AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Gary Klein

Bass Connections

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PREFACE

The following Oral History is the result of a recorded interview with Gary Klein conducted by Jon Rosen on July 8, 2021. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

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

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Interviewee: Gary Klein
Interviewer: Jon Rosen

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Jon Rosen: I'm Jon Rosen, a student at Duke Law School and a member of the Bass Connections American Predatory Lending and Global Financial Crisis team. It is Thursday, July 8, 2021. I am speaking with Gary Klein, Director of the COVID Eviction Legal Help Project at Greater Boston Legal Services for an oral history interview. Mr. Klein joins me via Zoom. Thank you so much for joining me today.

Gary Klein: Thanks for having me.

Jon Rosen: I'd like to start by establishing a little bit about your background. I believe that you went to Yale for college and then Rutgers for law school. Is that right?

Gary Klein: Yes.

Jon Rosen: When in your career did you start working on residential mortgages?

Gary Klein: I started all the way back in 1985. In my first job out of law school, I went to Community Legal Services in Philadelphia, which is a city of homeowners. When I arrived there, I was asked to do consumer and housing work, which in those years meant helping people who had entered into very high-rate mortgages [and] who were trying to save their home. We used a number of tools to protect them from loans that were made - often with no regulatory oversight - in those years there were a series of preemptions that allowed lenders to make [mortgage] loans at rates as high as or higher than 31%.

Jon Rosen: You mentioned some of the tools that you use. Can you just expand a little more on that?

Gary Klein: The tools have changed over time, but in those early years we were using the bankruptcy system and a variety of consumer protection statutes, like the Truth in Lending Act, unfair trade practice laws, and, to the extent they still existed at that time, some of the usury laws. What we were doing is using those laws to challenge proofs of claim by high-rate predatory lenders in the bankruptcy process and to get their claims reduced to the amounts that were legally owed.

Jon Rosen: And you mentioned federal preemption. Can you just discuss that a little bit and how it affected your work?

Gary Klein: When I started in legal services, we were about five years into almost total federal preemption of state law. There were a number of different preemption statutes. There was Garn-St. Germain, which preempted a number of the traditional state protections. There was the Depository Institutions Deregulation and Monetary Control Act - the

DIDMCA we would call it - which essentially deregulated any usury limits for first position loans. There was AMTPA which was the Alternative Mortgage Transaction Parity Act. Those three laws together had the effect of essentially allowing anything goes [by preempting] state regulation. Problematically, when those laws were passed, the federal government didn't substitute a set of federal laws to provide equal consumer protections. So, consumers were kind of left defenseless in those situations.

Jon Rosen: In the 1990s, you worked for the National Consumer Law Center. Can you just talk about your role at the center and the types of matters you would work on?

Gary Klein: The center, at that time, was a backup center for legal services programs that were working on behalf of low-income consumers across the country. We supported lawyers in cases across the country. I was also able to do some direct litigation for clients in Massachusetts. I wrote about predatory lending and I was involved as a lobbyist in some of the projects the center had to get better laws passed for consumers.

Jon Rosen: Can you talk about what kind of mortgage and housing issues you were seeing at your center? And were there problematic aspects of mortgages that you were noticing?

Gary Klein: When I arrived at the center, there was a second crisis of high-rate lending that involved finance companies that often were associated with banks. For example, Fleet Bank, which at that time was a Rhode Island lender, had a separate company called Fleet Consumer Discount Company. Consumers' interest rates were often affected by which door to the bank they entered. If they walked in through the main branch banking business, they would get a fairly standard prime rate or near prime rate mortgage from the bank. But if they happened to be in a community where the only available entry point to Fleet was the finance company, they'd walk in and they'd get a rate of 19-21%, often with the same credit characteristics as people who are getting prime loans from the bank. Then there was another related problem, some lenders had developed a practice of repeatedly offering refinance arrangements to their customers. So, lenders would consistently refinance with a new set of costs, sometimes with a higher interest rate [and] often with worse terms. But always with advantages to the lender that the borrower couldn't understand.

Jon Rosen: During this time, you mentioned these loan arrangements would differ based on where you walked in. Were you noticing that there were specific demographic groups or geographic areas that were having more of these funding issues?

Gary Klein: The finance companies were very cynically set up to fill a void, particularly in communities of color. I think their goal in setting these finance companies up, in some cases, was to be able to say that they were offering loans in communities of color to satisfy their obligations under the Community Reinvestment Act. And really what they were doing is they were acting in a predatory way in communities of color and acting in a more reasonable and more consistent [manner] with marketplace fairness in the bank branches that were more typically in white communities.

Jon Rosen: I was wondering, could you expand on that Community Reinvestment Act and what these institutions were trying to do?

