15-2398

IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BEVERLY ADKINS, CHARMAINE WILLIAMS, REBECCA PETTWAY, RUBBIE McCOY, and WILLIAM YOUNG, on behalf of themselves and all others similarly situated, and MICHIGAN LEGAL SERVICES,
Plaintiffs-Appellants,

v.

MORGAN STANLEY, MORGAN STANLEY & CO. LLC, MORGAN STANLEY ABS CAPITAL I INC., and MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC,
Defendants-Appellees.

Appeal from an Opinion and Order of the United States District Court for the Southern District of New York, Case No. 1:12-cv-7667-VEC-GWG

BRIEF FOR *AMICI CURIAE* AMERICAN FEDERATION OF STATE, COUNTY & MUNICIPAL EMPLOYEES, AFL-CIO, AND SERVICE EMPLOYEES INTERNATIONAL UNION, IN SUPPORT OF PLAINTIFFS-APPELLANTS

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 29(c), *Amici Curiae* hereby provide the following disclosure statements:

American Federation of State, County, and Municipal Employees, AFLCIO ("AFSCME"), is a non-profit labor union.

Service Employees International Union ("SEIU") is a non-profit labor union.

Amici have no parent corporations, and no publicly-held corporation owns 10% or more of any *Amici* organization's stock.

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STATEMENTS OF INTEREST OF *AMICI CURIAE*[1]

Amici are labor unions dedicated to ensuring that all people who work can enjoy the fruits of their labor—decent paychecks and benefits, safe jobs, respect and fair treatment, and, ultimately, access to the American dream—rewards which are threatened by the predatory, discriminatory lending at issue in this case.

Amici respectfully submit this brief pursuant to Federal Rule of Appellate Procedure 29 and Second Circuit Local Rule 29.1. The brief should be permitted without leave of court because all parties have consented to its filing. FED. R. APP. P. 29(a).

Amicus the American Federation of State, County and Municipal Employees, AFL-CIO ("AFSCME"), is a union of 1.6 million members in the United States and Puerto Rico, both in the public and private sectors, who share a commitment to service.

Amicus the Service Employees International Union ("SEIU") is an international labor union representing more than 2.2 million men and women in healthcare, property services, and public service employment in the United States,

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[1] Neither party's counsel authored this brief, in whole or in part. Nor did either party or party's counsel contribute money intended to fund the preparation or submission of the brief. No person, including *Amici* curiae, their members, or their counsel contributed money that was intended to fund the preparation or submission of the brief.

Canada and Puerto Rico. SEIU's Racial Justice Task Force seeks to develop a shared union-wide analysis of structural racism against African-Americans, its connection to economic inequality, and to make recommendations on SEIU's role in dismantling it. The Taskforce seeks to understand the key elements of structural racism against African-Americans, including its effects on jobs and wages as well as housing, and how these elements fuel economic injustice for everyone.

Amici are participating in this case to advance their shared mission of helping working people and working people of color achieve the American dream, especially the tens of thousands of Detroit–area workers and retirees *Amici* collectively represent. As the AFSCME Constitution states, AFSCME members "promote the organization of workers" in order, "individually and collectively, to fulfill the promise of American life" and to work "towards the end that the material riches of American society be more justly distributed and the moral promise of American life be realized."

Likewise, as the SEIU Constitution provides, SEIU is "dedicated to improving the lives of workers and their families and creating a more just and humane society," a society where "union solidarity stands firm against the forces of discrimination." SEIU believes it "ha[s] a special mission to bring economic and social justice to those most exploited in our community – especially to women and workers of color." In a resolution adopted at SEIU's 2012 Convention, SEIU

recognized the far-reaching consequences of the U.S. mortgage crisis and its particular impact on African-American communities. SEIU resolved to "work extensively in collaboration with community advocates, labor unions and state legislatures to develop a comprehensive policy response to the mortgage foreclosure crisis," including various measures to combat predatory lending such as "loan modification that is reasonable and fair for each homeowner…[and] to reduce the principal of the homes that are underwater or worth less than is owed."

SUMMARY OF ARGUMENT

Amici fight hand-in-hand with their hardworking members to achieve the American dream that all workers and their families deserve. But despite many victories in pursuit of this mission, *Amici's* efforts have been severely hampered by predatory lending, a scourge that has particularly targeted *Amici's* African-American members. This is all the more true in Detroit. Predatory mortgage lending in Detroit has not only harmed *Amici's* members as individuals, but also collectively due to the devastation wrought by the massive foreclosure rates which played a major role in forcing the City to declare Chapter 9 bankruptcy in 2013.

