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***EXHIBIT 4***

**UNITED STATES DISTRICT COURT  
DISTRICT OF MASSACHUSETTS**

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CECIL BARRETT, JR., ET AL.,	)	
on behalf of themselves and all others	)	
similarly situated,	)	C.A. No. 08-10157
	)	
Plaintiffs,	)	<b>CLASS CERTIFICATION</b>
	)	<b>REBUTTAL REPORT OF</b>
vs.	)	<b>PATRICIA A. McCOY</b>
	)	
OPTION ONE MORTGAGE CORPORATION,	)	
ET AL.,	)	
	)	
Defendants,	)	
_____	)	

CONFIDENTIAL—SUBJECT TO PROTECTIVE ORDER

I, Patricia A. McCoy, respectfully submit this class certification report on behalf of Cecil Barrett, Jr., Cynthia Barrett, Jean Blanco Guerrier, Angelique M. Bastien, Jacqueline Grissett, Craig Grissett, Steven Parham, Betty Hoffman, Edward Hoffman, Doris Murray, Joslyn Day, Keisha Chavers, and similarly situated individuals (Plaintiffs) in the above-captioned case.

**I. Basis of Expert Opinion and Compensation**

All of the expert opinions expressed in this report are based on my personal knowledge and on materials I have reviewed regarding the parties and transactions at issue in this case, which include specific documents produced by the parties, certain depositions in this case, certain pleadings, and my own and other authors' publications, including without limitation:

- The Second Amended Class Action Complaint;
- The Class Certification Report of Ian Ayres;
- The Rebuttal Report of Darius Palia;
- Transcript of the Deposition of Vivian Olson and exhibits thereto;
- Transcript of the Deposition of Dale Sugimoto;
- Transcript of the Deposition of People's Choice Mortgage;
- Transcript of the Deposition of John Veracka;
- Transcript of the Day Two Deposition of William M. Mullin;
- Transcript of the Deposition of Maritime Mortgage Corp.;
- Transcript of the Deposition of Peter Fraser;
- Relevant regulations and laws; and
- The reports and scholarly works cited in this report.

My opinions are solely based on my personal knowledge and belief and on materials I have reviewed. I reserve the right to supplement and/or modify my opinions based on future discovery in this case and other information not now known to me.

My expert compensation in this case is \$500.00 per hour.

**II. Expert Qualifications**

I am the Connecticut Mutual Professor of Law and Director of the Insurance Law Center at the University of Connecticut School of Law, where I specialize in financial services regulation. I earned my J.D. at the University of California (Berkeley) School of Law and clerked for the late Hon. Robert S. Vance of the Eleventh Circuit Court of Appeals immediately after law school. In addition, I was a Visiting Scholar at the Massachusetts Institute of Technology Department of Economics in 2002-2003. My resume is attached to this expert report as Appendix A.

Currently, I am a member of the Editorial Advisory Board for the Cambridge Series on Law, Finance, and Economics at Oxford University Press. I am also a Fellow at the Center for Law, Economics and Finance at George Washington University School of Law. Last year, Columbia Law School appointed me as Adjunct Research Scholar at the National State Attorneys General Program.

I am a recognized national authority on the mortgage crisis due to my extensive expertise in the structure and economics of the residential lending and mortgage broker industry and mortgage securitization. My expertise is based in part on research into residential mortgage industry practices and economics that resulted in the authorship of the following articles, book chapters, and working papers:

Op Ed, *Another View: The Best Way to Protect Borrowers*, THE NEW YORK TIMES DEALBOOK, March 8, 2010.

*Barriers to Federal Home Mortgage Modification Efforts During the Financial Crisis* (Working Paper, Joint Center for Housing Studies, Harvard University, April 20, 2010), available at <http://www.jchs.harvard.edu/>.

*Securitization and Systemic Risk Amid Deregulation and Regulatory Failure*, 41 CONN. L. REV. 1327 (2009) (with Andrey D. Pavlov and Susan Wachter).

*From Credit Denial To Predatory Lending: The Challenge Of Sustaining Minority Homeownership*, in SEGREGATION: THE RISING COSTS FOR AMERICA (James H. Carr & Nandinee Kutty, eds., Routledge, 2008) (with Kathleen C. Engel).

*The Impact of Predatory Lending Laws: Policy Implications and Insights* (with Raphael Bostic, Kathleen C. Engel, Anthony Pennington-Cross and Susan Wachter) in BORROWING TO LIVE: CONSUMER AND MORTGAGE CREDIT REVISITED 138 (Nicolas P. Retsinas & Eric S. Belsky eds., Joint Center for Housing Studies of Harvard University and Brookings Institution Press, 2008).

*The Legal Infrastructure of Subprime and Nontraditional Mortgage Lending* (with Elizabeth Renuart), in BORROWING TO LIVE: CONSUMER AND MORTGAGE CREDIT REVISITED 110 (Nicolas P. Retsinas & Eric S. Belsky eds., Joint Center for Housing Studies of Harvard University and Brookings Institution Press, 2008).

*State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms*, 60 J. ECON. & BUS. 47-66 (2008) (with Raphael Bostic, Kathleen C. Engel, Anthony Pennington-Cross and Susan Wachter) (peer reviewed), full working paper version available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1005423](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1005423).

*The Home Mortgage Disclosure Act: A Synopsis and Recent Legislative History*, 29 J. REAL ESTATE RESEARCH 381-397 (2007) (peer reviewed), [http://cbeweb-1.fullerton.edu/finance/journal/papers/abstract/forth/accepted/JRER\\_SI\(0703S02R1\)\\_5.htm](http://cbeweb-1.fullerton.edu/finance/journal/papers/abstract/forth/accepted/JRER_SI(0703S02R1)_5.htm).

*Predatory Lending and Community Development at Loggerheads*, in FINANCING LOW-INCOME COMMUNITIES (Julia Rubin, ed., Russell Sage Foundation, 2007) (with Kathleen C. Engel), working paper version available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=687161](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=687161).

*Rethinking Disclosure in a World of Risk-Based Pricing*, 44 HARV. J. LEGIS. 123 (2007), [http://www.law.harvard.edu/students/orgs/jol/vol44\\_1/mccoy.pdf](http://www.law.harvard.edu/students/orgs/jol/vol44_1/mccoy.pdf).

*Turning a Blind Eye: Wall Street Finance Of Predatory Lending*, 75 FORDHAM L. REV. 2039 (2007) (with Kathleen C. Engel), <http://www.law.uconn.edu/faculty/pmccoy/blind-eye.pdf>.

*Accounting for Subprime Losses: The Impact of FAS 157*, EY FACULTY CONNECTION, Issue 20 (Dec. 2007), [http://www.ey.com/global/content.nsf/US/EY\\_Faculty\\_Connection\\_\(Issue\\_20\)](http://www.ey.com/global/content.nsf/US/EY_Faculty_Connection_(Issue_20)) (with Amy Dunbar).

Interview panelist in *Perspectives on Assessing CRA's Impact, Effectiveness, and Applicability for the Future*, CR (COMMUNITY REINVESTMENT) REPORT (Fed. Res. Bank of Cleveland, Summer 2007), [http://www.clevelandfed.org/CommAffairs/CR\\_Reports/CRReport\\_summer07.pdf](http://www.clevelandfed.org/CommAffairs/CR_Reports/CRReport_summer07.pdf).

Guest Author (with Kathleen Engel), *Credit Slips* blog, Dec. 11-15, 2006, [www.creditslips.org/](http://www.creditslips.org/).

*Banking on Bad Credit: New Research on the Subprime Home Mortgage Market*, published online in the Proceedings of the Third Federal Reserve System Conference (titled "Promises and Pitfalls: As Consumer Finance Options Multiply, Who Is Being Served and at What Cost?"), 2005, [http://www.chicagofed.org/cedric/files/2005\\_conf\\_discussant\\_session1\\_mccoypdf](http://www.chicagofed.org/cedric/files/2005_conf_discussant_session1_mccoypdf).

*A Behavioral Analysis of Predatory Lending*, 38 AKRON L. REV. 725 (2005), <http://www.uakron.edu/law/lawreview/docs/McCoy384.pdf>.

*Predatory Lending: What Does Wall Street Have to Do with It?*, 15 HOUSING POL=Y DEBATE 715 (2004) (with Kathleen C. Engel), [http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd\\_1503\\_Engel.pdf](http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Engel.pdf).

*Predatory Lending Practices: Definition and Behavioral Implications*, in PREDATORY LENDING: WHY THE POOR PAY MORE FOR FINANCIAL SERVICES (Greenwood Press 2004, Gregory Squires ed.).

*A Tale of Three Markets Revisited*, 82 TEX. L. REV. 439 (Dec. 2003) (with Kathleen C. Engel).

*A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255 (2002) (with Kathleen C. Engel), <http://www.law.uconn.edu/faculty/pmccoy/three-markets.pdf>.