Gary Klein: The Community Reinvestment Act was designed to encourage banks to invest in underserved communities and in particular, communities of color. The thought process was to create banking resources in typically underserved communities. So, when a bank like Fleet Bank would offer high-rate loans in communities of color, they were only cynically meeting the requirements of the Community Reinvestment Act, [while nevertheless redlining].

Jon Rosen: During your time at the National Consumer Law Center, were you representing individual clients or was it more class action work?

Gary Klein: I did have some individual clients in those years. It was at the very beginning of the National Consumer Law Centers' litigation related work. I was representing about half a dozen clients in various communities in and around Boston. I was also working on a project with Greater Boston Legal Services at that time where I was training some of their housing lawyers to deal with high-rate mortgage problems.

Jon Rosen: In terms of mortgage and foreclosure litigation, were there major specific types of causes of action, like just general common law like unconscionability or usury?

Gary Klein: We had a number of tools that were used throughout that period of time. This was before there were a lot of specific laws directed at predatory lending. We used the Truth in Lending Act and, in particular, the rescission provision under the Truth in Lending Act. That provision allows people to cancel mortgages if they don't get all the proper disclosures associated with the loan. We had a lot of creative theories about how loans could be canceled and what the consequences of cancellation were. We also used unfair trade practice laws, which more generally prohibited unfair and deceptive practices. The reality of most of these loans is that they couldn't have been made without at least deceptive practices if not outright, unfair practices like lying to consumers about their terms.

Jon Rosen: Related to the Truth in Lending Act, can you talk a little bit about the *Beach v. Ocwen Federal Bank* decision and how that affected [the] Truth in Lending Act?

Gary Klein: Yeah, that was a very frustrating case. As part of my responsibilities at NCLC, I was responsible for lobbying Congress for certain consumer protections associated with bankruptcy, as well as preventing creditors from enacting [statutory changes] and making bankruptcy harder for consumers. One of the protections I successfully advocated was a specific provision that allowed consumers to rescind [non-purchase money] mortgage loans even after the three years expired, if they were rescinding defensively in the context of a foreclosure. And we had successfully litigated some cases across the country. I had litigated one in Massachusetts where people had exercised what I think is best called an extended right to rescind [in recoupment], as a matter of defending a high-rate loan transaction. A case went to the Supreme Court and we kind of lost control of it. The lawyer who had litigated on behalf of the consumers in that case hired somebody who didn't know any consumer law. I was frustrated because we could not, for reasons I still don't understand after all these years, convince him to argue that the Truth in Lending law allowed for late rescissions [in the context of foreclosure.]

Jon Rosen: While you were at the center, did you engage in any kind of foreclosure prevention or consumer education efforts?

Gary Klein: We did all sorts of education. I was [one of] the first authors of a book that's still published, called *Surviving Debt* which essentially was a guide for consumers about how to manage debts, including high-rate loans. But, over time, I grew frustrated with consumer education efforts. I would say there's two primary reasons for that, one is that they were often seen as a substitute for true substantive regulation. So, the education efforts allowed banks to say [that] consumers should self-educate and protect themselves from these kinds of high rate and predatory transactions. Second, I didn't think that those education efforts were really reaching the people who most needed the help. My experience in that time was that many of the consumers who were entering into these transactions were very smart people, but they weren't necessarily the kind of people who would sit through an educational class, pick up a book about predatory lending, or even necessarily read flyers that were available in the community. So, I didn't feel like it was having a huge impact.

Jon Rosen: You lobbied in support of the Home Ownership and Equity Protection Act [HOEPA] that became federal law in 1994. Can you describe what that law did and what your priorities were?

Gary Klein: I mean, we were addressing the problem as we understood it to be at that time, which was very high-rate lending in the lowest income community. Our thought was that we wanted to stop the loans that were made at rates like 15-20% with 10, 15, or 20 upfront points being charged as a percentage of the loan amount. So, we designed a law that had special protections kick in at high, or very high rates, … if there were more than a certain number of points charged, which I believe at the time the law was passed was 8 points--it came down a little bit after that-- and at rates that were above the prime rate lending level. I can amplify that by saying that I think in retrospect, the law was wrong-headed and that it contributed in some ways to some part of the mortgage crisis that followed in the late 1990s and … the mortgage meltdown of 2007 to 2008.

That's because some lenders - and AmeriQuest was the poster child for this - understood that what that law meant was they could come right up to the cap and make loans that sat just right under those cap limits. [They could then assert that their loans did] not have any special consumer protections or argue to courts that Congress had enacted a law that permitted their loans, or explicitly encouraged the loans that they were making. So, what HOEPA did is it led to a problem of scale where companies like AmeriQuest and Countrywide figured out that they could essentially make tens of millions of those very high-rate loans, as long as they didn't reach the [HOEPA] caps.

