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Discretionary Pricing, Mortgage Discrimination, and the Fair Housing Act

Robert G. Schwemm and Jeffrey L. Taren*

ABSTRACT

For generations, mortgage lending has always been the gateway to the American dream of homeownership, and, historically, has also been characterized by widespread discrimination against racial and ethnic minorities and their communities. Mortgage discrimination in the modern era has often been accomplished through a technique known as discretionary pricing, in which lenders allow their loan officers and brokers to increase borrowers' costs from an objectively determined base rate. In the past decade alone, discretionary pricing has cost minority homeowners billions of dollars in extra payments, which, in turn, has led these minorities to suffer higher foreclosure rates than whites and has reversed recent gains in their homeownership rates.

This Article explores the civil rights implications of discretionary pricing, which is currently being challenged in a series of nationwide class-action lawsuits based primarily on the federal Fair Housing Act. We begin with some background on the mortgage industry's performance in recent years and a survey of the evidence of the discrimination that has existed within this industry. We then review current legal responses to this discrimination, with a particular focus on the series of FHA-based class actions that have focused on the racial impact of discretionary pricing. We conclude with a discussion of non-litigation reforms that are also needed to ensure that the home-finance industry provides a less discriminatory marketplace in the future.

I. INTRODUCTION

The American home mortgage market's performance in recent years has been a story of heady successes followed by spectacular failures. This article focuses on a widespread practice within the mortgage industry—discretionary pricing—in which lenders allow their loan officers and brokers to increase borrowers' costs above an objectively determined “par” rate. Specifically, we consider whether this practice has a racially discriminatory impact that violates the federal Fair Housing Act (“FHA”)¹ or other civil rights laws.

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¹ Title VIII of the Civil Rights Act of 1968, Pub. L. No. 90-284, 82 Stat. 73 (1968). The FHA, as amended, is codified at 42 U.S.C. §§ 3601–3619 (2006).

The importance of this issue can hardly be overstated. Apart from the role that discretionary pricing may have played in exacerbating the collapse of the country's home-finance system,² this practice has resulted in widespread discrimination against African American and Latino borrowers.³ These minorities have often been charged substantially higher interest rates and closing costs than comparable white borrowers, resulting in blacks and Latinos incurring billions of dollars in extra payments for their mortgages; this, in turn, has caused them to suffer higher foreclosure rates than whites and has reversed recent gains in their homeownership rates, thereby substantially reducing minorities' overall wealth.⁴

Discretionary pricing is now being challenged in a series of class-action lawsuits that are pending in various federal courts throughout the country.⁵ The ultimate resolution of these cases—and particularly how they interpret the FHA—will establish the regulatory framework for fair lending in the mortgage industry for years to come. Whether as a result of these cases or otherwise, new ways must be found to eliminate the cancer of racial discrimination in the home-finance system.⁶ Our purpose here is to find these new approaches through detailed examination of the litigation and regulatory responses to discretionary mortgage pricing, with the ultimate goal of securing the right of Americans of all racial and ethnic backgrounds to pursue the dream of homeownership through fair and non-discriminatory financing techniques.

We begin with some background in Part II, first on the mortgage industry's evolution and performance in recent years and then with a review of the evidence of discrimination that has existed within this industry. Part III deals with the modern legal response to this discrimination, with a particular focus on the series of FHA-based class actions that are now challenging the

² These failures, in turn, led to a recession of epic proportions, perhaps the worst since the Great Depression of the 1930s. See *infra* Part II.B.

³ We follow the federal government's nomenclature regarding racial and ethnic groups by referring to "black" as equivalent to "African American"; "Hispanic" as equivalent to "Latino"; and "white" as equivalent to "non-Hispanic white." See, e.g., U.S. CENSUS BUREAU, OVERVIEW OF RACE AND HISPANIC ORIGIN (2001); R.B. Avery et al., *New Information Reported under HMDA and Its Application in Fair Lending Enforcement*, 91 FED. RES. BULL. 344, 351–52 (2005) [hereinafter *Fed's New HMDA Report*].

Other racial groups may also be affected by discretionary mortgage pricing. As a general matter, Asians seem to be treated similarly as whites, but two other groups—American Indian/Alaska Native and Native Hawaiian/Other Pacific Islander—do suffer some discrimination, albeit not to the same degree as blacks and Hispanics. See, e.g., Federal Reserve reports cited *infra* note 134. Reflecting such research, and the FHA litigation that has challenged discretionary pricing, this Article focuses primarily on mortgage discrimination against blacks and Hispanics.

⁴ See *infra* notes 42–47 and accompanying text. The importance of the issue of mortgage discrimination is also highlighted by the fact that "the minority share of households [in the United States] is projected to increase from 29 percent in 2005 to 35 percent in 2020." See JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *THE STATE OF THE NATION'S HOUSING: 2009*, at 5 (2009) [hereinafter 2009 HOUSING].

⁵ See cases cited *infra* notes 159–166.

⁶ For a discussion of some non-litigation ideas on this point, see *infra* Part IV.

racial impact of discretionary pricing policies used by many large mortgage lenders. Part IV discusses non-litigation reforms that will be needed—regardless of how these class action cases are resolved—to ensure that the home-finance industry provides a less discriminatory marketplace in the future.

II. DISCRIMINATION AND OTHER PROBLEMS IN THE HOME MORTGAGE MARKET

A. *This Decade's Boom-and-Bust Housing Market*

Over the past decade, America's housing market has gone from boom to bust. Until 2000, average prices for single-family homes rose in line with median household incomes and general price inflation.⁷ Then, in the boom period of 2000–2005, house-price appreciation shot ahead of these benchmarks, outstripping income growth more than six-fold.⁸ The national homeownership rate, which fell in the 1980s and early 1990s, rose 4.6 percentage points in the ten-year period ending in 2005⁹ to an all-time high of 69.2%.¹⁰ Rates for minorities, which have always been substantially below those for whites,¹¹ did particularly well during this boom period.¹²

In 2005, U.S. housing prices were rising at their fastest pace since 1978,¹³ but then began to stagnate or decline in much of the country.¹⁴ From October of 2005 to January of 2009, the median price of a home fell by 29.8%,¹⁵ and the declines continued in the first half of 2009.¹⁶ Meanwhile, the homeownership rate lost almost two percentage points from its 2005

⁷ See JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *THE STATE OF THE NATION'S HOUSING: 2006*, at 7 (2006) [hereinafter 2006 HOUSING].

⁸ *Id.*

⁹ See 2009 HOUSING, *supra* note 4, at 13.

¹⁰ See Press Release, U.S. Department of Commerce, U.S. Census Bureau News: Census Bureau Reports on Residential Vacancies and Homeownership 4 (Feb. 2, 2010) [hereinafter Census-Homeownership], available at <http://www.census.gov/hhes/www/housing/hvs/hvs.html>.

¹¹ See *infra* note 43 and accompanying text.

¹² See, e.g., RAKESH KOCHHAR ET AL., *THROUGH BOOM AND BUST: MINORITIES, IMMIGRANTS AND HOMEOWNERSHIP* i (2009) (reporting that “[f]rom 1995 through the middle of this decade, homeownership rates rose more rapidly among all minorities than among whites”), available at <http://pewhispanic.org/files/reports/109.pdf>.

¹³ 2006 HOUSING, *supra* note 7, at 7. In 2005, inflation-adjusted house prices were up 9.4%, the largest gain in over forty years. *Id.* at 7-8.

¹⁴ U.S. GOV'T ACCOUNTABILITY OFFICE, *HOME MORTGAGE DEFAULTS AND FORECLOSURES: RECENT TRENDS AND ASSOCIATED ECONOMIC AND MARKET DEVELOPMENTS* 32 (2007) [hereinafter GAO MORTGAGE REPORT].

¹⁵ 2009 HOUSING, *supra* note 4, at 8.

¹⁶ See, e.g., Jack Healy, *Declines in Home Prices Are Slowing*, N.Y. TIMES, Jul. 1, 2009, at B3 (reporting that in April 2009, “home prices in 20 major metropolitan areas fell 18.1 percent from a year ago”). Prices rose later in 2009, but were still well below those of a year earlier. See, e.g., Press Release, S&P Indices, Home Prices Show Sustained Improvement through the Third Quarter of 2009 According to the S&P/Case-Shiller Home Price Indices (Nov. 24, 2009), available at <http://www.standardandpoors.com/indices/sp-case-shiller-home-price-indi>

peak and fell to 67.3% in the first quarter of 2009, erasing all of the gains since 2000.¹⁷

The boom's latter phase was fueled by an easing of traditional credit standards.¹⁸ For example, in the two-year period ending in 2005, interest-only home-loans (i.e., loans in which principal payments are deferred for a set number of years) went from being virtually nonexistent to an estimated 20% of the dollar value of all loans and 37% of adjustable rate mortgages.¹⁹ Furthermore, payment-option loans (i.e., loans in which borrowers make minimum payments that are even lower than the interest due and roll the balance into the overall amount owed) accounted for nearly 10% of loan originations in 2005.²⁰ Lenders also required less documentation of borrowers' income and assets.²¹

The first half of this decade also saw a dramatic increase in "subprime lending." Subprime loans generally refer to first-lien home-loans that have an annual percentage rate ("APR") of at least three percentage points above the rate on U.S. Treasury securities of comparable maturity.²² Subprime loans, which had accounted for less than 5% of all home-loan originations in 1994, made up 23% of the total mortgage market in 2006.²³ During the 2001–2006 period, subprime mortgage originations grew from \$210 billion to \$640 billion, with the comparable figure being only \$35 billion in 1994.²⁴

ces/en/us/?indexId=spusa-cashpidff—p-us—— (reporting a 3.1% rise in the recent third quarter and "an 8.9% decline in the third quarter of 2009 versus the third quarter of 2008").

¹⁷ 2009 HOUSING, *supra* note 4, at 16.

¹⁸ See, e.g., GAO MORTGAGE REPORT, *supra* note 14, at 41–42, 44.

¹⁹ 2006 HOUSING, *supra* note 7, at 1, 17. Adjustable rate loans accounted for one-third of home mortgages in 2004. 2009 HOUSING, *supra* note 4, at 19.

²⁰ 2006 HOUSING, *supra* note 7, at 1–2.

²¹ See, e.g., 2006 HOUSING, *supra* note 7, at 17; GAO MORTGAGE REPORT, *supra* note 14, at 41–42, 44. Among the new loan products that mortgage lenders introduced during the boom years were the "stated income" (or "low-doc") loan and the no-document (or "no-doc") loan. These loans charged a premium to borrowers to dispense with traditional creditworthiness verifications (e.g., a pay stub or a tax return). Stated-income loans generally required only that borrowers verbally verified their employment status and income, while no-document loans, as their title suggests, dispensed with virtually all verification of income and assets.

²² See *infra* notes 130–132 and accompanying text; KOCHHAR ET AL., *supra* note 12, at 13 n.2.

²³ *Fed's New HMDA Report*, *supra* note 3, at 349 (reporting the 1994 figure); Brian M. McCall, *Learning from Our History: Evaluating the Modern Housing Finance Market in Light of Ancient Principles of Justice*, 60 S.C. L. REV. 707, 710 (2009) (reporting the 2006 figure); see also AMAAD RIVERA ET AL., FORECLOSED: STATE OF THE DREAM 2008 4–5 (2008) ("Starting in the early 1990s as a small niche market, by 2006 the subprime mortgage industry rose to 20.1% of the market, growing from a \$35 billion to a \$665 billion-a-year-business."). For more on the history of subprime mortgage lending, see KENNETH TEMKIN ET AL., SUBPRIME MARKETS, THE ROLE OF GSEs, AND RISK-BASED PRICING 7–12 (2002).

²⁴ See KEITH ERNST ET AL., STEERED WRONG: BROKERS, BORROWERS, AND SUBPRIME LOANS 6 (2008) (providing the 2006 figure); 2006 HOUSING, *supra* note 7, at 18 (providing the 2001–2005 figures); McCall, *supra* note 23, at 710 (providing the 1994 figure); see also *Examining the Making Home Affordable Program: Hearings Before the Subcomm. on Housing and Community Opportunity of the H. Comm. on Financial Servs.*, 111th Cong. 4 (2009) (testimony of Ellen Harnick, Senior Policy Counsel at the Center for Responsible Lending) (subprime and other nonprime lending "constituted 33.6% of all mortgage production" at its high point in 2006), available at http://financialservices.house.gov/hearings_all.shtml. GAO MORT-

Some of these subprime loans included such egregious terms that they were virtually impossible for the borrowers to repay and became known as “predatory” loans.²⁵ Why would a mortgage lender make loans that borrowers could not repay? Two reasons suggest themselves. First, as long as the value of the underlying homes was appreciating, borrowers could be counted on to re-finance their loans later (with the lender receiving additional fees in connection with the second loan) or, if foreclosure did result, the lender would take possession of properties that might well exceed the amount of the original loans.²⁶ Second, lenders could sell many of their loans to financial institutions in the secondary market, thereby passing on to others the risk of non-payment by the borrowers.²⁷

Use of this latter technique—in which subprime loans were pooled by large secondary buyers for ultimate re-sale to investors as residential mortgage-backed securities (“RMBS”) —became known as “securitization.”²⁸ The securitization system allowed for virtually any mortgage to be sold by the originating lender in the secondary market. Government-backed purchasers played a large role in this process,²⁹ but private investors’ market share grew rapidly during the boom years, ultimately surpassing that of the

GAGE REPORT, *supra* note 14, at 18 (reporting that, in the 2003–2006 period, subprime loans grew in dollar terms from about 9% to 24% of mortgage originations).

²⁵ A precise definition of a “predatory” loan is somewhat elusive, but it generally involves one or more highly egregious terms. *See, e.g.*, Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1260 (2002) (describing predatory lending as “a catalogue of onerous lending practices, which are often targeted at vulnerable populations” and listing five practices and terms that, either alone or in combination, mark a loan as predatory). Predatory lending occurs most frequently, but not exclusively, in subprime loans. *Id.* at 1261.

²⁶ *See, e.g.*, U.S. DEPT OF JUSTICE, CIVIL RIGHTS DIV., FAIR-LENDING ENFORCEMENT PROGRAM (2001), http://www.usdoj.gov/crt/housing/bl_01.php [hereinafter JUSTICE ENFORCEMENT] (“Some lenders . . . make loans to borrowers whose income level is insufficient to meet the new debt obligations; these loans will inevitably lead to foreclosure or another refinancing transaction that takes even more equity.”); Kristen David Adams, *Homeownership: American Dream or Illusion of Empowerment?*, 60 S.C. L. REV. 573, 606 (2009) (“Lenders knew that most of these [subprime adjustable-rate mortgages originated in 2006] were unsustainable at the reset rate and never intended them to perform at that rate; instead, lenders approved the loans with the expectation that they would be refinanced prior to the time of reset.”).

²⁷ *See, e.g.*, GAO MORTGAGE REPORT, *supra* note 14, at 52-53 (“Until the 1990s, lenders held most loans on their balance sheets, so the same entity that originated the loan and created the risk bore the risk[, but in] recent years, lenders and mortgage brokers originated loans that were quickly sold down a chain of aggregators and investors.”).

²⁸ For descriptions of how the modern mortgage securitization system worked, see Engel & McCoy, *supra* note 25, at 1273-74; Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2045-48 (2007).

²⁹ *See, e.g.*, GAO MORTGAGE REPORT, *supra* note 14, at 19, 49. The government-backed purchasers operating in the secondary mortgage market were the Government National Mortgage Association (a government agency commonly known as “Ginnie Mae”) and two government-sponsored enterprises (“GSEs”), the Federal National Mortgage Association (commonly known as “Fannie Mae”) and the Federal Home Loan Mortgage Corporation (commonly known as “Freddie Mac”). *See id.* at 3.

governmental entities by 2005.³⁰ Less-than-prime loans accounted for much of this growth in private securitization; for example, from 2002 to 2006, “the share of private label RMBS comprised of subprime and Alt-A loans increased from 43 percent to 71 percent by dollar volume.”³¹

Also during the boom, the role of independent mortgage brokers grew. By one estimate, the number of such brokerage firms rose in the 2000–2004 period from about 30,000 to 53,000, up from only about 7,000 in 1987.³² In 2005, brokers accounted for about 60% of originations in the subprime market and about 25% in the prime market.³³ Unlike mortgage lenders, mortgage brokers “do not fund loans; they simply identify potential customers, process the paperwork, and submit the loan application to a wholesale lender, which underwrites and funds the mortgage.”³⁴ Also unlike mortgage lenders, brokers are generally not subject to federal regulation.³⁵

³⁰ See *id.* at 49; see also *id.* at 38 (noting that “private label securitized mortgages [represented] about 56 percent of RMBS issuances in 2006”).

³¹ *Id.* at 48. “Alt-A” refers to a middle category of loans between prime and subprime. *Id.* For 2006, one estimate put the amount of subprime mortgage debt held in securities at \$825 billion, with an additional \$722 billion held in securities backed by Alt-A mortgages. See ERIC S. BELSKY & REN S. ESSENE, HARVARD UNIV. JOINT CTR. FOR HOUS. STUDIES, CONSUMER AND MORTGAGE CREDIT AT A CROSSROADS: PRESERVING EXPANDED ACCESS WHILE INFORMING CHOICES AND PROTECTING CONSUMERS 21 (2008), available at http://www.jchs.harvard.edu/publications/finance/understanding_consumer_credit/papers/ucc08-1_belsky_essene.pdf.

³² See GAO MORTGAGE REPORT, *supra* note 14, at 53 (giving the figures for the 2000–2004 period); William C. Apgar & Allegra Calder, *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending*, in *THE GEOGRAPHY OF OPPORTUNITY: RACE AND HOUSING CHOICE IN METROPOLITAN AMERICA* 105 (Xavier de Souza Briggs ed., 2005) (giving the figures of 44,000 for 2002 and 7000 for 1987). The number of mortgage brokers fell dramatically once the housing bubble burst. See, e.g., MORTGAGE BANKERS ASSOC., MORTGAGE BANKERS AND MORTGAGE BROKERS: DISTINCT DIFFERENCES WARRANTING DISTINCT REGULATION 10 (2008), available at <http://www.nga.org/Files/pdf/0805FORECLOSUREBANKER.pdf> [hereinafter MORTGAGE BANKERS/BROKERS] (noting that the figure for 2007 was about 25,000).

³³ GAO MORTGAGE REPORT, *supra* note 14, at 53. Increasingly during this period, subprime lenders came to rely on brokers for mortgage originations. See, e.g., KEITH ERNST ET AL., *supra* note 24, at 6 (reporting that the portion of subprime loans originated by brokers grew from 48% in 2003 to 63%–81% in 2006); MORTGAGE BANKERS/BROKERS, *supra* note 32, at 10 (noting that, at the height of the housing boom, “70 to 80 percent of nonprime loans are estimated to have been mortgage broker originations”). By 2007, one commentator remarked, “Mortgage brokers have become the face of the mortgage lending industry and are often the only person a borrower will ever actually meet in the lifetime of a loan.” Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2281 (2007).

³⁴ Apgar & Calder, *supra* note 32, at 105. For a further description of the differences between mortgage brokers and lenders, see MORTGAGE BANKERS/BROKERS, *supra* note 32, at 12–23.

³⁵ See, e.g., U.S. GOV'T ACCOUNTABILITY OFFICE, FAIR LENDING: DATA LIMITATIONS AND THE FRAGMENTED U.S. FINANCIAL REGULATORY STRUCTURE CHALLENGE FEDERAL OVERSIGHT AND ENFORCEMENT EFFORTS 28–30, 34–35, 63 (2009) [hereinafter GAO FAIR LENDING REPORT]. States may regulate mortgage brokers, but state regulatory and licensing requirements vary substantially. See, e.g., BELSKY & ESSENE, *supra* note 31, at 40 (noting “the lack of serious licensing standards for loan brokers in many states”); ERNST ET AL., *supra* note 24, at 8 (describing a typical state licensing regime for mortgage brokers and concluding that, while all states license brokers, “the breadth and depth of state broker regulation varies considerably”); MORTGAGE BANKERS/BROKERS, *supra* note 32, at 7, 24–25 (describing state licensing laws of

When the housing bubble burst, a huge rise in defaulted mortgages and foreclosures occurred. For example, in 2005, there were some 847,000 foreclosures;³⁶ in 2009, the number reached 2,400,000, and worse times were predicted to follow.³⁷ In 2007, the overall default rate grew to “almost a 28-year high.”³⁸ It was worse in 2008, with a 3.3% of all first-lien loans in foreclosure, an increase of 62% in one year.³⁹ The increase in defaults and foreclosures “has been concentrated among subprime loans.”⁴⁰ Apart from the devastating human cost represented by these statistics, the financial cost to American households was staggering, as real home equity fell by \$2.5 trillion in both 2007 and 2008.⁴¹

The reversals have been particularly hard on African American and Latino families and their communities.⁴² In 2009, minority homeownership rates fell for blacks to 46.0% (from a peak of 48.6% in 2005) and for Hispanics to 48.1% (from a peak of 50.1% in 2007).⁴³ Moreover, subprime

mortgage brokers as “diverse” and “uneven”); Peterson, *supra* note 33, at 2219 n.191 (describing recent research on states’ regulation of mortgage brokers).

³⁶ See, e.g., ELLEN SCHLOEMER ET AL., CTR. FOR RESPONSIBLE LENDING, LOSING GROUND: FORECLOSURES IN THE SUBPRIME MARKET AND THEIR COST TO HOMEOWNERS 7 (2006), available at <http://www.responsiblelending.org/mortgage-lending>; see also GAO MORTGAGE REPORT, *supra* note 14, at 21 (providing charts showing default and foreclosure levels from 1979 through 2007).

³⁷ See CTR. FOR RESPONSIBLE LENDING, SOARING SPILLOVER: ACCELERATING FORECLOSURES TO COST NEIGHBORS \$502 BILLION IN 2009 ALONE 1 (2009), available at <http://www.responsiblelending.org/mortgage-lending> (providing the figure for 2009 and projecting that 9 million foreclosures will occur during the 2009–2012 period); see also Press Release, Mortgage Bankers Association, Delinquencies Continue to Climb in Latest MBA National Delinquency Survey (Nov. 19, 2009) (on file with author) (reporting that, during the third quarter of 2009, more than 14% of borrowers, or about 7.4 million households, were either delinquent on their mortgage (9.6%) or somewhere in the foreclosure process (4.5%), the highest level recorded since this survey began in 1972, and predicting that the foreclosure and delinquency rates would worsen through early 2010).

³⁸ GAO MORTGAGE REPORT, *supra* note 14, at 4.

³⁹ 2009 HOUSING, *supra* note 4 at 19; see also KOCHHAR ET AL., *supra* note 12 at v (noting that the “national foreclosure rate tripled from 2006 to 2008, increasing from 0.6% to 1.8%”).

⁴⁰ GAO MORTGAGE REPORT, *supra* note 14, at 48; see also *id.* at 24 (reporting that, from the second quarter of 2005 through the second quarter of 2007, “subprime loans accounted for 15 percent of loans serviced, but about two-thirds of the overall increase in defaults and foreclosures”); 2009 HOUSING, *supra* note 4, at 1–2 (reporting that “the share of subprime loans entering foreclosure soared to 4.1 percent in 2008 – shattering the 2.3 percent record set in 2001 when the subprime market share was much smaller”).

Even before the housing bust, it was well-known that defaults and foreclosures occurred at a disproportionately high rate in subprime loans. See, e.g., JUSTICE ENFORCEMENT, *supra* note 26, at 8 (reporting on two 2000 HUD studies showing a surge in mortgage foreclosures that occurred disproportionately in subprime loans); SCHLOEMER ET AL., *supra* note 36, at 3–4 (summarizing evidence of high and accelerating foreclosure rates in subprime loans issued between 1998 and 2006).

⁴¹ 2009 HOUSING, *supra* note 4, at 13; see also Janet L. Yellen, President and CEO, Fed. Reserve Bank of San Francisco, Presentation to Forecasters Club of New York: The Uncertain Economic Outlook and the Policy Responses (Mar. 25, 2009) (noting that families’ household wealth had fallen “by \$13 trillion – or nearly 25 percent – since the peak in mid-2007”), available at <http://www.frbsf.org/news/speeches/2009/0325.html>.

⁴² See generally KOCHHAR ET AL., *supra* note 12.

⁴³ See Census-Homeownership, *supra* note 10, at 8. The white homeownership rate in 2009 fell to 74.5% from its high of 76.0% in the 2005–2008 period. *Id.*

home loans, and thus foreclosures, “are heavily concentrated in low-income minority neighborhoods.”⁴⁴ To make matters worse, the poverty and unemployment rates of minorities are continuously higher than those of whites,⁴⁵ and home equity accounts for a disproportionately high portion of the overall wealth of minority families.⁴⁶ A 2008 report concluded that “subprime borrowers of color will lose between \$164 billion and \$213 billion for loans taken during the past eight years,” and that this represents “the greatest loss of wealth for people of color in modern US history.”⁴⁷

⁴⁴ 2009 HOUSING, *supra* note 4, at 29. Additionally, “HUD estimates indicate that the median share of high-cost loans issued between 2004 and 2006 in low-income minority census tracts was nearly one-half, while the median share in low-income white neighborhoods was one-third.” *Id.*; see also GAO MORTGAGE REPORT, *supra* note 14, at 18 (reporting that, in the 2003–2006 period, “the subprime share of the market for home purchase mortgages grew most rapidly in census tracts with lower median incomes and higher concentrations of minorities”); G. THOMAS KINGSLEY ET AL., THE IMPACTS OF FORECLOSURES ON FAMILIES AND COMMUNITIES 13–15 (2009), available at http://www.urban.org/UploadedPDF/411909_impact_of_foreclosures.pdf [hereinafter FORECLOSURE IMPACTS] (providing measures showing that the density of subprime lending in predominantly black and Hispanic neighborhoods was much higher than in predominantly white neighborhoods in 2004–2006); RIVERA ET AL., *supra* note 23, at vii (“people of color are more than three times more likely to have subprime loans: high-cost loans account for 55% of loans to Blacks, but only 17% of loans to Whites”); Chris Mayer & Karen Pence, *Subprime Mortgages: What, Where, and to Whom?* 3 (Fed. Reserve Bd. Staff, Working Paper No. 2008-29, 2008), available at <http://www.federalreserve.gov/pubs/feds/2008/200829/200829pap.pdf> (finding that subprime mortgages in 2005 were “concentrated in locations with high proportions of black and Hispanic residents, even controlling for the income and credit scores of these Zip codes”); JUSTICE ENFORCEMENT, *supra* note 26, at 7 (reporting on studies conducted by HUD, Fannie Mae, Freddie Mac, and others showing that: (1) subprime loans are five times more likely in African American neighborhoods than in white neighborhoods; (2) in 1998, subprime loans accounted for 51% of home loans in predominantly African American neighborhoods compared with only 9% in predominantly white areas; and (3) these differences hold regardless of income level (citing, inter alia, U.S. DEP’T OF HOUS. & URBAN DEV., UNEQUAL BURDEN: INCOME AND RACIAL DISPARITIES IN SUBPRIME LENDING IN AMERICA (2000), available at <http://archives.hud.gov/reports/subprime/subprime.cfm> (reporting that, in low-income neighborhoods, 54% of African American borrowers, but only 18% of white borrowers, obtained subprime loans; in moderate-income neighborhoods, the figures were 44% for African Americans and 10% for whites; and in upper-income neighborhoods, the figures were 39% for African Americans and 6% for whites))).

