

In my view, this does not violate the Fair Housing Act, as I explain in a column I wrote some years ago for *Legal Times* (see appendix to my testimony). The Supreme Court has never resolved the question whether there is a "disparate impact" cause of action under the Act, although the courts of appeals have almost all recognized it, which is too bad. It is hard to predict what the Supreme Court will do, if this issue ever does come before it, although I will note that the current Court is correctly wary of the disparate-impact approach (see *Ricci v. DeStefano*, 129 S. Ct. 2658 (2009), including Justice Scalia's concurrence noting the constitutional problems that the approach raises). See also *Smith v. City of Jackson*, 544 U.S. 228 (2005) (suggesting that most justices are not willing to recognize an "effects" test for a law absent statutory language supporting it).

As matter of policy, I do not like the disparate-impact approach to civil-rights law enforcement, as I explain in, for example, a 2001 monograph, *Disparate Impact in the Private Sector: A Theory Going Haywire* (published by the National Legal Center for the Public Interest); this monograph expands on an earlier article, "The Bad Law of 'Disparate Impact,'" *Public Interest* (Winter 2000), at 79 [link: http://www.nationalaffairs.com/public_interest/detail/the-bad-law-of-disparate-impact]. In this regard, I would also like to cite testimony recently given to this Subcommittee in "Part I" of these hearings, by Professor Kenneth L. Marcus (on March 11, 2010) [link: http://judiciary.house.gov/hearings/pdf/Marcus100311.pdf]; see also Robert R. Detlefsen, *"HUDlining": Disparate Impact and Insurance* (Oct. 1977 Policy Brief published by the Center for Equal Opportunity) [link: http://www.ceousa.org/content/view/750/138/].

I will not rehash all I've written on the subject here. I will just say that disparate-impact discrimination is really not discrimination at all, and that the threat of disparate-impact lawsuits – in which a judge or jury will use dubious criteria to second-guess business judgments, making the outcome hard to predict, and which are expensive for defendants, win or lose – inevitably pushes potential defendants into either getting rid of perfectly legitimate selection criteria, or overlaying those criteria with quotas, or both. There is an obvious irony here: In the name of civil-rights enforcement, disparate-impact claims actually cause discrimination.

The claim is always made that disparate-impact lawsuits are an essential tool because it is too difficult to prove disparate treatment, but this is not true. Parties bring and win disparate-treatment cases all the time, especially in the housing area, and it is perfectly permissible to use statistical and circumstantial evidence in these cases. Furthermore, it is disturbing for the government to say, since we are having trouble proving an offense, we are going to fix the problem by making it illegal to do something that is not offensive. What's worse, in this area, even if the defendant can prove that he had no discriminatory intent, he will still be held liable.

Unintended consequences of discouraging subprime lending. I am a lawyer and not an economist, so I'm not really in a position to offer much in the way of advice on what the government's role should be with respect to subprime lending.

Of course, as noted above, I think that it is illegal racial discrimination if the lender engages in disparate treatment on the basis of race, but it should not be considered illegal racial discrimination if there is only a disparate impact. So, if a lender is charging African Americans higher interest rates than Asian Americans, because of race, then that is and should be illegal. On the other hand, if it turns out that his racially neutral policy of charging higher interest rates to those with poor credit histories has a disparate impact on the basis of race, that is not and should not be illegal.

Putting aside the (quite correct) ban on racial discrimination, as a conservative I am generally inclined to say the government should let private parties negotiate their own contracts. It may be plausible, however, that in this area an exception should be made and there should be government regulation, on the grounds that there might be aggregate and unacceptable macroeconomic consequences when there has been widescale subprime lending and the economy suffers a downturn. But this is an economic issue, not a civil-rights issue.

And let me add this caveat: An unintended consequence of government limits on subprime lending may be to make loans unavailable *on any terms* to people with marginal creditworthiness, even from otherwise willing lenders. That is, a lender might be willing to make a subprime loan to someone, but if the government intervenes and starts to dictate the conditions of that loan, the lender may decide simply not to make a loan to that person, period. Now, this might actually prevent the prospective lendee from entering into a bad bargain, but it might also prevent someone from buying a home under terms that he was happy with and could have met.

By the way, if there was an uptick in subprime lending in the recent past, it may have come about because lenders were being pressured by government and quasi-government agencies to make more loans to individuals with marginal creditworthiness. The response of the lenders might have been, "Fine, but if we have to make these loans, we will have to charge higher interest rates to make them economically feasible." Thus, the same people who are lamenting "predatory lending" may have caused it by pushing for more loans to members of this or that racial, ethnic, or income group.

Discrimination and the mortgage meltdown. I noted earlier that I am not an economist, so there is little point in me giving you my opinion on what caused the mortgage meltdown in general or, specifically, what role racial and ethnic discrimination played in it. I hope that the other witnesses today who are not economists, and the members of the Subcommittee who are not economists, will likewise be cautious in the conclusions they draw – especially since there is no consensus even among economists about the cause of the Great Recession, or the Great Depression, or many other things.

I will note, however, that there is strong evidence that politically correct racial and ethnic discrimination played at least as important a role as politically incorrect racial and ethnic discrimination in the mortgage crisis. In this regard, I would refer the Subcommittee to an important report: United States Commission on Civil Rights, *Civil Rights and the Mortgage Crisis* (September 2009). Other experts have concluded that, indeed, government efforts to push lenders to make more loans to certain racial, ethnic, and income groups helped cause the crisis. See, for example, Stan J. Liebowitz, *Anatomy of a Train Wreck: Causes of the Mortgage Meldown* (2008) [link: http://www.independent.org/pdf/policy_reports/2008-10-03-trainwreck.pdf]; Thomas Sowell, *The Housing Boom and Bust* (Basic Books, 2010); Howard Husock, "Housing Goals We Can't Afford," *N.Y. Times* (December 11, 2008) [link: http://www.nytimes.com/2008/12/11/opinion/11husock.html]; see also Paul Taylor, "The Risks Posed to National Security and Other Programs by Proposals to Authorize Private Disparate Impact Claims Under Title VI," 46 *Harv. J. Legis.* 57, 105-06 (2009); Editorial, "Covering Their Fannie," *Investor's Business Daily* (April 3, 2010) [link: http://www.investors.com/NewsAndAnalysis/Article.aspx?id=529897]; Editorial, "The Subprime Lending Bias," *Investor's Business Daily* (December 22, 2008); Hans von Spakovsky, "It's Time to Uproot the Real Cause of the Mortgage Crisis," *Pajamas Media* (December 20, 2008) [link: http://pajamasmedia.com/blog/its-time-to-uproot-the-real-cause-of-the-mortgage-bailout/].

It seems to me, Mr. Chairman, that the last thing the government should do is encourage lenders to worry about anything other than creditworthiness in making loans. We are not out of the woods of the Great Recession yet, and, when we are, we certainly don't want to turn around and go back into those woods. Ramping up the use of disparate-impact civil-rights enforcement, and any other kind of pressure on lenders to make sure that they get their racial and ethnic numbers right, is a bad idea.

Conclusion

In sum, Mr. Chairman, our fair housing laws should and do make it illegal for lenders to treat people differently on the basis of race or ethnicity, and that is how they should be enforced. As a matter of law, legal policy, and economics, those laws should not be used to coerce lenders into arriving at politically correct statistical results.

Thank you again for the opportunity to testify today.

Appendix

Legal Times
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October 7, 2002
Volume 25; Issue 39
Section: Points of View; Discriminating Eye

HOME IMPROVEMENT

THE COURT SHOULD KILL AN UNFAIR HOUSING STRATEGY WITH NO BASIS IN LAW.

Roger Clegg

Cuyahoga Falls v. Buckeye Community Hope Foundation, scheduled for Supreme Court argument this term, has received relatively little publicity so far. But one of the issues for which the Court granted cert is extremely important: Whether the federal Fair Housing Act's ban on racial discrimination can be violated by someone who does not engage in racial discrimination.

The answer to that question ought to be an obvious no. But unfortunately the federal courts of appeals have generally allowed "disparate impact" claims to be brought under the statute. These claims do not allege, and need not prove, that individuals were treated differently because of their race. Instead, it is enough to show that a neutral practice has a disproportionate effect--that is, a disparate impact--on some racial group.

For instance, if a landlord refuses to rent to people who are unemployed, and it turns out that this excludes a higher percentage of whites than Asians, then a white would-be renter could sue. It would not matter that the reason for the landlord's policy was race-neutral and had nothing to do with hostility to whites. The landlord would be liable, unless he could show some "necessity" for the policy. This, in turn, would hinge on whether he could convince a judge or jury that the economic reasons for preferring to rent to the gainfully employed were not only nondiscriminatory but essential. And that is a role of the dice.

More-Disparate Impact

There are lots of other examples of race-neutral policies that can be challenged because of the disparate impact they have in the housing market. Suppose a lender refuses to make home loans to felons--or simply to people with poor credit ratings. Those practices also will have a disparate impact. The same is likely true if a city makes a particular zoning decision (the underlying controversy in Cuyahoga Falls) or has per-house or per-apartment occupancy limits (an increasing area of controversy in many communities).

Federal regulations under the Fair Housing Act also cover insurers. This raises additional disparate-impact issues. Suppose an insurance company refuses to write policies for homes more than 40 years old, or if their market value is less than $40,000. Such rules of thumb are in fact common, and they tend to have a disproportionate impact on certain (often minority) neighborhoods.

In Cuyahoga Falls, the plaintiffs include a nonprofit corporation that sought (ultimately, with success) to build a low-income apartment complex in the city. Despite some public opposition, the city council approved the plan, but subsequently opponents invoked a referendum process. The U.S. Court of Appeals for the 6th Circuit held, among other things, that the city's decision to allow the referendum subjected it to liability under the Fair Housing Act, even if no discriminatory intent were shown.

It is a good sign that the Supreme Court has granted review in Cuyahoga Falls. A majority of the justices are clearly uncomfortable with the disparate-impact approach in a variety of contexts, and rightly so. It is a powerful engine in favor of quotas and racial preferences and against rational and economically sound selection criteria (so it's no surprise that the civil-rights left is so enamored of it). Thus in the two past

terms, the Court has raised questions about the legality of federal regulations that use the disparate-impact approach (Alexander v. Sandoval in 2001) and granted review in another case (Adams v. Florida Power Corp., dismissed earlier this year as improvidently granted) that challenged the approach under the Age Discrimination in Employment Act.

The last time the disparate-impact controversy made it to the Supreme Court in a housing case was in Town of Huntington v. NAACP (1988). The Reagan administration filed a brief urging the Court to reject the "disparate impact" approach. But the Court decided the case on other grounds, and expressly reserved the disparate-impact issue for another day. The first Bush administration continued the Reagan administration's policy of not adopting the disparate-impact approach under the Fair Housing Act, but the Clinton administration reversed it. The current Bush administration has filed an amicus brief in Cuyahoga Falls supporting the city, but the brief explicitly states that it "does not address the disparate impact question."

The heart of the Fair Housing Act is 42 U.S.C. Section 3604(a) and (b), which ban all discrimination in selling or renting dwellings "because of" race or national origin, among other things. It's impossible to square the "because of" requirement with the disparate-impact approach. The Supreme Court itself, in Personnel Administrator v. Feeney (1979), makes this point: "It ['discriminatory purpose'] implies that the decisionmaker... selected or reaffirmed a particular course of action at least in part "because of,' not merely "in spite of,' its adverse effects upon an identifiable group."

The statute's text uses not only the phrase "because of" race but also "on account of" (Section 3606) and "based on" (Section 3604(c)). It's very hard to see how all of these phrases can be read to include a disparate-impact cause of action. All of them, to the contrary, are naturally read to require a showing of disparate treatment.

The phrase "on account of" appears not only in Section 3606, but also in Section 3617. Plaintiffs would, presumably, insist that in the former the phrase allows disparate-impact causes of action. But it is quite implausible for it to be interpreted that way in the latter Section , which bans coercion and intimidation of those exercising fair-housing rights. And reading language one way in one Section and another way in another Section is disfavored.

Likewise, the law includes Section 3631, which delineates certain fair-housing violations as crimes. It is very hard to see how any criminal provision would be interpreted to allow prosecutions based on a disparate-impact theory. Yet Section 3631 uses the same "because of" language as Section 3604. Once again, a construction of the statute that interprets a phrase one way in one Section and in another way elsewhere is implausible.

Indeed, the disparate-impact approach would render many of the provisions in the statute regarding the handicapped superfluous. For instance, the failure to make or allow "reasonable modifications" and "reasonable accommodations" as required by Section 3604(f)(3)(A) and (B), respectively, could have been attacked under a disparate-impact theory without those provisions.

More broadly, an effects approach will require judges and juries to conduct a standardless "balancing" test of discriminatory effect versus myriad, hard-to-quantify interests of the city. Congress should be held to a clear statement rule in this area. If it wants to make something illegal, it must say so, and plaintiffs must prove that Congress did so. Lack of a clear answer means defendants win.

There is overwhelming evidence in the legislative history of the original, 1968 act that the statute did not allow a disparate-impact cause of action. Respondents may argue, however, that somehow extensive amendments made to the act in 1988 negate that. But there was no amendment in the wording of the relevant parts of the statute. The natural reading of that text is to require a showing of disparate treatment. That was not changed.

Moreover, by 1988, the Supreme Court had repeatedly--for example, in Washington v. Davis (1976), City

of Mobile v. Bolden (1980), and Guardians Association v. Civil Service Commission of New York (1983)--noted the important distinction between disparate-treatment causes of action and disparate-impact causes of action. Yet Congress still failed to spell out that disparate-impact causes of action were going to be allowed under the 1988 amendments.

Congress knew and knows how to do so. It codified the disparate-impact approach when it passed the 1982 amendments to the Voting Rights Act; it spelled out a disparate impact cause of action under the Americans With Disabilities Act in 1990; and it codified that approach for Title VII of the Civil Rights Act of 1964 in its 1991 amendments to that statute. These are the only three federal civil rights statutes that explicitly contain a disparate impact cause of action, and the Court has not recognized one under any other statute. (To be sure, it did so for Title VII before it was explicitly codified, although it soon thereafter refused to do so for Title VI.)

And so President Ronald Reagan, in signing the 1988 amendments, stated his understanding that the statute "speaks only to intentional discrimination." And the president's understanding of legislation is as important as Congress'; they are both participants in the lawmaking process.

If there is no textual support for a disparate-impact cause of action in the 1988 amendments, and if there is no definitive support for it in the legislative history, the remaining argument to support disparate impact in fair housing law is that many lower courts had recognized a disparate-impact cause of action under the original 1968 version of the act. That means, so the argument goes, that Congress implicitly endorsed the approach when it reenacted the statute in 1988 with full knowledge of those decisions.

But Congress also knew that the Supreme Court had not resolved this question. During the summer of 1988, while the amendments were still before Congress, the Justice Department was arguing to the Supreme Court that it ought to grant certioriari in Huntington and rule against a disparate-impact approach (the 2nd Circuit's Huntington decision was cited in a House report dated June 17). In other words, Congress could hardly be said to have been endorsing settled case law by passing the 1988 legislation, because no settled case law existed.

Reading the Law

Finally, the conservatives on the Court have been reluctant to allow legislative history to trump statutory text. It is not speeches and hearings and committee reports that Congress enacts into law, but the words of a bill. By the same token, the justices ought to be reluctant to allow the meaning of statutory text to be trumped by lower court interpretations and by an unrealistic assumption that senators and representatives were aware of and approved those decisions.

No one has any quarrel with the proposition that there is liability under the Fair Housing Act if a policy singles out particular racial groups for disparate treatment. And there's also no quarrel with enforcing the law if an ostensibly race-neutral policy is in fact unequally enforced, or even if a neutral policy--classically, a "grandfather clause"--is deliberately adopted because it will tend to exclude members of a racial group. The issue, rather, is whether a policy that is racially neutral by its terms, in its application, and in its intent can nonetheless be treated as illegal discrimination because of racially disproportionate results.

And the issue is a very real one. Earlier in this column I alluded to the possibility that a lender's reluctance to make loans to people with poor credit ratings might be challenged as having a disparate impact. This isn't a far-fetched horror story. On Sept. 13 the Federal National Mortgage Association-- Fannie Mae--was sued because it "focuses overwhelmingly on a prospective home buyer's credit score" and "Credit scoring systems routinely penalize minority applicants with higher interest rates or outright denials of mortgages." And so the complaint alleges, among other things, a disparate-impact violation of the Fair Housing Act.

The disparate-impact approach is dubious as a matter of policy, and lacks support in the text of the Fair Housing Act. The Supreme Court has a great opportunity in Cuyahoga Falls to set the law straight.

Mr. NADLER. I now recognize Ms. Miller for 5 minutes.

TESTIMONY OF GILLIAN N. MILLER

Ms. MILLER. I'm here to share my homeowner experience. I became aware of a program in a local newspaper assisting first-time home buyers with a down payment on a home. I wasn't certain I qualified because I had previously owned a home in another State. Nonetheless, I met with the person and found they were a combined mortgage broker and realty firm. I was told I didn't qualify for this down payment program because of one negative account on my credit report. I believe they would have found anything negative just so they wouldn't have qualified me for a down payment, and I realized the add was a ploy to get people in the door.

As such, I decided to work for the realtor from that office and a mortgage broker at Summit Mortgage instead. Our initial meeting was at a Dunkin' Donuts and subsequent meetings were made at places of similar nature, rather than in an office setting.

My credit score, as it turned out, which was above 660, was high enough that it qualified me for a hundred percent financing. I must admit I was not entirely sure of what a hundred percent financing meant. The broker informed me that it qualified me for no down payment.

Our second meeting was to give her my financial information, bank statements, and pay stubs. I was also asked if I had any retirement savings, although I found it odd that the broker would ask me about a 401. It wasn't something I questioned until much later, when I found out it was counted as part of my income.

At a later meeting, I learned that I would receive an 80/20 loan and that it meant the loan would be split. However, I still was not really clear on what that meant until closing where I had two sets of documents to sign and what appeared to be two mortgages. This is when my eyebrow was first raised.

During closing, I read through as much of the huge number of documents as I could, but there were so many documents I couldn't read through everything. I asked the broker why I received this kind of mortgage. The broker stated this was the best deal we could do for you; and I responded, with my credit score, this is the best deal?

At the end, I decided to trust her. I am a consumer. It is not my job to know what a broker does. All I can do as a consumer is ask the right questions and hope that the answers given are truthful based on the nature of that person's profession and trust that that person knows what he or she is doing.

I was apprehensive in signing the documents and voiced this to the broker and to the broker's closing attorney, but it was stressed to me that my closing was imperative so that the sellers could close on time, which was the same day.

In essence, I was coerced into signing the papers due to the sellers needing to have the money from my closing to attend their closing and because I was worried about losing the home and my deposit. It was during closing that I learned for the first time that my two loans would be sold to Countrywide.

At the end of the day, I did receive two mortgages. The first loan, despite my good credit, was a variable rate with an APR of 11.52

percent. The loan included more than $8,500 in settlement charges. The second loan was at 11.317 percent. Under that loan, after making 179 payments of $629.38, I would have a balloon payment of more than $55,000 due in a lump sum.

As I had no way of knowing the rates paid by White borrowers with similar credit to me, it wasn't until much later that I learned that it was very likely that my loans were at rates and on terms that were worse than those available to White borrowers who are similar to me.

While I am not a person who cries discrimination whenever a problem arises, I do think that the system needs to be designed so that people with the same credit ultimately get the same rates and all borrowers should be able to rely on a system that allows them to get loans with understandable terms at affordable rates.

In the end, the loan, despite my best efforts, were unaffordable. Three months after I moved into the home, I lost my job. I lived off of a small savings until I ran into financial difficulty. I reached out to a nonprofit. They paid the second mortgage, and it was during this meeting in which the woman I met saw discrepancies with the fees on my loan documents.

I also reached out to Countrywide to inform them of my financial situation and asked if the loan could be modified.

It is imperative that I emphasize that I am very marketable in terms of job skills, and I did not anticipate being out of work for too long. I took whatever job I could, but I could not manage the high payments. I worked a series of temp jobs with a decrease in pay and worked with several employment agencies to find permanent employment. I tried refinancing with another lender. I contacted several non-profits to assist me in paying the mortgage or to help me negotiate a modification with Countrywide, to no avail. I eventually had to take two jobs, one working 11 p.m. To 7 a.m., the other working from 11 a.m. To 7 p.m., in addition to attending classes two evenings a week to obtain my bachelor's degree.

I sent all of the necessary paperwork to the modification department at Countrywide. It was 2 weeks before I spoke with anyone, and that was only after I initiated contact to find out the status. I was told they hadn't received the paperwork. I resubmitted it for the second time, where I was informed that I did not qualify for the modification. I fought with them, stressing the combined income from the two jobs, and they resubmitted the paperwork for a third time.

When I finally heard back from a representative from the modification department, it was via voicemail. As such, we played phone tag and never spoke. And a few days later, I received a notice to foreclose.

I was still willing to fight for the house, and my last effort to keep the house was to file Chapter 13. But with the new bankruptcy laws in place, the payments to the trustees pushed me over my monthly income limit and, sadly, I was forced to convert to Chapter 7 a few months later. I was told by a court clerk that I would have to vacate the premises because the stay would be lifted and the foreclosure procedure would commence immediately. Not wanting to be homeless with my children, I rented a townhouse within walking distance from the said property.

The house was supposed to foreclose in 2007, 2008, and again in 2009, but as of date, it is still sitting there.

When President Obama passed the stimulus package, I was told by Countrywide that my status was placed on hold and this is why the house had not foreclosed. Yet they were unwilling to work with me on getting the house back, because, according to the person I spoke with, I have to reside in the home in order to get help.

In closing, I'd like to say that we speak about having the American dream, and as an immigrant to this country from Barbados, it was something to look forward to achieving, having an education, a great career, home ownership, a family. I worked hard in achieving my educational goals. This fall, I will be enrolled in a master's degree program. And, in spite of being divorced, I have managed to single-handedly raise three great children who excel in academics, civic duties, and sports.

I once had home ownership. The experts say when you fall into financial difficulty, the first thing you should do is contact your creditors. Well, I did just that. I took all of the necessary steps. I did everything right, and, in the end, that American dream was taken from me. I was victimized by the lender, the broker, and the courts.

However, even through this ordeal that has caused me great angst and stress, if it means that my story will help the next person not be a victim of someone's pre-judgement based on their skin color or their status, then my attempts to fight for my home, something I worked very hard at attaining, has not been in vain.

[The prepared statement of Ms. Miller follows:]

PREPARED STATEMENT OF GILLIAN N. MILLER

TESTIMONY OF GILLIAN N. MILLER
Subcommittee on the Constitution, Civil Rights and Civil Liberties
April 29, 2010

Prior to moving back to Boston, I was married for 10 years and had been a homeowner. When I returned to Boston with my three kids, owning a home was not a priority, albeit, it was a goal. I rented an apartment for four years when I decided that as my children were getting older, it was important to maintain the same standard of living they were once accustomed to: a home, a backyard, a neighborhood. So began my search; it was the fall/winter of 2005.

In a local newspaper I came across an ad for a program assisting first time home buyers with a downpayment on a home. I wasn't certain I qualified because I had previously owned a home in another state; nonetheless I met with the person and found they were a combined mortgage broker and realty firm. I was told I didn't qualify for this down payment program because of one negative account on my credit report. I believed they would've found anything negative just so they wouldn't qualify me for the downpayment and I realized the ad was a ploy to get people in the door. As such, I decided to work with the realtor and not the mortgage broker. After looking at several properties and not finding anything I liked and/or could afford, I gave it a rest and told myself I would resume searching when the weather broke. It was during this break that I was introduced to a mortgage broker at Summit Mortgage.

Our initial meeting was at a Dunkin Donuts and subsequent meetings were made at an Au Bon Pain or places of a similar nature, rather than in an office setting. My credit score, as it turned out, which was above 660, was high enough that it qualified me for 100%

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financing. I must admit I was not entirely sure of what 100% financing meant. The broker informed me that it qualified me for no down payment. Our second meeting was to give the broker my financial information: bank statements and pay stubs. I was also asked if I had any retirement savings, though I found it odd that the broker would ask me about a 401, it wasn't something I questioned until much later when I realized it was counted as part of my income.

At a later meeting I learned that I would receive an "80/20" loan and that it meant the loan would be split; however, I still was not really clear on what that meant until closing where I had two sets of documents to sign and what appeared to be two mortgages. As aforementioned, I owned a home in the past; closing in that case was done at our dining room table and my ex-husband and I only signed one set of papers so I was a little perplexed. This is when my eyebrow was first raised. During closing I read through as much of the huge number of documents as I could, paying specific attention to fees and dates.

I noticed immediately a few discrepancies. The high interest rate on one loan, the balloon payment, and the fact that I didn't have a fixed-rate mortgage, rather a fixed for 2 years and an adjustable-rate thereafter in which the date the adjustable rate was scheduled to increase was dated at six months from the date of the documents. I asked the broker why did I receive this kind of mortgage? The broker stated, "This was the best deal we could do for you." And I responded, "With my credit score this is the best deal?" I am a

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consumer. It's not my job to know what a broker does, all I can do as a consumer is ask the right questions and hope that the answers given are truthful based on the nature of that person's profession and trust that that person knows what he/she is doing.

I was apprehensive in signing the documents and voiced this to the broker and to the broker's closing attorney. I was worried about losing the home and my deposit. It was also stressed to me that my closing was imperative so that the sellers could close on time, which was the same day. In essence, I was coerced into signing the papers due to the sellers needing to have the money from my closing to attend their closing, with the assurance that the adjustable rate date would be corrected and be mailed for my signature.

Although in the end I did receive corrected papers, I never received copies of the documents with the lenders' signature. Additionally, there were other issues. There wasn't a Homestead in place and because the broker took it upon herself to not have a Homestead in place, there were fees paid on "my behalf" toward taxes and/or insurance. As such, I had to go back to closing a second time to file the Homestead and be reimbursed those fees. I was supposed to have the deposit I submitted with my application returned. When I questioned why it hadn't been returned I was told that it went toward the down payment; however, I was never given the courtesy of asking if I wanted to put that toward a down payment, and further, why would I have to if I qualified for 100% financing?

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I also learned for the first time that my two loans would be "sold" to Countrywide immediately after closing.

At the end of the day I did receive two mortgages. The first loan, despite my good credit, was a variable rate with an APR of 11.52%. That loan included more than $8,500 in settlement charges. The second loan was at 11.317%. Under that loan, after making 179 payments of $629.38, I would have a balloon payment of more than $55,000 due in a lump sum.

As I had no way of knowing the rates paid by white borrowers with similar credit to me, it wasn't until much later that I learned that it was very likely that my loans were at rates and on terms that were worse than those available to white borrowers who are similar to me. While I am not a person who cries "discrimination" whenever a problem arises, I do think that the system needs to be designed so that people with the same credit ultimately get the same rates. And, all borrowers should be able to rely on a system that allows them to get loans with understandable terms at affordable rates.

And, in the end, the loan, despite my best efforts was unaffordable. Three months after I moved into the home I lost my job. I lived off of a small savings until I ran into difficulty paying the mortgage. I reached out to a non-profit, Ecumenical Social Action Committee (ESAC). They paid the second mortgage (the smaller payment) and it was during this meeting in which the woman whom I met saw discrepancies with the fees on my loan

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documents. I also reached out to Countrywide to inform them of my financial situation and asked if the loan could be modified. It is imperative that I emphasize, that I am very marketable in terms of my job skills and I did not anticipate being out of work for too long. I took whatever job I could, but I could not manage the high payments. I worked a series of temp jobs, albeit with a decrease in pay and I worked with several employment agencies to find permanent employment. I tried refinancing with another lender; I contacted several non-profits to assist me in paying the mortgage to help me negotiate a modification with Countrywide to no avail.

I eventually took on two jobs, one working from 11pm to 7am the other working from 11am to 7pm, in addition to attending classes two evenings a week to obtain my bachelors degree. I sent all the necessary paperwork to the modification department at Countrywide. It took weeks before I spoke with anyone and that was only after I initiated contact to find out the status. I was told they hadn't received the paperwork. I resubmitted everything for a second time where I was informed that I did not qualify for the modification. I fought with them about this stressing the combined income with from the two jobs and they resubmitted the paperwork a third time. When I finally heard back from a representative from the modification department, it was via voicemail. As such, we played phone tag and never spoke. A few days later I received a notice to foreclose. The time frame from when I first reached out to Countrywide until the foreclosure notice was March/April to October of 2006.

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I was still willing to fight for this house and my last effort to keep the house was to file Chapter 13. However, with the new bankruptcy laws in place, the payments to the trustee pushed me over my monthly income limit and sadly, I was forced to convert to Chapter 7 a few months later. I was told by a court clerk that I would have to vacate the premises because the stay would be lifted and the foreclosure procedure would commence immediately. Not wanting to be homeless with my children, I rented a townhouse within walking distance from the property.

During this time, I worked with a realtor who had buyers for the property for a short sale but because the house was in bankruptcy it caused problems, equally Countrywide was not being cooperative (according to the realtor). In fact, for whatever reason Countrywide wanted my financial documentation forwarded to them through the realtor as one of the criteria's to sell the house. Due to all of the back and forth issues and paperwork with Countrywide, the buyers and realtor grew frustrated and decided it was too much of a hassle due to the uncooperative personnel at Countrywide and both parties pulled out.

The house was supposed to foreclose in 2007, 2008 and again in September 2009, but as of date, it is still sitting there. I do recall at one point Countrywide changed the locks and the realtor had to contact them to gain access. When President Obama passed the stimulus package I was told by Countrywide that my status was placed on hold and this is why the house had not foreclosed. Yet, they were unwilling to work with me on getting

the house back because according to the person I spoke with I have to reside in the home in order to get help.