Jon Rosen: Were there things that you think now should have been in the law that might've made it better and avoided that problem?

Gary Klein: I mean, I've always been someone who believes that there is a certain point where the government has to step in and say, "This is just wrong. This needs to be prohibited." I've always believed in interest rate caps. I'm aware that those caps need to be somewhat flexible, that interest rate environments change. But if you set a cap and it's tied to the prevailing rate, there's got to be a point where the loan is at such a high rate that no reasonable consumer should have access to capital at that rate, because it's only going to lead to foreclosure or other financial problems.

Jon Rosen: While you were lobbying for the bill, did you notice major lobbying interest or factions lobbying both for and against the bill? What were the dynamics there?

Gary Klein: It was a David and Goliath battle. We were a team of advocates and non-profits, fighting a team of very highly paid lawyers and lobbyists for banks. Depending on what committee was holding the hearing and who was in charge, we'd often go to hearings and testify in settings where it was one consumer advocate and five bank lawyers. It always felt like we were the underdog.

Jon Rosen: In that effort, did you notice that there were Congress people or types of different Congress people that were more or less receptive to your arguments?

Gary Klein: Before I talk about that, I wanted to add that it was our experience that we could often get in and see staff members - Senators' staff members, Representatives' staff members - and they would hear us out, but while we were in talking to the staff members, we'd watch the bank lobbyists go by and go in and sit with the Senator or the Representative him or herself. That was just the dynamic of money in Washington. Now, to answer your question more specifically, it was not quite as clearly tied to party as it is now. There were [less partisan] divides in terms of how people looked at these issues.

The prime example of that was a former Senator from North Carolina, Lauch Faircloth, who was a Republican. He was Jesse Helms' contemporary. He was as conservative as any Senator in the Senate, but he was conservative in an old school way, in the sense that he understood, perhaps on a biblical basis, that there's a point where people need protection from high-rate lending. He was one of the senators, he and a couple of others, who, when we would testify, would often come out and sit and meet with us directly and express his concern about what was going on for his constituents. I don't think that is any longer the case. You very rarely would see a Republican Senator even paying lip service to the idea that their constituents are appropriately protected from economic interests of a powerful institution.

Jon Rosen: You spoke against the FHA raising the single-family loan limit, [which] ended late nineties. Can you talk about the FHA loan program and why you felt that the loan limit shouldn't be raised?

Gary Klein: That's a very long discussion that I don't see as completely tied to the predatory lending issue. I will answer your question somewhat orthogonally, which is that I do think that there are aspects of the nonprofit housing community and of the government regulatory process which are at least nominally responsible for protecting low-income homeowners. I do think there is an aspect of their choices that did ultimately contribute to the mortgage crisis. That is, as they subsidized loans and made it easier for first time home buyers, they didn't take account of the fact that they were creating risky home ownerships. They weren't educating consumers about the fact that as soon as they moved into their home, they were going to start getting inundated by credit card offers, refinancing offers, and all sorts of things that would take what was already risky and make it riskier. Many of the loans that companies like Countrywide and Ameriquest made were [refinance loans] made to consumers who originally had reasonably well-protected FHA loans [at far lower rates]. The other concern here is that as you raise loan limits, it's easier and easier for those making the loans to identify a class of slightly better off homeowners to make loans to and avoid the folks that the program was originally intended to serve.

Jon Rosen: In 2000 Freddie Mac launched a consumer protection campaign to educate consumers about predatory home lending practices. Did you have any experience dealing with that and what were your views of that effort?

Gary Klein: We had a contract with Freddie Mac in those years that I ran for the National Consumer Law Center, which was to experiment with different loan modification options. The importance of loan modification options, especially back then, was that it gave people essentially a second chance if they were involved in a loan they couldn't afford. So, we were working on different options that would reduce people's monthly payments, reduce their interest rates to a certain amount, reduce principal if the loan was under secured. Most of those worked pretty well. One of the unique features of that program was that everyone who was involved in modifying their loans had a community counselor to work with who could advise them about which loan [modification] terms were most advantageous. The sad thing to me was that those lessons were not passed through Freddie Mac to regulators. The Treasury, ... when the loan prices ultimately hit, designed the HAMP [Home Affordable Modification Program] program, which was for the vast majority of people a total failure, because loans weren't properly modified.

Jon Rosen: In 2001, you launched the firm Roddy Klein & Ryan, why did you think it was important to launch that law firm and what kind of matters did you pursue?