⁴⁵ See, e.g., 2009 HOUSING, *supra* note 4, at 19–20. For example, in November 2009, the unemployment rates were 9.3% for whites, 15.6% for blacks, and 12.7% for Hispanics. See News Release, U.S. Dep’t of Labor, Bureau of Labor Statistics, Unemployment in November 2009 (Dec. 4, 2009), available at <http://stats.bls.gov/opub/ted/>.

⁴⁶ See, e.g., George Lipsitz & Melvin L. Oliver, *Integration, Segregation, and the Racial Wealth Gap*, in THE INTEGRATION DEBATE: COMPETING FUTURES FOR AMERICAN CITIES 153 (Chester Hartman & Gregory D. Squires eds., 2009) (noting that home equity accounts for 63% of the total average net worth of black households compared with 38.5% for whites and that blacks “possess just 7 cents for every dollar of net worth that whites possess”); Alan M. White, *Borrowing While Black: Applying Fair Lending Laws to Risk-Based Mortgage Pricing*, 60 S.C. L. REV. 677, 679–80 (2009) (noting the substantial gap in net worth between black and Hispanic households compared to whites and the fact that the “smaller wealth endowment of minority families is also much more concentrated in home values and equity”). In other words, because African Americans and Latinos rely on home equity for their net worth to a far greater extent than whites who have more diverse sources, even an across-the-board loss in home equity has far more devastating consequences for minorities.

⁴⁷ RIVERA ET AL., *supra* note 23, at vii, 17.

B. The Resulting National Recession and Tightening Credit Markets

The bursting of the housing bubble had a devastating impact on home-lending institutions and, ultimately, the entire national economy. In 2007, credit rating agencies changed their evaluation methodologies to reflect the worsening performance of subprime loans, which introduced uncertainty about the credit quality of subprime RMBS.⁴⁸ By 2009, investors, “[s]tung by the horrible performance of subprime mortgage pools, . . . essentially stopped buying any mortgage-backed securities that [were] not guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae.”⁴⁹

In 2007, home-loan applications fell 22% and loans fell 25%,⁵⁰ while an unprecedented number of mortgage originators “ceased operations because of a bankruptcy or other adverse business event.”⁵¹ The next year was even worse, as loan applications and originations fell sharply from their 2007 levels.⁵² In 2008, subprime loan originations fell to \$23 billion, down 88% from the 2007 amount.⁵³

⁴⁸ GAO MORTGAGE REPORT, *supra* note 14, at 50-51.

⁴⁹ 2009 HOUSING, *supra* note 4, at 17; *see also id.* (reporting that “[b]etween 2006 and 2008, the Fannie and Freddie share of new mortgage-backed security issuances soared from 40 percent to 74 percent, while the Ginnie Mae share jumped from 4 to 22 percent” and concluding that these three organizations, along with the Federal Housing Administration, “now dominate the market”); Robert B. Avery et al., *The 2008 HMDA Data: The Mortgage Market during a Turbulent Year*, 95 FED. RES. BULL. 7 (2009), available at <http://www.federalreserve.gov/pubs/bulletin> [hereinafter *Fed 2008 HMDA Report*] (reporting that subprime loans sold through the private securitization process fell “from about 10 percent of sold loans in 2006 to less than 1 percent in 2008”).

⁵⁰ Robert B. Avery et al., *The 2007 HMDA Data*, 94 FED. RES. BULL. 3 (2008), available at <http://www.federalreserve.gov/pubs/bulletin/2008/articles/hmda> [hereinafter *Fed 2007 HMDA Report*].

⁵¹ *Id.* at 2; *see also supra* note 32 and accompanying text; CALIFORNIA REINVESTMENT COALITION ET AL., PAYING MORE FOR THE AMERICAN DREAM: THE SUBPRIME SHAKEOUT AND ITS IMPACT ON LOWER-INCOME AND MINORITY COMMUNITIES 3 (2008), available at <http://www.calreinvest.org/system/assets/125.pdf> [hereinafter *PAYING MORE*] (reporting that, from late 2006 through early 2008, 228 mortgage lenders that had made over a million loans nationally “imploded” (i.e., closed, went bankrupt, or were sold)). In early 2008, the Federal Trade Commission “went so far as to develop a consumer fact sheet called, ‘How to Manage Your Mortgage If Your Lender Closes or Files for Bankruptcy.’” *Id.* For examples of specific mortgage companies that suffered major financial difficulties during the housing bust, *see infra* notes 54-56, 159, 163.

⁵² *Fed 2008 HMDA Report*, *supra* note 49, at 2. The decline in loan originations continued into 2010. *See, e.g.*, David Streitfeld & Javier C. Hernandez, *New-Home Sales Plunged to Record Low in January*, N.Y. TIMES, Feb. 25, 2010, at B8 (reporting that applications for home-purchase loans dropped in February of 2010 “to the lowest level in 13 years”).

⁵³ *Fed 2008 HMDA Report*, *supra* note 49, at 3; *see also id.* at 30 (describing data “reflecting the collapse of the subprime market” between 2006 and 2008, including the fact that the percentage of borrowers with higher priced loans fell from 20.3 to 3.3 in this two-year period); *Mortgage Lending Reform: A Comprehensive Review of the American Mortgage System: Hearings Before the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Servs.*, 111th Cong. 3 (2009) (statement of Julia Gordon, Senior Policy Counsel, Center for Responsible Lending) (testifying in early 2009 that “the subprime mortgage market . . . has virtually disappeared” and that all forms of nonprime lending had fallen to only 2.8% of all mortgage production by the fourth quarter of 2008), available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/gordon_testimony_3-11-09_final.pdf.

Losses on subprime loans and other debt-related investments pushed several large financial institutions into bankruptcy, including Lehman Brothers and Countrywide (at one time, the nation's largest originator of subprime home-loans).⁵⁴ Without the unprecedented infusion of federal funds that occurred, more surely would have gone under.⁵⁵ The federal government took Fannie Mae and Freddie Mac into conservatorship.⁵⁶

Problems emanating from the housing market forced financial institutions to take massive write-downs on their mortgage portfolios, igniting a broader credit crisis.⁵⁷ The results for the overall national economy were devastating.⁵⁸

⁵⁴ As for Lehman, see, e.g., Andrew Ross Sorkin, *Lehman Files for Bankruptcy; Merrill Is Sold*, N.Y. TIMES, Sept. 14, 2008, at A1. As for Countrywide, after a decade of stunning growth peppered by numerous lawsuits around the country, it imploded in 2007 as many of its mortgage loans went into default, and it was acquired a year later by Bank of America. See CTR. FOR RESPONSIBLE LENDING, UNFAIR AND UNSAFE: HOW COUNTRYWIDE'S IRRESPONSIBLE PRACTICES HAVE HARMED BORROWERS AND SHAREHOLDERS 1 (2008), available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/unfair-and-unsafe-countrywide-white-paper.pdf>. Bank of America soon thereafter accepted some \$45 billion in federal bailout funds. See, e.g., Louise Story, *Bank of America Ready to Refund Federal Bailout*, N.Y. TIMES, Dec. 3, 2009, at B1. Also filing for bankruptcy in 2007 was the nation's second largest subprime lender, New Century Financial Corporation. See, e.g., Zachery Kouwe, *Civil Suit Says Lender Ignored Own Warnings*, N.Y. TIMES, Dec. 8, 2009, at B1. Among the financial institutions that ceased operations in 2008 were three banks and twelve independent mortgage companies that had accounted in 2007, in the aggregate, for about 5% of all conventional first-line home loans. See *Fed 2008 HMDA Report*, supra note 49, at 5.

⁵⁵ 2009 HOUSING, supra note 4, at 9. See generally U.S. GOV'T ACCOUNTABILITY OFFICE, TROUBLED ASSET RELIEF PROGRAM: STATUS OF GOVERNMENT ASSISTANCE TO AIG, GAO-09-975 (2009), available at <http://www.gao.gov/products/GAO-09-975> (noting that, to address the risks of the failure of American International Group ("AIG"), "the Federal Reserve and Treasury made over \$182 billion available to assist AIG between September 2008 and April 2009"); Nick Buckley, *Treasury to Give \$3.8 Billion More to GMAC in a Third Taxpayer Bailout*, N.Y. TIMES, Dec. 31, 2009, at B3 (describing GMAC's latest infusion of federal funds, which totaled over \$16 billion); Eric Dash, *Squinting Citigroup Tries to See a Profit*, N.Y. TIMES, Oct. 16, 2009, at B7 (recounting Citigroup's difficulties in repaying the \$45 billion in federal bail-out funds it received in late 2008 and 2009); Eric Dash & Andrew Martin, *Wells Fargo to Repay U.S., a Coda to the Bailout Era*, N.Y. TIMES, Dec. 15, 2009, at B1 (describing Wells Fargo's announcement that it would repay "the \$25 billion it was given to weather the worse financial storm since the Depression").

⁵⁶ 2009 HOUSING, supra note 4, at 10. The financial difficulties of Fannie Mae and Freddie Mac continued throughout 2009. See, e.g., Mary Williams Walsh, *Burdens by the Billions*, N.Y. TIMES, Dec. 17, 2009, at B1.

⁵⁷ See, e.g., 2009 HOUSING, supra note 4, at 2.

⁵⁸ Entire books have been written about the economic crisis of 2008–2009. See, e.g., DANIEL GROSS, *DUMB MONEY* (2009); GILLIAN TETT, *FOOL'S GOLD* (2009); DAVID WESSEL, IN FED WE TRUST: BEN BERNANKE'S WAR ON THE GREAT PANIC (2009). More are sure to come. The depth of this crisis is illustrated by following facts:

- The year 2008 saw a \$5.3 trillion plunge in the real value of stocks and mutual funds held by households. See 2009 HOUSING, supra note 4, at 13.
- "[P]ersonal bankruptcies nearly doubled from 600,000 in 2006 to 1.1 million in 2008." 2009 HOUSING, supra note 4, at 3.
- In 2009, iconic American companies Chrysler and General Motors were reorganized in bankruptcy proceedings, see, e.g., U.S. GOV'T ACCOUNTABILITY OFFICE, TROUBLED ASSET RELIEF PROGRAM: CONTINUED STEWARDSHIP NEEDED AS TREASURY DEVELOPS STRATEGIES FOR MONITORING AND DIVESTING FINANCIAL INTEREST IN CHRYSLER AND GM, GAO-10-151 (2009), available at <http://www.gao.gov/products/GAO-10-151>, while numerous state

The economic crisis also resulted in an extreme tightening of available credit for housing. After years of record-breaking home-loan originations, proliferation of new products, and tolerance of low underwriting standards, mortgage lending did an about-face beginning in 2007. In 2008, home-loan originations fell by 33% in real terms and by 62% from their 2003 level.⁵⁹ By 2009, most of the subprime market had dried up,⁶⁰ and new tight mortgage rules excluded even many potential homebuyers who would have been considered good credit risks by traditional standards a decade ago.⁶¹

C. *Discrimination in the Home Mortgage Market*

1. *Background: Home-Loan Discrimination in the 20th Century*

Racial discrimination has been pervasive within the home-finance industry for much of the twentieth century.⁶² In the 1930s, the federal government adopted policies that discouraged Savings and Loan Associations (“S&Ls”) from lending in minority neighborhoods.⁶³ For decades thereafter, S&Ls and other lending institutions refused to provide home loans in these areas or provided them only on the most egregious terms.⁶⁴ In addition, appraisal standards explicitly required that the presence of minorities in

and local governments flirted with it (the most dramatic example being California, which resorted in mid-2009 to issuing “IOUs” to pay its suppliers and employees), see Jesse McKinley, *Budget Deal Ending Need for I.O.U.'s in California*, N.Y. TIMES, Aug. 14, 2009, at A10.

• By 2009, the recession turned back the clock on Americans’ personal wealth to 2004 and wiped out a staggering \$1.3 trillion as home values shrank and investments withered, with net worth declining by 2.6% in the first three months of the year. ASSOCIATED PRESS (June 12, 2009) (re: Federal Reserve announcement on 6-11-09).

• By October of 2009, the overall unemployment rate had risen to 10.2%, the highest since the early 1980s, with the unemployment-plus-underemployment rate of 17.5% being the highest since the Great Depression of the 1930s, see David Leonhardt, *Jobless Rate Hits 10.2%, With More Underemployed*, N.Y. TIMES, Nov. 7, 2009, at A1, making this “the only recession since the Great Depression to wipe out all jobs growth from the previous business cycle,” Peter S. Goodman, *Joblessness Hits 9.5%, Deflating Recovery Hopes*, N.Y. TIMES, July 3, 2009, at A1.

⁵⁹ 2009 HOUSING, *supra* note 4, at 17; see also *id.* at 9 (reporting that the shutdown of private mortgage lending was so complete “that 73 percent of the loans originated in 2008 . . . were bought, insured, or guaranteed by a federal agency or by Fannie Mae and Freddie Mac”).

⁶⁰ See *supra* note 53 and accompanying text.

⁶¹ See, e.g., David Streitfeld, *Tight Mortgage Rules Exclude Even Good Risks*, N.Y. TIMES, July 11, 2009, at A1.

⁶² GREGORY D. SQUIRES, CAPITAL AND COMMUNITIES IN BLACK AND WHITE: THE INTERSECTIONS OF RACE, CLASS, AND UNEVEN DEVELOPMENT 67 (1994).

⁶³ See, e.g., DOUGLAS S. MASSEY & NANCY A. DENTON, AMERICAN APARTHEID: SEGREGATION AND THE MAKING OF THE UNDERCLASS 51-54 (1993).

⁶⁴ See, e.g., *id.* at 50–52, 54–55, 105; JOHN YINGER, CLOSED DOORS, OPPORTUNITIES LOST: THE CONTINUING COSTS OF HOUSING DISCRIMINATION 63-85 (1995). For a more recent review of the research on historical redlining, see Amy E. Hiller, *Spacial Analysis of Historical Redlining: A Methodological Exploration*, 14 J. HOUSING RES. 137, 142–44 (2003).

a neighborhood be viewed as a negative factor in evaluating homes for purposes of securing mortgage loans.⁶⁵

The 1968 FHA and then also the 1974 Equal Credit Opportunity Act (“ECOA”)⁶⁶ banned home-loan discrimination based on race, national origin, and certain other factors.⁶⁷ Passage of these laws, however, did not end such discrimination. For example, the American Institute of Real Estate Appraisers continued to promulgate race-based appraisal standards until the Department of Justice (“Justice Department”) challenged this practice in a FHA suit concluded in 1977.⁶⁸

The Justice Department did not file any mortgage discrimination cases in the 1970s and 1980s, and few private cases were brought during this time.⁶⁹ Proof of illegal mortgage discrimination was difficult to obtain. Unlike FHA rental and sales cases where “testers” could be used to demonstrate discriminatory behavior by landlords and sales agents,⁷⁰ testing in lending cases is severely limited by the fact that federal law prohibits misrepresenting information on a mortgage application.⁷¹ Thus, unless there

⁶⁵ See *infra* note 68 and accompanying text.

⁶⁶ 15 U.S.C. §§ 1691-1691f (2006).

⁶⁷ 42 U.S.C. § 3605 (2006) specifically outlaws home-loan discrimination, and its other provisions bar making housing unavailable and discriminatory terms and conditions. 42 U.S.C. §§ 3604(a) and 3604(b) may also be violated by discrimination in mortgage lending. See, e.g., *Beard v. Worldwide Mortgage Corp.*, 354 F. Supp. 2d 789, 808–09 (W.D. Tenn. 2005) (violation of § 3604(b)); *Hargraves v. Capital City Mortgage Corp.*, 140 F. Supp. 2d 7, 20–22 (D.D.C. 2000) (violation of § 3604(a)). The 1968 FHA outlawed discrimination based on race, color, national origin, and religion, and the statute was later amended to add sex, handicap, and familial status to the types of discrimination outlawed. See ROBERT G. SCHWEMM, HOUSING DISCRIMINATION: LAW AND LITIGATION §§ 11C:1 n.3 (2009) (sex); *id.* § 11D:1 n.1 (handicap); *id.* § 11E:1 n.1 (familial status).

The ECOA outlaws discrimination in all aspects of credit transactions. See 15 U.S.C. § 1691(a) (2006) (includes home loans). See, e.g., *Cartwright v. Am. Sav. & Loans Ass’n*, 880 F.2d 912, 925–27 (7th Cir. 1989); *Markham v. Colonial Mortgage Serv. Co., Assoc.*, 605 F.2d 566 (D.D.C. 1979). The ECOA bans discrimination based on race, color, religion, national origin, sex, marital status, age, or the fact that the credit applicant derives income from any public assistance program or has exercised consumer protection rights. See 15 U.S.C. § 1691(a).

⁶⁸ See *United States v. Am. Inst. of Real Estate Appraisers*, 442 F. Supp. 1072, 1076 (N.D. Ill. 1977), *appeal dismissed*, 590 F.2d 242 (7th Cir. 1978).

⁶⁹ See SCHWEMM, *supra* note 67, § 18:1 nn.6-10 and accompanying text.

⁷⁰ See generally SCHWEMM, *supra* note 67, § 32:2. Testers are “individuals who, without an intent to rent or purchase a home or apartment, pose as renters or purchasers for the purpose of collecting evidence of unlawful . . . practices.” *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 373 (1982). Apart from their use in FHA litigation, testers have been the basis for three national studies conducted by HUD to measure the degree of rental and sales discrimination in the United States. See MARGERY AUSTIN TURNER ET AL., DISCRIMINATION IN METROPOLITAN HOUSING MARKETS: NATIONAL RESULTS FROM PHASE I HDS 2000 i-ii (2002), available at http://www.huduser.org/Publications/pdf/Phase1_Report.pdf (describing the HUD studies of 1977, 1989, and 2000).

⁷¹ See Steve Tomkowiak, *Using Testing Evidence in Mortgage Lending Discrimination Cases*, 41 URB. LAW. 319, 335–36, 335 n.59 (2009) (referring to the general anti-fraud criminal statute, 18 U.S.C. § 1001 (2006)).

Unlike HUD’s regular use of testing to measure rental and sales discrimination, see *supra* note 70, the only example of HUD’s relying on testing for mortgage discrimination is a 2002 “pilot” study dealing with the pre-application stage that involved 250 paired tests in Chicago

was direct evidence of discrimination (e.g., a loan officer's race-based comments), a minority plaintiff could only prove discrimination by showing that a lender treated bona fide white applicants better, a daunting task given that the information necessary to make such a showing was usually not readily available to such a plaintiff.

Even if a FHA plaintiff managed to obtain sufficient information to file a complaint and proceed to discovery, there was no guarantee that evidence could be obtained from the defendant-lender's files or other sources to show that the defendant had made loans to comparable white applicants. In the absence of such evidence, courts generally ruled against such a plaintiff's discrimination claim. A classic example was *Simms v. First Gibraltar Bank*,⁷² where the Fifth Circuit held that a rejected mortgage applicant's proof failed to show intentional discrimination because, although the defendant-bank had clearly treated the plaintiff poorly, there was no "evidence that similar 'non-protected' applications [had] received dissimilar treatment."⁷³ Put another way, a lending institution's bad treatment of racial minorities does not violate the FHA, absent proof that it approved loans for similarly situated whites while rejecting the plaintiff.⁷⁴

For its part, the Justice Department, prompted by a series of newspaper articles,⁷⁵ finally filed its first mortgage discrimination case against Atlanta's Decatur Federal Savings & Loan Association in 1991.⁷⁶ Thereafter, the Justice Department's activity in this area accelerated, as it brought sixteen "pattern or practice" cases involving race or national origin discrimination

and Los Angeles and found that "African American and Hispanic homebuyers face a significant risk of receiving less favorable treatment than comparable whites when they visit mortgage lending institutions to inquire about financing options." MARGERY AUSTIN TURNER ET AL., OTHER THINGS BEING EQUAL: A PAIRED TESTING STUDY OF MORTGAGE LENDING INSTITUTIONS iii (2002), available at <http://www.huduser.org/Publications/PDF/aotbe.pdf>; see also Tomkowiak, *supra* note 71, at 333-35 (describing private testing of mortgage brokers conducted from 2004 to 2006).

⁷² 83 F.3d 1546 (5th Cir. 1996).

⁷³ *Id.* at 1559.

⁷⁴ See, e.g., *id.* at 1558 (holding that the plaintiff's evidence of the bank's "arbitrary and unreasonable" conduct toward him was insufficient to create an inference of intentional discrimination, because "he presented absolutely no evidence that other, 'non-protected' applicants or applications were treated any differently around the time of Simms' rejection"). Post-*Simms* cases have followed this same general approach. See *infra* note 244.

For a recent critique of how such "comparable" evidence has been used in intent-based employment discrimination cases, see Charles A. Sullivan, *The Phoenix from the Ash: Proving Discrimination by Comparators*, 60 ALA. L. REV. 191 (2009).

⁷⁵ See YINGER, *supra* note 64, at 64 (describing Bill Dedman, *The Color of Money*, ATLANTA J.-CONSTITUTION, May 1-5, 1988).

⁷⁶ See *United States v. Decatur Fed. Sav. & Loan Assoc.*, Case No. 1 92-CV-2198-CAM (N.D. Ga. 1992), described in JUSTICE ENFORCEMENT, *supra* note 26, at 3 (noting that this case involved "[d]iscrimination in underwriting—the process of evaluating the qualifications of credit applicants" and was based in part on evidence discovered in the defendant's loan files that "bank employees were providing assistance to white applicants that they were not providing to African American and Hispanic applicants" such as not helping "minority applicants explain negative information on their credit reports and document all of their income").

against home lenders in the 1990s.⁷⁷ These cases tended to involve three distinct issues: (1) “redlining,” in which the defendant-lenders were accused of refusing to make loans in minority areas that were comparable to white areas where they did business; (2) “underwriting discrimination,” in which defendant-lenders like Decatur Federal were accused of denying loans by applying their credit standards more stringently against minorities than whites; and (3) “pricing discrimination,” in which the defendant-lenders were accused of allowing their loan officers and brokers to charge discretionary rates and fees that were higher for minorities than similarly creditworthy whites.⁷⁸ All of these Justice Department-initiated cases were resolved before trial through consent decrees.⁷⁹

Much of the increased litigation activity in the 1990s could be traced to data produced by lenders pursuant to 1989 amendments to the Home Mortgage Disclosure Act (“HMDA”).⁸⁰ The 1989 HMDA amendments required most financial institutions to make yearly reports on the number and dollar amount of their mortgage loans and applications “grouped according to census tract, income level, racial characteristics, and gender.”⁸¹ The first year for which such data was produced (1990) showed much higher rejection rates for blacks and Hispanics than for whites,⁸² a pattern that continued in the succeeding years.⁸³ Racial disparities in rejection rates shown by these HMDA data, however, could not by themselves prove illegal discrimination. This is because the HMDA data did not measure many of the characteristics of loan applicants that might legitimately be considered in determining creditworthiness, such as their indebtedness and credit history.⁸⁴

⁷⁷ See, for instance, cases described in JUSTICE ENFORCEMENT, *supra* note 26, at 2–6.

⁷⁸ *Id.*

⁷⁹ See *id.* The same is true for the few mortgage cases that Justice has filed in the 2000s. See SCHWEMM, *supra* note 67, § 18:2 n.24 and accompanying text (discussing Justice’s lending litigation during the recent Bush Administration).

⁸⁰ 12 U.S.C. §§ 2801–2810 (2006). HMDA was originally enacted in 1975. See Pub. L. No. 94-200, 89 Stat. 1125 (1975). HMDA data collection is administered by the Federal Reserve Board. The Fed’s HMDA regulations, see 12 C.F.R. § 203 (2009), have been amended over the years to require a broad range of information regarding home-loan originations. See Press Release, Fed. Reserve Bd. et al., Frequently Asked Questions About the New HMDA Data (Mar. 31, 2005), available at <http://www.federalreserve.gov/boarddocs/press/bcreg/2005/>; *infra* notes 130-132 and accompanying text. As of 2008,

[t]he HMDA data consist of information reported by about 8,600 home lenders, including all of the nation’s largest mortgage originators. The loans reported are estimated to represent about 80 percent of all home lending nationwide; thus, they likely provide a broadly representative picture of home lending in the United States.

Fed 2008 HMDA Report, *supra* note 49, at 2.

⁸¹ 12 U.S.C. § 2803(b)(4).

⁸² See Glenn B. Canner & Dolores S. Smith, *Home Mortgage Disclosure Act: Expanded Data on Residential Lending*, 77 FED. RES. BULL. 859, 868–69 (1991) (reporting nationwide rejection rates for conventional home-purchase loans of 33.9% for black applicants, 21.4% for Hispanics, and 14.4% for whites).

⁸³ See SCHWEMM, *supra* note 67, § 18:2 n.13.

⁸⁴ See Canner & Smith, *supra* note 82, at 875–76; *infra* notes 136-138 and accompanying text.

