EXPERT REPORT
(In Response to Expert Report of Joel Spolin)

In the Matter County of Cook Illinois v. Bank of America, et al,

Civil Case No. 14-CV-2280 (N.D. Ill.)

DR. GARY LACEFIELD

January 13, 2021

I am issuing this report in response to the Expert Report of Joel Spolin ("Spolin Report"). The paragraph numbers set forth below correspond to those in the Spolin Report and I incorporate by reference my November 9, 2020 Expert Report ('Lacefield Report").

For the reasons and analysis set forth below, I disagree with Mr. Spolin's conclusions and confirm the analysis and conclusions in the Lacefield Report.

Para 13. I did not have to review individual loan files because the performance of the loans speaks for themselves. Had Mr. Spolin reviewed loan files he would have discovered serious flaws with the Defendants' origination, underwriting, and servicing of subject loans during the relevant period (2004 – 2018). There existed additional data to indicate the Defendants did not comply with its own origination, underwriting, and servicing policies and procedures prior to and after the relevant period.

Para 16.a. My report does not misrepresent how underwriting guidelines are used and I did not ignore the 'inherent subjectivity and complexity' of loan origination decisions. Based upon former Defendant's executives and other employee's statements under oath, Defendants admitted that typical origination and underwriting guidelines were ignored for the sole purpose of increasing production. These same former employees indicated that borrower's income and debts were manipulated for the purposes of loan production. See Lacefield Report, Appendix 7 at ¶¶26-27 (citing August 21, 2014 Department of Justice, Settlement Agreement, Annex 1-Statement of Facts, Bank of America to Pay $16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis ("DOJ Settlement") at p. 9-11); Lacefield Report, Appendix 7 at ¶¶43-47; 52 (citing Declaration of Michael Winston dated October 25, 2020 ("Winston Decl.") at ¶¶ 5-6, 9-12, 17); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶93 (citing deposition testimony of Brian Robinett at 151:22-152:2; 161:24-162:8); Lacefield Report, Appendix 7 at ¶98 (citing deposition transcript of Cindi Graveline-Thomas at 115:4-12; 116:2-14; 118:2-25).

Para 16.b. My 'red flag' analysis is not arbitrary, flawed, or inconsistent with underwriting practices. Each red flag or delimiter on its own can be a factor in determining whether a loan will perform. The individual delimiter on its own may not indicate a discriminatory effect, but combinations of these delimiters demonstrated that the impact on minority families living in predominately non-white neighborhoods was discriminatory and resulted in a statistically significant adverse impact on these families.

Para 16.c. My report does not mischaracterize non-traditional loan products as inherently Discriminatory. My emphasis was that the performance of non-traditional loan products indicated that the application of these loan products by the Defendants had a discriminatory impact in neighborhoods that were predominately minority. I agree with Mr. Spolin that many of these non-traditional loan products provided 'access to credit for borrowers who would not qualify for traditional loans'. However, due to the fact that the Defendants did not follow their own origination and underwriting guidelines, these actions intentionally caused harm to African American and Hispanic families. Minority borrowers may have qualified for a mortgage, just not the mortgage the Defendants placed them in. Additionally, my conclusions were not erroneous regarding Defendant's lending practices. Sworn testimony from Defendant's executives, supervisors, and other key employees revealed that Defendants intentionally did not follow safe, prudent, and reasonable lending practices and procedures. See Lacefield Report, Appendix 7 at ¶ 48-53 (citing Winston Decl. at ¶¶ 13-18); Lacefield Report, Appendix 7 at ¶65 (citing deposition transcript of Rebecca Steele at 54:20-55:12, deposition transcript of Joseph Miller at 191:5-192:7, BANACC0000183874, and BANACC0000194516); Lacefield Report, Appendix 7 at ¶99-100 (citing deposition transcript of David Doyle at 193:10-19).

Para 16.d. I do not claim 'without evidence' that because Defendants purportedly planned to sell the majority of their loans to the secondary loan market that their underwriting was defective and substandard. Further, I do not opine that simply because loans are sold constitutes defective and substandard underwriting. It is the resulting significantly high foreclosure rate in predominantly minority neighborhoods along with Defendant's statements under oath is the factual "evidence" used to determine discriminatory impact. Based upon sworn statements by Defendant's executives and supervisors that had authority over appraisal policy[1], it was the Defendant's policy and practice to "overvalue" collateral with the express knowledge of management[2]. Evidence revealed that if an appraiser did not "value" the property at the contract price, regardless of its true value, the appraisers would no longer be employed or used by Defendants. Therefore, appraisers were induced to overvalue properties or lose their positions.[3] I did appropriately delineate between the different underwriting and origination guidelines used by the Defendants prior to their merger. It was Defendants that continued with the same origination and quality control practices for years after the merger.

Para 16.e. Mr. Spolin is inaccurate when he states that I implied Defendant's underwriting policies were intentionally designed to disadvantage minority borrowers. I opined that it was the "application" of the underwriting policies, practices and procedures that resulted in causing discriminatory adverse impact on minority families living in predominately non-white neighborhoods.

Para 17. Mr. Spolin states that underwriters for Defendants used a holistic approach to determine the borrower's ability and willingness to repay the loan and that the Defendant's underwriting guidelines was simply a tool to aid in this determination. I opined that underwriting guidelines are more than just a tool and represents the bulk of the lender's decision-making process for each loan. Lacefield Report, Appendix 7 at ¶¶69-71. Loan products and programs have specific

[1] Declaration of Michael Winston dated October 25, 2020 at ¶54.
[2] *Ibid*.
[3] *Ibid*.

guidelines not only based upon investor requirements and the resulting risk associated with any loan product. A loan may become unsalable if the underwriting guidelines are not followed.