Gary Klein: The thought process there was that I was watching the industry scale up to make more and more high-rate predatory loans to more and more people. One of the problems in legal services is that you're basically representing one client at a time. In those years, we had very little latitude to file class actions in legal services. The concern is you can represent 10 people or 20 people, but you know there's another 200 or 500 people either sitting in the waiting room or waiting to get in and you're not helping those people at all. So, my thought at the time was let's explore the class action vehicle as a way that we can serve many more people by aggregating their claims. That's what we tried to do for the years I was in private practice.

Jon Rosen: Can you describe a little bit the mechanics of how a mortgage class action suit operates?

Gary Klein: We would get a dozen phone calls about a particular lender that presented a common theme, a common practice typically, where everybody was affected by the same practice. So, we would identify two or three of the people who contacted us as potential representatives of the class. And that class would include all of the people affected by that practice. The mechanics were to try to focus cases as tightly as possible on a single practice or set of practices that was generating high-rate loans and foreclosures.

Jon Rosen: Can you just talk about the kind of relief that plaintiffs would get in these mortgage class action cases?

Gary Klein: They really ran the gamut. The hard issue in a class action is getting the class certified, because there is a rule that requires certain things to be true before the class can be approved. And over the years, financial services lawyers for banks and other defendants figured out how to interject issues based on various questions, like whether there's really a common claim. Over the years, the courts have been receptive to those arguments and have made it more and more difficult for classes to be certified. In those cases where either we could get a class certified or where a lender was willing to negotiate something even before a class was certified, we would get remedies like cash back to folks for specific predatory practices. But I always thought more importantly, we'd get a set of practice changes going forward that would prevent some of the problems that led to the loans being made in the first place. We would often, as we did in Household Finance, get a set of rules for them to modify mortgages, to make mortgages more affordable to consumers. Household Finance is a great example of that. We negotiated a settlement that included a foreclosure avoidance plan under which Household Finance modified about 44,000 mortgages across the country. While I'm sure some people continued to have problems even with their modified mortgage, tens of thousands of people avoided foreclosure under that settlement.

Jon Rosen: Can you just talk a little more about the Household Finance case and that process?

Gary Klein: That was the first of the big scale class action litigation cases that I was involved in. And the bigger the scale of the litigation, the more likely it is that other lawyers around the country file similar cases. When that happens, one way or another, typically the different cases get thrown together. Sometimes that happens through the multi-district litigation process. But in that particular case, it was an informal arrangement that Household Finance encouraged so that they could resolve all of the class action litigation against them at once. We negotiated for about a full year in Chicago [and San Francisco] with an excellent mediator who really forced us to look at ways in which we could creatively address the worst of the consequences [of the loans] for homeowners. And that's how that foreclosure avoidance plan resulted.

I do think that one of the big factors in getting that case resolved is that while we were in these negotiations, which were very sticky stop and start negotiations, a big bank, HSBC, bought Household Finance and Beneficial, the two companies we were litigating against. And because [HSBC] had more of a reputational interest in getting those issues resolved, as well as some regulatory pressure to get them resolved, the dynamic of the negotiations changed, and we were able to settle the case. But I am super proud to this day of the fact that we were able to use that settlement to get mortgage modifications for tens of thousands of families.

Jon Rosen: When you were litigating these cases, were there particular parts of mortgage contracts or mortgage practices that you would generally pursue or was it all over?

Gary Klein: Well, there were two kinds of cases in those years and throughout my practice, one was cases that were based on the origination of the loan. What were the terms of the origination? What were the practices that led the borrower sometimes to enter into a loan on predatory or unfair terms? And what remedies were available in that origination context? But we also litigated over many years a set of issues about mortgage servicing. There are practices in the servicing industry - essentially the servicing is the process under which homeowners would pay back their loans. And there were servicers like Fairbanks, which is now Select Portfolio Servicing, which would - because they could earn fees off loans that were in default - essentially engage in practices designed to put people into default.

Then, the servicer would charge fees against the account. The fees were ultimately paid in many cases by the investor in the context of foreclosure, that is the loans were underwater, but these servicing fees made it very hard for homeowners to successfully prevent foreclosure. So, the fact that they had run those fees into the account just meant that more money came out of the investor's pocket in the process of foreclosure. It turned into a very lucrative business for loan servicers. And we would litigate the servicing practices that were unfair, the mortgage screw-ups in some cases, the high fees that were being charged, things like inspection fees that they would charge in every account without doing real inspections, and appraisal fees, when the house wasn't really being appraised, that kind of thing. We litigated many of those cases over the years as well.

Jon Rosen: When you were litigating these class actions, were there any ever kind of *res judicata* type issues where consumers wouldn't want to litigate for fear of giving up an opportunity to litigate later on a different issue?

