IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

NATIONAL CREDIT UNION ADMINISTRATION BOARD, as Liquidating Agent of U.S. Central Federal Credit Union, Western Corporate Federal Credit Union, Members United Corporate Federal Credit Union, Southwest Corporate Federal Credit Union, and Constitution Corporate Federal Credit Union,	)	
	)	Case No.
Plaintiffs,	)	
	)	**JURY TRIAL DEMANDED**
v.	)	
WELLS FARGO BANK, NATIONAL ASSOCIATION,	)	
Defendant.	)	

COMPLAINT

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The National Credit Union Administration Board ("NCUA Board"), acting in its capacity as liquidating agent for each of U.S. Central Federal Credit Union ("U.S. Central"), Western Corporate Federal Credit Union ("WesCorp"), Members United Corporate Federal Credit Union ("Members United"), Southwest Corporate Federal Credit Union ("Southwest"), and Constitution Corporate Federal Credit Union ("Constitution"), (collectively, the "CCUs" and with the NCUA Board as liquidating agent for each, the "Plaintiffs"), by and through their attorneys, for this action against Wells Fargo Bank, National Association ("Wells Fargo" or "Defendant"), alleges as follows:

I. NATURE OF THE ACTION

1. Plaintiffs bring this action against Defendant for violating the Trust Indenture Act of 1939 (the "TIA"), 15 U.S.C. § 77aaa *et seq*., and, regarding the New York trusts, for violating New York Real Property Law § 124 *et seq.* (the "Streit Act") to recover the damages they have suffered because of Defendant's violations of its statutory and contractual obligations.

2. This action arises out of Defendant's role as trustees for 27 trusts identified on Exhibit A that issued residential mortgage-backed securities ("RMBS"). Each trust consists of hundreds of individual residential mortgage loans that were pooled together and securitized for sale to investors. Investors purchased certificates issued by the RMBS trusts that entitled the investors (or "certificateholders") to fixed principal and interest payments from the income stream generated as borrowers made monthly payments on the mortgage loans in the trusts.

3. The CCUs purchased the certificates in the trusts identified on Exhibit A at an original face value of approximately $2.4 billion.

4. The certificates' value was dependent on the quality and performance of the mortgage loans in the trusts and swift correction of any problems with the loans. But, because of

the structure of the securitizations, certificateholders do not have access to the mortgage loan files or the power to remedy or replace any defective loans. Instead, certificateholders must rely on the trustee to protect their interests.

5. Defendant, as the trustee for the trusts, had contractual and statutory duties to address and correct problems with the mortgage loans and to protect the trusts' and the certificateholders' interests. The trustee for each trust has three primary duties. First, the trustee must take possession and acknowledge receipt of the mortgage files, review the documents in the mortgage files, identify any mortgage files that lack a complete chain of title or that have missing documents, and then certify that the mortgage files are complete and accurate. If the trustee identifies defects in the mortgage files, it must notify the appropriate parties and take steps to enforce the responsible party's obligation to cure, substitute, or repurchase any mortgage loans with defective mortgage files.

6. Second, if the trustee discovers a breach of the representations and warranties concerning the mortgage loans, including but not limited to representations concerning the characteristics of the mortgage borrowers, the collateral for the mortgage loans, and assurances that the mortgage loans were originated in accordance with applicable underwriting criteria, the trustee must notify the appropriate parties and take steps to enforce the responsible party's obligation to cure, substitute, or repurchase the defective mortgage loans. If the trustee fails to exercise this duty, then the trusts and the certificateholders will suffer losses properly borne by the party responsible for the defective loans.

7. Third, the trustee must act to protect the interests of the trust and the certificateholders when it becomes aware of defaults concerning the trust. Thus, when the trustee discovers a default, or is notified by other parties, such as servicers, of defaults like breaches of

representations and warranties with respect to the underlying mortgage loans, the trustee must act prudently to investigate those defaults, notify certificateholders of the defaults, and take appropriate action to address the defaults.

8. Here, Defendant failed even to perform the threshold duties of taking full possession of the original notes and mortgages and properly reviewing the mortgage loan files for irregularities. If Defendant had fulfilled its obligations, a significant percentage of the mortgage loans in the trusts would have been repurchased or substituted.

9. Moreover, an overwhelming number of subsequent events alerted Defendant to the fact that the trusts suffered from numerous problems, yet it did nothing. First, the trusts suffered enormous losses due to the high number of mortgage defaults, delinquencies, and foreclosures caused by defective loan origination and underwriting. Second, highly publicized government investigations and enforcement actions, public and private litigation, and media reports highlighted the mortgage originators' systematic abandonment and disregard of underwriting guidelines and the deal sponsors' poor securitization standards in the years leading up to the financial crisis. As summarized below, these actions and reports detail the incredible volume of defective loans and notorious activities of the originators, sponsors, and other players in the RMBS industry. Yet Defendant failed to take steps to preserve its rights or hold the responsible parties accountable for the repurchase or substitution of defective mortgage loans in direct contravention of its obligations as trustee.

10. Finally, Defendant failed to address servicer and/or master servicer defaults and events of default. Defendant knew that the master servicers and servicers were ignoring their duty to notify other parties, including Defendant as trustee, upon the master servicers' and servicers' discovery of breaches of the mortgage loan representations and warranties. Despite

Defendant's knowledge of these ongoing defaults and events of default, Defendant failed to act prudently to protect the interests of the trusts and the certificateholders.

11. Defendant's failures resulted in the trusts and certificateholders suffering losses rightfully borne by other parties. Had Defendant adequately performed its contractual and statutory obligations, breaching loans would have been removed from the loan pools underlying the certificates and returned to the responsible party. Defendant's improper conduct directly caused losses to certificateholders like the Plaintiffs.

12. Even after ample evidence came to light that the trusts were riddled with defective loans, Defendant shut its eyes to such problems and failed to take the steps necessary to protect the trusts and certificateholders. Defendant failed to act in part because protecting the best interests of the trusts and the certificateholders would have conflicted with Defendant's interests. As a participant in many roles in the securitization process, Defendant was economically intertwined with the parties it was supposed to police.

13. Because of the widespread misconduct in the securitization process, Defendant had incentives to ignore other parties' misconduct in order to avoid drawing attention to its own misconduct. Thus, Defendant failed and unreasonably refused to take action to protect the trusts and certificateholders against responsible party breaches.

14. Indeed, it is precisely this type of trustee complicity and inaction that led Congress to enact the TIA to "meet the problems and eliminate the practices" that plagued Depression-era trustee arrangements and provide investors with a remedy for trustees that utterly neglect their obligations. *See, e.g.*, 15 U.S.C. § 77bbb(b) (explaining purposes of the TIA in light of problems identified in 15 U.S.C. § 77bbb(a)).

15. To that end, several sections of the TIA impose duties on trustees. First, TIA

Section 315(a) provides that, prior to default (as that term is defined in the governing documents), the trustee is liable for any duties specifically set out in the governing documents. 15 U.S.C. § 77ooo(a)(1). Second, TIA Section 315(b) provides that the trustee must give holders of covered securities “notice of all defaults known to the trustee, within ninety days after the occurrence thereof.” 15 U.S.C. § 77ooo(b). Third, Section 315(c) requires a trustee to act prudently in the event of a default (as that term is defined in the governing documents). 15 U.S.C. § 77ooo(c). Finally, the TIA states that “[n]otwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security . . . shall not be impaired or affected without the consent of such holder.” 15 U.S.C. § 77ppp(b).

16. In addition, Section 124 of the Streit Act imposes a duty upon the trustee to discharge its duties under the applicable indenture with due care to ensure the orderly administration of the trust and to protect the trust beneficiaries’ rights. N.Y. Real Prop. Law § 124. Like the TIA, following an event of default, the Streit Act provides that the trustee must exercise the same degree of skill and care in the performance of its duties as would a prudent person under the same circumstances. N.Y. Real Prop. Law § 126(1).

17. Finally, upon awareness of the various failures discussed in this complaint, the governing agreements require Defendant to exercise its rights and powers using the same degree of care and skill as a prudent person would exercise or use under the circumstances in the conduct of such person’s own affairs.

18. Defendant’s failure to perform its duties under the TIA, the Streit Act, and the governing agreements has caused Plaintiffs to suffer enormous damages.

II. PARTIES

19. The National Credit Union Administration ("NCUA") is an independent agency of the Executive Branch of the United States Government that, among other things, charters and regulates federal credit unions and operates and manages the National Credit Union Share Insurance Fund ("NCUSIF") and the Temporary Corporate Credit Union Stabilization Fund ("TCCUSF"). The TCCUSF was created in 2009 to allow the NCUA to borrow funds from the United States Department of the Treasury ("Treasury Department") to stabilize corporate credit unions under conservatorship or liquidation, or corporate credit unions threatened with conservatorship or liquidation. The NCUA must repay all monies borrowed from the Treasury Department for the purposes of the TCCUSF by 2021. The NCUSIF insures the deposits of account holders in all federal credit unions and the majority of state-chartered credit unions. The NCUA has regulatory authority over state-chartered credit unions that have their deposits insured by the NCUSIF. The NCUA Board manages the NCUA. *See* Federal Credit Union Act ("FCU Act"), 12 U.S.C. §§ 1751, 1752a(a). Pursuant to 12 U.S.C. § 1787(a) and (b)(2)(A), the NCUA Board, in specified circumstances and in a distinct capacity, may close an insured credit union and appoint itself the Liquidating Agent for such credit union. As Liquidating Agent, the NCUA Board succeeds to all rights, titles, powers, and privileges of the credit union, its members, accountholders, officers, and directors.

20. U.S. Central was a federally chartered corporate credit union with its offices and principal place of business in Lenexa, Kansas. As a corporate credit union, U.S. Central provided investment and financial services to other credit unions.

21. WesCorp was a federally chartered corporate credit union with its offices and principal place of business in San Dimas, California. As a corporate credit union, WesCorp

provided investment and financial services to other credit unions.

22. Members United was a federally chartered corporate credit union with its offices and principal place of business in Warrenville, Illinois. Members United was created in mid-2006 by the merger of Empire and Mid-States Corporate Federal Credit Unions. As a corporate credit union, Members United provided investment and financial services to other credit unions.

23. Southwest was a federally chartered corporate credit union with its offices and principal place of business in Plano, Texas. As a corporate credit union, Southwest provided investment and financial services to other credit unions.

24. Constitution was a federally chartered corporate credit union with its offices and principal place of business in Wallingford, Connecticut. As a corporate credit union, Constitution provided investment and financial services to other credit unions.

25. The NCUA Board placed U.S. Central and WesCorp into conservatorship on March 20, 2009, pursuant its authority under the FCU Act, 12 U.S.C. § 1786(h). On October 1, 2010, the NCUA Board placed U.S. Central and WesCorp into involuntary liquidation pursuant to 12 U.S.C. § 1766(a) and 12 U.S.C. § 1787(a)(1)(A) and appointed itself Liquidating Agent. On September 24, 2010, the NCUA Board placed Members United, Southwest, and Constitution into conservatorship pursuant to the FCU Act. On October 31, 2010, the NCUA Board placed Members United, Southwest, and Constitution into involuntary liquidation, appointing itself Liquidating Agent.

26. Pursuant to 12 U.S.C. § 1787(b)(2)(A), the NCUA Board as Liquidating Agent has succeeded to all rights, titles, powers, and privileges of the CCUs and of any member, account holder, officer or director of the CCUs, with respect to the CCUs and their assets, including the right to bring the claims asserted in this action. As Liquidating Agent, the NCUA

Board has all the powers of the members, directors, officers, and committees of the CCUs, and succeeds to all rights, titles, powers, and privileges of the CCUs. *See* 12 U.S.C. §1787(b)(2)(A). The NCUA Board may also sue on the CCUs' behalf. *See* 12 U.S.C. §§ 1766(b)(3)(A), 1787(b)(2), 1789(a)(2).

27. Wells Fargo Bank, National Association ("Wells Fargo") is a national banking association organized and existing under the laws of the State of South Dakota with its principal executive offices at 101 N. Phillips Avenue, Sioux Falls, South Dakota 57104. Wells Fargo operates 50 corporate trust offices across the country, including in New York City, and currently serves as trustee for hundreds of RMBS trusts, including the trusts at issue in this litigation.

28. Wells Fargo is the primary United States operating subsidiary of Wells Fargo & Company, a multinational banking and financial services holding company with $1.5 trillion in assets that is incorporated in Delaware and headquartered in San Francisco, California. Wells Fargo & Company employs 265,000 individuals in offices worldwide, including numerous offices in New York State and New York City. Wells Fargo & Company is the second largest bank and the twenty-third largest company in the United States. In 2008, Wells Fargo & Company acquired the Charlotte-based bank Wachovia, including Wachovia's RMBS trustee business, in an all-stock transaction valued at approximately $14.8 billion.