In closing I'd like to say that we speak about having the American dream and as an immigrant to this country from Barbados it was something to look forward to achieving: Having an education, a great career, homeownership, a family. I worked hard at achieving my educational goals; this fall I will be enrolled in a social work master degree program, and in spite of being divorced, I have managed to singlehandedly raise three great children who excel in academics, civic duties and sports. I once had homeownership. The experts say when you fall into financial difficulty the first thing you should do is contact your creditors. Well I did just that and more. I took all the necessary steps, I did everything right and in the end that American dream was taken from me. I was victimized by the lender, the broker and the courts; however, even through this ordeal that caused me great angst and stress, if it means that my story will help the next person not be a victim of someone's pre-judgment based on their skin color or their status, then my attempts to fight for my home, something I worked very hard at obtaining has not been in vain.

Mr. NADLER. Let me ask you something on that bankruptcy, Ms. Miller.

You couldn't do Chapter 13 because, including your payments, it was more than the court figured you could afford?

Ms. MILLER. Correct.

Mr. NADLER. So, in other words, you were too poor to qualify for chapter 13 under the new bill?

Ms. MILLER. Probably so. Right.

Mr. NADLER. I just note that because, when we considered that bill, which some of us here were very much opposed to at the time, the whole idea of the bill was to get more people into Chapter 13, away from Chapter 7, and some of us raised the question at that point that by putting on these additional fees and so forth we would make some people too rich for chapter 7 and too poor for Chapter 13 and they wouldn't be able to go bankrupt at all. And we were told don't worry about that. That will never happen. But, obviously, it did.

I'm sorry for that digression.

Mr. Klein is recognized for 5 minutes.

TESTIMONY OF GARY KLEIN, RODDY, KLEIN & RYAN

Mr. KLEIN. I want to thank you, Chairman Nadler, and the distinguished Members of the Subcommittee for the opportunity to testify today.

I am lead counsel in several class actions that seek remedies for minority victims in mortgage lending discrimination.

Some of you may remember that a number of years ago during the 1990's, when I was working at the National Consumer Law Center, I would darken doorways on Capitol Hill talking about subprime lending problems even then and consumer protections for homeowners, including the bankruptcy system. The issue I'm here to talk about today, mortgage discrimination, is a direct consequence of some of the abuses of the subprime lending market that have been in place for at least 10 years and haven't been fixed.

As discussed in my written testimony, the data is now irrefutably clear that minority homeowners, due to a variety of lender practices, pay more for their homes than White borrowers. Date shows that Black and Hispanic homeowners are significantly more likely than White homeowners to have high-cost mortgages. When the data is drilled down, rates for minority borrowers are about one-half of 1 percent higher than for Whites. On a $125,000 mortgage loan, that represents an extra $500 per year in interest costs. Over the life of a 30-year loan, that's about $15,000 more. This has a significant impact on people's lives.

That is, by itself, of course, wrong. The additional borrowing costs paid by minority homeowners means that those borrowers use more of their income each month than Whites to cover their housing costs. The resulting budgetary strain leads to additional foreclosures, especially in these troubled economic times.

From a legal perspective, though, the question is, are these rate disparities driven by real credit differences between minority and White borrowers or do they result from discriminatory practices? Stated another way, are there legitimate business justifications for

charging African American and Hispanic borrowers more for their home loans?

In recent years, statisticians have looked at this issue using straightforward regression analysis. Buyer regression analyses have looked at many millions of home mortgage transactions and can control for differences in credit characteristics such as credit score, home values, debt, and income. And to the surprise of no one in the civil rights community, it turns out that minority borrowers do pay more than similarly situated Whites, even after controlling for an extensive array of credit factors.

In the case of one lender, the data shows that African American and Hispanic borrowers as a group were obligated to pay $102.5 million more than similarly credentialed White borrowers, and that's just in the first 5 years of their loan. Discrimination in this context is highly profitable.

I note, too, that it is not just civil rights lawyers that have reached the conclusion that African American and Hispanic borrowers pay more than similarly situated Whites. As noted in my written testimony, there is a body of academic evidence that finds disparities after controlling for credit and loan characteristics; and analysts working for lenders themselves have reached similar conclusions in self-testing programs. Yet the problem is still not fixed.

So why do these disparities arise and what can be done to fix the problem?

Ms. Miller testified eloquently about her personal struggle with loans made to her by Countrywide at APRs in excess of 11 percent, despite good credit. The high cost of her loan made her vulnerable to even a short period of underemployment. How is it that she became a target for subprime credit and why didn't she have the tools to protect herself?

The first and most prevalent problem is the dirty little secret of the mortgage industry. Loan prices at the end of the day are not set entirely based on objective credit factors but rather are discretionary with the sales force. That is, loan officers and loan brokers have discretion to attempt to convince borrowers to sign up for loans at rates above the rates determined by objective credit factors like credit scores and debt-to-income ratios. In fact, loan officers and loan brokers get paid more when they jack up the interest rate.

Similarly, loan officers and loan brokers have discretion to add to the many fees and charges that are now part of any home mortgage loan. A broker, for example, can add certain charges to a loan which have the effect of increasing that broker's compensation. The unfortunate reality is that these discretionary charges disproportionately affect minority borrowers.

The second problem is that minority borrowers—even borrowers with excellent credit—are more vulnerable to be targeted for and steered into subprime loans. That is, when a lender has a choice, some borrowers are more likely to be pressed into subprime because subprime is more profitable.

The third problem contributing to mortgage discrimination is the sheer complexity of the modern mortgage loan. Closings involve hundreds of pages of paperwork describing often incredibly complex loan terms.

Ms. Miller just testified about a loan made in an 80/20 format. Her first mortgage had a teaser rate and variable rate that only the first 2 years were fixed. After the end of the first 2 years, the rate could increase from 6.75 ultimately up to as high as 12.75 percent. It can be virtually impossible for even a well-educated consumer to decipher variable interest rates, pre-payment penalty terms, rate change provisions, and other similar issues. Borrowers simply don't have the tool in the current lending environment to protect themselves.

Finally, it's fair to ask what needs to be done. Most obviously, we need to rebuild a functional marketplace that does not leave in place the discretion to discriminate. All loans should be made at rates grounded only in objective credit qualifications without discretionary markups and fees. Equally importantly, borrowers who are suffering under the weight of a loan bearing discriminatory term need remedies.

Loans should be reformed to make rates charged to minority borrowers consistent with those charged to Whites; and when real hardship has already been manifest, as it is in Ms. Miller's case, in delinquencies and foreclosures, where victims of discrimination may lose their homes, nondiscretionary mortgage workout loans terms are necessary. Failure to act to prevent foreclosures will not lead just to loss of home ownership but also to property abandonment, abandonment in minority communities, decay, reduction of property values, and to a renewed sense of despair.

Thank you very much for the opportunity to testify.

[The prepared statement of Mr. Klein follows:]

PREPARED STATEMENT OF GARY KLEIN

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

April 29, 2010

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Mortgage Lending Discrimination
and its Role in the Subprime Lending Crisis

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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* Gary Klein and Shennan Kavanagh handle predatory lending class actions at Roddy Klein & Ryan in Boston, Massachusetts. Mr. Klein is a former Senior Attorney at the National Consumer Law Center in Boston and at Community Legal Services in Philadelphia, Pennsylvania.

[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.chasecb2b.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/ncredisclimstudy.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

[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

[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 Modern 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

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[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

[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.")

Mr. NADLER. Thank you.

I will begin the questioning by recognizing myself for 5 minutes.

Mayor Wharton, the City of Memphis and Shelby County is seeking redress for the injuries caused by Wells Fargo, allegedly caused by Wells Fargo, and you contend they have engaged in a practice of illegal and discriminatory mortgage practice lending. What assistance do cities like yours need in battling the practices of banks like Wells Fargo? What should the Civil Rights Division do that it's not doing? What should we in Congress do what we haven't done?

Mr. WHARTON. Thank you, Mr. Chairman.

With respect to the lawsuit, we certainly need the assistance and the investigative powers that the Federal Government has. We reached into our meager funds to retain counsel. We do not have the investigative authority that the government does.

Mr. NADLER. Excuse me. You don't have the resources or the State doesn't have the subpoena or other authority or the city doesn't? Which is it?

Mr. WHARTON. With respect to preparing for the lawsuit, taking the statements of witnesses, the Federal Government has many more investigative resources than those of us at the city level. This is a municipal lawsuit.

Additionally, with respect—and some of the suggestions that have been made even before we get to the lawsuit, more in the way—I will not say by way of legislation—more in the way of financial literacy, perhaps some stopgaps as consumers start down this long and treacherous path, as was the case with Ms. Miller, some intervention there before—there is just no daylight in there. Before the consumer finds out anything, they are already in danger.

I know in some consumer practices there are rights to rescind before the whole process is complete. And the relative positions that the parties share, there should be some—and perhaps this goes to your question at the beginning—some fiduciary responsibility. The relative positions of the purchaser and the lenders here are just so out of balance. These are amazingly complex transactions.

This is not a matter of buying an MP3 player, whatever, you go home, and that's it. These are transactions that even—I did not practice real estate law, but I made a real estate transaction the other day, and I haven't the slightest idea of what I did. They said sign, and I signed. I shouldn't have done that.

But if there could be legislative, many more protections as we go through this almost raising to the level of the lender having the fiduciary responsibility.

And I might—just one other thing. If these were situations in which this was just a benign set of circumstances and the lender goes in and makes a transaction, that's one thing. I perhaps would not be here. This is more than just taking advantage of a maligned—of a benign situation. This is a malignant, intentional act that we're complaining about. Those ought to be outlawed.

Mr. NADLER. Thank you.

Let me ask Mr. Klein. You've represented people in this situation. Talk about malignant acts. Ms. Miller testified one of the mortgages was I think she said $597 a month or something like that for X number of months and then a $50,000 balloon. Now, is

there any way that a lender could expect a person to be able to—a middle-class or moderate-income person be able to pay a $50,000 balloon coming one day? Should such practices be outlawed entirely?

Mr. KLEIN. Put simply, Mr. Chairman, there is no way that a lender could expect that to have been paid.

Mr. NADLER. Could he have been expecting refinancing at that point?

Mr. KLEIN. That's exactly why those kinds of loans are made, Mr. Chairman. They are made so the borrower will be in a position to have no choice other than to refinance at a higher interest rate.

And I should mention as well that Ms. Miller's loan included a prepayment penalty. So had she chosen to refinance fairly early on in the process, she would have incurred that penalty and had to pay even more in order to get out of the situation where the balloon came due.

Mr. NADLER. Let me ask you, Mr. Klein, what further steps are needed to enforce the law in order to combat and prevent these practices, like similarly situated borrowers subjected to discriminatory practices?

Mr. KLEIN. There are a number of arguments that Mr. Clegg made based on a body of opinion I think that disparate impact shouldn't be applicable to cases under the Fair Housing Act; and I think that's just dead wrong, Mr. Chairman.

First of all, as a lawyer, I take comfort in saying that there are 12 courts of appeal, all of whom have decided that disparate impact analysis does apply under the Fair Housing Act.

Mr. NADLER. Wait a minute. I would certainly agree with you. But putting aside the question of disparate impact, if you find that a company, Wells Fargo or somebody else, is generally offering differing mortgage terms to African Americans or to Hispanic people than they are to White people of the same income level, it's not a disparate impact analysis. That's out and out straight discrimination.

Mr. KLEIN. Well, it is and the issue from the court's perspective is that you can't establish the treatment being different without looking back toward the policy that would lead to disparate impact. So, in this particular context, it's the discretionary pricing policy allowing markup by loan officers and loan brokers that's being challenged in these cases. So they are disparate impact cases and probably appropriately so.

When someone speaks of eliminating disparate impact analysis under the Fair Housing Act, what they're really saying is there shouldn't be a remedy for any discrimination.

Mr. NADLER. I'd like you to reply to that, Mr. Clegg.

Mr. CLEGG. I don't think that's true at all. I think the testimony that Mr. Klein gave and that we've heard here and that Mr. Perez gave earlier shows that bringing disparate treatment cases is quite straightforward, and those cases can be brought and won.

The racist comments that Mr. Perez quoted——

Mr. NADLER. Let's assume nobody is stupid enough to make racist comments.

Mr. CLEGG. Well, people are stupid enough to make them.

Mr. NADLER. Sometimes.

Mr. CLEGG. And even when they aren't, you can use statistical evidence and circumstantial evidence in order to prove—in order to show—disparate treatment.

So I don't—I am not somebody who thinks that it ought to be okay for people to discriminate on the basis of race in lending and get away with it. But the government needs to be able to—I think the government should have to prove disparate treatment, and I do think they can do that.

Mr. NADLER. My time is running out.

Would you comment on that, Mr. Klein?

Mr. KLEIN. Sure, Mr. Chairman.

Mr. Clegg is simply dead wrong on the issue. The proof required is proof of disparate impact. There is no treatment issue when everyone is treated facially the same. Everyone is subject to the same possibility of discretionary pricing so that minority homeowners and White homeowners are both subject to discretionary pricing. It's the application of that policy which leads to a disparate impact evaluation which is this fiscal analysis under which you can evaluate what happens to similarly situated Blacks.

Mr. NADLER. Which you need in the absence of an e-mail saying, give a different rate to Black people, or something.

Mr. KLEIN. Absolutely right, Your Honor. And what these cases show is that when you do do the analysis—did I call you Your Honor? Mr. Chairman.

Mr. NADLER. I like to think I'm honorable.

Mr. KLEIN. What the analyses do show when you drill down is that after you take out every conceivable credit characteristic and loan characteristic such that you're looking at the exactly similar situation that Black payers pay more.

Mr. NADLER. Thank you. My time has expired.

The gentleman from Virginia is recognized.

Mr. SCOTT. Mr. Clegg, when you do find discrimination, what is the remedy when there is discrimination in lending?

Mr. CLEGG. Well, the Fair Housing Act has been violated and the Equal Credit Opportunity Act has been violated. Of course, if a State agency is involved, then the Constitution has been violated. And I believe, in some instances, Title II of the 1964 Civil Rights Act is implicated as well.

There are a variety of—those are just the Federal laws that have been violated. There are also frequently State and local laws as well.

Mr. SCOTT. Are there any class-action lawsuits pending that you're aware of on this issue?

Mr. CLEGG. I'm sorry?

Mr. SCOTT. Are there class-action lawsuits pending on this issue?

Mr. CLEGG. I believe so. I think Mr. Klein is bringing——

Mr. SCOTT. Mr. Klein, can you give us a review of some of those pending lawsuits and some that perhaps may have been concluded?

Mr. KLEIN. Yes, Congressman Scott.

There are a number of cases pending in various jurisdictions. Some of them have been consolidated. There are a series of cases pending against Wells Fargo Home Mortgage, pending in a multidistrict litigation proceeding in San Francisco. There are also a series of cases pending against Countrywide, pending in a multi-dis-

trict litigation proceeding in the Western District of Kentucky. There are similar cases against other lenders, including HSBC, Chase, and many of the big subprime lenders like Green Point, 1st Franklin, which is owned by Bank of America.

Mr. SCOTT. What is the basis of the lawsuits?

Mr. KLEIN. They are disparate impact cases based on the discretionary pricing policies of those lenders. What those cases allege is that lenders allowed brokers and loan officers to mark up loans and that that discretion was used in a differential way to mark up loans of minority customers more than White customers.

Mr. SCOTT. Have any of those gone through trial?

Mr. KLEIN. None of them have gone through trial. Several of them are in the process of class certification. One of them, the earliest one for class certification, is pending before Judge Henderson, Judge Thelton Henderson in the Northern District of California.

Mr. CLEGG. Can I make an observation?

I think it's very interesting that the claim here is that the process should be made more mechanical because the lack of mechanicalness has a disparate impact. We hear precisely the opposite claim in other contexts—for instance, college admissions. You know, the claim is that, well, universities should not mechanically make admission decisions just based on SAT scores and grades. It needs to be more "holistic." And that the failure of a university to engage in that kind of holistic review has a disparate impact.

Now, in this context, we are hearing just the opposite. I think that what this, I think, indicates is the whole problem with the disparate-impact approach. I think that this shows that—the touchstone should always be whether there is disparate treatment. It's certainly possible that using a very discretionary touchy-feely standard in this area, in the mortgage area, can facilitate racial discrimination. But I think the challenge should be against the racial discrimination—not saying that, well, because the discretionary standard has this result that we should win this lawsuit even if we are not able to show——

Mr. SCOTT. Well, sometimes, as you call it, touchy-feely results in discrimination. Sometimes a mechanical approach, if you're not using the right standard, can—I mean, if you're using SAT scores, what you're doing is not evaluating the student's potential but the discriminatory education they were subjected to.

Mr. CLEGG. But, see, I think the same sort of argument can be made here, too. You can say, look, why shouldn't the individual be treated as an individual rather than simply looking at his credit score. Maybe——

Mr. SCOTT. There's nothing wrong with the approach. I think what Mr. Klein is complaining about is, when they have that discretion, they used it in a discriminatory way. If they use it in a fair way, then we wouldn't be here.

Mr. CLEGG. Right. And what I'm saying, is when you bring that kind of a lawsuit, the ultimate question should be whether in fact disparate treatment has been proven or not.

Mr. SCOTT. I think you can look at the numbers.

If I can ask one more question.

Mr. Mayor, can you tell us—you're testifying as a mayor of a city. Can you tell us what damage is done when there's widespread discrimination in housing, what it does to a city?

Mr. WHARTON. Certainly.

Forty percent of the operating revenues for the City of Memphis come from property taxes. It has certainly had a damaging effect on our major source of revenue. The police calls—I'm getting into detail. Police calls to boarded-up homes, the effect on neighboring properties of homes that are now vacated, boarded up, and neglected, all of those drive down property values in the immediate neighborhood; and then it tends to spread. Those are very precise, damaging effects that these practices have had on our neighborhoods.

As I indicated in my prepared remarks, they are all racially identifiable. This was not just something that they stumbled upon, but it has had a very damaging effect on property values in those areas that have been hard hit by these practices.

Mr. SCOTT. Some cities have sued because of the damage inflicted on the city for lending practices. Has Memphis filed a lawsuit, or are you aware of other cities who have filed lawsuits?

Mr. WHARTON. We have filed such a lawsuit.

Mr. SCOTT. What is the basis of your lawsuit?

Mr. WHARTON. The Fair Housing Act, and in an amended complaint we are alleging violations of certain State laws.

As I indicated earlier pursuant to the Chair's question, what are we asking, your question brings us to the question of whether we really have the standing for the United States government to become involved in that through the Attorney General's Office. That question would be out of the way.

It would be horrible for our lawsuit to be thrown out simply because the city, for whatever reason, at the early stage could not demonstrate damages, although we know the practices are there. It would seem sort of a miscarriage of justice to say, well, there may be something out there, but you're not the one to come in here and tell us about it. And this is why we are seeking help from the United States Government on this.

Mr. SCOTT. Mr. Chairman, if we could get copies of the lawsuits or any briefs that have been filed, that would be helpful.

[The information referred to follows:]

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

CITY OF MEMPHIS 125 N. Main Street, Room 336 Memphis, TN 38103, and **SHELBY COUNTY** 160 N. Main Street, Suite 660 Memphis, TN 38103 Plaintiffs, v. **WELLS FARGO BANK, N.A.** 464 California Street San Francisco, CA 94104, **WELLS FARGO FINANCIAL TENNESSEE, INC.** 800 Walnut Street Des Moines, IA 50309-3605, and **WELLS FARGO FINANCIAL TENNESSEE 1, LLC** 800 Walnut Street Des Moines, IA 50309-3605 Defendants.	Case No. 2:09-cv-02857x-STA-dkv

FIRST AMENDED COMPLAINT FOR DECLARATORY
AND INJUNCTIVE RELIEF AND DAMAGES

NATURE OF THE ACTION

1. This suit is brought pursuant to the Fair Housing Act of 1968, as amended, 42 U.S.C. §§ 3601 *et seq.*, and the Tennessee Consumer Protection Act of 1977, as

amended, Tenn. Code Ann. §§ 47-18-101 *et seq.*, by the City of Memphis ("City" or "Memphis") and Shelby County ("County" or "Shelby County") to seek redress for the injuries caused by Defendants Wells Fargo Bank, N.A., Wells Fargo Financial Tennessee, Inc., and Wells Fargo Financial Tennessee 1, LLC's (collectively "Wells Fargo") pattern or practice of illegal, discriminatory, unfair, and deceptive mortgage lending. Specifically, Memphis and Shelby County seek injunctive relief and damages for the injuries caused by foreclosures on Wells Fargo loans in their minority neighborhoods that are the result of Wells Fargo's unlawful, irresponsible, unfair, deceptive, and discriminatory lending practices.

2. Wells Fargo is one of the largest mortgage lenders in Memphis and Shelby County. Its market share and number of foreclosures are among the highest of any mortgage lender in Memphis and Shelby County.

3. Since at least 2000, Wells Fargo has been engaged in a pattern or practice of targeting African-American neighborhoods in Memphis and Shelby County for deceptive, predatory or otherwise unfair lending practices. The discriminatory targeting of such practices is known as "reverse redlining" and has repeatedly been held to violate the Fair Housing Act. These practices also violate the Tennessee Consumer Protection Act of 1977.

4. Reverse redlining by Wells Fargo has caused an excessive and disproportionately high number of foreclosures in African-American neighborhoods in Memphis and Shelby County. Wells Fargo's foreclosures are concentrated in these neighborhoods even though the bulk of its lending is in white neighborhoods. Fully 41.1% of Wells Fargo's foreclosures are in predominantly African-American neighborhoods (more than 80% African-American), even though it makes only 15.1% of

its loans in these neighborhoods. At the same time, only 23.6% of its foreclosures are in predominantly white neighborhoods (less than 20% African-American), although the majority (59.5%) of its loans are located in these neighborhoods.

5. Wells Fargo's foreclosure rate for loans in predominantly African-American neighborhoods of Shelby County is nearly seven times as high as its foreclosure rate for loans in predominantly white neighborhoods. Almost 18% of Wells Fargo loans in the County's predominantly African-American neighborhoods result in foreclosure, but the same is true for less than 3% of Wells Fargo loans in its predominantly white neighborhoods.

6. Wells Fargo's disproportionately high foreclosure rate in Memphis' and Shelby County's African-American neighborhoods is the result of reverse redlining. Wells Fargo has been, and continues to be, engaged in a pattern or practice of unfair, deceptive and discriminatory lending activity in the City's and County's minority neighborhoods that has the effect and purpose of placing vulnerable, underserved borrowers in loans they cannot afford. These practices maximize short-term profit to Wells Fargo without regard to the borrowers' best interest, the borrowers' ability to repay, or the financial health of underserved minority neighborhoods. Wells Fargo averts any significant risk to itself by selling the loans on the secondary market shortly after originating them.

7. If Wells Fargo were properly and uniformly applying responsible underwriting practices in African-American and white communities, it would have comparable foreclosure rates in both. Wells Fargo possesses sophisticated underwriting technology and data that allow it to predict with precision the likelihood of delinquency, default or foreclosure. The fact that Wells Fargo's foreclosure rate is so much higher in

African-American neighborhoods is not the product of chance events and is fully consistent with a practice of targeting African-American neighborhoods and customers for discriminatory practices and predatory pricing and products. It is also consistent with a practice of failing to underwrite African-American borrowers properly and of putting these borrowers into loans they cannot afford in order to maximize the company's profits.

8. Former Wells Fargo employees have explained precisely how the company has used discretion in pricing and financial incentives to encourage its employees to target African-American neighborhoods for deceptive, high priced loans that predictably result in unnecessary foreclosures. The former employees confirm that, among other things, Wells Fargo gave loan officers broad discretion and large financial incentives to steer customers who qualified for prime and Federal Housing Administration ("FHA") mortgages into much more costly subprime products with increased interest rates, points, and fees that, in one declarant's words, put a "bounty" on African Americans targeted for subprime loans; deceived customers in order to give them subprime loans by, for example, telling them not to put any down payment on a property or not to submit full documentation for their loan, which would cause the loans to "flip" from prime to subprime; deceived African Americans about the full range of more advantageous products that were available to them and that they qualified for; drafted subprime marketing materials on the basis of race by using software to "translate" the materials into what Wells Fargo literally defined as the "language" of "African American;" referred to subprime loans located in minority communities as "ghetto loans;" and generally fostered a discriminatory culture that was tolerated by management. (These practices are described in greater detail in paragraphs 67-119 below.)

9. Consistent with these practices, Wells Fargo's high-cost or subprime loans are disproportionately found in Memphis' and Shelby County's predominantly minority neighborhoods, while its low-cost or prime loans are disproportionately found in the City's and County's predominantly white neighborhoods.

10. In short, Wells Fargo makes significantly more loans in white neighborhoods, yet the number of foreclosures in minority neighborhoods is drastically and disproportionately higher. At the same time that it is foreclosing on African-American neighborhoods at seven times the rate of white neighborhoods, it is using its underwriting expertise and technology to make unprecedented numbers of low-cost loans in white neighborhoods.

11. Wells Fargo's discriminatory practices have inflicted significant and substantial harm in the minority neighborhoods of Memphis and Shelby County. Wells Fargo's unnecessary foreclosures in these neighborhoods have caused direct and continuing financial harm to Memphis and Shelby County.

12. Wells Fargo foreclosures cause homes to become vacant. Vacancies cause, among other harms, squatters, increased risk of crime and fire, and infrastructure damage such as burst water pipes and broken windows. Expensive responses by Memphis and Shelby County are required to address these harms at Wells Fargo foreclosure properties. Using detailed data maintained by the City and County regarding items such as police calls, fire calls, the costs of boarding and cleaning vacant properties, and more, the financial harm caused by Defendants' discriminatory lending practices and resulting foreclosures on Wells Fargo loans at Wells Fargo properties can be calculated precisely. It can also be distinguished from harm attributable to non-Wells Fargo foreclosures or other causes. Examples of specific services that Memphis and Shelby

County have been required to provide at Wells Fargo foreclosure properties because of reverse redlining are set forth in precise detail in paragraphs 149-198 below.

13. Vacancies also cause significant declines in the property values of homes in close proximity to Wells Fargo foreclosure properties. This reduces property tax revenues collected by the City and County. These losses can also be calculated precisely and distinguished from losses due to other causes.

14. Absent judicial relief, the extent of the City's and County's injuries resulting from Wells Fargo's actions will continue to grow as more Wells Fargo loans move into foreclosure.

PARTIES

15. Plaintiff City of Memphis is a home rule municipal corporation pursuant to Article XI, Section 9 of the Tennessee Constitution. Memphis is authorized to institute suit to recover damages it has suffered. Memphis has a population of approximately 670,000 and is located in Shelby County, Tennessee.

16. Plaintiff Shelby County is a political subdivision of the State of Tennessee, created pursuant to Article 7, Section 1 of the Tennessee Constitution, and existing by and virtue of the Charter of Shelby County. Shelby County is authorized to institute suit to recover damages it has suffered. Shelby County has a population of approximately 900,000. Approximately three-quarters of Shelby County's residents live in Memphis.

17. Defendant Wells Fargo Bank, N.A. is organized as a national banking association under the laws of the United States. Upon information and belief, its corporate headquarters are located in California. Wells Fargo Bank, N.A. maintains multiple offices in Memphis and Shelby County for the purposes of soliciting

applications for and making residential mortgage loans and engaging in other business activities.

18. Wells Fargo Home Mortgage is a division of Wells Fargo Bank, N.A. that was formerly incorporated in California as a separate company and registered to do business in the State of Tennessee under the name Wells Fargo Home Mortgage, Inc. Wells Fargo Home Mortgage, Inc. merged into Wells Fargo Bank, N.A. on or about May 5, 2004. Wells Fargo Bank, N.A. continues to do business under the name Wells Fargo Home Mortgage, including in Memphis and Shelby County.

19. Defendant Wells Fargo Financial Tennessee, Inc. is a Tennessee corporation. Upon information and belief, Wells Fargo Financial Tennessee, Inc. engages in the solicitation of applications for and origination of residential mortgage loans in Memphis and Shelby County.

20. Defendant Wells Fargo Financial Tennessee 1, LLC is a Tennessee limited liability company. Upon information and belief, Wells Fargo Financial Tennessee 1, LLC engages in the solicitation of applications for and origination of residential mortgage loans in Memphis and Shelby County.

21. Wells Fargo has been one of the largest providers of mortgage credit to homeowners in Memphis and Shelby County for many years. From 2002 to 2008 (the last year for which data is available), Wells Fargo made at least 1,000 mortgage loans a year to Shelby County homeowners with a collective value of more than $2 billion. In the same period, it made at least 400 loans a year to Memphis homeowners with a collective value of more than $725 million. Upon information and belief, Wells Fargo continues to make loans in the City and County at a comparable pace.

22. Each of the Defendants was and is the agent, employee, and representative of the other Defendants. Each Defendant, in acting or omitting to act as alleged in this Complaint, was acting in the course and scope of its actual or apparent authority pursuant to such agencies, or the alleged acts or omissions of each Defendant as agent were subsequently ratified and adopted by each agent as principal. Each Defendant, in acting or omitting to act as alleged in this Complaint, was acting through its employees, agents, and/or representatives, and is liable on the basis of the acts and omissions of its employees, agents, and/or representatives.

JURISDICTION AND VENUE

23. This Court has jurisdiction over this matter pursuant to 42 U.S.C. § 3613 and 28 U.S.C. §§ 1331, 1343, because the claims alleged herein arise under the laws of the United States.

24. Venue is proper in this district under 28 U.S.C. § 1391(b) because Defendants conduct business in and are residents of the district and a substantial part of the events and omissions giving rise to the claims occurred in the district.

FACTUAL BACKGROUND

A. The Foreclosure Crisis in Memphis and Shelby County

25. Wells Fargo's practices have contributed significantly to the severe foreclosure crisis in Memphis and Shelby County. The number of foreclosure proceedings commenced in the County increased by 10% from 2007 to 2008, and the number of completed foreclosures increased by 27% in the same period.