Para 18. I did not misrepresent these fundamental principles of mortgage underwriting, however, "Defendants routinely originated loans without consideration of the borrowers' ability to repay" and instead originated loans based on the 'value' of the collateral. Mr. Spolin apparently ignored sworn statements of Defendants' executives and staff employees that clearly indicated that Defendants routinely ignored and/or altered information without consideration of the borrowers' ability to repay only the ability of the Defendants to close loans. *See* Lacefield Report, Appendix 7 at ¶¶25 (citing DOJ Settlement at pp. 10); Lacefield Report, Appendix 7 at ¶ ¶46-47 (citing Winston Decl. at ¶¶ 10-12). Mr. Spolin does accurately state Bank of America's 2009 loan underwriting manual and its purpose. However, Bank of America did not follow its own underwriting guides through policy, practice, or procedure in determining the borrower's ability to repay the mortgage, viewing this factor secondary to production.

Para 19-21. I agree that the written policies, expected practices, and formal posted guidelines are consistent with industry standards. However, it was the Defendants' application of these policies, practices, and procedures that loan officers and underwriters ignored or simply did not follow. Defendants' actions, based upon foreclosure rates and sworn statements by many of Defendants' employees, revealed that the primary "objective" of Defendants was to close and fund as many mortgage loans as possible regardless of the borrower's ability and willingness to repay.

Para 22-23. Mr. Spolin accurately depicts what Defendants guidelines state, but originators, underwriters, and appraisers did not follow those guidelines. Mr. Spolin states that there "are no simple yes-or-no answers" when it comes to determining the ability of borrowers to perform, however certain verifiable factors can objectively influence ability to pay. For example, a borrower with a fixed hourly income knows exactly what that income is via pay stubs and bank statements. Where Defendants also knew the exact borrower income but placed the borrower in a loan product with documentation type "stated income," which means the borrower does not have to prove his or her income, the only reasonable conclusion is the borrower could not qualify for the loan product if the borrower had to reveal their true income. Therefore, the lender places the borrower into this loan documentation type for the sole purpose of "qualifying" the borrower, the exact opposite of originating loans that the borrower has the ability to repay. In my three plus decades of reviewing loan files, I have never seen borrowers state their income lower than it actually is (with the exception of borrowers who intentionally understate their income in order to qualify for government subsidized programs that have a maximum income ceiling or borrowers that are trying to hide assets from the IRS).

Para 26. When I described the change in underwriting tolerances as "further loosening" underwriting standards, I was being conservative. I agree that risk changes over time, however, during the relevant period as underwriting guidelines changed-the changes were made in order to originate more loans to borrowers who could not qualify. For example, a certain loan product has an underwriting guideline of 620 minimum credit score. The loan documents provided by the Defendants indicated that many loans originated had credit scores between 600 and 500. *See* Lacefield Report, Appendix 7 at ¶111 (citing BANACC0000522887, FICO tab); ¶116 (citing BANACC0000522890, HMDA Stage 2-327 Analysis tab); ¶117 (citing BANACC0000720362 2007 HMDA Analysis and BANACC0000720366). Based upon Mr. Spolin's analysis, a compensating factor was probably used by underwriting to "adjust" the minimum credit score downward. In fact, my analysis revealed that there were no compensating factors indicated such as LTV, CLTV, lower debt-to-income ratios, etc., to justify approving the loan in most cases with a lower credit score. I agree with Mr. Spolin that "guidelines always required the underwriter to ask and answer the fundamental question: Did the borrower have the ability and willingness to repay the loan?" Unfortunately, Defendant underwriters may have asked the question but did not follow through by determining the answer.

Para 27. Mr. Spolin points out the Defendants used automated underwriting systems (AUS) to issue recommendations for loan approval or denial. However, any computer based AUS recommendations are only as good as the information input into the system. Statements made under oath by former Defendant employees revealed that loan officers manipulated the "input" by overstating borrower income and assets while understating the borrower's debt. Real estate agents, brokers, and lenders coached uninformed and unsophisticated borrowers to provide inaccurate information in order to qualify. Defendants "qualified" borrowers for loan products and programs such as SISA, SI, NINA etc., where consumers do not have to prove how much money they make or prove assets or even if the borrower is employed. *See* Lacefield Report, Appendix 7 at ¶ 95 (citing deposition transcript of Brian Robinett at 236:8-239:12; 240:4-15); Lacefield Report, Appendix 7 at ¶¶37-38 (citing DOJ Settlement at p. 14). I agree the underwriter has the ability to reject the AUS decision if, for example, there are significant errors in the data used for approval. The problem is that underwriters did not challenge the "significant errors" in many cases because management over-ruled the underwriters' decision based upon fears and concerns as set forth in the sworn statements made by Defendant underwriters' staff.

Para 32. I agree with Mr. Spolin when he states, "…no matter which underwriting guidelines are used to originate a loan, a lender generally will not approve and fund a loan until the underwriter determines that the borrower has the willingness and ability to repay the loan…" However, the results of the performance of many of these loans as well as sworn statements by ex-Defendant employees, revealed that the lender did approve thousands of loans where the borrower did not have the ability to repay the loan. *See* Lacefield Report, Appendix 7 at ¶¶25 (citing DOJ Settlement at pp. 10); Lacefield Report, Appendix 7 at ¶ ¶46-47 (citing Winston Decl. at ¶¶ 10-12).

Para 33. Mr. Spolin accurately depicts my opinion that "mortgages were underwritten without regard for a borrower's ability to repay the loan" but I disagree with Mr. Spolin's assertion that I stated that "loan approvals were based solely upon borrowers' collateral without considering their ability to repay" to the extent that Mr. Spolin implies that I opined that "all" loan approvals were based solely on collateral. Based on my experience as a Certified Fraud Examiner, the only reasonable explanation that so many loans went into foreclosure in predominately minority communities was for the purpose of stripping any perceived or earned equity. For example, thousands of borrowers were placed in adjustable-rate mortgages (ARMs) with a "teaser" rate of 'x'. The underwriters approved these loans based upon this initial low teaser rate instead of the fully indexed rate required by law. These rates adjusted in different time frames based upon the product, some as quickly as 90 days. A borrower approved for a mortgage loan based upon the teaser rate may not qualify for the same loan when the rate makes its first adjustment due to the increase of debt (increase debt-to-income ratio). For example, where the teaser rate was 3.5%, three months later the rate adjusts to the standard rate of 8.5%. Unless the borrower had a substantial increase in income, the borrower would not be able to satisfy the increased payment. Add that scenario to the high probability that the property was overvalued with a "qualifying" appraisal. So when the loan goes into foreclosure because the borrower did not have the ability to repay the loan on overvalued collateral, the lender benefits to the detriment of the borrower.