29. Wells Fargo, together with its affiliates, is involved in virtually all aspects of the private-label RMBS market. For example, Wells Fargo originated approximately $1.5 trillion in residential mortgages between 2004 and 2008 that were sold and securitized in various RMBS. Wells Fargo also sponsored approximately 160 RMBS between 2004 and 2008 with an original face value of approximately $165 billion. Finally, Wells Fargo, together with various of its loan servicing arms, is one of the largest mortgage loan servicing businesses in the United States,

serving as master servicer for approximately $1.16 trillion in RMBS issued between 2004 and 2008.

III. JURISDICTION AND VENUE

30. This Court has subject matter jurisdiction pursuant to the following statutes: (a) 12 U.S.C. § 1789(a)(2), which provides that "[a]ll suits of a civil nature at common law or in equity to which the [NCUA Board] shall be a party shall be deemed to arise under the laws of the United States, and the United States district courts shall have original jurisdiction thereof, without regard to the amount in controversy"; (b) 28 U.S.C. § 1345, which provides that "the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress"; (c) 15 U.S.C. §77v, providing for jurisdiction for claims under the TIA; (d) 15 U.S.C. § 1331, providing for "original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States"; and (e) 15 U.S.C. § 1367, providing for "supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy." This Court also has jurisdiction over the claims asserted under the Streit Act because this case involves New York common law trusts.

31. Venue is proper in this District under Section 22 of the Securities Act, 15 U.S.C. § 77v(a), and/or 28 U.S.C. §1391(b)(1), because Defendant is a resident of and/or conducts business in this District. This Court has personal jurisdiction over Defendant because it is a resident of and/or conducts business in this District and under N.Y. C.P.L. 301, New York's long arm statute. The claims relate to Defendant's role as trustee over trusts created under New York law and/or administered at least in part in New York. In addition, Defendant has filed foreclosure

cases on behalf of the trusts in New York and in the course of such proceedings either discovered or should have discovered multiple defaults and representation and warranty breaches.

IV. THE TRUSTS

32. The trusts identified on Exhibit A are 27 New York common law trusts or Delaware statutory trusts created in connection with residential mortgage-backed securitizations between 2004 and 2008.

33. The trusts have a high concentration of loans originated by the following lenders and their affiliates: Option One Mortgage Corp.; Bank of America, N.A.; Countrywide Home Loans, Inc.; New Century Mortgage Corporation; First Franklin Financial Corp.; Impac Mortgage Holdings, Inc. and Impac Funding Corp.; National City Mortgage Co.; GreenPoint Mortgage Funding; Fremont Investment & Loan; WMC Mortgage Corp.; Paul Financial; Decision One Mortgage Co., LLC; and Ameriquest Mortgage Company (collectively, the "originators").

34. A significant portion of the trusts were sponsored by the following sponsors and their affiliates: Option One Mortgage Corp.; Bank of America, N.A.; Impac Mortgage Holdings, Inc. and Impac Funding Corp.; Greenwich Capital Financial Products, Inc.; DLJ Mortgage Capital, Inc.; Merrill Lynch Mortgage Lending, Inc.; and Morgan Stanley Mortgage Capital, Inc. (collectively, the "sponsors").

V. BACKGROUND

A. RMBS Trusts

35. RMBS certificates are debt instruments issued to investors by an issuing trust that holds one or more mortgage pools. The corpus of the trust – like the trusts at issue here – consists almost exclusively of the underlying mortgage loans. Certificateholders receive a portion of the

income stream generated by the trust as borrowers make payments on their mortgage loans.

36. Because residential mortgage loans are the assets collateralizing RMBS, the origination of mortgages starts the process that leads to the creation of RMBS. Originators decide whether to loan potential borrowers money to purchase residential real estate through a process called mortgage underwriting. The originator applies its underwriting standards or guidelines to determine whether a particular borrower is qualified to receive a mortgage for a particular property.

37. The securitization process begins with a sponsor who purchases loans in bulk from one or more originators. The sponsor transfers title of the loans to an entity called a depositor.

38. The depositor transfers the loans to a trust called the issuing entity.

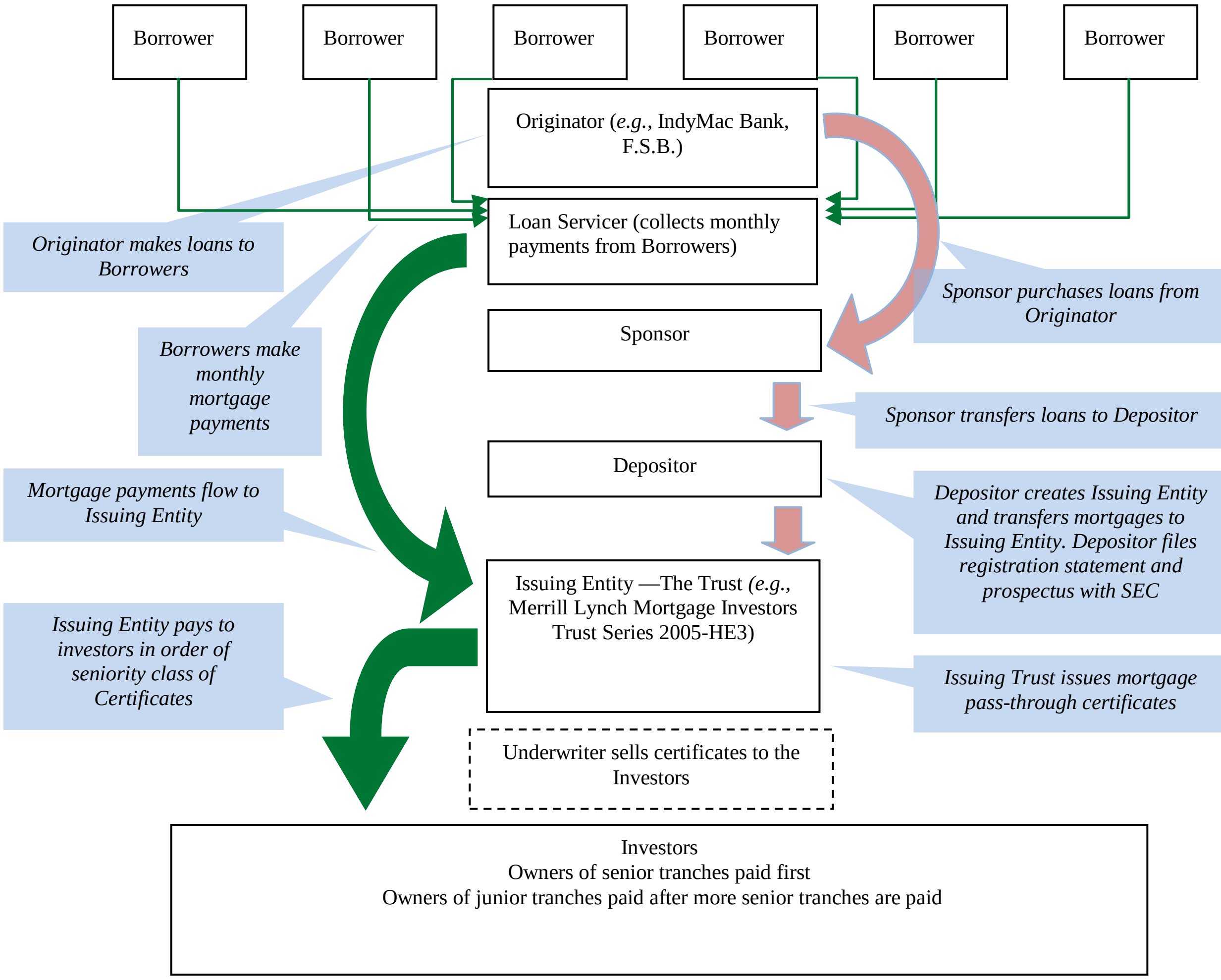
39. The issuing entity then issues notes and/or certificates, providing certificateholders scheduled principal and interest payments derived from the cash flow from the mortgage pool underlying the securities (*i.e.*, the principal and interest generated as borrowers make monthly payments on the mortgages in the pool).

40. The depositor files required documents (such as registration statements and prospectuses) with the U.S. Securities and Exchange Commission ("SEC") so the certificates can be offered to the public.

41. One or more underwriters then sell the notes or certificates to investors.

42. Figure 1 (*infra*) depicts a typical securitization process.

Figure 1
Illustration of the Securitization Process



43. The establishment and administration of each trust is governed by a series of contracts (the "governing agreements"). The vast majority of trusts are governed by an agreement called a Pooling and Servicing Agreement ("PSA") and certain related agreements that the PSA references and incorporates. The remaining trusts are governed by a document called an Indenture and certain related agreements that the Indenture references and incorporates, including a document called the Sales and Servicing Agreement. All of the governing agreements are substantially similar, and impose the same duties on Defendant. Accordingly, this Complaint primarily refers to the PSAs or the governing agreements when discussing the

trustee's contractual obligations.

44. Once the loans are deposited into a trust, borrowers begin making payments to the trust through a master servicer. The master servicer is ultimately responsible for servicing the loans, but may use a designee, typically called a servicer or sub-servicer, to perform some or all of the mortgage servicing functions. The master servicer's duties include monitoring delinquent borrowers, foreclosing on defaulted loans, monitoring compliance with representations and warranties regarding loan origination, tracking mortgage documentation, and managing and selling foreclosed properties.

45. When the master servicer collects loan payments from borrowers, it then transfers those payments, less allowable deductions, to the trustee. The trustee then uses the payments, less allowable fees and expenses, to make scheduled principal and interest payments to certificateholders. The trustee also delivers monthly remittance reports to certificateholders describing the performance of underlying loans and compliance with the governing agreements. The contents of those reports are specified in the governing agreements and in Item 1121 of SEC Regulation AB. *See* 17 C.F.R. § 229.1121. The servicer provides data to the trustee to include in these remittance reports.

46. Thus, each trust is administered primarily by two entities – the trustee and the master servicer, under the oversight of the trustee. The trustee owes certificateholders certain duties set forth in the governing agreements, as well as those duties imposed by the TIA and the Streit Act.

47. The purpose of having a trustee in an RMBS securitization is to ensure there is at least one independent party to the governing agreements who, unlike the RMBS certificateholders, does not face collective action, informational, or other limitations, and as a

result can protect the trusts and the interests of RMBS certificateholders. The governing agreements, the TIA, and the Streit Act impose critical duties on trustees, and the trustees' adherence to those duties affects the value of the RMBS.

B. The Trustee's General Duties

48. Although the governing agreements for each of the trusts are separate agreements that were individually negotiated and display degrees of variation, the terms that are pertinent to the subject matter of this Complaint are substantially similar, if not identical, in all of the governing agreements and impose substantially the same, if not identical, duties and obligations on the parties to the governing agreements. Further, upon information and belief, Defendant employed the same general set of policies and procedures to oversee and manage the trusts regardless of the individual variations contained within the governing agreements.

49. Most importantly, Defendant has an absolute duty under the governing agreements, the TIA, and the Streit Act to acquire and protect the trust corpus for the benefit of certificateholders. The Trustee "declares that it or its Custodian on its behalf holds and will hold such documents and any other documents constituting a part of the Mortgage Files delivered to it in trust for the use and benefit of all present and future Certificateholders." PSA Section 2.02.[1]

C. The Trustee's Duties Under the Pooling and Servicing Agreements

50. The PSAs are contracts between, in addition to others, the depositor, the master servicer or servicer, and the trustee, which govern the trusts that issued the certificates. The PSAs for each of the trusts are substantially similar and memorialize the following events and conditions: (i) the transfer and conveyance of the mortgage loans from the depositor to the trust;

[1] All cites to "PSA Section ___" or any related agreements are to the PSA and related agreements specific to the Merrill Lynch Mortgage Investors Trust Series 2005-HE3 ("MLMI 2005-HE3") offering, which, as alleged above, is substantially similar to the governing agreements for all of the trusts. A copy of the MLMI 2005-HE3 PSA is attached as Exhibit B.

(ii) the trust's issuance of beneficial certificates of interests in the trust to raise the funds to pay the depositor for the mortgage loans; and (iii) the terms of those certificates.[2]

51. The PSAs also set forth Defendant's contractual duties and obligations, which are identical or substantially identical for each trust. Specifically, each PSA requires Defendant to oversee and enforce the depositors' and the servicers' obligations. In performing these contractual obligations, Defendant must act in the best interests of and for the protection of the trusts and the certificateholders. Certificateholders, unlike the trustee, have no direct contact with the depositors and servicers. Moreover, under the PSAs, certificateholders do not have the right to compel the trustee to enforce the responsible party's representations and warranties,[3] absent satisfaction of the collective action provisions. Certificateholders must rely on the Defendant to protect their interests.

D. Duty Properly to Take Title to the Mortgage Loans Conveyed to the Trust

52. The trusts must take title to the mortgages conveyed to them for due consideration for the RMBS properly to be backed by mortgage loans. The PSAs establish the conveyance terms of the mortgage loans to the trustee, on behalf of the trust and the RMBS

[2] Some of the trusts have a different structure—they issued notes pursuant to an indenture (collectively, the "Indentures") on which the Defendant serves as indenture trustee. A separate agreement, such as a Sale and Servicing Agreement ("SSA"), governs other terms of these transactions. Although there are some differences between the PSA and Indenture structures, with regard to this Complaint, both the nature of the claims asserted and Defendant's duties and obligations are similar under the two structures.