*The CRA Implications of Predatory Lending*, 29 FORDHAM URB. L.J. 1571 (2002) (with Kathleen C. Engel).

*The Law and Economics of Remedies for Predatory Lending*, in FEDERAL RESERVE SYSTEM, CHANGING FINANCIAL MARKETS & COMMUNITY DEVELOPMENT 155 (2001) (with Kathleen C. Engel).

By virtue of my mortgage lending expertise, I have headed major research initiatives on subprime lending. At Columbia Law School, I am currently the lead Adjunct Research Scholar overseeing the North Carolina Predatory Lending Project, sponsored by the National State Attorneys General Program. Previously, in 2004, I served as the guest co-editor of a special

symposium issue of *Housing Policy Debate* on subprime home mortgage lending, titled *Special Issue on Market Failures and Predatory Lending*, 15 HOUSING POL=Y DEBATE Issue 3 (2004).

My mortgage lending expertise also builds on my broader expertise in federal banking and securities regulation, both in practice and as an academic. In practice, I handled complex banking, securities fraud, and discrimination cases at the law firm of Mayer, Brown, & Platt (now Mayer, Brown, LLP) in Washington, D.C., from 1984 to 1992, where I was a partner and earlier an associate. In that capacity, while representing nationally recognized accounting firms, I reviewed numerous residential loan files and internal lending controls in cases involving failed banks and savings and loan institutions.

While in academe, I have published two books on federal banking regulation. In 2000, I wrote a leading treatise on federal bank regulation titled *BANKING LAW MANUAL: FEDERAL REGULATION OF FINANCIAL HOLDING COMPANIES, BANKS AND THRIFTS* (Lexis 2d ed. 2000 & cum. supp.). In 2002, I served as the editor for and a contributor to *FINANCIAL MODERNIZATION AFTER GRAMM-LEACH-BLILEY* (Lexis 2002), which dealt with modernization of the financial services industry. My latest book, *THE SUBPRIME VIRUS*, coauthored with Kathleen C. Engel, will be published in late 2010 by Oxford University Press.

Since 2002, I have served on several national boards where I reviewed and gave advice on mortgage lending practices. From 2002 to 2004, I was a member of the Consumer Advisory Council of the Board of Governors of the Federal Reserve System. There, I chaired the Council's Consumer Credit Committee, which studied developments in home mortgage lending and considered whether there was a need to amend the federal statutes and regulations governing that area, including the Truth in Lending Act, the Home Ownership and Equity Protection Act, and the Real Estate Settlement Procedures Act. In 2006, I served on the Blue Ribbon Advisory Committee on Risk or Race of the Joint Center on Housing Studies at Harvard University and I currently sit on the Research Advisory Council of the Center for Responsible Lending. Both of these advisory committees examined home lending practices. In 2008, I was appointed to the Advisory Committee on the Ford Foundation Subprime Crisis Project, sponsored by the Harvard University Joint Center for Housing Studies. Closer to home, through 2007, I sat on the board of directors and was Treasurer of the Connecticut Fair Housing Center, a non-profit organization that seeks to further equal access to housing and mortgage lending.

Other of my recent activities drew on my expertise on subprime and predatory lending. In 2009, I testified twice before the U.S. Senate and once before the U.S. House of Representatives on mortgage lending reforms.<sup>1</sup> In February 2008, I testified before the Committee of Banks of the Connecticut General Assembly on mortgage lending reform in the subprime industry. In July

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<sup>1</sup> Hearing before the Subcommittee on Securities, Insurance, and Investment of the U.S. Senate Committee on Banking, Housing, and Urban Affairs at hearing titled "Securitization of Assets: Problems and Solutions," October 7, 2009, Washington, D.C.; Hearing before the Subcommittee on Domestic Monetary Policy and Technology of the U.S. House Committee on Financial Services at hearing titled "Regulatory Restructuring: Safeguarding Consumer Protection and the Role of the Federal Reserve," July 16, 2009, Washington, D.C. Hearing before the U.S. Senate Committee on Banking, Housing, and Urban Affairs at hearing titled "Consumer Protections in Financial Services: Past Problems, Future Solutions," March 3, 2009, Washington, D.C.

2006, I testified in Atlanta, Georgia, before the Federal Reserve Board at hearings on the Home Ownership and Equity Protection Act. I also helped design a national subprime mortgage database for the Ford Foundation.

### **III. Prior Expert Appearances**

I have appeared in the following expert engagements to date:

- Expert for plaintiff borrowers in *Ramirez, et al. v. GreenPoint Mortgage Funding, Inc.*, Case No. 3:08-cv-00369-THE (N.D. Cal.): filed expert rebuttal report in mortgage lending discrimination case.
- Expert for defendant title insurance company in *Mesa Bank v. Alexander*, No. CV2008-019063 (Maricopa County, Arizona, Superior Court): filed expert report and testified at expert deposition in mortgage fraud case.
- Expert for plaintiff borrowers in *In re Ameriquest Mortgage Co. Mortgage Lending Practices Litigation*, MDL No. 1715, Lead Case No. 05-cv-07097 (N.D. Ill.): filed expert report in support of settlement and distribution plan.
- Expert for defendant title insurance company in *Rubin v. Coppenger et al.*, No. CV-2006-07-4229 (Summit County, Ohio, Court of Common Pleas): filed expert report in mortgage fraud case.
- Expert for defendant title insurance company in *Countrywide Home Loans, Inc. vs. LandAmerica American Title Company et al.*, Cause No. 07-14386-I (Dallas County, Texas, District Court: 162d Jud. District): provided background consultation in mortgage fraud case.
- Expert for defendant title insurance company in bankruptcy proceeding titled *Credit Suisse Financial Corporation, et al. v. Parish Marketing & Development Corporation, et al.*, C.A. 0:08-cv-01038-DWF-SRN, Claim #F34052233, F34052083, and F34052229 (D. Minn.): provided background consultation in mortgage fraud case.
- Expert witness for defendant title insurance companies in *Countrywide Home Loans, Inc. v. National Land Title of Tarrant, Inc. et al.*, Cause No. 06-11971-H (Dallas County, Texas, District Court: 160th Jud. District) and related litigation: filed expert report in mortgage fraud case.
- Expert witness for defendant title insurance companies in *Ohio Savings Bank v. Commonwealth Land Title Insurance Co. et al.*, Cause No. 2006-32092 (Harris County, Texas, District Court: 295<sup>th</sup> Jud. District): filed expert report in mortgage fraud case.
- Expert witness for defendant title insurance company in *ABN AMRO Mortgage Group, Inc. v. The Mortgage Zone, Inc.*, Case No. 05-74150 (E.D. Mich.): filed expert report in predatory mortgage lending case.

- Expert witness for defendant title insurance company in *ABN-AMRO Mortgage Group, Inc. v. New Partners Mortgage Company*, Case No. 1:05 CV 1167 (N.D. Ohio): filed expert report in predatory mortgage lending case.
- Expert witness for state agency plaintiffs in *State of Connecticut v. Approved Mortgages, Inc. et al.*, Docket No. HHD-X09-CV-05-40097378-S (Connecticut Superior Ct., Jud. District of Hartford): testified at expert deposition in predatory mortgage lending case.
- Expert witness for borrower plaintiff in *Devlin v. Northeast Mortgage Corp.*, original Docket No. X01-CV-03-0178670-S (Connecticut Superior Ct., Jud. District of Waterbury), later transferred to U.S. Bankruptcy Court: testified at expert deposition in predatory mortgage lending case.
- Expert witness for state agency plaintiffs in *State of Connecticut v. GRZ, LLC*, Docket No. CV 03 0829985S (Connecticut Superior Ct., Jud. District of Waterbury Complex Litigation): filed expert report and testified at expert deposition in predatory mortgage lending case.
- Expert witness for borrower plaintiff in *Heaton v. Monogram Credit Card Bank of Georgia*, Civil Action No: 98-1823 c/w 99-2603 Section: "J" (1) (U.S. District Court for the Eastern District of Louisiana): filed expert report in challenge to a claim of federal preemption by a credit card bank.

#### IV. Background

Plaintiffs sue Option One Mortgage Corporation (Option One) and H&R Block Mortgage Corp. n/k/a Option One Mortgage Services, Inc. (H&R Block Mortgage) for discrimination in mortgage lending under the Equal Credit Opportunity Act and Title VIII of the Fair Housing Act. Second Amended Complaint. Option One was a nonprime<sup>2</sup> mortgage lender that originated most of its loans through outside mortgage brokers via the wholesale lending channel. Olson Depo. at 14, 54-56. H&R Block Mortgage was a prime and nonprime mortgage lender that originated most of its loans through its in-house loan officers via the retail lending channel. Olson Depo. at 15, 54-55, 58. H&R Block Mortgage was a subsidiary of Option One. Olson Depo. at 52.