Make no mistake: the structural features of the mortgage securitization market are the root cause of pernicious and discriminatory lending. Securitization of subprime home loans by investment banks—especially in the voracious fashion

exemplified by Appellee Morgan Stanley in this case—necessarily creates a series of mismatched incentives that reward predatory lending. At its core, securitization represents a concerted strategy to develop capital structures for judgment-proofing predatory loans, aiming to leave injured borrowers with no remedy. Predictably, this structural victimization of working people has hit people of color especially hard.

Congress has targeted the evil of predatory lending with a number of statutory causes of action. Among these, the Fair Housing Act's direct prohibition on securitization practices that have a disparate impact on racial minorities—and especially the availability of class-action litigation to enforce that prohibition—stands alone in terms of the strength it can provide borrowers victimized by predatory loans. Unlike the FHA, other federal consumer protection statutes that create a private right of action for borrowers are severely limited in scope of coverage, remedy (especially with respect to the viability of class actions), and ability to even reach mortgage securitizers in the first place. Therefore, without meaningful class-action relief for borrowers under the FHA, victims of predatory lending would be left with no remaining effective remedy against the investment banks whose mortgage securitization has bankrupted countless families and at least one City. This would effectively award predatory lending a victory over borrowers by allowing the mercenary market to operate unchecked.

The Plaintiffs in the instant action have made an incredibly strong case against Morgan Stanley under the FHA for the racially disparate impact of the predatory loans that Morgan Stanley securitized without hesitation, and it is hard to imagine a better candidate for class certification of a case against a mortgage securitizer. Thus, denying class certification might be the death knell not only of this case, but also of any significant accountability by Wall Street to borrowers for an unparalleled pattern of predation, leaving these harmful lending practices to continue unabated.

ARGUMENT

I. PREDATORY LENDING IS A BARRIER BETWEEN *AMICI*'S HARDWORKING MEMBERS AND THE ECONOMIC AND RACIAL JUSTICE THEY HAVE LONG FOUGHT FOR

In this complex contest over the hyper-technical requirements of Rule 23, the Court should not lose sight of the human cost to denying class certification. The reality is that denying class certification would threaten years of efforts by *Amici* and their members to fight for economic justice and working people's right to access the American dream. Additionally, it would mean a huge step backwards in *Amici's* efforts to achieve racial justice and address the economic inequalities that are the result of structural racism.

Together, AFSCME and SEIU, through their local affiliates, represent tens of thousands of Detroit-area employees and retirees, many of whom are or were government employees. Consistent with the demographics of *Amici's* nationwide membership, the majority of the employees and retirees represented by *Amici* in the Detroit-area are African-American. Thus *Amici*'s members and retirees undoubtedly make up a sizeable portion of the proposed class in this case, African-American borrowers in the Detroit-area who have been discriminated against in the provision of predatory loans.

Amici's members have fought hard for the gains they have made at the collective bargaining table. These efforts in part have been toward securing *Amici's* members' right to access the American dream, "the classic pathway" to which has always been homeownership.[2] These gains are particularly notable in light of the well-documented benefits union membership has on upward economic mobility for both union members and their children.[3]

Yet predatory lending in the Detroit-area has stood squarely in the way of *Amici*'s members' dreams and *Amici's* efforts to help achieve them. Despite the gains they have won through their union, *Amici*'s members are far from rich; the

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[2] Reid Cramer & Trina R. Williams Shanks, *The Assets Perspective: The Rise of Asset Building and its Impact on Social Policy* at 161 (2014).
[3] Richard Freeman, Eunice Han, David Madland, & Brendan Duke, Center for American Progress, *Bargaining for the American Dream: What Unions do for Mobility*, 1-3 (2015).

average AFSCME retiree in Detroit earned an annual pension of only about $19,000 *before* those benefits were reduced an additional 4.5% by the City's bankruptcy last year—an outcome that would have been far more dire without AFSCME's advocacy during the bankruptcy.[4] So when one of *Amici's* members is victimized by a predatory loan like those at issue in this case, gains made through collective bargaining and years of hard work may be immediately erased. This is, of course, also the story of the subprime loan market generally, which has decreased overall U.S. homeownership and devastated families nationwide.[5]

Amici's members in Detroit have not only been harmed individually by predatory lending when they have received such loans, but also collectively by the impact predatory lending has had on the City. As Judge Baer recognized in his opinion denying Morgan Stanley's motion to dismiss, "Detroit's recent bankruptcy filing only emphasizes the broader consequences of predatory lending and the foreclosures that inevitably result." *Adkins v. Morgan Stanley ("Adkins I")*, No. 12

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[4] Scott Cohn, *Detroit Bankruptcy Deal Would Limit Pension Cuts*, CNBC, June 15, 2014, available at http://www.cnbc.com/2014/06/15/detroit-bankruptcy-deal-would-limit-pension-cuts.html (reporting on the tentative deal, but figure cited did not change from when article was written).