Para 34. Contrary to Mr. Spolin's opinion, I do believe written and posted underwriting guidelines are established on paper to determine risk. However, it is the application of underwriting policies, practices, and procedures that were not adhered to based upon sworn testimony from Defendant employees as well as the resulting foreclosures. *See* Lacefield Report, Appendix 7 at ¶¶26-27 (citing DOJ Settlement at pp. 9-11); Lacefield Report, Appendix 7 at ¶¶43-47 (citing Winston Decl. at ¶¶ 5-6, 9-12); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶93 (citing deposition testimony of Brian Robinett at 151:22- 152:2; 161:24-162:8); Lacefield Report at ¶133 (citing foreclosure data); Lacefield Report, Appendix 7 at ¶43 (citing Winston Decl. at ¶8). Once again, I have never implied that all loans were solely approved based upon the collateral.

Para 37. Mr. Spolin alleges that I ignored the fact the Defendants are "cash flow lenders," and as Mr. Spolin points out that, "As the guidelines clearly indicate, both Bank of America and Countrywide were cash flow lenders with guidelines that required full credit review and an assessment of ability to repay during the underwriting process." My review of the guidelines revealed that there were many programs in which the Defendants placed thousands of borrowers in mortgages, where the guidelines did not require a 'full credit review' or an assessment of the borrower's ability to repay. Examples of these programs, as previously mentioned, included stated income-stated-asset loans and no income-no asset products. Then there were programs such "reduced doc" even "no doc" that describes the level of documentation required to approve the loan at a lesser document standard. These loans have not been reviewed to Mr. Spolin's stated full credit review and assessment of the ability of the borrowers to repay standard.

Para 38. I justifiably opine that Defendants did not comply with or disregarded industry standards, underwriting practices, and their own origination policies and practice based upon sworn statements by Defendant's employees and resulting foreclosures. Mr. Spolin opines that I misused the word "delimiters" versus the phrase "red flag." A "red flag" is an issue you look at to prevent something bad from happening, while a 'delimiter' is an issue you review after it has already happened. Therefore, underwriters do use the term 'red flag' appropriately before the loan is closed, while we are analyzing Defendant's data we are identifying "delimiters" which is after the fact.

Para 39 - 40. Mr. Spolin states that my use of "red flags" to attempt to show disparate impact was arbitrary and flawed. He is incorrect. Mr. Spolin states that "a detailed loan-level analysis is necessary to assess a loan's compliance with the applicable underwriting guidelines." I disagree. The loan level documentation provided by Defendants would be more than enough information to determine if a loan substantially complied with underwriting guidelines. I never implied that the "use of a single red flag for a group of loans" was the basis to form a conclusion of whether compliance with underwriting guidelines was taking place. However, a single delimiter such as "income insufficient to support loan amount" would be a great indicator that the borrower does not make enough money to repay the loan.

Para 41. The delimiters I identified were not 'invented' by me but represent more than three decades in the industry with my primary expertise focused on compliance and quality control regarding the review of loan data relationship relative to underwriting standards and investor guidelines. The delimiters are all issues that underwriters must consider. For example: there is no justification or compensating factor that I am aware that would allow an underwriting approval for a "stated income" loan to a 40-hour per week secretary paid hourly.

Para 42. Mr. Spolin opines that without an individual loan file review, a determination of compliance with underwriter standards and steering cannot be accomplished. He is wrong. First, a plethora of sworn statements from ex-Defendant employees including front line supervisors and executives show that Defendants did not comply with underwriting guidelines. *See* Lacefield Report, Appendix 7 at ¶¶26-27 (citing DOJ Settlement at pp. 9-11); Lacefield Report, Appendix 7 at ¶¶43-47 (citing Winston Decl. at ¶¶ 5-6, 9-12); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶93 (citing deposition testimony of Brian Robinett at 151:22- 152:2; 161:24-162:8). Secondly, the statistically significant high foreclosure rate in predominately non-white neighborhoods is gleaned from the Defendant's own data. And third, the review of delimiters per loan identified from Defendant's data provides an indication as to why a loan did not or could not perform.

Para 43. I do state that Countrywide approved loans regardless of whether the consumer had the ability to repay. A loan-level analysis would not be required in order to determine if any loan was approved without an analysis of willingness and ability to repay, or whether the loan complied with the guidelines. I agree that the applicable guidelines have explicit directions about how to assess a borrower's ability to repay and the underwriter must follow those guidelines. However, Defendants did not follow their own underwriting guidelines, based upon sworn testimony from former Defendant employees, the resulting high foreclosure rate, and the number of delimiters identified. *See* Lacefield Report, Appendix 7 at ¶¶26-27 (citing DOJ Settlement at pp. 9-11); Lacefield Report, Appendix 7 at ¶¶43-47 (citing Winston Decl. at ¶¶ 5-6, 9-12); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶93 (citing deposition testimony of Brian Robinett at 151:22- 152:2; 161:24-162:8). A borrower's ability to repay can be computed from aggregate data alone.

Para 44. I agree that loan underwriting requirements are different for lenders, loan programs, and loan products. Mr. Spolin states, "For example, on a loan program where the DTI ratio can go up to 50%, a DTI ratio of 45% would not be considered a red flag. If another set of guidelines allowed only a 38% DTI ratio, then the 45% DTI ratio would be a red flag." However, if the same examples had identified other 'red flags' in addition to the DTI ratio, then that would be an indication the loan was approved without consideration of the borrower's ability to repay.