According to Plaintiffs, Option One and H&R Block Mortgage employed a discretionary loan pricing policy that caused blacks to be charged more for home mortgages than comparably situated whites between January 1, 2001 and the date of judgment in this action. Second Amended Complaint ¶¶ 2, 9-10, 184; Ayres Report at 3-4, 7. The class allegations in the complaint cover both Option One's wholesale channel subprime mortgage loans and H&R Block Mortgage's retail channel subprime mortgage loans. This report refers to Option One and H&R Block together as the "Defendants."

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<sup>2</sup> In this opinion, I use the word "nonprime" to denote subprime loans designed for borrowers with weaker credit plus the so-called "Alt-A loans," which included low- and no-documentation loans and other nontraditional mortgages such as interest-only ARMs.

## V. Class Certification Opinion

Defendants' rebuttal expert, Dr. Darius Palia, opposes class certification on grounds that Plaintiffs' expert, Professor Ian Ayres, should have applied his regression model separately to each of Option One's thousands of mortgage brokers. In addition, Dr. Palia argues that Professor Ayres should have applied his regression model "separately to the local geographic markets in which borrowers applied for and obtained their mortgage loans," instead of to the national market. Palia Report at 4. He contends that both of these analyses require individualized proof that obviates class certification.

What Dr. Palia ignores is that the lending discrimination in this case resulted from uniform, national discretionary pricing policies established by the Defendants. These policies were designed to achieve lending operations that were national in scope and to advance Defendants' profit objectives for their nationwide operations. The policies and practices instituted by Defendants and the regulatory environment in which they operated were both common to the class and allowed Defendants' mortgage brokers and loan officers to overcharge customers in general and to charge even more to black borrowers, wherever they were located across the country. These policies and practices were driven by Defendants' sale of mortgages to Wall Street investors and included Defendants' discretionary pricing policies, their use of risk-based pricing, the secrecy of their rate sheets, inadequate federal disclosure of yield spread premiums, and Defendants' conscious use of product differentiation to impede informed comparison-shopping.

### A. **Defendants Consciously Adopted National Pricing Policies To Maximize The Proceeds From The Sale Of Mortgages On the Secondary Market**

Defendants consciously designed the pricing policies at issue in this case to maximize their revenues from selling their mortgages to investors for securitization. These policies were designed to produce the types of mortgages that investors wanted to buy at the yield that investors wanted while meeting Defendants' profit targets.

Thirty years ago, most lenders performed the key functions of residential mortgage lending themselves in-house. Back then, lenders solicited loan applicants through their loan officers, underwrote and funded loans, serviced the loans, and held the loans in portfolio.

In the past few decades, however, the structure of the home mortgage industry underwent fundamental change. Starting in the 1970s, lenders increasingly unbundled many of their key lending functions and outsourced them to outside individuals and firms.

One aspect of this unbundling featured the sale of mortgage loans to investors. The invention of securitization in the late 1970s eliminated the need for lenders to hold their mortgages on their books until repayment or maturity.<sup>3</sup> In securitization, a lender bundles home mortgages and sells them to a bankruptcy-remote trust. Then an investment bank repackages the monthly loan payments into bonds for sale to investors. The bonds are divided into tranches, rated by rating agencies, and secured by the underlying mortgages as collateral. The investors in these private-

<sup>3</sup> For fuller treatment of these developments, see Kathleen C. Engel and Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255 (2002).

label mortgage-backed securities were mostly large institutional investors operating on a national and global basis. They included pension plans, insurance companies, banks, mutual funds, hedge funds, and sovereign governments, in the United States, Europe, and Asia.

Defendants deliberately adopted an “originate-to-distribute” business model in which they originated most of their mortgages for sale to investors for securitization. The sales proceeds from securitization were a critical funding source for Defendants’ businesses. Under that model, Defendants originated their loans to investors’ specifications as to underwriting and yield. Defendants employed investor relations specialists to answer investors’ questions about issues including underwriting. Olson Depo. at 24, 234-236; Sugimoto Depo. at 70. All of Defendants’ mortgage origination activities – including their discretionary pricing policies for mortgage brokers and for their loan officers – were national in operation and scope by necessity because they were designed to produce the loan features and rates of return that Defendants’ investors demanded and expected in the national and international bond markets.

**B. During The Class Period, Option One Adopted A Conscious Business Strategy Of Soliciting Mortgages Through Outside Mortgage Brokers In Order To Maximize Volume And Profits**

As part of the mortgage market’s transformation over the past forty years, numerous lenders, including Option One, placed increasing reliance on outside mortgage brokers to recruit potential borrowers, take their loan applications, and verify the *bona fides* of their loan applications. The use of mortgage brokers to solicit business for lenders was referred to as the “wholesale lending channel.” Olson Depo. at 54-57.

Option One specifically embraced the wholesale channel to extend its lending operations nationwide while minimizing the cost of nationwide operations. Lenders such as Option One gravitated to wholesale channel in order to cut costs and maximize profits. Any retail lender that aspired to a large market share had to have a large sales force in order to extend its geographic reach.

In view of the need for a large sales force, cutting costs was one of the foremost motivations for originating through mortgage brokers. Soliciting business through a standing force of in-house loan officers was an expensive proposition, entailing high overhead. Lenders often compensated their loan officers with salaries (in whole or in part) and also paid them costly fringe benefits, including health insurance and pensions. Lenders also had to maintain brick-and-mortar offices in order to house their loan officers.

These costs remained fixed, regardless whether mortgage applications were booming or waning. Residential mortgage lending is a volatile business, alternating between periods of high and low demand. Retail lenders who assembled large sales forces to meet high demand from customers during busy periods later often found themselves stuck with the same high cost structure of loan officers if their mortgage business fell off, as it periodically did. Mass layoffs of loan officers during slow periods were painful and could engender litigation.

For these reasons, Option One made a business decision during the class period to substantially avoid these fixed costs by farming out the traditional duties of loan officers to outside mortgage

brokers.<sup>4</sup> Option One originated most of its loans through the wholesale lending channel. Olson Depo. at 14, 54-56. Its heavy dependence on mortgage brokers was part of a strategy to run a national mortgage lending business while minimizing costs.

To achieve this national business strategy, Option One asserted control over the wholesale lending process and its mortgage brokers in numerous ways. Option One was the creditor and the borrowers owed their debts to Option One. Each of those wholesale loans had to meet with Option One's approval as to underwriting standards, loan origination procedures, and pricing terms in order for Option One to fund them. Unless Option One approved, those loans would not be made.<sup>5</sup> Olson Depo. at 57-58, 115-119; People's Choice Mortgage Depo. at 79, 155-157; [REDACTED] Option One also set the final price of all of its wholesale loans. Olson Depo. at 66-67; People's Choice Mortgage Depo. at 156; [REDACTED] Maritime Mortgage Corp. Depo. at 133, 135-136; [REDACTED]. Option One set its underwriting policies and prices nationally to meet investor demand in the national and international bond markets.

Option One asserted other forms of control over its mortgage brokers as well. It instructed mortgage brokers what information to submit for underwriting and underwrote the loans to Option One's standards. It pulled the borrower's credit report itself to monitor fraud. [REDACTED] [REDACTED] It specified the format of appraisals and ordered review appraisals on occasion. Option One maintained a list of unacceptable appraisers and retained the right to reject appraisals from those appraisers. [REDACTED] For full documentation loans, Option One had a policy of verifying the applicant's income; for its stated income loans, Option One underwriters were supposed to assess whether the applicant's stated income was reasonable. Option One retained discretion to reject a stated income loan and to require the applicant to submit income documentation. [REDACTED] The company also had a policy of determining whether its brokers met all of the loan conditions before it funded and closed loans. [REDACTED] People's Choice Mortgage Depo. at 86.

Option One instituted its broker force in order to operate nationwide and to increase its aggregate profits from its national operations. As part of its business model, Option One asserted control over its mortgage brokers via policies and procedures of national scope to assure that the brokers advanced Option One's national business strategy. For these reasons, any analysis of pricing disparities in Option One's loans should be done from a national perspective.

### **C. Defendants Gave Their Brokers And Loan Officers The Ability And Latitude To Overcharge Consumers**

The Class Certification Report of Ian Ayres establishes that Defendants' black borrowers were charged higher Annual Percentage Rates (APRs) than comparable whites even after controlling for creditworthiness. Ayres Report at 41-44. These pricing disparities arose from a national

<sup>4</sup> See William Apgar, Amal Bendimerad and Ren S. Essene, Mortgage Market Channels and Fair Lending: An Analysis of HMDA Data 7-8 (Working Paper, Joint Center for Housing Studies at Harvard University, 2007).