[3] The governing agreements specify the party that is responsible for repurchasing any defective loan. With modest variations across the governing agreements, they provide that, upon discovery and/or notice of a breach of a representation and warranty with respect to a mortgage loan that materially and adversely affects the interests of the certificateholders, the responsible party shall cure the breach or repurchase the affected mortgage loan at its purchase price, which is equal to the then-outstanding amount due on the mortgage loan. The responsible party is generally either the originator of the loans, the seller of the loans, or the sponsor of the securitization. These roles are frequently undertaken by the same or affiliated entities. For simplicity's sake, this complaint uses "responsible party" to refer to the entity responsible for repurchase of any defective loans.

certificateholders, and those terms are intended to ensure that the trustee, on behalf of the trusts, takes full title to the mortgage loans.

53. The first part of this conveyance involves the depositor assigning to the trustee, among other things, its rights, title, and interest in the mortgage loans and the depositor's rights under the transfer agreement whereby the depositor acquired the mortgage loans. PSA Section 2.01 ("Conveyance of Mortgage Loans") provides in relevant part:

> The Depositor, concurrently with the execution and delivery hereof, does hereby sell, transfer, assign, set over and convey to the Trustee without recourse all the right, title and interest of the Depositor in and to the assets of the Trust Fund . . . . In addition to the conveyance made in the first paragraph of this Section 2.01, the Depositor does hereby convey, assign and set over to the Trustee for the benefit of the Certificateholders its rights and interests under the Sale Agreement, including the Depositor's right, title and interest in the representations and warranties contained in the Sale Agreement, the rights in the Transfer Agreements described therein, and the benefit of the repurchase obligations and the obligation of the Seller contained in the Sale Agreement to take, at the request of the Depositor or the Trustee, all action on its part which is reasonably necessary to ensure the enforceability of a Mortgage Loan.

54. Furthermore, the PSAs require Defendant, or its agents acting as custodians, to acknowledge receipt of the mortgage loans on behalf of the trust and to acknowledge that all mortgage pool assets—including the mortgage files and related documents and property—are held by it as trustee. Significantly, Defendant, or its agents, must take physical possession of the mortgage files, including the mortgage note and the mortgage, properly endorsed and assigned to the trustee. PSA Section 2.02.

55. Section 2.01 of the PSA specifically sets forth the operative documents that must be contained in the mortgage file:

> In connection with such assignment, the Depositor does hereby deliver to, and deposit with, the Trustee or its Custodian, the following documents or instruments with respect to each Mortgage Loan:
>
> (A) The Original Mortgage Note endorsed in blank or, "Pay to the order of Wells Fargo Bank, N.A., as trustee, without recourse" together with all riders thereto. The

Mortgage Note shall include all intervening endorsements showing a complete chain of the title from the originator to [___________] or "Pay to the order of Wells Fargo Bank, N.A., as trustee, without recourse."

(B) Except as provided below and for each Mortgage Loan that is not a MERS Loan, the original recorded Mortgage together with all riders thereto, with evidence of recording thereon, or, if the original Mortgage has not yet been returned from the recording office, a copy of the original Mortgage together with all riders thereto certified to be true copy of the original of the Mortgage that has been delivered for recording in the appropriate recording office of the jurisdiction in which the Mortgaged Property is located and in the case of each MERS Loan, the original Mortgage together with all riders thereto, noting the presence of the MIN of the Loan and either language indicating that the Mortgage Loan is a MOM Loan or if the Mortgage Loan was not a MOM Loan at origination, the original Mortgage and the assignment thereof to MERS, with evidence of recording indicated thereon, or a copy of the Mortgage certified by the public recording office in which such Mortgage has been recorded.

(C) In the case of each Mortgage Loan that is not a MERS Loan, the original Assignment of each Mortgage, endorsed either in blank or, to "Wells Fargo Bank, N.A., as trustee"

(D) The original policy of title insurance (or a preliminary title report, commitment or binder if the original title insurance policy has not been received from the title insurance company).

(E) Originals of any intervening assignments of the Mortgage, with evidence of recording thereon or, if the original intervening assignment has not yet been returned from the recording office, a copy of such assignment certified to be a true copy of the original of the assignment which has been sent for recording in the appropriate jurisdiction in which the Mortgaged Property is located.

(F) Originals of all assumption and modification agreements, if any.

(G) If in connection with any Mortgage Loan, the Depositor cannot deliver the Mortgage, Assignments of Mortgage or assumption, consolidation or modification, as the case may be, with evidence of recording thereon, if applicable, concurrently with the execution and delivery of this Agreement solely because of a delay caused by the public recording office where such Mortgage, Assignments of Mortgage or assumption, consolidation or modification, as the case may be, has been delivered for recordation, the Depositor shall deliver or cause to be delivered to the Trustee or its Custodian, if applicable, written notice stating that such Mortgage or assumption, consolidation or modification, as the case may be, has been delivered to the appropriate public recording office for recordation. Thereafter, the Depositor shall deliver or cause to be delivered to the Trustee or its Custodian, if applicable, such Mortgage, Assignments of Mortgage or assumption, consolidation or modification, as the case may be, with evidence of recording indicated thereon, if applicable, upon receipt thereof from the public recording office. To the extent any required endorsement is not contained on a Mortgage Note or an Assignment of Mortgage, the Depositor shall make or cause such endorsement to be made.

(H) With respect to any Mortgage Loan, none of the Depositor, the Servicer, the Custodian or the Trustee shall be obligated to cause to be recorded the Assignment of Mortgage referred to in this Section 2.01. In the event an Assignment of Mortgage is not recorded, the Servicer shall have no liability for its failure to receive and act on notices related to such Assignment of Mortgage.

56. Once the mortgage files are in Defendant's or its custodian's possession, Defendant, or the custodian on Defendant's behalf, is required to ensure that the underlying mortgage loans were properly conveyed to the trusts, and that the trusts have perfected enforceable title to the mortgage loans by reviewing the mortgage files for each mortgage loan. Defendant, or the custodian on the Defendant's behalf, is required to review each mortgage file within a certain period after the "closing date" of the securitization and deliver to the depositor a certification that all documents required have been executed and received. This duty overlaps with and forms part of the requirements that the trustee must satisfy to properly take title to the mortgage loans. As set forth in PSA Section 2.02 (emphasis added):

> The Trustee agrees, for the benefit of Certificateholders, to review or cause to be reviewed by the Custodian, on its behalf (pursuant to the Custodial Agreement) each Mortgage File delivered to it within 60 days after the Closing Date. **The Trustee or the Custodian, as applicable, will ascertain and certify, within 70 days of the Closing Date, to the Depositor and the Servicer that all documents required by Section 2.01 have been executed and received**, and that such documents relate to the Mortgage Loans identified in Exhibit B-1 that have been conveyed to it.

E. Duty to Provide Notice of Incomplete or Defective Mortgage Files and Enforce Repurchase Rights with Respect to Mortgage Files that Cannot be Cured

57. If Defendant or the custodian identifies any defect in a mortgage loan file for an underlying mortgage loan contained in a trust, Defendant must identify such defect and promptly provide notice to the relevant parties. As set forth in PSA Section 2.02 (emphasis added):

> If the Trustee or Custodian finds any document or documents constituting a part of a Mortgage File to be missing or defective (that is, mutilated, damaged, defaced or unexecuted) in any material respect, **the Trustee or Custodian, as applicable, shall promptly (and in any event within no more than five Business Days) after such finding so notify the other and the Servicer, the Seller and the Depositor.** In addition, the Trustee or Custodian, as applicable, shall also notify the other and the Servicer, the Seller and the Depositor, if the original Mortgage with evidence of recording thereon with respect to a Mortgage Loan is not received within 70 days of the Closing Date . . . .

58. Once incomplete mortgage files or loans with defective transfer documentation are identified, the parties to the governing agreements must work to remedy these deficiencies. As set forth in PSA Section 2.02 (emphasis added):

> **The Trustee shall request that the Seller correct or cure such omission, defect or other irregularity, or substitute a Mortgage Loan pursuant to the provisions of Section 2.03**, within 90 days from the date the Seller was notified of such omission or defect and, if the Seller does not correct or cure such omission or defect within such period, that the Seller purchase such Mortgage Loan from the Trust Fund within 90 days from the date the Trustee or the Custodian, as applicable, notified the Seller of such omission, defect or other irregularity at the Purchase Price of such Mortgage Loan.

59. The trustee's sole remedy to protect the trust from such defective loans is to enforce the obligation of the responsible party to repurchase such loans. As set forth in PSA Section 2.02:

> It is understood and agreed that the obligation of the Seller to purchase, cure or substitute any Mortgage Loan as to which a material defect in or omission of a constituent document exists shall constitute the sole remedy respecting such defect or omission available to the Trustee on behalf of Certificateholders.

F. Duty to Provide Notice of Breaches and to Enforce Repurchase Rights with Respect to Defective Loans

60. The quality of the mortgage loans to which the trusts purportedly receive title is also critical to an RMBS securitization. For that reason, the governing agreements contain "representations and warranties" by the responsible party attesting to the characteristics of the borrower and collateral for the mortgage loans conveyed to the trusts, and that the loans were made in accordance with applicable underwriting guidelines.

61. As in instances of missing documents or where the transfer of the mortgage was incomplete, the governing agreements also require the responsible party to cure, substitute, or repurchase any mortgage loans that materially breach the responsible party's representations and warranties concerning the quality of the mortgage loans conveyed to the trusts. Specifically, the governing agreements require the trustee, among others, to provide notice of the breaches and enforce the responsible party's repurchase obligations:

> Upon discovery by any of the Depositor, the Servicer, the Trustee or the Custodian of a breach of any of such representations and warranties that adversely and materially affects the value of the related Mortgage Loan, Prepayment Charges or the interests of the Certificateholders, **the party discovering such breach shall give prompt written notice to the other parties.** Within 90 days of the discovery of such breach of any representation or warranty, the applicable Transferor or the Seller, as applicable, shall either (a) cure such breach in all material respects, (b) repurchase such Mortgage Loan or any property acquired in respect thereof from the Trustee at the Purchase Price or (c) within the two year period following the Closing Date, substitute a Replacement Mortgage Loan for the affected Mortgage Loan. In the event of discovery of a breach of any representation and warranty of any Transferor or the Seller, **the Trustee's rights shall be enforced under the applicable Transfer Agreement and the Sale Agreement for the benefit of Certificateholders.**

PSA Section 2.03(c) (emphasis added).

62. Consequently, under the governing agreements, Defendant is entrusted to ensure that the mortgage loans in the trusts were properly underwritten, were of a certain risk profile, and had characteristics of a certain quality as represented by the responsible party.

63. To protect the trusts and all certificateholders, the governing agreements require Defendant to give prompt written notice to all parties to the governing agreements upon its knowledge of a breach of a representation or warranty made by the responsible party about the mortgage loans that materially and adversely affects the value of any mortgage loan or the interests of the certificateholders in any loan, and to take such action as may be necessary or appropriate to enforce the rights of the trusts regarding the breach.

G. Duties under the Transfer Agreements

64. Depending on the parties, there are several methods whereby the depositor acquires the loans for securitization. These include Mortgage Loan Purchase Agreements ("MLPAs"), Sale and Servicing Agreements ("SSAs"), Mortgage Loan Sale and Assignment Agreements ("MLSAAs"), and Assignment and Recognition Agreements (collectively, "transfer agreements"). These agreements are all substantially similar and govern the terms for transferring mortgage loans acquired for securitization from the originator to the depositor. These transfer agreements are generally between either the originator and the depositor, or the sponsor and the depositor.

65. One of the parties to the transfer agreement—typically an originator or sponsor—makes extensive representations and warranties concerning the characteristics, quality, and risk profile of the mortgage loans in either the PSA or the associated transfer agreement.[4] For simplicity's sake, this Complaint refers to that party as the "responsible party."

66. The responsible party's typical representations and warranties in the transfer agreements include, *inter alia*, the following: (i) the information in the mortgage loan schedule is true and correct in all material respects; (ii) each loan complies in all material respects with all applicable local, state and federal laws and regulations at the time it was made; (iii) the mortgaged properties are lawfully occupied as the principal residences of the borrowers unless specifically identified otherwise; (iv) the borrower for each loan is in good standing and not in default; (v) no loan has a loan-to-value ("LTV") ratio of more than 100%; (vi) each mortgaged property was the subject of a valid appraisal; and (vii) each loan was originated in accordance with the underwriting guidelines of the related originator. To the extent mortgages breach the

[4] The governing agreements frequently refer to the same entity by different titles depending upon the role being played. The role of seller or transferor generally overlaps with that of the sponsor.

responsible party's representations and warranties, the mortgage loans are worth less and are much riskier than represented.

67. Under the transfer agreements, upon discovery or receipt of notice of any breach of the responsible party's representations and warranties that has a material and adverse effect on the value of the mortgage loans in the trusts or the interests of the certificateholders therein, the responsible party is obligated to cure the breach in all material respects.

68. If a breach is not cured within a specified period, the responsible party is obligated either to substitute the defective loan with a loan of adequate credit quality, or to repurchase the defective loan.