Para 45-51. I agree that the Defendant's policies require a determination of the ability and willingness to repay. However, contrary to industry standards, Defendants did not comply with their own underwriting guidelines based upon sworn testimony from former Defendant employees, the resulting high foreclosure rate, and the number of delimiters identified. *See* Lacefield Report, Appendix 7 at ¶¶26-27 (citing DOJ Settlement at pp. 9-11); Lacefield Report, Appendix 7 at ¶¶43-47 (citing Winston Decl. at ¶¶ 5-6, 9-12); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶93 (citing deposition testimony of Brian Robinett at 151:22- 152:2; 161:24-162:8).

Para 52. In my opinion, if the raw numbers do not make sense, a red flag should go up and the lender should question the reasonableness of the loan amount or program. This statement is not false and is not contrary to how mortgage underwriters work and think. Relying on a simple "red flag" test across one dimension does provide evidence that should be reviewed that an underwriter acted in a manner inconsistent with the lender's own underwriting philosophy and guidelines. Red flags are exactly what they mean, indicators of issues that should be reviewed and to ensure a consumer will have the ability to make their monthly payments. Having underwriting policies and guidelines in place are irrelevant if the Defendants did not follow their own policies and guidelines as confirmed by former Defendant executives and staff's sworn statements and confirmed by the resulting foreclosures. *See* Lacefield Report, Appendix 7 at ¶¶26-27 (citing DOJ Settlement at pp. 9-11); Lacefield Report, Appendix 7 at ¶¶43-47 (citing Winston Decl. at ¶¶ 5-6, 9-12); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶93 (citing deposition testimony of Brian Robinett at 151:22- 152:2; 161:24-162:8).

Para 53. My "red flag" approach does not "oversimplify" borrower risk but identifies key factors that should be considered. All of the loans that went into default had at least one of my "red flags" and I did consider sworn statements from Defendants' former employees that policies and practices were underwritten outside of Defendants' guidelines without consideration for the ability to repay. *See* Lacefield Report, Appendix 7 at ¶¶25 (citing DOJ Settlement at p. 10); Lacefield Report, Appendix 7 at ¶ ¶46-47 (citing Winston Decl. at ¶¶ 10-12).

Para 54-55. My D-1 red flag does act as a test if "Income [is] Insufficient To Support Loan Amount." Every legitimate lender of which I am aware uses the industry "rule of thumb" that the mortgage loan amount should be less than 2.5 times gross income.[4] Another article states, "The 2.5X rule: This rule says to choose a home priced at about 2.5 times your annual household income. Example: If your income (minus taxes) is $180,000, you should be looking at homes priced around $450,000."[5] This is just one article of several hundred that I identified to confirm my assumptions. It is clear that Mr. Spolin and I come from very different backgrounds. My red flag is only an indicator, it is not intended to be used as exact criteria for underwriting a loan. It is, however, an indication to the home buyer of the maximum property value they should look for in order to be able to afford a mortgage.

Para 56. Mr. Spolin is correct when he states that all of my red flags "are not necessarily guideline violations..." My red flags are exactly that -- indicators as to why a loan might have failed or is to be considered a high-risk factor. Additionally, first time home buyers are typically unaware or unsophisticated with the mortgage process. "Buying a home for the first time can prove to be a challenging task. First-time buyers often don't know the meaning of real estate and mortgage terms. The amount of paperwork needed to close a mortgage loan sometimes overwhelms them. And the amount of money they need to put together to purchase a home can be intimidating."[6] Once again, I agree the Defendants had policies in place but did not enforce those polices as reflected in sworn testimony from former Defendant employees and resulting foreclosures. *See* Lacefield Report, Appendix 7 at ¶¶26-27 (citing DOJ Settlement at pp. 9-11);

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[4] Guerra, *Home Guides: The Recommended Ratio of a House Price to Your Yearly Income* SF Gate, last accessed Jan. 12, 2021, https://homeguides.sfgate.com/percent-income-banks-require-towards-mortgage-payment-94740.html

[5] C.E. Larusso, 2020, *How Much House Can I Afford? 8 Rules of Thumb to Help Estimate*, Homelight.com, last accessed Jan. 12, 2021, https://www.homelight.com/blog/buyer-how-much-house-can-i-afford-rule-of-thumb/#:~:text=If%20you're%20following%20this,payment%20(principal%20and%20interest).

[6] Rafner, *Home Guides: What Are Some Challenges of a First Time Home Buyer?* SF Gate, last accessed Jan. 12, 2021, https://homeguides.sfgate.com/challenges-first-time-home-buyer-7811.html

Lacefield Report, Appendix 7 at ¶¶43-47 (citing Winston Decl. at ¶¶ 5-6, 9-12); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶93 (citing deposition testimony of Brian Robinett at 151:22-152:2; 161:24-162:8).

Para 57-58. I asserted that Defendants "discriminated against Black and Hispanic borrowers in their loan origination activity based on loan product type" for the same reasons as explained in para 56. Additionally, a HUD reported study in part stated, "Private market products such as teaser rates, hybrid adjustable-rate mortgages, and negative amortization were often used to qualify borrowers who would be ineligible under traditional underwriting practices. These nontraditional mortgages, with their higher costs and higher-risk qualifying advantages, disproportionately went to minorities and low-income borrowers and clearly were not designed for sustainable homeownership." [7] This same HUD report stated that one of the barriers for first time homebuyers is "…lack of knowledge about buying a home and sustaining homeownership."[8] A New York Times article by Gretchen Morgenson stated "… many lenders peddled the most abusive and costly loans to unsophisticated, first-time home buyers. Known as "affordability products," the mortgages generated big commissions up front and were designed to require refinancing later on — which included yet another round of luscious fees for lenders."[9] Morgenson also stated that, "With refinancing no longer an option, it is becoming obvious that these loans were designed to fail. True to their design, they are. And those who thought they might get a chance at owning a home are headed back to the rent rolls."[10] As far as consumer preference, unsophisticated as well as sophisticated borrowers rely on the lender to help them determine what loans they might be qualified for. Mr. Spolin stated that I did not address 'credit quality', which I do address in Delimiter 12 - Credit scores under or less than 560.