26. Foreclosures have multiple and far-reaching impacts on the places in which they occur, especially when they are concentrated in distressed neighborhoods that are already struggling with issues of economic development and poverty. Foreclosures in

these neighborhoods frequently lead to abandoned and vacant homes. Concentrated vacancies driven by foreclosures cause neighborhoods, especially ones already struggling, to decline rapidly. Even a notice of foreclosure standing alone, without a completed foreclosure proceeding, can cause property values to decline and residents to abandon their homes or stop maintaining them. The United States Department of Housing and Urban Development ("HUD") and the United States Department of the Treasury ("Treasury") explained in a joint report on predatory subprime lending that "foreclosures can destabilize families and entire neighborhoods" and that "[f]oreclosed homes are often a primary source of neighborhood instability . . . ." HUD & Treasury, *Curbing Predatory Home Mortgage Lending* (2000) at 13, 51 (available at http://www.huduser.org/Publications/pdf/treasrpt.pdf) ("HUD/Treasury Report").

27. One example of how foreclosures and consequent vacancies harm neighborhoods is by reducing the property values of nearby homes. In Memphis and Shelby County, as in localities around the country, foreclosures are responsible for the loss of hundreds of millions of dollars in the value of homes. This, in turn, reduces the City's and County's revenues from property taxes. It also makes it harder for the City and County to borrow funds because the value of the property tax base is used to qualify for loans.

28. Cities and counties with high rates of foreclosure, like Memphis and Shelby County, must also spend additional funds for services related to foreclosures, including the costs of securing vacant homes, holding administrative hearings, and conducting other administrative and legal procedures. The funds expended also include the costs of providing additional police and fire protection as vacant properties become centers of dangerous and illicit activities.

B. The Role of Subprime Lending

29. The growing crisis of foreclosures in Memphis, Shelby County, and across the nation is due in large part to the rapid expansion of subprime lending. Subprime lending developed in the mid-1990s as a result of innovations in risk-based pricing and in response to the demand for credit by borrowers who were denied prime credit by traditional lenders.

30. Prior to the emergence of subprime lending, most mortgage lenders made only "prime" loans. Prime lending offered uniformly priced loans to borrowers with good credit. Individuals with blemished credit were not eligible for prime loans. Although borrowers with blemished credit might still represent a good mortgage risk at the right price, prime lending did not provide the necessary flexibility in price or loan terms to serve these borrowers.

31. In the early 1990s, technological advances in automated underwriting allowed lenders to predict with improved accuracy the likelihood that a borrower with blemished credit will successfully repay a loan. This gave lenders the ability to adjust the price of loans to match the different risks presented by borrowers whose credit records did not meet prime standards. Lenders found that they could now accurately price loans to reflect the risks presented by a particular borrower. When done responsibly, this made credit available much more broadly than had been the case with prime lending.

32. As the technology of risk-based pricing developed rapidly in the 1990s, so did the market in subprime mortgages. Subprime loans accounted for only 10% of mortgage loans in 1998, but within five years grew to 23% of the market. Outstanding subprime mortgage debt is well over $1 trillion today, up from $65 billion in 1995 and $332 billion in 2003. These subprime loans have allowed millions of borrowers to obtain

mortgages, at marginally increased prices, even though their credit profiles do not qualify them for lower-cost prime loans. They have opened the door to homeownership to many people, especially low- to moderate-income and minority consumers, who otherwise would have been denied mortgages. At the same time, subprime lending has created opportunities for unscrupulous lenders to engage in irresponsible lending practices that result in loans that borrowers cannot afford. This, in turn, has led directly to defaults and foreclosures.

33. Enticed by the prospect of short-term profits resulting from exorbitant origination fees, points, and related pricing schemes, many irresponsible subprime lenders took advantage of a rapidly rising real estate market to convince borrowers to enter into loans that they could not afford. Often this was accomplished with the help of deceptive practices and promises to refinance at a later date. These abusive subprime lenders did not worry about the consequences of default or foreclosure to their business because once made, the loans were sold on the secondary market. As one report on Memphis's Hickory Hill neighborhood put it, a "new subculture" of lenders developed that is more "foreclosure-tolerant than foreclosure adverse" because the lenders do not have any long-term "skin in the game." Phyllis G. Betts, The Brookings Institution, *Neighborhood Housing Markets and the Memphis Model* (2006) at 14 (available at http://www.brookings.edu/~/media/Files/rc/reports/2006/11communitydevelopment_betts/20061127_memphis.pdf). In a break from the past, these lenders' profits are "less depend[e]nt on due diligence and risk avoidance than on high-volume, fee-driven lending." *Id.*

34. As the subprime market grew, the opportunities for abusive practices grew with it. As a consequence, abusive and predatory practices "are concentrated in the

subprime mortgage market," as the federal government has found. HUD/Treasury Report at 1. These practices, which in recent years have become the target of prosecutors, legislators and regulators, include the following:

a. Failing to prudently underwrite hybrid adjustable rate mortgages (ARMs), such as 2/28s and 3/27s. After the borrower pays a low "teaser rate" for the first two or three years, the interest rate on these loans resets to a much higher rate that can continue to rise based on market conditions. Subprime lenders often underwrite these loans based only on consideration of whether the borrower can make payments during the initial teaser rate period, without regard to the sharply higher payments that will be required for the remainder of a loan's 30-year term. Irresponsible lenders aggressively market the low monthly payment that the borrower will pay during the teaser rate period, misleading borrowers into believing that they can afford that same low monthly payment for the entire 30-year term of the loan, or that they can refinance their loan before the teaser rate period expires.

b. Failing to prudently underwrite refinance loans, where borrowers substitute unaffordable mortgage loans for existing mortgages that they are well-suited for and that allow them to build equity. Such refinanced loans strip much or even all of that equity by charging substantial new fees, often hiding the fact that the high settlement costs of the new loan are also being financed. Lenders that aggressively market the ability of the borrower to pay off existing credit card and other debts by refinancing mislead borrowers into believing that there is a benefit to consolidating all of their debt into one mortgage loan, obscuring the predictable fact that the borrower will not be able to repay the new loan. The

refinanced loans are themselves often refinanced repeatedly with ever-increasing fees and higher interest rates, and with ever-decreasing equity, as borrowers seek to stave off foreclosure.

c. Allowing mortgage brokers to charge "yield spread premiums" for qualifying a borrower for an interest rate that is higher than the rate the borrower qualifies for and can actually afford.

d. Failing to underwrite loans based on traditional underwriting criteria such as debt-to-income ratio, loan-to-value ratio, FICO score, reserves, and work history. These criteria ensure that a borrower is obtaining a loan that he or she has the resources and assets to repay, and ignoring these criteria results in many loans that bear no relation to borrowers' ability to repay them. This allows the lender to make a quick profit from the origination, but sets the borrower up for default and foreclosure.

e. Requiring substantial prepayment penalties that prevent borrowers whose credit has improved from refinancing their subprime loan to a prime loan. Prepayment penalties not only preclude borrowers from refinancing to a more affordable loan, but reduce the borrowers' equity when a subprime lender convinces borrowers to needlessly refinance one subprime loan with another.

f. Charging excessive points and fees that are not associated with any increased benefits for the borrower.

g. Placing borrowers in subprime loans even though they qualify for prime or FHA loans on better terms.

35. As long as housing prices continued to rise, the deleterious effect of these practices was delayed and thus hidden. But the inevitable occurred when the real estate

bubble burst in 2007 and home prices began to fall, and foreclosure rates began their dramatic rise. Bent on maximizing short-term profits and protected by the ability to sell their loans on the secondary market, irresponsible subprime lenders have left countless homeowners saddled with mortgage debts they cannot afford and no way to save their homes.

C. The Foreclosure Crisis Hits African-American Neighborhoods the Hardest

36. The impact of the foreclosure crisis is felt most acutely in minority communities. This is because of the prevalence of "reverse redlining." As used by Congress and the courts, the term "reverse redlining" refers to the practice of targeting residents in certain geographic areas for credit on unfair terms due to the racial or ethnic composition of the area. In contrast to "redlining," which is the practice of denying *prime* credit to specific geographic areas because of the racial or ethnic composition of the area, reverse redlining involves the targeting of an area for the marketing of deceptive, predatory or otherwise deleterious lending practices because of the race or ethnicity of the area's residents. This practice has repeatedly been held to violate the federal Fair Housing Act. *See, e.g.*, *Barkley v. Olympia Mortgage Co.*, No. 04-cv-875, 2007 WL 2437810 (E.D.N.Y. Aug. 22, 2007); *Hargraves v. Capital City Mortgage Corp.*, 140 F. Supp. 2d 7 (D.D.C. 2000).

37. The HUD/Treasury Report (discussed in paragraph 26 above) found that reverse redlining in subprime mortgage lending is a major problem: "Predatory lenders often engage in 'reverse redlining' – specifically targeting and aggressively soliciting homeowners in predominantly lower-income and minority communities . . . ." HUD/Treasury Report at 72. "Testimony at the forums [held by the HUD/Treasury National Predatory Lending Task Force] strongly indicates that many predatory lenders

may have engaged in reverse redlining, or targeting abusive practices to protected groups." *Id.*

38. There is a substantial body of empirical evidence that supports the HUD/Treasury finding and establishes that subprime mortgage lending and the predatory practices often associated with subprime lending are targeted at African Americans and African-American neighborhoods.

39. The Fannie Mae Foundation found that many borrowers who qualify for prime mortgage loans are instead given subprime loans, and that the problem is particularly acute for African-American borrowers. James H. Carr & Lopa Kolluri, Fannie Mae Foundation, *Predatory Lending: An Overview* (2001) (available at http://www.cra-nc.org/financial.pdf). Fannie Mae stated that "research by Freddie Mac reports that as much as 35 percent of borrowers in the subprime market could qualify for prime market loans" and that "Fannie Mae estimates that number closer to 50 percent." *Id.* at 37. Focusing on race, Fannie Mae concluded that "the level of subprime lending to black households and communities far exceeds the measured level of credit problems experienced by those households." *Id.*

40. A study by the National Community Reinvestment Coalition ("NCRC") reached the same conclusion. National Community Reinvestment Coalition, *The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age – Subprime Lending in Ten Large Metropolitan Areas* (2003) (available at http://www.ncrc.org/images/stories/pdf/research/ncrcdiscrimstudy.pdf). The NCRC studied subprime mortgage loans in metropolitan areas across the country. *Id.* at 6, 24-25. It combined data that lenders are required to release to the public under the federal Home Mortgage Disclosure Act ("HMDA") with credit scoring data on a census tract

level that the authors obtained from one of the three major credit bureaus. *Id.* at 19-20, 25. (Credit scores are not released under HMDA.) The NCRC controlled for differences in credit scores and found a statistically significant and positive correlation between the percentage of African Americans in a census tract and the percentage of subprime loans in the tract. *Id.* at 31-34.

41. HUD, though it did not have access to credit scores or other data about creditworthiness, studied 1998 HMDA data on almost 1 million mortgages and likewise concluded that the growth of subprime lending was disproportionately concentrated in African-American neighborhoods. HUD also found that the disparity persisted across income lines and actually increased as neighborhood income increased and stated that the problem requires "closer scrutiny." HUD, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (2000) at 4-5 (available at http://www.huduser.org/Publications/pdf/unequal_full.pdf). HUD observed with alarm that "only one in ten families in white neighborhoods [receive subprime loans and] pay higher fees and interest rates, but *five in ten families in African-American communities are saddled with higher rates and costs*." *Id.* at 4 (emphasis in original). Describing HUD's research in their subsequent joint report, HUD and Treasury stated that "the research consistently revealed that, controlling for income, predominantly non-white census tracts showed much higher subprime refinance penetration rates than predominantly white census tracts." HUD/Treasury Report at 105.

42. A study of 2000 HMDA data covering every metropolitan statistical area in the country found a parallel racial disparity in the frequency of subprime loans. Calvin Bradford, Center for Community Change, *Risk or Race? Racial Disparities and the Subprime Refinance Market* (2002) at vii-ix (available at

http://www.knowledgeplex.org/redir.html?id=1032&url=http%3A%2F%2Fwww.knowledgeplex.org%2Fkp%2Freport%2Freport%2Frelfiles%2Fccc_0729_risk.pdf).

43. The studies discussed above show that African Americans and residents of African-American neighborhoods receive subprime loans at a much greater frequency than whites and residents of white neighborhoods, and that the disparity is much greater than legitimate underwriting factors can explain.

44. The following studies provide empirical evidence that, after controlling for creditworthiness and other legitimate underwriting factors, there are likewise substantial disparities based on race in the terms and conditions of the subprime loans given to African Americans and residents of African-American neighborhoods.

45. A study by the Center for Responsible Lending ("CRL") found racial disparities in the pricing of loans. The study included loans made by Wells Fargo. The study found that African Americans receive higher-priced subprime mortgages than whites who are similarly situated with respect to credit and other underwriting criteria. Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* (2006) (available at http://www.responsiblelending.org/mortgage-lending/research-analysis/rr011-Unfair_Lending-0506.pdf). This study combined HMDA data with a proprietary database to determine whether race had a statistically significant effect on the pricing of subprime loans in 2004. *Id.* at 3, 9. The proprietary database covered 87% of the U.S. subprime market. *Id.* at 9. It included credit criteria such as the credit score and loan-to-value ratio for each loan; such data is not released under HMDA and is not publically available. *Id.*

46. The CRL found that, after controlling for credit and other underwriting factors, the odds were 40% to 84% higher that an African-American borrower would receive a high-cost purchase loan than a similarly-situated white borrower. *Id.* at 16. The difference was statistically significant for most types of purchase loans. *Id.* Similarly, the study found that the odds were 4% to 62% higher that an African-American borrower would receive a high-cost refinance loan than a similarly-situated white borrower, also after controlling for credit and other underwriting factors. *Id.* at 17. The difference was statistically significant for refinance loans with prepayment penalties, which constituted nearly two-thirds of the refinance loans analyzed. *Id.*

47. Another study by the Center for Responsible Lending found that subprime borrowers in predominantly African-American and other minority neighborhoods are much more likely to be given loans with prepayment penalties than subprime borrowers in predominantly white neighborhoods who are similarly situated with respect to credit and other characteristics. Center for Responsible Lending, *Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans* (2005) (http://www.responsiblelending.org/mortgage-lending/research-analysis/rr004-PPP_Minority_Neighborhoods-0105.pdf). The Center analyzed proprietary data from The First American Corporation on 1.8 million subprime loans originated from 2000 to mid-2004. First American's proprietary database allowed the Center to control for a variety of underwriting factors, such as credit score, loan-to-value ratio, debt-to-income ratio, and more. *Id.* at 5, App.-1. The study found that "[t]he odds of borrowers receiving prepayment penalties are consistently and positively associated with minority concentration, and the differences are statistically significant." *Id.* at 1-2. It concluded, "[i]n the simplest terms, the odds of avoiding a prepayment penalty on a subprime loan

are significantly better for borrowers who live in predominantly white neighborhoods." *Id.* at 7.

48. Another study found racial disparities with respect to requiring borrowers to pay yield spread premiums. Howell E. Jackson & Jeremy Berry, "Kickbacks or Compensation: The Case of Yield Spread Premiums" (2002) (available at http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf). The authors analyzed data on creditworthiness and other underwriting criteria, including credit scores and loan-to-value ratios, that was obtained in discovery in a mortgage lending lawsuit under the federal Real Estate Settlement Procedures Act, 12 U.S.C. § 2601, *et seq.* *Id.* at 7, 122-23 & n.147. They found that, after controlling for such criteria, African Americans (and Hispanics) paid substantially more in yield spread premiums than other borrowers, and that the disparity was statistically significant. *Id.* at 9, 125. Moreover, they found that for every dollar paid by borrowers in yield spread premiums, the borrowers gained only 20 to 25 cents of value. *Id.* at 127.

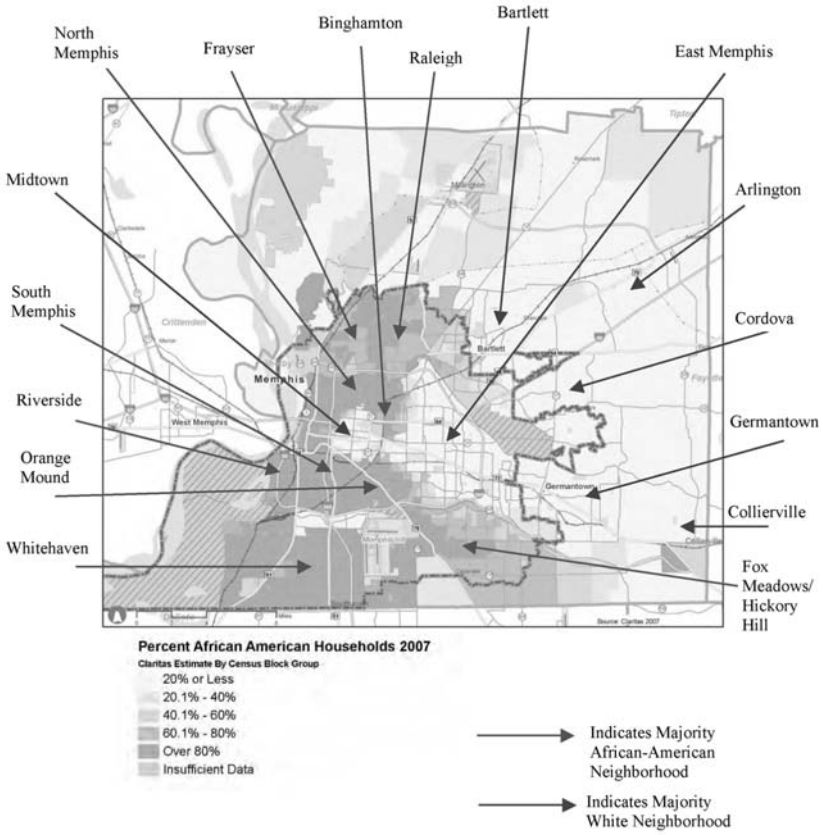
D. Reverse Redlining is Prevalent in Memphis and Shelby County

49. Reverse redlining typically flourishes in cities where two conditions are met. First, the practice afflicts cities where minorities historically have been denied access to credit and other banking services. The legacy of historic discrimination, or redlining, often leaves the residents of minority communities without the means or resources required to identify loan products and lenders offering products with the most advantageous terms for which they might qualify. This makes them especially vulnerable to irresponsible subprime lenders who, instead of underwriting carefully to ensure that the loans they offer are appropriate for their customers, engage in the unscrupulous lending practices described in paragraph 34 above.

50. Second, reverse redlining arises in cities where there are racially segregated residential living patterns. This means that the people who are most vulnerable to abusive lending practices are geographically concentrated and therefore easily targeted by lenders.

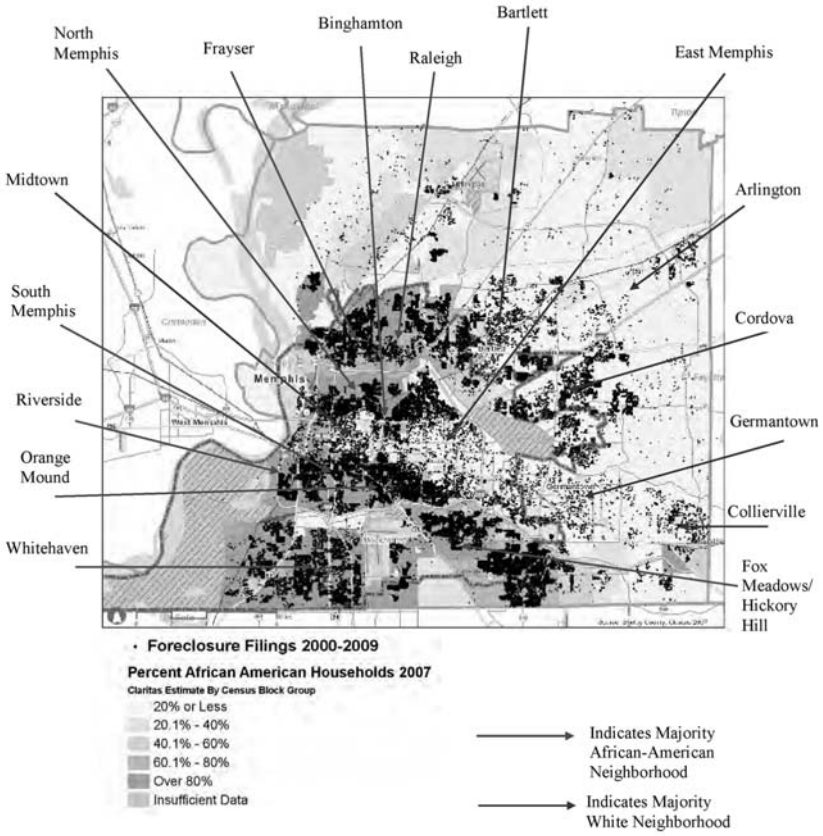
51. Both of these conditions are present in Memphis and Shelby County. First, Memphis' and Shelby County's minority communities historically have been victimized by traditional redlining practices that persisted for decades.

52. Second, the City and County are highly segregated between African Americans and whites. As the following map shows, even though Memphis is 61% African-American and 34% white, and Shelby County is 52% African-American and 45% white, many neighborhoods have a much higher concentration of one racial group or the other.


North Memphis
Frayser
Binghamton
Raleigh
Bartlett
East Memphis
Midtown
Arlington
South Memphis
Cordova
Riverside
Germantown
Orange Mound
Collierville
Whitehaven
Fox Meadows/ Hickory Hill
Memphis
Bartlett
Germantown
Percent African American Households 2007
Claritas Estimate By Census Block Group
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Insufficient Data
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

53. A recent study of lending in Shelby County is consistent with the existence of a pattern or practice of reverse redlining by lenders providing mortgages to residents of the City. Phyllis G. Betts, Carol Gothe & Adam Foster, Community Development Council & Center for Community Building and Neighborhood Action, *Beyond Subprime Lending* (2008) (available at http://cbana.memphis.edu/lending2006/documents/LendingSummary2006_Beyond_Subprime_Lending.pdf). The authors analyzed 2006 HMDA data for Shelby County and found that "[b]lack borrowers are more than twice as likely to have a subprime loan as white borrowers, with disparities at all income levels." *Id.* at 6.

54. The locations of foreclosures in Memphis and Shelby County are also consistent with the existence of a pattern or practice of reverse redlining by lenders providing mortgages to residents of the City and County. As shown in the following map, although foreclosures have occurred in many parts of Memphis and Shelby County, they are disproportionately concentrated in the City's and County's African-American neighborhoods. Neighborhoods like South Memphis, Binghamton, Fox Meadows/Hickory Hill, Orange Mound, North Memphis and Whitehaven, all with African-American populations above 80%, are at the center of the foreclosure crisis. Countywide, census tracts that are above 80% African-American account for 40.9% of all filings, even though they account for only 24.4% of the owner-occupied households. Citywide, such census tracts account for 53.2% of all filings but only 39.6% of owner-occupied households.


North Memphis
Frayser
Binghamton
Raleigh
Bartlett
East Memphis
Midtown
Arlington
South Memphis
Cordova
Riverside
Germantown
Orange Mound
Collierville
Whitehaven
Fox Meadows/ Hickory Hill
Memphis
Foreclosure Filings 2000-2009
Percent African American Households 2007
Claritas Estimate By Census Block Group
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Insufficient Data
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

E. Wells Fargo is a Major Contributor to the Foreclosure Crisis in Memphis' and Shelby County's African-American Neighborhoods

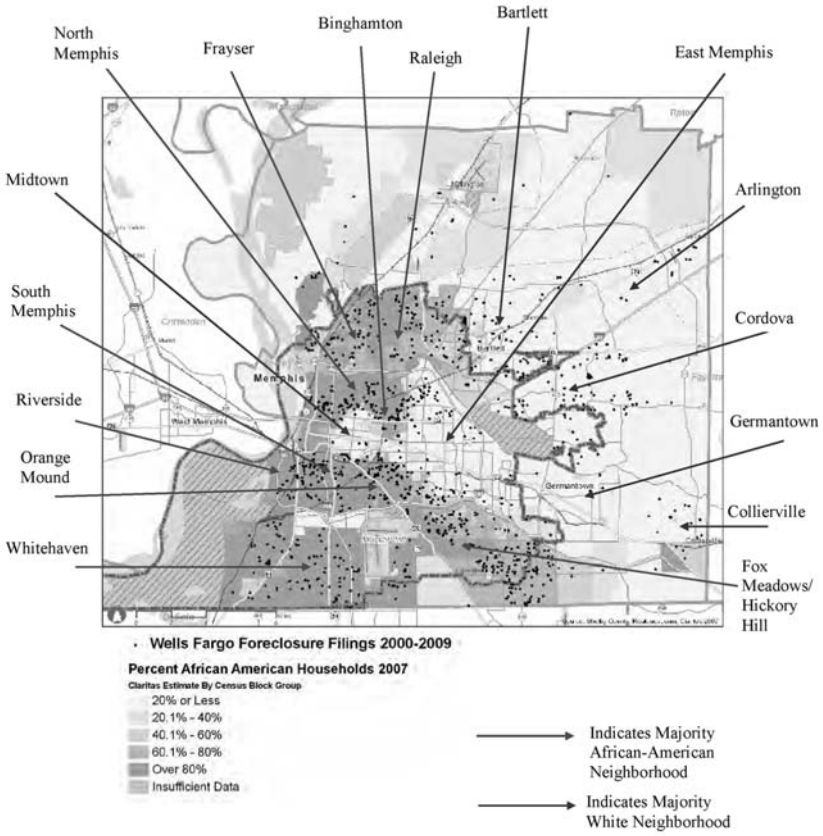
55. Wells Fargo is one of the largest mortgage lenders in Memphis and Shelby County. It has made at least 1,000 mortgage loans in Shelby County in each of the last seven years for which data is available (2002-2008) with a collective value of more than $2 billion, and at least 400 mortgage loans a year with a collective value of more than $725 million in the City. Wells Fargo makes loans in both the white and African-American neighborhoods of Memphis and Shelby County.

56. Far from being a responsible provider of much-needed credit in minority communities, however, Wells Fargo is one of the leading causes of the disproportionately high rate of foreclosure in Memphis' and Shelby County's African-American neighborhoods. Its foreclosures since at least 2000 have been concentrated in South Memphis, Binghamton, Fox Meadows/Hickory Hill, Orange Mound, North Memphis, Whitehaven, and other neighborhoods with African-American populations exceeding 80%.

57. In the City, 54.2% of Wells Fargo's foreclosures from 2005 to 2009 were in census tracts that are predominantly African-American, but only 12.5% were in tracts that are predominantly white. In the County, 46.8% of Wells Fargo's foreclosures from 2005 to 2009 were in predominantly African-American census tracts but only 20.1% were in tracts that are predominantly white.

58. The figures are comparable for Wells Fargo's foreclosures in the City and County from 2000 to 2004. Half of the foreclosures in the City were in tracts that are predominantly African-American and only 7.1% were in tracts that are predominantly white. In the County 37.2% of the foreclosures were in tracts that are predominantly African-American and only 18.9% were in tracts that are predominantly white.

59. At the same time, Wells Fargo has the second largest number of foreclosures in Shelby County of any lender from 2000 to 2009. The following map represents the concentration of Wells Fargo's foreclosures in African-American neighborhoods.


North Memphis
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Binghamton
Raleigh
Bartlett
East Memphis
Midtown
Arlington
South Memphis
Cordova
Riverside
Germantown
Orange Mound
Collierville
Whitehaven
Fox Meadows/ Hickory Hill
Memphis
Germantown
Wells Fargo Foreclosure Filings 2000-2009
Percent African American Households 2007
Claritas Estimate By Census Block Group
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Insufficient Data
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

60. The likelihood that a Wells Fargo loan from 2000 to 2008 in a predominantly African-American neighborhood will result in foreclosure is dramatically greater than the likelihood of foreclosure for a Wells Fargo loan in a predominantly white neighborhood. In the County, 17.7% of Wells Fargo's loans in predominantly African-American neighborhoods result in foreclosure, but the same is true for only 2.6% of its loans in neighborhoods that are predominantly white. In the City, 17.5% of Wells Fargo's loans in predominantly African-American neighborhoods result in foreclosure, but the same is true for only 3.3% of its loans in neighborhoods that are predominantly white. In other words, a Wells Fargo loan in a predominantly African-American neighborhood in Shelby County is almost seven times more likely to result in foreclosure as one in a predominantly white neighborhood. In Memphis, it is 5.3 times more likely to result in foreclosure.

F. Wells Fargo Targets Memphis' and Shelby County's African-American Neighborhoods for Improper and Irresponsible Lending Practices

61. Wells Fargo's failure to underwrite loans in minority and underserved communities in a responsible manner has been the subject of public attention and concern for years. For example, its practices are the focus of a 2004 report from the Center for Responsible Lending. The report concluded that the company's customers "too often face the loss of their home or financial ruin as a result" of its "predatory practices." Center for Responsible Lending, *A Review of Wells Fargo's Subprime Lending* (Apr. 2004) at 10 (available at http://www.responsiblelending.org/mortgage-lending/research-analysis/ip004-Wells_Fargo-0404.pdf). The predatory practices identified in the report include charging excessive fees; charging excessively high interest rates that are not justified by borrowers' creditworthiness; requiring large prepayment penalties while deliberately misleading borrowers about the penalties; using deceptive sales practices to

wrap insurance products into mortgages; convincing borrowers to refinance mortgages into new loans that only benefit Wells Fargo; deceiving borrowers into believing that they are getting fixed rate loans when they are really getting adjustable rate loans, and more.

62. Wells Fargo's pattern or practice of failing to follow responsible underwriting practices in Memphis' and Shelby County's African-American neighborhoods is evident from the type of loans that result in foreclosure filings in those neighborhoods. Approximately 65% of Wells Fargo's County loans that result in foreclosure, and 67% of its City loans that result in foreclosure, are fixed rate loans. For both the City and County, this ratio is nearly the same in African-American and white neighborhoods. This establishes that there is no legitimate reason for the stark difference in Wells Fargo's foreclosure rates by race.