<sup>5</sup> A small percentage of Option One's home mortgages consisted of correspondent loans made through its wholesale channel. These correspondent loans were closed in the mortgage brokers' names and then transferred to Option One, often immediately. As with Option One's traditional wholesale channel loans, Option One underwrote and set the price for all of its correspondent loans. Option One did not make a correspondent loan unless the loan met with its approval. Olson Depo. at 59-61.

policy adopted by Defendants to give discretion to their mortgage brokers and loan officers in the pricing of nonprime loans.

Both Option One and H&R Block Mortgage used discretionary pricing systems of national scope with an adverse disparate impact on black borrowers when compared to whites. These pricing systems had three important discretionary components: the rate sheet, fees charged to borrowers, and pricing exceptions.

*Rate-Sheet Pricing:* Defendants formalized much of their discretionary pricing policy in documents known as rate sheets, which they made available to brokers and loan officers but not to the public. These rate sheets specified interest rates for Defendants' individual loan products, depending on a matrix of factors. Defendants created the rate sheets and defined the options on the rate sheets; brokers did not. People's Choice Mortgage Depo. at 155, 157.

To determine the rate sheet price for a given loan, Defendants first assigned each subprime borrower an initial price using an automated process based on objective credit criteria predictive of default risk. [REDACTED] This initial price was known as the "par rate" for the loan and was calculated before any adjustments. [REDACTED] The par rate depended on the borrower's credit grade, the loan-to-value ratios, the documentation type, the loan product type, the underwriting guidelines (e.g., Legacy, Latitude, etc.), the occupancy status, the property type, the lien status, and any mortgage late payments. In general, Defendants' rate sheets applied nationally; some applied to specific geographic areas or to large institutional brokers such as Wells Fargo. Defendants controlled the decision as to a rate sheet's scope. [REDACTED]

Then, once the par rate was determined, Defendants gave their mortgage brokers and loan officers discretion to increase the final price charged to the consumer through a system of optional price adjustments and exceptions. The rate sheets described adjustments that could drive the final rate up or down from the par rate. These adjustments worked the same way for different loan products, for yield spread premiums and borrower credits, and for wholesale and national accounts. Under these adjustments, the final rate could change depending on the payment of a yield spread premium (for Option One loans), the size of the loan, the presence of a prepayment penalty, the occupancy status of the home (i.e., owner-occupied or investor), the property type (i.e., single-family or multi-family), the length of any fixed rate, the term of the loan, whether the borrower was a first-time homebuyer, whether the loan was for a condominium or for a second home, the borrower's payment of points, and the presence of a piggyback second mortgage. These adjustments allowed Defendants to charge higher APRs to black customers, in comparison with comparable whites, without the customers' knowledge.

*Fees Charged to Borrowers:* Defendants also gave their mortgage brokers and loan officers latitude to set the amount of certain fees and collect them directly from borrowers. These fees included origination fees, application fees, and processing fees. Defendants allowed the fees to be reduced or waived in individual circumstances. This discretion to set fees, combined with latitude to reduce them or waive them in individual cases, created the opportunity to charge disproportionately higher fees to black customers.

*Pricing Exceptions:* Finally, Defendants, at their discretion, granted exceptions to the prices on their rate sheets. [REDACTED]

[REDACTED] A downward pricing exception allowed a borrower to pay less for a loan than the price stated on the rate sheet. [REDACTED]

[REDACTED] Defendants' policy of allowing discretionary downward pricing exceptions opened the door to racially discriminatory pricing by allowing Defendants to charge lower prices to white borrowers than to comparably situated blacks.

**1. Specifics About Option One's Discretionary Pricing System For Mortgage Brokers**

**a. Elements Of Discretion In Option One's Loan Pricing**

*Rate Sheet Pricing:* Option One provided its mortgage brokers with proprietary rate sheets that set out different combinations of interest rates and yield spread premiums (YSPs) that Option One was willing to pay its brokers, depending on a borrower's credit rating and the loan-to-value ratio. Option One paid YSPs to its mortgage brokers for convincing borrowers to pay an interest rate above par (in other words, a higher interest rate than they qualified for based on their creditworthiness). Under that system, the higher the interest rate on the loan, the higher the broker's YSP. Olson Depo. at 89-90, 146-147. Option One tied the size of the YSPs it was willing to pay to how high the interest rate rose, using a formula that brokers could discern from the rate sheets. Olson Depo. at 145-147. The size of a YSP and the interest rate increase it produced were not in any way related to the borrower's creditworthiness. Olson Depo. at 201.

YSPs worked to borrowers' detriment in a number of ways. They artificially pushed up the interest rates on borrowers' loans, making borrowers pay more and increasing their likelihood of default. People's Choice Mortgage Depo. at 60-61, 69, 74-75. Often, YSPs resulted in stiff prepayment penalties on loans. In addition, by offering even higher YSPs on particular loan products, Option One could encourage mortgage brokers to steer their customers toward loan products that were more profitable to fund. Some of those loan products placed borrowers at a heightened risk of default.

*Fees Charged to Borrowers:* Option One also gave its mortgage brokers discretion to charge borrowers origination fees and junk fees and to determine their amount. Option One allowed its brokers to charge borrowers thousands of dollars in origination fees, either along with a yield spread premium or without. In addition, Option One allowed brokers to assess junk fees, including application fees and processing fees, which borrowers paid to the brokers. Olson Depo. at 102-103, 108-109, 142-144, 146-147, 162-164, 167; Exhibits 1-4 to Olson Depo. (HUD-1 settlement statements); People's Choice Mortgage Depo. at 73, 97, 100.

Brokers were not the only ones with discretion in charging fees. Discretion also crept into pricing because of Option One's own fees to borrowers. Option One assessed borrowers with underwriting fees, commitment fees, application fees, processing fees, and funding fees. Sometimes it also charged them loan discount points. [REDACTED]

[REDACTED] This discretion created another avenue for disparate pricing to the detriment of black borrowers.

*Pricing Exceptions:* Option One allowed its mortgage brokers, at their discretion, to petition Option One for pricing exceptions. [REDACTED]

[REDACTED] The ability to lower rates in individual cases opened up the door to favorable treatment to white customers at the expense of black customers.

In these ways, Option One's discretionary pricing system created a symbiotic relationship that inured to the profit of both Option One and its mortgage brokers. As the Joint Center for Housing Studies at Harvard University noted, both the lender and the mortgage broker "benefit financially" from discretionary pricing "by the placement of a specific loan product or a loan made at a higher rate than suggested by the rate sheet."<sup>6</sup> Thus, Option One consciously instituted a discretionary pricing system that looked the other way at what its mortgage brokers charged with the purposes of boosting its profits.

**b. Option One Gave Its Mortgage Brokers Broad Latitude In Pricing Loans To Attract And Keep Their Business**

One reason Option One granted discretionary pricing was to compete for mortgage brokers' business. Mortgage brokers could do business with many wholesale lenders and were not obliged to deliver loans to any given lender. As a result, mortgage brokers shopped for lenders who would pay them the most. In fact, Option One called mortgage brokers "clients" and "customers" because it was vying for their business. Olson Depo. at 20.

Option One's discretionary pricing program was designed to encourage mortgage brokers to do business with Option One by maximizing their compensation. Option One's mortgage brokers testified that they compensated their loan officers based mostly on commission, not on salary.

[REDACTED] see People's Choice Mortgage Depo. at 85; II Mullin Depo. at 33; [REDACTED] Those commissions were computed based on the percentage of profit on the loan. Accordingly, loan officers at Option One's mortgage brokerages had incentives to do business with whatever lender would let them earn the highest compensation on loans in order to maximize their commissions. Brokers' incentives to steer their business to such lenders was boosted by the fact that they did not bear the default risk on those loans.

In turn, the more loans brokers sent to Option One, the higher its profits. Option One's business model was based on volume. The more loans Option One originated, the more loans it could sell to the secondary market and the more sales proceeds it could collect. For this reason, Option One paid its account executives commissions based on the number of loans they originated. Sugimoto Depo. at 120-121. For the same reason, Option One consciously designed its discretionary pricing system to entice mortgage brokers to send it more loans. [REDACTED]

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<sup>6</sup> William Apgar, Amal Bendimerad and Ren S. Essene, Mortgage Market Channels and Fair Lending: An Analysis of HMDA Data 8 (Working Paper, Joint Center for Housing Studies at Harvard University, 2007).

[REDACTED]

Option One had written documentation of its final brokers' fees for any given loan before the loan went to closing and could have reviewed that compensation for discriminatory effect. Olson Depo. at 148-151; Exhibit 2 to Olson Depo., at 799. However, Option One did not cap its brokers' compensation or police how high it could go except in two very limited circumstances. Option One had a policy of banning high-cost loans for purposes of the Home Ownership and Equity Protection Act (HOEPA).<sup>7</sup> The HOEPA evaluation affected only a tiny sliver of loans, however, because HOEPA accounted for no more than one percent of all subprime loans.<sup>8</sup> And Option One had a policy of evaluating fees for purposes of its benefit to borrower test. Only a limited number of states imposed that test. Apart from these two narrow circumstances, Option One did not question or attempt to limit its mortgage brokers' compensation. Olson Depo. at 88-89, 104-105, 129-131; People's Choice Mortgage Depo. at 100; II Mullin Depo. at 20.