Para 59-60. In my opinion, based on the high number of delimiters identified and the foreclosure rates by minority census tracts, and my response in para 57-58, race and ethnicity was a determining factor in who received subprime loans by the Defendants, and the data provided by Defendants revealed that a statistically significant number of minorities received subprime loans compared to White applicants. My experience with whether a borrower would be better off with a subprime mortgage versus an FHA loan is based upon my role as vice-president for Compliance and Quality control with Centex, a Fortune 500 company. Centex had CTX as its prime lender and had Centex Home Equity as its subprime lender. My review of hundreds of loans revealed that over 85% of borrowers would have been better off with an FHA loan than a subprime loan. Interviews with brokers and loan officers revealed that loan officers pushed

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[7] Department of Housing and Urban Development 2012, *Paths to Homeownership for Low-Income and Minority Households*, last accessed Jan. 12, 2021, https://www.huduser.gov/portal/periodicals/em/fall12/highlight1.html.
[8] *Ibid*.
[9] Morgenson 2007, *Blame the Borrowers? Not So Fast*, The New York Times, last accessed Jan. 12, 2021, https://www.nytimes.com/2007/11/25/business/25gret.html
[10] *Ibid*.

consumers to subprime because the loan officer would make significantly more money on a subprime loan opposed to an FHA loan. Anecdotally, on a due diligence mission for Centex to examine loans in a portfolio to be considered for purchase from New Century Mortgage revealed that of 100 subprime files I reviewed, all 100 would have qualified for an FHA loan. Additionally, upon review of 50 loans that were subprime and had gone into default, all 50 loans would have qualified for FHA approval and would have better served the borrower.

Para 61. I agree with Mr. Spolin that it does not make sense that Countrywide would focus on maximum production regardless of the borrower's ability to repay. However, that is exactly what they did based upon sworn statements by former Countrywide executives and staff, confirmed with high foreclosure rate. *See* Lacefield Report, Appendix 7 at ¶¶26-27 (citing DOJ Settlement) at pp. 9-11); Lacefield Report, Appendix 7 at ¶¶43-47, 52 (citing Winston Decl. at ¶¶ 5-6, 9-12, 17); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶98 (citing deposition transcript of Cindi Graveline-Thomas at 115:4-12; 116:2-14; 118:2-25).

Para 62. Mr. Spolin did not challenge the veracity of the following statements: I contend that exception rates for "risky" loans were increasing; that "approximately 15% of nonconforming loans that Countrywide was originating through CMD were exception loans" and that "Countrywide originated a substantial number of loans as exceptions to its Loan Program Guides." In Mr. Spolin's experience, exceptions were granted according to the usual and customary process during the Relevant Period, no more or less than prior years and at other lenders. However, if you examine Mr. Spolin's experience, he worked for Defendants from 1992 to 2003 and additionally worked for lenders that were forced to sale, merger, or shut down based upon originating subprime loans including Washington Mutual, Long Beach Mortgage and National City Mortgage —all of whom had severe delinquencies with subprime and Alt-A products such as Pick a Pay, etc. It is my experience and industry standard that if there are a high number of exceptions made to underwriter guidelines, then the guidelines should be changed to reduce the number of exceptions.

Para 63. I do assert that some "types of loans [such as 'Pick-a-Payment' loans, interest only loans, and stated income loans] are fraught with land mines, especially for inexperienced home buyers duped by loan officers focused on originating loans rather than assuring the ability of the consumer to have the ability to repay the loan." *See* Lacefield Report at ¶¶28, 79-80, 99. My assumptions are backed up by sworn statements from ex-Defendant employees and resulting high foreclosure rate. Lacefield Report, Appendix 7 at ¶¶25-27 (citing DOJ Settlement) at p. 9-11); Lacefield Report, Appendix 7 at ¶¶43-48 (citing Winston Decl. at ¶¶ 5-6, 9-12); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶98 (citing deposition transcript of Cindi Graveline-Thomas at

115:4-12; 116:2-14; 118:2-25). Additionally, as CNN reported[11] on September 3, 2008, and according to a Fitch Rating report, "pick-a-payment" mortgages, or option ARMs, are referred to as "pure poison. Now their default rates, which are already high, are about to explode,."[12] The Wall Street Journal[13] reported in 2009 that "For the third straight month, option adjustable-rate mortgages are generating proportionally more delinquencies and foreclosures than subprime mortgages, the scourge of the U.S."[14] The Journal also reported, "As of April, 36.9% of Pick-A-Pay loans were at least 60 days past due, while 19% were in foreclosure, according to data from First American CoreLogic, a unit of Santa Ana, Calif.-based First American Corp. In contrast, 33.9% of subprime loans were delinquent, with 14.5% of those loans in foreclosure." [15]

[11]Christie 2008, *Pick-a-payment loans turn poisonous* CNN, last accessed Jan. 12, 2021, https://money.cnn.com/2008/09/02/real_estate/pick_a_poison/index.htm
[12] *Ibid*.
[13] Eckblad 2009, *Pick-a-pay Loans: Worse than Subprime*, Wall Street Journal, last accessed Jan. 12, 2021, https://www.wsj.com/articles/SB124744382165530247
[14] *Ibid*.
[15] *Ibid*.