[5] Rayth T. Myers, *Foreclosing on the Subprime Loan Crisis: Why Current Regulations Are Flawed and What Is Needed to Stop Another Crisis from Occurring*, 87 OR. L. REV. 311, 341 (2008). *See also, id.* at 343 ("Stated in concrete terms, of more than three million subprime loans issued in 2006, only 354,172 brought new homeowners to the market. In that same year, an estimated 624,631 subprime foreclosures took place--resulting in a net homeownership loss of more than 270,000 homes.").

CV 7667(HB), 2013 WL 3835198, at *2 (S.D.N.Y. July 25, 2013). Judge Baer explained:

> By 2012, banks had foreclosed on 100,000 homes [in Detroit], which drove down the city's total real estate value by 30 percent and spurred a mass exodus of nearly a quarter million people. The resulting blight stemming from 60,000 parcels of vacant land and 78,000 vacant structures, of which 38,000 are estimated to be in potentially dangerous condition has further strained Detroit's already taxed resources. And as residents flee the city, Detroit's shrinking ratepayer base renders its financial outlook even bleaker. Given these conditions, it is not difficult to conclude that Detroit's current predicament, at least in part, is an outgrowth of the predatory lending at issue here.

Id. (quotations and citations omitted). While this collateral damage has long been common knowledge and not confined to Detroit,[6] it has been especially pronounced there.

Since Judge Baer issued his opinion, the dust has settled on the Detroit bankruptcy, and the connection between predatory lending and the City's demise has become even clearer. The Detroit News recently reported that more than 1-in-3 city properties have been foreclosed in either tax or mortgage foreclosures since

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[6] *See, e.g.,* William C. Apgar & Mark Duda, *Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom* at 4, May 11, 2005, available at http:// www.hpfonline.org/PDF/Apgar-Duda_study_final.pdf (estimating that vacant properties from foreclosures cost cities more than $30,000 per unit in some cases).

2005, with 56% of the mortgage foreclosures now blighted or abandoned.[7] Demolishing only 13,000 of them will cost the City a projected $195 million, not to mention $300 million in unpaid taxes on the foreclosed homes.[8] Together, this $495 million cost amounts to more than half of the money Detroit needed to raise via the "Grand Bargain" to save its pensions and art museum.[9] The cause: Detroit had one of the highest rates of subprime lending in the country at 68% of all city mortgages in 2005 (compared to 24% nationwide), totaling nearly $4 billion in loans—78% of which are now in poor condition or tax foreclosed.[10] Of the top 20 census tracts nationwide with the highest rates of subprime lending in 2005, 8 were in Detroit alone.[11]

Thus *Amici*'s members in Detroit, whether they received predatory loans themselves or not, are collectively suffering the consequences of those loans. They need effective relief if they are to achieve the American dream that they and *Amici* have fought so hard for hand-in-hand. As we now explain, mortgage securitization

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[7] Christine MacDonald & Joel Kurth, *Foreclosures fuel Detroit Blight, Cost City $500 million: Risky Loans Contribute to Swaths of Empty Homes, Lost Tax Revenue*, THE DETROIT NEWS, June 6, 2013, *available at* http://www.detroitnews.com/story/news/special-reports/2015/06/03/detroit-foreclosures-risky-mortgages-cost-taxpayers/27236605.
[8] *Id.*
[9] Randy Kennedy, *'Grand Bargain' Saves the Detroit Institute of Arts*, NEW YORK TIMES, Nov. 8, 2014, at C1.
[10] MacDonald and Kurth, *supra* note 7.
[11] *Id.*

practices like those of the Appellees are at the root of the problem,[12] and thus any real remedy must right the wrongs of the securitization market.