Nevertheless, HMDA data did provide a way for enforcement agencies and private litigants to focus on lending institutions whose high disparate denial rates suggested the need for more inquiry.⁸⁵ As the Justice Department noted with respect to the defendants in its underwriting cases: "Our attention was focused on these institutions by [HMDA] statistics showing that African-American and Hispanic applicants were rejected for mortgage loans at significantly higher rates than were white applicants."⁸⁶

Furthermore, in 1992, an influential study published by the Boston Federal Reserve Bank showed that, even when all of these other legitimate factors were held constant, the rejection rates for blacks and Hispanics were significantly higher than for whites.⁸⁷ In 1999, the Urban Institute undertook a comprehensive review of the existing studies to determine whether the fact that minorities were denied mortgages and obtained them on less favorable terms than whites resulted from discrimination or minorities' lower creditworthiness. This lengthy review concluded that "minority homebuyers in the United States do face discrimination from mortgage lending institutions."⁸⁸ The Urban Institute report noted that mortgage lending is a multi-stage process, which includes advertising and outreach; pre-application inquiries; loan approval or denial; terms and conditions; and loan administration.⁸⁹ "Discrimination may occur at any of these stages and may take

⁸⁵ Among the privately initiated FHA cases that relied on HMDA data to accuse a particular mortgage lender of racial discrimination during the 1990s was *Buycks-Robertson v. Citibank Federal Savings Bank*, 162 F.R.D. 322 (N.D. Ill. 1995). In that case, the plaintiffs' "pivotal allegation [wa]s that Citibank gives its loan originators considerable discretion when making loan decisions" and that such "subjective decisionmaking" resulted in the discriminatory denial of "home loans to over 780 African-Americans between 1992 and 1993." *Id.* at 329-30. The HMDA data provided to the court showed that in these two years, "the percentage of loan applications approved by Citibank was far lower in areas where the racial composition of the neighborhood was predominantly African-American than it was in areas where the composition of the neighborhood was predominantly White." *Id.* at 327. "Plaintiffs' theory [wa]s that the HMDA data show that 'as the percentage of minorities in an area increases, the percentage of loans approved decreases, regardless of income.'" *Id.* at 327 n.8. Based on these allegations, the court decided to certify the case as a class action. *Id.* at 328-38. The plaintiffs' lawyers included Barack Obama. *See id.* at 325.

⁸⁶ JUSTICE ENFORCEMENT, *supra* note 26, at 3.

⁸⁷ *See* Alicia H. Munnell et al., *Mortgage Lending in Boston: Interpreting HMDA Data* (Fed. Reserve Bank of Boston Working Paper No. 92-7, 1992) (finding that the home-loan rejection rates for blacks and Hispanics were 56% higher than for whites in the Boston area, even when all significant nonracial variables were held constant). This study has been severely criticized, but its key findings about the statistical significance of minority status in producing higher home-loan denial rates have been supported by subsequent research. *See, e.g.,* Stephen L. Ross & John Yinger, *Does Discrimination in Mortgage Lending Exist? The Boston Fed Study and Its Critics*, in MORTGAGE LENDING DISCRIMINATION: A REVIEW OF EXISTING EVIDENCE 43-83 (Margery Austin Turner & Felicity Skidmore eds., 1999), available at http://www.urban.org/UploadedPDF/mortgage_lending.pdf.

⁸⁸ Margery Austin Turner & Felicity Skidmore, *Introduction, Summary, and Recommendations*, in MORTGAGE LENDING DISCRIMINATION: A REVIEW OF EXISTING EVIDENCE 2 (Margery Austin Turner & Felicity Skidmore eds., 1999), available at http://www.urban.org/UploadedPDF/mortgage_lending.pdf.

⁸⁹ *Id.* at 5-7; *see also* TURNER ET AL., *supra* note 70, at i.

different forms at different stages.”⁹⁰ In subsequent years, additional government and private HMDA-based studies continued to find evidence that minorities and minority communities were much more likely to receive subprime loans, even after controlling for borrowers’ income and other risk-related factors.⁹¹

2. *Changing Focus: Credit Scoring, Reverse Redlining, and Other Pricing Issues*

As noted above, the home-loan industry underwent numerous changes in the 1990s and the early years of the 21st century, including significant growth in subprime loans and other types of products offered, in the number of independent mortgage brokers, and in the securitization of mortgage loans.⁹² Another major change was the growing use of automated credit scoring systems to evaluate would-be borrowers and, with it, the rise of “risk-based pricing,” in which lenders would vary rates and fees for individual loans based on the particular risks that a borrower presented.⁹³ Credit scoring—and the resulting individualized pricing system—contrasted with the earlier era, in which:

lenders offered consumers a relatively limited array of products at prices that varied according to the characteristics of the loan and property but not according to the creditworthiness of the borrower. Effectively, borrowers either did or did not meet the underwriting criteria for a particular product, and those who met the criteria paid about the same price.⁹⁴

⁹⁰ TURNER ET AL., *supra* note 70, at i; *see also* Turner & Skidmore, *supra* note 88, at 5 (“Home mortgage lending is a complex process, composed of many different decision points and institutional policies. The potential for discrimination exists at any one or more points along the way. . . . [A] finding of little or no discrimination at one stage in the process does not necessarily prove the absence of discrimination in the process as a whole.”); *id.* at 7–15 (summarizing what then was known about discrimination at each of these stages of the mortgage process).

⁹¹ *See* DEBBIE GRUENSTEIN BOCIAN ET AL., UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 7 (2006), available at <http://www.responsiblelending.org/mortgage-lending/research> (describing, inter alia, U.S. DEP’T OF HOUS. AND URBAN DEV. & U.S. DEP’T OF THE TREASURY, CURBING PREDATORY HOME MORTGAGE LENDING (2000); Paul Calem et al., *The Neighborhood Distribution of Subprime Mortgage Lending*, 29 J. OF REAL ESTATE FINANCE AND ECONOMICS 4 (2004)).

⁹² *See supra* notes 18–35 and accompanying text.

⁹³ “Perhaps the most important of these changes [in modern credit markets] is the shift from a credit rationing to a risk-based pricing system. Prior to 1990, the lending industry rationed credit to prime borrowers using tight underwriting guidelines to assess and control risk. Today, far fewer applicants are denied credit. Instead, they are offered credit at higher prices intended to reflect the greater risk posed by these loans. . . . With these new risk pricing and management tools, subprime lending in the mortgage industry skyrocketed after 2003.” BELSKY & ESSENE, *supra* note 31, at 16–17. For more on the evolution of risk-based pricing in home loans, *see* TEMKIN ET AL., *supra* note 23, at 27–32.

⁹⁴ *Fed’s New HMDA Report*, *supra* note 3, at 349; *see also* BELSKY & ESSENE, *supra* note 31, at 19 (noting the “increasing reliance on statistical credit scores” in modern credit markets

Among other things, risk-based pricing meant that borrowers whose credit flaws might well have disqualified them under traditional underwriting standards could often obtain mortgages, albeit at higher prices than borrowers with better credit scores.⁹⁵

These changes, in turn, shifted the focus of discrimination problems within the industry. Whereas earlier discrimination had generally taken the form of denying credit to minorities and their communities,⁹⁶ the new system had the potential of greatly expanding credit availability, and with less discrimination. As the Justice Department noted in 2001, “[c]redit scoring systems hold out the promise of promoting fairer lending practices because they purport to use objective, mathematical models for identifying and measuring those factors that demonstratively predict credit performance in place of discretionary decision-making that can be infected by bias and discrimination.”⁹⁷

This new system, however, could be misused. For one thing, the automated credit models themselves might be based on factors that unfairly impacted minorities.⁹⁸ Even if the objective systems were nondiscriminatory, they generally allowed loan officers to “override” their conclusions. While such overrides might be justified in certain situations,⁹⁹ the Justice Department in 2000 sued a large southern bank for violating the FHA by allowing its “individual branch loan officers to ‘override’ automated underwriting decisions [with the result that] African-American applicants were more than three times as likely to be rejected as similarly situated white applicants.”¹⁰⁰

and the fact that the “use of credit scores traces back to the 1970s in the case of credit cards, the mid-1990s in the case of auto loans, and the 1990s in the case of mortgage loans, with each taking a number of years before the majority of loan origination decisions involved these scores”).

⁹⁵ See, e.g., JUSTICE ENFORCEMENT, *supra* note 26, at 6 (“responsible subprime lending serves an important role in the economy by providing access to credit at higher prices to borrowers whose past credit performance or current debt and income status make them higher risks for lenders”).

⁹⁶ See *supra* notes 62–79 and accompanying text.

⁹⁷ JUSTICE ENFORCEMENT, *supra* note 26, at 4.

⁹⁸ See *id.* (“Those who develop and use credit scoring models should take care to determine whether individual credit scoring factors or the overall systems have a disparate adverse impact on minority and other borrowers in protected classes and, if they do, whether other factors or formulations with lesser impact can be used with similar capability to predict creditworthiness.”); see also *infra* note 278.

⁹⁹ See, e.g., JUSTICE ENFORCEMENT, *supra* note 26 (providing the denial of a second loan “to a borrower who previously defaulted on a loan with the bank, even though a passing credit score indicates that the borrower does not currently pose a greater risk of default than other borrowers to whom the bank is lending” as an example of a legitimate reason for an override).

¹⁰⁰ *Id.* (discussing the Justice Department’s lawsuit of Deposit Guaranty National Bank, which resulted in a \$3 million settlement); see also Settlement Agreement, United States v. Deposit Guar. Nat’l Bank, No. 3:99CV670 (S.D. Miss. 1999), available at <http://www.justice.gov/crt/housing/documents/dgnbsettle.php>. Based on this type of case, the Justice Department concluded that:

lenders must be careful in allowing overrides. Where disproportionate numbers of white applicants are approved for credit despite a failing credit score or disproportionate numbers of minorities are denied credit even with a passing credit score,

Another “modern” type of mortgage discrimination involved targeting minorities and minority neighborhoods for predatory loans. This practice, which came to be known as “reverse redlining,” was first the subject of FHA litigation in private suits. For example, in *Hargraves v. Capital City Mortgage Corp.*,¹⁰¹ the minority plaintiffs alleged that the home loans they received from the defendant not only included predatory terms, but that the defendant focused these loans on African Americans and made a much greater portion of its predatory loans in heavily black areas.¹⁰² In an amicus brief, the Justice Department supported the plaintiffs’ view that this behavior violated the FHA,¹⁰³ and the district court agreed in a 2000 opinion.¹⁰⁴ The case was then settled,¹⁰⁵ but its conclusion that “reverse redlining” violates the FHA was ultimately endorsed in a number of other decisions, which upheld FHA claims based on lenders’ directing their predatory loans to racial minorities, their neighborhoods, or both.¹⁰⁶

As the *Hargraves* opinion held, predatory lending does not violate the FHA unless it is targeted at a class of persons protected by the statute. Thus, as the Justice Department has noted: “Predatory lending practices sometimes violate the fair lending laws, sometimes violate state and federal con-

there is a concern that discrimination may be at work. The concern is heightened when a lender is not documenting the reasons for the overrides or has a large number where no specific rationale is given for an override decision.

Id. For a description of other Justice cases alleging FHA violations based on discriminatory overrides, see *infra* notes 110–115 and accompanying text.

¹⁰¹ 140 F. Supp. 2d 7 (D.D.C. 2000), *motion for reconsideration granted in part and denied in part*, 147 F. Supp. 2d 1 (D.D.C. 2001).

¹⁰² See *id.* at 20–21. Based on many of the same facts alleged in *Hargraves*, the defendant there was also sued by the Federal Trade Commission in 1998 for a variety of unfair trade practices. See JUSTICE ENFORCEMENT, *supra* note 26.

¹⁰³ See *id.*; *Hargraves*, 140 F. Supp. at 22.

¹⁰⁴ See *id.* at 20–22.

¹⁰⁵ Interview with John P. Relman, Plaintiffs’ Counsel in *Hargraves* (Jan. 10, 2010).

¹⁰⁶ See, e.g., *Jackson v. Novastar Mortgage, Inc.*, 645 F. Supp. 2d 636, 646 (W.D. Tenn. 2007) (upholding FHA claim based on defendants’ alleged targeting of minority borrowers for predatory mortgage loans); *Martinez v. Freedom Mortgage Team, Inc.*, 527 F. Supp. 2d 827, 833–35 (N.D. Ill. 2007) (upholding FHA and ECOA claims based on defendants’ alleged targeting of Hispanics for predatory home loans); *Johnson v. Equity Title & Escrow Co. of Memphis*, 476 F. Supp. 2d 873, 881 (W.D. Tenn. 2007) (upholding FHA claim based on defendants’ alleged targeting of blacks and black neighborhoods for predatory home-improvement loans); *Beard v. Worldwide Mortgage Corp.*, 354 F. Supp. 2d 789, 808–09 (W.D. Tenn. 2005) (upholding FHA claim based on allegation that defendants targeted blacks and black neighborhoods with fraudulent loan practices designed to take away their homes); see also *M & T Mortgage Corp. v. Miller*, 323 F. Supp. 2d 405, 411 (E.D.N.Y. 2004) (upholding, as affirmative defense in mortgage foreclosure case, black borrowers’ allegations that their predatory loan violated the FHA); *Eva v. Midwest Nat’l Mortgage Banc, Inc.*, 143 F. Supp. 2d 862, 886–90 (N.D. Ohio 2001) (upholding FHA claim based on allegations that defendants targeted women for predatory home loans); *Honorable v. Easy Life Real Estate System*, 100 F. Supp. 2d 885, 892 (N.D. Ill. 2000) (holding, in pre-*Hargraves* decision, that “reverse redlining” violates the FHA); *McGlaw v. Pa. Human Relations Comm’n*, 891 A.2d 757 (Pa. Commw. Ct. 2006) (upholding “reverse redlining” claim under state fair housing law); cases described *infra* note 107 and accompanying text.

sumer protection laws, and sometimes violate both.”¹⁰⁷ An example of both was a 2001 suit by the Justice Department, HUD, and the Federal Trade Commission against subprime-lender Delta Funding Corporation, where the defendant was accused of violating the FHA, ECOA, and consumer protection laws by “underwriting and funding home mortgage loans with higher mortgage broker fees for African-American females than for similarly situated white males, paying kickbacks to brokers to induce them to refer loan applicants to Delta, and approving loans without regard to the borrower’s ability to repay.”¹⁰⁸

Unlike earlier forms of discrimination, “reverse redlining” does not involve the denial of credit to minorities, but involves “*too much easy access to high-cost credit.*”¹⁰⁹ The practice of lenders making loans to minorities at higher prices than to whites was also at issue in three other FHA cases brought by the Justice Department in the mid-1990s. All three involved the discriminatory application of “overages,” a pricing system in which a lender gives discretion to its “employees or brokers to charge rates higher than the lender’s set rates, for which the employees receive additional compensation.”¹¹⁰ In two of these cases, the Justice Department alleged that the defendants’ “loan officers were charging African-American and/or Hispanic borrowers higher up-front fees for home mortgage loans than they were charging to similarly situated white borrowers.”¹¹¹ The third case, which continues to have significance for current lending litigation,¹¹² alleged that California’s Long Beach Mortgage Company:

allowed both its employee loan officers and its independent loan brokers the discretion to charge borrowers up to 12% of the loan amount above the lender’s base price. . . . Younger white male

¹⁰⁷ JUSTICE ENFORCEMENT, *supra* note 26. For a description of predatory lending cases prosecuted by the Federal Trade Commission and other federal regulatory agencies from 1998 through 2005, see Engel & McCoy, *supra* note 28, at 125–27 n.121.

¹⁰⁸ JUSTICE ENFORCEMENT, *supra* note 26 (describing the Justice Department’s lawsuit against Delta Funding Corporation). For the settlement in this case, see Settlement Agreement and Order, United States v. Delta Funding Corp., No. CV 00 1872 (E.D.N.Y. 2000), available at <http://www.justice.gov/crt/housing/documents/deltasettle.php>.

¹⁰⁹ JUSTICE ENFORCEMENT, *supra* note 26 (emphasis in original).

¹¹⁰ *Id.*; see also *supra* note 101 and accompanying text.

¹¹¹ *Id.* (discussing Department of Justice lawsuits against The Huntington Mortgage Co. and Fleet Mortgage Corp.). The Huntington Mortgage Co. and the Fleet Mortgage Corp. reached settlements with the Justice Department of \$420,000 and \$4 million, respectively. See Settlement Agreement, United States v. The Huntington Mortgage Co., No. 1:95 CV 2211 (N.D. Ohio 1995), available at <http://www.justice.gov/crt/housing/documents/huntingtonsettle.php>; Settlement Agreement, United States v. Fleet Mortgage Corp., No. CV 96 2279 (E.D.N.Y. 1996), available at <http://www.justice.gov/crt/housing/documents/fleetsettle.php>.

Most mortgage lenders pay their loan officers commissions based upon both the volume of loans and the net dollar amount of “overages” that the loan officer generates. Certain cost adjustments (e.g., those associated with extending a lock-in period or converting a product to a stated income or no-document loan, see *supra* note 21, or increases in the loan amount and interest rate to cover closing costs) produce additional income to the lender that may then be split between the loan officer (as a commission) and her branch office.

¹¹² See *infra* notes 180–187 and accompanying text.

borrowers got the lowest rates, and older, African-American, single women fared the worst. White females, African-American males and Hispanics fell somewhere in between. The discrimination was evident with loans made by Long Beach's own officials, but was even more marked with loans that came through some of its mortgage brokers. Because Long Beach ultimately was responsible for underwriting all of the loans and allowed the brokers to charge the discriminatory prices, we asserted that Long Beach was liable, not only for the alleged discrimination of its own employees, but also for that of the brokers.¹¹³

Also during this period, the Justice Department made similar claims of discriminatory pricing in consumer loan cases based on the ECOA.¹¹⁴

These pricing cases demonstrated the growing importance of the issue of whether minorities were receiving loans on equal terms with their white counterparts. As the Justice Department commented in 2001 with respect to the "overages" problem: "The use of an employee or broker incentive program such as an overage system is not unlawful per se, but it becomes unlawful if applied in a manner to extract higher prices from minorities or women because of their race, national origin or gender."¹¹⁵

More generally, the focus of mortgage discrimination cases was shifting from access issues to pricing issues.¹¹⁶ As one commentator recently put it: "In the contemporary United States mortgage loan market, the predomi-

¹¹³ JUSTICE ENFORCEMENT, *supra* note 26 (discussing Department of Justice lawsuit against Long Beach Mortgage Co. in the Central District of California in 1960, which resulted in a settlement requiring the defendant to change its pricing policies and to pay \$3 million to 1,200 borrowers who had been given higher-priced loans). *See also* Settlement Agreement and Order Thereon, *United States v. Long Beach Mortgage Co.*, No. CV-96-159DT (CWx) (C.D. Cal. 1996), available at <http://www.justice.gov/crt/housing/documents/longbeachsettle.php>.

Long Beach Mortgage was later taken over by Washington Mutual, one of the nation's biggest subprime lenders, which in turn was eventually put into receivership by the FDIC and taken over by JPMorgan Chase Bank. *See* PAYING MORE, *supra* note 51, at 5-6; Eric Dash & Andrew Ross Sorkin, *Government Seizes WaMu and Sells Some Assets*, N.Y. TIMES, Sept. 25, 2008, at A1.

¹¹⁴ *See* JUSTICE ENFORCEMENT, *supra* note 26 (discussing three such cases). In addition, the Justice Department addressed the "overages" issue in an amicus brief filed in a private, ECOA-based suit against Nissan Motor Acceptance Corporation, where the plaintiffs alleged that defendant's "practice of permitting auto dealers, at their discretion, to set finance charges independent of risk has resulted in African Americans paying higher finance charges." *Id.* Justice's amicus brief argued that "a lender has a non-delegable duty to comply with ECOA, and, thus, is liable under ECOA for discriminatory pricing in loans that it approves and funds." *Id.* (describing Brief of the United States in Support of Plaintiffs' Opposition to Defendant's Motion for Summary Judgment as Amicus Curiae, *Cason v. Nissan Motor Acceptance Corp.*, No. 3-98-0223 (M.D. Tenn. Aug. 1, 2000)). The *Cason* case is further discussed *infra* notes 193 and 247.

¹¹⁵ JUSTICE ENFORCEMENT, *supra* note 26.

¹¹⁶ *See, e.g.*, BELSKY & ESSENE, *supra* note 31, at 26 (noting that, while in the past, "discrimination and unfair treatment took the almost exclusive form of discouraging or denying loan applicants[, n]ow consumers can be victims of discrimination or unfair treatment without ever having been denied a loan").

nant fair lending issue is no longer denial of loan applications; it is instead the fact that minority homeowners pay much more in interest rates and are much more likely to get risky subprime mortgages that lead to foreclosure.¹¹⁷ The next section focuses exclusively on pricing issues and on the principal industry technique—discretionary pricing—that became a primary facilitator of discriminatory mortgage rates.

3. *The Role of Discretionary Pricing in Modern Home-Loan Discrimination*

Much of the recent discrimination in the home-loan industry can be traced to a technique called “discretionary pricing.” As discussed in the previous section, the Justice Department as early as 1996 charged a California mortgage lender with FHA violations that allegedly resulted from the lender’s discretionary pricing system in which it allowed loan officers and brokers to add charges above the defendant’s base price.¹¹⁸ Despite the obvious dangers of such a system, discretionary pricing became a common practice in which many large mortgage lenders engaged. In a 2005 report, the Federal Reserve described this practice as follows:

Discretionary pricing. Many creditors provide their loan officers and agents working on their behalf (for example, mortgage brokers) with rate sheets that indicate the creditors’ minimum prices by product (for example, for conventional loans of various types or with various types of government backing), loan characteristics (for example, term to maturity and LTV ratio), and borrower creditworthiness (for example, credit history score and debt-to-income ratio). . . . A loan officer may quote a prospective borrower a price above the rate sheet (sometimes referred to as an “overage”), and if the consumer accepts the price without demanding cash back to offset loan fees or other closing costs, the contract interest rate or loan fees on such “overaged loans” will be higher than they might otherwise have been.¹¹⁹

The following steps are involved in this process: First, a mortgage lender provides its loan officers and affiliated brokers with the training and forms necessary to complete a loan; these include the lender’s rate sheets, which list the available prices for specific loan products and for borrowers with particular credit attributes.¹²⁰ Next, the lender evaluates a prospective

¹¹⁷ White, *supra* note 46, at 678; see also PAYING MORE, *supra* note 51, at 1 (“In the past, the concern was whether all borrowers were able to obtain loans, and analysis focused on the fact that loan applicants of color were more likely to be denied home loans. Today, with credit more widely available, the concern is whether certain groups pay more for their loans.”).

¹¹⁸ See *supra* note 113 and accompanying text.

¹¹⁹ *Fed’s New HMDA Report*, *supra* note 3, at 369–70.

¹²⁰ For examples of rate sheets, see ERNST ET AL., *supra* note 24, at 37–38 (providing a Countrywide rate sheet from September 2007); SUSAN WOODWARD, A STUDY OF CLOSING

borrower's risk of default based on objective information in the loan-application file (e.g., the borrower's credit score) and determines that the borrower qualifies for a certain risk-based interest rate; this is known as the "par rate," which is the rate at which the lender is willing to make the loan with no additional payment from the borrower.¹²¹ Finally, the lender authorizes its loan officers and brokers to impose additional charges to this objectively determined par rate.¹²² A 2008 decision upholding a FHA challenge to Countrywide's version of this system described the defendant's pricing policy as follows:

Countrywide obtains customers' credit information through its loan officers, brokers, or correspondent lenders. Based on these objective criteria, Countrywide computes a "par rate." Agents, brokers, or correspondent lenders at the point of sale, however, are allowed to impose additional charges, fees, and rates that are unrelated to objective risk factors. Countrywide communicates not only the applicable par rates, but also the additional authorized

COSTS FOR FHA MORTGAGES 6 (2008), available at <http://www.urban.org/publications/411682.html> (providing a typical rate sheet from 2000).

¹²¹ See *supra* text accompanying notes 95–97. The par rate may differ depending on whether the loan is generated by the lender's own loan officers or by outside brokers; in the latter situation, the par rate may be lower, reflecting the lender's lower costs in not having to use its own employees and facilities, but the borrower in a broker-generated loan will have to pay a fee to the broker, either up-front or through a "yield spread premium" that is built into the amount financed.

A yield spread premium:

is a payment by a lender to a broker based on the extent to which the interest rate on the loan exceeds a base or 'par' rate. The lender's payment of a yield spread premium to the broker, and the broker's imposition of a higher interest rate, are unrelated to the borrower's creditworthiness.

Steele v. GE Money Bank, No. 08 C 1880, 2009 WL 393860, at *1 n.2 (N.D. Ill. Feb. 27, 2009) (quoting *Ware v. Indymac Bank, FSB*, 534 F. Supp. 2d 835, 839 (N.D. Ill. 2008)); see also ERNST ET AL., *supra* note 24, at 8 (describing a yield spread premium as "an extra payment that brokers receive from lenders for delivering a mortgage with a higher interest rate than that for which the borrower qualifies"); MORTGAGE BANKERS/BROKERS, *supra* note 32, at 16 (describing yield spread premiums as "payments made from the mortgage banker to the broker for origination services . . . based on the rate of the loan and/or other loan pricing features . . . , [which] consumers pay . . . through higher interest rates and higher monthly payments"). For an example of how a yield spread premium works, see ERNST ET AL., *supra* note 24, at 37–38, app. 1.

"Yield spread premium" is a term usually reserved for brokered transactions. In loans wholly originated by a lender, the same type of premium is usually referred to as an "overage." GRUENSTEIN BOCIAN ET AL., *supra* note 91, at 45 n.40. For more on overages, see *supra* notes 100, 110–113 and accompanying text.