Gary Klein: The complicating issue in the foreclosure and [the] mortgage world is that in some states there are judicial foreclosure statutes where people have to be sued and the mortgage has to be terminated by a court. In Pennsylvania, where I started practice, we had judicial foreclosure and we could raise defenses in court. I moved to Massachusetts where we have non-judicial foreclosure. So, the *res judicata* issues that come up typically come up in the intersection between judicial foreclosure and the opportunity for people to get remedies for predatory lending later.

Jon Rosen: You were litigating these cases right up to and during 2008 where the housing bubble - there was a housing crash. Was there a point while you were doing these mortgage class actions that you realized there was a systemic issue that might result in something like what happened?

Gary Klein: We realized that as far back as 1995. I was at a hearing in the Senate Banking Committee around 1998, [which] was convened by Senator Phil Gramm of Texas. I made the case at that hearing that there was no way that this was sustainable, because there was no way that the consumers who were being targeted for these loans could ever ultimately afford to pay them back. There is a transcript somewhere of that hearing

[when] Senator Gramm famously went on at some length about how his family and his personal wealth was built in the pawn broking industry. From his perspective, there could never be a bad loan because you were giving people money. So, he just didn't think that there could be anything like a predatory loan so, from his perspective, it was pointless to talk about it.

But over the years what I saw was an increase in scale. The poster child for that particular issue was AmeriQuest. If there was a sort of guiding genius to generating predatory loans that could be sold in the secondary market, it was Roland Arnall, who passed away after hiding all of his money in family trusts. What he understood was that with a retail banking business - and a list of leads, they would buy lead lists - he could basically call homeowners all over the country. They could scale this business up and essentially take money off the top of tens of thousands of mortgages every day without any risks, because they would turn around and sell the loans at a profit through various securities that were typically arranged by Lehman or Salomon Brothers, or one of the other financial companies in New York.

Roland Arnall perfected this to the point where one of his staff, the Capital Markets manager, would wake up in the morning at five o'clock. This is literally every morning, every day of the week. And he would get on a Capital Markets call with the Lehman brothers, Capital Markets folks, and they would tell AmeriQuest exactly what they wanted to buy that day. Just by way of example, on a given day, Lehman might say, "we can pay 103 cents on the dollar for every loan you can generate that is a two year exploding ARM [adjustable rate mortgage]", meaning that the rate is fixed on the loan for two years. Then after that, the rate starts increasing rapidly based on an accelerator, under the mortgage and the note.

And what [Ameriquest] would do at that point is they would rejigger their compensation system on a daily basis. I learned this from depositions of high-level staff. They would rejigger their compensation system every day and whatever it was that they could sell at the highest price was what earned the highest commission. They weren't telling their staff to commit fraud to generate these loans, but they were compensating them to commit fraud. Because of course, if you could earn 7 cents on the dollar [in commission], on a particular type of loan, you were going to offer that to the customers as the only type of loan available and sell them on the benefits. So, AmeriQuest had this finely tuned system where its' sales staff would generate loans that AmeriQuest could make huge profits [from]. The other aspect of AmeriQuest business, that even now to me is shocking, is that they would charge seven points upfront. If they were lending someone $200,000, they would keep $14,000 off the top.

So, they're borrowing money from a lender, lending it out to the consumer, taking 7% of the loan amount off the top, and then selling it at the end of the day for the full market value of the loan - $200,000 plus a premium of 3 to 7%. It's essentially all return on equity. There was almost nothing invested at AmeriQuest for the money they made. To top it off, those loans would include penalties and the existence of the points would act also as an additional prepayment penalty [because they weren't refundable upon refinancing]. So almost as soon as that loan was made, AmeriQuest staff was incentivized [by commissions] to call back to get the customer to agree to refinance because in the refinancing transaction they could either recover a prepayment penalty or they could charge a new set of points and get another $14,000 off the top or do both in the same transaction. That's why you would see these spiraling sets of refinancing transactions where the consumer might be getting tiny amounts of cash. We used to refer to that as equity stripping - little strips of the consumers equity would be taken out one step at a time.

Jon Rosen: …[Y]ou mentioned [that] you sued AmeriQuest in the mid-2000s. Can you just talk about that representation and how it came together?

Gary Klein: AmeriQuest was another case where a number of firms sued AmeriQuest in class actions on different theories. Again, in that context, we were put into multi-district litigation in Chicago, in front of a judge and a magistrate. I was one of the three lawyers appointed to take charge of that case. We litigated, we took dozens and dozens of depositions, got a ton of data, and ultimately started negotiating with them. The problem for us was that while we were negotiating, after years of hard work, the Attorneys Generals jumped in and, without a very substantial investigation, settled with AmeriQuest for about half a billion dollars. While half a billion dollars sounds like a lot of money, it was really a drop in the bucket. The company had stripped tens of billions and perhaps hundreds of billions of dollars out of consumers' home equity. And for consumers to get back tiny amounts was almost a slap in the face. But what it ended up doing, unfortunately, was it led to the company winding down.