II. MORTGAGE SECURITIZATION PRACTICES BY PRIVATE INVESTMENT BANKS LIKE MORGAN STANLEY DRIVE THE MARKET FOR PREDATORY LOANS

As Judge Caproni correctly observed in her opinion denying class certification, "Wall Street Banks," such as Appellees, have "exhibited a quenchless appetite for high-priced, risky loans for use in residential mortgage-backed securitization." *Adkins v. Morgan Stanley* ("*Adkins II*")*,* 307 F.R.D. 119, 129 (S.D.N.Y. 2015) (quotation omitted). That demand, in turn, has "led to a significant expansion in . . . the subprime mortgage loan market." *Id.* (quotation omitted). In fact, as of 2008, a full 80% of subprime loans were securitized.[13]

Most of these loans followed some variation of the formula used by Morgan Stanley here and accurately described in broad strokes by Judge Caproni: a loan

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[12] Kathleen C. Engel & Patricia A. McCoy, *Turning A Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2076 (2007) (summarizing the interrelationship between "abusive lending" and "securitization" as causes of harm to "borrowers, neighborhoods, and cities"). *Amici* note that Professor McCoy was an expert witness for the Plaintiffs here, and although Judge Caproni expressed some doubt as to the admissibility of parts of her report, it recognized her "significant relevant experience" while dismissing Morgan Stanley's *Daubert* motion as moot in light of the denial of class certification.

[13] James Carlson, *To Assign, or Not to Assign: Rethinking Assignee Liability as A Solution to the Subprime Mortgage Crisis*, 2008 COLUM. BUS. L. REV. 1021, 1030 (2008).

originator sold residential mortgage loans to an investment bank, which in turn bundled the loans into securities that were sold on the secondary market. *Adkins II,* 307 F.R.D. at 129 (citation omitted). Those loans were "regularly . . . based on questionable underwriting." *Id.* at 126 (citation omitted). The bank's "preferences had a significant impact on" the lending practices of the originator, which "was under pressure" to deliver loans in high volume to the securitizing bank. *Id.* at 128.

Yet Judge Caproni's account omits a critical point, and one that is virtually uncontested in the academic literature: mortgage securitization leads ineluctably to subprime loans which are *predatory*[14]—a word that appears not once in Judge Caproni's opinion. *Cf. Adkins I,* 2013 WL 3835198, at *1, *2, *9. Predatory loans, of course, are what this litigation is really about, and are what the Complaint seeks to address through its delineation of "Combined-Risk Loans." *See* Compl. ¶¶ 33-34.

To understand why mortgage securitization breeds predatory lending, it is necessary to fill out the picture of how securitization works beyond the explanation provided by Judge Caproni:

> Securitization goes by the moniker "structured finance," in part because a securitizer structures the transaction to isolate the loan pool from the original lender. This is accomplished by selling the loan pool to a special purpose vehicle or "SPV" that is owned by, but legally distinct

[14] Carlson, *supra* note 13.

> from, the lender. The SPV then resells the loan pool to a second SPV, which is also independent of the lender and takes title to the bundle. The second SPV is typically in the form of a trust.[15]

This process of passing loans from originators to investors via the special purpose entity of a trust is precisely how Morgan Stanley securitized the loans at issue in this litigation. *See* Compl. ¶¶27-28.

The securitization of home loans via special purpose trusts creates a series of mismatched incentives that reward predatory lending.[16] First, because the loan originator disposes of its loans quickly—and long before having to deal with any potential foreclosure proceedings—it has no incentive to worry about the riskiness of the loan,[17] unless the securitizing purchaser imposes one. The crux of the Complaint's allegations in the instant case is that, in fact, Morgan Stanley did the opposite by encouraging risky loans. Second, as a result of the enormous capital channeled by Wall Street to originators for these quickly-assigned subprime loans, securitization empowers originators with limited assets to strategically operate as fly-by-night entities, churning out an incredibly high number of predatory loans

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[15] Engel & McCoy, *supra* note 12 at 2045.
[16] Carlson, *supra* note 13 at 1033.
[17] William Apgar & Allegra Calder, *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending*, in THE GEOGRAPHY OF OPPORTUNITY: RACE AND HOUSING CHOICE IN METROPOLITAN AMERICA 101, 104 (Xavier de Souza Briggs, ed., 2005).

without consequences proportionate to the scale of the harm, because the lender can always find safe harbor in bankruptcy proceedings.[18]

Ultimately, because "securitization allows originators to operate at the edge of solvency with little regard to the quality of originated loans," the borrowers targeted for these predatory loans will often "find that the originator has disappeared and that the securitized trust is legally immune," leaving the borrower "without a house, despite having a legitimate claim for fraudulent and abusive conduct."[19] This analysis is not controversial—it has been echoed by numerous commentators in the academic literature on all sides of the issue.[20] The lesson is

[18] Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2220-21 (2007). Here, too, the allegations in the Complaint reflect this problem, as New Century, the originator whose predatory lending is at the heart of the Complaint, declared bankruptcy. *See Adkins v. Morgan Stanley* (Adkins II), 307 F.R.D. at 126.

[19] Carlson, *supra* note 13 at 1033-34.