69. The repurchase provisions ensure that the trust need not continue to hold mortgage loans for which the responsible party breached its representations and warranties. Thus, the repurchase provisions are designed to transfer the risk of any decline, or further decline, in the value of defective mortgage loans that results from a breach from the trusts to the responsible party.

70. Under the transfer agreements, the demanding party must merely show that the breach has a material and adverse effect on the value of the mortgage loans in the trusts or the certificateholders' interests in the loans. The responsible party's cure, substitute, and repurchase obligations do not require any showing that the responsible party's breach of representations caused any realized loss in the related mortgage loan in the form of default or foreclosure, or require that the demanding party prove reliance on servicing and origination documents.

71. Upon the sale of the mortgage loans to the trust, the rights under the transfer agreements, including the responsible party's representations and warranties concerning the mortgage loans, are generally assigned to the Defendant, as trustee, for the benefit of the trusts

and all certificateholders, in accordance with the governing agreements.

H. Duties Regarding the Servicers

72. Each PSA requires the master servicer or servicer to prudently service the loans underlying the trusts.

73. Section 3.01 of the PSA states:

> For and on behalf of the Certificateholders, the Servicer shall service and administer the Mortgage Loans in accordance with Accepted Servicing Practices [defined as "[t]he Servicer's normal servicing practices, which will conform to the mortgage servicing practices of prudent mortgage lending institutions which service for their own account mortgage loans of the same type as the Mortgage Loans in the jurisdictions in which the related Mortgaged Properties are located."]

74. Under the PSAs, Defendant, as trustee, has certain duties and obligations regarding monitoring the master servicers and/or servicers. In particular, the PSAs set forth Defendant's obligations upon occurrence of an "event of default" which is defined as a specified failure of the servicer to perform its servicing duties and cure this failure within a specified time.[5] Section 7.01 of the PSAs identifies several types of failures by the servicer that may give rise to such an event. Such failures include a breach of servicer representations and warranties and failure to observe or perform in any material respect any other covenants or agreements, which continues unremedied after written notice of such failure.

75. The remedies for uncured servicer events of default include, among other things, termination of the master servicers and/or servicers.

I. The Trustee's Duties upon Knowledge of an Event of Default

76. The PSAs impose additional obligations upon Defendant once one of its responsible officers knows a default or a servicer event of termination has occurred. First, under

[5] Similarly, for those trusts structured with an indenture instead of a PSA, events of default is defined as a specified failure of the issuer to perform some similar duty.

Section 7.01 of the PSAs, Defendant must give written notice to the servicer of the occurrence of such an event within the specified period after Defendant obtains knowledge of the occurrence.

77. Second, within sixty days after a default has occurred, Defendant must provide written notice to all certificateholders about that event, unless the default has been cured or waived. As set forth in PSA Section 7.03(b):

> Within 60 days after the occurrence of any Event of Default, the Trustee shall transmit by mail to all Certificateholders notice of each such Event of Default hereunder known to the Trustee, unless such Event of Default shall have been cured or waived.

78. Third, and most importantly, Section 8.01 of the PSAs requires Defendant to exercise the rights and powers vested in it by the PSA using "the same degree of care and skill in their exercise as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs."

J. The Trustee's Duties and Obligations under the TIA and the Streit Act

79. Each of the PSAs (or indentures) is substantially similar and imposes substantially the same duties on Defendant as trustee. Moreover, the TIA applies to and is deemed to be incorporated into each of the PSAs (or indentures) and the related trusts. 15 U.S.C. § 77ddd(a)(1).

80. The TIA imposes two sets of duties and obligations on Defendant as trustee of the trusts – one set "prior to default" and the other set "in case of default."

81. Prior to default, a trustee must perform "such duties as are specifically set out in [the] indenture," *i.e.*, the instrument governing the trust. 15 U.S.C. § 77ooo(a)(1). Under that provision, Defendant had to perform the duties specifically assigned to it under the governing agreements, including those duties described above.

82. Also, prior to default, a trustee must "examine the evidence furnished to it [by

obligors of the indenture] to determine whether or not such evidence conforms to the requirements of the indenture." 15 U.S.C. § 77ooo(a) (citing 15 U.S.C. § 77nnn). Thus, Defendant was required to examine the evidence the master servicer or custodian provided to the trusts, certifying their compliance with the covenants it made under the governing agreements, and Defendant also had to determine whether that evidence conformed to the governing agreements' requirements.

83. In addition, a trustee must "give to the indenture security holders . . . notice of all defaults known to the trustee, within ninety days after the occurrence thereof." 15 U.S.C. § 77ooo(b) (citing 15 U.S.C. § 77mmm(c)). Defendant consequently had to inform RMBS certificateholders of defaults and breaches of the governing agreements within ninety days after their occurrence.

84. In case of a default (as defined in the PSA or indenture), a trustee must exercise "such of the rights and powers vested in it by such indenture, and [ ] use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs." 15 U.S.C. § 77ooo(c).

85. Section 124 of the Streit Act imposes a similar duty upon the trustee to discharge its duties under the applicable indenture with due care to ensure the orderly administration of the trust and to protect the trust beneficiaries' rights. N.Y. Real Prop. Law § 124. Like the TIA, following an event of default, the Streit Act provides that the trustee must exercise the same degree of skill and care in performing its duties as a prudent person would under the same circumstances. N.Y. Real Prop. Law § 126(1).

86. As set forth below, Defendant is liable to Plaintiffs under the TIA and the Streit Act for failing to exercise the same degree of skill and care as a prudent person in enforcing its

rights and powers under the governing agreements.

VI. DEFENDANT SHOULD HAVE CAREFULLY INVESTIGATED THE FACT THAT TRUSTS SUFFERED FROM WIDESPREAD DEFAULTS IN THE FORM OF BREACHES OF REPRESENTATIONS AND WARRANTIES AND TAKEN APPROPRIATE ACTION

87. The trusts' loan pools contained large numbers of loans that materially breached the responsible parties' representations and warranties concerning the originators' compliance with underwriting guidelines, owner occupancy statistics, appraisal procedures, and other associated standards. By 2009 at the latest, Defendant had a duty to carefully investigate the evidence, public evidence or evidence otherwise available to trustees, demonstrating the widespread breaches of representations and warranties in the trusts, including: 1) general reports concerning originators' systematic abandonment of their underwriting standards and reports concerning the sponsors' pervasive disregard of prudent securitization standards; 2) specific reports concerning the originators of loans in the trusts abandoning their underwriting standards and sponsors of the securitizations failing to follow prudent practices; 3) the high number of borrower delinquencies and defaults on mortgages in the trusts' loan pools and enormous losses to the trusts; 4) the collapse of the certificates' credit ratings from high, investment-grade ratings when purchased to much lower ratings, including numerous "junk" ratings; and 5) the numerous lawsuits brought against Defendant and its affiliates alleging the systematic abandonment of originator underwriting guidelines.

A. General Reports Concerning Originators' Systematic Abandonment of their Underwriting Standards and Sponsors' Disregard of Prudent Securitization Standards

88. By 2009, government reports, public and private investigations, and media reports had surfaced concerning the collapse of the RMBS market and revealed the potential for massive problems in the trusts such that a reasonable and prudent trustee would have taken upon itself the

duty to carefully investigate these issues and to take action as necessary. These reports and investigations identified the originators' pervasive abandonment of underwriting standards and sponsors' disregard of prudent securitization standards as the cause of the crisis.

89. For example, the Office of the Comptroller of the Currency (the "OCC"), published a report in November 2008 listing the "Worst Ten" metropolitan areas with the highest rates of foreclosures and the "Worst Ten" originators with the largest numbers of foreclosures in those areas ("2008 'Worst Ten in the Worst Ten' Report"). In this report the OCC emphasized the importance of adherence to underwriting standards in mortgage loan origination:

> The quality of the underwriting process—that is, determining through analysis of the borrower and market conditions that a borrower is highly likely to be able to repay the loan as promised—is a major determinant of subsequent loan performance. The quality of underwriting varies across lenders, a factor that is evident through comparisons of rates of delinquency, foreclosure, or other loan performance measures across loan originators.

90. Despite the importance of sticking to underwriting standards, it was clear that originators were not following them. Chairman of the Federal Reserve Board, Benjamin Bernanke, spoke to the decline of underwriting standards in his speech before the World Affairs Council of Greater Richmond on April 10, 2008:

> First, at the point of origination, underwriting standards became increasingly compromised. The best-known and most serious case is that of subprime mortgages, mortgages extended to borrowers with weaker credit histories. To a degree that increased over time, these mortgages were often poorly documented and extended with insufficient attention to the borrower's ability to repay. In retrospect, the breakdown in underwriting can be linked to the incentives that the originate-to-distribute model, as implemented in this case, created for the originators. Notably, the incentive structures often tied originator revenue to loan volume, rather than to the quality of the loans being passed up the chain. Investors normally have the right to put loans that default quickly back to the originator, which should tend to apply some discipline to the underwriting process. However, in the recent episode, some originators had little capital at stake, reducing their exposure to the risk that the loans would perform poorly.

Benjamin Bernanke, Chairman, Federal Reserve Board, Speech to the World Affairs Council of Greater Richmond, *Addressing Weaknesses in the Global Financial Markets: The Report of the*

President's Working Group on Financial Markets, Apr. 10, 2008, *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20080410a.htm.

91. In November 2010, the Congressional Oversight Panel, which was established as part of the Emergency Economic Stabilization Act of 2008, issued a report entitled "Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation." The report recounts widespread foreclosure abuses in connection with mortgages that have been securitized and the numerous federal and state investigations that have detailed this problem. The abuses identified in the report—including forged or back-dated mortgage assignments and "robo-signing" of false affidavits used in foreclosure actions—arise from failures in the documentation and transfer of mortgage loans from the originators to other entities in the securitization process, and ultimately into the trusts. As the report explains, irregularities in the chain of title between the originator and the trust can have significant legal consequences that damage the trusts and certificateholders. Cong. Oversight Panel, *Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation*, Pub. L. No. 110-343 (2010), *available at* http://www.gpo.gov/fdsys/pkg/CPRT-111JPRT61835/pdf/CPRT-111JPRT61835.pdf.

92. Other reports reached similar conclusions. The Permanent Subcommittee on Investigations in the United States Senate ("PSI") issued a report detailing the causes of the financial crisis. Using Washington Mutual Bank as a case study, the PSI concluded through its investigation:

> Washington Mutual was far from the only lender that sold poor quality mortgages and mortgage backed securities that undermined U.S. financial markets. The Subcommittee investigation indicates that Washington Mutual was emblematic of a host of financial institutions that knowingly originated, sold, and securitized billions of dollars in high risk, poor quality home loans. These lenders were not the victims of the financial crisis; the high risk loans they issued became the fuel that ignited the financial crisis.

Staff of S. Permanent Subcomm. on Investigations, 112th Cong., *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse* 50 (Subcomm. Print 2011).

93. The Financial Crisis Inquiry Commission ("FCIC") issued its final report in January 2011 that detailed, among other things, the collapse of mortgage underwriting standards and the subsequent collapse of the mortgage market and wider economy. *See* Fin. Crisis Inquiry Comm'n, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (2011) ("FCIC Report").

94. The FCIC Report concluded that there was a "systemic breakdown in accountability and ethics." "Unfortunately—as has been the case in past speculative booms and busts—we witnessed an erosion of standards of responsibility and ethics that exacerbated the financial crisis." *Id*. at xxii. The FCIC found:

> [I]t was the collapse of the housing bubble—fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages—that was the spark that ignited a string of events, which led to a full-blown crisis in the fall of 2008. Trillions of dollars in risky mortgages had become embedded throughout the financial system, as mortgage-related securities were packaged, repackaged, and sold to investors around the world.

Id. at xvi.

95. The FCIC Report also noted that during the housing boom, mortgage lenders focused on quantity rather than quality, originating loans for borrowers who had no realistic capacity to repay the loan, and noted "that the percentage of borrowers who defaulted on their mortgages within just a matter of months after taking a loan nearly doubled from the summer of 2006 to late 2007." *Id*. at xxii. A default in the first few months of a mortgage, known as an early payment default, is known in the mortgage industry as a significant indicator of pervasive disregard for underwriting standards. Not surprisingly, the FCIC Report noted that mortgage fraud "flourished in an environment of collapsing lending standards." *Id*.

96. In this lax lending environment, mortgage lenders went unchecked, originating mortgages for borrowers in spite of underwriting standards:

> Lenders made loans that they knew borrowers could not afford and that could cause massive losses to investors in mortgage securities. As early as September 2004, Countrywide executives recognized that many of the loans they were originating could result in "catastrophic consequences." Less than a year later, they noted that certain high-risk loans they were making could result not only in foreclosures but also in "financial and reputational catastrophe" for the firm. But they did not stop.

Id.

97. Lenders and borrowers took advantage of this climate, with borrowers willing to take on loans and lenders anxious to get those borrowers into the loans, ignoring even loosened underwriting standards. The FCIC Report observed: "Many mortgage lenders set the bar so low that lenders simply took eager borrowers' qualifications on faith, often with a willful disregard for a borrower's ability to pay." *Id*. at xxiii.