Para 64. I agree that many of my criticisms were made with the benefit of hindsight. I start with the foreclosure and review the origination and servicing processes of the lender to determine what could have been the cause of the default. I agree that at that time Defendants promoted that these loans were generally considered reasonable and safe for borrowers and that very little criticism of these loan programs was seen or heard. However, sworn statements from Defendant ex-employees revealed that Defendant management was aware of the issues and intentionally ramped production of these very same loan products. *See* Lacefield Report, Appendix 7 at ¶¶99-100 (citing deposition transcript of David Doyle at 193:10-19;); Lacefield Report, Appendix 7 at ¶ ¶46-49, 52 (citing Winston Decl. at ¶¶ 10-13, 17). Mr. Spolin does state that, "Pick-a-Payment" loans were attractive as they gave the borrower the right to make less than the full interest payment, … without the borrower incurring late fees, penalties, and/or facing the immediate possibility of foreclosure." It is the phrase "immediate possibility of foreclosure" that would lead a reasonable person to believe that "foreclosure" was part of the scheme to strip the equity. I did not acknowledge that "Pick-a-Payment" loans had been successfully offered because that data would be outside the "relevant period." I do acknowledge Mr. Spolin's statement that property value declines exceeded 40%. One of the primary reasons property values declined was the over-valuation or inflation of the property value at origination. An article[16] titled The Great Recession's Impact on the Housing Market stated that "in 2007, the housing market started to plummet; a combination of rising home prices, loose lending practices, and an increase in subprime mortgages pushed up real estate prices to unsustainable levels; and foreclosures and defaults crashed the housing market, wiping out financial securities backing up subprime mortgages."[17]

Para 65. Mr. Spolin states that interest only loans "were not perceived as higher risk" at the time. However, interest only loans are risky because, "Unfortunately, many people find themselves in the hole when the set period is over and it's time to start making larger payments."[18] The same article states, "Interest-only loans are risky for people who end up getting a loan that they cannot afford any other way. It goes without saying that if you have cash flow issues that aren't resolved before the interest-only period is over, you aren't going to be able to make the higher payments. Also, during the interest-only part of the loan, you are not paying the principal and therefore you are not building equity in your home. This can end up being a big speed bump if you plan to refinance when the interest-only period is over."[19]

Para 66. I did claim that some of these non-traditional loan products were higher risk and had higher delinquency rates and losses. I also alleged that Countrywide knew borrowers were

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[16] Boykin 2019, *The Great Recession's Impact on the Housing Market*, Investopedia, last accessed Jan. 12, 2021, https://www.investopedia.com/investing/great-recessions-impact-housing-market/
[17] *Ibid*.
[18] Johnson, *Dangers of Interest-Only Mortgage*, Mortgageloan.com, last accessed Jan. 12, 2021, https://www.mortgageloan.com/dangers-interest-only-mortgage-8322
[19] *Ibid*.

picking the lower payment option on the "Pick-a-Payment" loans and, as a result, loan performance would suffer. Mr. Spolin states that "it is impossible to assess the "risk" of a product in isolation, as "risk" depends not only the features of loan product but also the borrower's credit characteristics." However, statements by Defendant executives revealed that Countrywide had a serious delinquency problem with Pick-a-Pay loans. Countrywide determined that the majority of borrowers were only 'picking' the interest only feature. Countrywide knew these loans were originated with the intent to default.

Para 67-68. I did assert that stated income loans were categorically inappropriate for salaried and fixed income borrowers and come at a high cost to the borrower. See Para 26. The Defendants also know the exact borrower income but placed the borrower in a loan product with documentation type "stated income," which means the borrower does not have to prove his income. The only reasonable conclusion is the borrower could not qualify for the loan product if the borrower had to reveal their true income. Therefore, the lender has placed the borrower into this loan documentation type for the sole purpose of "qualifying" the borrower, the exact opposite of originating loans that the borrower has the ability to repay. As a Certified Fraud Examiner, I have not seen a stated income loan where the salaried borrower's income matched the income that they "stated.", In my experience, 100% of the time the stated salary was always higher than their salary. Countrywide did have guidance on stated income loans but failed to follow that guidance. *See* Lacefield Report, Appendix 7 at ¶23; Lacefield Report, Appendix 7 at ¶25 (citing DOJ Settlement at 10); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 38:17-39:15; 41:21-42:5).

Para 69. I did assert that "(Stated Income) loans have extremely high interest rates due to the risk associated with these loans." The rate for stated income loans is higher than prime rate in every instance I have reviewed. Mr. Spolin uses World Savings and Washington Mutual as his examples. Both of these companies failed primarily due to subprime mortgage defaults of which 'stated income loans' were part of that failure. Mr. Spolin then compares stated income loans to 'fast and easy' document type. Comparing documentation type with subprime mortgage product is like comparing raisons to watermelons.

Para 70-71. I did allege that both Bank of America and Countrywide engaged in "predatory lending" by approving multiple consecutive cash-out refinances, leading to "equity stripping." An article titled, <u>Beware of These Four Home Equity Scams</u> defines this scam as, "When a lender persuades a homeowner to get multiple mortgage refinances repeatedly, that's loan flipping. We've seen cases of elderly homeowners persuaded to refinance their mortgage every year. This kind of victim may not realize how much they're being taken advantage of.[20] The article also explains, "But beware as more of your equity can be used to cover any fees and

[20] Opperman, *Beware of These Four Home Equity Scams*, Credit.org, last accessed Jan. 12, 2021, https://credit.org/blog/beware-of-these-four-home-equity-scams/

closing costs for the refinance, so your equity just got lower than you think. There are also other fees associated with a refinance, such as an appraisal, so be fully aware of what refinancing might cost you."[21] A study titled Foreclosure Equity Stripping: Legal Theories and Strategies to Attack a Growing Problem[22] states that, "Skyrocketing housing prices and high foreclosure levels, accompanied by growth in the subprime lending market, have exacerbated the foreclosure equity-stripping problem." Multiple refinancing, another form of equity stripping is commonly known to be a mortgage loan scam wherein "loan officers …. try[] to get you to refinance over and over again. They'll suggest you put in a new pool, and refinance your home for the funds. Then they might suggest a family vacation, and you can refinance again to generate immediate cash. Loan officers are doing this because they can charge you higher interest rates each time you refinance. You continue to accrue more fees for financing and, even though the payments might be spread out over a longer period of time, they might be higher as well."[23]