[20] One author advocating *against* strengthening current legal remedies for predatory lending described the problem in similar terms:

> [E]ven enhanced liability rules may be insufficient to deter predatory brokers and lenders, since they are often thinly-capitalized and have the ability to churn loans and make short-term profits … This creates an incentive to push volume, at the expense of underwriting standards. The subprime mortgage market thus faces the problem of "fly by night" lending and brokerage operations that generate predatory loans, sell them into a RMBS, and then disappear, thus leaving the consumer with no remedy... The current securitization schema has allowed these "fly by night" lenders and brokers to operate, on the brink of bankruptcy, by selling their predatory loans into pools,

that securitization represents a concerted strategy to develop capital structures for judgment-proofing predatory loans.[21]

Furthermore, even apart from the structural effects of securitization, the subprime loans Wall Street so hungrily sought from originators inherently lend themselves to predatory characteristics. "Although not all subprime loans are predatory, nearly all predatory loans are subprime."[22] One reason for this correlation is that individuals forced to borrow at subprime rates—*i.e.*, borrowers whose creditworthiness should be (but unfortunately is often not[23]) lower than average—are offered "nontraditional products" to guard against their credit-riskiness, such as adjustable rates or interest-only payment features.[24] These and other "complex loan terms . . . create an opportunity for predatory practices," such as inaccurate and untimely disclosures, excessive fees, large prepayment penalties

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> which are later securitized into a RMBS... Essentially, the current securitization structure has facilitated the funding of consumer mortgages while simultaneously creating judgment-proof lenders and brokers.

Derrick M. Land, *Residential Mortgage Securitization and Consumer Welfare*, 61 CONSUMER FIN. L.Q. REP. 208, 221 (2007).

[21] Peterson, *supra* note 18 at 2269.

[22] Arielle L. Katzman, *A Round Peg for A Square Hole: The Mismatch Between Subprime Borrowers and Federal Mortgage Remedies*, 31 CARDOZO L. REV. 497, 500 (2009).

[23] Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy*, WALL STREET JOURNAL, Dec. 3, 2007, at A1.

[24] Katzman, *supra* note 22 at 500-01.

that prevent borrowers from refinancing, or plain-old unaffordable monthly payments, especially given the generally "weaker economic conditions" of subprime borrowers in the first place.[25] The danger for foreclosures stemming from these predatory loans is heightened further by the lack of escrow accounts in the subprime market.[26]

In sum, "securitization has created a system that gives lenders and brokers financial incentives to push expensive loans with unfavorable terms for borrowers that ultimately increase the loan's level of risk," while making it "de facto impossible" to hold the lenders and other responsible parties accountable for their predatory behavior.[27]

III. EXCEPT UNDER ANTIDISCRIMINATION STATUTES, WALL STREET IS ESSENTIALLY IMMUNE FROM FEDERAL LITIGATION BY VICTIMS OF PREDATORY LENDING—AND THUS CLASS CERTIFICATION IS ESPECIALLY NECESSARY HERE

As Judge Baer held, the Fair Housing Act makes mortgage securitizers like Appellee liable if one or more of their policies "has a disproportionate impact on minorities." *Adkins I,* 2013 WL 3835198, at *8-*9. *See also* 42 U.S.C. § 3605

[25] Katzman, *supra* note 22 at 501.
[26] *Id*.
[27] Myers, *supra* note 5 at 323 (2008). *See also id.* at 322 ("[T]he securitization of subprime loans—and of mortgages in general—has made it difficult for borrowers to assert legal claims or defenses in proceedings by or against the borrower.").

(FHA bars discrimination in the "purchasing of loans . . . secured by residential real estate"); 24 C.F.R. § 100.125(b)(2) (applying FHA prohibition to "[p]ooling or packaging loans"); *Hack v. President of Yale College,* 237 F.3d 81, 88 (2d Cir. 2000) (disparate impact theory available). Because the FHA allows for prototypical class action lawsuits by private parties under Rule 23 to enforce the FHA's broad remedial provisions, *see* 42 U.S.C. § 3613, it should be a meaningful tool for borrowers to hold Wall Street accountable. Unfortunately, the FHA is unique in this respect, which only heightens the stakes in the current case. If class certification is denied here—where the facts alleged in the Complaint so clearly trace a direct line from the policies of a mortgage securitizer to some of the most predatory, discriminatory lending imaginable—it would essentially immunize Wall Street from actions by borrowers hoping to combat predatory lending.