In short, Option One did not care whether brokers charged more to black customers in order to pad their income so long as brokers sent increasing numbers of loans to Option One to originate as a result. Furthermore, Option One made more money on loans with above-par interest rates when it sold them on the secondary market. The yield spread premium component of Option One's discretionary pricing system was designed to produce above-par interest rates to increase Option One's revenues and profits. At the same time, YSPs added to the discriminatory prices paid by blacks.

## **2. H&R Block Mortgage Also Used Discretionary Pricing For Its Retail Nonprime Loans**

H&R Block Mortgage gave its loan officers similarly broad discretion in pricing loans. While the specifics of this discretion varied somewhat from Option One's pricing system, the effect was the same: to produce a detrimental disparate impact on black borrowers.

*Rate Sheet Pricing:* H&R Block Mortgage Corporation had a discretionary pricing policy for its nonprime loans that resembled that of Option One's. Under that policy, H&R Block set a par rate according to objective factors bearing on creditworthiness. Then, it allowed adjustments to the par rate consisting of overages and underages. Olson Depo. at 241.

Under the overage policy, borrowers who did not pay points could be charged a higher interest rate without necessarily understanding the effect on their rate. Similarly, the final rate a borrower paid could change if the loan product offered to the borrower changed. Exhibit 14 to Olson Depo. at 1. Loan officers also had discretion whether to slot borrowers into loans carrying large prepayment penalties. Finally, rogue loan officers could charge borrowers higher prices by attributing them with a lower credit score on the rate sheet matrix than they deserved. The adjustments, the ability to impose prepayment penalties, and the ability to manipulate a

<sup>7</sup> 15 U.S.C. §§ 1601, 1602(aa), 1639(a)-(b).

<sup>8</sup> EDWARD M. GRAMLICH, SUBPRIME MORTGAGES: AMERICA'S LATEST BOOM AND BUST 28 (Urban Institute Press, 2007).

borrower's credit score created opportunities to increase the final rate charged to black borrowers compared to whites.

*Fees Charged to Borrowers:* Like Option One, H&R Block Mortgage charged its borrowers an array of fees, including underwriting fees, commitment fees, application fees, processing fees, funding fees, and sometimes loan discount points. [REDACTED]

[REDACTED] This discretion was conducive to disparate pricing to the detriment of black borrowers.

*Pricing Exceptions:* H&R Block Mortgage, similar its parent corporation Option One, granted pricing exceptions for its retail subprime loans. [REDACTED]

[REDACTED] As a result, H&R Block Mortgage's personnel had the ability to lower loan prices for white borrowers while refusing to grant the same exceptions for black borrowers.

By giving its loan officers ample discretion in rate sheet pricing, in the imposition of fees to borrowers, and in individual price exceptions, H&R Block Mortgage created a discretionary pricing system of nationwide scope that inured to the detriment of black borrowers in comparison with comparable qualified whites.

**D. The Evidence Establishes That The Cost Structure Of Option One's Mortgage Brokers Did Not Vary By Race**

Dr. Palia argues that Plaintiffs' expert, Professor Ayres, should have run regression analyses by individual mortgage broker and by region. His critique implies that the disparities in the APRs charged to Option One's black customers were reasonable because they resulted from individual or regional variations in the cost structures of the mortgage brokers Option One used to originate wholesale loans. The record conclusively establishes, however, that brokers did not incur higher costs for black customers than for whites.

Of course, Option One's individual mortgage brokers had different costs, depending on the borrower and the broker. However, Dr. Palia ignores one crucial fact. That is that Option One's mortgage brokers consistently testified that black customers did not entail more time, more work, or higher costs than white customers for Option One's mortgage brokers. People's Choice Mortgage Depo. at 159-160, 163; [REDACTED] II Mullin Depo. at 17-18; Maritime Mortgage Corp. Depo. at 119; [REDACTED] This testimony by Option One's brokers conclusively establishes that whatever the cost differentials Option One's brokers faced, broker costs did not vary by race. Accordingly, individualized proof of broker cost structures is irrelevant to proving the disparate impact of Option One's mortgage loan pricing policies on the members of the Class. Instead, disparate impact can be proven with common evidence and methods.

Defendants point to no evidence that Option One's brokers incurred higher costs for blacks. Option One's brokers testified that they did not keep time records for their loan officers'

activities. People's Choice Mortgage Depo. at 158-161; [REDACTED] II Mullin Depo. at 16-17; Maritime Mortgage Corp. Depo. at 124-125; [REDACTED] Furthermore, I am aware of no academic literature to the effect that mortgage broker costs are higher for blacks as a group compared to whites.

In sum, any cost assumption underlying Dr. Palia's report is seriously misplaced. The testimony of Option One's brokers refutes any such assumption by conclusively establishing that Option One's mortgage brokers did not have higher costs for black loan customers.

**E. Option One Used Reduced-Documentation Loans and Automated Systems To Attract More Mortgage Brokers And Standardize Their Costs**

Any underlying implication by Dr. Palia's report as to differences in broker costs is incorrect for another reason. Option One specifically adopted innovations to drastically reduce and standardize broker costs nationwide. These innovations further helped Option One build the broker force that was so essential to attaining nationwide operation.

Option One was dependent on its mortgage brokers for a steady stream of loans. It knew that mortgage brokers shopped for lenders who would pay them the most for doing the least amount of work. During the class period, Option One used two devices -- low- and no-documentation loans and automated underwriting -- to drastically reduce the amount of work its mortgage brokers had to do for a set level of compensation.

Low-documentation and no-documentation loans -- such as stated income loans -- permitted loan approval without written verification of income and/or assets. Option One offered a wide assortment of low-doc and no-doc loans. In its stated income loans, applicants stated their income on the loan application but did not prove it. Option One also offered "no income" loans, in which applicants did not state their incomes at all, let alone prove them. Olson Depo. at 79-80.

Low- and no-doc loans were highly popular with mortgage brokers because the brokers could maximize their profits by dispensing with the time and effort needed to verify income and assets. For unscrupulous brokers, low- and no-doc loans had added appeal, because the lack of verification made it easier for them to inflate borrowers' incomes or assets without detection. By so doing, brokers could increase their loan approval rate and thus their fee volume. Due to these dynamics, low- and no-doc loans came to be known as "liars' loans."

Option One also used automated underwriting (AU) starting in 2005 to enable mortgage brokers to maximize profits. Automated underwriting allowed a mortgage broker to input data from a customer's loan application into a computer system. Then, using statistical modeling, the computer system analyzed the customer's creditworthiness and issued a loan recommendation, consisting of approval, approval with modifications, or referral to an underwriter for review. Automated underwriting recommended loan approval even without documentation of income. Olson Depo. at 27-30, 71-72.

Option One offered both of these lures to mortgage brokers to direct loans to Option One. Option One specifically offered stated income-stated asset loans. Similarly, Option One adopted automated underwriting. In tandem with Option One's discretionary pricing system, both of

these innovations by Option One were national in scope, were common to the Class, and allowed Option One's mortgage brokers to minimize costs and maximize profits.

## **F. Defendants Used Several Techniques To Overcharge Customers**

The record establishes that the APR disparities identified by Professor Ayres were not the result of cost differentials along racial lines. Rather, Defendants exploited mortgage market defects to impede competitive pricing. They took added advantage of the relative vulnerability of minority borrowers to charge minorities even higher prices than comparable whites. Defendants made these discriminatory overages possible by instituting discretionary pricing policies and by not policing lending discrimination by Option One's mortgage brokers.

In a competitive market that did not overcharge consumers, customers could obtain binding price quotes of the key price terms of a mortgage up-front to allow them to comparison-shop. In the nonprime mortgage market, however, lenders such as Defendants and mortgage brokers used a variety of techniques to make meaningful comparison-shopping difficult or impossible.

### **1. Impeding Comparison Shopping**

In a competitive market, sellers post their prices publicly and do so early enough in the shopping process so that consumers can compare prices. Defendants were able to thwart this type of comparison-shopping by keeping their price structures secret and by delaying when they revealed the true price of a borrower's loan.

Defendants deliberately blocked comparison shopping by its customers by concealing their price structure from public view. Borrowers had to read Defendants' rate sheets in order to know what par rate they qualified for and the effect of any YSPs on their interest rates. But defendants, like most mortgage lenders,<sup>9</sup> had an express policy of keeping rate sheets secret from consumers and did not post them publicly. For example, Option One only made its rate sheets available to its mortgage brokers, not to the public. Olson Depo. at 195. Similarly, Option One did not require its brokers to inform borrowers about exactly how high their interest rates went when yield spread premia were paid. Olson Depo. at 191-196.