Para 72-73. When I described the Defendants, I generally include Bank of America and Countrywide together for several reasons. First, a review of underwriting guidance for Countrywide had the Bank of America title instead of Countrywide for several years after the merger. In 2007, a year prior to the merger, Bank of America invested $2 billion dollars in Countrywide.[24] Most companies do not make this type of investment without conducting due diligence unless they know what they are investing in. In the transcript of an NPR program[25] January 13, 2013, reporter Jim Zarroli[26]stated, "When the deal took place, Bank of America, under its CEO Ken Lewis, was growing fast, mostly through acquisitions. And it was eager to expand its mortgage business. Founded by Angelo Mozilo, California-based Countrywide had exploded in growth by offering subprime mortgages to people with credit problems." Zarroli continued, "Once the acquisition went through, Bank of America began pouring over Countrywide's books, and it was in for a rude shock. It turned out that the problems were much worse than anyone had suspected. Many of Countrywide's loans had gone to people who couldn't afford them, and with

[21] *Ibid*.
[22] Foreclosure Equity Stripping: Legal Theories and Strategies to Attack a Growing Problem (umn.edu) Prentiss Cox, *Foreclosure Equity Stripping: Legal Theories and Strategies to Attack a Growing Problem,* 39 CLEARINGHOUSE REV. 607 (2006), last accessed Jan. 12, 2021, https://scholarship.law.umn.edu/faculty_articles/275.
[23] *Mortgage Loan Scams:Protect Yourself From Mortgage Loan Scams,* last accessed Jan. 12, 2021, https://www.banklady.com/mortgage-loan-scams.asp
[24] Rothacker 2014, *The deal that cost Bank of America $50 billion – and counting*, Charlotte Observer, last accessed Jan. 12, 2021,
https://www.charlotteobserver.com/news/business/banking/article9151889.html?fb_comment_id=1640695495978112_2241431489237840, AUGUST 17, 2014.
[25], Jim Zarroli, January 11, 2013*, Looking Back On Bank Of America's Countrywide Debacle*, NPR, last accessed Jan. 12, 2021 https://www.npr.org/2013/01/11/169108131/looking-back-on-bank-of-americas-countrywide-debacle#:~:text=Transcript-,Five%20years%20ago%20Friday%2C%20Bank%20of%20America%20announced%20it%20was,of%20the%20commercial%20banking%20business.
[26] Jim Zarroli is an NPR correspondent based in New York. He covers economics and business news. Last accessed Jan. 12, 2021, https://www.npr.org/people/4581822/jim-zarroli

the housing market in turmoil, a flood of foreclosures was coming its way."[27] Once Bank of America purchased Countrywide, "Bank of America's solution to this problem was simple. They haphazardly dumped the loans and the servicing on the secondary market when America's Wholesale Lender became an issue after the financial crisis."[28]

Para 74-75. I did imply that most of a lender's mortgages were sold to investors, it had discriminatory or otherwise improper underwriting standards. I relied in part on a May 2007 internal memorandum which stated: "A core principal [sic] underlying product guidelines is salability." It is clear to me that the focus of underwriting product guidelines was to sell to the secondary market; not a focus on risk or quality of the loans and is not therefore, irrelevant. *See* Lacefield Report, Appendix 7 at ¶46 (citing Winston Decl. at ¶ 11); Lacefield Report, Appendix 7 at ¶26 (citing DOJ Settlement at p. 10).

Para 76. I agree with Mr. Spolin that, "A mortgage loan is always underwritten based on the applicable underwriting guidelines, and those guidelines inform all underwriting decisions made by the lender." However, Defendants did not follow their own underwriting guidelines based upon sworn testimony from Defendant's ex-employees, the delimiter tests, and high foreclosure rate. *See* Lacefield Report, Appendix 7 at ¶¶26-27 (citing DOJ Settlement at pp. 9-11); Lacefield Report, Appendix 7 at ¶¶43-47 (citing Winston Decl. at ¶¶ 5-6, 9-12); Lacefield Report, Appendix 7 at ¶64 (citing deposition transcript of Anne Marie Dean at 35:16-19); Lacefield Report, Appendix 7 at ¶93 (citing deposition testimony of Brian Robinett at 151:22-25; 152:2-10; 161:24-25; 162:2-8).

Para 77-78. My opinion on "salability" is that Countrywide and Bank of America did not care about whether the borrowers of its loans sold into the secondary market defaulted. Mr. Spolin states that, "This implication is inconsistent with the economics of the industry. If a loan is sold in the secondary market, and the loan defaults, there are negative consequences to the lender. Loan sellers typically represent to buyers that the loans being sold are generally underwritten according to the applicable guidelines." I agree with Mr. Spolin that their actions did not make economic sense. However, numerous lawsuits and regulatory fines, liability against Defendants for losses because the loans were not underwritten to guidelines have totaled more than $91.2 billion from 51 major legal settlements, judgments, and regulatory fines.[29] I believe these settlements confirm my opinion.

[27] *Ibid*.
[28] Mortgage Fraud Investigations: Miami May 2020, *Countrywide Financial May Be Gone But It's America's Wholesale Lender Scam Is Creating Title Nightmares Decades Later,* last accessed Jan. 12, 2021, https://mfi-miami.com/2020/05/americas-wholesale-lender-scam/
[29] Maxfield 2014, *The Complete List: Bank of America's Legal Fines and Settlements Since 2008*, Motley Fool, last accessed Jan. 12, 2021, https://www.fool.com/investing/general/2014/10/01/the-complete-list-bank-of-americas-legal-fines-and.aspx

Para 79-81. I do claim that "Bank of America and Countrywide management 'punished' appraisers if they failed to value the property at or above contract price." I base my opinions on sworn statements from ex Defendant employees including the executive over appraisals. *See* Lacefield Report, Appendix 7 at ¶¶54-57 (citing Winston Decl. at ¶¶19-25).