98. In an interview with the FCIC, Alphonso Jackson, the Secretary of the Department of Housing and Urban Affairs ("HUD") from 2004 to 2008, related that HUD had heard about mortgage lenders "running wild, taking applications over the Internet, not verifying people's income or their ability to have a job." *Id*. at 12-13 (internal quotation marks omitted).

99. The predominant RMBS securitization method involved an originate-to-distribute ("OTD") model where the originators of the loans do not hold the loans, but instead repackage and securitize them. The OTD model created a situation where the origination of low quality mortgages through poor underwriting thrived. The Financial Stability Oversight Council ("FSOC") found:

> In the originate-to-distribute model, originators receive significant compensation upfront without retaining a material ongoing economic interest in the performance of the loan. This reduces the economic incentive of originators and securitizers to evaluate the credit quality of the underlying loans carefully. Some research indicates that securitization was associated with lower quality loans in the financial crisis. For instance, one study found

> that subprime borrowers with credit scores just above a threshold commonly used by securitizers to determine which loans to purchase defaulted at significantly higher rates than those with credit scores below the threshold. By lower underwriting standards, securitization may have increased the amount of credit extended, resulting in riskier and unsustainable loans that otherwise may not have been originated.

Fin. Stability Oversight Council, Macroeconomic Effects of Risk Retention Requirements (2011) ("FSOC Report") at 11 (footnote omitted).

100. The FSOC reported that as the OTD model became more pervasive in the mortgage industry, underwriting practices weakened across the industry. The FSOC Report found "[t]his deterioration was particularly prevalent with respect to the verification of the borrower's income, assets, and employment for residential real estate loans." *Id*. Similarly, the sponsors responsible for securitizing residential mortgages for trusts between 2004-2008 failed to conduct adequate due diligence reviews of the mortgage pools to ensure the mortgage loans were of the represented quality and also failed to ensure that the purported mortgaged property's appraised value was accurate.

101. As the FCIC Report noted:

> The Commission concludes that firms securitizing mortgages failed to perform adequate due diligence on the mortgages they purchased and at times knowingly waived compliance with underwriting standards. Potential investors were not fully informed or were misled about the poor quality of the mortgages contained in some mortgage-related securities. These problems appear to have been significant.

FCIC Report at 187.

102. Additionally, the evidence shows that sponsors, and the third party due diligence providers they hired, failed to analyze adequate sample sizes of the loan pools, sometimes reviewing as little as 2%-3% of the entire loan pools. More importantly, when the sponsors and their due diligence firms identified high percentages of mortgage loans in their sample reviews as defective, the sponsors often "waived in" mortgage loans in the interest of preserving their

business relationships and their own profits.

103. In sum, reports regarding the disregard of underwriting standards and poor securitization practices became common by 2009. If validated, those practices would have directly contributed to the sharp decline in the quality of mortgages that became part of mortgage pools collateralizing RMBS, resulting in steep losses. By 2009, it was apparent to trustees that the originators and sponsors involved in the securitization of the trusts had engaged in problematic practices such that a reasonable and prudent trustee would have taken upon itself the duty to carefully investigate these issues fully in connection with the trusts entrusted to its care.

B. Specific Reports Concerning the Originators of Loans in the Trusts Abandoning their Underwriting Standards and the Sponsors Disregarding Prudent Securitization Practices

104. The governing agreements for each of the trusts incorporated representations and warranties concerning title to the mortgage loans, the characteristics of the borrowers and the collateral for the mortgage loans, and the credit criteria and underwriting practices for the origination of loans.

105. However, as discussed below, Defendant had reason to suspect that those representations and warranties were false. Numerous investigations, lawsuits, and media reports have demonstrated that nearly all of the largest mortgage loan originators in the RMBS market between 2000 and 2008 systematically disregarded their stated underwriting guidelines while pursuing profit by recklessly originating loans without regard for the borrowers' ability to repay. In addition, investigations, lawsuits, and media reports have shown that the primary sponsors in the RMBS market ignored prudent securitization standards.

106. The information below provided ample reason for Defendant to suspect, as trustee for the trusts, that the loans underlying the trusts did not comply with the representations and

warranties in the governing agreements. As a result, Defendant should have carefully investigated those issues in the context of the trusts entrusted to its care, provided notice to certificateholders, and taken appropriate action to protect the trusts.

1. Ameriquest/Argent

107. ACC Capital Holdings ("ACC Capital"), based in Orange, California, was the nation's largest privately-owned subprime lender. Ameriquest Mortgage Company ("Ameriquest") was ACC Capital's retail mortgage lending unit. Argent Mortgage Company, LLC ("Argent") was ACC Capital's wholly-owned wholesale lending unit that made loans through independent brokers. On September 1, 2007, Citigroup purchased Argent from ACC Capital, and Ameriquest announced that it was shutting down lending operations.

108. Ameriquest originated or contributed a substantial portion of the loans in the mortgage pools underlying the trusts.

109. The New York Times reported that Ameriquest refused to sign up for a tax verification service for verifying the reported taxes of borrowers as part of its underwriting process. Gretchen Mortgenson, *A Road Not Taken By Lenders*, N.Y. Times, Apr. 6, 2010, *available at* http://www.nytimes.com/2008/04/06/business/06gret.html.

110. In a video released by the American News Project on May 11, 2009, reporters Lagan Sebert and Mike Fritz interviewed several former employees of Argent and Ameriquest regarding their lending practices. American News Project, *Fraud by Mortgage Companies Key Cause of Foreclosures* (May 11, 2009), *available at* http://www.youtube.com/watch?v=MFPi6mcNubo.

111. Tamara Loatman-Clark, a former loan closer for Argent, stated "I mean you did what you had to do and again if that meant manipulating documents so that you can get them out

so that they could conform, that's what you did…. [T]here were incentives to get as many done as possible. So on a typical Thursday, I may have 15 or 20 files that I need to get funded somehow and you know you need to work very hard to get 20 files funded. Whatever hit your desk for the day is what you wanted to get out." *Id*.

112. According to the video, "It was the Wall Street business that drove the frantic pace. Even before proper papers were signed, Ameriquest was bundling the loans and passing them on." Loatman-Clark said, "And so sometimes when they came back and you're talking about, you know, names not properly on mortgage documents . . . you're talking about missing documents, like internally the incentive was to do whatever you needed to do to get them out and that sometimes meant that you manipulated documents to get them out." *Id*.

113. The video report contained the following exchange:

> Reporter: "So you are saying the goal was to make these loans and then get them off your books as quick as possible?"
>
> Loatman-Clark: "Exactly. That was the pressure."
>
> Reporter: "But who were the people who were buying, who were like the most hungry for these loans?"
>
> Loatman-Clark: "Bear Stearns . . . Citigroup was another one. Basically the ones that were/are hardest hit were the people who invested. And these were the people we were shuffling these documents out to by any means necessary."

Id.

114. Omar Kahn, a former Ameriquest Loan Officer, also told the reporters, "Every closing we had was a bait and switch, because you could never get them to the table if you were honest." "There were instances where the borrower felt uncomfortable about signing the stated income letter, because they didn't want to lie, and the stated income letter would be filled out later on by the processing staff." *Id*.

115. Another former Ameriquest Loan Officer named Tyson Russum said, "The entire system is built to do whatever you can to close as many loans at the highest fee amount as possible." *Id*.

116. In testimony before the FCIC on Jan. 14, 2010, Illinois Attorney General Lisa Madigan explained that a multistate investigation of Ameriquest "revealed that the company engaged in the kinds of fraudulent practices that other predatory lenders subsequently emulated on a wide scale ... includ[ing]: inflating home appraisals." FCIC Report at 12.

117. According to another article, Steve Jernigan, a fraud investigator at Argent, said that when he sent an appraiser to check on a subdivision for which Argent had made loans, the address on the loans was clearly fictitious because the appraiser was standing in the middle of a cornfield. Michael W. Hudson, *Silencing the Whistle-blowers*, The Investigative Fund, May 10, 2010, *available at* http://www.theinvestigativefund.org/investigations/economiccrisis/1308/silencing_the_whistle-blowers/.

118. When Jernigan reviewed the loan files, he determined that the houses did not exist and that each of the loan files contained the picture of the same house. *See id.* The article also reported that Argent had been ripped off by a con man named Robert Andrew Penn, who later admitted that he had appropriated victims' names and credit histories to obtain loans and buy properties for inflated prices around Indianapolis. *See id*. Although Argent was warned about the man in 2004, Jernigan said the company did not "conduct a serious investigation" into the fraud until mid-2006 when it learned the scheme was about to be made public by another duped lender. *Id*.

119. The article stated that the reluctance to investigate fraud was deliberate because

management did not want to "crimp loan sales." *Id*. The article quoted Kelly Dragna, a fraud investigator at Ameriquest who said, "You're like a dog on a leash. You're allowed to go as far as a company allows you to go." "At Ameriquest, we were on pretty short leash. We were there for show. We were there to show people that they had a lot of investigators on staff." *Id*.

120. The article outlined the story of one fraud investigator's career at Ameriquest to demonstrate the extent to which Ameriquest turned a blind eye to fraud:

> Ed Parker signed on as Ameriquest's head of mortgage fraud investigation in early 2003, as the company was on the verge of becoming the nation's largest subprime lender. The first case he took on involved allegations that employees at the company's Grand Rapids, Mich., branch were pushing real-estate appraisers to inflate loan applicants' home values. Workers admitted to the scheme, Parker said, and the company shut down the branch and repurchased hundreds of loans from the investors who'd bought them.
>
> Parker saw the investigation as a success. He thought he'd helped set a precedent that fraud wouldn't be tolerated. But he discovered that his actions didn't endear him to many of his co-workers. One executive told him the sales force looked on him as "Darth Vader." On another occasion, when a suspicious loan file was brought up during a staff meeting, a senior executive said: "Don't give it to Ed. If you give it to him, that one file will multiply and become hundreds of files."
>
> Parker said higher-ups began pushing him to limit the scope of his inquiries and focus on smaller cases rather than big-impact ones like Grand Rapids. This message was driven home after Ameriquest learned that a TV reporter was digging into problems at a branch in Mission Valley, Calif. Two loans raised questions about whether branch employees were falsifying not only borrowers' incomes but also their ages, so that the inflated incomes would seem plausible. One borrower was 67, but the loan application prepared in her name said she was 41. Another was 74, but the loan application indicated the borrower was 44. The company, Parker said, wanted to limit its exposure and portray the problem as a couple of isolated cases. The company had all of the branch's loan files boxed up and transported to the fraud investigation team in Orange County. Management sent word, however, that Parker's team shouldn't open the boxes. His investigators looked anyway. As they cracked open the files, they saw that falsified incomes and ages were a problem that went beyond two borrowers' loans. When senior managers discovered what the team was doing, Parker said, they weren't happy. "They said: 'Don't look anymore,'" he recalled. "They didn't want to know."

Id.

121. In January 2010, Ameriquest and Argent agreed to pay $22 million to settle 29

class action lawsuits against them that had been consolidated in the Northern District of Illinois, alleging that Argent and Ameriquest inflated appraisal values and borrower income or asset statements and aggressively employed misleading marketing/sales techniques as part of a business strategy to force potential borrowers to close loans. *See In re Ameriquest Mortgage Co. Mortgage Lending Pracs. Litig.*, MDL No. 1715 (N.D. Ill).

2. Bank of America

122. Bank of America was a major sponsor of mortgage-backed securities during the relevant period. Bank of America originated or contributed a material portion of the loans in the mortgage pools underlying the trusts and, with its acquired subsidiary Merrill Lynch Mortgage Lending, Inc. ("Merrill Lynch"), sponsored many of the trusts.

123. Bank of America-originated loans are the subject of multiple lawsuits around the country, including lawsuits filed by the SEC, the Department of Justice, and the Federal Housing Finance Agency ("FHFA"). In each of the lawsuits below, Bank of America and/or its affiliates acted as the originator of the underlying loans and/or the sponsor, depositor and/or underwriter of the RMBS at issue. The overwhelming evidence revealed that Bank of America and its affiliates systematically failed to adhere to their obligations in any of their roles in the securitization process.

- **DOJ:** Complaint, *United States v. Bank of America Corp.*, No. 13-cv-446 (W.D.N.C. Aug. 6, 2013).
- **SEC:** Complaint, *SEC v. Bank of America Corp.*, No. 13-cv-447 (W.D.N.C. Aug. 6, 2013).
- **FHFA:** Am. Complaint, *FHFA v. Bank of America Corp.*, No. 11-cv-06195 (S.D.N.Y. June 28, 2012); Mot. Dismiss denied in *FHFA v. UBS Americas, Inc.*, 858 F. Supp. 2d 306 (S.D.N.Y. 2012), motion to certify appeal granted (June 19, 2012), *aff'd*, 712 F.3d 136 (2d Cir. 2013).