¹²² Lenders that use discretionary pricing carry out this policy by, inter alia: (1) providing training, marketing support, loan-related forms, and instructions to help their employees and brokers implement the policy; (2) evaluating and monitoring the brokers' compliance and rewarding them financially for successfully steering clients into loans with higher interest rates; (3) pricing all loans according to this policy; and (4) assuming part or all of the risk on these above-par loans. See, e.g., *Steele*, 2009 WL 393860, at *6.

discretionary charges to its loan officers, brokers, and correspondent lenders through regularly published “rate sheets.”¹²³

Allowing discretionary add-ons to the par rate results in a pricing system that elevates lender profit and broker compensation above what is justified by economic risk, as loan officers and brokers are incentivized to increase unsuspecting borrowers’ costs above par rates.¹²⁴ Both lenders and brokers profit when borrowers pay inflated discretionary rates and fees: the lenders lock borrowers into higher-than-par interest rates (which, *inter alia*, may raise their commission-paid loan officers’ compensation and increase the value of the loans on the secondary market); and brokers get paid higher fees, up to the maximum amount authorized by the lender. The extra, unjustifiable charges lead not only to financial hardship for the borrowers, but also to a substantially increased risk of default and foreclosure. And it is the rare borrower who has the time or sophistication necessary to comparison shop for lower costs after having once gone through the difficult process of applying for a residential loan.

¹²³ *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251, 254 (D. Mass. 2008). As this quote indicates, a lender’s mortgages may be originated through “correspondent lenders” as well as through in-house loan officers and independent brokers. With respect to the former:

Correspondent lenders typically are smaller financial institutions that operate much like retail lenders in that they take applications and underwrite and fund mortgages. Although loans are funded in the name of the correspondent, they are later sold to a wholesale lender under prearranged pricing and loan delivery terms and in compliance with established underwriting standards. Brokers, by contrast, do not fund loans; they simply identify potential customers, process the paperwork, and submit the loan application to a wholesale lender, which underwrites and funds the mortgage.

Apgar & Calder, *supra* note 32, at 105. In the *Miller* case, the named defendants included one of Countrywide’s correspondent lenders, Summit Mortgage LLC. *See infra* note 160.

¹²⁴ Discretionary pricing not only allows loan officers and brokers to mark-up the interest rate but also to tack on other discretionary fees and terms such as prepayment penalties. *See, e.g., Steele*, 2009 WL 393860, at *8 (describing a minority borrower that paid “a \$4,900 origination fee and a \$995 processing fee to her broker . . . and a \$950 administrative fee” to her lender). These additional fees and costs are often folded into the principal being borrowed, so they do not seem as if they are being paid “out-of-pocket” by the borrower. *See, e.g., U.S. DEPT OF HOUS. & URBAN DEV. & U.S. DEPT OF THE TREASURY, CURBING PREDATORY HOME MORTGAGE LENDING 9* (2000), available at <http://www.huduser.org/portal/publications/hsgfin/curbing.html> [hereinafter HUD-TREASURY REPORT] (“Financing points and fees may disguise the true cost of credit to the borrower, especially for high interest rate loans.”).

This is an inherently unfair system,¹²⁵ and one that is designed to steer borrowers with prime credentials into worse-than-prime loans.¹²⁶ Furthermore, discretionary pricing predictably leads to racial minorities being charged higher rates and fees for mortgages than similarly-creditworthy whites, as shown by numerous studies dating back to at least 2000.¹²⁷ What is more, similar discretionary pricing practices by the car-finance industry were challenged as being racially discriminatory in a series of ECOA-based class actions earlier in this decade.¹²⁸

For its part, the Federal Reserve commented on the risk of such discrimination in a 2005 report:

Discretionary pricing can be a legitimate business practice and can help ensure that markets allocate resources in the most efficient

¹²⁵ See, e.g., BELSKY & ESSENE, *supra* note 31, at 4, 27–28, 41–43 (noting ways in which the mortgage market, due to consumers' relative lack of information, falls short of the competitive ideal, resulting in borrowers often paying more than they would in a fairly competitive market); ERNST ET AL., *supra* note 24, at 7 (same); Apgar & Calder, *supra* note 32, at 118–21 (same). One reason underlying the basic unfairness of this market is, as the Federal Reserve Board recently noted in commenting on proposed changes to its consumer protection rules, that borrowers “generally lack expertise in complex mortgage transactions because they engage in such mortgage transactions infrequently.” Truth in Lending, 74 Fed. Reg. 43282 (proposed Aug. 26, 2009) (to be codified at 12 C.F.R. § 226). Racial minorities as a group are particularly susceptible to this source of unfairness, because they tend to have less consumer knowledge and experience than whites. See, e.g., Robert B. Avery et al., *Higher-Priced Home Lending and the 2005 HMDA Data*, 84 FED. RESERVE BULL. A123, A127 (2006), available at <http://www.federalreserve.gov/pubs/bulletin/2006/hmda> [hereinafter *Fed 2005 HMDA Report*] (noting that discretionary pricing has a greater impact on “borrowers with less experience in the mortgage market, such as first-time homebuyers, . . . [which] may be correlated with race . . . [because] minorities are disproportionately first-time homebuyers”).

¹²⁶ As early as 1996, a Freddie Mac study found that 10 to 35% of borrowers who received subprime mortgages may have actually qualified for a prime-rate loan. See HUD-TREASURY REPORT, *supra* note 124, at 23 n.6. See generally Peterson, *supra* note 33, at 2214–15 n.176 (describing sources showing that a significant percentage of recent subprime borrowers actually qualified for prime loans). According to the Justice Department, the figures in the Freddie Mac study “suggest that conventional lenders are either not fairly serving minority communities and are engaged in redlining or marketing discrimination, or that they are not fairly underwriting loan applications from minorities.” JUSTICE ENFORCEMENT, *supra* note 26, at 7.

¹²⁷ See HUD-TREASURY REPORT, *supra* note 124, at 23–24 (concluding, in a 2000 report, that many people of color could qualify for more affordable loans than they were allowed to receive); see also MICHAEL S. BARR ET AL., HARVARD UNIV. JOINT CTR. FOR HOUS. STUDIES, BEHAVIORALLY INFORMED HOME MORTGAGE CREDIT REGULATION 31 (2008), available at http://www.jchs.harvard.edu/publications/finance/understanding_consumer_credit/papers/ucc-08-12_barr_mullainathan_shafir.pdf (describing a 2001 study showing that “within the group of borrowers paying yield spread premiums, African Americans paid \$474 more for their loans, and Hispanics \$590 more, than white borrowers”); *infra* notes 133–135 and accompanying text (describing studies showing that mortgage lenders gave high-cost loans to minorities at a significantly higher rate than they did to comparable white borrowers).

¹²⁸ See, e.g., *Coleman v. General Motors Acceptance Corp.*, 220 F.R.D. 64 (M.D. Tenn. 2004); *Smith v. Chrysler Fin. Co.*, No. Civ. A. 00-6003 (DMC), 2003 WL 328719 (D.N.J. Jan. 15, 2003); *Cason v. Nissan Motor Acceptance Corp.*, 212 F.R.D. 518 (M.D. Tenn. 2002); *Jones v. Ford Motor Credit Co.*, No. 00 CIV. 8330 (LMM), 2002 WL 88431 (S.D.N.Y. Jan. 22, 2002); see also Kerwin Kofi Charles et al., *Rates for Vehicle Loans: Race and Loan Source*, 98 AM. ECON. REV. 315 (2008) (finding that blacks pay higher rates for new-car financing compared with whites having similar risk profiles).

way. However, when loan officers are permitted latitude in establishing prices, the lender runs the risk that differential treatment on a basis prohibited by law may arise. Obtaining overages more often, or in higher amounts, from minority borrowers or targeting only minorities for overaging may constitute a fair lending violation unless some legitimate, nondiscriminatory reason exists for the result.¹²⁹

When the Fed published this report in 2005, it had good reason to be concerned about pricing discrimination in the home-loan industry. Three years earlier, the Fed had amended its HMDA regulations to require that, beginning in 2004, mortgage lenders report certain information about their loan prices.¹³⁰ These amendments required reporting of certain “rate-spread” information regarding a specified set of loans, i.e., first-lien loans where the difference between the loan’s APR and the return on Treasury certificates of comparable maturity exceeded 3% and second-lien loans where this spread exceeded 5%.¹³¹ In covering only these “higher-priced” loans, the Fed’s regulation was designed not to require reporting of the great majority of prime loans but “would require reporting for about 98 percent of the subprime loans.”¹³²

The data produced pursuant to this new requirement have been analyzed by the Fed staff in yearly reports covering 2004–2008. For each of these years, the Fed studies show that black and Hispanic borrowers were far more likely than whites to receive high-cost loans.¹³³ This was true even after controlling for the borrowers’ income and a variety of other non-racial factors.¹³⁴ Numerous private studies have confirmed that these minorities,

¹²⁹ *Fed’s New HMDA Report*, *supra* note 3, at 369–70; *see also Fed 2005 HMDA Report*, *supra* note 125, at A128–29 (noting that, due to its potential for differential treatment of minorities, discretionary pricing has been identified as a “risk factor” by federal regulators charged with determining whether lenders are engaging in illegal price discrimination).

¹³⁰ *See* Home Mortgage Disclosure, 67 Fed. Reg. 43218 (June 27, 2002) (to be codified at 12 C.F.R. § 203.4) (requires lenders to report the lien status of a loan or application and requires lenders to ask applicants their ethnicity, race, and sex in applications taken by telephone); Home Mortgage Disclosure, 67 Fed. Reg. 30771 (May 8, 2002) (to be codified at 12 C.F.R. § 203.4) (postponing implementation date to ensure faithful industry compliance and requiring reporters to use 2000 census data instead of 1990 census data to ensure report accuracy and usefulness); Home Mortgage Disclosure, 67 Fed. Reg. 7222 (Feb. 15, 2002) (to be codified at 12 C.F.R. § 203.4) (requires lenders to report the difference between the APR and the Treasury yield, whether a loan is covered by the Home Ownership and Equity Protection Act (“HOEPA”), and whether an application or loan involves a manufactured home).

¹³¹ *See* 12 C.F.R. § 203.4(a)(12)(i) (2010).

¹³² *Fed’s New HMDA Report*, *supra* note 3, at 349–50. Effective October 1, 2009, the Fed made some changes to the definition of the “higher priced” loans required to be reported, based on the agency’s view that this adjusted definition was needed to more effectively capture the subprime market. *See* Home Mortgage Disclosure, 73 Fed. Reg. 63329 (Oct. 24, 2008) (to be codified at 12 C.F.R. § 203.4).

¹³³ *See Fed 2008 HMDA Report*, *supra* note 49, at 31–34.

¹³⁴ For the years 2004–2007, *see Fed 2007 HMDA Report*, *supra* note 50, at A139 (concluding that, for conventional home-purchase loans in the second half of 2007, “the gross mean incidence of higher-priced lending was 29.5 percent for blacks and 9.2 percent for non-

compared to similarly situated white borrowers, were more likely to receive higher-priced loans and mortgages with subprime characteristics, such as prepayment penalties and balloon payments.¹³⁵

Hispanic whites” and the results for Hispanics “are similar,” though when controlling for borrower-related factors (income, loan amount, location of the property or metropolitan statistical area, presence of a co-applicant, and sex), these differences are reduced by less than 50%); Robert B. Avery et al., *The 2006 HMDA Data*, 93 FED. RES. BULL. A73, A95 (2007) (reporting that, on conventional home-purchase loans, the gross mean incidence of higher-priced lending was 36.0 percentage points higher for African-Americans (53.7%) than for whites (17.7%) and the difference between these two racial groups for refinancing was 27.1 percentage points, with these differences being reduced by less than one-fifth when certain borrower-related factors other than race and lender characteristics were controlled for); *Fed 2005 HMDA Report*, *supra* note 125, at A159 (concluding that, on conventional home-purchase loans, the gross mean incidence of higher-priced lending was 54.7% for blacks versus 17.2% for whites, with the difference being reduced by only about one-fifth when certain borrower-related factors other than race were controlled for, and reporting similar race-based differences for refinancing loans); *Fed’s New HMDA Report*, *supra* note 3, at 376–84, 393 (concluding that, for conventional first-lien home-purchase loans, “the mean unadjusted incidence of higher-priced lending was 32.4 percent for blacks and 8.7 for non-Hispanic whites” and that one-fourth of this difference could not be explained by differences in these groups’ economic characteristics).

The methodology used by the Fed to analyze this issue changed somewhat in its study of the 2008 data, but the basic result was the same. *See Fed 2008 HMDA Report*, *supra* note 49, at 62–63 (reporting that, on conventional home-purchase loans, the gross adjusted mean incidence of higher-priced lending was 6.8% higher for African Americans (10.5%) than for whites (3.7%), and the difference between these two racial groups for refinance loans was 15.6%, with these differences being reduced by only about 2% when certain borrower-related factors other than race were controlled).

¹³⁵ *See, e.g.*, Debbie Gruenstein Bocian et al., *Race, Ethnicity and Subprime Home Loan Pricing*, 60 J. ECON. & BUS. 110 (2008); *see also* GAO FAIR LENDING REPORT, *supra* note 35, at 3 (noting that various HMDA-based research reports “indicate that on average, African-American and Hispanic mortgage borrowers may pay substantially higher interest rates and fees than similarly situated non-Hispanic white borrowers”). Other recent private studies that support these conclusions include:

- A 2009 study of fourteen major lenders based on the 2006 HMDA data showed that, among high-income borrowers, “African Americans were three times as likely as whites to pay higher prices for mortgages – 32.1 percent compared to 10.5 percent. Hispanics were nearly as likely as African Americans to pay higher prices for their mortgages at 29.1 percent.” ANDREW JAKABOVICS & JEFF CHAPMAN, UNEQUAL OPPORTUNITY LENDERS? ANALYZING RACIAL DISPARITIES IN BIG BANKS’ HIGHER-PRICED LENDING I (2009), available at http://www.americanprogress.org/issues/2009/09/pdf/tarp_report.pdf.
- A 2008 study based on the 2006 HMDA found that middle- and upper-income African Americans were at least twice as likely as comparable whites to receive high cost loans in 71.4% of the metropolitan areas examined, and this was also true among low- and moderate-income borrowers in 47.3% of the areas examined. NATIONAL COMMUNITY REINVESTMENT COALITION, INCOME IS NO SHIELD AGAINST RACIAL DIFFERENCES IN LENDING II: A COMPARISON OF HIGH-COST LENDING IN AMERICA’S METROPOLITAN AND RURAL AREAS 3 (2008), available at <http://www.nrcr.org/images/stories/pdf/research/income%20is%20no%20shield%20ii.pdf>.
- A 2007 study of the nation’s top residential mortgage lenders by the Association of Community Organizations for Reform Now found that, nationally, African American home purchasers were 2.7 times more likely and Latinos were 2.3 times more likely than white borrowers to be issued a subprime loan. *See* ASS’N OF COMMUNITY ORGANIZATIONS FOR REFORM NOW FAIR HOUSING, FORECLOSURE EXPOSURE: A STUDY OF RACIAL AND INCOME DISPARITIES IN HOME MORTGAGE LENDING IN 172 AMERICAN CITIES 3 (2007), available at <http://www.acorn.org/fileadmin/>

However, as with the earlier HMDA data, the price-related HMDA data cannot, standing alone, show unlawful discrimination. This is because, as the Fed staff regularly points out, many of the factors that affect an individual's creditworthiness and a loan's price (e.g., the borrower's credit score) are not captured or reported in the HMDA data.¹³⁶ Because the HMDA data "are not sufficient by themselves for drawing conclusions about . . . the activities of any individual lender,"¹³⁷ the Fed has insisted that reliance on the "raw data . . . can lead to inaccurate conclusions, which in turn may be unfair to particular institutions."¹³⁸

Nevertheless, as with earlier HMDA studies, the recent HMDA-based studies dealing with price disparities, while not by themselves establishing unlawful discrimination, might well suggest that certain lenders' pricing behavior warrants further investigation.¹³⁹ Indeed, in the wake of its analysis of the 2004 HMDA data, the Fed asked about 200 individual mortgage lenders for explanations of their pricing disparities, and the Justice Department followed up with letters to a number of these lenders seeking further information,¹⁴⁰ although no government-initiated lawsuits ever resulted from these inquiries.¹⁴¹

In addition, one private study combined the 2004 HMDA data with another data set that did take into account borrowers' credit scores and other relevant underwriting factors and found that, for many types of loans, blacks and Latinos "were more than 30 percent more likely to receive a higher rate loan than white borrowers, even after accounting for differences in risk."¹⁴²

HMDA/2007/HMDAreport2007.pdf. For refinance loans, this study found that, nationally, African Americans were 1.8 times more likely and Latinos were 1.4 times more likely than white borrowers to be issued a subprime loan. *Id.* These racial disparities were found to persist even among borrowers of the same income level. *Id.*

¹³⁶ See, e.g., *Fed 2008 HMDA Report*, *supra* note 49, at 31, 36; *Fed's New HMDA Report*, *supra* note 3, at 345, 393.

¹³⁷ *Fed's New HMDA Report*, *supra* note 3, at 345.

¹³⁸ *Id.* at 393.

¹³⁹ See *Fed 2008 HMDA Report*, *supra* note 49, at 31 (noting that, while it is impossible "to determine from HMDA data alone whether racial and ethnic pricing disparities reflect illegal discrimination . . . [a]nalysis using the HMDA data can account for some factors that are likely related to the lending process . . . [and can] be viewed as suggestive"); see also *id.* at 36 (noting that, because differences in loan prices may "be due to discriminatory treatment of minorities or other actions by lenders, . . . [t]he HMDA data are regularly used to facilitate the fair lending examination and enforcement processes" and that federal banking agencies' examiners "analyze HMDA price data in conjunction with other information and risk factors" in evaluating whether financial institutions have fair lending problems).

¹⁴⁰ See SCHWEMM, *supra* note 67, § 18:2 text accompanying nn.18-19.

¹⁴¹ See SCHWEMM, *supra* note 67, § 18:2 n.23; see also *Community and Consumer Advocates' Perspective on the Obama Administration's Financial Regulatory Reform Proposals: Hearing Before the H. Financial Servs. Comm.*, 111th Cong. 15 (2009) (testimony of John Taylor, President and CEO of the Nat'l Cmty. Reinvestment Coal.), available at http://financialservices.house.gov/hearings_all.shtml [hereinafter *Taylor Testimony*] ("Shockingly, not a single case of discrimination or civil rights violations have arisen from the roughly 470 Federal Reserve referrals.")

¹⁴² GRUENSTEIN BOCIAN ET AL., *supra* note 91, at 3.

The racial disparities found were “large and statistically significant.”¹⁴³ This study posited several possible causes for these disparities, one of which was “the considerable leeway mortgage originators have to impose charges beyond those justified by risk-based pricing.”¹⁴⁴

Other private studies also focused on specific lenders’ HMDA data. According to one of these, the 2005 HMDA data of seven large national lenders that originated a substantial volume of both prime and subprime loans—Citigroup, Countrywide, GMAC, HSBC, JP Morgan Chase, Washington Mutual, and Wells Fargo—showed that these lenders, both individually and as a group, provided blacks and Latinos with higher-cost loans far more often than they provided such loans to whites.¹⁴⁵ Such large lenders have accounted for a huge share of the overall subprime mortgage market.¹⁴⁶ As we shall see, many of these same lenders ultimately became the principal defendants in privately initiated class actions challenging their discriminatory pricing.¹⁴⁷

III. THE LEGAL RESPONSE TO DISCRIMINATORY PRICING

A. Overview

As mortgage defaults and home foreclosures accelerated in recent years, a variety of legal theories were used to try to protect borrowers from losing their homes. These included state consumer protection and fraud laws to challenge predatory loans¹⁴⁸ and federal statutes designed to protect borrowers against unfair lending practices.¹⁴⁹ Some complaints alleged race or national origin discrimination in violation of the FHA, ECOA, and their

¹⁴³ *Id.*

¹⁴⁴ *Id.* at 5.

¹⁴⁵ See *PAYING MORE*, *supra* note 51, at i (reporting that, for these seven lenders in the six metropolitan areas studied, “the percentage of total home purchase loans to African Americans that were higher-cost was 6 times greater than the percentage of higher cost home purchase loans to whites in the same cities (41.1 percent vs. 6.9 percent). The percentage of total home purchase loans to Latinos that were higher-cost was 4.8 times greater than the percentage of higher cost home purchase loans to whites (32.8 percent vs. 6.9 percent). In each of the cities examined, the seven lenders combined showed larger African American/white and Latino/white disparities than those exhibited for the overall lending market.”).

¹⁴⁶ See, e.g., *Fed 2005 HMDA Report*, *supra* note 125, at A146 (reporting that, in 2005, “the ten lenders with the largest volume of higher-priced loans extended 59 percent of all such loans, a share that had increased from 38 percent in 2004”).

¹⁴⁷ See *infra* notes 159–166 and accompanying text.

¹⁴⁸ See, e.g., cases cited in *SCHWEMM*, *supra* note 67, § 18:1 n.34; see also *Commonwealth v. Fremont Inv. & Loan*, 897 N.E.2d 548 (Mass. 2008) (enjoining lender’s foreclosure proceeding based on state unfair trade law, Massachusetts Predatory Home Loan Practices Act, in case involving an alleged predatory loan); *Engel & McCoy*, *supra* note 28, at 2090–93 (describing state and local anti-predatory lending statutes and ordinances).

¹⁴⁹ See, e.g., *SCHWEMM*, *supra* note 67, § 18:1 n.35 (describing cases that included claims under the Truth in Lending Act (“TILA”), the Real Estate Settlement Procedures Act, the Home Ownership and Equity Act (“HOEPA”), the Credit Repair Organizations Act, and the Racketeer Influenced and Corrupt Organizations Act).

state-law counterparts.¹⁵⁰ Often a borrower would include multiple claims, some involving civil rights laws and others not requiring a showing of discrimination.¹⁵¹

For the most part, these cases pitted individual borrowers against their lenders, with the litigation seeking to block a foreclosure, rescission or reformation of the loan, and/or other individualized relief. A few cases alleged that predatory lenders engaged in “reverse redlining” by targeting minority neighborhoods, but even these cases generally sought only relief from the particular loans involved and prohibitory injunctions against the specific lenders that had made them.¹⁵²

Civil rights litigation seeking institutional relief in this area has been rare. Apart from the class actions discussed below, only a handful of major private suits have been filed; these include two directed at race-based predatory lending¹⁵³ and one accusing two major lenders of forcing blacks into subprime mortgages while giving lower rates to similarly situated whites.¹⁵⁴ For its part, the Justice Department brought far fewer FHA mortgage cases during the recent Bush Administration than in the 1990s.¹⁵⁵ Thus, the class

¹⁵⁰ See, e.g., *McGlawn v. Pennsylvania Human Relations Comm’n*, 891 A.2d 757 (Pa. Commw. Ct. 2006) (described *supra* note 106); SCHWEMM, *supra* note 67, § 18:3 n.13; Press Release, Illinois Attorney General, Madigan Sues Wells Fargo for Discriminatory and Deceptive Mortgage Lending Practices (July 31, 2009), available at http://www.ag.state.il.us/press-room/2009_07/20090731.html (describing state-court case alleging violations of, inter alia, Illinois civil rights law based on a mortgage lender providing African Americans and Hispanics with higher priced loans than comparable white borrowers).

¹⁵¹ See, e.g., *Whitley v. Taylor Bean & Whitacker Mortgage Corp.*, 607 F. Supp. 2d 885 (N.D. Ill. 2009) (upholding most of black homeowners’ claims of predatory lending under a variety of federal statutes and state-law theories).

¹⁵² See, e.g., “reverse redlining” cases described in SCHWEMM, *supra* note 67, § 18:3 n.13.

¹⁵³ See *Mayor of Baltimore v. Wells Fargo Bank*, 677 F. Supp. 2d 847 (D. Md. 2010) (granting sole defendant’s motion to dismiss FHA claim based on its alleged predatory lending within Baltimore, but allowing plaintiffs to amend their complaint to cure perceived deficiencies); *NAACP v. Ameriquest Mortgage Co.*, 635 F. Supp. 2d 1096 (C.D. Cal. 2009) (denying defendants’ motion to dismiss nationwide class action brought by the NAACP against numerous mortgage lenders accused of predatory lending in violation of the FHA and other laws); see also *City of Cleveland v. Ameriquest Mortgage Sec., Inc.*, 621 F. Supp. 2d 513 (N.D. Ohio 2009) (dismissing city’s claim that defendants’ predatory lending activities violated state nuisance law); Michael Powell, *Memphis Accuses Wells Fargo of Discriminating Against Blacks*, N.Y. TIMES, Dec. 31, 2009, at A15 (describing Baltimore-like suit brought in late 2009 by Memphis officials against a single lender).

For a description of the Baltimore case by one of the plaintiff’s lawyers, see John P. Relman, *Foreclosures, Integration, and the Future of the Fair Housing Act*, 41 IND. L. REV. 629, 632-43 (2008).

¹⁵⁴ See Class Action Complaint, *NAACP v. Wells Fargo Bank, N.A.*, No. CV09-01758 DDP (JCX) (C.D. Cal. Mar. 13, 2009), available at <http://www.naacp.org/news/press/2009-03-13/Original.complaint.against.Wells.Fargo.Bank.Wells.Fargo.Home.Mortgage.pdf>.

¹⁵⁵ See SCHWEMM, *supra* note 67, § 18:2 nn.21-24 and accompanying text; see also GAO FAIR LENDING REPORT, *supra* note 35, at 53-58 (surveying Justice Department and Federal Trade Commission (“FTC”) suits in the 2005-2009 period and finding only one race-based pricing case brought by Justice and only two by the FTC). See generally Charlie Savage, *Report Examines Civil Rights Enforcement During Bush Years*, N.Y. TIMES, Dec. 3, 2009, at A26 (describing GAO report finding a significant drop in the enforcement of major anti-discrimination laws during the Bush Administration).

actions appear to be the principal effort designed to bring about nationwide systemic change in the modern home-finance industry, at least apart from non-litigation efforts such as legislative reform relating to this industry.¹⁵⁶ These class-action lawsuits are examined in detail in the remainder of Part III, while non-litigation efforts are discussed in Part IV.