Para 82. I agree that most lenders do have a quality control program, but a quality control program should identify trends that would have shown up due to the high foreclosure rate. Mr. Spolin stated that **every** loan that closed at Countrywide had a Quality Verification Documentation Questionnaire (QVDQ) completed. However, despite Plaintiff having requested quality control reports and the court having ordered the production of documents relating to defendants' compliance with fair housing and fair lending laws and post-funding quality reviews, Plaintiff did not receive any of the QVDQ forms that "multiple parties would check." I agree that Defendants had quality control guidelines in place, but I did not see evidence that Defendants acted upon the QC findings if any. I do not understand a statement in the QVDQ incentive program: Training must include sales techniques, follow-up methods and the use of HELOCs in place of mortgage insurance. It appears that Defendant was steering borrowers to HELOCs.[30]

Para 83-84. I did not see any evidence that Defendants took measurable actions resulting from the Compliance Audits. My opinion was that the "thoroughness of these audits" was a sham. The high foreclosure rate would have been detected within the first 90 days of closure and action taken by management. Additionally, Countrywide reduced its audit staff based upon sworn statement from Defendants' ex-employee.[31] I reviewed 35 QVDQ Compliance Control[32] reviews from 2006. These reviews indicated 'Risk Description' but does not indicate anywhere on these forms about what the exact violation was or how to correct the violation. For example: One Risk Description[33] stated: Failure to comply with OCC rules and regulations with origination of Countrywide Bank loans, resulting in lost profits and missed opportunity to fund within CFC.' The report does not indicate what the OCC violation was, how to correct the deficiency, or accountability measures to be taken (the deficiency added to the training scheduled for all originators). Another example of a potentially dangerous deficiency was: 'Loan Program Guidelines (LPG) can be over-ridden at the point of sale and transferred to processing, resulting in marketability issues regarding the packaging and sale of loans to investors.' Was a review conducted of all previous loans originated by the offending loan officer? Was a review

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[30] QVDQ Incentives, BANACC0000382634

[31] **Countrywide also eliminated the position of compliance specialist**, an individual previously responsible for conducting a final, independent check on a loan to ensure that all conditions on the loan's approval were satisfied prior to funding. Finally, to further ensure that loans would proceed as quickly as possible to closing, <u>Countrywide revamped the compensation structure of those involved</u> in loan origination, basing performance bonuses solely on volume.[31] June 30, 2013, America Lost: Remember PennyMac is also known as Countrywide, See http://saveourdream.blogspot.com/2013/06/remember-penny-mac-is-also-know-as.html

[32] QVDQ Compliance Control, BANACC0000400327

[33] *Ibid* p2

conducted of loan files closed in the subject branch? How long had this been happening, and who else was involved? The report does not indicate any changes were put in place to make sure loan officers could not manipulate borrower's information or change loan data. A third file indicated the Risk Description[34] as 'Failure to properly deliver and transfer quality loan files to processing entities in a timely manner, resulting in disclosure compliance issues, processing delays, and increased cancellations.' Exactly what was the specific deficiency, how to correct the deficiency, and resulting accountability? The majority of the QVDQ form's Description of Control cited company guidelines[35] but fail to describe the exact deficiency in the guidelines nor how to prevent the deficiency from recurring or what the guideline was that was deficient.

Para 85. Mr. Spolin states that because not all of the loans in question were FHA, that the FHA audit process did not apply. I disagree wholeheartedly with this statement for several reasons, specifically the fact that HUD quality controls have been mirrored by most investors including FNMA and FHLMC. Additionally, the use of my red flags certainly could demonstrate deficiencies in Quality Control. For example: High foreclosure rates are typically based upon a handful of issues. If the red flags indicated a high default rate existed with borrowers in the 'Fast and Easy' program, a review of the loan files to assure that the borrower was qualified for that program. The red flags would direct an auditor where to start the examination.

Para 86. The whole point of this case is that the Defendants had neutral non-discriminatory policies on their face, but the polices, practices and procedures have a disproportionately negative effect (impact) on members of legally protected groups.

Para 87. The 'targeting' appeared to be subprime loan products marketed to families living in predominately minority neighborhoods.

Para 88. I did describe some policies in my report that "describes Defendants" alleged practice of originating loans that contain "predatory or higher cost features" and "are not in the borrowers' best interest" to borrowers with substandard credit ratings/DTI ratios. Mr. Spolin stated that I did not identify any specific policy that would incentivize or facilitate this alleged behavior. However, loan officers were incentivized with higher commission rate for originating subprime loans versus prime loans.

Para 89. Mr. Spolin stated that internal underwriting guidance in the report did not support our allegation that Defendants maintain "underwriting policies or practices that permit" several exceptions to their standard underwriting guidelines. These internal underwriting guidance prove the fact, in my opinion.

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[34] *Ibid* p.6
[35] *Ibid*.

Para 90. It is the policy and practice to target low income and minorities with subprime products in predominately minority communities based upon statements by ex-Defendant employees. Further, Defendant Countrywide's executive leadership announced publicly its intent to target minority families for subprime and risky loan products. Defendants' discretionary pricing policies resulted in predatory mortgage lending on a discriminatory basis by targeting neighborhoods with high concentration of African American and Hispanic families without regard to borrowers' ability to repay their mortgage loans. There were sales incentives at Countrywide to originate loans for multicultural borrowers.[36] Doyle stated that some multicultural customers were challenging because they wanted the transaction explained in Spanish, that "many-- some were relatively new to the country and didn't have a great facility with the U.S. banking system and may, in fact, be a little bit intimidated by it. So, you know, the notion of applying for a mortgage and going through the process was challenging for them."[37]

Para 91. I believe that Mr. Spolin's rebuttal was inaccurate, flat wrong in many areas, and was self-serving.

January 13, 2021

Respectfully Submitted,

Gary E. Lacefield

[36] Deposition transcript of David Doyle at 268:12-20
[37] *Ibid* at 269:7-270:17