By the time we were able to negotiate a settlement, there were almost no assets left that we could recover a judgment from. And we settled for an additional sum of money, but it wasn't enough. In addition, all of the loans had been sold in various ways. So, there was no way that we could get a remedy against AmeriQuest, like we had against Household Finance, that would've allowed people to refinance or restructure their loans. It was a much less successful case than Household Finance in my eyes.

Jon Rosen: Just going off of that, in your time litigating these cases, were there other lawsuits where a state-level prosecutor or a federal prosecutor would step in, or was it more siloed?

Gary Klein: It's a fairly common thing. Certainly, I'm not somebody who believes that a class action solves every problem in the world. But I'm also aware that the Attorneys General, the federal government, and the state regulatory framework have limits on what they can do and what they have achieved. Often those limits are political limits. They're looking in many cases for a quick victory so that they can announce something that might get them reelected. In other cases, they're pulling their punches because the interests on the other side are powerful and, in some cases, probably donating to their campaigns. It's a messy system. Unfortunately, I think until we go back to the old-fashioned system where some very bad practices are simply prohibited, it's very difficult to get appropriate remedies that put the cat back in the bag.

Jon Rosen: In 2008, you sued GMAC Mortgage Corp in Massachusetts. Can you talk about that representation?

Gary Klein: I probably sued GMAC more than once. I think you're probably referring not just to a case against GMAC but to a case against a variety of lenders. We sued Countrywide, Wells Fargo, Greenpoint, and half a dozen other lenders for charging higher rates to people of color than to similarly situated white borrowers. Over the years what I learned was that, while everybody was getting fleeced, people of color were getting fleeced worse. So, the objective of most of those cases was to litigate issues under the Fair Housing Act and the Equal Credit Opportunity Act to recover money for people who had paid even more in predatory loans than white borrowers where the data bore that out. It was quite clear. After we used regression analysis to find similarly situated black and white borrowers, the black and Hispanic borrowers were paying about 0.1% more for their loans in all cases on average. What that means in practical terms is that they pay about $500 more a year on average for their money, for which they're not getting any extra benefit. It's not like getting a better TV, they're getting the same amount of money, they're just paying more for it, despite equal credit characteristics to their white neighbors.

Jon Rosen: You sued Bank of America, JP Morgan and others for their noncompliance with the renegotiation of HAMP. Can you talk about those representations?

Gary Klein: I can. …I want to talk more about the Fair Housing Act cases, because I really think that the issues are probably still present in society. There is a set of implicit biases that lead to people being vulnerable in communities of color [and] to agreeing to pay slightly higher rates for the same loan product. It's still the problem that many banks have different doors open in different communities. So, I think those cases, which were not in every case successful, because of the class action rules and a decision called *Dukes vs. Walmart*, which limited what we could do in an adverse impact case in a class action. It's still an issue that needs serious regulatory attention. When we couldn't get classes certified, we turned over our data and our expert reports to the federal government. In some cases, the government did get outcomes for people of color, outcomes that totaled hundreds of millions of dollars. But it was still not as much as has been stripped out of the minority community over many years by these unequal lending practices. Do you want me to come back to the HAMP issues now? It's sort of the next chapter, so I'm happy to go there.

Jon Rosen: ... I know you testified in front of Congress on the Fair Housing Act. I was wondering if you could talk about what the Fair Housing Act does and then your experience talking with members about that?

Gary Klein: So, the Fair Housing Act is part of the civil rights laws. We spent a good deal of time litigating the question of whether you can use adverse impact analysis under the Fair Housing Act and under the Equal Credit Opportunity Act, which is another law that protects against different terms of credit to minority home buyers and homeowners. Ultimately the courts concluded that we could. ... differences in the terms of credit are one of the things that the Fair Housing Act and the Equal Credit Opportunity Act cover. The problem is that Justice Scalia in that *Dukes vs. Walmart* decision I mentioned essentially said, "unless you can show that everybody was a victim of the same discrimination [and] that everyone had the same impact from the discrimination, that the cases don't have a common question and therefore can't be litigated on behalf of a class."

What that effectively does is put litigants out of court. There's no way to litigate about whether terms of credit are different without very significant discovery costs to get the whole database of loans that the lender was making, to hire experts, to do the necessary regressions, and to take some depositions to find out how the discretion got imbedded in the pricing system. So, you're not going to do that for an individual client. What that means is unless government steps in there's no private remedy for folks who are victims of this kind of discrimination - where there's very limited private remedies, I think is probably a better framing of it. I think it's a very cramped reading of the statutes and of the class action law. It is something that I think, if we ever get to a less polarized legislative environment, it's something that really should be looked at so that people will again have remedies [and] so that they can address these problems where the proof is like we found it.