Defendants' decision to conceal their rate sheets from consumers impeded consumers' ability to comparison-shop in at least three respects. The first involved Defendants' use of risk-based pricing. Under risk-based pricing, the minimum interest rate that Defendants were willing to charge a borrower varied according to the borrower's creditworthiness and other indicia of risk (such as the loan-to-value ratio).<sup>10</sup> Defendants employed matrices with the minimum interest rates according to credit grade. Because borrowers could not see the rate sheets, they could not tell what rate they should get given their risk level or whether they were instead being overcharged.

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<sup>9</sup> See Alan M. White, *Risk-Based Mortgage Pricing: Present and Future Research*, 15 HOUSING POLICY DEBATE 503, 509-512 (2004).

<sup>10</sup> See Alan M. White, *Risk-Based Mortgage Pricing: Present and Future Research*, 15 HOUSING POLICY DEBATE 503, 509-512 (2004).

Defendants' use of risk-based pricing also made it more difficult for consumers to get a binding quote up front and opened the door to bait-and-switch techniques. Defendants could not determine the actual price for a loan until a consumer first went through the loan application process and revealed his or her creditworthiness. See Exhibit 14 to Olson Depo. at 2. Furthermore, Defendants did not offer rate locks to their nonprime borrowers. Olson Depo. at 199, 232; Exhibit 14 to Olson Depo. at 1. Absent a rate lock, federal disclosure law at the time allowed Defendants to change the loan product and the price of the loan up until the closing (so long as they re-disclosed fully immediately before closing), creating an opportunity for bait-and-switch tactics.<sup>11</sup> A recent study by researchers at the University of North Carolina at Chapel Hill substantiated this bait-and-switch phenomenon.<sup>12</sup> Defendants had a repricing policy that was conducive to bait-and-switch schemes. See Olson Depo. at 199-200, 209-210; Exhibit 14 to Olson Depo.

Finally, the secrecy shrouding Option One's rate sheets meant that Option One's wholesale borrowers did not know that YSP payments to their brokers would boost their interest rates. Nor did they know the magnitude of that effect. Federal mortgage disclosure laws during the class period did not require lenders or mortgage brokers to disclose the effect of YSPs on interest rates to borrowers. During the class period, in fact, the only YSP disclosure that the Real Estate Settlement Procedures Act required was a cryptic reference on the HUD-1 settlement statement at the closing to a "YSP (POC)" or something to a similar effect. Olson Depo. at 144; Exhibit 2 to Olson Depo. (HUD-1 Settlement Statement). Most borrowers did not know that those six letters meant that the lender had paid the broker some sort of compensation outside of settlement. Furthermore, most borrowers were in the dark about the effect of YSPs on their interest rates. Option One's discretionary pricing policy allowed Option One's mortgage brokers to place minority borrowers into costlier loans than the borrowers deserved, based on their credit scores and risk factors, in order to increase their YSPs from Option One.<sup>13</sup>

Similarly, federal disclosure laws during the class period did not require mortgage brokers to offer customers a choice of price trade-offs or loan products. Researchers have documented that mortgage brokers did not always offer such trade-offs.<sup>14</sup> Option One did not require its brokers to explain to loan applicants that they could pay a higher rate to avoid paying an underwriting fee. Similarly, Option One did not require its brokers to explain exactly how high borrowers' interest rates rose due to the yield spread premia that Option One paid to its brokers. Olson Depo. at 191-196; Exhibit 2 to Olson Depo., at 743.

## **2. Defendants Also Evaded Price Competition By Segmenting Markets Through Product Differentiation**

During the class period, Defendants used product differentiation – consisting of a bewildering assortment of loans, many with different features – to make it difficult for consumers to

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<sup>11</sup> See Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-Based Pricing*, 44 HARV. J. LEGIS. 123 (2007).

<sup>12</sup> Jonathan S. Spader and Roberto G. Quercia, *Mortgage Brokers and the Refinancing Transaction: Evidence from CRA Borrowers*, 10 JOURNAL OF REAL ESTATE FINAN. ECON. (2009).

<sup>13</sup> William Apgar, Amal Bendimerad and Ren S. Essene, *Mortgage Market Channels and Fair Lending: An Analysis of HMDA Data 8-10* (Working Paper, Joint Center for Housing Studies at Harvard University, 2007).

<sup>14</sup> Jonathan S. Spader and Roberto G. Quercia, *Mortgage Brokers and the Refinancing Transaction: Evidence from CRA Borrowers*, 10 JOURNAL OF REAL ESTATE FINAN. ECON. (2009).

comparison-shop.<sup>15</sup> By manufacturing an apples-to-oranges problem, Defendants made it easier to evade competitive pricing.

For example, Option One gave plaintiffs Cecil Barrett, Jr., and Cynthia Barrett a Latitude Advantage five-year interest-only adjustable-rate mortgage with thirty-year amortization. This product was a hybrid interest-only adjustable-rate interest-only mortgage with a fixed initial interest rate for the first five years and a floating interest rate for the remaining twenty-five years. Olson Depo. at 115.

This loan product had complex moving parts that made it hard for customers to compare its price to the price of other types of loans. For instance, consumers could not easily gauge the interest rate and monthly payments after the five-year fixed-rate period expired. At that point, the interest rate could go up depending on the movement of the underlying index, subject to a lifetime cap that Option One only disclosed at closing. Moreover, if the initial fixed rate was an artificially low teaser rate, the rate could go up even more sharply on the rate reset date. Finally, the interest-only feature of the loan introduced added uncertainty by allowing customers to only make interest payments and defer principal payments for several years. Sometime later, however, borrowers would have to pay the piper and start paying principal, further increasing their monthly payments substantially. All of these features made it more difficult and often well nigh impossible for borrowers to grasp the true price of the loan and compare it to other products with different combinations of features.<sup>16</sup>

Lenders like Option One and H&R Block Mortgage heavily marketed interest-only ARMs like these because the initial minimum monthly payments were lower. During the class period, lenders commonly qualified borrowers for these loans based only on the initial minimum monthly payments because that way more borrowers could qualify for loans. This practice was especially common in states such as California, Arizona, and Nevada, with rapidly appreciating housing prices. Mortgage brokers gravitated towards interest-only ARMs because they could qualify borrowers more easily and thus more easily earn commissions on those loans. By consciously promoting a proliferation of complex loan products with incompatible terms, Defendants defeated comparison-shopping by consumers and made it easier for its mortgage brokers to overcharge customers for loans.

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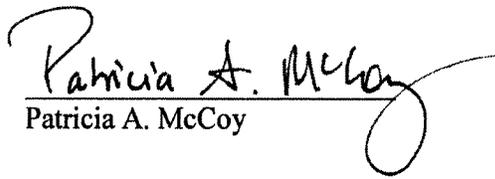
In conclusion, the price disparities in this case were a product of conscious policies and practices by the Defendants, which had national application and were designed to maximize Defendants' profits on a national basis. These policies and practices were common to the Class and allowed Defendants to overcharge black borrowers.

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<sup>15</sup> Researchers at the University of North Carolina at Chapel Hill found, for instance, that borrowers who refinanced through mortgage brokers were more likely to receive adjustable-rate mortgages in general – with their more complex features – and high-cost ARMs in particular, than borrowers using retail lenders. Jonathan S. Spader and Roberto G. Quercia, *Mortgage Brokers and the Refinancing Transaction: Evidence from CRA Borrowers*, 10 JOURNAL OF REAL ESTATE FINAN. ECON. (2009).

<sup>16</sup> Ren S. Essene and William Apgar, *Understanding Mortgage Market Behavior: Creating Good Mortgage Options for All Americans 18-21* (Joint Center for Housing Studies at Harvard University Working Paper, 2007).

Respectfully submitted,

  
Patricia A. McCoy

June 18, 2010

## APPENDIX A

**PATRICIA A. McCOY**  
**University of Connecticut School of Law**  
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### **EMPLOYMENT**

Connecticut Mutual Professor of Law, 2010. George J. & Helen M. England Professor of Law, University of Connecticut School of Law, 2006-2010. Director of the Insurance Law Center, 2009-present. Professor of Law, 2002-06. Visiting Professor, Spring 2000.

- Have taught Banking Regulation, Securities Regulation, Consumer Finance Law, Business Organizations, Retirement Security Law, Regulation of Mutual Funds, Cybercommerce Law.
- Dean Search Committee (search coordinator); Faculty Appointments Committee; Chair, Personnel Action Committee Working Subcommittee; Academic Support Committee; Computer Committee; University Senate.
- Guest Lecturer, Hong Kong Polytechnic University, June 2007.

Honorary Guest Professor, University of International Business and Economics, School of Insurance, Beijing, China, 2007-date. Co-Chair, Law and Economics Program, 2008-date.

Visiting Scholar, Massachusetts Institute of Technology, Department of Economics, 2002-2003.