63. Unlike adjustable rate loans, where the price may fluctuate with changing market conditions, the performance of fixed rate loans is relatively easy to predict using automated underwriting models and loan performance data because monthly payments do not vary during the life of the loan. Using these sophisticated risk assessment tools, and relying on traditional underwriting criteria such as FICO scores, debt-to-income ratios, loan-to-value ratios, and cash reserves, any lender engaged in responsible underwriting practices designed to identify qualified borrowers can predict with statistical certainty the likelihood of default and/or delinquency. Lenders engaged in marketing fixed rate loans in a fair and responsible manner should have no difficulty sifting out unqualified borrowers, or borrowers whose loans would likely result in delinquency, default or foreclosure.

64. Because the percentage of fixed rate loans is so high and the same in both African-American and white neighborhoods, Wells Fargo should, if it properly underwrites, have comparable foreclosure rates in both communities. The fact that Wells Fargo's underwriting decisions result in foreclosure five to seven times more often in African-American neighborhoods than in white neighborhoods means that it is not following fair or responsible underwriting practices with respect to African-American customers.

65. The disparate foreclosure rates are instead consistent with the type of unscrupulous subprime lending practices described in paragraph 34. Wells Fargo engages in these and similarly inappropriate practices when making loans to African Americans and in African-American neighborhoods. This pattern or practice of targeted activities fully explains the disparate rates of foreclosure. The disparities are not the result of or otherwise explained by legitimate non-racial underwriting criteria.

66. A closer look at Wells Fargo's lending practices and the characteristics of its loans in Memphis and Shelby County demonstrates that it is engaged in a pattern or practice of reverse redlining with respect to the City's African-American neighborhoods. As described in sections F.1 through F.7 below, information from former Wells Fargo employees and examination of Wells Fargo's loans and pricing rules indicate it is engaged in unfair, deceptive and discriminatory practices in Memphis' and Shelby County's African-American neighborhoods that have the effect and purpose of placing underserved borrowers in loans they cannot afford and that require higher monthly payments than loans for which they qualify. Wells Fargo's unfair, deceptive and discriminatory practices maximize short-term profit without regard to the borrower's best interest, the borrower's ability to repay, or the financial health of underserved minority

neighborhoods. This targeted pattern or practice has resulted in the disproportionately high rate of foreclosure found in Memphis' and Shelby County's African-American neighborhoods. These discriminatory and predatory practices cause foreclosures and vacancies because they make it more difficult for borrowers to stay current on their payments and remain in their homes.

1. Former Wells Fargo Employees Explain How the Company Targets African Americans in Memphis and Shelby County for Subprime Loans and Abusive Subprime Lending Practices

67. Four people who worked for Wells Fargo in Memphis between 2002 and 2008 – Doris Dancy, Michael Simpson, Mario Taylor, and Camille Thomas – confirm that Wells Fargo engaged in a myriad of deceptive, unfair, abusive, and predatory subprime lending practices in Memphis and Shelby County. Their testimony is corroborated by two other former Wells Fargo employees, Tony Paschal and Elizabeth Jacobson, who state that Wells Fargo engaged in these practices nationally. Declarations from all six former employees are attached to this amended complaint. *See* Attachs. A-G.

68. Ms. Dancy, Mr. Paschal, Mr. Taylor, and Ms. Thomas further confirm that Wells Fargo targeted its abusive subprime lending practices at residents of African-American neighborhoods in Memphis and Shelby County. This constitutes reverse redlining.

69. Simpson worked at the Wells Fargo Financial branch office on Park Avenue from November 2002 until January 2008. Simpson was a credit manager for approximately 1½ years and was then promoted to branch manager. As a credit manager, he was responsible for soliciting current Wells Fargo customers and others to apply for new subprime loans. As a branch manager, he supervised credit managers and loan processors.

70. Thomas worked as a loan processor at the Wells Fargo Financial branch offices in Bartlett, Cordova, Collierville, and on Winchester Street from January 2004 until January 2008. These offices only handled subprime loans. Thomas was responsible for all of the paperwork for the loans in her office and submitted the files to Wells Fargo underwriters for approval and funding. Thomas was very familiar with Wells Fargo's practices and underwriting rules and guidelines because of her responsibilities as a loan processor.

71. Taylor worked at the Wells Fargo Financial branch offices in Cordova and Quince and on Park Avenue from June 2006 until February 2008. He was a credit manager and was responsible for soliciting people to apply for Wells Fargo loans.

72. Dancy was a credit manager at the Wells Fargo Financial branch office on Park Avenue from July 2007 until January 2008. She was responsible for soliciting people to apply for Wells Fargo loans.

73. Paschal was a Wells Fargo loan officer from September 1997 to September 2007 (with a hiatus of approximately 2½ years beginning in June 1999). Paschal worked in Virginia and Maryland but his job was to solicit Wells Fargo borrowers from throughout the country to refinance their home mortgage with a prime or Federal Housing Administration ("FHA") loan. FHA loans have interest rates that are closer to prime than subprime rates. Paschal worked with many applicants from Memphis and Shelby County. Paschal referred the borrowers who did not qualify for a prime or FHA loan to the Mortgage Resources division, known as "MORE." MORE originates subprime loans exclusively and does so across the country, including in Memphis and Shelby County. Paschal worked on the same floor of the same building as MORE employees and he communicated with them daily.

74. Jacobson worked for Wells Fargo as a loan officer and then as a Sales Manager from August 1998 until December 2007. Jacobson made subprime loans exclusively and was one of Wells Fargo's top three subprime loan officers nationally year after year, and in some years was the company's top subprime loan officer in the country. She was based in Maryland but is familiar with Wells Fargo's policies and practices nationally, including in Memphis and Shelby County.

a. Targeting African Americans for Subprime Mortgage Loans

75. Wells Fargo targeted African Americans in Memphis and Shelby County in different ways. The branch offices' primary goal was to solicit new subprime business, and the former Wells Fargo Memphis employees explain that they targeted their efforts at lists of "leads" who were predominantly and disproportionately African-American. Wells Fargo developed these lists by obtaining information about people who financed purchases like furniture and jewelry at businesses in African-American areas of Memphis and Shelby County and by identifying African Americans who previously had loans with Wells Fargo. Even at branch offices in neighborhoods with many white residents, the vast majority of the leads were African-American.

76. Credit managers in the branch offices were instructed to contact these predominantly African-American leads to persuade them to apply for new subprime loans with Wells Fargo. Credit managers "cold-called" the leads repeatedly and even showed up at their homes.

77. Wells Fargo's Memphis branches targeted African Americans for subprime loans because employees held negative views of African Americans. Taylor explains that "[t]he prevailing attitude was that African-American customers weren't

savvy enough to know they were getting a bad loan, so we would have a better chance of convincing them to apply for a high-cost, subprime loan."

78. Likewise, Thomas explains that "[i]t was generally assumed that African-American customers were less sophisticated and intelligent and could be manipulated more easily into a subprime loan with expensive terms than white customers." She heard employees joke about customers' race and say things like, "You know that guy isn't so smart – is it because he's black?"

79. Elderly African Americans were thought to be particularly vulnerable and so were frequently targeted for subprime loans with high interest rates.

80. Paschal confirms based on his nationwide lending responsibilities that Wells Fargo targeted its subprime lending in Memphis and Shelby County at African Americans. Paschal explains that Wells Fargo targeted subprime marketing at predominantly African-American zip codes in the City and County, but did not target white zip codes. Paschal also heard employees in the MORE division, which makes subprime loans nationally, comment that white areas are not good for subprime loans.

81. Another way in which Wells Fargo targeted African Americans was by tailoring its subprime marketing materials on the basis of race. Wells Fargo devised software to print out subprime promotional materials in different languages, one of which it called "African American." A computer screen shot from 2006 showing this option is attached hereto as Attachment H. These promotional materials were available to loan officers across the country, including in Memphis and Shelby County. Wells Fargo did not remove the African American "language" option until Tony Paschal complained.

82. Like the branch employees in Memphis, Wells Fargo's subprime loan officers in the MORE division held derogatory stereotypes of African Americans. This

contributed to their targeting of African Americans in Memphis and Shelby County for subprime loans. Paschal heard subprime loan officers from MORE describe African-American and other minority customers as "mud people" and say that "those people have bad credit" and "those people don't pay their bills." They referred to loans in minority communities as "ghetto loans." Paschal's manager, Dave Zoldak, was promoted even after Paschal complained to management about Zoldak's use of the slur "nigger."

b. Steering Customers into Subprime Loans They Cannot Afford

83. The former Well Fargo Memphis employees state that Wells Fargo steered its customers into high-cost subprime loans they could not afford. These loans caused borrowers' financial conditions to deteriorate and needlessly increased the risk that borrowers would lose their homes. The branch offices in Memphis used a range of tactics to steer potential customers into bad subprime loans that the customers could not afford. Each of the former Memphis employees describes these practices as unethical. Employees were pressured to engage in these unethical and predatory practices by upper management even though it was apparent that the practices would cause people to lose their homes.

84. The leads were the starting point for many of Wells Fargo's predatory practices in Memphis. Credit managers were instructed to focus on leads for whom Wells Fargo had information about the value of their house and to get as many of the leads as possible to apply for loans. The managers worked to persuade these potential customers to consolidate different existing debts – such as credit cards, student loans, car loans, and loans for product purchases – into a new high-cost subprime loan secured by their house. Although the existing consumer debt did not place the customers' homes at risk, by consolidating debt in this manner and using the house as collateral, the borrowers

now stood to lose their homes should they default on the loan. Employees would deceive customers about these loans by telling them that they were "getting rid of" the existing debts when they were really just refinancing and combining the debts into an expensive subprime loan, but now with the house at risk.

85. The managers likewise worked to persuade their potential customers to refinance any existing mortgage debt into the new high-cost subprime loan.

86. In addition to consolidating and refinancing existing debts in a subprime loan, the Memphis branches also jammed new high-cost debts onto their customers' homes. The Memphis employees confirm that Wells Fargo's goal was to get their customers to take on as many loans as possible. If employees convinced someone to consolidate their debts with a subprime home equity loan, for example, they would then try to persuade the borrower to take out an auto loan, too. Both the subprime home equity loan and the auto loan would be secured by the house.

87. Employees likewise pushed new high interest rate credit cards on borrowers that were secured by the borrower's house. They would bring all the credit card paperwork to the closing on another loan and say that the customer had "qualified" for a "preferred line of credit" as part of a "package deal."

88. Similarly, employees encouraged borrowers to take cash out of their homes. This would increase the size of their mortgages and make the mortgages more difficult to pay back.

89. Employees would also pressure borrowers to open a line of credit secured by their home. Some credit managers lied to customers about using the house as collateral, telling them that the line of credit was like an ordinary credit card and not telling them that it was actually a second mortgage secured by the customer's home.

90. Wells Fargo also solicited customers in the Memphis area by mailing live checks to leads. When deposited, the checks instantly became high interest loans, often with a rate of 20-29%. Wells Fargo would then pursue the people who deposited the checks to talk them into refinancing this loan. The new loan would be yet another subprime loan with an interest rate that was only marginally lower, and this time the new customer's house would be placed at risk because it would be used as collateral.

91. The Memphis branches loaded all of this expensive subprime debt onto their customers without regard for whether their customers qualified for the loans or had the capacity to sustain them. Employees affirmatively and aggressively pushed unaffordable loans on customers. Customers were given high-priced subprime loans when they should not have been given any loan. Doris Dancy states that she saw Wells Fargo give subprime loans – sometimes with rates as high as 17% – to people with very poor credit scores and very high debt-to-income ("DTI") ratios. Dancy says that she "would shake my head in disbelief and ask myself, 'how could this happen?'"

92. Even though Wells Fargo's own rules prohibited loans with a DTI ratio above 50%, it violated these rules to make loans to customers with higher DTI ratios, even customers with low credit scores. Mario Taylor was told to disregard customers' ability to repay loans and just "get the documents from them so we can send the deal up."

93. Likewise, the Memphis branches made loans with exorbitant loan-to-value ("LTV") ratios. First mortgage LTV ratios went as high as 110% and second mortgage LTV ratios went as high as 132%. Auto loan LTV ratios went as high as 160% because customers were not required to make any down payment and were given a large portion of the loan as a cash payment. These auto loans were secured by customers' homes.

94. Employees would deceive customers into believing they could repay these loans. One way was by only telling customers what their monthly payment would be under an initial "teaser rate." Rates on loans with teaser rates were adjustable and could go up significantly and become unaffordable, but employees were instructed not to tell customers that the rate was adjustable. They would simply say, "This is your monthly payment."

95. The loans became even more harmful to Wells Fargo's customers – and more profitable for Wells Fargo – because employees included expensive add-ons that only benefited the company. For example, employees were instructed to include a "Home/Auto Security Plan" with many loans. This costly insurance product did not benefit the customer but drove up the price of the loan. Wells Fargo presented it as a necessary part of the loan even though it was actually optional.

96. Employees likewise pressured customers to buy other insurance products, such as life and health insurance, even if they already had sufficient insurance. Simpson states that the district manager, to whom he and the other branch managers reported, told subordinates to include as many features as possible with every loan, no matter what.

97. Many loans also included an exorbitant fee of 4 points, or 4% of the loan amount, as part of the closing costs. These points were profit for Wells Fargo.

98. The Memphis branches made these high-cost subprime loans without regard to whether their customers qualified for better loans. Even if a customer could qualify for a lower-priced loan, it was not offered. Wells Fargo had software that was supposed to filter loans to make sure that applicants were offered the best loans for which they qualified, but the filters were regularly evaded and did not work. Employees knew

how to manipulate the application data so that the filter swould allow them to sell the higher-priced subprime loans instead.

99. The managers also misled their customers so that they could sell them costly subprime loans instead of better loans for which they qualified. One way they did this was by encouraging borrowers to apply for "stated income" loans instead of submitting income documentation, even though the borrowers were willing and able to provide the documentation. They did not tell borrowers that this would disqualify them from getting a less expensive loan. Thomas explains that another technique used by managers to conceal what they were really doing from their clients was to talk quickly and shuffle lots of paper.

100. In addition to deceiving customers, employees in the Memphis branches deceived underwriters by falsifying documents. For example, white-out was used on pay records to change borrowers' incomes. When Thomas objected to the practice of falsifying income records, a branch manager responded, "we gotta do what we gotta do." Similarly, managers deliberately used inflated appraisals that they knew were not accurate to manipulate LTV calculations. Some managers falsified the mileage on car loan applications. These practices made it look like loans satisfied eligibility requirements when, in fact, they did not.

101. The Wells Fargo Memphis employees further state that Wells Fargo employees engaged in these abusive, predatory practices because they were both incentivized and pressured into doing so. Managers received large commissions and bonuses of up to $10,000 a month for meeting Wells Fargo's quotas for subprime loans. Managers who failed to meet their quota were put on probation or written up. District managers used this system to pressure credit managers into making loans that should not

have been made. Wells Fargo created an atmosphere in the Memphis branch offices in which unethical practices were condoned and encouraged.

102. Some Memphis employees objected to Wells Fargo's predatory subprime lending practices, refused to engage in them, and raised their concerns with upper management. Nonetheless, the practices and the pressure to perpetrate them remained. Employees who objected to the practices were disfavored for promotion.

103. Based on their national and local experience, Jacobson and Paschal confirm that Wells Fargo engaged in predatory practices in Memphis and Shelby County, including steering borrowers who qualified for prime loans into subprime loans. They explain that Wells Fargo gave loan officers substantial financial incentives and the discretion to steer borrowers in this manner. Paschal was instructed by management to refer borrowers who could have qualified for more advantageous prime or FHA loans to the subprime unit. He was even reprimanded for giving too many people FHA loans instead of referring them for subprime loans.

104. One of the borrowers who Paschal was instructed to steer into a subprime loan was an African American from Memphis. The borrower had excellent credit but had been given a subprime 2/28 adjustable rate loan by Wells Fargo two years earlier. He wanted to refinance that loan to keep his monthly payment from suddenly rising. He qualified for a prime fixed-rate refinance loan, but Paschal's manager instructed him to give the borrower another adjustable rate subprime loan instead. Paschal refused and was disciplined as a result.

105. Although Jacobson was based in Maryland, she regularly communicated with and traveled to meet with Wells Fargo employees from across the country. She is knowledgeable about Wells Fargo's mortgage policies and practices nationally, including

their application in Memphis and Shelby County. Jacobson states that Wells Fargo created very substantial financial incentives to steer people into subprime loans. "A reps," who made prime loans, generally made more money in referral fees by referring a person with prime credit to a subprime loan officer than by originating a prime loan. Subprime loan officers, whose pay was based on commissions and fees, likewise made more money by originating loans with higher interest rates and fees. Paschal describes the effect of Wells Fargo's compensation system for subprime loans as putting "bounties" on minority borrowers.

106. Wells Fargo also gave lavish gifts and trips to successful subprime loan officers, even as foreclosures increased in recent years. This was part of a culture, confirmed by Paschal and Jacobson, that focused only on making the most money possible and not on putting borrowers in loans that were appropriate for them.

107. Jacobson and Paschal also confirm that loan officers were able to steer people with good credit into subprime loans because Wells Fargo gave them broad discretion. Jacobson knows from regularly communicating with Wells Fargo employees around the country that in Memphis and Shelby County, Wells Fargo's underwriting guidelines and pricing rules gave ample discretion to A reps to allow them to steer customers who qualified for prime loans into subprime loans by referring them to subprime loan officers. She confirms that the subprime loan officers then had discretion to offer the customers higher-priced products.

108. Jacobson and Paschal explain that Wells Fargo loan officers developed a multitude of unscrupulous ways to apply their discretion to get away with steering subprime loans to people who qualified for prime or FHA loans. One method was to intentionally mislead customers by, for example, giving "stated income" loans to

customers who could document their income (a practice also described by Camille Thomas), or telling customers not to make a down payment or to take more cash from their home equity, which would automatically cause a prime loan to "flip" into a subprime loan. Another was to intentionally mislead underwriters by saying that the customer chose not to provide documentation in support of a loan application, did not have verified assets, or wanted to close the loan quickly. Loan officers used such techniques to increase their commissions while discriminating against minority applicants. These techniques were applied by loan officers responsible for Memphis and Shelby County.

109. In 2004 Wells Fargo responded to public criticism by creating the "filters" discussed in paragraph 98 above that were supposed to prevent the steering of prime customers into subprime loans. Jacobson and Paschal confirm the former Memphis employees' statements that it was widely understood that the filters were not effective. Loan officers learned many ways to work around the filters by using the broad discretion they were afforded by Wells Fargo. These techniques were widely used. Senior managers were aware of their use and eventually made certain changes in response, but the loan officers continued to easily undermine the filters. The filters were also ineffective because Wells Fargo did not create disincentives to steering prime customers into subprime loans. To the contrary, employees continued to have substantial financial incentives to engage in such steering and continued to do so.

110. Wells Fargo's steering practices and techniques were applied regularly in Memphis and Shelby County and caused many customers who qualified for prime or FHA loans to receive subprime loans. Borrowers who were steered in this manner could

be identified by reviewing Wells Fargo's loan files for loans in Memphis and Shelby County.

c. Other Abusive Subprime Lending Practices Engaged in by Wells Fargo

111. The former Wells Fargo employees further state that Wells Fargo routinely misled and deceived its customers in order to raise the cost of their loans. Dancy, Simpson, Taylor, and Thomas all explain the many ways this was done by the Memphis branches.

112. One way was by failing to inform borrowers that their loans had adjustable rates, which could cause their monthly payments to increase dramatically. When borrowers knew that their rate was adjustable, credit managers would promise that the loan could be refinanced before the rate increased, even though they knew there was a good chance that the borrower would not be able to refinance the loan.

113. Memphis employees were also instructed to deceive customers about the addition of sizable closing costs and fees to their loans. These were added to increase Wells Fargo's profit, not to benefit the borrower.

114. Credit managers at Memphis branches also told borrowers that interest rates were locked prior to closing when they were not. This prevented borrowers from taking advantage of declining interest rates.

115. Employees were not supposed to inform customers about the details of their loans, telling them instead only the bottom-line monthly payment. For example, borrowers were not informed about the inclusion and significance of onerous prepayment penalties in the terms and conditions of their loans. Prepayment penalties typically made it difficult for borrowers to refinance into new and better loans. When the subject was

raised, borrowers were told that prepayment penalties could be waived, even though this was not true.

116. The former Wells Fargo employees confirm that employees were given substantial discretion to increase the costliness of subprime loans and that they regularly used this discretion at the expense of subprime borrowers. Credit managers and loan officers had broad discretion to set the pricing, points, and fees for subprime loans. Even when Wells Fargo created some limits in 2007, employees retained significant discretion. Employees had strong financial incentives to increase the pricing, points, and fees because it would increase their commissions.

117. Employees also used their discretion to discriminate against minority borrowers in Memphis and Shelby County by not offering them Wells Fargo's newer and better loan products. Those products had lower fixed interest rates and fees than the products that were offered to minority borrowers.

118. Wells Fargo also qualified adjustable rate subprime loans in Memphis and Shelby County as if the borrower would be paying the teaser rate for the life of the loan instead of just the first two or three years. This means that it was or should have been apparent to Wells Fargo from the outset that many of the people to whom it gave adjustable rate mortgages did not have the ability to repay those loans. Foreclosures are a predictable result of this practice.

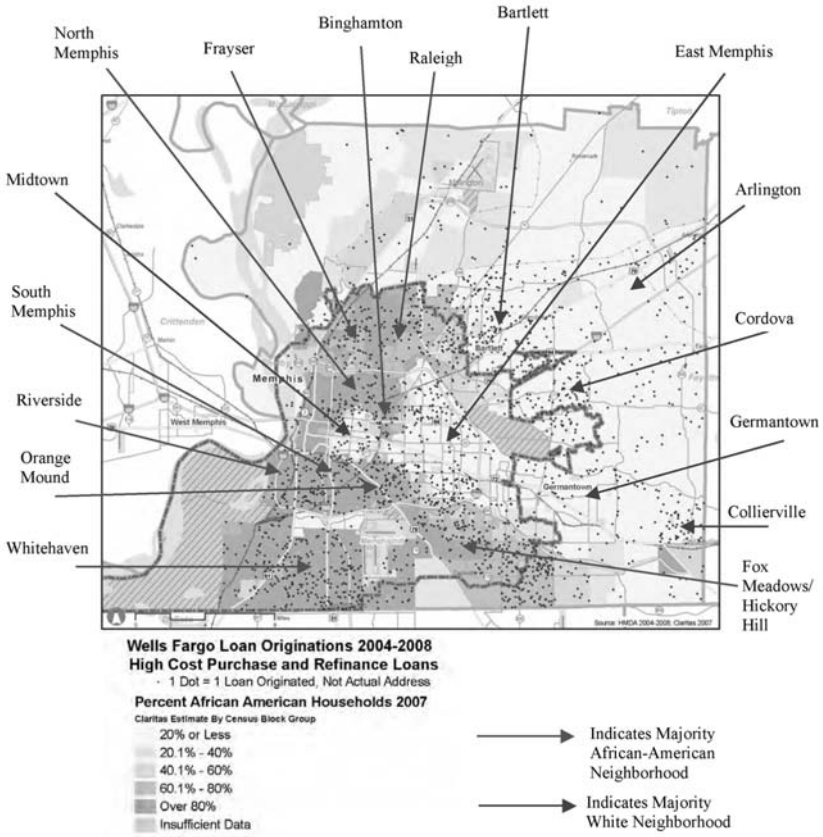
119. Dancy, Simpson, Taylor, and Thomas all found Wells Fargo's subprime lending practices to be unethical and all quit their jobs voluntarily to find other employment. Dancy explains that the practices were so bad that she would cry at the end of the day. She left to find a job "where I could feel good about what I was doing."

2. Publicly Available Home Mortgage Disclosure Act Data Shows that Wells Fargo's High-Cost Loans are Disproportionately Located in African-American Neighborhoods in Memphis and Shelby County

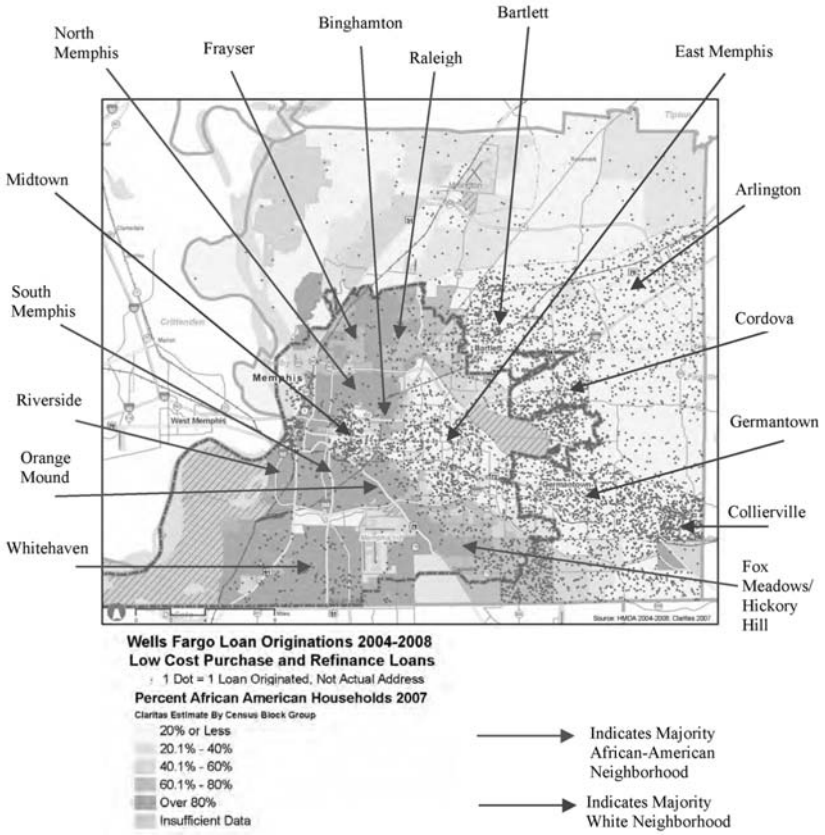
120. Publicly available data reported by Wells Fargo to federal regulators pursuant to the Home Mortgage Disclosure Act ("HMDA") shows that from 2004 to 2008, Wells Fargo made high-cost loans (*i.e.*, loans with an interest rate that was at least three percentage points above a federally-established benchmark) to 51% of its African-American mortgage customers in Shelby County, but only 17% of its white customers in the County. In Memphis, it made high-cost loans to 63% of its African-American customers but only 26% of its white customers. (HMDA data for 2009 is not yet available.)

121. Racial disparities in the pricing of Wells Fargo's mortgage loans are confirmed by a study released this year. National People's Action, *The Truth About Wells Fargo: Racial Disparities in Lending Practices* (2009) at 2 (available at http://www.npa-us.org/downloads/truthaboutwellsfargo.pdf). The study found that the disparity actually increased at higher income levels. *Id.*

122. The map that follows shows the geographic distribution of high-cost loans in African-American and white neighborhoods in Memphis and Shelby County. The map demonstrates that Wells Fargo's high-cost loans are disproportionately located in Memphis' and Shelby County's African-American neighborhoods. The fact that Wells Fargo's high-cost loans are more heavily concentrated in Memphis' and Shelby County's African-American neighborhoods is consistent with the practice of reverse redlining and, upon information and belief, has contributed significantly to the disproportionately high rate of foreclosure in Memphis' and Shelby County's African-American communities.


North Memphis
Frayser
Binghamton
Raleigh
Bartlett
East Memphis
Midtown
Arlington
South Memphis
Cordova
Riverside
Germantown
Orange Mound
Collierville
Whitehaven
Fox Meadows/ Hickory Hill
Memphis
West Memphis
Germantown
Wells Fargo Loan Originations 2004-2008
High Cost Purchase and Refinance Loans
1 Dot = 1 Loan Originated, Not Actual Address
Percent African American Households 2007
Claritas Estimate By Census Block Group
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Insufficient Data
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

123. The stark disparity in the location of Wells Fargo's high-cost or subprime mortgage loans in Memphis and Shelby County is especially disturbing when one considers the location of Wells Fargo's low-cost or prime mortgage loans. Almost 70 percent of those loans are located in predominantly white neighborhoods, which encompass 38.3% of the County's households, while only 6.9% of the loans are in predominantly African-American neighborhoods, which encompass 30.2% of County households. In other words, while Wells Fargo is targeting African-American neighborhoods for predatory subprime loans that disproportionately lead to foreclosure, it is also failing to allow residents of African-American neighborhoods to have access to prime loans. Wells Fargo is simultaneously engaged in reverse redlining and redlining of minority neighborhoods, exacerbating the harm caused by each unlawful practice. The following map demonstrates Wells Fargo's failure to make prime credit available in African-American neighborhoods.