Jon Rosen: Going off of that, about the *Walmart* case, did you find that after that ruling you were kind of more restricted in your ability to pursue class actions, especially related to kind of civil rights issues?

Gary Klein: Yeah. It's one of several decisions that cut back on consumer rights. The *Inclusive Communities* case, which restricted the types of practices that could be evaluated for disparate impact, is another case. Then there've been a series of cases directly under consumer protection laws about issues like standing. [For example,] *Spokeo* and then this week, the court issued a decision in a case called TransUnion v. Ramirez - - which very, very heavily restricted standing for consumer protection claims and is going to be another barrier for remedies to consumers in coming years.

Jon Rosen: If we could just go back to the HAMP issue and your experience.

Gary Klein: Sorry to preempt your question earlier. We reached the point where we started getting calls from all over the country from people who were saying that they had not just reached an agreement on a loan modification, but had complied with their trial period plan. Then the lender didn't follow through by actually providing them with the modification. So, we developed a contract theory that essentially [said] the trial payment plan, if honored, led to a binding contract, which required the lender to provide a permanent loan modification that was more affordable to the homeowner. It was chaos and the Treasury simply did not come down on the lending community to make them honor the commitments they were making. The lending community very disingenuously would engage in wholesale practices of destroying information that consumers sent them [and] failing to update their books to honor modifications.

It led to tons of foreclosures that never should've happened. We attempted to litigate those issues and, I would say, it was very difficult for similar reasons, to some that I've discussed about the class action rule - the cramped reading the courts were willing to give to what are common questions made it very difficult for us to get even injunctive relief to have courts mandate that lenders honor the modifications that consumers completed. We had data from half a dozen or more mortgage companies that showed a pervasive pattern of payments being miscredited, payments being misdated, [and] of information not being entered into the correct files. There's always a question in these cases of whether that was done in a venal way or [if] they were just incompetent. There's one school of thought that they very much didn't want to undertake a process that was somewhat costly to them to meaningfully modify people's mortgages, to give homeowners a second chance, despite the national crisis that they created. For the most part, these were the same banks who created the mortgage crisis by predatory lending practices.

The other school of thought is that [banks] just didn't have staff that were well-trained to manage the flood. I mean, there were millions and millions of families looking for modifications. This is another situation where the Attorneys General stepped in. They got a settlement that, I think was misrepresented to the public. A lot of what they claimed credit for was getting debt written off that was never going to be paid back at all. So, treating it as if it was a dollar saved was a misrepresentation in some ways. And the remedies that were in place did not, in most cases, without a lot more work on a case-by-case level analysis, result in the modifications that people were entitled to. I will say that my own state, Massachusetts, did a much better job through its Attorney General office than some of the Attorney General offices in other states. But even in Massachusetts, the remedy was paltry in light of how many people lost their homes under unfair circumstances.

Jon Rosen: Can you just expand a little on that? Why the remedy wasn't adequate to the problem.

Gary Klein: Because once the errors occurred, it was very difficult to put the borrower back where they should have been post-hoc. That is, the accounting is so messed up, so many fees and charges got run into the loan. So [it was] difficult to figure out how to recalculate the interest to make it consistent with what the consumer was contractually entitled to. And it was very difficult in some cases to figure out how to provide any remedy at all for someone who actually lost their home to a foreclosure, was out of the home and would have had to unwind a foreclosure related transaction where there was a third-party purchaser and someone new in the property. I mean, if I were going to sum up my career, it's like a whack-a-mole game over many years.

We would see one problem and we come up with a strategy to address it, as we've discussed, often using class actions. But somebody was out there in that same period of time, developing a new way to generate either high-rate loans, to generate income from poor servicing choices or to create a basis on which they could charge more in communities of color. I worry about that. While we might be in a slightly better position now and with the Consumer Financial Protection Bureau, there's more of a watchdog, I am fairly certain that we're just waiting for some of the same folks to crawl back out from under rocks, where they've been hiding, in order to engage in similar practices in new ways.

Jon Rosen: Do you mind if we go a few minutes over?

Gary Klein: I don't mind. ... No one ever asks about these things. So, as you can tell, I'm very eager to talk about them. It's been a pleasure to answer questions about these issues, after all these years and with some hindsight.

Jon Rosen: Great. During the 2008 crisis, Fannie and Freddie had a network of law firms that mortgage firms would use. Can you talk about your experiences with those firms and your view [of them]?