A. Other Federal Consumer Protection Statutes Do Not Grant Borrowers a Private Right of Action Adequate to Impact Mortgage Securitization

As a general matter, "the holder-in-due-course rule shields investors and securitized trusts from most litigation contesting predatory loan terms," thus denying "injured borrowers legal recourse."[28] "Essentially the doctrine means that the holder of a loan purchased for consideration is not liable for anything that could have been brought against the originator," which thereby "compounds the

[28] Engel & McCoy, *supra* note 12 at 2041.

securitization incentive mismatch," discussed in Section II *supra*, "by preventing the borrower from asserting claims against the trusts holding the pooled loans."[29] Indeed, one of the key reasons that "Wall Street prizes aggregation" and securitization of mortgage loans is to profit from the "reduced legal risk" provided by the holder-in-due-course doctrine.[30]

The federal antidiscrimination statutes—FHA and ECOA—are unique among anti-predatory lending statutes in that "liability under the statute is not derivative of the actions of another party, but based on the assignee's own involvement in a discriminatory behavior."[31] In contrast, the other federal statutes that create a cause of action for borrowers who fall victim to predatory lending—the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA), as well as the Home Ownership and Equity Protection Act (HOEPA) that amends TILA—do not create direct liability for the actions of loan purchasers on the secondary market, and the limited scope of any assignee liability under these statutes is not enough to make a real impact on Wall Street.

These other federal statutes are weak on a number of fronts. As a threshold matter, RESPA does not reach bona fide secondary market transactions, and thus is of little help in combatting the acts of mortgage securitizers. *See* 24 C.F.R. §

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[29] Carlson, *supra* note 13 at 1034 & n. 54.
[30] Engel & McCoy, *supra* note 12 at 2065.
[31] Peterson, *supra* note 18 at 2239.

3500.5. Even if RESPA did create assignee liability for Wall Street, remedies would still be dilute. RESPA "was not designed to regulate the substantive terms of loans, and therefore provides little assistance to subprime borrowers unless they can prove specific violations of RESPA's prohibited practices," which create a private cause of action only for "claims for kickbacks and unearned fees, and servicing irregularities."[32] Moreover, class actions under RESPA are allowed only up to the *lesser* of $1,000,000 or one percent of the creditor's net worth. 15 U.S.C. § 2605(f)(2). These damages are insufficient to deter or disincentivize Appellee Morgan Stanley or the rest of Wall Street from placing profits before people in the predatory lending game.

TILA and HOEPA are likewise toothless when it comes to improving the behavior of the big investment banks that securitize predatory loans. Although TILA technically provides for assignee liability, it only allows borrowers to recover against assignees for originators' violations, if those violations are "apparent on the face of" federal disclosure statements. 15 U.S.C. § 1641. This requirement makes it very difficult to establish liability.[33] Thus, lenders who securitize mortgages fiercely contest assignee liability, as evidenced in the instant case by the fact that Morgan Stanley argued to the District Court that Appellants'

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[32] Katzman, *supra* note 22 at 513 (citing 12 U.S.C. §§ 2605, 2607).
[33] *Id.* at 525.

ECOA claim should be dismissed for want of assignee liability. *See* Reply Br. in Supp. of Morgan Stanley's Mot. to Dismiss, at 7 (Doc. No. 43, filed Feb. 20, 2013).[34]

Even if TILA did define assignee liability more expansively, its remedies would be inadequate. To start, it suffers from the same problem as RESPA in that it limits class actions only up to the lesser of $1,000,000 or one percent of the creditor's net worth. 15 U.S.C. § 1640(a)(2)(B). "This will hardly deter multi-billion dollar banks from wholesale violations, especially because some disclosure violations (and the consequent fees earned from hoodwinked consumers that would follow) could be more profitable than any potential liability."[35] Moreover, courts have held that TILA class actions cannot collectively seek one of the strongest individual remedies TILA provides: loan rescissions. *See, e.g., Andrews v. Chevy Chase Bank*, 545 F.3d 570, 571 (7th Cir. 2008) (collecting cases). Meanwhile, borrowers in individual actions face a "nearly impossible to satisfy test" to attain actual damages under TILA in the first place.[36] Thus, "[b]ecause lenders only face relatively small statutory damages liability and individualized rescissions of illegal

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[34] *Adkins I,* 2013 WL 3835198, at *7 (The District Court did not reach this question because it dismissed the ECOA claims on statute of limitation grounds).
[35] Deborah Goldstein &Matthew Brinegar, *Policy and Litigation Barriers to Fighting Predatory Lending*, 2 NE. U.L.J. 193, 212 (2010).
[36] *Id.* at 195 (citing *Turner v. Beneficial Corp.,* 242 F.3d 1023 (11th Cir. 2001)).

loans," there is very little incentive for them to comply with TILA.[37] This lack of incentive for originators, alongside the difficulty of proving assignee liability, demonstrates that TILA does not constitute an effective check on the involvement of mortgage securitizers in predatory lending.