124. The Department of Justice explained its allegations in the following August 6,

2013, press release titled “Department of Justice Sues Bank of America for Defrauding Investors in Connection with Sale of Over $850 Million of Residential Mortgage-Backed Securities”:

> [T]he United States has filed a civil lawsuit against Bank of America Corporation and certain of its affiliates, including Merrill Lynch, Pierce, Fenner & Smith f/k/a/ Banc of America Securities, LLC, Bank of America, N.A., and Banc of America Mortgages Securities, Inc. (collectively “Bank of America”). The complaint alleges that Bank of America lied to investors about the relative riskiness of the mortgage loans backing the residential mortgage-backed securities (RMBS), made false statements after intentionally not performing proper due diligence and filled the securitization with a disproportionate amount of risky mortgages originated through third party mortgage brokers.
>
> ...
>
> “Bank of America’s reckless and fraudulent origination and securitization practices in the lead-up to the financial crisis caused significant losses to investors,” U.S. Attorney Tompkins said. “Now, Bank of America will have to face the consequences of its actions. We have made a commitment to the American people to hold financial institutions accountable for practices that violated the law and wreaked havoc on the financial system, and my office takes that commitment very seriously. Our investigation into Bank of America’s mortgage and securitization practices continues.”
>
> ...
>
> The civil complaint filed today in U.S. District Court in Charlotte alleges that Bank of America defrauded investors, including federally insured financial institutions, who purchased more than $850 million in RMBS from Bank of America Mortgage Securities 2008-A (BOAMS 2008-A) securitization. The government’s civil complaint also seeks civil penalties from Bank of America under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). According to the complaint, in or about January 2008, Bank of America sold BOAMS 2008-A RMBS certificates to investors by knowingly and willfully making materially false and misleading statements and by failing to disclose important facts about the mortgages collateralizing the RMBS, including Bank of America’s failure to conduct loan level due diligence in the offering documents filed with the U.S. Securities and Exchange Commission (SEC). These misstatements and omissions concerned the quality and safety of the mortgages collateralizing the BOAMS 2008-A securitization, how it originated those mortgages and the likelihood that the “prime” loans would perform as expected.
>
> First, according to the filed complaint, a material number of the mortgages in the BOAMS 2008-A collateral pool failed to materially adhere to Bank of America’s underwriting standards. Specifically, more than 40% of the 1,191 mortgages in the BOAMS 2008-A collateral pool did not substantially comply with Bank of America’s underwriting standards in place at the time they were originated and did not have sufficient documented compensating factors. As alleged in the complaint, Bank of America knew that specific loans in the BOAMS 2008-A collateral pool did not materially adhere or comply with Bank of America’s underwriting standards.

Second, Bank of America did not conduct any loan-level due diligence at the time of securitization. According to the complaint, this was a violation of Bank of America's own policies, procedures and prior practice, and was contrary to industry standards and investor expectations. Moreover, this decision allowed Bank of America to keep bad loans in the deal. According to the complaint, these bad loans had a range of glaring origination problems, such as overstated income, fake employment, inflated appraisals, wrong loan-to-value ratios, undisclosed debt, occupancy misrepresentation, mortgage fraud and other red flags wholly inconsistent with a purportedly prime securitization. As a result of this lack of due diligence, Bank of America had no basis to make many of the representations it made in the offering documents regarding the credit quality of the underlying mortgages.

Finally, Bank of America concealed important risks associated with the mortgages backing the BOAMS 2008-A securitization. For example, Bank of America originated more than 70% of the loans through third party mortgage brokers. These loans, known as "wholesale mortgages," were riskier than similar mortgages originated directly by Bank of America. More significantly, at the same time Bank of America was finalizing this deal, it was receiving a series of internal reports that showed an alarming and significant decrease in the quality and performance of its wholesale mortgages. According to the complaint, Bank of America did not disclose that important information or the associated risks to investors.

Investors in the BOAMS 2008-A certificates have already suffered millions of dollars in losses and it is estimated that total losses sustained by investors will exceed $100 million.

Available at http://www.justice.gov/opa/pr/2013/August/13-ag-886.html.

125. The SEC's lawsuit against Bank of America had similar allegations:

"In its own words, Bank of America 'shifted the risk' of loss from its own books to unsuspecting investors, and then ignored its responsibility to make a full and accurate disclosure to all investors equally," said George S. Canellos, Co-Director of the SEC's Division of Enforcement.

…

The SEC alleges that Bank of America deceived investors about the underlying risks as well as the underwriting quality of the mortgages, misrepresenting that the mortgage loans backing BOAMS 2008-A were underwritten in conformity with the bank's own guidelines. These mortgage loans, however, were riddled with ineligible appraisals, unsupported statements of income, misrepresentations regarding owner occupancy, and evidence of mortgage fraud. The key ratios of debt-to-income and original-combined-loan-to-value were routinely miscalculated, and then the materially inaccurate ratios were provided to the investing public.

> According to the SEC's complaint, a disproportionate concentration of high-risk wholesale loans and the inclusion of a material number of loans failing to comply with internal underwriting guidelines resulted in BOAMS 2008-A suffering an 8.05 percent cumulative net loss rate through June 2013 – the greatest loss rate of any comparable BOAMS securitization.

Press Release, *SEC Charges Bank of America with Fraud in RMBS Offering* (Aug. 6, 2013), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539751924#.UgzSb5LVAkQ.

126. Other cases involving Bank of America and its affiliates acting as originator, sponsor, depositor and/or underwriter in RMBS have included allegations concerning investors' forensic analysis or re-underwriting of loan files that highlight the poor quality of mortgage loans securitized and sold by Bank of America to the trusts. *See, e.g.*, Complaint, *Western Southern Life Ins. v. Bank of America, N.A.*, No. 11-cv-00667 (Ohio Ct. Com. Pl. Aug. 18, 2011) (alleging misrepresentations regarding LTV and owner occupancy); Complaint, *CIFG Assurance N. Am. Inc. v. Bank of America, N.A.*, No. 654028/2012 (N.Y. Sup. Ct. Nov. 20, 2011) (alleging that Bank of America's faulty securitization practices led to inclusion of a high percentage of defective loans); Complaint, *Prudential v. Bank of America et al.*, No. 13-cv-01586 (D.N.J. Mar. 14, 2013) ("Prudential's loan-level analysis has revealed systematic failures in Defendants' loan underwriting and assignment practices"); Complaint, *Texas County Dist. Ret. Sys. v. J.P. Morgan Secs. LLC et al.*, No. 1-GN-14-000998 (Tex. Civ. Dist. Ct. May 2, 2014) (forensic review demonstrated that "Bank of America included recklessly underwritten loans in its RMBS that failed to meet the applicable standards systematically disregarding its own and third-party due diligence, and then misrepresented the quality of those loans to investors").

3. Countrywide

127. Countrywide Financial, Countrywide Home Loans, Inc., Countrywide Mortgage

Funding, Inc. and Countrywide Home Loans Servicing LP ("Countrywide") was one of the largest originators of residential mortgages in the United States during the period leading up to the financial crisis. Countrywide originated or contributed a material portion of the loans in the mortgage pools underlying the trusts.

128. In a television special titled, "*If You Had a Pulse, We Gave You a Loan*," Dateline NBC reported on March 27, 2009:

> To highlight just how simple it could be to borrow money, Countrywide marketed one of its stated-income products as the "Fast and Easy loan."
>
> As manager of Countrywide's office in Alaska, Kourosh Partow pushed Fast and Easy loans and became one of the company's top producers.
>
> He said the loans were "an invitation to lie" because there was so little scrutiny of lenders. "We told them the income that you are giving us will not be verified. The asset that you are stating will not be verified."
>
> He said they joked about it: "If you had a pulse, we gave you a loan. If you fog the mirror, give you a loan."
>
> But it turned out to be no laughing matter for Partow. Countrywide fired him for processing so-called "liar loans" and federal prosecutors charged him with crimes. On April 20, 2007, he pleaded guilty to two counts of wire fraud involving loans to a real estate speculator; he spent 18 months in prison.
>
> In an interview shortly after he completed his sentence, Partow said that the practice of pushing through loans with false information was common and was known by top company officials. "It's impossible they didn't know."
> …
>
> During the criminal proceedings in federal court, Countrywide executives portrayed Partow as a rogue who violated company standards.
> But former senior account executive Bob Feinberg, who was with the company for 12 years, said the problem was not isolated. "I don't buy the rogue. I think it was infested."
>
> He lamented the decline of what he saw as a great place to work, suggesting a push to be number one in the business led Countrywide astray. He blamed Angelo Mozilo, a man he long admired, for taking the company down the wrong path. It was not just the matter of stated income loans, said Feinberg. Countrywide also became a purveyor of loans that many consumer experts contend were a bad deal for borrowers, with low introductory interest rates that later could skyrocket.

> In many instances, Feinberg said, that meant borrowers were getting loans that were "guaranteed to fail."

Chris Hansen, *If You Had a Pulse, We Gave You a Loan,* NBC Dateline (Mar. 22, 2009), *available at* http://www.msnbc.msn.com/id/29827248/ns/dateline_nbc-the_hansen_files_with_chris_hansen.

129. On June 4, 2009, the SEC sued Angelo Mozilo and other Countrywide executives, alleging securities fraud. Specifically, the SEC alleged that Mozilo and the others misled investors about the credit risks that Countrywide created with its mortgage origination business, telling investors that Countrywide was primarily involved in prime mortgage lending, when it was actually heavily involved in risky sub-prime loans with expanded underwriting guidelines. *See* Complaint, *SEC v. Mozilo*, No. 09-cv-3994 (C.D. Cal. June 4, 2009). Mozilo and the other executives settled the charges with the SEC for $73 million on October 15, 2010. *See* Walter Hamilton & E. Scott Reckard, *Angelo Mozilo, Other Former Countrywide Execs Settle Fraud Charges*, L.A. Times, Oct. 16, 2010, at A1.

130. Internal Countrywide e-mails released in connection with the SEC lawsuit and publicly available show the extent to which Countrywide systematically deviated from its underwriting guidelines. For instance, in an April 13, 2006 e-mail from Mozilo to other top Countrywide executives, Mozilo stated that Countrywide was originating home mortgage loans with "serious disregard for process, compliance with guidelines and irresponsible behavior relative to meeting timelines." Mozilo also wrote that he had "personally observed a serious lack of compliance within our origination system as it relates to documentation and generally a deterioration in the quality of loans originated versus the pricing of those loan[s]."

131. Indeed, in a September 1, 2004 email, Mozilo voiced his concern over the "clear

deterioration in the credit quality of loans being originated," observing that "the trend is getting worse" because of competition in the non-conforming loans market. With this in mind, Mozilo argued that Countrywide should "seriously consider securitizing and selling ([Net Interest Margin Securities]) a substantial portion of [Countrywide's] current and future sub prime [sic] residuals."

132. In 2006, HSBC Holdings plc ("HSBC"), a purchaser of Countrywide's 80/20 subprime loans, began to force Countrywide to repurchase certain loans that HSBC contended were defective under the parties' contract. In an e-mail sent on April 17, 2006, Mozilo asked, "[w]here were the breakdowns in our system that caused the HSBC debacle including the creation of the contract all the way through the massive disregard for guidelines set forth by both the contract and corporate." Mozilo continued:

> In all my years in the business I have never seen a more toxic prduct. [sic] It's not only subordinated to the first, but the first is subprime. In addition, the [FICOs] are below 600, below 500 and some below 400 . . . . With real estate values coming down . . . the product will become increasingly worse. There has [sic] to be major changes in this program, including substantial increases in the minimum [FICO].

133. Countrywide sold a product called the "Pay Option ARM." This loan was a 30-year adjustable rate mortgage that allowed the borrower to choose between various monthly payment options, including a set minimum payment. In a June 1, 2006 e-mail, Mozilo noted that most of Countrywide's Pay Option ARMs were based on stated income and admitted that "[t]here is also some evidence that the information that the borrower is providing us relative to their income does not match up with IRS records."

134. An internal quality control report e-mailed on June 2, 2006, showed that for stated income loans, 50.3% of loans indicated a variance of 10% or more from the stated income in the loan application.

135. Mozilo admitted in a September 26, 2006 email that Countrywide did not know how Pay Option ARM loans would perform and had “no way, with any reasonable certainty, to assess the real risk of holding these loans on [its] balance sheet.” Yet such loans were securitized and passed on to unsuspecting investors such as the CCUs.

136. With growing concern over the performance of Pay Option ARM loans, Mozilo advised in a November 3, 2007 email that he “d[id]n’t want any more Pay Options originated for the Bank.” In other words, if Countrywide was to continue to originate Pay Option ARM loans, it was not to hold onto the loans. Mozilo’s concerns about Pay Option ARM loans expressed in the same email were rooted in “[Countrywide’s] inability to underwrite [Pay Option ARM loans] combined with the fact that these loans [we]re inherently unsound unless they are full doc, no more than 75% LTV and no piggys.”

137. In a March 27, 2006 e-mail, Mozilo reaffirmed the need to “oversee all of the corrective processes that will be put into effect to permanently avoid the errors of both judgement [sic] and protocol that have led to the issues that we face today” and that “the people responsible for the origination process understand the necessity for adhering to the guidelines for 100% LTV sub-prime product. This is the most dangerous product in existence and there can be nothing more toxic and therefore requires that no deviation from guidelines be permitted irrespective of the circumstances.”