B. Class Action Cases Challenging Discretionary Pricing

1. The Basic Claim

Beginning in 2007, a series of lawsuits challenging the discretionary pricing policies of many of the largest mortgage lenders were brought in various federal courts throughout the country.¹⁵⁷ All of the suits are putative nationwide class actions brought on behalf of African American and Hispanic homeowners that allege the defendants engaged in race and national origin discrimination in originating, funding, acquiring, and servicing residential mortgage loans in violation of the FHA and ECOA.¹⁵⁸ The basic allegations are similar in all of the cases, but each was brought against only a single lender (sometimes along with its affiliated corporate partners). The lenders sued include Accredited Home Lenders;¹⁵⁹ Countrywide;¹⁶⁰ GE

¹⁵⁶ For examples of such legislative activity, see *infra* notes 281–282 and accompanying text.

¹⁵⁷ See cases cited *infra* notes 159–166. The earliest of these suits was filed on July 12, 2007. See *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251, 261 (D. Mass. 2008). Most of the rest were filed later in 2007 or in early 2008, but at least one was filed as late as April of 2009. See *Watson v. Homecomings Financial, LLC*, No. 09-859 (DWF/JJG), 2009 WL 3517837, at *2 (D. Minn. Oct. 23, 2009).

¹⁵⁸ For a representative complaint, see Class Action Complaint, *Guerra v. GMAC LLC*, No. 208CV01297 (E.D. Pa. July 22, 2008) [hereinafter *Guerra Complaint*]. The specific provisions in the FHA and ECOA that ban mortgage discrimination are described *supra* note 67.

¹⁵⁹ See *Taylor v. Accredited Home Lenders, Inc.*, 580 F. Supp. 2d 1062 (S.D. Cal. 2008). The defendants named in this case are Accredited Home Lenders, Inc. (“AHL”) and Accredited Home Lenders Holding Company, *id.* at 1064, both of which filed for bankruptcy in 2009. *Accredited Home Lenders Holding Co.*, HOOVERS COMPANY BASIC RECORDS, July 8, 2009, available at 2009 WLNR 12984795. Founded in 1990, AHL enjoyed spectacular growth for many years as an originator of subprime mortgages, providing some \$2 billion of such loans annually at the height of the real estate bubble. See Jason Cornell, *Accredited Home Lender Files for Bankruptcy and Lists Repurchaser Claims as its Largest Creditors*, DELAWARE BANKRUPTCY LITIGATION, May 10, 2009, <http://delawarebankruptcy.foxrothschild.com> (search for “AHL”).

¹⁶⁰ See *Miller*, 571 F. Supp. 2d at 251; *Garcia v. Countrywide Fin. Corp.*, No. EDCV 07-1161-VAP (JCRx), 2008 U.S. Dist. LEXIS 106675 (C.D. Cal. Jan. 17, 2008). In the former case, the named defendants are Countrywide Bank, N.A., Countrywide Home Loans, Inc., two of their wholly owned subsidiaries (Countrywide Correspondent Lending and Full Spectrum Lending, Inc.), a correspondent lender (Summit Mortgage LLC), and a mortgage broker (Loans for Residential Homes Mortgage Corp.). See *Miller*, 571 F. Supp. 2d at 251; Class Action Complaint ¶¶ 10–16, *Miller v. Countrywide Bank, N.A.*, No. 07CV11275 (D. Mass. July 12, 2007). In the *Garcia* case, the two named defendants are Countrywide Financial Corporation and Countrywide Home Loans, Inc. *Garcia*, 2008 U.S. Dist. LEXIS 106675 at *2. Countrywide went bankrupt in 2007 and was taken over by Bank of America in 2008. See *supra* note 54.

Money Bank;¹⁶¹ GMAC;¹⁶² GreenPoint Mortgage Funding;¹⁶³ HSBC North American Holdings and its lending subsidiaries;¹⁶⁴ H & R Block's two mortgage subsidiaries, H & R Block Mortgage Corp. and Option One Mortgage Corp.;¹⁶⁵ and Wells Fargo.¹⁶⁶

These cases allege FHA and ECOA violations based solely on a disparate impact theory. Plaintiffs allege that the policy of all of these defendant-lenders in allowing discretionary pricing, although facially neutral, has an adverse effect on minority borrowers compared to similarly situated whites. In short, they claim that minority borrowers pay more discretionary charges, both in frequency and amount, than whites with similar credit backgrounds.

Most of the defendant-lenders in these cases responded to the complaints by filing motions to dismiss. In each such case, the trial court upheld

¹⁶¹ See *Steele v. GE Money Bank*, No. 08 C 1880, 2009 WL 393860 (N.D. Ill. Feb. 17, 2009). The principal defendant in this case, GE Money Bank, "is a wholly owned subsidiary of GE Consumer Finance, Inc., a consumer lending unit of General Electric Company." *Id.* at *1. A second defendant, WMC Mortgage, LLC, "is a successor in interest to WMC Mortgage Corporation . . . [which, along with] its parent company, WMC Finance Co., were acquired by . . . GE Consumer Finance[] in 2004." *Id.*

¹⁶² See *Guerra v. GMAC LLC*, No. 2:08-cv-01297-LDD, 2009 WL 449153 (E.D. Pa. Feb. 20, 2009). The principal defendants in this case are GMAC LLC and certain of its subsidiaries, including GMAC Mortgage, LLC, GMAC Bank, and Homecomings Financial, LLC. See *Guerra Complaint*, *supra* note 158, ¶¶ 1, 58–62. A separate suit against Homecomings Financial was filed in 2009. See *Watson v. Homecomings Fin., LCC*, No. 09-859 (DWF/JJG), 2009 U.S. Dist. LEXIS 99260, at *1 (D. Minn. Oct. 23, 2009).

¹⁶³ See *Ramirez v. GreenPoint Mortgage Funding, Inc.*, 633 F. Supp. 2d 922 (N.D. Cal. 2008). There is only one defendant named in this case. See *id.* at 922. GreenPoint, which was once one of the nation's largest originators of Alt-A mortgages, was shut down in 2007 less than a year after being taken over by Capital One Financial Corp. See E. Scott Reckard, *Subprime Chaos Claims 500 Jobs at Countrywide*, L.A. TIMES, Aug. 21, 2007, at C4.

¹⁶⁴ See Court Documents, *Allen v. Decision One Mortgage Co.*, C.A. No. 1:07-cv-11669-GAO (D. Mass. Nov. 27, 2009) (on file with author). This case, which is further described *infra* notes 241 and 262, names as defendants HSBC North America Holdings, Inc. and five of its lending subsidiaries (Decision One Mortgage Company, LLC; HSBC Finance Corporation; HSBC North America Holding Inc.; HSBC Mortgage Corporation (USA); and HSBC Mortgage Services, Inc.). See *Class Action Complaint* ¶¶ 19–20, *Allen v. Decision One Mortgage Co.*, C.A. No. 1:07-cv-11669-GAO (D. Mass. Nov. 27, 2009) (on file with author). HSBC Finance Corporation is the former Household International, which included Household Finance Company and Beneficial Finance Company and which purchased Decision One in 1999. *Id.*

¹⁶⁵ See *Barrett v. H & R Block, Inc.*, 652 F. Supp. 2d 104 (D. Mass. 2009); *Hoffman v. Option One Mortgage Corp.*, 589 F. Supp. 2d 1009 (N.D. Ill. 2008). In the former case, the principal defendants are H & R Block Mortgage Corporation and Option One Mortgage Corporation, which are described as wholly owned subsidiaries of H & R Block, Inc. *Barrett*, 652 F. Supp. 2d at 107. H & R Block, Inc. was also named as a defendant, but the court dismissed it for lack of personal jurisdiction. *Id.* at 113–16. In the *Hoffman* case, H & R Block Mortgage Corp. was also described as "Option One Mortgage Services, Inc." *Hoffman*, 589 F. Supp. 2d at 1009.

¹⁶⁶ See *In re Wells Fargo Residential Mortgage Lending Discrimination Litigation*, No. M:08-CV-1930 MMC, 2009 WL 2473684 (N.D. Cal. Aug. 11, 2009). Wells Fargo has also been sued in a number of other discriminatory pricing cases. See *supra* notes 149, 153, and 154 and *infra* note 255.

the plaintiffs' basic claims.¹⁶⁷ As a result, all of these cases are now in the pre-trial discovery stage.

2. Three Strategic Issues

These class action lawsuits raise three major strategic questions for plaintiffs. The first is whether to employ an intentional discrimination theory of liability, as opposed to a disparate impact theory. The second is whether to base the claims on the individual plaintiff-borrower's race or national origin or on that of the borrower's neighborhood as a whole. Finally, the third is whether to add the mortgage brokers, rather than simply the mortgage lenders, as defendants. This section examines each of these issues in turn.

First, plaintiffs face a strategic choice whether to adopt an intentional discrimination theory of liability. In other mortgage lending cases based on similar facts, minority plaintiffs have accused their lenders of intentional discrimination.¹⁶⁸ This raises the question of why the class action cases do not include an intent-based count, along with their disparate impact claim. After all, assuming that the lender-defendants' discretionary pricing policies do negatively impact minorities and that these lenders knew or should have known of this disparate impact,¹⁶⁹ such a scenario would present strong evidence of intentional discrimination.¹⁷⁰

The answer seems to be a matter of litigation strategy. While it is true that evidence of intentional discrimination is lurking in these cases,¹⁷¹ prov-

¹⁶⁷ See cases cited *supra* notes 159-166. Some decisions dismissed particular defendants or otherwise granted parts of the defendants' motions to dismiss. See, e.g., *supra* note 165 and *infra* notes 185-187 and accompanying text.

¹⁶⁸ See, e.g., *Mayor of Baltimore v. Wells Fargo Bank*, 631 F. Supp. 2d 702, 704 (D. Md. 2009), *complaint dismissed*, 677 F. Supp. 2d 847 (D. Md. 2010); *Ware v. Indymac Bank*, 534 F. Supp. 2d 835, 840 (N.D. Ill. 2008); *Newman v. Apex Financial Group, Inc.*, No. 07 C 4475, 2008 WL 130924, at *3-5 (N.D. Ill. Jan. 11, 2008); *Martinez v. Freedom Mortgage Team, Inc.*, 527 F. Supp. 2d 827, 834-35 (N.D. Ill. 2007).

¹⁶⁹ See *supra* notes 110-114 and 126-135 and accompanying texts, *infra* notes 171-173 and accompanying text.

¹⁷⁰ "Frequently the most probative evidence of intent will be objective evidence of what actually happened rather than evidence describing the subjective state of mind of the actor." *Washington v. Davis*, 426 U.S. 229, 253 (1976) (Stevens, J., concurring); see also *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 987 (1988) ("the necessary premise of the disparate impact approach is that some employment practices, adopted without a deliberately discriminatory motive, may in operation be functionally equivalent to intentional discrimination").

¹⁷¹ The cases actually present a "hybrid" impact/intent claim, because the defendant-lenders' "neutral" policies that produced racially disparate impacts (i.e., granting discretion to their loan officers and brokers to increase charges above levels necessary to account for credit risk) *allowed* these agents to intentionally discriminate even if the lenders did not specifically intend for such discrimination to occur. Cf. *Ho v. Donovan*, 569 F.3d 677, 680 (7th Cir. 2009) (ruling against a FHA defendant who was described as having "behaved like an ostrich," and commenting that "[c]onscious avoidance of information is a form of knowledge"); *Mathews v. Gov't Emp. Ins. Co.*, 23 F. Supp. 2d 1160, 1164 (S.D. Cal. 1998) (holding that for purposes of determining whether a Fair Credit Reporting Act ("FCRA") violation is sufficiently willful to justify punitive damages, it is enough to show that defendants recklessly disregarded any of their FCRA responsibilities and that they cannot evade such liability "by sticking their heads in the sand and pleading ignorance").

ing it might be a daunting and distracting task. It would require producing evidence—in addition to the HMDA-based studies showing racial and national origin disparities—that some policy-maker for each defendant-lender directed that minority borrowers be targeted for higher cost loans.¹⁷² This type of evidence has surfaced occasionally, for example from whistle-blowers who once worked for a lender,¹⁷³ but it is not easy to find such witnesses and convince them to testify. Furthermore, a disparate impact case poses fewer hurdles. For example, once statistically significant disparities are proven in a disparate impact case, the focus turns to the issues of the defendant's business justifications and the existence of less discriminatory alternatives, issues for which the defendants may have the burden of proof.¹⁷⁴ Finally, as a matter of equity as well as legal theory, the plaintiffs believe the defendant-lenders should be held responsible for the discriminatory *results* of their policies, whether or not they can be shown to have intended those results.¹⁷⁵

The second strategic choice made by plaintiffs in these lawsuits is to base their claims entirely on the plaintiff-borrowers' race and national origin, as opposed to the race or national origin of the borrowers' neighborhoods, as would be the case in "redlining," "reverse redlining," and other types of area-focused claims of mortgage discrimination.¹⁷⁶ In individual cases, evidence may be produced that a particular lender-defendant has a record of other types of financial discrimination, including neighborhood-based discrimination, but this is not the specific focus of these cases. Rather, the focus is the negative impact of the defendants' discretionary pricing policy on minority borrowers, regardless of where they live.

The third strategic choice made by plaintiffs in these lawsuits is generally not to add as defendants the mortgage brokers who, presumably, were the initial cause of the higher rates and fees to which plaintiffs were sub-

¹⁷² It is worth noting that, in one of the few cases where both impact and intent claims were alleged, the trial court upheld the impact claim, but dismissed as "speculative" allegations based on discriminatory intent. See *Garcia v. Countrywide Fin. Corp.*, No. EDCV 07-1161-VAP (JCRx), 2008 U.S. Dist. LEXIS 106675, at *40-42 (C.D. Cal. Jan. 17, 2008).

¹⁷³ See, e.g., *Mayor of Baltimore*, 631 F. Supp. 2d at 704 (referring to plaintiffs' having submitted affidavits of two of defendant's former employees in support of plaintiffs' FHA claims of discriminatory lending). For a further description of the whistle-blower testimony in this case, see Michael Powell, *Suit Accuses Wells Fargo of Steering Blacks to Subprime Mortgages in Baltimore*, N.Y. TIMES, June 7, 2009, at A15.

¹⁷⁴ See *infra* notes 237-238 and accompanying text.

¹⁷⁵ Intent-based claims might also add to the difficulties of class-action certification. See *infra* notes 192-193 and accompanying text. Because these cases involve hundreds of thousands of loans, defendants might argue that the Rule 23 requirements of commonality and typicality are lacking (e.g., because the class members dealt with different brokers, different loan officers, or purchased different loan packages from a given lender than did the representative plaintiffs). Some courts have, in fact, opined that the Rule 23 requirements are more easily satisfied in a disparate impact case than an intent case. See, e.g., *Stastny v. Southern Bell Tel. & Tel. Co.*, 628 F.2d 267, 274 n.10 (4th Cir. 1980).

¹⁷⁶ For discussions of redlining and reverse redlining, see, respectively, *supra* note 64 and accompanying text and *supra* notes 101-106 and accompanying text.

jected, at least for the loans they originated. The issue of whether a lender should be liable for the discriminatory acts of the mortgage brokers with whom it deals is a difficult one. In 2003, the Supreme Court held in *Meyer v. Holley*¹⁷⁷ that “traditional vicarious liability rules” govern FHA claims and that these rules “ordinarily make principals and employers vicariously liable for acts of their agents or employees in the scope of their authority or employment.”¹⁷⁸ In *Meyer*, this meant that the discrimination of a real estate salesman could be attributed to his employer-corporation, “but not the owner or officer [of the corporation],” because only the corporation was the salesman’s “principal or employer, and thus subject to vicarious liability for torts committed by its employees or agents.”¹⁷⁹

Under *Meyer*, it is clear that lenders are vicariously liable for the discriminatory acts of their own loan officers and other employees. As for a lender’s liability for its brokers’ FHA violations, however, *Meyer* may require that a principal-agent relationship exist between the lender and these brokers. The defendant-lenders maintain that brokers act only on behalf of borrowers, not the lender who ultimately makes the loan.¹⁸⁰ Thus, argue the lenders, if a broker discriminates unlawfully against its customers, *Meyer* instructs the victims to sue the broker, but it does not authorize lender liability for such FHA violations.

The plaintiffs respond that a lender should be held responsible for all of its discriminatory loans, regardless of who originally generated them.¹⁸¹ It is each lender’s pricing policies—and its failure to adequately monitor the consequences of those policies—that have led to the racial disparities challenged by these cases.¹⁸² Furthermore, even if *Meyer* is a problem with

¹⁷⁷ 537 U.S. 280 (2003).

¹⁷⁸ *Id.* at 285.

¹⁷⁹ *Id.* at 286.

¹⁸⁰ Indeed, laws in some states establish a fiduciary relationship between a broker and its borrowers. *See, e.g.*, KY. REV. STAT. ANN. § 286.8–270 (2009) (imposing, in Kentucky statute passed in 2008, fiduciary duties on mortgage loan brokers in favor of borrowers); *see also* MORTGAGE BANKERS/BROKERS, *supra* note 32, at 25 (“Some state laws hold that a broker must act as an agent of the borrower. In other states, courts have ruled that agency relationships exist based on the broker’s conduct. Other states have concluded there is no agency relationship implied.”). For more on the issue of whether brokers represent borrowers, *see infra* note 289 and accompanying text.

¹⁸¹ Plaintiffs point to the large degree of control that the defendant-lenders exerted over their affiliated brokers as showing that the lenders’ policies caused the discriminatory impact at issue. Each lender screened and approved individual brokers before allowing them to offer the lender’s loan products. A lender’s chosen brokers were given internet and intranet access to the lender’s proprietary underwriting databases and were required to adhere to wholesale-lending manuals prepared and administered by the lender. Because lenders were required to keep HMDA data for all broker-initiated loans, each instructed its brokers on how to report that data to the lender. Each lender issued daily rate sheets for all of its products to its brokers, and most capped the fees that their brokers could charge (e.g., between 3% and 5% of the loan). Finally, each lender had the ability to monitor broker activities and to suspend or bar particular brokers from carrying its products. *See also supra* text accompanying notes 120–123.

¹⁸² *Cf. Dunn v. Washington County Hosp.*, 429 F.3d 689, 691 (7th Cir. 2005) (holding employer liable under Title VII even though the discriminatory terms and conditions complained of were initiated by a third party, on the ground that, because “liability is direct rather

respect to FHA liability, it does not govern claims under the ECOA, which does authorize lender liability for broker-initiated loans.¹⁸³

The plaintiffs also have a strategic rationale for suing only the lenders. The plaintiffs view mortgage brokers—who are often small operations and notoriously elusive, going into and out of business very quickly¹⁸⁴—as simply a distraction in the overall problem of discretionary loan prices. The fact that such brokers exist at all, much less that they have engaged in this type of pricing discrimination, is ultimately due to the lenders, which set up and maintained this system. A major goal of this litigation is to end the overall system of discretionary pricing in mortgage loans, and this can be accomplished by suing only the lenders. To also name the individual brokers would involve a colossal effort, with very little reward.

To date, one trial court in these cases has agreed in part with the defendant-lenders' position in ruling on a preliminary motion.¹⁸⁵ This court held that the plaintiffs' allegations

do not support an inference that the defendant lenders had the ability to control the manner and method in which the brokers carried out their work Because the existence of an actual or apparent agency relationship is based entirely on speculation, the portions of the complaint which rest on an agency theory between the defendants and the brokers are dismissed.¹⁸⁶

However, the court noted that this ruling does not affect the plaintiffs' claim

against the lender defendants based on their own actions. . . . An agency relationship between a lender and a broker need not exist for a lender to direct a broker to take a specified action in order for

than derivative, it makes no difference whether the person whose acts are complained of is an employee [or] an independent contractor Ability to 'control' the actor plays no role. . . . This is, by the way, the norm of direct liability in private law as well: a person 'can be subject to liability for harm resulting from his conduct if he is negligent or reckless in permitting, or failing to prevent, negligent or other tortious conduct by persons, whether or not his servants or agents, upon premises or with instrumentalities under his control.' *RESTATEMENT (SECOND) OF AGENCY* § 213(d).")

¹⁸³ Under the ECOA, a lender is responsible for the entire loan price, including elements of the price that are set by third parties. *See Coleman v. General Motors Acceptance Corp.*, 220 F.R.D. 64, 93 (M.D. Tenn. 2004) (noting, in ECOA case challenging discretionary pricing by a car finance company, that plaintiffs "make a much stronger case for GMAC's liability under ECOA's definition of creditor or assignee than under the agency theory"); 15 U.S.C. § 1691a(e) (2009); *see also* 12 C.F.R. § 202.2(l) (2009) (defining a "creditor" for purposes of ECOA liability as anyone who "participate[d] in a credit decision"); *see also supra* text accompanying note 113 (setting forth Justice Department's position that, because a lender is ultimately responsible under ECOA for all of its loans, a lender should be liable "not only for the alleged discrimination of its own employees, but also for that of the brokers").

¹⁸⁴ *See supra* notes 32–35 and accompanying text; *infra* note 28 and accompanying text.

¹⁸⁵ *Steele v. GE Money Bank*, No. 08 C 1880, 2009 WL 393860, at *5–7 (N.D. Ill. Feb. 27, 2009).

¹⁸⁶ *Id.* at *6.

that broker to do business with that lender. [Given the plaintiffs' allegations that this] second kind of relationship existed, . . . the court's dismissal of any claims based on an agency theory does not require dismissal of claims based merely on alleged directions to brokers provided by the defendant lenders.¹⁸⁷

3. *Other Issues: Relief Requested; Class Certification; Timeliness*

Plaintiffs in these cases seek both equitable and monetary relief. As for the former, the complaints pray for an equitable decree that, *inter alia*, would: enjoin the defendant-lenders' from engaging in subjective decision-making in the pricing of future home loans; bar defendants from continuing to collect any non-risk charges resulting from unlawful discrimination; disgorge and provide restitution regarding all such charges; and reform the above-par loans currently held by defendants to the risk-related rates that the plaintiff-borrowers should have had on the dates their loans closed.¹⁸⁸ Plaintiffs also seek damages as authorized by the FHA and ECOA.¹⁸⁹

These cases have been brought as class actions,¹⁹⁰ in part to provide some equalizing of the litigation resources on the plaintiffs' side against the huge national finance companies that are the defendants. In addition, class actions are the only cost-effective way of prosecuting the borrowers' tens of thousands of claims, the individual prosecution of which "would not only unnecessarily burden the judiciary, but would prove uneconomic for potential plaintiffs."¹⁹¹

¹⁸⁷ *Id.* at *7; *see also* Anderson v. Wells Fargo Home Mortgage, Inc., 259 F. Supp. 2d 1143, 1148 (W.D. Wash. 2003) (noting, in similar circumstances, that agency relationship may not be required "to sustain an FHA claim" to the extent plaintiff "can maintain such a claim directly against Wells Fargo").

The *Steele* court went on to conclude that the absent brokers with whom the plaintiffs had dealt were necessary parties under FED. R. Civ. P. 19(a)(1), and therefore that "the plaintiffs must join the brokers if they wish to proceed with this action." *Steele*, 2009 WL 393860, at *9. For contrary rulings in similar cases, *see In re Wells Fargo Residential Mortgage Lending Discrimination Litig.*, No. M:08-CV-1930 MMC, 2009 WL 2473684 (N.D. Cal. Aug. 11, 2009); Jackson v. Novastar Mortgage, Inc., 645 F. Supp. 2d 636, 642-43 (W.D. Tenn. 2007).

¹⁸⁸ *See, e.g.*, Guerra Complaint, *supra* note 158, at "Prayer" after ¶ 162.

¹⁸⁹ *See id.*; FHA, *supra* note 1, § 3613(c); ECOA, *supra* note 66, § 1691(a)-(b).

¹⁹⁰ A typical class is defined as including:

[a]ll minority persons in the United States who obtained a residential mortgage loan from [Defendants] between January 1, 2001 and the present and were harmed by Defendants' racially discriminatory policies and/or practices. . . . By "minority," Plaintiffs refer to "any and all non-Caucasian/White racial groups protected under the [ECOA] and the [FHA], including, without limitation, African-Americans and Latinos."

Guerra v. GMAC LLC, No. 2:08-cv-01297-LDD, 2009 WL 449153, *1 n.1 (E.D. Pa. Feb. 20, 2009); *see also Steele*, 2009 WL 393860, at *10-11 (describing a similar class).

¹⁹¹ Hanlon v. Chrysler Corp., 150 F.3d 1011, 1023 (9th Cir. 1998). *See generally* General Tel. Co. v. Falcon, 457 U.S. 147, 155, 159 (1982) (describing the principal purpose of class actions as achieving efficiency and economy of litigation for the parties and the courts).

None of the trial judges in these cases has yet decided whether a class action should be certified. While class certification is essential to the success of these cases, it is a procedural matter that is tangential to the substantive issues we are discussing in this Article. However, it is worth noting that cases alleging race discrimination generally lend themselves to class action treatment¹⁹² and these particular cases seem to be appropriate candidates for class certification.¹⁹³

As for timeliness, the relevant statute-of-limitations period for both the FHA and ECOA is two years,¹⁹⁴ and some members of the plaintiff-classes were exposed to the defendants' illegal policies and given discriminatory loans more than two years before the cases were filed. Plaintiffs assert, however, that these claims, as well as those of the named plaintiffs and other class members whose loans *were* issued within the limitations period, are

¹⁹² See, e.g., *E. Tex. Motor Freight Sys. v. Rodriguez*, 431 U.S. 395, 405–06 (1977).

¹⁹³ A class action in federal court must meet all four of the requirements of Rule 23(a) and at least one of the requirements of Rule 23(b). See FED. R. Civ. P. 23(a)–(b). It seems fairly obvious that these cases meet 23(a)'s first two requirements (numerosity and common questions). See, e.g., *Cason v. Nissan Motor Acceptance Corp.*, 212 F.R.D. 518, 520 (M.D. Tenn. 2002); *Rodriguez v. Ford Motor Credit Co.*, No. 01 C 8526, 2002 WL 655679, at *2–3 (N.D. Ill. Apr. 19, 2002). The requirements of typicality and adequate representation are generally fact-based determinations, but the complaints have presumably identified lead plaintiffs and claims in such a way that these elements are also likely to be satisfied. Cf. *Cason*, 212 F.R.D. at 520; *Rodriguez*, 2002 WL 655679, at *3.