North Memphis
Frayser
Binghamton
Raleigh
Bartlett
East Memphis
Midtown
Arlington
South Memphis
Cordova
Riverside
Germantown
Orange Mound
Collierville
Whitehaven
Fox Meadows/ Hickory Hill
Memphis
West Memphis
Wells Fargo Loan Originations 2004-2008
Low Cost Purchase and Refinance Loans
1 Dot = 1 Loan Originated, Not Actual Address
Percent African American Households 2007
Claritas Estimate By Census Block Group
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Insufficient Data
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

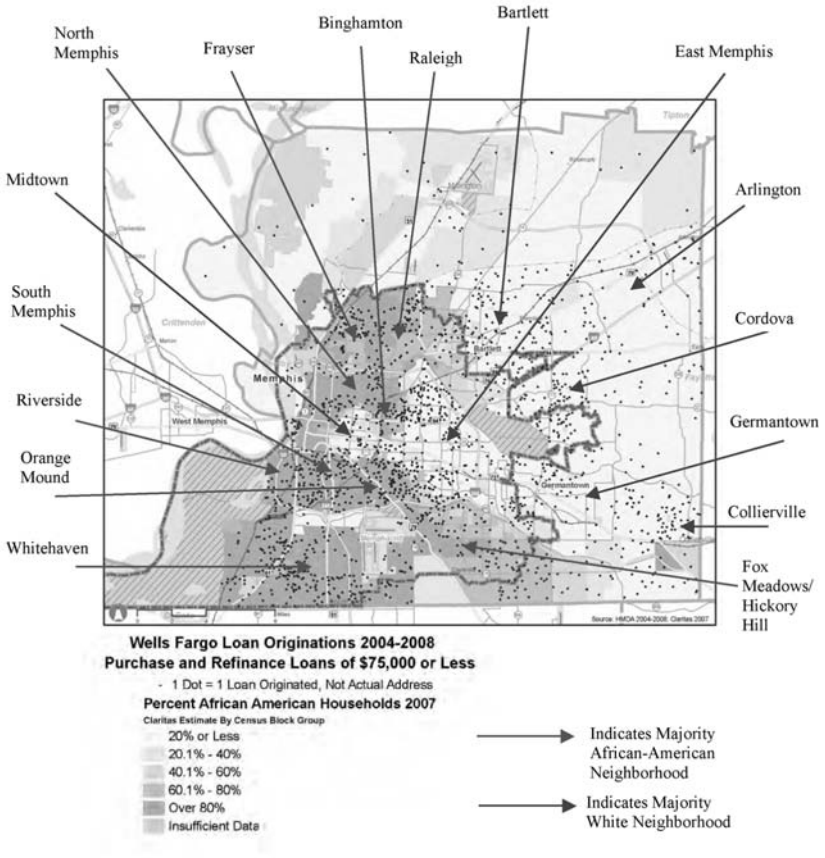
3. Wells Fargo's Pricing Sheets Show that it Targets Homes that are More Likely to be Located in African-American Neighborhoods for Interest Rate Increases, and Lowers Rates for Homes that are Disproportionately Located in White Neighborhoods

124. One reason that residents of Memphis' and Shelby County's African-American neighborhoods are more likely to pay higher prices for Wells Fargo loans than residents of Memphis' and Shelby County's white neighborhoods is the discriminatory pricing found on its pricing sheets. As set forth explicitly on the Wells Fargo Home Mortgage 2005 pricing sheet, attached as Attachment I, Wells Fargo requires a 50 basis point increase in the loan rate for loans of $75,000 or less, a 12.5 basis point decrease for loans of $150,000 to $400,000, and a 25 basis point decrease for loans larger than $400,000. This means that a borrower with a $75,000 thirty-year fixed rate loan who qualifies for an 8% interest rate instead receives an 8.5% interest rate, which costs an extra $9,493 over the life of the loan. An equally creditworthy borrower with a $150,000 loan receives a 7.875% interest rate, which costs $4,698 less than an 8% loan. A similarly qualified borrower with a $400,001 loan would receive a 7.75% interest rate, which costs $24,987 less than an 8% loan.

125. The Fannie Mae Foundation has likewise documented how modest interest rate disparities can cause dramatic financial consequences for borrowers steered into higher-cost loans. James H. Carr and Jenny Schuetz, Fannie Mae Foundation, *Financial Services in Distressed Communities: Framing the Issue, Finding Solutions* (2001) at 12-13 (available at http://www.cra-nc.org/financial.pdf) (1% increase in interest rate on 30-year $81,000 mortgage translates into loss of over $78,000 in wealth due to increased payments and lost investment opportunity).

126. Wells Fargo's pricing rules have a clear and foreseeable disproportionate adverse impact on African-American borrowers. As demonstrated by the maps that

follow, loans originated by Wells Fargo in the City from 2004 through 2008 in the amount of $75,000 and less were almost three times more likely to be in census tracts where the population is predominantly African-American than in tracts where the population is predominantly white. By contrast, loans originated by Wells Fargo of more than $150,000 were ten times more likely in the City, and sixty-six times more likely in the County, to be in tracts that are predominantly white than in tracts that are predominantly African-American.



Wells Fargo Loan Originations 2004-2008
Purchase and Refinance Loans of $75,000 or Less

- 1 Dot = 1 Loan Originated, Not Actual Address

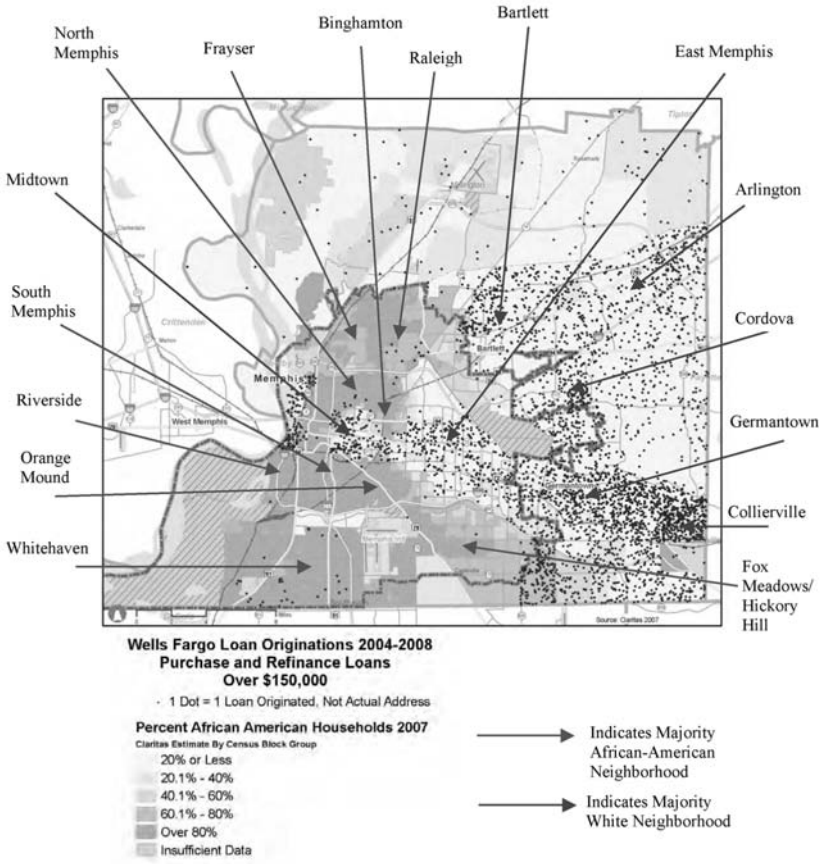
Percent African American Households 2007

Claritas Estimate By Census Block Group

- 20% or Less
- 20.1% - 40%
- 40.1% - 60%
- 60.1% - 80%
- Over 80%
- Insufficient Data

→ Indicates Majority African-American Neighborhood

→ Indicates Majority White Neighborhood



Wells Fargo Loan Originations 2004-2008
Purchase and Refinance Loans
Over $150,000

- 1 Dot = 1 Loan Originated, Not Actual Address

Percent African American Households 2007
Claritas Estimate By Census Block Group

- 20% or Less
- 20.1% - 40%
- 40.1% - 60%
- 60.1% - 80%
- Over 80%
- Insufficient Data

→ Indicates Majority African-American Neighborhood

→ Indicates Majority White Neighborhood

127. Upon information and belief, the discriminatory pricing reflected in Wells Fargo's pricing sheets is consistent with unfair practices associated with reverse redlining and has contributed significantly to the disproportionately large number of foreclosures found in Memphis' and Shelby County's African-American communities.

4. Investigation of Wells Fargo's Pricing Practices in Philadelphia Further Demonstrates the Company is Targeting the African-American Community for Unfair and Improper Lending Practices

128. Discriminatory pricing observed in Wells Fargo's loan data in Memphis and Shelby County is consistent with findings drawn from data obtained in litigation brought against Wells Fargo in Philadelphia. An expert report in a lawsuit based on Wells Fargo's Philadelphia loans concluded that "African American borrowers, and borrowers residing in African American neighborhoods (i.e., census tracts), pay more than comparable non-African Americans and residents of communities in which White people predominate." Aff. of I. Goldstein, *Walker v. Wells Fargo Bank, N.A.*, No. 05-cv-6666 (E.D. Pa. July 20, 2007) at ¶ 7 (Docket No. 24, Attach. 1).

129. Upon information and belief, Wells Fargo's pricing practices in Philadelphia are consistent with its practices in Memphis and Shelby County, and provide further evidence that the company is engaged in a pattern or practice of unfair lending that contributes significantly to the disproportionately high rate of foreclosure found in Memphis' and Shelby County's African-American neighborhoods.

5. Wells Fargo Underwrites Adjustable Rate Loans in Memphis' and Shelby County's African-American Neighborhoods that Borrowers Cannot Afford

130. Wells Fargo frequently originates "3/27" adjustable rate mortgages, and frequently originated "2/28" adjustable rate mortgages until mid-2007, to borrowers from predominantly African-American neighborhoods in Memphis and Shelby County.

Thirty-eight percent of Wells Fargo's foreclosures from 2000 to 2008 involved adjustable rate loans. Unless properly underwritten, such loans are destined to fail.

131. Wells Fargo does not properly underwrite these loans when made to African Americans and in African-American neighborhoods. Wells Fargo does not adequately consider the borrowers' ability to repay these loans, especially after the teaser rate expires and the interest rate increases. The fact that these loans would result in delinquency, default and foreclosure for many borrowers was, or should have been, clearly foreseeable to Wells Fargo at the time the loans were made.

132. The use of "2/28" and "3/27" adjustable rate mortgages in the manner described above is consistent with the practice of reverse redlining, has subjected African-American borrowers to unfair and deceptive loan terms, and has contributed significantly to the high rate of foreclosure found in Memphis' and Shelby County's African-American neighborhoods.

6. The Caps on Wells Fargo's Adjustable Rate Loans are Higher in African-American Neighborhoods

133. Upon information and belief, Wells Fargo has discretion to apply different caps on adjustable rate loans. The cap is the maximum rate that a borrower can be charged during the life of an adjustable rate loan.

134. The average cap on a Wells Fargo adjustable rate loan that was subject to foreclosure from 2000 to 2008 in predominantly African-American neighborhoods in Memphis and Shelby County was 15.19%. The cap on such loans in predominantly white neighborhoods in Memphis and Shelby County was only 13.9%.

135. The disparity observed in caps imposed on adjustable rate loans in predominantly African-American neighborhoods and predominantly white neighborhoods further demonstrates that Well Fargo is engaged in a pattern or practice of

unfair and improper lending in Memphis' and Shelby County's African-American communities that contributes significantly to the high rate of foreclosure in these neighborhoods.

7. Wells Fargo's Loans to African Americans Result in Especially Quick Foreclosures

136. A comparison of the time from origination to foreclosure of Wells Fargo's loans in Memphis and Shelby County shows a marked disparity with respect to the speed with which loans to African Americans and whites move into foreclosure. The average time to foreclosure for borrowers in African-American neighborhoods is 2.20 years in the City and 2.26 years in the County. It is 2.79 years for borrowers in white neighborhoods in the City, or 27% longer, and 2.76 years in white neighborhoods in the County, or 22% longer.

137. This disparity in time to foreclosure is further evidence that Wells Fargo is engaged in lending practices consistent with reverse redlining. As with all of the practices identified in paragraphs 67-119 above, and like the abusive practices identified in paragraph 34 above, the disparity in time to foreclosure demonstrates that Wells Fargo is engaged in irresponsible underwriting in African-American communities that does not serve the best interests of borrowers. If Wells Fargo were applying the same underwriting practices in Memphis' and Shelby County's African-American and white neighborhoods, there would not be a significant difference in time to foreclosure. Were Wells Fargo underwriting borrowers in both communities with equal care and attention to proper underwriting practices, borrowers in African-American communities would not find themselves in financial straits significantly sooner during the life of their loans than borrowers in white communities. The faster time to foreclosure in African-American neighborhoods is consistent with underwriting practices in the African-American

community that are less concerned with determining a borrower's ability to pay and qualifications for the loan than they are in maximizing short-term profit.

138. The HUD/Treasury Report confirms that time to foreclosure is an important indicator of predatory practices. HUD and Treasury stated that "[t]he speed with which the subprime loans in these communities have gone to foreclosure suggests that some lenders may be making mortgage loans to borrowers who did not have the ability to repay those loans at the time of origination," and that "lenders should not lend to borrowers that do not have the capacity to repay the loans that the lender offers." HUD/Treasury Report at 25.

INJURY TO MEMPHIS AND SHELBY COUNTY CAUSED BY WELLS FARGO'S DISCRIMINATION IN MORTGAGE LENDING

139. Wells Fargo has engaged in a pattern or practice of reverse redlining that has resulted in a disproportionately high rate of foreclosure on loans to African Americans and in Memphis' and Shelby County's majority African-American neighborhoods. Wells Fargo continues to engage in this discriminatory pattern or practice with similar and continuing deleterious consequences for Memphis' and Shelby County's African-American neighborhoods.

140. The foreclosures caused by Defendants' discriminatory reverse redlining practices have caused, and continue to cause, multiple types of injuries to Memphis and Shelby County, including:

a. A significant decline in the value of homes that are in close proximity to the Wells Fargo foreclosure properties, resulting in a decrease in property tax revenue;

b. Increased expenditures for police and fire responses to Wells Fargo foreclosure properties that have become vacant and have turned into centers for squatting, drug use, drug distribution, prostitution, and other unlawful activities;

c. Increased expenditures to secure, stabilize, clean, acquire, and rehabilitate Wells Fargo foreclosure properties;

d. Additional expenditures for administrative, legal, and social services in connection with notices of foreclosure at Wells Fargo properties.

141. Examples of the City and County's injuries are described in greater detail below.

A. Memphis and Shelby County Have Been Injured By Having to Provide Costly Municipal Services at Properties in African-American Neighborhoods as a Direct Result of Discriminatory Loans Originated By Wells Fargo

142. Wells Fargo foreclosure properties that become vacant result in injuries to Memphis and Shelby County that are especially costly. Vacancies cause, among other harms, squatters, increased risk of crime and fire, and infrastructure damage such as burst water pipes and broken windows. Expensive responses by Memphis and Shelby County are required to address these harms at Wells Fargo foreclosure properties. The costs incurred by the City and County are the direct result of the foreclosures on Wells Fargo loans.

143. Even when a house is not vacant, foreclosures cause serious housing code violations. These violations likewise require expensive responses by the City and County. The costs of responding to these violations are also the direct result of the foreclosures on Wells Fargo loans. Housing code violations caused by Wells Fargo foreclosures occur disproportionately in predominantly African-American neighborhoods. These violations include environmental problems, properties in need of

repair, properties with structural damages, and properties that are extremely dilapidated. Plaintiffs must respond to all of these problems.

144. Damages suffered by Memphis and Shelby County as a result of vacancies resulting from Wells Fargo's foreclosures at Wells Fargo properties are fully capable of empirical quantification.

145. Memphis and Shelby County maintain detailed records that allow for the precise calculation of the expenses they have incurred in addressing the harms caused by specific Wells Fargo foreclosures and consequent vacancies. This includes, among others, records regarding police and fire calls and housing code enforcement efforts (such as the costs of boarding vacant Wells Fargo properties).[1]

146. Nearly all of the Wells Fargo properties specifically identified in paragraphs 149 through 198 below became vacant because of Wells Fargo's discriminatory lending practices and the foreclosures that are the direct result of those practices. One or both Plaintiffs have been required to provide increased municipal services at these properties. The police and fire department services described below were provided while the properties were vacant as a result of the Wells Fargo foreclosures. The housing code violations described below are also the result of the

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[1] A recent study commissioned by the Homeownership Preservation Foundation demonstrates that, using such records, the costs of increased municipal services that are necessary because of foreclosures can be determined empirically. *See* William C. Apgar, Mark Duda & Rochelle Nawrocki Gorey, *The Municipal Cost of Foreclosures: A Chicago Case Study* (Feb. 27, 2005) at 24-26 (available at http://www.nw.org/network/neighborworksProgs/foreclosuresolutions/documents/ 2005Apgar-DudaStudy-FullVersion.pdf). The study isolated twenty-six types of costs incurred by fifteen government agencies in response to foreclosures in Chicago. It then analyzed the amount of each cost based on different foreclosure scenarios, such as whether the home is left vacant, whether and to what degree criminal activity ensues, and whether the home must be demolished. The study found that the total costs ran as high as $34,199 per foreclosure.

Application of a methodology like the one employed by Apgar to data regularly maintained by Memphis and Shelby County can be used to quantify precisely the cost to the City and County of having to provide increased municipal services because of Defendants' discriminatory lending practices, including but not limited to those described above, and the Wells Fargo foreclosures that are the direct result of those practices.

Wells Fargo foreclosures. These violations have required the City and County to board, clean, demolish, rehabilitate, control vermin, and take legal action regarding these properties and to provide other costly services, and will continue to require such services in the future.

147. The properties and services identified in paragraphs 149-198 below represent examples of the damages the City and County have sustained as a result of Wells Fargo's practices. More services have been required at these properties, and there are many more Wells Fargo foreclosure properties where one or both Plaintiffs have been injured by needing to provide increased municipal services.

148. The costs of taking each of the actions listed for each Wells Fargo foreclosure property below constitute specific damages caused by Defendants' illegal lending practices. Plaintiffs will have to continue to provide these and other municipal services at these properties in the future, particularly with respect to the many that remain vacant.

149. **2783 Harvard Avenue:** The code enforcement department devoted personnel time to conduct five physical inspections of the property in 2003, two physical inspections of the property in 2004, five physical inspections of the property in 2006, twelve physical inspections of the property in 2007, and six physical inspections of the property in 2008. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2003 and again in 2004. The city paid a private contractor to demolish the property in 2008.

150. **883 Ayers Street:** The code enforcement department devoted personnel time to conduct five physical inspections of the property in 2007, four physical inspections of the property in 2008, sixteen physical inspections of the property in 2009, and an additional physical inspection of the property in 2010. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2009. The police department dispatched officers to the property in 2008 in response to a call for service. The city paid a private contractor to demolish the property in 2010.

151. **497 Marianna Street:** The code enforcement department devoted personnel time to conduct five physical inspections of the property in 2006, eight physical inspections of the property in 2007, five physical inspections of the property in 2008, and eight physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2007. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2006 and again in 2007.

152. **1305 Adelaide Street:** The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2007. The police department dispatched officers to the property four times in 2008 in response to calls for service.

153. **918 Decatur Street:** The code enforcement department devoted personnel time to conduct three physical inspections of the property in 2006, two physical

inspections of the property in 2007, and seven physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2009. The police department dispatched officers to the property six times in 2007 in response to calls for service. The fire department dispatched a fire truck, three fire engines, two Battalion Chief vehicles, a rescue vehicle, and twenty-two personnel to the property in response to a call for service in 2007. The fire department dispatched a fire truck, three fire engines, a Battalion Chief vehicle, a rescue vehicle, a medical vehicle, and twenty-three personnel to the property in response to another call for service in 2007.

154. **2013 Pamela Drive:** The County spent funds for the acquisition and rehabilitation of the property in 2009 and 2010.

155. **3252 Given Avenue:** The code enforcement department devoted personnel time to conduct six physical inspections of the property in 2006, two physical inspections of the property in 2007, and seven physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2010. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2007 and again in 2009. The police department dispatched officers to the property five times in 2004 in response to calls for service.

156. **1529 S. Third Street:** The code enforcement department devoted personnel time to conduct one physical inspection of the property in 2006, five physical

inspections of the property in 2007, and four physical inspections of the property in 2008. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The fire department dispatched a fire truck, a medical vehicle, and six personnel to the property in response to a call for service in 2006. The fire department dispatched a fire engine, a medical vehicle, and six personnel to the property in response to a call for service in 2007. The fire department dispatched a vehicle and personnel to the property in response to a second call for service in 2007. The fire department dispatched a vehicle and personnel to the property in response to a third call for service in 2007. The fire department dispatched a fire truck, a medical vehicle, and five personnel to the property in response to a fourth call for service in 2007. The fire department dispatched three fire engines, a fire truck, a Battalion Chief vehicle, a Division Chief vehicle, a rescue vehicle, and twenty-two personnel to the property in response to a fifth call for service in 2007. The fire department dispatched a fire truck, a medical vehicle, and six personnel to the property in response to a call for service in 2008. The city paid a private contractor to demolish the property in 2008.

157. **2965 Mt. Olive Road:** The code enforcement department devoted personnel time to conduct three physical inspections of the property in 2006, two physical inspections of the property in 2007, two physical inspections of the property in 2008, and four physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2010. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2008 and again in 2009.

158. **3246 Morningview Drive:** The code enforcement department devoted personnel time to conduct one physical inspection of the property in 2005, eight physical inspections of the property in 2006, two physical inspections of the property in 2007, nine physical inspections of the property in 2008, and three physical inspections of the property in 2008. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The police department dispatched officers to the property in 2008 in response to a call for service. The fire department dispatched three fire engines, a fire truck, two Battalion Chief vehicles, a rescue vehicle, and twenty-two personnel to the property in response to a call for service in 2008.

159. **1319 Horace Street:** The code enforcement department devoted personnel time to conduct two physical inspections of the property in 2005. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2006 and again in 2009. The police department dispatched officers to the property in 2006 in response to a call for service.

160. **961 Kirkland Avenue:** The code enforcement department devoted personnel time to conduct two physical inspections of the property in 2002, one physical inspection of the property in 2003, one physical inspection of the property in 2005, three physical inspections of the property in 2008, and three physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The police department dispatched officers to

the property twice in 2004, twice in 2005, and twice in 2007 in response to calls for service. The fire department dispatched a fire truck, a medical vehicle, and six personnel to the property in response to a call for service in 2007.

161. **1620 Carpenter Street:** The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2007, in 2008, and again in 2009.

162. **1129 Capital Avenue:** The code enforcement department devoted personnel time to conduct three physical inspections of the property in 2007, three physical inspections of the property in 2008, and three physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2007, in 2008, and again in 2009. The police department dispatched officers to the property twice in 2009 in response to calls for service.

163. **1397 Valse Road:** The code enforcement department devoted personnel time to conduct three physical inspections of the property in 2003, three physical inspections of the property in 2007, nine physical inspections of the property in 2008, eleven physical inspections of the property in 2009, and an additional physical inspection of the property in 2010. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2003 and again in 2009. The police department dispatched officers to the property in 2007 in response to a call for service.

164. **1599 Preston Street:** The code enforcement department devoted personnel time to conduct one physical inspection of the property in 2005, three physical inspections of the property in 2008, and twelve physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The police department dispatched officers to the property in 2009 in response to a call for service.

165. **721 Lucy Avenue:** The code enforcement department devoted personnel time to conduct sixteen physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2008 and again in 2009. The police department dispatched officers to the property in 2007 and 2008 in response to calls for service.

166. **3640 Elm Park Road:** The code enforcement department devoted personnel time to conduct four physical inspections of the property in 2004, three physical inspections of the property in 2005, two physical inspections of the property in 2006, six physical inspections of the property in 2008, and an additional physical inspection of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2005 and again in 2008. The police department dispatched officers to the property four times in 2006 and once in 2008 in response to calls for service.

167. **4939 Manson Road:** The code enforcement department devoted personnel time to conduct one physical inspection of the property in 2003, three physical inspections of the property in 2004, two physical inspections of the property in 2005, three physical inspections of the property in 2006, and three physical inspections of the property in 2007. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair.

168. **3003 S. Mendenhall Road:** The code enforcement department devoted personnel time to conduct ten physical inspections of the property in 2009 and an additional physical inspection of the property in 2010. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair.

169. **304 Elder Road:** The code enforcement department devoted personnel time to conduct five physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The police department dispatched officers to the property twice in 2008 in response to calls for service.

170. **4439 Sunnyslope Drive:** The code enforcement department devoted personnel time to conduct seven physical inspections of the property in 2008 and eight physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair.

171. **358 Allen Street:** The code enforcement department devoted personnel time to conduct six physical inspections of the property in 2005, seven physical inspections of the property in 2007, and an additional physical inspection of the property in 2008. The code enforcement department identified code violations at the property

and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2003. The police department dispatched officers to the property three times in 2005 in response to calls for service.

172. **2404 Norman Avenue:** The code enforcement department devoted personnel time to conduct five physical inspections of the property in 2008, seven physical inspections of the property in 2009, and an additional physical inspection of the property in 2010. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property twice in 2009 and again in 2010. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2008.

173. **564 E. Gage Avenue:** The code enforcement department devoted personnel time to conduct six physical inspections of the property in 2003, one physical inspection of the property in 2005, two physical inspections of the property in 2008, and five physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2009. The police department dispatched officers to the property in 2009 in response to a call for service.

174. **1211 Azalia Street:** The code enforcement department devoted personnel time to conduct nine physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009.

175. **4988 Rosefield Avenue:** The code enforcement department devoted personnel time to conduct seven physical inspections of the property in 2007, four physical inspections of the property in 2008, and an additional physical inspection of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair.

176. **3339 Rosamond Avenue:** The code enforcement department devoted personnel time to conduct three physical inspections of the property in 2005, two physical inspections of the property in 2008, and eight physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2009.

177. **2145 Kentucky Street:** The code enforcement department devoted personnel time to conduct three physical inspections of the property in 2008 and four physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The police department dispatched officers to the property once in 2008 and five times in 2009 in response to calls for service.

178. **919 Lewis Street:** The code enforcement department devoted personnel time to conduct three physical inspections of the property in 2006, two physical inspections of the property in 2007, five physical inspections of the property in 2008, and two physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair.

The police department dispatched officers to the property in 2006 in response to a call for service.

179. **7386 Eggleston Road:** The code enforcement department devoted personnel time to conduct four physical inspections of the property in 2005, thirteen physical inspections of the property in 2006, nine physical inspections of the property in 2007, and six physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property 2006. The police department dispatched officers to the property three times in 2007 in response to calls for service.

180. **1215 College Street:** The code enforcement department devoted personnel time to conduct two physical inspections of the property in 2005, five physical inspections of the property in 2008, and fourteen physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The police department dispatched officers to the property in 2009 in response to a call for service.

181. **927 N. Third Street:** The code enforcement department devoted personnel time to conduct six physical inspections of the property in 2005, three physical inspections of the property in 2006, and six physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2009.

182. **2096 Riverside Boulevard:** The city paid a private contractor to board the property in 2009. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2009.

183. **963 Doris Avenue:** The code enforcement department devoted personnel time to conduct one physical inspection of the property in 2007, two physical inspections of the property in 2008, and seven physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2009. The fire department dispatched a vehicle and personnel to the property in response to a call for service in 2009.

184. **895 Griffith Avenue:** The code enforcement department devoted personnel time to conduct four physical inspections of the property in 2008, and six physical inspections of the property in 2009.

185. **6836 Greenbark Drive:** The code enforcement department devoted personnel time to conduct nine physical inspections of the property in 2006 and nine physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009.

186. **1093 S. Orleans Street:** The code enforcement department devoted personnel time to conduct four physical inspections of the property in 2008 and seven physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair.

The police department dispatched officers to the property four times in 2005 in response to calls for service.

187. **592 Lucy Avenue:** The code enforcement department devoted personnel time to conduct one physical inspection of the property in 2005, one physical inspection of the property in 2007, and five physical inspections of the property in 2008. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2008. The city paid a private contractor to demolish the property in 2009.

188. **2778 Hale Avenue:** The code enforcement department devoted personnel time to conduct two physical inspections of the property in 2008 and ten physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2007.

189. **3570 Pearson Road:** The code enforcement department devoted personnel time to conduct four physical inspections of the property in 2008 and seven physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2009. The police department dispatched officers to the property in 2009 in response to a call for service.

190. **871 Decatur Street:** The code enforcement department devoted personnel time to conduct six physical inspections of the property in 2006, two physical inspections of the property in 2007, and an additional physical inspection of the property in 2008. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2009. The city paid a private contractor to demolish the property in 2008.

191. **1119 Ethel Street:** The code enforcement department devoted personnel time to conduct three physical inspections of the property in 2008 and five physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The police department dispatched officers to the property twice in 2007 in response to calls for service.

192. **1508 McMillan Street:** The code enforcement department devoted personnel time to conduct four physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2009. The police department dispatched officers to the property once in 2006 and twice in 2009 in response to calls for service. The city paid a private contractor to demolish the property in 2009.

193. **2557 Supreme Avenue:** The code enforcement department devoted personnel time to conduct seven physical inspections of the property in 2008. The code enforcement department identified code violations at the property and/or deteriorating

conditions in need of repair. The city paid a private contractor to board the property in 2009.

194. **408 E. Trigg Avenue:** The code enforcement department devoted personnel time to conduct three physical inspections of the property in 2006, two physical inspections of the property in 2008, and three physical inspections of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009. The police department dispatched officers to the property four times in 2008 in response to calls for service.

195. **360 Boston Street:** The code enforcement department devoted personnel time to conduct one physical inspection of the property in 2009 and two physical inspections of the property in 2010. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2010. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property twice in 2009.

196. **1479 Gabay Street:** The code enforcement department devoted personnel time to conduct a physical inspection of the property in 2009. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2009.

197. **3229 Boone Street:** The code enforcement department devoted personnel time to conduct four physical inspections of the property in 2009. The code enforcement

department identified code violations at the property and/or deteriorating conditions in need of repair. The city paid a private contractor to board the property in 2009.

198. **2504 Heard Avenue:** The code enforcement department devoted personnel time to conduct one physical inspection of the property in 2005, five physical inspections of the property in 2006, one physical inspection of the property in 2007, and an additional physical inspection of the property in 2008. The code enforcement department identified code violations at the property and/or deteriorating conditions in need of repair. The grounds maintenance department devoted personnel time to cutting and removing high grass and weeds at the property in 2007.

B. Memphis and Shelby County Have Been Injured By a Reduction in Property Tax Revenues Caused By Wells Fargo Foreclosures

199. Wells Fargo foreclosure properties and the problems associated with them likewise cause especially significant declines in property values because the neighborhoods become less desirable. This reduces the property tax revenues collected by the City and County.