138. Yet Countrywide routinely found exceptions to its underwriting guidelines without sufficient compensating factors. In an April 14, 2005 e-mail, Frank Aguilera, a Countrywide managing director, explained that the “spirit” of Countrywide’s exception policy was not being followed. He noted a “significant concentration of similar exceptions” that “denote[d] a divisional or branch exception policy that is out side [sic] the spirit of the policy.”

Aguilera continued: "The continued concentration in these same categories indicates either a) inadequate controls in place to mange [sic] rogue production units or b) general disregard for corporate program policies and guidelines." Aguilera observed that pervasive use of the exceptions policy was an industry-wide practice:

> It appears that [Countrywide Home Loans]' loan exception policy is more loosely interpreted at [Specialty Lending Group] than at the other divisions. I understand that [Correspondent Lending Division] has decided to proceed with a similar strategy to appease their complaint customers. . . . [Specialty Lending Group] has clearly made a market in this unauthorized product by employing a strategy that Blackwell has suggested is prevalent in the industry.

139. Aguilera confirmed in a June 12, 2006 email that internal reports months after an initial push to rein in the excessive use of exceptions with a "zero tolerance" policy showed the use of exceptions remained excessive.

140. In February 2007, nearly a year after pressing for a reduction in the overuse of exceptions and as Countrywide claimed to be tightening lending standards, Countrywide executives found that exceptions continued to be used at an unacceptably high rate. In a February 21, 2007 email, Aguilera stated that any "[g]uideline tightening should be considered purely optics with little change in overall execution unless these exceptions can be contained."

141. John McMurray, a former Countrywide managing director, expressed his opinion in a September 7, 2007 e-mail that "the exception process has never worked properly."

142. Countrywide conceded that the poor performance of loans it originated was, in many cases, due to poor underwriting. In April 2007, Countrywide noticed that its high CLTV ratio stated income loans were performing worse than those of its competitors. After reviewing many of the loans that went bad, Countrywide executive Russ Smith stated in an April 11, 2007 email that "in most cases [poor performance was] due to poor underwriting related to reserves and verification of assets to support reasonable income."

143. On October 6, 2008, 39 states announced that Countrywide agreed to pay up to $8 billion in relief to homeowners nationwide to settle lawsuits and investigations regarding Countrywide's deceptive lending practices.

144. On July 1, 2008, NBC Nightly News aired the story of a former Countrywide regional Vice President, Mark Zachary, who sued Countrywide after he was fired for questioning his supervisors about Countrywide's poor underwriting practices.

145. According to Zachary, Countrywide pressured employees to approve unqualified borrowers. Countrywide's mentality, he said, was "what do we do to get one more deal done. It doesn't matter how you get there." NBC Nightly News, *Countrywide Whistleblower Reports "Liar Loans,"* July 1, 2008. Zachary also stated that the practices were not the work of a few bad apples, but rather: "It comes down, I think from the very top that you get a loan done at any cost." *Id.*

146. Zachary also told of a pattern of: 1) inflating home appraisals so buyers could borrow enough to cover closing costs, but leaving the borrower owing more than the house was truly worth; 2) employees steering borrowers who did not qualify for a conventional loan into riskier mortgages requiring little or no documentation, knowing they could not afford it; and 3) employees coaching borrowers to overstate their income to qualify for loans. *Id.*

147. NBC News interviewed six other former Countrywide employees from different parts of the country, who confirmed Zachary's description of Countrywide's corrupt culture and practices. Some said that Countrywide employees falsified documents intended to verify borrowers' debt and income to clear loans. NBC News quoted a former loan officer: "'I've seen supervisors stand over employees' shoulders and watch them . . . change incomes and things like that to make the loan work.'" *Id.*

148. Countrywide's complete disregard for proper loan underwriting has spawned numerous lawsuits. As part of these lawsuits, plaintiffs have performed forensic analyses and re-underwritten entire loan files. Public disclosure of the staggering number of loans breaching the associated representations and warranties discovered in these cases should have alerted the trustee that Countrywide loans were highly likely to have breached the associated representations and warranties.

4. Decision One

149. Decision One Mortgage Co., LLC and Decision One Mortgage Corp. ("Decision One") was a major lender specializing in mortgage loans that are commonly referred to as Alt-A lending options, and non-conforming or sub-prime loans. In 2006, Decision One ranked as the 14th largest subprime lender in the nation. Decision One originated or contributed a material portion of the loans in the mortgage pools underlying the trusts.

150. A 2011 complaint filed by Allstate Insurance Company contains allegations based on confidential witness statements in which former Decision One employees "described Decision One's lax attitude towards its own origination and underwriting standards and explained that Decision One had been approving loans that should have never been issued." Complaint, *Allstate Ins. Co. v. Morgan Stanley*, No. 651840/2011, ¶ 95 (N.Y. Sup. Ct. July 5, 2011). On March 15, 2013, the Court granted Morgan Stanley's Motion to Dismiss with respect to a negligent misrepresentation claim, but denied the Motion in all other respects.

151. According to testimony and documents submitted to the FCIC by a Clayton executive, during 2006 and the first half of 2007, Clayton reviewed 911,039 loans issued by originators, including Decision One, for securitization. Clayton determined over 10% of Decision One's loans did not comply with its underwriting guidelines and had no compensating

factors. *See* Clayton All Trending Report at 10, available at http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0923-Clayton-All-Trending-Report.pdf.

152. Decision One's reckless lending practices earned it a spot on the OCC's 2009 "Worst Ten in the Worst Ten" list.

5. DLJ

153. DLJ Mortgage Capital, Inc. ("DLJ"), is a Delaware corporation and subsidiary of Credit Suisse Securities, an affiliate of Credit Suisse Financial Corp. (collectively, "Credit Suisse") with its headquarters at Credit Suisse's office in New York.

154. On June 28, 2013, U.S. Bank, acting as trustee, filed an amended complaint against DLJ seeking repurchase of defective loans in a pool of over 5,000 mortgages. *See* Am. Complaint, *Home Equity Asset Trust 2007-1 v. DLJ Mortgage Capital Inc.*, No. 650369/2013 (N.Y. Sup. Ct. June 28, 2013).

155. After suffering severe losses, U.S. Bank conducted a forensic review of more than 1,500 loans. It found that nearly 80% of the loans breached DLJ's representations and warranties. *Id*. ¶ 5. A loan-level review of approximately 1,000 more loans confirmed that "the principal originators of the Mortgage Loans failed to adhere to industry-standard and reasonable underwriting guidelines in an extremely high percentage of cases." *Id*.

156. On December 18, 2013, the Attorney General of New Jersey announced that the State had filed a lawsuit against Credit Suisse, DLJ, and Credit Suisse First Boston Mortgage Securities. The complaint includes allegations that the defendants offered over $10 billion in RMBS for sale to investors, but failed to disclose that "there had been a wholesale abandonment of underwriting guidelines" and numerous originators had high delinquency and default rates. Press Release, *Acting Attorney General Announces Lawsuit Against Credit Suisse Arising From*

Sale of Over $10 Billion in Troubled Mortgage Backed Securities (Dec. 18, 2013), *available at* http://nj.gov/oag/newsreleases13/pr20131218a.html.

157. Credit Suisse and DLJ have also been the target of other significant RMBS investigations and lawsuits. A review of loan files by MBIA, which wrote insurance on DLJ Mortgage certificates, demonstrates that DLJ Mortgage routinely misrepresented the quality of loans included in the securitizations. Complaint, *MBIA Ins. Corp. v. Credit Suisse Securities (USA) LLC, et al.*, No. 603751/2009 (N.Y. Sup. Ct. Dec. 14, 2009). In carrying out its review of the approximately 1,386 DLJ defaulted loan files, MBIA found that 87% of the defaulted or delinquent loans in those securitizations contained breaches of DLJ Mortgage's representations and warranties. *Id.* ¶ 68. These findings demonstrated "a complete abandonment of applicable guidelines and prudent practices such that the loans were (i) made to numerous borrowers who were not eligible for the reduced documentation loan programs through which their loans were made, and (ii) originated in a manner that systematically ignored the borrowers' inability to repay the loans." *Id.* ¶ 11. Moreover, "[t]he rampant and obvious nature of the breaches confirms that Credit Suisse made intentional misrepresentations concerning its mortgage loans and the due diligence that Credit Suisse purported to perform regarding the quality of those loans." *Id.*

158. Investors have reached similar conclusions regarding the defective loan collateral underlying Credit Suisse securitizations in their review of loans from Credit Suisee-label trusts. For example, FHFA conducted a forensic review of numerous loans in Credit Suisse securitizations. Complaint, *FHFA v. Credit Suisse Holdings (USA), Inc.*, No. 11-cv-06200 (S.D.N.Y. Sept. 2, 2011). The forensic review "revealed that for a majority of the loans reviewed in those Securitizations, there were numerous breaches of the originators' underwriting guidelines, such as failure to evaluate the reasonableness of the borrower's stated income or to

correctly account for the borrower's debt, both key factors bearing on eligibility for a mortgage loan." *Id*. ¶ 6.

159. In November 2011, Allstate Insurance Company ("Allstate") filed an amended complaint alleging fraud against Credit Suisse, DLJ Mortgage and other affiliates in connection with the sale of approximately $232 million in "highly-rated certificates." Am. Complaint, *Allstate Insurance Co. et al. v. Credit Suisse Secs. (USA) LLC et al.*, No. 650547/2011 (N.Y. Sup. Ct. Nov. 16, 2011). Allstate performed a forensic review of a sampling of loans from the loan pools, which showed that the loans were riddled with defects constituting pervasive breaches of representations and warranties. For example, Allstate found that Credit Suisse systematically and significantly overstated the number of owner-occupied properties and understated the loans' LTV and CLTV ratios, and "routinely included" loans that "failed to conform to the originator's stated underwriting standards." *Id*. ¶¶ 126-61. Moreover, Allstate's forensic analysis found that Credit Suisse loan originators "systematically abandoned underwriting standards." *Id*. ¶¶ 162-199.

160. In another case, Prudential's loan-level "analysis revealed systematic failures in Defendants' loan underwriting and assignment practices." Complaint, *Prudential Ins. Co. of America v. Credit Suisse Secs. (USA) LLC et al.*, No. 12-cv-07242, at ¶ 1 (D.N.J. Nov. 21, 2012). Specifically, Prudential found that across the twenty-three Credit Suisse securitizations that it tested, a staggering 48.67% of the mortgage loans contained at least one material defect. *Id.* ¶ 18.

161. In other cases, monoline insurers and investors have reached similar findings regarding Credit Suisse's widespread breach of representations and warranties concerning the loans securitized in Credit Suisse-label trusts. *See, e.g.*, Complaint, *Assured Guaranty Municipal Corp. v. DLJ Mortgage Capital Inc.*, No. 652837/2011 (N.Y. Sup. Ct. Oct. 17, 2011) (forensic

review confirmed that DLJ breached representations about the loans and that a huge number of defective mortgages were packaged into securities); Complaint, *FGIC v. Credit Suisse Secs. (USA) LLC*, No. 651178/2013, at ¶ 9 (N.Y. Sup. Ct. Apr. 2, 2013) (forensic review confirmed that "Credit Suisse's pre-closing representations were fraudulent, the warranties it made in the Insurance Agreement were false, and it willfully disregarded and frustrated its contractual covenants"); Complaint, *Mass. Mut. Life Ins. Co. v. DLJ Mortgage Capital, Inc.*, No. 11-cv-30047, at ¶ 6 (D. Mass. Feb. 25, 2011) (analysis confirmed "Credit Suisse Defendants abandoned or disregarded disclosed underwriting guidelines, often originating or acquiring loans issued to borrowers regardless of the borrowers' ability to repay").

6. First Franklin

162. First Franklin Financial Corporation ("First Franklin") originated or contributed a material portion of the loans in the mortgage pools underlying the trusts.

163. Starting in 2009, First Franklin was named in numerous lawsuits alleging that it systematically abandoned its underwriting guidelines in the pursuit of profits. These lawsuits contain ample evidence that mortgage loans originated by First Franklin breached the associated representations and warranties. Not only do these lawsuits contain eye-witness accounts from confidential witnesses and former employees of First Franklin, but many complaints also contain detailed information based on forensic reviews of individual loans.

164. One of the earliest lawsuits naming First Franklin was filed on February 17, 2009. Complaint, *Public Employees' Retirement System of Mississippi v. Merrill Lynch & Co. et al.*, No. 09-cv-1392 (S.D.N.Y. Feb. 17, 2009). The complaint alleged that First Franklin "systematically ignored, or abandoned their stated and pre-established underwriting and appraisal standards." *Id.* at ¶ 11. The litigation was eventually settled.

165. First Franklin was also named in a 2010 class action suit that alleged it systemically disregarded its underwriting guidelines when originating mortgages that were subsequently securitized into RMBS. *See* Corrected Am. Compl. For Rescission and Damages, *Federal Home Loan Bank of Chicago v. Banc of America Funding Corp et al.*, No. 10-ch-45003 (Ill. Cir. Ct. Apr. 8, 2011) ("FHLB Chicago Am. Compl.").