HOEPA too suffers from narrow coverage. For one, it covers only very high-cost loans: those with rates of 6.5% above the prime for first liens, or 8.5% above prime for subordinate liens. *See* 12 C.F.R. 1026.32.[38] By contrast, the federal Home Mortgage Disclosure Act (HMDA)—the basis for identifying a "high-cost" loan in the Complaint —defines a high-cost loan as a first lien with an APR and borrowing costs more than 3% above prime, or 5% above prime for a subordinate lien. *See* Compl. ¶31. As the Federal Reserve Board explained in 2006, "only a minority of loans that have their rate spreads reported under HMDA are HOEPA loans," because "Congress limited HOEPA's protections and disclosures to the highest-priced loans in the subprime home mortgage market, while the Board set HMDA's price thresholds to include the vast majority of subprime-rate mortgage loans."[39] One author concluded in 2008, at the close of the time period at

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[37] *Id.*

[38] Alternatively, HOEPA calculates high-cost loans based on the total points and fees charged, with similarly narrow coverage. *See* 12 C.F.R. § 1026.32(a)(1)(ii).

[39] *Frequently Asked Questions about the New HMDA Data*, Federal Reserve Board, (Apr. 3, 2006), *available at* http://www.federalreserve.gov/newsevents/press/ bcreg/bcreg20060403a1.pdf. (The HOEPA definition of a high-cost loan has come down since 2006, but is still far above the HMDA threshold).

issue in the instant case, that high-cost loans covered by HOEPA—and thus the universe of loans eligible for assignee liability under HOEPA—"amount to less than 1% of all originations."[40] And even under HOEPA, "the burdens on the borrower are particularly high—meaning that even if assignee liability is present under HOEPA in theory, it may not be of any practical effect."[41]

Furthermore, because of its focus on the prime rate alone, HOEPA is unable to capture a wide swathe of predatory loans. As one author explained:

> Since the laws involve interest rate triggers for assignee liability, they leave open the possibility of predators merely shifting to use of balloon payments, negative amortization, or other practices. Loans can still have predatory characteristics without charging high interest rates. For example, they can still be made to people who cannot possibly afford them, while including balloon payments to maximize the payout before default. In that case, only originators are actionable. Assignees are untouchable, leaving the same problems that caused the 2007 crash.[42]

The Complaint—which seeks not to capture high cost loans that fall short of the HOEPA threshold, but rather those that are high-cost under HMDA while also containing additional risk features such as balloon payments or negative amortization, *see* Compl. ¶ 34—is directed at precisely this problem.

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[40] Carlson, *supra* note 13 at 1037.
[41] Myers, *supra* note 5 at 328.
[42] Carlson, *supra* note 13 at 1048.

B. The Lack of an Effective Class-Action Remedy for Borrowers Against Securitizers Under Other Consumer Protection Statutes Reinforces the Importance of This FHA Class Action

The virtual absence of an effective class-action remedy for borrowers against securitizers under RESPA, TILA, and HOEPA is a setback for the fight against predatory lending. Without the right to bring effective class actions to combat the role of investment banks in predatory lending, borrowers are effectively powerless. This is true for many reasons, but two stand out.

First, securitization itself has an impact on civil procedure that makes non-class litigation impractical. For securitized loans, "[d]iscovery, negotiation, and litigation in general is more expensive" because "selling a loan into a contemporary structured finance conduit can force consumers to communicate with and litigate against many more business entities," making "[e]ven simple litigation tasks, such as service of process, interrogatories, and requests for production of documents . . . much more complicated."[43] Wall Street is thereby able to "use procedural dispute resolution costs as a hedge against enforcement of substantive law." The instant lawsuit provides a good illustration of this problem: there are five separate defendant legal entities, all affiliated with Morgan Stanley. *See* Compl. ¶¶ 19-23.

[43] Peterson, *supra* note 18 at 2263-65.