Gary Klein: The law firms that were handling foreclosures, not just for Fannie and Freddie but for banks and other mortgage holding entities, like trusts, really became part of the problem. They were narrowly focused on foreclosures. They were unwilling to consider that a consumer could have a defense to a foreclosure. They would often not even know what records were available to prove that a homeowner was in default. I'm aware of instances where these law firms would pursue a foreclosure, even on a borrower who had paid their loan up to date. The law firms interfered with any opportunity to work through what the borrower truly owed and to provide solutions if there was a delinquency. But the other big problem is that these foreclosure firms were charging flat fees, retainers that had nothing to do with how much work they were putting into cases.

From their perspective, their fees were fair because a complicated foreclosure might lead to $5,000 worth of work and a simple foreclosure might've been $500 worth of work. If they charged everyone $2,500, their fees were fair. But the problem is that the guy who had a foreclosure where the lawyer only did $500 work really can't be asked under any fairness analysis to pay the extra costs for their neighbor whose foreclosure cost the law firm $5,000. So, I considered that and still consider that an industry-wide abuse. The other thing that was going on in some of these years is that nobody really had a sense of who the legal owner of the mortgage was. They weren't even suing [or foreclosing] in the correct name. So, there were many foreclosures that, under any kind of a strict analysis of state law, were not leading to a valid termination of the homeowner's rights or proper foreclosure sales.

Jon Rosen: You mentioned earlier that some states have a judicial foreclosure system, but others have a separate administrative procedure. I was wondering if you could just talk about those systems and your evaluation of them?

Gary Klein: Well, some states don't even have an administrative procedure, they just allow the lender to go forward in a private sale. So, the borrower has to come forward and hire someone to create a legal action, if they're going to raise any defenses at all. Otherwise, the court has no visibility onto the foreclosure at all. Judicial foreclosure states are imperfect in the sense that a lot of the foreclosure actions are essentially rubber stamps for the foreclosing entity. But at least they provide some opportunity for homeowners to raise claims that the foreclosure is unfair, [or] that the amount claimed due is wrong. It's an opportunity, in some cases, for the borrower to generate enough delay to get back on their feet. It might take six months, at which point the borrower may have a feasible plan to start paying their mortgage again and appropriately apply for a modification.

Given that a home is, in most cases, the most important asset that an American family might own, the idea that a foreclosure should essentially run with no oversight or protection for the family is quite shocking from any sort of due process point of view. One quick story, which is that at one time I was asked to talk to members of the Russian Duma about foreclosures in the United States, because they were creating a free enterprise system [in Russia] and they wanted to understand what the issues were in [allowing] foreclosures [of privately made mortgages]. The Duma members were probably the most receptive audience I ever had to the idea that you shouldn't be allowed to simply rip somebody's house out from under them without even giving them an opportunity to protest. That was something that was very inconsistent with the socialist aspect of the communist economy. It was striking how they had no tolerance for the idea that the state had no responsibility to make sure that people got a fair shot to keep their homes.

Jon Rosen: Looking back on the crisis over a decade later, what do you see as the most important lessons for policy makers?

Gary Klein: I've touched on some of them. I think number one is that there should be prohibitions. There are some things that should be so far out of bounds that lenders aren't allowed to try them, very high-rate loans are an example, [as well as] certain terms that are incomprehensible to the average consumer, balloon payment type loans to people who don't have the prospect of having higher income or assets when the balloon comes due, all those things should be flatly prohibited. The other really important thing here is that consumers are at sea without advocates. When I talked earlier about a problem of scale, it's because there is almost no safety net for consumers across the country who are being treated unfairly. What that means is they have nowhere to turn.

There's no network that's going to help them with their legal claims. There's no network that was available when AmeriQuest was running rampant making predatory loans across the country. There was no network of lawyers readily available to help. So, better funding for legal services for low and moderate-income consumers is essential. The other thing [that] is important for people to understand is that the system runs better when regulators are present and paying attention. When the Consumer Financial Protection Bureau is given broader authority and when state banking regulators are not captured by banks, we're going to have a more even playing field. So, I really feel strongly that states and the federal government can't overly coddle the business community. Yes, they have a valid point of view. Yes, we don't want to undermine them to the point they don't have viable businesses. But, no, they shouldn't be the only point of view, there needs to be consumer representation and there needs to be a thumb on the scale in favor of consumers.

Jon Rosen: We're nearing the end of the interview. Is there anything that I didn't ask about that you'd like to talk about?

Gary Klein: I'm sure there is, but I do feel like I've had a nice cathartic opportunity to talk about things that in many ways are swept under the rug, even though we're still only a short time from the financial crisis and the economic meltdown caused by abusive lending. I don't think the problem has been fully studied and I would love to see researchers really drill down into what was going on, because I think there are a lot of unlearned lessons. I do think that the problem will recur unless we create a meaningful history of what really happened.

Jon Rosen: Well, thank you so much, Mr. Klein. It was really great to speak with you. Thank you for your time.

[END OF SESSION]