

COMMONWEALTH OF MASSACHUSETTS

SUFFOLK, ss.

SUPERIOR COURT
CIVIL ACTION NO.

COMMONWEALTH OF MASSACHUSETTS,)
)
 Plaintiff,)
 v.)
)
 H&R BLOCK, INC.)
 and)
 BLOCK FINANCIAL CORP.)
 and)
 OPTION ONE MORTGAGE CORP.)
 and)
 H&R BLOCK MORTGAGE CORP.,)
 and)
 AH MORTGAGE ACQUISITION CO.)
 d/b/a)
 AMERICAN HOME MORTGAGE SERVICING, INC.)
)
 Defendants.)

08-2474-BLS

COMPLAINT

RECEIVED
 SUPERIOR COURT
 SUFFOLK COUNTY
 08/21/08 11:30

I. INTRODUCTION

1. The Commonwealth of Massachusetts, by and through its Attorney General, Martha Coakley, brings this enforcement action pursuant to the Massachusetts Consumer Protection Act, G.L. c. 93A, § 4, and the Massachusetts Antidiscrimination Act, G.L. c. 151B, § 9, and G.L. c. 12, § 10, to require H&R Block Inc., Block Financial Corp., Option One Mortgage Corp., and H&R Block Mortgage Corp., (collectively “the HRB Entities”) to pay civil penalties, restitution, and other damages arising from their unfair, deceptive, and discriminatory origination and servicing of mortgage loans in Massachusetts, and to disgorge their ill-gotten gains and profits from such conduct. The Commonwealth also seeks such injunctive relief against the HRB Entities and AH

Mortgage Acquisition Co., d/b/a American Home Mortgage Servicing, Inc. (“American Home Mortgage”) as may be determined to be appropriate and equitable in order to remedy, address, and prevent additional harm arising from HRB Entities’ unlawful conduct.

2. Option One Mortgage Corp. (“Option One”) and H&R Block Mortgage Corp. (“HRBMC”) were national mortgage lenders. The HRB Entities’ residential lending business model consisted of making subprime residential loans, or loans ostensibly intended for borrowers with limited or impaired credit. As described herein, the HRB Entities, in fact, steered even prime borrowers into more costly subprime loans. From 2003 to the present, the HRB Entities were among the top five originators and servicers of subprime loans in the United States.

3. Traditionally, banks and mortgage companies originated mortgages designed for long-term performance, under conditions where the loan was likely to be repaid, and where there was an adequate secured equitable interest in the subject property, because they held the loans over the long term.

4. In contrast, the HRB Entities increasingly disregarded underwriting standards, created incentives for loan officers and brokers to disregard the interests of the borrowers and steer them into high-cost loans, and originated thousands of loans that they knew or should have known the borrowers would be unable to pay, all in an effort to increase loan origination volume so as to profit from the practice of packaging and selling the vast majority of the HRB Entities’ residential subprime loans to the secondary market. In doing so, the HRB Entities did not have the same interest in ensuring that

loans would be repaid or that foreclosures could be avoided if real estate values stopped rising.

5. Beginning in approximately 2004, the HRB Entities began to abandon traditional underwriting standards and instead originate loans featuring multiple layers of risk without regard to whether their borrowers could afford the loan obligations. These unduly risky loans, which were often 100% financed, typically featured what are commonly referred to as “exploding ARMs,” i.e., variable interest rates that adjusted upward, usually after two years, causing a significant increase in the borrowers’ monthly payment, and also featured prepayment penalty provisions, which required borrowers to pay large penalties if they refinanced with other lenders during the introductory period. The combined impact of these risk features was that the HRB Entities routinely closed loans that they knew or should have known borrowers could not repay, especially after the “teaser rate” adjusted, and which were doomed to foreclosure.

6. These loans were designed not for long term viability, but for short-term refinancing, and brokers and agents routinely promised that borrowers could refinance before the loan became unaffordable when the introductory rate expired. But this business model, promoting serial refinancing, relied on a perpetual increase in home valuations because many loans were at or near 100% loan-to-value. As soon as the housing market flattened, the HRB Entities’ already misleading promises of future refinancing became wholly illusory.

7. Predictably, many HRB Entities borrowers found themselves unable to refinance before their interest rate “exploded,” because they have little or no home equity to draw upon to finance the prepayment penalty required of them to refinance. With no

way to afford the rising mortgage payments, many HRB Entities borrowers face foreclosure or the prospect of foreclosure. For hundreds of HRB Entities customers in Massachusetts already, and perhaps thousands more to come, the American dream of owning a home, due to defendants' unfair mortgage products and deceptive sales tactics, has turned quickly into the nightmare of payment delinquency, foreclosure, and the potential loss of home and valuable home equity.

8. On top of designing and marketing structurally unfair loans to subprime borrowers, the HRB Entities' loan origination policies encouraged loan officers and mortgage brokers to steer people into costly loan products, and to originate more loans, to maximize their own compensation. As a result, HRB Entities' agents and brokers steered borrowers with good credit scores and income into loans with high subprime interest rates, and encouraged borrowers with lower credit scores and income to accept risky loans. To support applications for the unduly risky loans, agents and brokers frequently overstated an applicant's income and/or ability to pay, and inflated the appraised value of the applicant's home. The HRB Entities, intentionally or recklessly, failed to verify or audit that information, and avoided implementing reasonable measures that would have prevented or limited these fraudulent practices.

9. The HRB Entities induced homeowners to accept their risky loan products by: (i) failing to clearly and conspicuously disclose how much and how soon the interest rate (and, therefore, the monthly payment) would increase after the teaser rate expired; (ii) failing to clearly and conspicuously disclose whether stated monthly payments included amounts due for insurance and taxes, which they generally did not; (iii) failing to clearly and conspicuously disclose closing costs and fees; (iv) making false promises

that the HRB Entities would refinance the loan prior to a rate increase; and (v) failing to disclose the true costs and risks associated with the false promise that refinancings would be available as an exit strategy when the HRB Entities' loan became unaffordable after the interest rate adjusted.

10. The HRB Entities knew or should have known that substantial numbers of their subprime loans would result in foreclosure, particularly in light of their qualification of borrowers based only on their ability to pay a two-year "teaser rate," and their reliance on serial refinancing, which in turn relied on a false assumption of perpetual home price appreciation. In fact, the origination policies that the HRB Entities employed from 2004 through 2007 have resulted in an explosion of foreclosures. These foreclosures will continue to have a devastating impact on Massachusetts communities. The number of foreclosures on Massachusetts properties with HRB Entities mortgages rose from 62 in 2005, to 382 in 2006, to 570 in just the first three quarters of 2007.

11. The Commonwealth and its cities and towns are incurring and likely will continue to incur enormous costs due to the HRB Entities' unfair, deceptive and predatory loan products. These costs include, but are not limited to, the costs of providing counseling and other assistance to consumers on the verge of foreclosure; the costs of providing additional services to consumers who have lost their homes due to foreclosure; the costs of providing increased law enforcement and emergency services in connection with incidents occurring in and around properties abandoned due to foreclosure; and costs associated with property value declines caused by foreclosure.

12. Absent intervention, the escalation in foreclosures on HRB Entities loans is expected to continue. The HRB Entities' unlawful lending practices were unfair and