Second, predatory lending victims are in a disadvantaged position for litigation. Most of them discover their claims once they are already in a defensive posture, facing foreclosure, at which point they "universally lack resources—that is, after all, why they did not pay their mortgages in the first place."[44] One commentator paints the predicament thusly:

> These participants in the legal system, who are facing the imminent prospect of homelessness, simply lack the capability to simultaneously defend a collection action … and to bring their own affirmative lawsuit against a broker, originator, or servicer. Even if they do have the wherewithal to bring an affirmative suit, that litigation is likely to drag on many months or even years after the assignee, often claiming to be a holder in due course, succeeds in foreclosing on the family home.[45]

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[44] Peterson, *supra* note 18 at 2267-68.
[45] *Id.* at 2268. This explanation continues:

> After losing the home, most borrowers and their advocates will quickly tire of the remaining lawsuit since the most important objective--saving the home--has already been defeated. The potential damages against the originator or broker will often be relatively small in comparison to the complexity of the litigation… [Bo]rrowers [may] have great difficulty finding counsel. Private lawyers may be unable to represent the borrower because the potential damages make the claim not cost effective for their practice. And, legal services lawyers may be forced to make difficult resource allocation choices where more pressing and catastrophic legal needs…outweigh the value of an affirmative claim against an originator that will… never bring the family home back.

Nor should these borrowers be asked to rely on government enforcement to redress their personal harms. When the government brings suit against a mortgage securitizer, even a victory will not directly and completely compensate the borrower's injury. Worse, the relevant government actor may simply choose not to pursue relief from the banks, perhaps out of fear the banks will retaliate against the government by withholding credit in other contexts—as was the case in Detroit, where the City declined to sue investment banks for predatory lending in the run-up to the City's bankruptcy filing.[46] Relatedly, it is patently unjust that in the wake of the 2008 financial crisis, *investors* who purchased subprime mortgages have found ample redress in the courts via securities class actions, a prototypical Rule 23 vehicle, while the courthouse doors remain closed to the *borrowers* most harmed by mortgage securitization.[47]

In the depths of this morass, the FHA provides a glimmer of hope for borrower-victims of predatory lending schemes. Despite the insufficiency of RESPA, TILA, and HOEPA, Congress saw fit to preserve a robust remedy for discriminatory lending under the FHA—one that includes a disparate impact

[46] Christine MacDonald & Joel Kurth, *Detroit Backed Off Suing Lenders Over Risky Mortgages, Blight: as Bankruptcy Closed in, City Leaders Had Other Priorities*, THE DETROIT NEWS, (June 25, 2015), *available at* http://www.detroitnews.com/story/news/special-reports/2015/06/25/detroit-backed-off-suing-lenders/29289237/.
[47] Katzman, *supra* note 22 at 506.

theory of liability consistent with its "central purpose . . . to eradicate racial discriminatory practices within" the entire housing sector. *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507, 2521 (2015) (citations omitted). As the Supreme Court has stated, disparate impact claims can succeed under the FHA by proving a "statistical disparity . . . if the plaintiff can[] point to a defendant's policy or policies causing that disparity." *Id.* at 2523. As Judge Baer held, that is precisely what the Plaintiffs here have alleged in the Complaint. *Adkins I,* 2013 WL 3835198, at *9.

To put it bluntly, and without rehashing Appellants' brief, the Plaintiffs here have set forth one of the strongest cases imaginable for tying a large investment bank practicing mortgage securitization to the racially discriminatory predatory loans foisted upon African-Americans during the worst of the housing bubble. It has, of course, always been broadly true that the "market for subprime loans represents a higher proportion of minorities" than the general population, as "[p]redatory lenders frequently target specific groups such as the elderly [and] ethnic minorities."[48] But the Complaint does not just point to that general harm, rather it identifies clear Morgan Stanley practices and ties them persuasively to the offending loans.

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[48] Katzman, *supra* note 22 at 501-02.

Simply put, if this class is not certified under Rule 23, it may be the death knell not only of this case, but of meaningful FHA relief against the discriminatory outcomes generated by mortgage securitization writ large. And that would also be the death knell of any significant accountability by Wall Street to borrowers for one of the greatest patterns of predation in our nation's history.

CONCLUSION

For the reasons stated above, this Court should vacate the denial of class certification and remand to the district court.

Dated: November 19, 2015

Respectfully submitted,

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I hereby certify that this brief complies with the type-volume limitation of FED. R. APP. P. 29(d) and 32(a)(7)(B) because this brief contains 5,976 words, excluding the parts of the brief exempted by FED. R. APP. P. 32(a)(7)(B)(iii), according to the word count of the Microsoft Word word-processing system used to prepare the brief.

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CERTIFICATE OF SERVICE

I hereby certify that on November 19, 2015, I electronically filed the foregoing *amicus* brief with the Clerk of the Court of the U.S. Court of Appeals for the Second Circuit by using the Appellate CM/ECF system. All participants are registered CM/ECF users and will be served by the Appellate CM/ECF system.

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