Certification under 23(b)(2) is likely to be appropriate since these claims allege that the defendants discriminated against a class of people and the primary relief sought is injunctive. See, e.g., *Dukes v. Wal-Mart, Inc.*, 509 F.3d 1168, 1174 (9th Cir. 2007); see also *Buycks-Robertson v. Citibank Fed. Sav. Bank*, 162 F.R.D. 322, 325 (N.D. Ill. 1995) (certifying a (b)(2) class action in a mortgage discrimination case that is further described *supra* note 85). Courts have routinely certified (b)(2) classes alleging disparate impact claims. See, e.g., *Robinson v. Metro-North Commuter R.R. Co.*, 267 F.3d 147 (2d Cir. 2001); *Rich v. Martin Marietta Corp.*, 522 F.2d 333 (10th Cir. 1975). See generally *Amchen Products, Inc. v. Windsor*, 521 U.S. 591, 614 (1997) (“Civil rights cases against parties charged with unlawful, class-based discrimination are prime examples [of (b)(2) class actions].”). The major issue regarding (b)(2) certification is likely to be whether such certification is jeopardized by the fact that the plaintiffs are also seeking monetary damages. See, e.g., *Coleman v. General Motors Acceptance Corp.*, 296 F.3d 443, 447 (6th Cir. 2002) (holding (b)(2) certification inappropriate in ECOA-based challenge to discretionary pricing in car loans, because the injunctive relief requested “does not predominate over the monetary damages”). Note, however, that after the Sixth Circuit’s decision in *Coleman*, the trial court on remand and a different court in *Cason* both certified (b)(2) classes after the plaintiffs abandoned their claims for monetary damages. See *Coleman v. General Motors Acceptance Corp.*, 220 F.R.D. 64, 100 (M.D. Tenn. 2004); *Cason*, 212 F.R.D. at 523.

A (b)(3) certification may also be appropriate for these cases, because common questions “predominate” and a class action is the “superior” way to adjudicate this controversy. In particular, superiority is demonstrated where “class-wide litigation of common issues will reduce litigation costs and promote greater efficiency.” *Valentino v. Carter-Wallace, Inc.*, 97 F.3d 1227, 1234 (9th Cir. 1996); see also *supra* note 191 and accompanying text. But see *Rodriguez*, 2002 WL 655679, at *4–5 (holding that trial of plaintiffs’ claims of car-loan price discrimination “would require an individualized inquiry into the reason for thousands of credit decisions,” thereby making (b)(3) certification improper).

¹⁹⁴ See FHA, *supra* note 1, § 3613(a)(1)(A); ECOA, *supra* note 66, § 1691e(f).

timely under the “continuing violation theory.”¹⁹⁵ This theory was endorsed for purposes of the FHA by the Supreme Court in 1982 in *Havens Realty Corp. v. Coleman*,¹⁹⁶ and it has also regularly been applied in ECOA cases.¹⁹⁷

Post-*Havens* decisions make clear that “when a defendant’s conduct is part of a continuing practice, an action is timely so long as the last act evidencing the continuing practice falls within the limitations period; in such an instance, the court will grant relief for the earlier related acts that would otherwise be time barred.”¹⁹⁸ The class action complaints allege a practice of lending discrimination that was the defendants’ standard operating procedure, which means that the continuing violation theory should make the claims of all class members timely.¹⁹⁹ Thus far, all of the trial courts that have reviewed this issue at the pleading stage have agreed.²⁰⁰ The application of the continuing violation theory is also likely to be an on-going point of dispute among the parties. With these issues in mind, we will move on to a discussion of the merits of these cases.

C. Analyzing the Prototypical Impact Case Against a Single Lender

1. Impact Theory under the FHA/ECOA: Overview and Elements

A preliminary issue is whether the FHA and ECOA even include an impact standard. Throughout the history of these statutes, the lower courts

¹⁹⁵ See, e.g., cases cited *infra* notes 197–198, 200. In addition to the continuing violation theory, plaintiffs have asserted other theories that would justify including class members whose loans were obtained beyond the limitations period. See, e.g., *Taylor v. Accredited Home Lenders, Inc.*, 580 F. Supp. 2d 1062, 1066 (S.D. Cal. 2008) (noting, but avoiding decision on, plaintiffs’ discovery and fraudulent concealment theories); *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251, 262–63 (D. Mass. 2008) (discussing, but avoiding decision on, plaintiffs’ discovery theory).

¹⁹⁶ 455 U.S. 363, 380–81 (1982).

¹⁹⁷ See, e.g., ECOA cases cited *infra* note 200; *Davis v. General Motors Acceptance Corp.*, 406 F. Supp. 2d 698, 705–06 (N.D. Miss. 2005) (applying the continuing violation doctrine to ECOA claims alleging racially discriminatory mark-ups on auto loans).

¹⁹⁸ *Cowell v. Palmer Twp.*, 263 F.3d 286, 292 (3d Cir. 2001); accord *Equal Rights Center v. AvalonBay Communities, Inc.*, No. AW-05-2626, 2009 WL 1153397, at *9–10 (D. Md. Mar. 23, 2009); *Wallace v. Chi. Hous. Auth.*, 321 F. Supp. 2d 968, 972–75 (N.D. Ill. 2004); *Hargraves v. Capital City Mortgage Corp.*, 140 F. Supp. 2d 7, 17–19 (D.D.C. 2000), *motion for reconsideration granted in part on other grounds*, 147 F. Supp. 2d 1 (D.D.C. 2001).

¹⁹⁹ There is a contrary view, based on the fact that the continuing violation theory generally requires that continuing unlawful acts—and not merely the continuing consequences of these acts—occur within the limitations period. See, e.g., *Paschal v. Flagstar Bank*, 295 F.3d 565, 572–74 (6th Cir. 2002) (applying this distinction to hold a FHA mortgage discrimination claim untimely); *Robinson v. Argent Mortgage Co.*, No. C-09-2075 MMC, 2009 U.S. Dist. LEXIS 69962 (N.D. Cal. Aug. 11, 2009) (same). See generally *Delaware State College v. Ricks*, 449 U.S. 250, 258 (1980).

²⁰⁰ See *Barrett v. H & R Block, Inc.*, 652 F. Supp. 2d 104, 110–12 (D. Mass. 2009); *Taylor v. Accredited Home Lenders, Inc.*, 580 F. Supp. 2d 1062, 1065–66 (S.D. Cal. 2008); *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251, 261–63 (D. Mass. 2008); *Ramirez v. Green-Point Mortgage Funding, Inc.*, 633 F. Supp. 2d 922, 929–30 (C.D. Cal. 2008); *Garcia v. Countrywide Fin. Corp.*, No. EDCV 07-1161-VAP (JCRx), 2008 U.S. Dist. LEXIS 106675, at *43–44 (C.D. Cal. Jan. 17, 2008).

have consistently upheld impact claims under both laws.²⁰¹ Furthermore, in 1994, the Justice Department, HUD, and eight other federal regulatory agencies took the position that lending practices that produced disparate impacts could result in FHA/ECOA liability.²⁰² Still, the Supreme Court has never endorsed this standard in a FHA or ECOA case, and defendants in modern lending cases invariably raise this issue in their motions to dismiss, arguing that the Court's 2005 decision in an employment-age discrimination case suggests that it would not allow impact-based liability under either the FHA or ECOA.²⁰³ Thus far, this defense has been unanimously rejected by the trial courts, including those in the discretionary pricing cases discussed here.²⁰⁴

²⁰¹ For the FHA, see, e.g., cases cited in SCHWEMM, *supra* note 67, § 10:4, nn.18–35, 41; for the ECOA, see, e.g., Haynes v. Bank of Wedowee, 634 F.2d 266, 269 n.5 (11th Cir. 1981); Smith v. Chrysler Fin. Co., LLC, No. Civ.A. 00-6003(DMC), 2003 WL 328719, at *5–6 (D. N.J. Jan. 15, 2003); cases cited *infra* note 204. See also 12 C.F.R. § 202.6(a) n.2 (2010) (commenting, in the Fed's ECOA regulations, that the ECOA “may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis,” based, *inter alia*, on the fact that the “effects test” doctrine, as developed in Title VII cases, was intended by Congress to “apply to the credit area”); *infra* note 202.

²⁰² See Interagency Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266, 18268–69 (Apr. 15, 1994) [hereinafter U.S. Policy Statement] (noting that a recognized method of proving lending discrimination under the FHA and ECOA is evidence of disparate impact, which was defined as “when a lender applies a practice uniformly to all applicants but the practice has a discriminatory effect on a prohibited basis and is not justified by business necessity”); accord OFFICE OF THE COMPTROLLER OF THE CURRENCY ET AL., INTERAGENCY FAIR LENDING EXAMINATION PROCEDURES ii, iv (2009), available at <http://www.ffiec.gov/PDF/FairLend.pdf>. The 1994 U.S. Policy Statement has been cited by the Justice Department in subsequent litigation in support of the proposition that “a plaintiff may establish a violation of ECOA under a disparate impact theory.” See Brief for the United States as Amicus Curiae Supporting Plaintiffs at 9, Cason v. Nissan Motor Acceptance Corp., 28 Fed. Appx. 392 (6th Cir. 2002) (No. 3-98-0223), available at <http://www.justice.gov/crt/housing/documents/nissan1.php>.

For a list of the ten agencies that joined the U.S. Policy Statement above, see 59 Fed. Reg. 18266 (Apr. 15, 1994). The fact that HUD and Justice joined is particularly significant for purposes of the FHA, because these agencies have FHA enforcement responsibilities, and their interpretations of the statute are therefore entitled to deference by the courts. See SCHWEMM, *supra* note 67, § 7:5.

²⁰³ The argument, based on *Smith v. City of Jackson*, 544 U.S. 228 (2005), is set forth in detail in various defendant-lenders' briefs. See, e.g., Brief in Support of Defendants' Motion to Dismiss Plaintiff's First Amended Complaint at *6-8, Guerra v. GMAC, LLC, 208 WL 5343096 (E.D. Pa. Aug. 25, 2008) (No. 2:08-cv-01297-LDD).

In *Smith*, the Supreme Court held that an impact theory—albeit one less favorable to plaintiffs than Title VII's—is available in cases under the 1967 Age Discrimination in Employment Act, 544 U.S. at 233–41, 43–47, and then went on to rule against the particular claim in this case both because the plaintiffs had failed to identify a specific employment practice that produced a disparate impact and because the defendant had sufficiently justified its challenged behavior under the relevant standard. *Id.* at 241–43.

²⁰⁴ See *Steele v. GE Money Bank*, No. 08 C 1880, 2009 WL 393860, at *3 (N.D. Ill. Feb. 27, 2009); Guerra v. GMAC, LLC, No. 2:08-cv-01297-LDD, 2009 WL 449153, at *2-3 (E.D. Pa. Feb. 20, 2009); *Barrett*, 652 F. Supp. 2d at 108–09; *Hoffman v. Option One Mortgage Corp.*, 589 F. Supp. 2d 1009, 1010–11 (N.D. Ill. 2008); *Taylor*, 580 F. Supp. 2d at 1066-67; *Miller*, 571 F. Supp. 2d at 255–58; *Ramirez*, 633 F. Supp. 2d at 926–29; *Garcia*, 2008 U.S. Dist. LEXIS 106675, at *39-40.

The issue of whether the FHA includes an impact standard goes well beyond the scope of our discussion here because it would apply to a variety of housing discrimination cases in addition to those alleging mortgage discrimination. As a result, we will move on to *how* that impact standard should be applied to the cases alleging discrimination as a result of discretionary pricing in home financing. We will also assume that, whatever the proper liability standards are under the FHA, those same standards would also govern ECOA claims, although we recognize that a particular court might decide to give a broader interpretation to one statute or the other,²⁰⁵ which is presumably why the plaintiffs in the discretionary pricing class actions have made claims under both statutes.²⁰⁶

In consistently interpreting the FHA to include an impact standard, the lower courts have generally agreed that three elements must be considered in analyzing an impact case under the FHA.²⁰⁷ First, the plaintiff must identify a policy or practice of the defendant that is neutral on its face but is shown to have caused a substantially greater negative impact on a protected class than on others. If this is done, then the defendant has the burden of showing that its policy or practice is justified by legitimate business considerations. Finally, whether the defendant can satisfy this burden of justification depends somewhat on whether there exists a less discriminatory alternative that

Other recent decisions involving mortgage discrimination have reached the same conclusion. *See, e.g.*, *NAACP v. Ameriqwest Mortgage Co.*, 635 F. Supp. 2d 1096, 1104–05 (C.D. Cal. 2009); *Nat'l Cmty. Reinvestment Coal. v. Accredited Home Lender Holding Co.*, 573 F. Supp. 2d 70, 76–78 (D.D.C. 2008), *discretionary appeal denied*, 597 F. Supp. 2d 120 (D.D.C. 2008); *Zamudio v. HSBC N. Am. Holdings, Inc.*, No. 07 C 4315, 2008 WL 517138, at *2 (N.D. Ill. Feb. 20, 2008); *see also* *Payares v. JP Morgan Chase & Co.*, No. CV 07-5540 ABC (SHx), 2008 WL 2485592 (C.D. Cal. June 17, 2008) (denying defendants' motion to pursue an interlocutory appeal from ruling that, *inter alia*, upheld plaintiffs' impact-based claims under the FHA and ECOA).

²⁰⁵ For example, the ECOA regulations explicitly recognize that liability may be based on a disparate impact theory. *See supra* note 201 (describing 12 C.F.R. § 202.6(a)(2)). Under the FHA, the impact theory has been uniformly endorsed by the courts, but without the benefit thus far of a regulation from HUD. The presence of such a regulation might be helpful, should this issue ever reach the Supreme Court. *See, e.g.*, *Smith v. City of Jackson*, 544 U.S. at 243–45 (Scalia, J., concurring) (relying on an EEOC regulation to hold, based on *Chevron* deference, that an impact standard is appropriate under the Age Discrimination in Employment Act).

Another potential difference between these two statutes arises from the fact that the ECOA and its implementing regulations seem clear that lenders are liable for their brokers' discrimination, whereas such derivative liability is more of an open question under the FHA. *See supra* notes 177–187 and accompanying text.

²⁰⁶ The ECOA has a provision that bars recovery for conduct that violates both the ECOA and the FHA “based on the same transaction,” *see* 15 U.S.C. § 1691(i) (2009), but this only bars double recovery, not the right of plaintiffs to bring suit under both statutes. *See, e.g.*, *Ameriqwest Mortgage Co.*, 635 F. Supp. 2d at 1105; *Taylor*, 580 F. Supp. 2d at 1069; *Ware v. Indymac Bank*, 534 F. Supp. 2d 835, 840 (N.D. Ill. 2008).

²⁰⁷ *See, e.g.*, *Budnick v. Town of Carefree*, 518 F.3d 1109, 1118 (9th Cir. 2008); *Graoch Associates # 33 v. Louisville/Jefferson County*, 508 F.3d 366, 374 (6th Cir. 2007); *Reinhart v. Lincoln County*, 482 F.3d 1225, 1229 (10th Cir. 2007); *Oti Kaga, Inc. v. S.D. Hous. Dev. Auth.*, 342 F.3d 871, 883 (8th Cir. 2003); *Lapid-Laurel, LLC v. Zoning Bd. of Adjustment of Twp. of Scotch Plains*, 284 F.3d 442, 466–67 (3d Cir. 2002).

would serve the defendant's needs as well as the challenged policy or practice does.²⁰⁸ The same three elements were also identified in the 1994 policy statement issued by HUD, Justice, and eight other federal agencies that regulate mortgage lenders.²⁰⁹ The next section analyzes how these three elements apply to the discretionary pricing class actions.

2. *Three Elements of an Impact-Based Challenge to Discretionary Pricing*

In addressing the three elements of an impact-based challenge to a mortgage lender's discretionary pricing, we first consider, in section 2.a, whether this is the type of policy that may be challenged under the disparate impact theory and whether statistical proof exists to show that this policy has caused a negative impact on minorities. Section 2.b then deals with justifications for this policy and whether less discriminatory alternatives are available.

a. *Discriminatory Impact of the Policy*

i. *Identifying the Policy*

The first step in a disparate impact case is for the plaintiff to identify a defendant's policy or practice that, although neutral on its face, has a more negative impact on minorities than whites. The specific policy being challenged here is discretionary pricing by mortgage lenders, a policy that was

²⁰⁸ With respect to the last two elements, some differences exist in how the appellate decisions have articulated the parties' respective burdens. This matter is further discussed *infra* notes 234–238 and accompanying text.

²⁰⁹ See U.S. Policy Statement, *supra* note 202. The three elements are described in this U.S. Policy Statement as follows:

[P]roof of lending discrimination using a disparate impact analysis encompasses several steps. . . . The existence of a disparate impact must be established by facts. Frequently this is done through a quantitative or statistical analysis. Sometimes the operation of the practice is reviewed by analyzing its effect on an applicant pool; sometimes it consists of an analysis of the practice's effect on possible applicants, or on the population in general. Not every member of the group must be adversely affected for the practice to have a disparate impact. Evidence of discriminatory intent is not necessary to establish that a policy or practice adopted or implemented by a lender that has a disparate impact is in violation of the FH Act or ECOA. . . .

[When] a lender's policy or practice has a disparate impact, the next step is to seek to determine whether the policy or practice is justified by "business necessity." The justification must be manifest and may not be hypothetical or speculative. Factors that may be relevant to the justification could include cost and profitability.

Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be discriminatory if an alternative policy or practice could serve the same purpose with less discriminatory effect.

Id. at 18269.

described earlier.²¹⁰ To repeat the salient points, this is a practice through which mortgage lenders provide financial incentives to their loan officers and brokers to mark up interest rates and add on other charges to home loans, resulting in borrowers paying rates substantially more than they should based on objective credit standards. As Judge Gertner put it in upholding the plaintiffs' claim in the *Countrywide* case:

The "specific and actionable policy" that plaintiffs challenge is Countrywide's discretionary pricing policy, which allows Countrywide's retail salesmen, independent brokers, and correspondent lenders to add various charges and fees based on subjective non-risk factors, and which, in turn, has a racially discriminatory impact on African-American borrowers. . . . Plaintiffs have identified the practice at issue: establishing a par rate keyed to objective indicators of creditworthiness while simultaneously authorizing additional charges keyed to factors unrelated to those criteria.²¹¹

Over two decades ago in *Watson v. Fort Worth Bank and Trust*,²¹² the Supreme Court made clear in the employment discrimination context that subjective or discretionary practices, akin to the defendant-lenders' pricing policies here, are impermissible if they have a disparate impact. According to the *Watson* opinion:

[D]isparate impact analysis is in principle no less applicable to subjective employment criteria than to objective or standardized tests. In either case, a facially neutral practice, adopted without discriminatory intent, may have effects that are indistinguishable from intentionally discriminatory practices If an employer's undisciplined system of subjective decision-making has precisely the same effects as a system pervaded by impermissible and intentional discrimination, it is difficult to see why Title VII's proscription against discriminatory actions should not apply We conclude, accordingly, that subjective or discretionary employment practices may be analyzed under the disparate impact approach in appropriate cases.²¹³

Under *Watson*, disparate impact analysis is applicable to an employer's facially neutral policy that is applied subjectively by those to whom the employer gives authority under the policy. Any other conclusion, the Court reasoned, would permit an entity required to comply with anti-discrimination laws to "insulate" itself from legal responsibility by "refrain[ing] from

²¹⁰ See *supra* notes 119–123 and accompanying text.

²¹¹ *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251, 255–57 (D. Mass. 2008).

²¹² 487 U.S. 977, 990–91 (1988).

²¹³ *Id.*

making standardized criteria absolutely determinative.”²¹⁴ This theory has been accepted in financing cases under the ECOA.²¹⁵

The plaintiffs’ theory in the mortgage cases is that the defendant-lenders’ discretionary pricing policies allowed racial bias to infect their loans. As noted above, numerous studies have demonstrated the adverse impact of discretionary pricing on black and Latino borrowers,²¹⁶ resulting in countless minority families paying thousands of dollars more for their home loans than comparable whites. As Judge Gertner wrote in upholding the plaintiffs’ claim against Countrywide, this is “a classic case of disparate impact,” because “[w]hite homeowners with identical or similar credit scores pay different rates and charges than African-American homeowners, because of a policy that allows racial bias to play a part in the pricing scheme.”²¹⁷

The defendants counter that their discretionary pricing systems do not amount to a sufficiently specific policy or practice for purposes of disparate-impact analysis. They point out that the Supreme Court in *Watson* required that when a defendant “combines subjective criteria with the use of more rigid standardized rules or tests,” the plaintiff must “isolat[e] and identify[] the specific . . . practices that are allegedly responsible for any statistical disparities.”²¹⁸ Thus, according to the defendants, while the Court has allowed disparate-impact challenges to certain subjective employment standards, its decisions do not authorize the plaintiffs’ generalized attack on discretionary pricing in mortgage loans here.²¹⁹

The plaintiffs respond that the defendant-lenders—by designing, disseminating, controlling, implementing, and profiting from the discretionary pricing policies—are indeed being charged with a sufficiently specific pattern of behavior.²²⁰ The lenders created and maintained these pricing systems, thereby allowing and encouraging their loan officers and brokers to carry out a policy that the lenders must have known would result in disproportionately higher charges to minorities.²²¹ Thus far, all of the trial judges

²¹⁴ *Id.* at 990.

²¹⁵ See, e.g., *Smith v. Chrysler Fin. Co.*, No. Civ.A. 00-6003(DMC), 2003 WL 328719, at *5–7 (D. N.J. Jan. 15, 2003); *Jones v. Ford Motor Credit Co.*, No. 00 CIV. 8330(LMM), 2002 WL 88431, at *3–4 (S.D.N.Y. Jan. 22, 2002). As the *Smith* opinion stated: “Subjective applications of neutral underwriting criteria is standardized conduct because the loan originators have the opportunity to use their discretion with respect to each loan application.” *Smith*, 2003 WL 328719, at *7 (quoting *Buycks-Roberson v. Citibank Fed. Sav. Bank*, 162 F.R.D. 322, 332 (N.D. Ill. 1995) (FHA case)).

²¹⁶ See *supra* notes 133–135 and 142–144 and accompanying texts.

²¹⁷ *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251, 254 (D. Mass. 2008).

²¹⁸ *Watson*, 487 U.S. at 994.

²¹⁹ See *id.* at 990; see also *Smith v. City of Jackson*, 544 U.S. 228, 241 (2005) (“it is not enough to simply . . . point to a generalized policy that leads to such an impact. Rather, the [plaintiff] is ‘responsible for isolating and identifying the *specific* . . . practices that are allegedly responsible for any observed statistical disparities.’”) (quoting *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 656 (1989)).

²²⁰ For a description of some of the acts that the defendant-lenders employ to carry out their discretionary pricing policies, see *supra* note 122 and accompanying text and note 181.

²²¹ Once again, Judge Gertner’s opinion in the *Countrywide* case is instructive:

in these cases, in responding to defendants' motions to dismiss, have upheld the claims with respect to the required element of identifying a sufficiently specific policy.²²²

ii. Proof of the Policy's Discriminatory Impact

Assuming that a sufficiently specific practice has been identified, the next step in the disparate impact analysis is for plaintiffs to prove that a defendant's discretionary pricing policy has a more negative impact on minorities than whites. The HMDA data and other reports described earlier show loan-price disparities between minorities and whites for the industry as a whole and for each of the defendant-lenders.²²³ The defendants claim, however, that these reports fail to prove any race-based impact, because, as pointed out earlier, HMDA-based studies cannot, by themselves, prove discrimination; factors other than race or national origin (e.g., credit scores) might account for the disparities.²²⁴

The plaintiffs respond that the HMDA-based studies often *do* control for many objective risk-based differences, and significant racial price disparities still remain.²²⁵ Furthermore, the HMDA data are the best information available to the public; in other words, if the lenders claim that other factors justify their record of giving higher-priced loans to minorities, it is only fair that they be required to produce the evidence supporting this claim. Plaintiffs also note that the discovery phase will provide them with access to each of the defendant's loan files, where additional evidence of the defendants' records of disparate pricing may be revealed.²²⁶ Historically, lenders have claimed that this is proprietary information and have kept it secret from the

Where the allocation of subjective decision-making authority is at issue, the "practice" Countrywide has enacted effectively amounts to the *absence* of a policy, an approach that allows racial bias to seep into the process. Allowing this "practice" to escape scrutiny would enable companies responsible for complying with anti-discrimination laws to "insulate" themselves by "refrain[ing] from making standardized criteria absolutely determinative."

Miller v. Countrywide Bank, N.A., 571 F. Supp. 2d 251, 258 (D. Mass. 2008) (quoting *Watson*, 487 U.S. at 990).

²²² See *Steele v. GE Money Bank*, No. 08 C 1880, 2009 WL 393860, at *3–5 (N.D. Ill. Feb. 27, 2009); *Guerra v. GMAC LLC*, No. 2:08-cv-01297-LDD, 2009 WL 449153, at *4–6 (E.D. Pa. Feb. 20, 2009); *Barrett v. H & R Block, Inc.*, 652 F. Supp. 2d 104, 110 (D. Mass. 2009); *Hoffman v. Option One Mortgage Corp.*, 589 F. Supp. 2d 1009, 1011–12 (N.D. Ill. 2008); *Taylor v. Accredited Home Lenders, Inc.*, 580 F. Supp. 2d 1062, 1067–69 (S.D. Cal. 2008); *Miller*, 571 F. Supp. 2d at 255–61 (D. Mass. 2008); *Ramirez v. GreenPoint Mortgage Funding, Inc.*, 633 F. Supp. 2d 922, 927–28 (N.D. Cal. 2008); *Garcia v. Country Wide Financial Corp.*, No. EDCV 07-1161-VAP (JCRx), 2008 U.S. Dist. LEXIS 106675, at *40–42 (C.D. Cal. Jan. 17, 2008).

²²³ See *supra* notes 133–135 and 139–145 and accompanying texts.

²²⁴ See *supra* notes 136–138 and accompanying text.

²²⁵ See *supra* notes 134–135 and 142–144 and accompanying texts.