200. Property tax losses suffered by Memphis and Shelby County as a result of vacancies resulting from Wells Fargo's foreclosures are fully capable of empirical quantification.

201. Routinely maintained property tax and other data allow for the precise calculation of the property tax revenues lost by Memphis and Shelby County as a direct result of particular Wells Fargo foreclosures. Using a well-established statistical regression technique that focuses on effects on neighboring properties, the City and County have isolated the lost property value attributable to each individual foreclosure or vacancy from losses attributable to other causes, such as neighborhood conditions. This technique, known as hedonic regression when applied to housing markets, isolates the

factors that contribute to the value of a property by studying thousands of housing transactions. Those factors include the size of a home, the number of bedrooms and bathrooms, whether the neighborhood is safe, whether neighboring properties are well-maintained, and more. Hedonic analysis determines the contribution of each of these house and neighborhood characteristics to the value of a home.

202. The number of foreclosures in a neighborhood is one of the neighborhood traits that hedonic analysis can examine. Hedonic analysis allows for the calculation of the impact on a property's value of the first foreclosure in close proximity (*e.g.*, ⅛ or ¼ of a mile), the average impact of subsequent foreclosures, and the impact of the last foreclosure.

203. Foreclosures attributable to Wells Fargo in Memphis and Shelby County have been analyzed through hedonic regression to calculate the resulting loss in the property values of nearby homes. This loss has been distinguished from any loss attributable to non-Wells Fargo foreclosures or other causes. The loss in property value in Memphis and Shelby County attributable to Wells Fargo's unlawful acts and consequent foreclosures has been used to calculate Memphis' and Shelby County's corresponding loss in property tax revenues.

204. Recent studies establish that hedonic regression can be used for this purpose. A study published by the Fannie Mae Foundation, using Chicago as an example, determined that each foreclosure is responsible for an average decline of approximately 1.1% in the value of each single-family home within an eighth of a mile. *See* Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 Housing Policy Debate 57 (2006) at 69.

205. Other studies have focused on the impact of abandoned homes on surrounding property values. A recent study in Philadelphia, for example, found that each home within 150 feet of an abandoned home declined in value by an average of $7,627; homes within 150 to 299 feet declined in value by $6,810; and homes within 300 to 449 feet declined in value by $3,542. Anne B. Shlay & Gordon Whitman, *Research for Democracy: Linking Community Organizing and Research to Leverage Blight Policy*, at 21 (2004).

206. Application of a hedonic regression methodology like the methodologies employed by Immergluck and Shlay to data regularly maintained by Memphis and Shelby County has been used to quantify precisely the property tax injury to the City and County caused by Defendants' discriminatory lending practices, including but not limited to those described above, and the Wells Fargo foreclosures that are the direct result of those practices.

207. This lost property tax revenue is a direct result of Defendants' discriminatory lending practices and of the Wells Fargo foreclosures that are the direct result of those practices.

* * *

208. Defendants' actions set forth herein constitute a pattern or practice of discriminatory, unfair, and deceptive lending and a continuing violation of federal and state law. Unless enjoined, Wells Fargo will continue to engage in the unlawful pattern or practice described above.

209. Memphis and Shelby County have been, and continue to be, adversely affected by the acts, policies, and practices of Defendants, their employees, and/or their agents.

210. Memphis and Shelby County have suffered an ascertainable loss of money as a result of the unfair and deceptive acts, policies, and practices of Defendants, their employees, and/or their agents.

211. The extent of Memphis' and Shelby County's injuries will increase unless and until Wells Fargo ceases to discriminate against African Americans and borrowers in majority African-American neighborhoods.

212. Defendants' unlawful actions described above were, and are, intentional, willful, and knowing, and/or have been, and are, implemented with callous and reckless disregard for Memphis' and Shelby County's rights under federal and state law.

FIRST CAUSE OF ACTION
(Federal Fair Housing Act)

213. Plaintiffs repeat and incorporate by reference all allegations contained in Paragraphs 1 through 212 as if fully set forth herein.

214. Defendants' acts, policies, and practices as documented above constitute intentional discrimination on the basis of race. Defendants have intentionally targeted residents of predominantly African-American neighborhoods in Memphis and Shelby County for different treatment than residents of predominantly white neighborhoods in Memphis and Shelby County with respect to mortgage lending. Defendants have intentionally targeted residents of these neighborhoods for subprime loans without regard to their credit qualifications and without regard to whether they qualify for more advantageous loans, including prime loans. Defendants have intentionally targeted residents of these neighborhoods for increased interest rates, points, and fees, and for other disadvantageous loan terms including but not limited to prepayment penalties. Defendants have intentionally targeted residents of these neighborhoods for unfair and

deceptive lending practices in connection with marketing and underwriting subprime mortgage loans.

215. Defendants' acts, policies, and practices have had an adverse and disproportionate impact on African Americans and residents of predominantly African-American neighborhoods in Memphis and Shelby County as compared to similarly situated whites and residents of predominantly white neighborhoods in Memphis and Shelby County. This adverse and disproportionate impact is the direct result of Defendants' policies of giving substantial discretion to loan officers and others responsible for mortgage lending; giving loan officers and others responsible for mortgage lending large financial incentives to give borrowers loans that are costlier than loans for which they qualify; otherwise encouraging and directing loan officers and others responsible for mortgage lending to steer people into subprime loans without regard for whether they qualify for better loans, including but not limited to prime loans; increasing the interest rate on loans of $75,000 or less and decreasing the interest rate on loans of $150,000 or more; and setting interest rate caps. *See, e.g.*, *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251 (D. Mass. 2008). These policies have caused African Americans and residents of predominantly African-American neighborhoods in Memphis and Shelby County to receive mortgage loans from Wells Fargo that have materially less favorable terms than mortgage loans given by Wells Fargo to similarly situated whites and residents of predominantly white neighborhoods in Memphis and Shelby County, and that are materially more likely to result in foreclosure.

216. Defendants' acts, policies, and practices constitute reverse redlining and violate the Fair Housing Act, as amended, 42 U.S.C. §§ 3604 and 3605:

(a) Defendants' acts, policies, and practices have made and continue to make housing unavailable on the basis of race and/or color, in violation of 42 U.S.C. § 3604(a);

(b) Defendants' acts, policies, and practices have provided and continue to provide different terms, conditions, and privileges of sale of housing, as well as different services and facilities in connection therewith, on the basis of race and/or color, in violation of 42 U.S.C. § 3604(b);

(c) Defendants' published policies and statements have expressed and continue to express a preference on the basis of race and/or color, in violation of 42 U.S.C. § 3604(c); and

(d) Defendants' acts, policies, and practices have provided and continue to provide different terms, conditions and privileges on the basis of race and/or color in connection with the making of residential real estate-related transactions, in violation of 42 U.S.C. § 3605.

SECOND CAUSE OF ACTION
(Tennessee Consumer Protection Act of 1977)

217. Plaintiffs repeat and incorporate by reference all allegations contained in Paragraphs 1 through 216 as if fully set forth herein.

218. Defendants have intentionally and knowingly deceived Memphis and Shelby County borrowers, and in particular African-American borrowers and borrowers residing in Memphis' and Shelby County's African-American neighborhoods, by placing them in loans they could not afford, deceived borrowers by placing them in loans that were more expensive than loans for which they qualified, made loans that harmed instead of benefited borrowers, misrepresented to borrowers the benefits of loans, deceived

borrowers about fees and costs added to loans, deceived borrowers about the terms and conditions of loans, made misrepresentations to borrowers about their right and ability to refinance loans at a later date, deceived borrowers about the necessity and benefit of purchasing additional products in connection with loans, falsified documents concerning borrowers' loan applications, and engaged in other unfair or deceptive acts or practices, as set forth in paragraphs 67 to 138 above. These unfair or deceptive acts or practices affect the conduct of trade or commerce and violate the Tennessee Consumer Protection Act of 1977, Tenn. Code Ann. §§ 47-18-104(a) and 47-18-104(b).

219. Defendants have targeted these unfair or deceptive acts or practices at African-American neighborhoods and African Americans in Memphis and Shelby County. By targeting these unlawful acts or practices in this manner, Defendants have caused unnecessary foreclosures in African-American neighborhoods in Memphis and Shelby County.

220. The unnecessary foreclosures in African-American neighborhoods in Memphis and Shelby County caused by Defendants' violations of the Tennessee Consumer Protection Act of 1977 have injured Memphis and Shelby County by causing them to suffer an ascertainable loss of money. Specifically, Defendants' violations of the Tennessee Consumer Protection Act of 1977 have caused Memphis and Shelby County to lose property tax revenues and to expend increased funds to provide additional municipal services at specific Wells Fargo foreclosure properties, as set forth in paragraphs 149 to 198 above.

221. Memphis and Shelby County are "persons" entitled to bring suit under the Tennessee Consumer Protection Act of 1977 pursuant to Tenn. Code Ann. §§ 47-18-103(9) and 47-18-109.

222. Defendants' violation of the Tennessee Consumer Protection Act of 1977 was and continues to be willful and knowing.

DEMAND FOR JURY TRIAL

223. Pursuant to Fed. R. Civ. P. 38(b), Plaintiffs demand a trial by jury on all issues triable as of right.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs respectfully pray that the Court grant it the following relief:

(1) Enter a declaratory judgment that the foregoing acts, policies, and practices of Defendants violate 42 U.S.C. §§ 3604 and 3605 and Tenn. Code Ann. §§ 47-18-104(a) and 47-18-104(b)

(2) Enter an injunction enjoining Defendants and their directors, officers, agents and employees from continuing to publish, implement, and enforce the illegal, discriminatory conduct described herein and directing Defendants and their directors, officers, agents and employees to take all affirmative steps necessary to remedy the effects of the illegal, discriminatory conduct described herein and to prevent additional instances of such conduct or similar conduct from occurring in the future;

(3) Award compensatory damages to Plaintiffs in an amount to be determined by the jury that would fully compensate Plaintiffs for their injuries caused by the conduct of Defendants alleged herein;

(4) Award treble damages to Plaintiffs pursuant to Tenn. Code Ann. § 47-18-109(3) for Defendants' willful and knowing violation of the Tennessee Consumer Protection Act of 1977;

(5) Award punitive damages to Plaintiffs in an amount to be determined by the jury that would punish Defendants for the willful, wanton and reckless conduct alleged herein and that would effectively deter similar conduct in the future;

(6) Award Plaintiffs their reasonable attorneys' fees and costs pursuant to 42 U.S.C. § 3613(c)(2) and Tenn. Code Ann. § 47-18-109(e)(1);

(7) Award prejudgment interest to Plaintiffs; and

(8) Order such other relief as this Court deems just and equitable.

April 7, 2010

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CERTIFICATE OF SERVICE
WESTERN DISTRICT OF TENNESSEE

I hereby certify that the foregoing Amended Complaint and attachments were filed and served this 7th day of April, 2010, using the CM/ECF system, which will serve as notification of such filing on the following:

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Mr. NADLER. I thank the gentleman.

The gentleman from Georgia is recognized.

Mr. JOHNSON. Thank you, Mr. Chairman.

About an hour or so ago, I sent out a clarion call for my brethren and sisters on the other side of the aisle to appear so that they can defend Mr. Clegg. And, thus far, no one has appeared. And I wonder if that is related to the effort by Congress to pass Wall Street reform. I will note that on the other side of the Capitol, the folks over there have been filibustering Wall Street reform, and I think they have now relented, and they will argue their case on the floor.

But I would like to ask you, Mr. Clegg, you mentioned earlier about the lending industry being pressured to make loans to non-creditworthy individuals. You did say that, correct?

Mr. CLEGG. That is correct.

Mr. JOHNSON. What kind of pressure was it?

Mr. CLEGG. Well, again, I would commend to your-all's reading the report by the U.S. Commission on Civil Rights. And also in my testimony I cite that report and also some other——

Mr. JOHNSON. That report is not a Federal law that compels the lending industry to do something. I guess you cited Federal laws in your paper or in that paper that would act to pressurize or pressure banks or lending institutions to grant lending, to grant loans to non-creditworthy individuals. What laws are you talking about?

Mr. CLEGG. I'm talking about the Community Reinvestment Act. I'm talking about lawsuits that were brought during the Clinton administration, in particular, using the disparate impact approach. Private lawsuits, you know, in that area as well. And Administration policies that I think were, in the Clinton administration, policies that were well intended.

Mr. JOHNSON. Did they actually pressure—I mean, did they pressure the lending institutions to make loans to non-creditworthy individuals?

Mr. CLEGG. Yes. Let me just read you something.

Mr. JOHNSON. Give me some examples.

Mr. CLEGG. Let me read you from this report.

It says, "at the root of the real estate crisis was a misguided notion that home ownership should be available to all people—what President Bush has called the 'ownership society.' 'The "I told you so" here is that home ownership is a nice thing, but it is not suitable for everyone.'"

Mr. JOHNSON. You're not telling me anything about how lending institutions were pressured to make these predatory loans to get people in houses when they really knew that the folks were uncreditworthy. I think that's a false argument. It puts the Wall Street debacle on—it blames the consumer for the Wall Street debacle, when, in fact, what was happening was these substandard predatory loans were packaged as securities. They were bundled together, packaged as securities, and sold on Wall Street.

Mr. CLEGG. I am not going——

Mr. JOHNSON. For exorbitant interest rate profits, correct?

Mr. CLEGG. I am not going to defend the practices on Wall Street. But what I'm saying is——

Mr. JOHNSON. Hold on now. Because those same Wall Street banks owned outfits like Countrywide and all of the others. And

then those very banks who bundled the securities together, or bundled the mortgages together, sold them as securities which then became non-performing loans, with the securities becoming worthless. Those same Wall Street banks are buying a short position from AIG so that they could not lose; and then the taxpayers end up bailing out AIG $160 billion, I believe it was.

Where are my friends on the other side of the aisle to come down and help you and defend you in the onslaught of my questions? I shouldn't say "onslaught". You deserve some protection.

Mr. CLEGG. I will do my best, Congressman, to defend myself.

I think if there was an uptick in subprime lending in the recent past, it may have come about—and, again, I'm not an economist, I'm just suggesting this—it may have come about because lenders were being pressured by government and quasi-government agencies like Freddie Mac and Fannie Mae to make more loans to individuals with marginal creditworthiness. The response of the lenders might have been to say, okay, fine, we are getting this pressure——

Mr. JOHNSON. We don't want to make that money that we've been making where we can't lose whether or not the mortgages are good or whether or not they are bad loans. We went anyway.

Mr. Klein, you said something about Mr. Clegg being dead wrong about some other topic during this hearing. Is he dead wrong about this?

Mr. KLEIN. Yes, Congressman, he is dead wrong again. No one in the civil rights community or in the consumer community or in the housing community ever created any pressure on the lending community to make loans that borrowers couldn't afford. It's absurd.

The whole idea was to go in and make loans at prime rates to give people home ownership opportunities. And what happened was the banks looked around, in my view, and said, oh, there's a vacuum there in those communities that we haven't been filling. And instead of filling them by building new brick-and-mortar branches and sending in mortgage representatives to make loans on the same terms as was made in White communities, they filled the vacuum by buying loans from brokers and sending in subprime units in order to make loans on different rates, and that's where the steering came in.

So that what happened was that, instead of going in and helping people fulfill the promise of home ownership, they went in sensing a profit-making opportunity to make high-rate subprime loans on terms that people couldn't afford; and it was exactly for the reason that you suggested, Congressman, because they knew that the secondary market would buy these things. They would be able to make their profit and leave the investors down the road somewhere holding the bag when things went sour. And that's exactly what happened, and that's a big part of the problem with the economy today.

Mr. JOHNSON. And that's pretty much what the Federal Government is alleging against Goldman Sachs in terms of selling long and buying short.

And I appreciate it, Mr. Chairman. I might close out by just saying that, after amending the Bankruptcy Code back in 2005 to

make it more difficult and expensive for aggrieved homeowners to file Chapter 13 to save their homes and being successful at it and then failing to oversee these practices that we just discussed in the financial services industry, I believe I know why no one showed up from the other side.

Thank you.

Mr. NADLER. Thank you.

Let me just ask one question of Mayor Wharton before we close the hearing.

The Federal Government is collaborating with a lot of cities and States to address the problem of predatory lending and reverse redlining. Has Memphis or Shelby County collaborated either with other cities or with the Federal Government to address these practices?

Mr. WHARTON. Yes. We have communicated on a number of occasions with Deputy Attorney General Perez, also with our State Attorney General, and in any way possible we will work with other cities. But, as I indicated earlier, there are some limits because of certain jurisdictional questions that cities are faced with that the Federal Government does not have to deal with when it comes to standing and other issues.

Mr. NADLER. Thank you very much; and, with that, I want to thank our witnesses.

Without objection, all Members will have 5 legislative days to submit to the Chair additional written questions for the witnesses which we will forward and ask the witnesses to respond as promptly as they can so that their answers may be made part of the record.

Without objection, all Members will have 5 legislative days to submit any additional materials for inclusion in the record.

With that, again, I thank the witnesses; and this hearing is adjourned.

[Whereupon, at 3:35 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

U.S. Department of Justice
Office of Legislative Affairs

Deputy Assistant Attorney General

Washington, D.C. 20530

June 9, 2010

The Honorable Jerrold Nadler
Chairman
Subcommittee on Constitution,
Civil Rights and Civil Liberties
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

With your permission, we wish to supplement the testimony of Assistant Attorney General for Civil Rights Thomas E. Perez that was presented at the April 29, 2010 Subcommittee hearing on *"Protecting the American Dream Part II: Combating Predatory Lending Under the Fair Housing Act."* We request that the enclosed supplements to Mr. Perez's testimony on that date be submitted for the record of the hearing. The supplements are a list of studies that address the barriers that minority-owned companies continue to face in business lending, as well as a disc containing the studies themselves.

We appreciate your willingness to accept these materials for the record.

Sincerely,

Ronald Weich
Assistant Attorney General

Enclosures

cc: The Honorable F. James Sensenbrenner, Jr.
Ranking Minority Member

"Protecting the American Dream Part II:
Combating Predatory Lending Under the Fair Housing Act ",
Before the House Subcommittee on the Constitution, Civil Rights and Civil Liberties,

April 29, 2010
Appendix for Hon. Thomas E. Perez Testimony

Studies and Reports Concerning Discrimination in Lending Markets*

- Lloyd Blanchard, Bo Zhao, and John Yinger, *Do Credit Market Barriers Exists for Minority and Women Entrepreneurs?*, Center for Policy Research, Maxwell School, Syracuse University, Working Paper No. 74 (2005)
- David G. Blanchflower, Phillip B. Levine, and David J. Zimmerman, *Discrimination in the Small-Business Credit Market*, 85(4) Review of Economics and Statistics 930 (2003)
- Boston Consulting Group, *The New Agenda for Minority Business Development* 14 (2005)
- Candida G. Brush et al., *An Investigation of Women-Led Firms and Venture Capital Investmen,* Prepared for the U.S. Small Business Administration, Office of Advocacy (2001)
- Ken Cavalluzzo & John Wolken, *Competition, Small Business Financing, and Discrimination: Evidence from a New Survey*, 75(4) Journal of Business 641 (2005)
- Ken Cavalluzzo & John Wolken, *Small Business Loan Turndowns, Personal Wealth, and Discrimination*, 78(6) Journal of Business 2153 (2005)
- Susan Coleman, *Access to Debt Capital for Women and Minority Owned Small Firms: Does Educational Attainment Have an Impact,* 9(2) Journal of Developmental Entrepreneurship 127 (2004)
- Susan Coleman, *The Borrowing Experience of Black and Hispanic-Owned Small Firms: Evidence from the 1998 Survey of Small Business Finances*, The Academy of Entrepreneurship Journal, 8, pp. 1-20 (2002)
- Susan Coleman, *Is There a Liquidity Crisis For Small, Black-Owned Firms*, Journal of Developmental Entrepreneurship (2005)
- Robert W. Fairlie and Alicia M. Robb, *Minority Business Development Agency Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs*, Prepared for the U.S. Department of Commerce (2010)
- Robert W. Fairlie and Alicia M. Robb, *Why are Black-Owned Businesses Less Successful Than White-Owned Businesses? The Role of Families, Inheritances, and Business Human Capital*, 25 Journal of Labor Economics 289 (2007)
- Robert W. Fairlie, *Minority Entrepreneurship*, The Small Business Economy, produced under contract with the SBA, Office of Advocacy (2005)

- Sang-Suk Lee and Diane Denslow, *A Study on the Major Problems of U.S. Women-Owned Small Businesses*, Journal of Small Business Strategy, 15 (2) (2005)
- Karlyn Mitchell & Douglas K. Pearce, *Availability of Financing to Small Firms Using the Survey of Small Business Finances*, 257 U.S. Small Business Administration (2005)
- Pennsylvania Advisory Comm. to the U.S. Comm'n on Civil Rights, *Barriers Facing Minority- and Women-Owned Bus's. in Pennsylvania* (2002)
- Howard Rasheed, *Capital Access Barriers to Government Procurement Performance: Moderating Effects of Ethnicity, Gender, and Education*, Journal of Developmental Entrepreneurship (2004)
- Alicia M. Robb, & Robert Fairlie, *Access to Financial Capital Among U.S. Businesses: The Case of African American Firms Constraints*, 613 Annals of the American Academy of Political and Social Science, September (2007)
- Hal Salzman and Signe-Mary McKernan, *Capital Access for Women, Profile and Analysis of U.S. Best Practice Programs*, The Urban Institute (2007)
- Jonathan Taylor, *Income and Wealth Transfer Effects of Discrimination in Small Business Lending*, 32(3/4) Review of Black Political Economy 87 (2005)
- U.S. Department of Commerce, Minority Business Development Agency, *Accelerating Job Creation and Economic Productivity: Expanding Financing Opportunities for Minority Businesses* (2004)

* Studies listed in this Appendix are on file with the Subcommittee on the Constitution, Civil Rights & Civil Liberties of the House Judiciary Committee.

THE ATTORNEY GENERAL'S 2009 ANNUAL REPORT TO CONGRESS PURSUANT TO THE EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS OF 1976

SUBMITTED BY
THOMAS E. PEREZ
ASSISTANT ATTORNEY GENERAL

APRIL 27, 2010

This report is submitted pursuant to Section 1691f of the Equal Credit Opportunity Act, as amended (ECOA), 15 U.S.C. § 1691, *et seq.*, regarding the activities of the Department of Justice (DOJ or the Department) under the statute. This report covers the 2009 calendar year.

In response to the devastation caused by the housing crisis, the Department has made fair lending a top priority for the Civil Rights Division. The Division has created the necessary infrastructure to support and expand our fair lending work, begun to identify major targets for enforcement and started to fundamentally reshape our relationships with other federal agencies and state partners, including state attorneys general.

We have created a Fair Lending Unit in the Division's Housing and Civil Enforcement Section in order to devote more resources to this critical work. Both current career attorneys and new hires will staff the unit, and we have already hired several new attorneys to fill additional positions. The unit will also have dedicated professional staff, including three economists, a mathematical statistician and staff to assist the attorneys. Initially, the unit will consist of more than 20 staff members who will devote all or a significant portion of their time to lending cases. Loosely modeled after the Human Trafficking Unit in the Division's Criminal section, which yielded tremendous results, this new unit will increase capacity, develop greater expertise and obtain significant results. The Division has also hired a Special Counsel for Fair Lending, a senior career position in the Office of the Assistant Attorney General, to ensure that fair lending issues receive immediate attention and high priority.

The Fair Lending Unit is focusing its efforts on the entire range of abuses seen in the market, from traditional access to credit issues, such as redlining, to reverse redlining, pricing discrimination and other areas. While the current crisis necessitates that much of our focus will be on mortgage lending, the unit will address discrimination in all areas of lending including unsecured consumer lending, auto lending, and credit cards.

I. REFERRALS

Pursuant to ECOA, bank regulatory agencies with enforcement responsibilities under this law "are authorized to refer matters to the Attorney General with a recommendation that an appropriate civil action be instituted." The agencies "shall refer the matter to the Attorney General whenever the agency has reason to believe that 1 or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit in violation of section 1691(a) of this title." 15 U.S.C. § 1691e(g). In addition to the information on referrals provided below, the attached charts show the total number of referrals to DOJ made by each agency, for each calendar year from 2001 through 2009, as well as the number of those referrals based upon allegations of race or national origin discrimination.

A. Referrals to DOJ

In 2009, DOJ received 31 fair lending referrals involving potential ECOA claims from the bank regulatory agencies:

- 21 from the Federal Deposit Insurance Corporation (FDIC);
- 6 from the Federal Reserve Board (FRB);
- 4 from the Office of Thrift Supervision (OTS); and
- None from the Office of the Comptroller of the Currency (OCC) or the National Credit Union Administration (NCUA).

These referrals included the following types of alleged discrimination: 13 involving marital status; 11 involving race or national origin; six involving age; and three involving gender.[1] As of December 31, 2009, we had returned 15 of the 31 referrals to the agencies for administrative resolution and continued to investigate the allegations in the 16 remaining referrals. By March 31, 2010, we had returned for administrative resolution 12 additional referrals made in 2008 or earlier. In addition to the 16 remaining referrals from 2009, we continue to investigate five referrals received in 2008 or earlier. For each of the referrals we returned to the agencies, we evaluated the facts and circumstances of the matter in light of the factors described in Section B below. The referrals are described (by agency) below.

Federal Deposit Insurance Corporation

The FDIC made 21 referrals in 2009: ten involved marital status discrimination; five involved race or national origin discrimination; four involved age discrimination; one involved gender discrimination; and one involved age and gender discrimination.

We returned 17 of these referrals for administrative resolution during 2009 and early 2010: ten involved marital status discrimination; two involved race or national origin discrimination; four involved age discrimination; one involved gender discrimination

The returned marital status discrimination referrals included allegations that the lender either applied different underwriting processes depending on whether co-applicants were married to each other, or improperly required spousal signatures on loan documents making a non-applicant spouse liable for the entire amount of the loan – not just on any jointly owned collateral – even when the individual spouse independently qualified for the loan under the creditor's standards of creditworthiness. The returned race and national origin discrimination referrals included allegations of discrimination in pricing of home loans or potential steering of higher priced mortgage loans. The returned age discrimination referrals included allegations of a preferential treatment for persons in age groups not entitled to preferential treatment. The returned gender discrimination referral involved allegations of pricing discrimination in automobile lending.

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[1] Several referrals involved multiple protected classes; therefore, the numbers of referrals by protected class categories appear to total more than 31.

During 2009 and early 2010 we also returned for administrative resolution eight referrals received from the FDIC in prior years. Two of the referrals involved allegations of discrimination in the pricing of mortgages on the bases of race and national origin; four involved allegations of marital status discrimination; one involved allegations of age discrimination; and one involved allegations of discrimination against borrowers for having exercised rights protected under the Consumer Credit Protection Act.

Key factors for determining to return a referral to the FDIC included the nature of the violation; whether the bank had revised its lending policy; whether the bank had taken, or expressed willingness to take, appropriate corrective action for any persons who were aggrieved by the discriminatory policy; and the number of potential victims. In one of the race or national origin referrals regarding loan pricing, the FDIC took corrective action in the form of a public Cease and Desist Order.

During 2010, we continue to review the four remaining FDIC referrals from 2009; three involve allegations that the lender discriminated on the basis of race or national origin in the pricing or origination of mortgage loans or in its marketing and advertising, and one referral involves allegations of age and gender discrimination in a credit card program.[2]

Federal Reserve Board

The FRB made six referrals in 2009: one involved alleged redlining based on race or national origin discrimination; two involved alleged pricing discrimination based on race or national origin; two involved marital status discrimination; and one involved age discrimination.

During 2009 and early 2010, we returned three referrals for administrative resolution: two involved marital status discrimination and one involved age discrimination. The returned marital status discrimination referrals included allegations that the lender improperly required spousal signatures on loan documents making a non-applicant spouse liable for the entire amount of the loan even when the individual spouse independently qualified for the loan under the creditor's standards of creditworthiness or when the non-applicant spouse has no corporate or business relationship with the applicant. The returned age discrimination referral included allegations that benefits were improperly granted through an age-restricted account. During 2009 and early 2010 we also returned for administrative resolution two referrals received from the FRB in prior years: one involving allegations of marital status discrimination and one involving allegations of discrimination based on gender. Key factors for determining to return a referral included the nature of the violation; whether the bank had revised its lending policy; and the number of potential victims.

During 2010, we continue to review the three remaining FRB referrals from 2009, which involve allegations that the lender discriminated on the basis of race or national origin in the pricing of mortgage loans or by redlining. We also continue to investigate two other referrals

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[2] We have resolved all referrals received from the FDIC prior to 2009, either by returning the referral to the FDIC for administrative resolution or by filing a lawsuit.

received from the FRB in prior years, both involving allegations that nationwide lenders discriminated in the pricing of mortgages based on race or national origin.

Office of Thrift Supervision

The OTS made four referrals in 2009. Three involve allegations of discrimination based on race or national origin in mortgage loan pricing or steering practices;[3] and one involves allegations of marital status and gender discrimination in the pricing of automobile loans. During 2010, we continue to review the four referrals received in 2009.

During 2009 and early 2010, we returned for administrative resolution two referrals received from the OTS in prior years: one involving allegations of marital status discrimination and one involving allegations of pricing discrimination based on race or national origin. Key factors for determining to return a referral included the nature of the violation; whether the bank had revised its lending policy; and whether the bank had taken appropriate corrective action for any persons who were aggrieved by the discriminatory policy.

During 2010, we continue our review of three other referrals received from the OTS in prior years: two referrals involving allegations of discrimination in the pricing of mortgages on the bases of race and national origin, one of which also involves allegations of marital status discrimination in mortgage lending; and one referral involving allegations of redlining based on race.

Office of the Comptroller of the Currency

The OCC made no referrals during 2009.

National Credit Union Administration

The NCUA made no referrals during 2009.

The Department of Housing and Urban Development[4]

HUD made no referrals during 2009.