- Focus on behavioral economics, public finance, and corporate finance.

Professor of Law, Cleveland-Marshall College of Law, Cleveland State University, 2001-2002. Associate Professor of Law with tenure, 1997-2001. Assistant Professor of Law, 1992-1997.

- Faculty member, Summer Law Institute in St. Petersburg, Russia, Summers 1995 and 2002. Taught Comparative Financial Services Regulation.
- Guest Lecturer, St. Petersburg State University, Moscow State University, and Volgograd State University, Russia, Spring 1994.

Partner, Mayer, Brown, Washington, D.C., 1991-1992. Associate, 1984-1990. Summer associate, Summer 1983.

- Specialized in complex banking, securities fraud, and general business law litigation at the trial and appellate levels. Represented numerous *pro bono* plaintiffs in housing and employment discrimination cases in conjunction with the Washington Lawyers' Committee for Civil Rights.
- Named Pro Bono Attorney of the Year for 1991-1992 by the District of Columbia Bar.

Law Clerk to the late Hon. Robert S. Vance, United States Court of Appeals for the Eleventh Circuit, 1983-1984.

Summer associate, Shaw, Pittman, Potts & Trowbridge, Washington, D.C., Summer 1982.

Summer associate, U.S. Nuclear Regulatory Commission, Bethesda, Maryland, Summer 1981.

*Earlier positions:* Legal assistant, McCutchen, Doyle, Brown and Enersen, San Francisco, California (1979-1980); Legal assistant, Kansas Legal Services, Pottawatomie and Kickapoo Nations (1977-1979); Research analyst for U.S. Commissioner of Education Terrel H. Bell, Washington, D.C. (1974-1975); Intern, Rep. William Roy (D-Kan.), U.S. House of Representatives, Washington, D.C. (1974); Intern, Common Cause, Washington, D.C. (1973).

## **EDUCATION**

Case Western Reserve University. Non-degree course work in mathematics, probability, and statistical analysis, 1998-2002.

University of California (Berkeley) School of Law. J.D. 1983.

- *Industrial Relations Law Journal* (now the *Berkeley Journal of Employment and Labor Law*). Editor-in-Chief, 1982-1983; Managing Editor, 1981-1982.

Ludwig Maximilians University (University of Munich) and Bavarian Film Academy, Germany. Graduate studies, 1976-1977.

- German Marshall Fund (Deutscher Akademischer Austauschdienst) Scholar.

Oberlin College. B.A. 1976, Government.

## **PUBLICATIONS**

### **Editorships and Research Appointments**

Member, Editorial Advisory Board, *The Journal of Accounting, Economics and Law – A Convivium*.

Lead Adjunct Research Scholar, National State Attorneys General Program, Columbia Law School.

Member, Editorial Advisory Board, Cambridge Series on Law, Finance, and Economics, Oxford University Press.

Symposium Co-Guest Editor, *Special Issue on Market Failures and Predatory Lending*, 15 HOUSING POL'Y DEBATE Issue 3 (2004).

### **Books**

THE SUBPRIME VIRUS (Oxford University Press, forthcoming 2010) (with Kathleen C. Engel).

FINANCIAL MODERNIZATION AFTER GRAMM-LEACH-BLILEY (Patricia A. McCoy ed., Lexis 2002).

BANKING LAW MANUAL: FEDERAL REGULATION OF FINANCIAL HOLDING COMPANIES, BANKS AND THRIFTS (Lexis 2d ed. 2000 & cumulative supplements), available on LEXIS.

Editor for 1996-2000 Releases for BARRY STUART ZISMAN, BANKS AND THRIFTS: GOVERNMENT ENFORCEMENT AND RECEIVERSHIP (Lexis 1991).

### **Book Chapters**

*Federal Preemption, Regulatory Failure and the Race to the Bottom in US Mortgage Lending Standards*, in THE PANIC OF 2008 (Lawrence Mitchell, ed., Edward Elgar Press, forthcoming 2010).

*The Impact of Predatory Lending Laws: Policy Implications and Insights* (with Raphael Bostic, Kathleen C. Engel, Anthony Pennington-Cross and Susan Wachter) in BORROWING TO LIVE: CONSUMER AND MORTGAGE CREDIT REVISITED 138 (Nicolas P. Retsinas & Eric S. Belsky eds., Joint Center for Housing Studies of Harvard University and Brookings Institution Press, 2008), working paper version at [http://www.jchs.harvard.edu/publications/finance/understanding\\_consumer\\_credit/papers/ucc08-9\\_bostic\\_et\\_al.pdf](http://www.jchs.harvard.edu/publications/finance/understanding_consumer_credit/papers/ucc08-9_bostic_et_al.pdf).

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*The Law and Economics of Remedies for Predatory Lending*, in FEDERAL RESERVE SYSTEM, CHANGING FINANCIAL MARKETS & COMMUNITY DEVELOPMENT 155 (2001) (with Kathleen C. Engel).

Contributor, AMERICAN NATIONAL BIOGRAPHY (Oxford University Press 1999) (biography of former SEC chairman William Cary).

*Special Factors Making Small Post-Socialist Economies Susceptible to Bank System Risk*, in GLOBAL TRENDS AND CHANGES IN EAST EUROPEAN BANKING 171 (Ewa Miklaszewska ed., 1998) (with Catherine D. Toth).

*Emerging Theories of Liability for Outside Counsel and Independent Outside Auditors of Financial Institutions*, in EMERGING ISSUES IN THE "NEW" BUSINESS OF BANKING (Practising Law Institute 1992).

### Articles and Monographs

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- Article formed basis of Louise Story and Vikas Bajaj, *As Woes Grow, Mortgage Ads Keep Up Pitch*, NEW YORK TIMES, Aug. 25, 2007, at A1.

*Turning a Blind Eye: Wall Street Finance Of Predatory Lending*, 75 FORDHAM L. REV. 2039 (2007) (with Kathleen C. Engel), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=910378](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=910378).

- Named Best Professional Paper of 2007 by the American College of Consumer Financial Services Lawyers.

*A Behavioral Analysis of Predatory Lending*, 38 AKRON L. REV. 725 (2005), available at <http://www.uakron.edu/law/lawreview/docs/McCoy384.pdf>.

*Predatory Lending: What's Wall Street Got to Do with It?*, 15 HOUSING POL'Y DEBATE 715 (2004) (with Kathleen C. Engel).

*A Tale of Three Markets Revisited*, 82 TEX. L. REV. 439 (Dec. 2003) (with Kathleen C. Engel).

*Realigning Auditors' Incentives*, 35 CONN. L. REV. 989 (2003).

*A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255 (2002) (with Kathleen C. Engel).

- Termed “groundbreaking” and “required reading for any policy analyst interest in the subject of predatory lending.” James H. Carr, *New Industry Developments*, in CHANGING FINANCIAL MARKETS AND COMMUNITY DEVELOPMENT 170, 172 (Federal Reserve System 2001).
- Front page of the *Wall Street Journal* cited the article’s suitability proposal and called suitability a “promising approach” that is “worth exploring.” David Wessel, *An Inner-City Predator Needs a New Leash*, WALL ST. J., Apr. 19, 2001, at A1.

*The CRA Implications of Predatory Lending*, 29 FORDHAM URB. L.J. 1571 (2002) (with Kathleen C. Engel).

YEAR 2000 READINESS FOR BANKS AND THRIFTS (Matthew Bender 2000).

*Technology Shifts and the Law: Year 2000 Readiness for Banks and Thrifts*, 19 ANN. REV. BANKING L. 153 (2000).

*Musings on the Seeming Inevitability of Global Convergence in the Regulation of Banking Law*, 7 CONN. INS. L.J. 433 (2000-2001).

THE DEMISE OF THE COMMON-LAW DOCTRINE IN *D'OENCH, DUHME* (Matthew Bender 1998).

*Levers of Law Reform: Public Goods and Russian Banking*, 30 CORNELL INT'L L.J. 45 (1997).

*A Political Economy of the Business Judgment Rule in Banking: Implications for Corporate Law*, 47 CASE W. RES. L. REV. 1 (1996).

*The Notional Business Judgment Rule In Banking*, 44 CATH. U.L. REV. 1031 (1995).

Co-author with John Pearson, *Footprints of a Just Man: The Case Law of Judge Robert S. Vance*, 42 ALA. L. REV. 987 (1991).

### **Book Review**

Review, *International Banking* by Michael P. Malloy, 12 THE TRANSNAT'L LAWYER 129 (1999).

### **Online, Newsletter, and Newspaper Publications**

Op Ed, *Another View: The Best Way to Protect Borrowers*, THE NEW YORK TIMES DEALBOOK, March 8, 2010.

*Of Loan Modifications And Writedowns* (February 2, 2010), commissioned by the Harvard University Joint Center for Housing Studies, available at <http://www.jchs.harvard.edu/>.