²²⁶ *Cf. Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 657–58 (1989) (noting, in response to a perceived objection that the Court was unduly burdening Title VII plaintiffs asserting impact claims, that "liberal civil discovery rules give plaintiffs broad access to employers' records in an effort to document their claims Plaintiffs as a general matter will have the

public. Now that these lawsuits have moved beyond the motion-to-dismiss stage and into discovery, plaintiffs expect to be able to gather further data that will advance their showing of disparate impact (e.g., based on a statistical analysis of each defendant's loan portfolio that will determine whether that lender has indeed charged minority borrowers higher discretionary rates and fees than comparable white borrowers).²²⁷

Defendants point out that, in addition to showing the existence of a specific policy and evidence that minorities received more expensive loans, plaintiffs must prove that this policy *caused* the discriminatory result. Otherwise, as the Supreme Court has noted, the disparate impact theory could "result in [defendants] being potentially liable for 'the myriad of innocent causes that may lead to statistical imbalances.'" ²²⁸ Here, the lenders argue that the required causal link between their discretionary pricing policy and whatever racial disparities exist cannot be shown.²²⁹

Plaintiffs respond that the racial disparities in the defendants' loans did not happen by chance. Rather, they are the direct result of each defendant's adopting and maintaining a discretionary pricing policy that was readily amenable to racial bias, thereby causing minorities to pay more for home loans than comparable whites.²³⁰ Simply put, discretionary pricing inevitably leads to minority borrowers being charged higher rates and fees. Furthermore, the fact that discretionary pricing has a substantial adverse impact on minority borrowers has long been known in the mortgage industry.²³¹ Thus, the defendant-lenders knew, or certainly should have known, that the

benefit of these tools to meet their burden of showing a causal link between challenged employment practices and racial imbalances in the work force").

²²⁷ For more on such statistical analyses, see *infra* notes 254–256 and accompanying text. For examples of mortgage discrimination cases in which discovery was ordered of the defendant's loan files, see *Hurt v. Dime Sav. Bank*, 151 F.R.D. 30 (S.D.N.Y. 1993); *Laufman v. Oakley Bldg. & Loan Co.*, 72 F.R.D. 116 (S.D. Ohio 1976). See also *Noland v. Commerce Mortgage Corp.*, 122 F.3d 551, 553 (8th Cir. 1997) (suggesting that plaintiff was entitled to properly focused discovery of defendant's loan files).

²²⁸ *Smith v. City of Jackson*, 544 U.S. 228, 241 (2005) (quoting *Wards Cove*, 490 U.S. at 657).

²²⁹ See, e.g., *Carpenter v. Boeing Co.*, 456 F.3d 1183, 1198–1204 (10th Cir. 2006) (rejecting Title VII impact claim challenging defendant's supervisors' exercise of discretion on the ground that plaintiffs' evidence failed to establish the required causation because it did not take into account all relevant variables that might explain the admittedly large gender disparities involved in the case).

²³⁰ In addition, as Judge Gertner pointed out in the case against Countrywide, minority borrowers "are more likely than white borrowers to apply for credit from Countrywide through its sub-prime subsidiary, Full Spectrum, or from an authorized broker or correspondent lender, which are on average more expensive than loans obtained directly from Countrywide." *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251, 254 (D. Mass. 2008).

²³¹ See, e.g., studies described *supra* notes 133 and 142–144 and accompanying texts. Knowledge concerning the significant discriminatory impact of commission-driven, discretionary credit-pricing systems has been available to the lending industry for many years, at least since the mid-1990s, as a result of numerous high profile cases brought by the Justice Department. See "Pricing Discrimination" cases discussed in JUSTICE ENFORCEMENT, *supra* note 26, at 5–6; *supra* notes 110–114 and accompanying text.

financial incentives they were offering their loan officers and brokers would result in their steering minorities to loans involving higher rates and fees.²³²

Plaintiffs' allegations concerning the necessary causal element have thus far been upheld. Thus, all of the trial judges in these cases, in responding to defendants' motions to dismiss, have held that the complaints adequately allege that the defendants' discretionary pricing policies have caused a sufficiently negative impact on minorities to satisfy the disparate impact theory.²³³

b. Justifications for the Policy and Less Discriminatory Alternatives

The parties differ as to which side in an impact case has the burden of persuasion on the issue of the defendant's justification and what exactly that justification standard is. The defendant-lenders argue that the parties' respective burdens and the appropriate standard should be governed by the Supreme Court's Title VII decision in *Wards Cove Packing Co. v. Atonio*,²³⁴ under which a defendant "bears only the burden of production, not the burden of persuasion" and an impact-producing practice is "permissible so long as it 'serve[d], in a significant way, the legitimate employment goals of the employer.'" ²³⁵ For their part, the plaintiffs can point to FHA precedents, both before and after *Wards Cove*, holding that, once disparate impact is shown, a defendant may prevail only if it proves that its challenged practice

²³² On the other hand, such knowledge has generally been hidden from the borrowing public. Thus, the plaintiffs in these cases allege that they did not know and reasonably could not have discovered that the defendant-lenders were charging them higher rates or fees than similarly creditworthy whites. See, e.g., Guerra Complaint, *supra* note 158, ¶¶ 83–88. According to the plaintiffs, the defendants actively concealed the fact that their rates and fees were discretionary and that plaintiffs were being assessed higher costs than comparable whites. *Id.* This is another reason why the defendants' efforts to block some of the plaintiff-class members' claims on statute of limitations grounds should fail. See *supra* note 195 and accompanying text. "[T]here is a difference between being aware that you got a bad deal and being aware that you were discriminated against in a systemic fashion." *Barkley v. Olympia Mortgage Co.*, No. 04 CV 875(RJD)(KAM), 2007 WL 2437810, at *17 (E.D.N.Y. Aug. 22, 2007) (quoting *Phillips v. Better Homes Depot, Inc.*, No. 02-CV-1168, 2003 U.S. Dist. LEXIS 27299, at *76–77 (E.D.N.Y. Nov. 12, 2003)).

²³³ See *Steele v. GE Money Bank*, No. 08 C 1880, 2009 WL 393860, at *3–5 (N.D. Ill. Feb. 27, 2009); *Guerra v. GMAC, LLC*, No. 2:08-cv-01297-LDD, 2009 WL 449153, at *4–6 (E.D. Pa. Feb. 20, 2009); *Barrett v. H & R Block, Inc.*, 652 F. Supp. 2d 104, 109–10 (D. Mass. 2009); *Hoffman v. Option One Mortgage Corp.*, 589 F. Supp. 2d 1009, 1011–12 (N.D. Ill. 2008); *Taylor v. Accredited Home Lenders, Inc.*, 580 F. Supp. 2d 1062, 1067–69 (S.D. Cal. 2008); *Miller*, 571 F. Supp. 2d at 255–61; *Ramirez v. GreenPoint Mortgage Funding, Inc.*, 633 F. Supp. 2d 922, 927–28 (N.D. Cal. 2008); *Garcia v. Countrywide Fin. Corp.*, No. EDCV 07-1161-VAP (JCRx), 2008 U.S. Dist. LEXIS 106675, at *40–42 (C.D. Cal. Jan. 17, 2008).

²³⁴ 490 U.S. 642, 657 (1989). Congress changed the *Wards Cove* standards for purposes of Title VII in the Civil Rights Act of 1991, Pub. L. No. 102–166, 105 Stat. 1071 (1991), but that statute "did not amend [other civil rights laws] or speak to the subject of [lending discrimination]." *Smith v. City of Jackson*, 544 U.S. 228, 240 (2005). Thus, the lenders argue, *Wards Cove* remains the controlling precedent in FHA/ECOA impact litigation.

²³⁵ *Ricci v. DeStefano*, 129 S.Ct. 2658, 2698 (2009) (Ginsburg, J., dissenting) (quoting *Wards Cove*, 490 U.S. at 659).

is justified by “business necessity.”²³⁶ In fact, the FHA appellate decisions, while generally eschewing the *Wards Cove* standards, have often used different phrases in dealing with these points from circuit to circuit.²³⁷ Therefore, it seems likely that the individual trial courts in the various mortgage class actions will simply follow whatever position has been adopted in prior FHA cases by their respective courts of appeals.²³⁸

As for the substance of these matters, the defendant-lenders have not yet been called upon to articulate a rationale for why they use discretionary pricing, but we presume that, once this happens, their reasons will all relate to competition of one form or another. First, an individual lender would claim to be at a competitive disadvantage if it were forced to abandon discretionary pricing on its own, because it could not compete for potential borrowers who are offered more attractive terms from a competing lender.²³⁹ All such business would presumably be lost, a result that would not only harm the lender, but also would mean that borrowers would be deprived of the opportunity to secure more favorable loans through price competition among lenders. Another type of competitive disadvantage for a lender forced to give up discretionary pricing unilaterally would be its inability to retain loan officers, who would be tempted to move to other companies that continue to use this practice and thus might offer them better compensation.

Plaintiffs respond that the history of civil rights enforcement is replete with claims by companies using discriminatory practices that they would suffer a competitive disadvantage if they were required to stop discriminating.²⁴⁰ This claim has generally been highly exaggerated, and, in any event, it cannot be allowed to justify ongoing discrimination.

²³⁶ See, e.g., *Pfaff v. HUD*, 88 F.3d 739, 747 (9th Cir. 1996); *Mountain Side Mobile Estates P’ship v. HUD*, 56 F.3d 1243, 1254 (10th Cir. 1995); *Betsey v. Turtle Creek Ass’ns.*, 736 F.2d 983, 988 (4th Cir. 1984); see also *supra* note 202.

²³⁷ See SCHWEMM, *supra* note 67, § 10:6 nn.15–19 and accompanying text; *infra* note 238.

²³⁸ The class action cases are pending in the First, Third, Seventh, and Ninth Circuits. See *supra* notes 159–166. The governing FHA precedents in these circuits are provided, respectively, by: *Langlois v. Abington Hous. Auth.*, 207 F.3d 43, 51 (1st Cir. 2000) (“a demonstrated disparate impact in housing [must] be justified by a legitimate and substantial goal of the measure in question”); *Betsey*, 736 F.2d at 988 (adopting “business necessity” standard); *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1290 (7th Cir. 1977) (adopting multi-factor approach to FHA impact cases); and *Pfaff*, 88 F.3d at 747 (adopting “business necessity” standard for most FHA cases). To the extent that these courts have ruled on the issue of which party has the burden of persuasion on this issue, they have put this burden on the defendant. See, e.g., *Betsey*, 736 F.2d at 988; *Salute v. Stratford Greens Garden Apts.*, 136 F.3d 293, 302 (2d Cir. 1998).

²³⁹ Similarly, with respect to broker-initiated loans, individual lenders claim they cannot require their affiliated brokers to abandon discretionary pricing, because these brokers would simply take their customers to other lenders.

²⁴⁰ See, e.g., *Vill. of Bellwood v. Dwivedi*, 895 F.2d 1521, 1530–31 (7th Cir. 1990) (noting, in an opinion by Judge Posner, that a merchant who refuses to hire blacks not out of personal prejudice but in response to others’ threatened action (e.g., customers’ threats to take their business elsewhere if blacks are hired) is nevertheless engaged in intentional discrimination in violation of Title VII and applying this principle to FHA cases involving racial steering).

There is good reason to believe that this fear is not well-founded in the mortgage industry. The fact is that some lenders have now eliminated discretionary pricing.²⁴¹ If they can do it without suffering severe economic consequences, then the individual defendants in the class action cases can too. Because the system of discretionary pricing is inherently discriminatory against minority borrowers, it should be eliminated entirely. If this cannot be done industry-wide, then it should be done lender-by-lender. Thus, according to the plaintiffs, while the defendants in these cases may be able to “articulate” some reasons for continuing to employ discretionary pricing, there are ready alternatives that would produce significantly less discrimination. This means under traditional disparate impact analysis, the defendants have violated the FHA and ECOA.²⁴²

D. Summary and Anticipated Results

The class action cases challenging discretionary pricing are exploring new ground. As far as we can tell, no discriminatory lending case based on the disparate impact theory has ever gone to trial. Indeed, even with respect to intent-based lending cases under the FHA, only a small number have been tried, and few of these have been successful.²⁴³ As noted earlier, for plaintiffs to prevail in a FHA lending case, they generally must show that the defendant has given more favorable loans to “comparable” white borrowers than to the minority plaintiffs.²⁴⁴ Defendants in these cases invariably offer

²⁴¹ See, e.g., Stipulation and Agreement of Settlement ¶ 3.6.b–c, *Allen v. Decision One Mortgage*, No.1:07-cv-11669-GAO (D. Mass. Nov. 27, 2009) [hereinafter *Decision One Settlement*] (on file with author) (stipulating that HSBC and its mortgage subsidiaries have not allowed discretionary pricing in their in-house loans since January 1, 2004).

²⁴² See *supra* notes 208–209 and accompanying text.

²⁴³ See *supra* notes 69–74 and accompanying text; cases cited *infra* note 244.

²⁴⁴ See *supra* notes 72–74 and accompanying text. Most intent-based lending cases under the FHA have been analyzed under the prima facie case approach, in which a key first step is for the minority plaintiff to show that the defendant-lender treated similarly situated white borrowers more favorably than the plaintiff. See, e.g., *Boykin v. Bank of Am. Corp.*, 162 Fed. Appx. 837, 839–40 (11th Cir. 2005); *Hood v. Midwest Sav. Bank*, 95 Fed. Appx. 768, 778–79 (6th Cir. 2004); *Rowe v. Union Planters Bank of Se. Mo.*, 289 F.3d 533, 535 (8th Cir. 2002); *Noland v. Commerce Mortgage Corp.*, 122 F.3d 551, 553 (8th Cir. 1997). This step usually requires an analysis of the defendant’s loan files showing that whatever racial disparities exist are not readily explainable by legitimate factors. *Id.* If a prima facie case is thus established, the burden shifts to the defendant to articulate a legitimate reason for the race-based disparities. See, e.g., *Boykin*, 162 Fed. Appx. at 839. Legitimate reasons may exist, see, e.g., *id.* at 840, although a lender will be hard pressed to provide them if it has not kept good records that justify the reasons for its loan-pricing decisions. See, e.g., *Simms v. First Gibraltar Bank*, 83 F.3d 1546, 1551 (5th Cir. 1996) (observing that the defendant’s lack of a “contemporaneous written record of its handling of [plaintiffs’ refinancing] proposal or its reasons for the rejection” meant that it had to rely exclusively on its loan officer’s memory and credibility). This justification stage essentially gives the defendant a second opportunity to offer legitimate explanations for its racial price disparities. If the defendant fails to produce a legitimate justification or if the justification offered is shown to be pretextual, then intentional discrimination may be found. See, e.g., *Boykin*, 162 Fed. Appx. at 839.

non-racial reasons why the selected white borrowers' credit profiles were different enough to justify better treatment.²⁴⁵

Thus, while the impact theory of the class action plaintiffs in the current mortgage cases appears sound—as demonstrated by the fact that all trial courts to consider this claim have denied the defendant-lenders' motions to dismiss²⁴⁶—difficult issues of proof remain.²⁴⁷ The pre-trial stage will require substantial discovery, some of which is likely to be contentious.²⁴⁸ When discovery finally ends, each defendant-lender is likely to move for summary judgment. Given the trial courts' prior rulings at the motion-to-dismiss stage and pursuant to the law-of-the-case doctrine,²⁴⁹ the defendants will not be able to challenge the plaintiffs' use of the impact theory nor the fact that the defendants' discretionary pricing policies are an appropriate target for this theory.²⁵⁰ Each will, however, claim that the plaintiffs' evidence is insufficient to establish that illegal race or national origin discrimination has occurred in its loans as a result of this policy.²⁵¹

An examination of some earlier mortgage and car-finance cases suggests how this argument will unfold. The starting point for evaluating evi-

²⁴⁵ See, e.g., *Boykin*, 162 Fed. Appx. at 840; *Rowe*, 289 F.3d at 535; *Noland*, 122 F.3d at 553; case described *supra* notes 72–74.

²⁴⁶ See *supra* notes 222, 233 and accompanying texts.

²⁴⁷ In addition, as noted *supra* Part III.B.3, the cases also present difficult procedural issues, particularly those involving class-action certification. The defendant-lenders will surely oppose class certification, see, e.g., *Decision One Settlement*, *supra* note 241, ¶ 3.1, and the trial courts are required to decide this issue at “an early practicable time.” See FED. R. CIV. P. 23(c)(1)(A). Indeed, in earlier ECOA-based challenges to discretionary pricing in car loans—which in some ways have served as a model for the current mortgage cases—the class certification issue was not only hotly contested, but resulted in two interlocutory appeals. See *Coleman v. General Motors Acceptance Corp.*, 296 F.3d 443 (6th Cir. 2002) (described *supra* note 193) and *Cason v. Nissan Motor Acceptance Corp.*, 28 Fed. Appx. 392 (6th Cir. 2002) (decision on remand described *supra* note 193), both of which had to be litigated before these cases were ultimately settled. See *infra* note 261 and accompanying text.

²⁴⁸ See, e.g., *In re Wells Fargo Residential Mortgage Lending Discrimination Litig.*, No. C 08-1930 MMC (JL), 2009 WL 1578920, at *1 (N.D. Cal. June 4, 2009) (ruling on defendant's claims that various types of privilege justify its refusal to allow discovery of thousands of pages of documents relating to its loan files and methodologies); *In re Wells Fargo Residential Mortgage Lending Discrimination Litig.*, No. M:08-CV-1930 MMC, 2009 WL 1858022, at *1 (N.D. Cal. June 29, 2009) (denying defendant's motion to compel discovery regarding plaintiffs' credit history and “real estate sophistication”); Joint Discovery Report Pursuant to FED. R. CIV. P. 26(f) at *2-5, No. 1:07 CV-11275-RGS, 2008 WL 792075 (D. Mass. Mar. 14, 2008) (describing various disputed points regarding discovery).

²⁴⁹ The law-of-the-case doctrine “posits that when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages of the same case.” *Arizona v. California*, 460 U.S. 605, 618 (1983). The subsequent stages of litigation covered by this doctrine include when “[a] trial court [rules] on a matter of law and then the same legal question [is] raised a second time in the same trial court.” Allan D. Vestal, *Law of the Case: Single-Suit Preclusion*, 11 UTAH L. REV. 1, 4 (1967). Thus, under this doctrine, “a district court's discretion to reconsider its own decisions is limited, at least absent an intervening change of law, to circumstances in which new evidence is available, an error must be corrected, or manifest injustice would otherwise ensue.” *Stichting Ter Behartiging Van De Belangen v. Schreiber*, 407 F.3d 34, 44 (2d Cir. 2005).

²⁵⁰ See, respectively, *supra* notes 204, 222 and accompanying texts.

²⁵¹ See *supra* notes 136–138, 228–229 and accompanying texts.

dence of discrimination in virtually all prior lending cases has been a statistical analysis of the particular defendant's loan files.²⁵² Based on HMDA data and related studies, the plaintiffs in the current class actions will probably be able to show that each of the defendant-lenders has charged minorities more for their mortgages than it has whites.²⁵³ The defendants will counter that these disparities are explainable by non-racial factors, such as differences in the borrowers' credit scores.

Each side will no doubt hire experts to do regression analyses on the defendants' loan files to support their respective positions. This type of loan-file analysis has been used in FHA lending cases since at least the mid-1990s.²⁵⁴ A modern example of this technique occurred in a recent case against Wells Fargo that is described in a 2009 article by the plaintiffs' lawyer.²⁵⁵ Similar expert testimony was presented in the car-finance cases.²⁵⁶

²⁵² See *supra* notes 73–75, 248 and accompanying texts.

²⁵³ See *supra* notes 133–135, 139–145 and accompanying texts.

²⁵⁴ See, e.g., *Proposals to Enhance the Community Reinvestment Act: Hearing Before the H. Financial Servs. Comm.*, 111th Cong. 28 (2009) (testimony of John Taylor, President and CEO of the Nat'l Cmty. Reinvestment Coal.), available at http://financialservices.house.gov/hearings_all.shtml (noting that "the Federal Reserve Bank of Richmond conducted matched file reviews of more than 300 loan applications in a CRA exam dated January 1996 of Signet Bank").

For a critique of the use of regression analysis in civil rights cases as being inferior to more recently developed statistical techniques, see D. James Greiner, *Causal Inference in Civil Rights Litigation*, 122 HARV. L. REV. 534 (2008).

²⁵⁵ See White, *supra* note 46, at 694–98. Here, the author, now a law professor, describes in detail the conflicting expert reports submitted in the case, *Walker v. Wells Fargo Bank, N.A.*, No. 05-cv-666 (E.D. Pa. dismissed pursuant to settlement Feb. 29, 2008), which involved allegations of both intent- and impact-based discrimination in the defendant's pricing of mortgage loans. Professor White notes that the defendant's expert used regression analysis to evaluate "whether legitimate business factors could adequately explain the disparities in pricing between all black and all white borrowers in Wells Fargo's portfolio," with the expert finding, unsurprisingly, that "credit scores and debt-to-income ratios were the major drivers of interest rates, and race was not a statistically significant factor." *Id.* at 696. This expert initially limited her analysis to a subset of Wells Fargo loans that the defendant had identified "as belonging to a channel, i.e., its wholesale lending division, and within that division, to a product category known as Home Credit Solutions." *Id.* at 696–97. In response to the plaintiff's expert's criticisms of this narrow focus, the defendant's expert submitted a second report dealing with a wider set of the defendant's loans, which, again, concluded that the race-based price disparities could be explained almost entirely on the basis of the borrowers' credit scores and other legitimate variables. *Id.* at 697.

This case was settled before the court could evaluate these conflicting expert reports. *Id.* at 695. Still, Professor White concludes the discovery was revealing in that it showed "that within a large financial institution such as Wells Fargo, mortgage prices for borrowers with similar credit scores and qualifications vary widely according to channels and products." *Id.* at 698. He notes that lenders like Wells Fargo could conceivably "offer cost-driven business justifications for charging different prices for loans made through different channels," *id.*, but concludes that it would be difficult for such a lender to justify "selling the same product . . . at different prices [just by] using different names." *Id.*

²⁵⁶ See, e.g., Reports of Dr. Mark A. Cohen (for plaintiffs) and Dr. Laurentius Marais (for defendants), referred to in Brief of Defendants Regarding Proposed Remedy, *Borlay v. Primus Auto. Fin. Serv., Inc.*, No. 3-02-0382, 2005 WL 4132590 (M.D. Tenn. 2005); Report of Dr. Calvin P. Bradford (for plaintiffs) in *Borlay v. Primus Auto. Fin. Serv., Inc.* (on file with author).

At the summary judgment stage, therefore, each side will have presented expert reports contending, respectively, that legitimate factors do or do not explain the defendants' race-based price disparities. The existence of conflicting expert testimony suggests that the defendants will have a hard time convincing the courts that summary judgment is appropriate,²⁵⁷ even though the plaintiffs bear the ultimate burden of persuasion on the issue of whether illegal discrimination has been shown.²⁵⁸

We cannot predict how the various trial judges will rule on the defendants' summary judgment motions. Given that the evidence will differ somewhat in each defendant-lender's case,²⁵⁹ it is certainly possible that some courts will deny summary judgment, while others may grant it. A denial is a non-appealable order, which means these cases would then be ready for trial. Conversely, a ruling in favor of summary judgment would end the case in the defendant's favor at the trial court level, and would presumably result in the plaintiffs filing an appeal. This would provide the appellate court with an opportunity to rule, in a case of first impression, on the nature of the evidence required to support an impact-based lending case under the FHA. As a result, a potential Supreme Court case might well be in the making.

Regardless of how the summary judgment motions are decided, the most likely result for all of these cases is that, like most civil litigation in federal court,²⁶⁰ they will be settled. Although these class actions are certainly not run-of-the-mill cases, it is instructive that their close cousins in the car-finance field were all settled before trial.²⁶¹ If, indeed, this is also the

²⁵⁷ Summary judgment in federal court is appropriate only when the discovery and other materials on file in the case "show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." FED. R. CIV. P. 56(c). "[T]he substantive law will identify which facts are material," and "a material fact is 'genuine' . . . if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). Thus, summary judgment should be denied if the key factual issues "may reasonably be resolved in favor of either party"; that is, if "reasonable minds could differ as to the import of the evidence." *Id.* at 250.

²⁵⁸ *See, e.g.*, *Budnick v. Town of Carefree*, 518 F.3d 1109, 1118–19 (9th Cir. 2008); *Reinhart v. Lincoln County*, 482 F.3d 1225, 1229–32 (10th Cir. 2007); *Simms v. First Gibraltar Bank*, 83 F.3d 1546, 1555–56 (5th Cir. 1996).

²⁵⁹ Presumably, despite the similarities in their discretionary pricing policies, the defendant-lenders did not all behave the same way towards blacks and Latinos in pricing their loans. *See, e.g.*, *JAKABOVICS & CHAPMAN*, *supra* note 135, at 2 (identifying, for each of fourteen major mortgage lenders, substantially different rates of providing higher-priced loans among various racial groups); *PAYING MORE*, *supra* note 51, at 3 (identifying Wells Fargo as having the highest black/white disparity ratio among seven major lenders studies and HSBC as having the largest Latino/white disparity ratio).

²⁶⁰ *See* ADMIN. OFFICE OF THE U.S. COURTS, FEDERAL JUDICIAL CASELOAD STATISTICS: MARCH 31, 2008 Table C-4 (2008), <http://www.uscourts.gov/caseload2008/tables/CO4Mar08.pdf> (noting that, of all civil cases terminated in the U.S. District Courts in the year ending March 31, 2008, only 4.1% reached the trial stage, with the figure being even smaller (1.3%) for civil rights cases of the kind involved here).

²⁶¹ *See, e.g.*, *Claybrooks v. Primus Auto. Fin. Services, Inc.*, 363 F. Supp. 2d 969, 972 (M.D. Tenn. 2005) (referring to the settlement in *Cason v. Nissan Motor Acceptance Corp.* (case described *infra* notes 193 and 247)); Memorandum of Plaintiff in Support of Final Ap-

ultimate fate for the mortgage cases,²⁶² then the plaintiffs will presumably achieve some, but not all, of their litigation goals.²⁶³ Furthermore, the opportunity for judicial guidance beyond that provided by the trial courts' decisions will be lost.