B. Factors Considered By DOJ When Evaluating Referrals

In 1996, upon the recommendation of the General Accounting Office, DOJ provided guidance to the federal bank regulatory agencies on pattern or practice referrals. We described

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[3] Two of the three race or national origin referrals involve institutions that have been placed into receivership and raise issues of successor liability.

[4] Pursuant to the Fair Housing Act, 42 U.S.C. §§ 3610(e)(2), 3612(o), HUD may make pattern or practice referrals, including those involving lending discrimination, to the Department.

the distinction between referrals that we would return to the agency for administrative resolution and those we would pursue for potential litigation. While numerous factors are considered, referrals that are most likely to be returned generally have the following characteristics: (1) the practice has ceased and there is little chance that it will be repeated; (2) the violation may have been accidental or arose from ignorance of the law's more technical requirements, such as spousal signature violations and minor price breaks for certain age groups not entitled to preferential treatment; and (3) there either were few potential victims or *de minimis* harm to any potential victims.

Referrals that would likely be considered for litigation by the Department are referrals that do not meet the criteria set forth above, and have one or more of the following characteristics: (1) the practice is serious in terms of its potential for either financial or emotional harm to members of protected classes (for example, discrimination in underwriting, pricing, or provision of lender services); (2) the practice is not likely to cease without court action; (3) the protected class members harmed by the practice cannot be fully compensated without court action; (4) damages for victims, beyond out-of-pocket losses, are necessary to deter the lender (or others like it) from treating the cost of detection as a cost of doing business; or (5) the agency believes the practice to be sufficiently common in the lending industry, or raises an important issue, so as to require action to deter lenders.

II. LITIGATION

1. On September 30, 2009, we simultaneously filed and settled a case against First United Security Bank in southwest Alabama, alleging discriminatory pricing of home mortgages and redlining in violation of the Fair Housing Act and the Equal Credit Opportunity Act. The FDIC referred this matter to DOJ based on its finding of pricing discrimination, and the Division investigated and added the redlining claim, which focused on the Bank's failure to provide lending services in majority-African American census tracts in the market area designated by the Bank in filings with the Securities and Exchange Commission. United States v. First United Security Bank, Civil Action Number 09-0644, (S.D. Ala.).

Under the terms of the settlement, which was entered by the court in November 2009, First United Security Bank is enjoined from discriminating on the basis of race, and will expand its operations in majority African-American areas of west central Alabama, including opening at least one new branch and expanding its assessment areas under the Community Reinvestment Act. The bank also will invest $500,000 in a special financing program for the formerly redlined areas, spend more than $110,000 for outreach to potential customers and promotion of its products and services in these areas, host regular consumer financial education, and pay up to $50,000 to the alleged victims of pricing discrimination.

2. On September 30, 2009, we filed a lawsuit against Nara Bank and two groups of car dealerships in the bank's automobile lending network, alleging that the defendants violated ECOA by charging non-Asian customers, many of whom are Hispanic, higher "overages" or "dealer mark-ups" than similarly-situated Asian customers. United States v. Nara Bank, et al., Civil Action Number CV 09-7124 RGK (JCx), (C.D. Cal.).

We simultaneously filed a partial consent order resolving our claims against Nara Bank only. Under the terms of the order, which was entered by the court in November 2009, the Bank is enjoined from discriminating on the basis of race or national origin against any loan applicant or consumer in the terms or conditions relating to the extension of credit, including the setting of overages in indirect automobile lending purchases. In order to remedy its part in the alleged discrimination, Nara Bank will pay up to $410,000 to compensate several hundred non-Asian borrowers who allegedly have been aggrieved by the discriminatory conduct. The case against Nara Bank was referred by the FRB; during the course of the Department's investigation we added the dealership defendants.

Litigation continues against the two dealerships–Union Auto Sales, Inc., d/b/a Union Mitsubishi; Han Kook Enterprises, Inc., d/b/a Los Angeles City Hyundai, Garden Enterprises, Inc., Grove Hyundai, Han Kook Imports, Vermont Chevrolet, and Han Kook Motors, Inc. Defendant Han Kook Enterprises filed a motion to dismiss on the grounds that the complaint fails to state a claim against it with sufficient specificity and that the complaint is barred by the ECOA statute of limitations. On March 3, 2010, the court found that the complaint is not time-barred because ECOA "does not impose a time limit on the Attorney General's ability to bring an action," provided the Attorney General alleges a pattern or practice of discrimination. The court, however, granted the motion to dismiss with leave to amend the complaint to provide additional specificity. On March 18, 2010, we filed the United States' First Amended Complaint. The litigation is ongoing.

3. In 2009, we initiated pre-suit negotiations in a case alleging pricing discrimination by two lenders. This case involves allegations that the lenders discriminated on the basis of race in their practice of delegating unsupervised and unmonitored broker fee pricing decisions to wholesale mortgage brokers. This practice had a disparate impact against African-American borrowers, in violation of the Fair Housing Act and the Equal Credit Opportunity Act. Our investigation into this matter resulted from a referral by the Office of Thrift Supervision. On March 4, 2010, we filed and simultaneously settled this case with a consent order providing for up to $6.1 million in damages to aggrieved persons and at least $1 million for consumer financial education, as well as general and specific injunctive relief. United States v. AIG Federal Savings Bank and Wilmington Finance, Inc., Civil Action Number 1:10-cv-178 JJF, (D. Del.).

III. INVESTIGATIONS

During 2009, the Department concentrated significant resources on fair lending investigations involving a variety of allegations.

The Department continued its focus on investigating potential cases of race or national origin discrimination in loan pricing and steering. Many of these investigations result from review, either by the Department or the bank regulatory agencies of loan pricing data now available under the Home Mortgage Disclosure Act (HMDA). Since 2004, HMDA has required reporting lenders to collect and publicly report certain information about the interest rate charged on home mortgage loans that they originate. During 2009, in several matters we examined

allegations that local, regional and national lenders priced mortgage loans or loan-related fees differently based on the race or national origin of the borrower, or offered different types of loan products based on the race or national origin of the borrowers.

The Department also continued to investigate allegations of redlining and reverse redlining. In a redlining case, a lender chooses not to provide its lending services on an equal basis in a neighborhood because of the race, color, or national origin of the people who live in the neighborhood, thereby denying residents of minority communities equal access to residential, consumer, or small business credit. During 2009, we examined allegations that several lenders discriminated on the basis of race and national origin by avoiding or refusing to do business in majority African-American and/or Hispanic neighborhoods because of the race, color, or national origin of those areas. We are particularly concerned that the prevalence of redlining will increase in the wake of the mortgage and foreclosure crisis. When prime lenders abandon communities by redlining, they become targets for less scrupulous lenders who may target minority neighborhoods for abusive products or loans. This latter practice is known as reverse redlining. During 2009 we examined allegations that several lenders or brokers targeted African-American and/or Hispanic communities for abusive loans. Lawsuits challenging redlining and reverse redlining practices are significant weapons in the battle against predatory lending.

During 2009, we also expanded our efforts to identify and address issues of potential discrimination in loan servicing and foreclosures related to the ongoing mortgage crisis. As discussed in Section IV, we are working with other government agencies and external stakeholders to address these issues.

IV. OTHER ACTIVITIES

Beginning in 2009, the Division participated in organizing and launching the federal Financial Fraud Enforcement Task Force, where the Assistant Attorney General for Civil Rights serves as a co-chair of the Non-Discrimination Working Group. Division representatives participated actively in a wide range of Task Force enforcement and outreach efforts in 2009, and these efforts are expanding in 2010. The Division has a particular focus on working collaboratively with the United States Attorneys' offices, as well as other federal and state enforcement agencies, to identify synergies between mortgage fraud and lending discrimination enforcement activities in order to increase efficacy in both areas. The Division also has played a key role in earlier collaborative efforts in 2009 to address the abuses of the mortgage crisis, through its participation in the State/Federal Mortgage Fraud Task Force. In addition, we regularly consult and work cooperatively with external stakeholders in a variety of education and outreach projects related to the mortgage crisis to get input from our partners about potential solutions. As noted above, in January 2010, the Division announced the creation of a fair lending unit in its Housing and Civil Enforcement Section to enhance all of the Division's fair lending activities.

We continue to participate in the federal Interagency Fair Lending Task Force with the FDIC, the FRB, the OCC, the OTS, the NCUA, HUD, the Office of Federal Enterprise Oversight (OFHEO), the Federal Housing Finance Board, and the Federal Trade Commission to discuss fair

lending issues and the activities of the various agencies. We also regularly meet with these agencies separately and in subgroups to discuss and coordinate fair lending enforcement activities.

During the year, Division representatives also participated in a variety of conferences and meetings involving lenders, enforcement agencies, advocacy and consumer groups, and others interested in fair lending throughout the country, in order to inform critical stakeholders about our enforcement policies and activities.

ALL REFERRALS	2009	2008	2007	2006	2005	2004	2003	2002	2001	Total
FDIC	21	12	15	29	35	42	29	33	5	**221**
FED	6	3	9	5	2	3	0	6	1	**35**
OTS	4	4	3	0	0	1	0	0	1	**13**
OCC	0	1	0	0	0	0	0	1	3	**5**
NCUA	0	0	0	0	0	—	—	—	—	**0**
HUD	0	0	0	0	1	1	0	2	—	**4**
Total	**31**	**20**	**27**	**34**	**38**	**47**	**29**	**42**	**10**	**278**

Race/Nat'l Origin Discrimination	2009	2008	2007	2006	2005	2004	2003	2002	2001	Total
FDIC	5	2	1	3	1	0	2	1	2	**17**
FED	3	0	4	2	0	0	0	1	1	**11**
OTS	3	3	2	0	0	0	0	0	1	**9**
OCC	0	0	0	0	0	0	0	0	0	**0**
NCUA	0	0	0	0	0	—	—	—	—	**0**
HUD	0	0	0	0	1	1	0	2	—	**4**
Total	**11**	**5**	**7**	**5**	**2**	**1**	**2**	**4**	**4**	**41**

Statement of Ms. Vanessa Fluker, Esq.

I am writing in hopes of someone understanding the real life effects of this mortgage crisis and the disingenuous nature of lenders in offering any assistance to borrowers locked into horrible subprime adjustable rate loans. Contrary to media hype and popular belief, the average individuals affected by subprime lending are the poor, minorities and elderly. In my practice, which unfortunately now consists almost solely of predatory lending cases and foreclosure matters--the vast majority of my clients are the poor, minorities, and senior citizens over the age of 75 years old, who initially owned their home outright until steered into ARMs, despite the fact they were on a fixed income, and now face foreclosure and homelessness. Lenders make great media comments about assisting borrowers, but in reality make no attempts to work with borrowers in these outrageous loans. The very financial institutions and Servicers that signed Servicer Participation Contracts under the Making Homes Affordable program, go into Court and say the program is voluntary. **How can it possibly be voluntary when the lenders are paid financial compensation for engaging in modification efforts pursuant to a contract?** Yet the lenders and the courts refuse to enforce the mandate under the making homes affordable program, and borrowers continued to be foreclosed upon and evicted. This is because most subprime loans were put in securitized trusts with serving agreements that included that they would not modify loans. Thus, the borrowers are becoming the homeless here in Michigan. **The Helping Families Save Their Homes Save Act passed May 2009, stated that it was the sense of Congress that there be a moratorium on foreclosures until the Treasury Department certified that the Home Affordable Modification Program is being implemented, yet lenders and servicers are sabotaging the program by modifying only a fraction of the 3-4 million loans that are affected, how come the moratorium has not been put into place.** Moreover, the lenders are continually economically infused by getting paid the full value of loans after foreclosure, so they can afford to litigate a case for years, appeal eviction cases, instead of negotiating a reasonable solution. Yet the poor, minority and elderly citizens are not able to afford the legal resources necessary to fight against these rich corporations. Myself, and several associates have committed our practice to attempting to help these people and bring some sense of justice back into the legal process. I would like someone to truly address the foreclosure issues, and look at the front line stories that we see every day. The disabled woman with blatant fraud being thrown out of her home since 1992 in the snow, because the Deustche Bank and its attorneys refuse to recognize the fraud and workout a reasonable resolution. Countrywide through its attorneys running rampant with foreclosures despite their being an Attorney General Consent and Compliance agreement with its admission of fraudulent practices in Michigan. My senior citizens who have sued HomeEq twice and are now fighting on appeal to keep their home of 30 years because of an error by HomEq now HomEq d/b/a Barclays Capital Real Estate. My client with a mother suffering from pancreatic cancer who is still fighting in federal court for a modification from Countrywide/Bank of America, whereas they just received an additional 7 billion dollars for modifications in January of 2010. This is just a very small number of instances I encounter everyday on the unjust and unreal rollercoaster of predatory lending and everyone getting assistance except for the people defrauded. It is difficult trying to fight the system for justice for the senior citizens minorities and the poor, while the very entities that have defrauded these people are being bailed out and continue to get rich [as a side note a large majority of residential mortgage loans are held in trust in asset back securities that have sold and resold on wall street, which is one of the reasons there is no great rush to modify or assist borrowers]. It is time that someone take a closer look at the hurting people and address this issue from the bottom up rather than the top down. It makes more economic sense as well as gives the victims of this mortgage crisis based upon predatory and fraudulent loans an opportunity to recover from the victimization of these lenders if a process was in place to 1) put a moratorium on foreclosures and evictions in Michigan until these predatory and fraudulent loans are reviewed and modified; 2) clearly articulated that modifications of these subprime loans are mandatory not voluntary; and 3) put the interest of the borrowers first instead of allowing lenders and servicer to set the process for addressing the same predatory loan packages they created.

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The Fair Housing Act (FHA): A Legal Overview

Todd Garvey
Legislative Attorney

January 15, 2010

Congressional Research Service
7-5700
www.crs.gov
95-710

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The Fair Housing Act (FHA) was enacted "to provide, within constitutional limitations, for fair housing throughout the United States." The original 1968 Act prohibited discrimination on the basis of "race, color, religion, or national origin" in the sale or rental of housing, the financing of housing, or the provision of brokerage services. In 1974, the act was amended to add sex discrimination to the list of prohibited activities. Likewise, in 1988 the act was amended to prohibit discrimination on the additional grounds of physical and mental handicap, as well as familial status. Although the FHA has been amended by a series of other laws in recent years, there has not been a major overhaul of the act since 1988.

The FHA may be enforced in varying ways by the Attorney General, by the Department of Housing and Urban Development (HUD), and by victims of discrimination. The act's coverage has been extended to "residential real estate-related transactions," which include both the "making [and] purchasing of loans ... secured by residential real estate [and] the selling, brokering, or appraising of residential real property." Thus, the provisions of the FHA extend to the secondary mortgage market.

In general, the FHA applies to all sorts of housing, public and private, including single family homes, apartments, condominiums, mobile homes, and others. However, the act includes some exemptions. The FHA does not "limit[] the applicability of any reasonable local, State, or Federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling."

Currently, no bills to directly amend the FHA have been introduced in the 111th Congress. This report will be updated as warranted.

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I. Introduction

The Fair Housing Act (FHA) was enacted "to provide, within constitutional limitations, for fair housing throughout the United States."[1] The original 1968 Act prohibited discrimination on the basis of "race, color, religion, or national origin" in the sale or rental of housing, the financing of housing, or the provision of brokerage services.[2] In 1974, the act was amended to add sex discrimination to the list of prohibited activities.[3] Likewise, in 1988 the act was amended to prohibit discrimination on the additional grounds of physical and mental handicap, as well as familial status.[4] Although the FHA has been amended by a series of smaller laws in recent years, there has not been a major overhaul of the act since 1988. Currently, no bills to directly amend the FHA have been introduced in the 111th Congress.[5]

The FHA may be enforced by the Attorney General, by the Department of Housing and Urban Development (HUD), and by victims of discrimination. (For more information on the enforcement of the act, see the "V. Enforcement of the Fair Housing Act" section of this report.) The act's coverage has been extended to "residential real estate-related transactions," which include both the "making [and] purchasing of loans ... secured by residential real estate [and] the selling, brokering, or appraising of residential real property."[6] Thus, the provisions of the FHA extend to the secondary mortgage market.[7]

In general, the FHA applies to all sorts of housing, public and private, including single family homes, apartments, condominiums, mobile homes, and others. However, the act includes some exemptions. For one, it does not apply to single family homes that are rented or sold by a private owner who owns no more than three single family homes at the same time, without the use of a real estate agent, provided that certain other conditions are met.[8]

Additionally, religious groups and nonprofit entities run by religious groups are not prevented by the act "from limiting the sale, rental, or occupancy of dwellings that it owns or operates for other than a commercial purpose to persons of the same religion, or from giving preferences to such persons, unless membership in such religion is restricted on account of race, color, or national origin."[9] The act also does not prevent private clubs "from limiting the rental or occupancy of [] lodgings to its members or from giving preference to its members" if those lodgings are not being

[1] 42 U.S.C. § 3601. The FHA, 42 U.S.C. §§ 3601 *et seq.*, was originally enacted as Title VIII of the Civil Rights Act of 1968.

[2] 42 U.S.C. §§ 3604-06.

[3] P.L. 93-383.

[4] P.L. 100-430.

[5] One bill relating to housing discrimination, though not directly amending the FHA, has been introduced in the 111th Congress. The Housing Fairness Act of 2009 directs the Secretary of HUD to conduct a nationwide study on housing discrimination and create a competitive matching grant program to assist private nonprofit organizations in conducting studies relating to the causes and effects of housing discrimination. H.R. 476, 111th Cong. (2009).

[6] 42 U.S.C. § 3605.

[7] *See*, 24 C.F.R. § 100.125

[8] 42 U.S.C. § 3603(b)(1). Other requirements include the condition that the house be sold or rented without a broker and without advertising. However, HUD regulations that implement the FHA provide that the exemptions specified in 42 U.S.C. § 3603(b) do not apply to advertising. In other words, advertising that indicates a discriminatory preference or limitation is prohibited even when such discrimination itself is not. 24 C.F.R. § 100.10(c).

[9] 42 U.S.C. § 3607(a).

run for a commercial purpose.[10] "Housing for older persons," as the term is defined by the act, are exempted from the FHA's proscription of discrimination on the basis of familial status. In other words, "housing for older persons" may exclude families with children.[11] (For more information on housing for older persons, see the "III. Familial Discrimination and Housing for Older Persons" section of this report.)

Finally, the FHA does not "limit[] the applicability of any reasonable local, State, or Federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling."[12] Concerned that occupancy limits may conflict with the prohibition against familial status discrimination, Congress enacted section 589 of the Quality Housing and Work Responsibility Act of 1998.[13] This legislation required HUD to adopt the standards specified in the March 20, 1991, Memorandum from the General Counsel,[14] which states that housing owners and managers have discretion to "implement reasonable occupancy requirements based on factors such as the number and size of sleeping areas or bedrooms and the overall size of the housing unit."[15] HUD concluded that "an occupancy policy of two persons in a bedroom, as a general rule, is reasonable" under the FHA.[16] (For more information about state and local restrictions on occupancy limits, see the "Group Homes and Zoning Restrictions" section of this report.)

II. Housing Practices in Which Discrimination Is Prohibited

The FHA prohibits discrimination on the basis of race, color, religion, sex, handicap, familial status, or national origin in the sale or rental of housing, the financing of housing, the provision of brokerage services, or in residential real estate-related transactions.[17] The HUD regulations elaborate upon the types of housing practices in which discrimination is prohibited and provide illustrations of such practices.[18] Under the regulations, the housing practices in which discrimination is prohibited include the sale or rental of a dwelling;[19] the provision of services or

[10] 42 U.S.C. § 3607(a).

[11] 42 U.S.C. § 3607(b).

[12] 42 U.S.C. § 3607(b)(1).

[13] P.L. 105-276, § 589.

[14] P.L. 105-276, § 589.

[15] *See*, 63 Fed. Reg. 70,982, 70,984 (December 18, 1998), which adopted the 1991 Memorandum.

[16] *Id.*

[17] Although the FHA does not specifically prohibit discrimination on the basis of sexual orientation, many state and local housing discrimination laws do prohibit discrimination based on sexual orientation. *See, e.g.* Minn. Laws § 363 A.02 (prohibiting discrimination "in housing and real property because of ... sexual orientation ..."). Additionally, HUD has announced a proposed regulation that would ensure its programs are open to all families regardless of sexual orientation, require that participants in HUD programs comply with local and state anti-discrimination laws, and mandate that sexual orientation not be taken into account in providing Federal Housing Administration loans. HUD Press Release, *Obama Administration to Ensure Inclusion of the LGBT Community in HUD Programs*, Oct. 21, 2009, *available at*: http://portal.hud.gov/.

[18] 24 C.F.R. Part 100.

[19] 24 C.F.R. § 100.60. Prohibited actions under this section include "(1) [f]ailing to accept or consider a bona fide offer ... (2) [r]efusing to sell or rent a dwelling [], or to negotiate for a sale or rental ... (3) [i]mposing different sales prices or rental charges for the sale or rental of a dwelling ... (4) [u]sing different qualification criteria or applications ... or (5) [e]victing tenants because of their race, color, religion, sex, handicap, familial status, or national origin...."

facilities in connection with the sale or rental of a dwelling;[20] other conduct which makes dwellings unavailable to persons;[21] steering;[22] advertising or publishing notices with regard to the selling or renting of a dwelling;[23] misrepresentations as to the availability of a dwelling;[24] blockbusting;[25] and the denial of "access to membership or participation in any multiple-listing service, real estate brokers association, or other service ... relating to the business of selling or renting dwellings."[26]

[20] 24 C.F.R. § 100.65. Such discriminatory conduct includes "(1) [u]sing different provisions in leases or contracts of sale ... (2) [f]ailing or delaying maintenance or repairs of ... dwellings; (3) [f]ailing to process an offer for the sale or rental of a dwelling or to communicate an offer accurately ... (4) [l]imiting the use of privileges, services or facilities in connection with the sale or rental of a dwelling because of race, color, religion, sex, handicap, familial status, or national origin ... or (5) denying or limiting services or facilities in connection with the sale or rental of a dwelling, because a person failed or refused to provide sexual favors."

[21] 24 C.F.R. § 100.70(d). Such discriminatory conduct includes "(1) [d]ischarging or taking other adverse action against an employee, broker, or agent because he or she refused to participate in a discriminatory practice [or] ... (2) [e]mploying codes or other devices to segregate or reject applicants, purchasers or renters ... or refusing to deal with certain real estate brokers or agents ... (3) [d]enying or delaying the processing of an application made by a purchaser or renter or refusing to approve such a person for occupancy in a cooperative or condominium ... [or] (4) [r]efusing to provide municipal services or property or hazard insurance for dwellings or providing such services or insurance differently because of race, color, religion, sex, handicap, familial status, or national origin."

[22] 24 C.F.R. § 100.70(c). Prohibited steering practices include "(1) [d]iscouraging any person from inspecting, purchasing, or renting a dwelling ... (2) [d]iscouraging the purchase or rental of a dwelling ... by exaggerating drawbacks or failing to inform any person of desirable features of a dwelling or of a community, neighborhood, or development ... (3) [c]ommunicating to any prospective purchaser that he or she would not be comfortable or compatible with existing residents of a community, neighborhood or development ... [or] (4) [a]ssigning any person to a particular section of a community, neighborhood or development, or to a particular floor of a building, because of race, color, religion, sex, handicap, familial status, or national origin."

[23] 24 C.F.R. § 100.75. Discriminatory advertisements or notices include "(1) [u]sing words, phrases, photographs, illustrations, symbols or forms which convey that dwellings are available or not available to a particular group of persons ... (2) [e]xpressing to agents, brokers, employees, prospective sellers or renters or any other persons a preference for or limitation on any purchaser or renter ... (3) [s]electing media or locations for advertising the sale or rental of dwellings which deny particular segments of the housing market information about housing opportunities ... [or] (4) [r]efusing to publish advertising for the sale or rental of dwellings or requiring different charges or terms for such advertising because of race, color, religion, sex, handicap, familial status, or national origin."

[24] 24 C.F.R. § 100.80. Illustrations of this prohibited activity include "(1) [i]ndicating through words or conduct that a dwelling which is available for inspection, sale, or rental has been sold or rented ... (2) [r]epresenting that [a person cannot rent or purchase a dwelling because] covenants or other deed, trust, or lease provisions which purport to restrict the sale or rental of a dwelling ... (3) [e]nforcing covenants or other deed, trust, or lease provisions which preclude the sale or rental of a dwelling to any person ... (4) [l]imiting information, by word or conduct, regarding suitably priced dwellings ... [or] (5) [p]roviding false or inaccurate information regarding the availability of a dwelling for sale or rental to any person ... because of race, color, religion, sex, handicap, familial status, or national origin."

[25] 24 C.F.R. § 100.85(b). The HUD regulations define "blockbusting" to mean "for profit, to induce or attempt to induce a person to sell or rent a dwelling by representations regarding the entry or prospective entry into the neighborhood of a person or persons of a particular race, color, religion, sex, familial status, or national origin or with a handicap. 24 C.F.R. § 100.85(a). For blockbusting to be established, profit does not have to be realized, as long as profit was a factor for engaging in the activity. 24 C.F.R. § 100.85(b).

[26] 24 C.F.R. § 100.90. Such prohibited actions include "(1) [s]etting different fees for access to or membership in a multiple listing service ... (2) [d]enying or limiting benefits accruing to members in a real estate brokers' organization ... (3) [i]mposing different standards or criteria for membership in a real-estate sales or rental organization ... [or] (4) [e]stablishing geographic boundaries or office location or residence requirements for access to or membership or participation in any multiple listing service, real estate brokers' organization or other service ... because of race, color, religion, sex, handicap, familial status, or national origin."

Yet another provision makes it unlawful to "coerce intimidate, threaten, or interfere with" individuals for exercising, or aiding others in the exercise of their rights under the FHA.[27]

Finally, as noted above, the FHA applies to public as well as private housing. As a result, a number of lawsuits over the years have challenged the fair housing practices of state and local housing authorities and even HUD itself, particularly with respect to discrimination in low-income public housing.[28] In one 2005 case, African-American residents of public housing in Baltimore sued HUD and various local agencies for race discrimination, and the court ultimately held that HUD had violated the FHA "by failing adequately to consider regional approaches to ameliorate racial segregation in public housing in the Baltimore Region."[29]

Disparate Impact Discrimination

In addition to outlawing direct discrimination against individuals on the prohibited grounds mentioned above, the federal courts have generally agreed that "under some circumstances a violation of section 3604(a) can be established by a showing of discriminatory effect[30] without a showing of discriminatory intent."[31] The Seventh Circuit justified such a holding in the following way:

> a requirement that the plaintiff prove discriminatory intent before relief can be granted under the statute is often a burden that is impossible to satisfy.... A strict focus on intent permits racial discrimination to go unpunished in the absence of evidence of overt bigotry ... [which] has become harder to find.[32]

One practice that is rarely intentionally directed at individual members of a minority group, but that may have a disparate impact on such persons, is "redlining." Redlining is a business's refusal to provide loans, home insurance coverage, etc., based on the characteristics of a neighborhood in which the home is located.[33] The courts have consistently held that redlining violates the FHA. The federal court in *Dunn v. Midwestern Indemnity Mid-American Fire and Casualty Co.*[34] explained it this way:

> the availability of appropriate insurance is a necessary predicate to the availability of financing, and financial assistance is a precondition to securing the availability of adequate

[27] 42 U.S.C. § 3617. Violations of this section include "(1) coercing a person ... to deny or limit the benefits provided that person in connection with the sale or rental of a dwelling or in connection with a residential real estate-related transaction ... (2) [t]hreatening, intimidating, or interfering with persons in their enjoyment of a dwelling ... (3) [t]hreatening an employee or agent with dismissal or adverse action, or taking such adverse employment action, for any effort to assist a person seeking access to the sale or rental of a dwelling or seeking access to any residential real estate-related transaction ... (4) [i]ntimidating or threatening any person because that person is engaging in activities designed to make other persons aware of [their fair housing rights, or] ... (5) [r]etaliating against any person because that person has made a complaint, testified, assisted, or participated in a proceeding under the Fair Housing Act." 24 C.F.R. § 100.400.

[28] *See, e.g.*, N.A.A.C.P. v. Sec'y of Hous. and Urban Dev., 817 F.2d 149 (1st Cir. 1987).

[29] Thompson v. U.S. Dep't of Hous. and Urban Dev., 348 F. Supp.2d 398, 524 (D. Md. January 6, 2005).

[30] The term "discriminatory effect" is used interchangeably with the term "disparate impact."

[31] Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights, 558 F.2d 1283, 1290 (7th Cir. 1977).

[32] *Id.* Such a holding is not limited to disparate impacts on the basis of race.

[33] *See*, 69 Fed. Reg. 63,760 (November 2, 2004).

[34] 472 F.Supp. 1106 (S.D. Ohio 1979)(describing studies on redlining).