*Accounting for Subprime Losses: The Impact of FAS 157*, EY FACULTY CONNECTION, Issue 20 (Dec. 2007) (with Amy Dunbar), available at [http://www.ey.com/global/content.nsf/US/EY\\_Faculty\\_Connection\\_\(Issue\\_20\)](http://www.ey.com/global/content.nsf/US/EY_Faculty_Connection_(Issue_20)).

Interview panelist in *Perspectives on Assessing CRA's Impact, Effectiveness, and Applicability for the Future*, CR (COMMUNITY REINVESTMENT) REPORT (Fed. Res. Bank of Cleveland, Summer 2007), available at [http://www.clevelandfed.org/CommAffairs/CR\\_Reports/CRReport\\_summer07.pdf](http://www.clevelandfed.org/CommAffairs/CR_Reports/CRReport_summer07.pdf).

Guest Author (with Kathleen C. Engel), *Credit Slips* blog, Dec. 11-15, 2006, [www.creditslips.org/](http://www.creditslips.org/).

Op Ed titled *Mortgage rate disparities hurt borrowers, communities* in THE PLAIN DEALER (Cleveland), Sept. 29, 2006 (with Kathleen C. Engel).

*Banking on Bad Credit: New Research on the Subprime Home Mortgage Market*, published online in the Proceedings of the Third Federal Reserve System Conference (titled "Promises and Pitfalls: As Consumer Finance Options Multiply, Who Is Being Served and at What Cost?"), 2005, available at [http://www.chicagofed.org/cedric/files/2005\\_conf\\_discussant\\_session1\\_mccoey.pdf](http://www.chicagofed.org/cedric/files/2005_conf_discussant_session1_mccoey.pdf).

#### **OTHER PROFESSIONAL ACTIVITIES**

James W. Cooper Fellow, Connecticut Bar Foundation, 2009.

Adviser, Congressional Oversight Committee on TARP (headed by Elizabeth Warren).

Adviser, Obama Transition Team, 2008.

Adviser, Obama Presidential Campaign, 2007-2008.

Member, Advisory Committee on Ford Foundation Subprime Crisis Project, Harvard University Joint Center for Housing Studies, 2008 (advising on study of the boom and bust of the subprime market).

Member, Blue Ribbon Committee, Harvard University Joint Center for Housing Studies, 2006-2007 (advising on study titled *Race or Risk: From Dueling Data to Systemic Solutions*, funded by the Ford Foundation).

Member, Demos: A Network for Ideas and Action, The Debt and Assets Working Group, January 2006 (sponsored by the Rockefeller Foundation).

Program Chair, Association of American Law Schools, Section on Financial Institutions and Consumer Financial Services, 2005.

Member, Research Committee, Center for Responsible Lending, Washington, D.C., 2005-present.

Consultant, Subprime Mortgage Database Project (in tandem with the National Consumer Law Center, funded by the Ford Foundation), 2004-present.

Member, Consumer Advisory Council, Federal Reserve Board of Governors, 2002-2004. Chair, Consumer Credit Committee, 2004-2005.

- Advised Federal Reserve governors and staff on needed reforms to federal consumer protection laws and regulations on home mortgages, credit cards, other consumer loans, real estate settlement procedures, credit reporting, lending discrimination, community reinvestment, financial privacy, and home mortgage data reporting.

Director, Connecticut Bar Foundation, 2008-date. Member, Audit and Finance Committees.

Director, Insurance Marketplace Standards Association, 2003-2008. Member, Audit Committee.

Director and Treasurer, Connecticut Fair Housing Center, 2004-2007. Member, Executive Committee.

Member, Research Working Group, National Consumer Law Center, 2003-2004.

Chair, Association of American Law Schools, Section on Financial Institutions and Consumer Financial Services, 2000-2001; Program Chair, 2006.

Consultant, Ohio Public School Finance Reform Project, 1999-2000.

Consultant on Bulgarian banking reforms for Chemonics International, Sofia, Bulgaria, May 1997.

Commentator on the draft of Part I of the Russian Civil Code under the auspices of the Institute for Reform in the Informal Sector (IRIS), University of Maryland, Spring 1994.

Director, Washington Council of Lawyers, 1986-1992.

Member, District of Columbia Bar (admitted 1984).

### **TESTIMONY AND EXPERT REPORTS**

Expert for plaintiff borrowers in *Ramirez, et al. v. GreenPoint Mortgage Funding, Inc.*, Case No. 3:08-cv-00369-THE (N.D. Cal.): filed expert rebuttal report in mortgage lending discrimination case.

Expert for defendant title insurance company in *Mesa Bank v. Alexander*, No. CV2008-019063 (Maricopa County, Arizona, Superior Court): filed expert report and testified at expert deposition in mortgage fraud case.

Expert for plaintiff borrowers in *In re Ameriquest Mortgage Co. Mortgage Lending Practices Litigation*, MDL No. 1715, Lead Case No. 05-cv-07097 (N.D. Ill.): filed expert report in support of settlement and distribution plan.

Testified before the Subcommittee on Securities, Insurance, and Investment of the U.S. Senate Committee on Banking, Housing, and Urban Affairs at hearing titled "Securitization of Assets: Problems and Solutions," October 7, 2009, Washington, D.C.

Expert for defendant title insurance company in *Rubin v. Coppenger et al.*, No. CV-2006-07-4229 (Summit County, Ohio, Court of Common Pleas): filed expert report in mortgage fraud case.

Testified before the Subcommittee on Domestic Monetary Policy and Technology of the U.S. House Committee on Financial Services at hearing titled "Regulatory Restructuring: Safeguarding Consumer Protection and the Role of the Federal Reserve," July 16, 2009, Washington, D.C.

Expert for defendant title insurance company in *Countrywide Home Loans, Inc. vs. LandAmerica American Title Company et al.*, Cause No. 07-14386-I (Dallas County, Texas, District Court: 162d Jud. District): provided background consultation in mortgage fraud case.

Expert for defendant title insurance company in bankruptcy proceeding titled *Credit Suisse Financial Corporation, et al. v. Parish Marketing & Development Corporation, et al.*, C.A. 0:08-cv-01038-DWF-SRN, Claim #F34052233, F34052083, and F34052229 (D. Minn.): provided background consultation in mortgage fraud case.

Testified before the U.S. Senate Committee on Banking, Housing, and Urban Affairs at hearing titled "Consumer Protections in Financial Services: Past Problems, Future Solutions," March 3, 2009, Washington, D.C.

Expert witness for defendant title insurance companies in *Countrywide Home Loans, Inc. v. National Land Title of Tarrant, Inc. et al.*, Cause No. 06-11971-H (Dallas County, Texas, District Court: 160th Jud. District) and related litigation: filed expert report in mortgage fraud case.

Testified before the Committee on Banks, Connecticut General Assembly, in hearing on mortgage lending bills, February 28, 2008.

Expert witness for defendant title insurance companies in *Ohio Savings Bank v. Commonwealth Land Title Insurance Co. et al.*, Cause No. 2006-32092 (Harris County, Texas, District Court: 295<sup>th</sup> Jud. District): filed expert report in mortgage fraud case.

Expert witness for defendant title insurance company in *ABN AMRO Mortgage Group, Inc. v. The Mortgage Zone, Inc.*, Case No. 05-74150 (E.D. Mich.): filed expert report in predatory mortgage lending case.

Expert witness for defendant title insurance company in *ABN-AMRO Mortgage Group, Inc. v. New Partners Mortgage Company*, Case No. 1:05 CV 1167 (N.D. Ohio): filed expert report in predatory mortgage lending case.

Expert witness for plaintiffs in *State of Connecticut v. Approved Mortgages, Inc. et al.*, Docket No. HHD-X09-CV-05-40097378-S (Connecticut Superior Ct., Jud. District of Hartford): testified at expert deposition in predatory mortgage lending case.

Expert witness for plaintiff in *Devlin v. Northeast Mortgage Corp.*, original Docket No. X01-CV-03-0178670-S (Connecticut Superior Ct., Jud. District of Waterbury), later transferred to U.S. Bankruptcy Court: testified at expert deposition in predatory mortgage lending case.

Testified before the Federal Reserve Board in hearings on the Home Ownership Equity and Protection Act, Atlanta, Georgia, July 11, 2006.

Expert witness for plaintiffs in *State of Connecticut v. GRZ, LLC*, Docket No. CV 03 0829985S (Connecticut Superior Ct., Jud. District of Waterbury Complex Litigation): filed expert report and testified at expert deposition in predatory mortgage lending case.

Expert witness for plaintiff in *Heaton v. Monogram Credit Card Bank of Georgia*, Civil Action No: 98-1823 c/w 99-2603 Section: "J" (1) (U.S. District Court for the Eastern District of Louisiana): filed expert report in challenge to a claim of federal preemption by a credit card bank.