These class action cases have already accomplished much of what they originally sought in terms of injunctive relief, in that some of the defendant-lenders have now abandoned their discretionary pricing policies and others may soon be forced to do so by regulatory changes.²⁶⁴ Whether the individual minority plaintiffs who have been victimized by the defendants' alleged discrimination will ultimately be compensated through these cases is harder to predict. Apart from the possibility of settlement, the plaintiffs could only achieve this result by prevailing on a long and daunting list of procedural and substantive issues. Given the defendant-lenders' vast litigation resources, and thus the likelihood of their seeking full appellate review on all key issues resolved against them at the trial-court level, it would seem that the plaintiffs would need many years and a few breaks along the way to achieve ultimate success on the merits.

Still, continuing prosecution of this litigation seems eminently worthwhile. One reason is that it is likely to produce a wealth of heretofore non-public data concerning how the individual defendant-lenders priced their loans.²⁶⁵ In addition, the guidance that would result from judicial decisions in these cases might be helpful in clarifying the law and/or in indicating the need for corrective amendments to the FHA and other civil rights statutes.

IV. OTHER IDEAS FOR REFORM BEYOND LITIGATION

In this part, we provide some broader thoughts on the class action cases discussed in Part III and look beyond this particular litigation to consider non-litigation reforms necessary to ensure that discrimination in the home-finance industry can be reduced in the future. The class actions are challenging mortgage practices whose discriminatory results have continued to block our Nation's promise, implicit in the Thirteenth Amendment and explicit in our civil rights laws, that "a dollar in the hands of a Negro will purchase the

proval of Settlement, *Smith v. Chrysler Fin. Co.*, Civil Action No. 00-CV-6003 (DMC), 2005 WL 3172009 (D. N.J. Sept. 29, 2005).

²⁶² At least one of these cases has already resulted in a settlement agreement, approval of which is currently pending before the court. *See* Decision One Settlement, *supra* note 241.

²⁶³ For a description of the relief originally sought by the plaintiffs, *see supra* notes 188–189 and accompanying text.

²⁶⁴ *See infra* notes 270–272 and accompanying text.

²⁶⁵ *See supra* notes 226–227, 254–256 and accompanying texts. This is not guaranteed, however, in light of the fact that much of modern discovery in large civil rights cases is subject to protective orders that prohibit public disclosure of what thereby becomes viewed as confidential information. *See generally* *Bond v. Utreras*, 585 F.3d 1061 (7th Cir. 2009) (rejecting efforts by a journalist and public officials to gain access to such information in a settled § 1983 action alleging police misconduct).

same thing as a dollar in the hands of a white man.”²⁶⁶ With credit policies vastly under-regulated in the past decade, mortgage lenders exploited the American dream of homeownership by charging a premium to minority borrowers because they could get away with it. This exploitation is just as wrong—and should be just as illegal—as redlining and other blatant forms of mortgage discrimination.²⁶⁷

The financial exploitation of minority consumers is nothing new in our society. When government fails to act to remedy this exploitation, private litigation has often paved the way for reform.²⁶⁸ This is the tradition in which the lending discrimination cases fit. The fact that some large mortgage lenders have now eliminated discretionary pricing shows that this litigation effort is succeeding.

As noted above, lenders claim they would face competitive problems in eliminating the practice of discretionary pricing on an individual basis,²⁶⁹ which suggests that a solution should be industry-wide. Indeed, on August 26, 2009, the Federal Reserve Board published a proposed set of regulations that will have the effect of banning most forms of discretionary pricing.²⁷⁰ This new rule would prohibit mortgage lenders from compensating brokers

²⁶⁶ Over forty years ago, in the same year that the FHA was passed, the Supreme Court, in upholding the constitutionality of another federal statute that also guarantees equal property rights, stated:

Negro citizens, North and South, who saw in the Thirteenth Amendment a promise of freedom—freedom to “go and come at pleasure” and to “buy and sell when they please”—would be left with “a mere paper guarantee” if Congress were powerless to assure that a dollar in the hands of a Negro will purchase the same thing as a dollar in the hands of a white man. At the very least, the freedom that Congress is empowered to secure under the Thirteenth Amendment includes the freedom to buy whatever a white man can buy, the right to live wherever a white man can live. If Congress cannot say that being a free man means at least this much, then the Thirteenth Amendment made a promise the Nation cannot keep.

Jones v. Alfred H. Mayer Co., 392 U.S. 409, 443 (1968) (quoting legislative history of that part of the 1866 Civil Rights Act that is now codified at 42 U.S.C. § 1982).

²⁶⁷ For a discussion of redlining and other such blatantly discriminatory practices, see *supra* Part II.C.1.

²⁶⁸ Private enforcement of the FHA has resulted, over time, in curbing such discriminatory tactics as restrictive covenants, blockbusting, and discriminatory zoning regulations. See private cases cited in SCHWEMM, *supra* note 67, at, respectively, § 3:3 nn.4, 9, 17 (restrictive covenants), § 17:2 nn.6, 8, 14 (blockbusting), and § 13:9 nn.14 and § 13:10 nn.2–5 (discriminatory zoning); cf. cases cited *supra* notes 128, 261 (private ECOA litigation challenging discriminatory markups charged by car-finance companies). For a recent example of how private litigation can—and was needed to—prompt federal agencies to take steps to prevent systematic violations of the FHA, see Sam Roberts, *Westchester County Agrees to Desegregate Housing in Mostly White Towns*, N.Y. TIMES, Aug. 11, 2009, at A14 (describing the settlement in the case of *United States ex rel. Anti-Discrimination Center of Metro New York, Inc. v. Westchester County*, 668 F. Supp. 2d 548 (S.D.N.Y. 2009)).

²⁶⁹ See *supra* note 239 and accompanying text.

²⁷⁰ See Truth in Lending, Regulation Z Amendment Proposal, 74 Fed. Reg. 43232 (proposed Aug. 26, 2009). The comment period for these new rules closed December 24, 2009. *Id.* at 43232.

and loan officers based on a loan's terms or conditions,²⁷¹ thereby eliminating both "yield spread premiums" on broker-initiated loans and "overages" on in-house loans.²⁷² The Fed proposal would not eliminate all pricing discretion,²⁷³ but it would remove some of the incentives for loan-originators to impose higher prices.

Eliminating the practice of discretionary pricing on an industry-wide, rather than an individual, basis would be the preferred solution. Statutory and regulatory changes, such as the Fed's proposal, may help eliminate the temptation of some lenders to extract larger profits from the more vulnerable segments of our society. Regulatory reform, however, is not a substitute for—but rather should go hand in hand with—private enforcement of existing civil rights laws.

One clear lesson from the recent housing crisis is that self-regulation by the mortgage lending industry is not sufficient. The temptation to make quick and large profits off an unsuspecting public in the multi-trillion-dollar home-finance market can be too great for many to resist. Some subprime lenders and their predatory practices may have disappeared, but they—or others like them—will soon return if the threat of effective litigation, as well as regulation, does not exist.²⁷⁴

Now that the Nation has entered a period of restrictive credit, mortgage lenders may find it easy to eschew discretionary pricing, but the class actions are intended to make an impression that will also last through times of plenty. Hopefully, verdicts and/or consent orders in these cases, coupled with regulatory reforms, will help ensure that future innovative credit practices are applied equally to consumers of all races and national origins.²⁷⁵

²⁷¹ See *id.* at 43233, 43279–85, 43331–32 (proposing new 12 C.F.R. § 226.36(d)(1)). As used here, a loan's "terms or conditions" include "the interest rate, annual percentage rate, or the existence of a prepayment penalty." *Id.* at 43283. Compensation for loan originators could, however, be based on "the originator's loan volume, the performance of loans delivered by the originator, or hourly wages." *Id.*

The new regulations would also prohibit mortgage brokers and loan officers from steering consumers "to transactions that are not in their interest in order to increase the mortgage broker's or loan officer's compensation." *Id.* at 43233; see also *id.* at 43285–86, 43332–33 (proposing new 12 C.F.R. § 226.36(d)(1) or (e)(1)).

²⁷² For descriptions of "yield spread premiums" and "overages," see, respectively, *supra* note 121 and notes 110–113 and accompanying text.

²⁷³ For example, the Fed proposal recognizes "that loan originators may need to expend more time and resources in originating loans for consumers with limited or blemished credit histories" and thus paying "an originator based on the time expended would be permissible under the proposed rule." Truth in Lending, *supra* note 270, at 43283.

²⁷⁴ There is evidence that such predatory lenders may already be returning, with some now claiming to be helpful "advisors" to homeowners in need of mortgage work-outs, foreclosure rescues, or other types of credit counseling. See, e.g., Peter S. Goodman, *Cashing In, Again, on Risky Mortgages: Subprime Brokers Resurface as Dubious Loan Fixers*, N.Y. TIMES, July 20, 2009, at A1; Carrick Mollenkamp, *Subprime Resurfaces As Housing-Market Woe*, WALL ST. J., July 9, 2009, at C1.

²⁷⁵ Responsible innovations in home financing should be encouraged in order to provide opportunities for borrowers with blemished credit. This must be done, however, with a strong emphasis on equality and transparency. Neutral policies employed by lenders must be validated to ensure that they are related to credit risk and have no unreasonable discriminatory

Attacking the discrimination problems posed by discretionary pricing can be difficult,²⁷⁶ but we must remember that these problems are only one part of the complex mosaic of discrimination that blacks and Latinos face in the home-finance process. Just as lenders have often steered individual minority borrowers to worse loans than their credit records justify, so too have they regularly targeted minority neighborhoods for predatory loans. Moreover, as credit becomes tighter, a new era of discriminatory loan refusals, not merely price discrimination, may re-emerge. These types of intent-based discriminatory practices are clearly illegal,²⁷⁷ but it remains an open question whether private litigation challenging them is able to achieve anything more than sporadic and individualized relief.²⁷⁸

impact. *See, e.g.,* TEMKIN ET AL., *supra* note 23, at 48; *cf.* 29 C.F.R. § 1607 (2009) (EEOC's employment discrimination guidelines). When a discriminatory impact is found, less discriminatory alternatives must be explored. And all of this should be done *before* the practice is imposed on an unsuspecting public.

²⁷⁶ It was easier to detect discrimination when a common set of underwriting rules was embraced with small deviations by all lenders. It is far more difficult to do so when lenders underwrite using very different rules, at a wide range of prices based on the experience of their own loan portfolios, and on the basis of particular loan conditions and terms. Detecting patterns of unfair or discriminatory treatment on the basis of price, fees, terms, and conditions occurs in the complicated context of an industry that has yet to agree on common practices and prices. It also raises the important question of whether a geographically segmented and differentiated strategy for originating and servicing loans in underserved markets may constitute unfair treatment in and of itself. BELSKY & ESSENE, *supra* note 31, at 26.

²⁷⁷ *See, e.g.,* Jackson v. Novastar Mortg. Inc., 645 F. Supp. 2d 636, 646–47 (W.D. Tenn. 2007) (upholding FHA and ECOA claims based on intentional discrimination in targeting minorities and minority neighborhoods for high priced loans); Simms v. First Gibraltar Bank, 83 F.3d 1546 (5th Cir. 1996) (discussed *supra* notes 72–73 and accompanying text); underwriting cases described *supra* notes 77–78 and accompanying text.

²⁷⁸ Another issue we have not addressed is whether the credit models used to implement “risk-based” pricing, *see supra* text notes 121, 123 and accompanying text, are fair to minority borrowers. These models rely on computer programs written by human beings who inevitably have their own biases, and the controlling factors written into these programs are generally kept secret from the public. Under these circumstances, there is no guarantee that risk-based pricing—which the class action cases challenging discretionary pricing have assumed are “objective” and therefore non-discriminatory—does, in fact, treat racial and ethnic minorities as well as whites. *See, e.g.,* Zamudio v. HSBC North Am. Holdings Inc., No. 07 C 4315, 2008 WL 517138, at *1–2 (N.D. Ill. Feb. 20, 2008) (upholding FHA/ECOA-based complaint alleging that mortgage lender’s “automated underwriting and credit scoring systems . . . have a discriminatory impact on minority mortgage applicants” due to “discriminatory assumptions . . . embedded in the statistical formulas used to analyze credit information and ultimately form underwriting decisions”); TEMKIN ET AL., *supra* note 23, at 47–48 (advising HUD to monitor automated underwriting systems to determine if they have a disproportionate adverse effect on protected classes of borrowers); White, *supra* note 46, at 698, 702–05 (concluding that one of the “potential culprits in racial mortgage price disparities” —in addition to lenders’ price-discretion policies—is “the fundamental question of the validity of the risk-based pricing models themselves” and describing flaws in some of these models); *cf.* Ojo v. Farmers Group, Inc., 600 F.3d 1205 (9th Cir. 2010) (en banc) (per curiam) (upholding, subject to possible McCarran-Ferguson Act preemption, FHA-based complaint alleging that defendant-insurance companies used a number of undisclosed factors in their credit-scoring system that disparately impact minorities); Lumpkin v. Farmers Group, Inc., No. 05-2868 Ma/V, 2007 WL 6996584, at *4 (W.D. Tenn. Apr. 26, 2007) (upholding class action complaint alleging that credit scoring system used by defendant to set its home-insurance rates had a disparate impact on minorities in violation of the FHA).

As for non-litigation ideas for reform, we would start by criticizing the federal agencies that are charged with regulating mortgage lenders. From a civil rights perspective, their performance over the past decade has been appalling. In particular, the Federal Reserve, which knew from its own studies as early as 2005 of large-scale discrimination in home-loan pricing,²⁷⁹ did virtually nothing to effectively challenge this discrimination. The Fed may simply be incapable of enforcing its civil rights mandate because it is primarily concerned with monetary policy and lenders' financial soundness.²⁸⁰ We therefore support pending legislation that would create a new federal Consumer Financial Protection Agency and provide it with a strong civil rights mandate.²⁸¹ Additional legislative changes being considered by the current Congress might also help improve federal oversight of the mortgage industry.²⁸² Regardless of which agencies are involved, there is no reason why federal regulators should continue to allow mortgage lenders to keep secret their data concerning race and national origin disparities in their loan prices.²⁸³ The failure to make such information public seems to be at the

²⁷⁹ See *supra* note 134 and accompanying text.

²⁸⁰ According to a former member of the Fed's Consumer Advisory Council: "I would hear Federal Reserve staff talk about serving their 'clients.' I initially thought clients meant the taxpayers but then I was shocked to learn that clients meant banks that were 'members' of the Federal Reserve System." *Taylor Testimony, supra* note 141, at 2; see also *id.* at 16 (quoting two former Federal Reserve governors as doubting that a central bank designed to regulate financial institutions can also effectively perform consumer-protection duties); *Community and Consumer Advocates' Perspective on the Obama Administration's Financial Regulatory Reform Proposals: Hearing Before the H. Financial Servs. Comm.*, 111th Cong. 2 n.2 (2009), (testimony of Nancy Zirkin, Executive Vice President of the Leadership Conference on Civil Rights), available at http://financialservices.house.gov/hearings_all.shtml (describing how then-Fed Chairman Alan Greenspan rebuffed efforts by fellow-governor Edward Gramlich to have the Fed take action against the growing danger of risky mortgages, as an example of the refusal of the Fed and other bank regulators to listen to concerns of civil rights and consumer advocates).

²⁸¹ On December 11, 2009, the House passed the Wall Street and Consumer Protection Act (H.R. 4173). See Press Release, House Financial Services Committee, House Approves Historic New Rules to Govern America's Financial System (Dec. 11, 2009), available at <http://financialservices.house.gov/>. This bill would, inter alia, create a new Consumer Financial Protection Agency ("CFPA") that is responsible for writing consumer protection and civil rights rules dealing with the financial services industry, including previously unregulated mortgage originators. See *id.* On March 15, 2010, Chairman Dodd of the Senate Banking, Housing, and Urban Affairs Committee introduced S. 3217, the Restoring American Financial Stability Act of 2010, which would create a Bureau of Consumer Financial Protection similar to the CFPA approved by the House. The bill is available at <http://banking.senate.gov/public>.

²⁸² Bills that were the subject of committee hearings by the 111th Congress in 2000, but were not enacted by the close of 2009, include: the Mortgage Reform and Anti-Predatory Lending Act of 2009 (H.R. 1728 and S. 2452), which would ban or limit a number of problematic mortgage practices (e.g., prepayment penalties for subprime loans); the Community Reinvestment Modernization Act (H.R. 1479), which would expand the CRA's coverage in various ways (e.g., by requiring inclusion of mortgage company affiliates of banks in CRA exams); the Foreclosure Rescue Fraud Act of 2009 (H.R. 1231 and S. 117); the Fairness for Homeowners Act of 2009 (H.R. 1782); and the Housing Fairness Act (H.R. 476).

²⁸³ See, e.g., GAO FAIR LENDING REPORT, *supra* note 35, at 4, 19–22, 61–62; JAKABOVICS & CHAPMAN, *supra* note 135, at 2.

In addition, federal regulators should update HMDA requirements to mandate reporting of certain crucial information that lenders now claim might legitimately "explain" their race-

heart of the dispute in the class action cases over whether legitimate factors can explain such disparities.²⁸⁴ It is unseemly for lenders to guard this as proprietary information and then criticize FHA-enforcement efforts for relying on the “limited” data that is made available to the public,²⁸⁵ particularly when many of these lenders now owe their very existence to huge infusions of public money.²⁸⁶

We would also suggest that mortgage brokers be subjected to similar licensing and regulatory restrictions as mortgage lenders.²⁸⁷ The large role that brokers seem to have played in discriminatory loan pricing, combined with the defendant-lenders’ claim that brokers’ discrimination is beyond the lenders’ control or legal responsibility,²⁸⁸ makes for an unacceptable situation. *Someone* must be held accountable when brokers discriminate. The claim that brokers “represent” their customers is belied by economic theory as well as actual experience; the fact is, they represent themselves.²⁸⁹ Addi-

based price disparities. See, e.g., GRUENSTEIN BOCIAN ET AL., *supra* note 91, at 26 (recommending that “HMDA should be modified to include the disclosure of factors such as loan-to-value ratios and credit scores of borrowers” along with certain other information); PAYING MORE, *supra* note 51, at 13 (calling for the Fed to “add data fields to those currently in use under HMDA [that would, inter alia,] include information on whether or not a loan was originated through a broker; . . . borrower credit score; . . . debt to income ratios; and loan to value ratios”); see also H.R. 3126, 111th Cong. (2009) (a bill that would create a new Consumer Financial Protection Agency, described *supra* note 281, and mandate a number of enhancements to the HMDA data).

²⁸⁴ See *supra* notes 223–227 and accompanying text.

²⁸⁵ At the very least, it would seem appropriate for every mortgage lender to have to certify that it is in compliance with the anti-discrimination mandates of the FHA and ECOA and to spell out the basis for its making this certification. Currently borrowers are required to swear on penalty of perjury that the information they are supplying to mortgage lenders is truthful, see *supra* note 71 and accompanying text, and requiring similar truthfulness from the lenders seems only fair. If such a lender’s oath were required, enforcement thereof might be accomplished, inter alia, by privately initiated qui tam actions under the False Claims Act. Cf. *United States ex rel. Anti-Discrimination Ctr. of Metro N.Y., Inc. v. Westchester County*, No. 06 Civ. 2860 (DLC), 2009 WL 455269 (S.D.N.Y. 2009) (described *supra* note 248).

²⁸⁶ See, e.g., *supra* note 54 (noting that Bank of America, which took over Countrywide in 2008, received some \$45 billion in TARP funds); *supra* note 55 (describing TARP funds received by GMAC, WellsFargo, and Citigroup).

²⁸⁷ See, e.g., ERNST ET AL., *supra* note 24, at 35–36 (calling for regulation that would significantly increase the bonding requirements for mortgage brokers and place on them a duty to recommend only products that are appropriate for their customers or at least a duty of good faith and fair dealing); MORTGAGE BANKERS/BROKERS, *supra* note 32, at 32 (advocating “rigorous and appropriate licensing standards” for all loan originators, including brokers); PAYING MORE, *supra* note 51, at 12 (calling for legislation that would “adequately regulate mortgage brokers”); Peterson, *supra* note 33, at 2280–81 (suggesting that Congress amend the consumer-protection mortgage laws “to explicitly govern the behavior of mortgage brokers, even where those brokers are not the party to whom a note is initially payable”).

²⁸⁸ See *supra* notes 177–182 and accompanying text.

²⁸⁹ “The mortgage broker is not the borrower’s agent. . . . Their goal as profit maximizers is to find the cheapest wholesale terms and charge what the market will bear.” Woodward, *supra* note 120, at 4; see also BARR ET AL., *supra* note 127, at 31 (noting that mortgage brokers “are compensated for getting borrowers to pay higher rates than those for which the borrower would qualify”); ERNST ET AL., *supra* note 24, at 9 (noting that their “compensation structure encourages brokers to originate as many loans as possible at the highest prices possible”); Apgar & Calder, *supra* note 32, at 6 (concluding that, given how they are compensated, brokers “do not work on behalf of the borrower” or anyone else and that, as a result, “borrowers

tionally, because there are few barriers to entry, mortgage brokers can go into and out of business at a moment's notice without the slightest proven awareness of applicable civil rights or consumer-protection laws.²⁹⁰ Given the serious harm that brokers can inflict on would-be borrowers, they must be made more accountable.

Finally, we would advocate that lenders, brokers, and everyone else who deals with mortgage applicants be required to offer, among other options, a "standard" mortgage product (e.g., a thirty-year fixed-rate loan).²⁹¹ A new HUD regulation, which became effective on January 1, 2010, and is designed to eliminate "unfair junk fees" that often surprise borrowers at closing, requires loan-originators to use forms that, for the first time, allow customers to "easily compare their estimated loan offer with the one to which they actually agree."²⁹² If this type of comparison can be required, it should be possible—and even more effective—to mandate that borrowers be given the opportunity to choose, at the outset, a loan product that their lender or broker is currently making available to similarly creditworthy customers and that does not have *any* "unfair junk fees" or other added costs.

Determining which of these legislative and regulatory reforms will be most effective in reducing racial disparities in mortgage lending is not an easy task, but we offer these observations. So long as our home-finance system relies primarily on profit-seeking lenders, it is naïve to believe that these firms will voluntarily put a high value on conforming with civil rights laws if discrimination appears to offer the prospect of more profits. This suggests that substantially more governmental oversight is the answer, but experience has shown that such oversight is only helpful if regulators have the interest, will, and resources to enforce their anti-discrimination and con-

who receive funding through the broker channel are charged a premium over apparently similar borrowers who receive their loans through retail channels").

Because mortgage brokers act merely as intermediaries between a lender and a prospective borrower and represent their own financial interests, their role is different from, say, a real estate broker who typically acts as an agent for a seller or buyer and thus is subject to fiduciary and ethical duties to represent the interests of its principal. This distinction is often not apparent to would-be borrowers, who may reasonably, but erroneously, assume that mortgage brokers are obligated to find them the best deal available. Because state regulations often require little, if any, education or experience for mortgage brokers, *see supra* note 35, borrowers who rely on brokers to be knowledgeable about civil rights and consumer-protection laws governing loan products may be misled.

²⁹⁰ *See supra* note 32; MORTGAGE BANKERS/BROKERS, *supra* note 32, at 23 ("Entering the mortgage brokerage business requires fewer resources and less operational capacity [than mortgage lending]. . . . Mortgage brokers generally are not required to have funding sources or net worth except in nominal amounts."); Engel & McCoy, *supra* note 28, at 2077 n.187 (noting that very little capital is required to become a mortgage broker).

²⁹¹ *See, e.g.*, U.S. DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 66-67 (2009), available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf (proposing that federal regulators be authorized to define and require mortgage providers to offer such a "plain vanilla" product).

²⁹² *See* Press Release, U.S. Department of Housing and Urban Development, HUD Announces Posting of Frequently Asked Question on New RESPA Rule (Aug. 13, 2009), available at <http://www.hud.gov/news/index.cfm>.

sumer-protection powers. Thus, we favor those reforms that provide the greatest degree of public information and transparency in the mortgage process. Private litigation will always be a necessary supplement to governmental regulation in this area, and neither can succeed without making much of what the mortgage industry has heretofore regarded as proprietary information available to the public. An additional value of heightened disclosure and transparency is that, in a market economy, one must ultimately rely on informed consumers to make choices that will not allow lenders to engage in the types of predatory and discriminatory behavior that have too often resulted from discretionary mortgage pricing.

V. CONCLUSION

We have examined the principal litigation response to the racial and ethnic discrimination that has characterized the home mortgage industry in recent years: a series of nationwide class actions based primarily on the Fair Housing Act alleging that the discretionary pricing policies of individual defendant-lenders resulted in unjustifiably higher rates and fees for minority borrowers. These discretionary pricing policies have been at the heart of the key fair-lending issue in the past decade: that is, how home-loans are priced, particularly in the boom times when the easy securitization of such loans encouraged lenders to reduce credit standards.

By focusing attention on this industry-wide pricing system, the pending class actions have already gone a long way toward ending this particular practice, but whether they can also secure relief for the tens of thousands of minority families placed in less-than-prime mortgages as a result of this practice remains to be seen. This litigation involves some of today's most challenging FHA issues, along with many difficult procedural questions. Indeed, one unmistakable insight demonstrated by our detailed discussion of these cases is that litigation is a chancy, albeit often necessary, technique for achieving fair-lending reform.

Whether this particular litigation response to recent discrimination problems in the mortgage industry ultimately proves successful or not, it must be seen as just one part of a much broader effort designed to eliminate unlawful discrimination from the home-finance system. This ongoing effort includes other private litigation based on both anti-discrimination and consumer-protection laws, government enforcement through litigation and regulation, and perhaps new legislation.

Mortgage lending has always been the gateway to the American Dream of homeownership, and, historically, it has also been characterized by widespread discrimination against racial and ethnic minorities and their communities. As the nation becomes increasingly more diverse and as better economic times return, there is no more important civil rights issue than making the process of buying and financing a home more open, fair, transparent, and available to all.