> housing. Since a discriminatory denial of financing violates § 3604(a), a discriminatory failure or refusal to provide property insurance on dwellings also must violate § 3604(a).[35]

Of course, not all policies and decisions that result in a disparate impact on a protected class are prohibited by the FHA. The decision in *Thomas v. First Federal Savings Bank of Indiana*[36] highlights the need for more than just a statistical discriminatory effect. In that case, black homeowners claimed that the defendant financial institution had redlined the plaintiffs' neighborhood when it refused the homeowners' application for a second mortgage. The court held:

> plaintiffs' statistical evidence is not sufficient as a matter of law to establish a violation of section 3605. Plaintiffs' attorneys offered no explanation of the meaning of these figures.... Although section 3605's redlining prohibition makes it illegal to discriminate on the basis of certain characteristics of the plaintiff's neighborhood (e.g., race, color, religion, sex or national origin), there are numerous legitimate business factors that go into a decision to make a loan which do not form the basis of a violation under section 3605.[37]

The courts, however, are not in agreement as to how to determine if a discriminatory effect violates the act. Some courts apply a four-factor test originally set out in the Seventh Circuit's *Village of Arlington Heights* decision. These factors are:

> (1) [the] strength of the plaintiff's statistical showing; (2) the legitimacy of the defendant's interest in taking the action complained of; (3) some indication—which might be suggestive rather than conclusive—of discriminatory intent; and (4) the extent to which relief could be obtained by limiting interference by, rather than requiring positive remedial measures of, the defendant.[38]

Other courts apply a burden-shifting regime to assess the validity of a disparate impact claim pursuant to the FHA.[39] Yet there are some differences in the tests applied, even among the various courts that apply burden-shifting schemes. All courts that use burden-shifting tests agree that the

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[35] *Id.* at 1109. 24 C.F.R. § 100.70(d)(4). The FHA does not explicitly address the issue of housing insurance, but language in §§ 3604 and 3605 of the act has been construed to apply to insurance. HUD regulations prohibit the refusal to provide "property or hazard insurance for dwellings or providing such ... insurance differently because of race, color, religion, sex, handicap, familial status, or national origin." *See, e.g.*, Nationwide Mut. Ins. Co. v. Cisneros, 52 F.3d 1351 (6th Cir. 1995), *cert. denied*, 516 U.S. 1140 (1996). In contrast, a federal district court has held that the FHA does not prohibit discrimination in connection with mortgage disability insurance, because § 3605 prohibits discrimination in the provision of housing-related "financial assistance" and mortgage disability insurance, unlike property and hazard insurance, is not a prerequisite to obtaining financing and thus is not a form of "financial assistance." Doukas v. Metro. Life Ins. Co., 882 F. Supp. 1197 (D.N.H. 1995).

[36] 653 F. Supp. 1330 (N.D. Ind. 1987).

[37] *Id.* at 1340. In addition to the creditworthiness of the borrower, other legitimate business factors raised by the court included the diversification of the defendant's assets and the salability of the home, the second of which could be affected by characteristics of the neighborhood in which the home was located. *Id.*

[38] Phillips v. Hunter Trails Cmty. Assoc., 685 F.2d 184, 189-190 (7th Cir. 1982) (*quoting Village of Arlington Heights*, 558 F.2d at 1290). *See also*, Hartman v. Greenwich Walk Homeowners' Assoc., Inc., 71 Fed. Appx. 135, 137 (3rd Cir. 2003).

[39] *See, e.g.*, Graoch Assoc. # 33, L.P. v. Louisville/Jefferson County Metro Human Relations Com'ee, 508 F.3d 366, 374 (6th Cir. 2007); Affordable Hous. Dev. Corp. v. City of Fresno, 433 F.3d 1182, 1195-96 (9th Cir. 2006); Darst-Webbe Tenant Ass'n Bd. v. St. Louis Hous. Auth., 417 F.3d 898, 901-02 (8th Cir. 2005); Lapid-Laurel, L.L.C. v. Zoning Bd. of Adjustment of the Township of Scotch Plains, 284 F.3d 442, 466-67 (3rd Cir. 2002); Langlois v. Abingdon Hous. Auth., 207 F.3d 43, 51 (1st Cir. 2000); Huntington Branch, NAACP v. Town of Huntington, 844 F.2d 926, 935-36 (2nd Cir. 1988).

burden is initially on the plaintiff to make a *prima facie* showing, generally with the use of statistics, that a specific policy results in a disparate impact upon a protected class, and that upon such a showing the burden shifts to the defendant to show that the policy was initiated for some nondiscriminatory, legitimate purpose.[40] From there, some courts keep the onus on the defendant to show there is not a less discriminatory alternative that would allow the defendant to meet the same legitimate purpose.[41] Other courts, upon a defendant showing a nondiscriminatory, legitimate purpose, shift the burden to the plaintiff to submit proof of a viable, less discriminatory alternative.[42]

Finally, there is a third group of courts that apply the burden-shifting framework, generally, but look to the four-factor balancing test to determine if the plaintiff has met his or her original burden of establishing a *prima facie* disparate impact.[43]

While there is a great deal of variation in how courts assess a disparate impact claim, one common thread is that they are all fact-intensive. This makes predicting how courts will decide disparate impact cases quite difficult.

III. Familial Discrimination and Housing for Older Persons

The Fair Housing Amendments Act of 1988 added "familial status," which generally means living with children under 18, to the grounds upon which discrimination in housing is prohibited.[44] One exception to the 1988 law barring familial status discrimination, however, is that "housing for older persons" may discriminate against families with children. The committee report that accompanied the 1988 amendments explains the purpose of this exemption:

> In many parts of the country families with children are refused housing despite their ability to pay for it. Although 16 states have recognized this problem and have proscribed this type of discrimination to a certain extent, many of these state laws are not effective.... The bill specifically exempts housing for older persons. The Committee recognizes that some older

[40] *Id.*

[41] *See, e.g.*, *Darst-Webbe*, 417 F.3d at 901-02.

[42] *See, e.g.*, Tsombanidis v. West Haven Fire Dept., 352 F.3d 565, 575 (2nd Cir. 2003).

[43] *See, e.g.*, *Thompson*, 348 F. Supp. at 417-18; Owens v. Nationwide Mut. Ins. Co., 2005 U.S. Dist. LEXIS 15701, 47-51 (N.D.Tex. 2005); *see, also,* 2922 Sherman Ave. Tenants' Assoc. v. District of Columbia, 444 F.3d 673, 679-80 (D.C. Cir. 2006).

[44] The statute (42 U.S.C. § 3602(k)) and the regulation (24 C.F.R. § 100.20) both define "familial status" as follows:

> "Familial status" means one or more individuals (who have not attained the age of 18 years) being domiciled with—
>
> (1) a parent or another individual having legal custody of such individual or individuals; or
>
> (2) the designee of such parent or other person having such custody, with the written permission of such parent or other person.
>
> The protections afforded against discrimination on the basis of familial status shall apply to any person who is pregnant or is in the process of securing legal custody of any individual who has not attained the age of 18 years.

The 1988 amendment also added the handicapped to the list of protected groups. For more information on this subject, *see* the "Discrimination Based on Handicap" section of this report.

> Americans have chosen to live together with fellow senior citizen[s] in retirement type communities. The Committee appreciates the interest and expectation these individuals have in living in environments tailored to their specific needs.[45]

"Housing for older persons" is defined as housing that is (1) provided under any state or federal housing program for the elderly, (2) "intended for and solely occupied by persons 62 years of age or older," or (3) "intended and operated for occupancy by persons 55 years of age or older" and that meet several other requirements such as having at least 80% of units occupied by a minimum of one individual 55 or older.[46]

An individual who believes in good faith that his or her housing facility qualifies for the familial status exemption will not be held liable for money damages, even if the facility does not in fact qualify as housing for older persons.[47]

IV. Discrimination Based on Handicap[48]

In addition to prohibiting discrimination on the grounds discussed above, the FHA also prohibits discrimination in housing on the basis of handicap. The act defines "handicap" as:

> (1) a physical or mental impairment which substantially limits one or more of such person's major life activities, (2) a record of having such an impairment, or (3) being regarded as having such an impairment.[49]

The definition of handicap expressly precludes the current, illegal use of or addiction to a controlled substance.[50] However, because this exclusion does not apply to former drug users, the definition of handicap thus could encompass individuals who have had drug or alcohol problems that are severe enough to substantially impair a major life activity, but who are not *current* illegal users or addicts. As a result, recovering alcoholics and addicts can fall within the definition of "handicap."[51]

Discrimination on the basis of handicap under the FHA includes not allowing handicapped individuals to make reasonable changes to a unit that will "afford [them] the full enjoyment of the premises."[52] However, a landlord may premise the changes on the handicapped individual's promise to return the unit to its original state. A landlord may not increase a required security

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[45] H.Rept. 100-711, 100th Cong., 2d Sess. 19, 21 (1988); *reprinted in* 1988 U.S.C.C.A.N. 2180, 2182.

[46] 42 U.S.C. § 3607(b)(2). The remaining requirements for the third category of housing for older persons are that "the housing facility or community publish[] and adhere[] to policies and procedures that demonstrate the intent required [to be a housing for older persons]" and that the facility comply with HUD rules for occupancy verification. 42 U.S.C. § 3607(b)(2)(C) and 24 C.F.R. §§ 100.304-07.

[47] 42 U.S.C. § 3607(b)(5).

[48] The generally accepted term is now "individual with a disability." However, since the FHA still uses the term "handicapped," that term is retained here in the discussion of the FHA.

[49] 42 U.S.C. § 3602(h).

[50] 42 U.S.C. § 3602(h). The regulations also state that "an individual shall not be considered to have a handicap solely because that individual is a transvestite." 24 C.F.R. § 100.201.

[51] *See, e.g.*, Oxford House-C v. City of St. Louis, 77 F.3d 249, 251 (8th Cir. 1996).

[52] 42 U.S.C. § 3604(f)(3)(A).

deposit to cover these changes, but may require handicapped persons to, in certain circumstances, make payments into an escrow account to cover restoration costs.[53]

Discrimination against a handicapped person also includes "refusal to make reasonable accommodations in rules, policies, practices, or services, when such accommodations may be necessary to afford such person equal opportunity to use and enjoy the dwelling."[54] In addition, all "covered multifamily dwellings"[55] built after March 13, 1991, must meet certain design and construction specifications that ensure they are readily accessible to and usable by handicapped persons.[56] The FHA's protection for handicapped persons does not require "that a dwelling be made available to an individual whose tenancy would constitute a direct threat to the health or safety of other individuals or whose tenancy would result in substantial physical damage to the property of others."[57]

It also is unlawful to ask about the handicaps of an applicant for housing (rental or purchase), or someone with whom they are associated. However, the regulations do allow raising certain questions that may have some bearing on one's handicap, as long as they are asked to all applicants. For example, all applicants could be asked whether they would be able to mow the lawn, as required in a rental agreement.[58]

The Americans with Disabilities Act (ADA),[59] which was enacted subsequent to the 1988 FHA amendments, does not apply to housing, although it does cover "public accommodations," including

> an inn, hotel, motel, or other place of lodging except for an establishment located within a building that contains not more than five rooms for rent or hire and that is actually occupied by the proprietor of such establishment as the residence of such proprietor.[60]

The ADA also covers "commercial facilities," which it defines as "facilities intended for nonresidential use ... whose operations affect commerce." The term excludes, however, "facilities that are covered or expressly exempted from coverage under the Fair Housing Act." In other

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[53] 24 C.F.R. § 100.203(a). Payments required to be made into escrow must be reasonable and must be for no more than restoration costs.

[54] 42 U.S.C. § 3604(f)(3)(B). As examples of reasonable accommodations required by the act, the regulations state that seeing eye dogs must be permitted even if a building otherwise prohibits pets, and handicapped parking spaces must be made available even if spaces are otherwise assigned on a first-come-first-served basis. 24 C.F.R. § 100.204(b).

[55] "Covered multifamily dwellings" have four or more living units. 24 C.F.R. § 100.201.

[56] 42 U.S.C. § 3604(f)(3)(C). In 1991, HUD published final Fair Housing Accessibility Guidelines to provide builders and developers with technical guidance with these accessibility requirements. 56 Fed. Reg. 9,472 (March 6, 1991). HUD supplemented these guidelines in 1994. 59 Fed. Reg. 33,362 (June 28, 1994).

[57] 42 U.S.C. § 3604(f)(9).

[58] 24 C.F.R. § 100.202(c). Examples that are provided in the regulations are:

> (1) Inquiry into an applicant's ability to meet the requirements of ownership or tenancy, (2) Inquiry to determine whether an applicant is qualified for a dwelling available only to persons with handicaps ... (4) Inquiring whether an applicant for a dwelling is a current illegal abuser or addict of a controlled substance....

[59] 42 U.S.C. §§ 12101, *et seq.* For a more detailed discussion of the ADA, *see,* CRS Report 98-921, *The Americans with Disabilities Act (ADA): Statutory Language and Recent Issues*, by Nancy Lee Jones.

[60] 42 U.S.C. § 12181(7)(A).

words, the ADA leaves to the FHA the determination as to which statute applies to any particular facility.[61]

Several other federal laws also protect individuals with disabilities from housing discrimination. Under section 504 of the Rehabilitation Act of 1973, discrimination against individuals with disabilities is prohibited in any federally funded or federally conducted program or activity,[62] and under the Architectural Barriers Act of 1968, certain publicly owned residential buildings and facilities must be accessible to individuals with physical disabilities.[63]

Group Homes and Zoning Restrictions

The FHA's prohibition against discrimination on the basis of handicap extends to protect group homes for the disabled from discrimination by certain types of state or local zoning laws. While the FHA does not "limit[] the applicability of any reasonable local, State, or Federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling,"[64] it does prohibit "[l]ocal zoning and land use laws that treat groups of unrelated persons with disabilities less favorably than similar groups of unrelated persons without disabilities."[65] Nevertheless, some municipalities have attempted to restrict the location of group homes for disabled individuals by enacting zoning ordinances that establish occupancy limits for group homes.[66] Typically established to maintain the residential character of certain neighborhoods, such occupancy limits frequently operate to restrict group homes for recovering drug users or other disabled individuals. It is also possible that a city's denial of a variance from such an occupancy ordinance could be in violation of the FHA if the denial is not reasonable.[67] As a result, these limits continue to be the subject of controversy and legal challenges under the FHA.[68]

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[61] The Department of Justice's comments on its ADA rules address *mixed* use facilities, such as hotels that also have separate accommodations for apartments. The comments explain that the residential wing would be covered by the FHA even though the rest of the hotel would be covered by the ADA. However:

> [i]f a hotel allows both residential and short-term stays, but does not allocate space for these different uses in separate, discrete units, both the ADA and the Fair Housing Act may apply to the facility. Such determinations will need to be made on a case-by-case basis.... A similar analysis would also be applied to other residential facilities that provide social services, including homeless shelters, shelters for people seeking refuge from domestic violence, nursing homes, residential care facilities, and other facilities where persons may reside for varying lengths of time. 56 Fed. Reg. 35,552 (July 26, 1991).

[62] 29 U.S.C. § 794(a).

[63] 42 U.S.C. §§ 4151-57.

[64] 42 U.S.C. § 3607(b)(1).

[65] Joint Statement of the Department of Justice and the Department of Housing and Urban Development, Group Homes, Local Land Use, and the Fair Housing Act, http://www.usdoj.gov/crt/housing/final8_1.htm.

[66] Discrimination against group homes for the disabled is prohibited not only by the FHA, but by the Constitution, to the extent that such discrimination is found to be irrational. In City of Cleburne v. Cleburne Living Center, 473 U.S. 432 (1985), the Supreme Court held unconstitutional a zoning ordinance that allowed group homes generally, but prohibited them for mentally retarded individuals. The basis for the decision was that the ordinance was based on irrational prejudice; that is, the discrimination failed a "rational basis" test under the Equal Protection Clause of the Fourteenth Amendment.

[67] A city could be subject to a disparate impact discrimination claim based on all of their denials for variances. (For more information on disparate impact analysis, *see* the "Disparate Impact Discrimination" section of this report.)

[68] Michael J. Davis, *Protecting Group Homes for the Non-Handicapped: Zoning in the Post-Edmonds Era*, 46 Kan. L. Rev. 777 (1998).

Indeed, in 1995, the Supreme Court considered the issue of zoning restrictions on group homes for the handicapped. In *City of Edmonds v. Oxford House, Inc.*,[69] a group home for 10 to 12 adults recovering from alcoholism and drug addiction was cited for violating a city ordinance because it was located in a neighborhood zoned for single-family residences. The ordinance that Oxford House, Inc. was charged with violating defined "family" as "persons [without regard to number] related by genetics, adoption, or marriage, or a group of five or fewer [unrelated] persons."[70]

The group home acknowledged that it was in violation of the ordinance, but claimed that it was entitled to be in the neighborhood anyway because the FHA required the city to "make reasonable accommodations in rules, policies, practices, or services, when such accommodations may be necessary to afford [handicapped] person[s] equal opportunity to use and enjoy a dwelling."[71] The city responded that it was not required to accommodate the group home because the FHA exempts from its coverage "any reasonable local, State, or Federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling."[72]

The Supreme Court held that this exemption did not permit the city's zoning ordinance because the ordinance's definition of family was not a restriction regarding "'the maximum number of occupants' a dwelling may house."[73] According to the Court, the FHA:

> does not exempt prescriptions of the family-defining kind, i.e., provisions designed to foster the family character of a neighborhood. Instead, § 3607(b)(1)'s absolute exemption removes from the FHA's scope only total occupancy limits, i.e., numerical ceilings that serve to prevent overcrowding in living quarters.[74]

Because the ordinance set a numerical ceiling for unrelated occupants but not related occupants, it was clearly designed to preserve the family character of neighborhoods, not to place overall occupancy limits on residences. As a result, the Court held that the ordinance was not exempt from the FHA's prohibition against disability discrimination.[75] (The Court did not decide whether or not this ordinance actually violated the FHA.[76])

In cases in which the ordinance in question is "designed to foster the family character of a neighborhood" or facially discriminates against a FHA protected class by differentiating on its face between protected groups and nonprotected groups, the burden is on the defendant to show that it is not unlawful discrimination under the FHA. However, the U.S. Courts of Appeals are split as to which of two discriminatory treatment tests defendants must meet in this situation.

Before addressing the details of these two tests, it is important to note that determining if zoning ordinances violate the FHA requires a case-by-case assessment, based on the ordinance language and the specific facts surrounding the alleged violation and/or the city's denial of a variance from

[69] 514 U.S. 725 (1995).

[70] *Id.* at 728.

[71] 42 U.S.C. § 3604(f)(3)(B); *see, Edmonds*, 514 U.S. at. 729-30.

[72] 42 U.S.C. § 3607(b)(1); *see, Edmonds*, 514 U.S. at. 736.

[73] *Edmonds*, 514 U.S. at 728 (*quoting* 42 U.S.C. § 3607(b)(1)).

[74] *Id.*

[75] *Id.* at 736-37. Of course, the FHA does not prevent zoning ordinances that restrict group homes occupied by individuals who are not of a protected class, such as fraternity students.

[76] *Id.* at 738.

the ordinance.[77] This makes predicting how a court will rule on a particular ordinance difficult, especially in light of the fact that the lower courts do not apply a single, uniform test. However, an analysis of existing case law can provide some guidance on the matter.

A minority of courts, including the Eighth Circuit, apply a rational basis test, which merely requires the defendant town or city to show there is a legitimate, nondiscriminatory purpose for classification (or denial from a variance) on the basis of a FHA protected class.[78] This is a relatively low burden to meet. The majority rule, which is followed by the Sixth, Ninth, and Tenth Circuits, on the other hand, requires the defendant to meet a more exacting test.[79]

In *Oxford House-C v. City of St. Louis,* the Eighth Circuit addressed a city ordinance that limited "single family dwellings" to three unrelated individuals, or in the case of a group home, to eight unrelated individuals. The court stated, "[r]ather than discriminating against Oxford House residents, the City's zoning code favors them on its face."[80] Because the ordinance was not deemed to be discriminatory, the Eighth Circuit held that the city need only provide a rational basis for enacting the ordinance, a requirement that was satisfied by the city's demonstration of an interest in preserving residential neighborhoods.[81] Furthermore, the Eighth Circuit held that the city "did not fail to accommodate the Oxford House as the act requires" because the group home refused to apply for a variance for higher occupancy limits and, therefore, never gave the city the opportunity to grant such accommodation.[82]

In contrast, the Sixth Circuit Court of Appeals, in *Larkin v. Department of Social Services*, addressed a state licensing requirement that group homes for the handicapped may not be spaced within a 1,500 foot radius of other such group homes and must notify the communities in which the group homes are to be located.[83] The court ruled that these spacing and notification requirements discriminated on their face, holding that "statutes that single out for regulation group homes for the handicapped are facially discriminatory."[84] Once the court ruled that these non-uniform conditions were facially discriminatory, the test shifted from a rational basis test, to a more demanding test that required the defendant to "demonstrate that they are warranted by the unique and specific needs and abilities of those handicapped persons to whom the regulations apply."[85] The Sixth Circuit held that the state had failed to meet this burden. In general, "[t]he Department of Justice and HUD take the position, and most courts that have addressed the issue agree, that density restrictions are generally inconsistent with the Fair Housing Act."[86]

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[77] *See,* Joint Statement of the Department of Justice and the Department of Housing and Urban Development, Group Homes, Local Land Use, and the Fair Housing Act, http://www.usdoj.gov/crt/housing/final8_1.htm.

[78] Oxford House-C v. City of St. Louis, 77 F.3d 249, 251-52 (8th Cir. 1996).

[79] Comty. House v. City of Boise, 490 F.3d 1041, 1050 (9th Cir. 2007); *Larkin*, 89 F.3d at 290; Bangerter v. Orem City Corp., 46 F.3d 1491, 1501-04 (10th Cir. 1995).

[80] *Oxford House*, 77 F.3d at 251.

[81] *Id.* at 252.

[82] *Id.* at 253.

[83] 89 F.3d 285 (6th Cir. 1996).

[84] *Id.* at 290.

[85] *Id.* See also, Marbrunak, Inc. v. City of Stow, 974 F.2d 45, 47 (6th Cir. 1992).

[86] Joint Statement of the Department of Justice and the Department of Housing and Urban Development, Group Homes, Local Land Use, and the Fair Housing Act, http://www.usdoj.gov/crt/housing/final8_1.htm.

With regard to claims that localities failed to make "reasonable accommodations" for group homes, the Joint Statement by HUD and the Department of Justice states:

> Whether a particular accommodation is reasonable depends on the facts, and must be decided on a case-by-case basis. The determination of what is reasonable depends on the answers to two questions: First, does the request impose an undue burden or expense on the local government? Second, does the proposed use create a fundamental alteration in the zoning scheme? If the answer to either question is "yes," the requested accommodation is unreasonable.[87]

One example of a necessary reasonable accommodation might be allowing a deaf tenant to have a hearing dog in an apartment complex that normally prohibits pets.[88] Another example might be the provision of a variance from an ordinance that bars five or more unrelated people from living in a single family home, for a group home of five handicapped individuals, where it is shown that such a home would "have no more impact on parking, traffic, noise, utility use, and other typcial concerns of zoning than an 'ordinary family.'" Denial of a variance from this ordinance likely would not be unreasonable for a group home of 35 handicapped individuals.[89]

V. Enforcement of the Fair Housing Act

Under the FHA, the Secretary of HUD, the Attorney General, and victims of discrimination may all take action to enforce the prohibition against discrimination. Typically, HUD has primary enforcement through agency adjudication, but the Department of Justice and aggrieved individuals may also bring actions in federal court under certain circumstances.

Enforcement by the Secretary

Within one year after an alleged discriminatory housing practice has occurred or terminated, an aggrieved person may file a complaint with the Secretary, or the Secretary may file a complaint on his own initiative. When a complaint is filed, the Secretary must, within 10 days, serve the respondent—the party charged with committing a discriminatory practice—with notice of the complaint. The respondent must then answer the complaint within 10 days.[90]

From the filing of the complaint, the Secretary has 100 days, subject to extension, to complete an investigation of the alleged discriminatory housing practice.[91] During this time, the Secretary

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[87] *Id.*

[88] *See*, Bronk v. Ineichen, 54 F.3d 425 (7th Cir. 1995).

[89] *See*, Joint Statement of the Department of Justice and the Department of Housing and Urban Development, Group Homes, Local Land Use, and the Fair Housing Act, http://www.usdoj.gov/crt/housing/final8_1.htm.

[90] 42 U.S.C. § 3610(a)(1).

[91] 42 U.S.C. § 3610(a)(1)(B)(iv). If the Secretary discovers that the complaint is within the jurisdiction of either a state or local public agency that the Secretary has certified, he must refer the complaint to that agency before taking any action. If the agency fails to commence the proceedings within 30 days after referral, or having commenced them, fails to carry them forward with reasonable promptness, or if the Secretary determines that the agency no longer qualifies for certification, then the Secretary may take further action. 42 U.S.C. § 3610(f). The rules regarding the certification and funding of state and local housing enforcement agencies is provided in 24 C.F.R. § 110 and was amended by a final rule at 72 Fed. Reg. 19,070 (April 16, 2007).

must, "to the extent feasible, engage in conciliation with respect to" the complaint.[92] Agreements arising out of such conciliation are subject to the Secretary's approval. Such agreements may provide for binding arbitration, which may award appropriate relief, including monetary relief, to the aggrieved party.[93] The Secretary may also authorize a civil action for temporary or preliminary relief, pending final disposition of the complaint.[94]

At the completion of the investigation, the Secretary must determine whether reasonable cause exists to believe that a discriminatory housing practice has occurred or is about to occur. If he finds no reasonable cause, then he must dismiss the complaint. If he finds reasonable cause, then he must issue a charge on behalf of the aggrieved person in the absence of a conciliation agreement.[95] If a charge is issued, then the Secretary or any party to the dispute may elect to have the case heard in a federal district court. Otherwise, the case shall be heard by an administrative law judge (ALJ).[96] In such a hearing, parties may appear with legal representation, have subpoenas issued, cross examine witnesses, and submit evidence.[97]

The ALJ must commence a hearing within 120 days of a charge being issued, unless adhering to that timeframe is impracticable. He also must "make findings of fact and conclusions of law within 60 days after the end of the hearing ... unless it is impracticable to do so."[98]

If the ALJ finds that a respondent has engaged or is about to engage in a discriminatory housing practice, the ALJ "shall promptly issue an order for such relief as may be appropriate, which may include actual damages ... and injunctive or equitable relief."[99]

The ALJ may also impose a civil penalty of up to $10,000 for a first offense or more if it is not a first offense.[100]

The ALJ's findings, conclusions, and orders may be reviewed by the Secretary.[101] Parties may appeal such orders to the federal courts.[102] The Secretary may seek enforcement of an administrative order in a federal court of appeals.[103] Such court may "affirm, modify, or set aside, in whole or in part, the order, or remand" it to the ALJ for additional proceedings. The court also

[92] 42 U.S.C. § 3610(b)(1).

[93] 42 U.S.C. § 3610(b). If the Secretary has reasonable cause to believe that the respondent has breached a conciliation agreement, the Secretary must refer the matter to the Attorney General with a recommendation that a civil action be filed to enforce the agreement. 42 U.S.C. § 3610(c).

[94] 42 U.S.C. § 3610(e)(1). Upon receipt of such authorization, the Attorney General must "promptly commence and maintain such an action."

[95] 42 U.S.C. § 3610(g)(2).

[96] 42 U.S.C. § 3612(a). Upon such an election the Secretary must authorize a civil action, which the Attorney General (within 30 days) must commence and maintain on behalf of the aggrieved person, who may intervene as of right in that civil action. If the federal court finds a discriminatory practice took place, it may award actual and punitive damages to the extent it would in a civil action commenced by a private person. 42 U.S.C. § 3612(o).

[97] 42 U.S.C. § 3612(c).

[98] 42 U.S.C. § 3612(g).

[99] *Id.*

[100] *Id.*

[101] 42 U.S.C. § 3612(h).

[102] 42 U.S.C. § 3612(i).

[103] 42 U.S.C. § 3612(j).

may grant any party "such temporary relief, restraining order, or other order as the court deems just and proper."[104]

In any administrative proceeding, or any civil action brought in lieu of an administrative proceeding, "the administrative law judge or the court, as the case may be, may allow the prevailing party, other than the United States, a reasonable attorney's fee and costs."[105]

Enforcement by the Attorney General

The Attorney General (AG) may bring a civil action in federal district court if (1) the AG has reasonable cause to think that an individual or a group is "engaged in a pattern or practice" of denying one's rights under the FHA and "such denial raises an issue of general public importance"; or (2) the Secretary refers to him a case involving a violation of a conciliation agreement or of housing discrimination.[106] In such a civil action, the court may issue preventive relief, such as an injunction or a restraining order, provide monetary damages, issue civil penalties, or provide some other appropriate relief. In some instances, prevailing parties may be able to recover reasonable legal costs and fees.[107]

Enforcement by Private Persons

An "aggrieved person"[108] may commence a civil action, in a federal district court or in a state court, within two years of "the occurrence or the termination of an alleged discriminatory housing practice, or the breach of a conciliation agreement...."[109] If the Secretary has filed a complaint, an aggrieved person may still bring a private suit, unless a conciliation agreement has been reached or an administrative hearing has begun.[110] The AG may intervene in a private suit if he determines that the suit is of "general public importance." If the court determines that discrimination has occurred or is going to occur, it may award punitive damages, actual damages, equitable relief

[104] 42 U.S.C. § 3612(k).

[105] 42 U.S.C. § 3612(p). *See also*, Buckhannon Bd. & Care Home, Inc. v. W. Va. Dep't of Health and Human Resources, 532 U.S. 598, 605 (2001) (denying attorneys' fees to plaintiffs who tried to claim "prevailing party" status where there was no "alteration in the legal relationship of the parties."). In addition, the United States is liable for such fees and costs to the extent provided by the Equal Access to Justice Act (EAJA), which makes the United States liable for the prevailing party's attorneys' fees if the United States fails to prove that its position "was substantially justified or that special circumstances make an award unjust." 5 U.S.C. § 504(a)(1), 28 U.S.C. § 2412(d)(1)(A). For more information on this subject, *see*, CRS Report 94-970, *Awards of Attorneys' Fees by Federal Courts and Federal Agencies*, by Henry Cohen.

[106] 42 U.S.C. § 3614(a)-(b). "Upon timely application, any person may intervene in a civil action commenced by the Attorney General." 42 U.S.C. § 3614(e).

[107] 42 U.S.C. § 3614(e).

[108] "An 'aggrieved person' includes any person who claims to have been injured by a discriminatory housing practice or believes that such person will be injured by a discriminatory housing practice that is about to occur." 42 U.S.C. § 3602(i).

[109] 42 U.S.C. § 3613(a)(1). The calculation of the two year period does not include the time that an administrative proceeding is pending.

[110] 42 U.S.C. §§ 3613(a)(2)—3613(a)(3).