166. Statements from confidential witnesses in the FHLB Chicago Am. Complaint represented that First Franklin originated mortgage loans in violation of its stated underwriting standards.

167. According to one confidential witness who was an underwriter at a First Franklin branch in Georgia from March 2004 to November 2007, account executives at First Franklin were making "$100,000 a month in commissions," which was based on the number and dollar amount of loans processed. Due to this incentive structure, account executives would often pressure underwriters to approve loans that should not have been approved. The executives would simply override the underwriter's decision so that, according to this confidential witness, "Nine out of ten times, the loan went through." *Id*. ¶¶ 387-88.

168. That same confidential witness explained that First Franklin used contract appraisers who inflated property values. There "were homes with busted out windows and the meter boxes [] missing" that appraised for $300,000. He also knew that many fake W-2s had been attached to loan applications because the tax withholdings did not match the income. Further, he knew that mortgage brokers who referred loan applications to First Franklin were "whiting out or faxing over" the actual numbers and writing in new numbers so that the loans would work. *Id*. ¶¶ 400, 402.

169. Another confidential witness was an underwriter and account executive at a First Franklin branch in Ohio from 2000 until 2007. Account executives were responsible for maintaining relationships with mortgage brokers that referred loan applications to the originating banks. This confidential witness stated that "account executives paid processors cash under the table to help them get loans closed," and went on to describe how one loan processor was caught manipulating the loan documents in order to close more loans. *Id*. ¶ 389.

170. One confidential witness, who was an underwriter at a First Franklin branch in Washington from 2005 until November 2007, described how the systematic disregard for underwriting standards grew worse after First Franklin purchased OwnIt Mortgage and OwnIt employees began working with the confidential witness. She stated that OwnIt employees "were used to approving anything. They'd say, 'If we don't approve it, somebody else will. So why lose the money?'" This witness's manager was a former OwnIt employee who would often override her employees' decisions to decline loans in order to meet performance goals. The witness also noted that First Franklin employees manipulated applications so that they would be approved. *Id*. ¶¶ 390, 406.

171. The confidential witness who worked at the Ohio branch represented that there was enormous pressure from management to close loans at any cost. "[P]eople were working until 8 p.m. on Saturdays and Sundays" in order to close the loans, stated the witness. As a result, "a lot of loans slipped through. People were tired of being beat up. With the rush of loans, stuff could have been overlooked. Maybe the conditions didn't exactly meet the guidelines." During the last few days of the month, some employees would go to the branch manager "begging for exceptions to close their loans." *Id*. ¶ 395.

172. Another confidential witness, who was, among other things, an account executive and underwriter at a First Franklin branch in Utah from 1996 until 2008, noted that account executives would often approach branch managers about overturning an underwriter's decision to reject a loan, and said that "some loans were approved that were not compliant with guidelines." *Id.* ¶ 396.

173. That same confidential witness also encountered the "blatant fraud" first hand. She recalled a $500,000 loan application for a home that was supposed to be owner occupied even though the same borrower and purchased a $1,000,000 home in the same neighborhood a month earlier and also claimed that it would be owner occupied. Although the underwriter was successful in blocking that particular application, her manager was mad at her for catching it. Other similar loans were approved. *See id.* ¶ 404.

174. When First Franklin began downsizing its mortgage operation in late 2007, it ordered all of its remaining underwriters to assist in loss mitigation. The confidential witness from the Utah branch was one of them. She reported that the loss mitigation group was tasked with reviewing the quality of a number of First Franklin's loans: she reported that among the loans she reviewed, fifty percent were not compliant with First Franklin's guidelines, citing problems such as inflated appraisal values, insufficient employment verification, and disqualifying credit scores. *See id.* ¶ 398.

175. According to another confidential witness, who was an underwriter at a First Franklin branch in Florida from 1999 until 2007, loan document manipulation at First Franklin grew to disconcerting levels. The witness stated that "a lot of fraudulent loans were going through. There was tons of fraud going on." *Id.* ¶ 401.

176. FHLB's complaint survived the defendants' motion to dismiss, with the court stating "the Bank has provided evidentiary facts, such as testimony, AVM analysis of appraisal values, delinquency and foreclosure rates, and pleadings from other civil actions involving the defendants, which demonstrate the strength of the Bank's case" that the originators systematically disregarded their underwriting standards. Order, No. 10-45033 (Ill. Cir. Ct. Sept. 19, 2012).

177. First Franklin has also been sued by Ambac Assurance Corporation, a company that provided monoline insurance, a form of credit enhancement for certain certificates in a RMBS. After paying hundreds of millions of dollars to certificateholders as a result of the many defaults and delinquencies on First Franklin-originated loans, Ambac reviewed 1,750 First Franklin loans. It found that 94% had material defects, including:

- Rampant fraud, primarily involving misrepresentation of the borrower's income, assets, employment, or intent to occupy the property;
- Failure by the borrower to accurately disclose his or her liabilities, including multiple other mortgage loans taken out to purchase additional investment property;
- Inflated appraisals; and
- Pervasive violations of the loan originator's own underwriting guidelines and prudent mortgage-lending practices, including loans made to borrowers (i) who made unreasonable claims as to their income, (ii) with debt-to-income and loan-to-value ratios above the allowed maximums, or (iii) with relationships to the applicable originator or other non-arm's-length relationships.

Complaint, *Ambac Assurance Corp. v. First Franklin Fin. Corp.*, No. 651217/2012, at ¶¶ 82-83 (N.Y. Sup. Ct. April 16, 2012).

7. Fremont

178. Fremont Investment and Loan ("Fremont") originated or contributed a material portion of the loans in the mortgage pools underlying the trusts.

179. Senator Carl Levin, at a hearing before the Senate PSI, singled out Fremont as a lender "'known for poor quality loans.'" Opening Statement of Sen. Carl Levin, Chairman, *Wall Street and the Financial Crisis: The Role of High Risk Home Loans*, Hearing Before S. Permanent Subcomm. on Investigations (Apr. 23, 2010). Senator Levin recounted how an analyst with S&P raised concerns about the quality of Fremont-originated loans in a Goldman Sachs RMBS offering:

> In January 2007, S&P was asked to rate an RMBS being assembled by Goldman Sachs using subprime loans from Fremont Investment and Loan, a subprime lender known for loans with high rates of delinquency. On January 24, 2007, an analyst wrote seeking advice from two senior analysts: "I have a Goldman deal with subprime Fremont collateral. Since Fremont collateral has been performing not so good, is there anything special I should be aware of?" One analyst responded: "No, we don't treat their collateral any differently." The other asked: "are the FICO scores current?" "Yup," came the reply. Then "You are good to go." In other words, the analyst didn't have to factor in any greater credit risk for an issuer known for poor quality loans, even though three weeks earlier S&P analysts had circulated an article about how Fremont had severed ties with 8,000 brokers due to loans with some of the highest delinquency rates in the industry. In the spring of 2007, Moody's and S&P provided AAA ratings for 5 tranches of RMBS securities backed by Fremont mortgages. By October, both companies began downgrading the CDO. Today all five AAA tranches have been downgraded to junk status.

Id.

180. Fremont currently faces a lawsuit filed by Cambridge Place Investment, Inc., which is mentioned in this August 15, 2010 article in the Myrtle Beach Sun-News:

> Cambridge hinges much of its case on 63 confidential witnesses who testified in court documents about the reckless lending practices that dominated the subprime market during the real estate boom.
>
> Fremont, for example, regularly approved loans with unrealistic stated incomes – such as pizza delivery workers making $6,000 a month, according to the lawsuit.
>
> Other Fremont witnesses said in court documents that loan officers spotted and ignored fraudulent information, such as falsified pay stubs, every day.

David Wren, *Myrtle Beach Area Loans Lumped Into Spiraling Mortgage-Backed Securities*, Myrtle Beach Sun-News, Aug. 15, 2010, at A, *available at* http://www.myrtlebeachonline.com/2010/08/15/1637463/investors-paying-for-risky-loans.html. On September 28, 2012, the court denied in principal part Defendants' Joint Motion to Dismiss For Failure to State a Claim. *See Cambridge Place Inv. Mgmt. Inc. v. Morgan Stanley & Co., Inc., et al.*, No. 10-2741 (Mass. Super. Ct.).

181. On December 21, 2011, the FHFA filed an amended complaint against UBS Americas, Inc., alleging securities laws violations concerning RMBS purchases made by Freddie Mac and Fannie Mae. In the complaint, the FHFA alleged:

> A confidential witness who previously worked at Fremont in its system operations and underwriting sections stated that Fremont consistently cut corners and sacrificed underwriting standards in order to issue loans. He noted that "Fremont was all about volume and profit," and that when he attempted to decline a loan, he was regularly told "you have signed worse loans than this." The same witness also said that employees at Fremont would create documents that were not provided by the borrowers, including check stubs and tax documents, in order to get loans approved. The confidential witness stated that Fremont regularly hired underwriters with no experience, who regularly missed substantial numbers of answers on internal underwriting exams. He explained that like many Fremont employees, he quit because he was uncomfortable with the company's practices.

See Second Am. Complaint, *FHFA v. UBS Americas, Inc.*, No. 11-cv-05201 (S.D.N.Y.) (Dec. 21, 2011). The court denied a motion to dismiss the complaint in May 2012. *See FHFA v. UBS Americas, Inc.*, 858 F. Supp. 2d 306 (S.D.N.Y. 2012). On July 25, 2013, the FHFA announced that it had reached an agreement to settle the case for $885 million.

182. Fremont's origination practices have also been addressed in numerous governmental investigations and reports. For example, the FCIC Report discusses that Moody's created an independent surveillance team in 2004 in order to monitor previously rated deals. The Moody's surveillance team saw a rise in early payment defaults in mortgages originated by

Fremont in 2006, and downgraded several securities with underlying Fremont loans or put them on watch for future downgrades. Moody's chief credit officer stated that Moody's had never had to put on watch deals rated in the same calendar year. In 2007, Moody's downgraded 399 subprime mortgage-backed securities that had been issued in 2006 and put an additional 32 securities on watch. Moody's noted that about 60% of the securities affected contained mortgages from one of four originators, one of which was Fremont. FCIC Report at 221-222.

183. According to the FCIC Report, when sponsors kicked loans out of securitization pools, some originators simply put those loans into new pools. Roger Ehrnman, Fremont's former regulatory compliance and risk manager, told the FCIC that Fremont had a policy of putting loans into subsequent pools until they were kicked out three times. FCIC Report at 168.

184. Fremont was also included in the 2008 "Worst Ten in the Worst Ten" Report, ranking 1st in Miami, Florida; 3rd in Riverside, California; 4th in Denver, Colorado and Sacramento, California; 5th in Stockton, California; 6th in Detroit, Michigan and Las Vegas, Nevada; 7th in Bakersfield, California; and 10th in Memphis, Tennessee. *See* 2008 "Worst Ten in the Worst Ten" Report. In the 2009 "Worst Ten of the Worst Ten" Report, Fremont held the following positions: 2nd in Fort Myers-Cape Coral, Florida and Fort Pierce-Port St. Lucie, Florida; 4th in Riverside-San Bernardino, California; 5th in Stockton-Lodi, California and Vallejo-Fairfield-Napa, California; 7th in Las Vegas, Nevada and Modesto, California; and 8th in Bakersfield, California and Merced, California. *See* 2009 "Worst Ten in the Worst Ten" Report.

8. GreenPoint

185. GreenPoint Mortgage Funding, Inc. ("GreenPoint"), based in Novato, California, was the wholesale mortgage banking unit of Capital One Financial Corp. ("Capital One").

Capital One acquired GreenPoint when it purchased GreenPoint's holding company, North Fork Bancorp, in December 2006. Capital One shut down GreenPoint's operations less than one year later on August 21, 2007. Capital One eventually liquidated GreenPoint in December 2008, taking an $850 million write-down due to mortgage-related losses associated with GreenPoint's origination business. GreenPoint originated or contributed a material portion of the loans in the mortgage pools underlying the trusts.

186. When originating stated income loans, GreenPoint often inflated the borrowers' income by as much as 5%. A September 12, 2008, article on Bloomberg reports on GreenPoint's underwriting practices:

> Many Alt-A loans go to borrowers with credit scores higher than subprime and lower than prime, and carried lower interest rates than subprime mortgages.
>
> So-called no-doc or stated-income loans, for which borrowers didn't have to furnish pay stubs or tax returns to document their earnings, were offered by lenders such as GreenPoint Mortgage and Citigroup Inc. to small business owners who might have found it difficult to verify their salaries.
> . . .
> "To grow, the market had to embrace more borrowers, and the obvious way to do that was to move down the credit scale," said Guy Cecala, publisher of Inside Mortgage Finance. "Once the door was opened, it was abused."
> . . .
> Almost all stated-income loans exaggerated the borrower's actual income by 5 percent or more, and more than half increased the amount by more than 50 percent, according to a study cited by Mortgage Asset Research Institute in its 2006 report to the Washington-based Mortgage Bankers Association.

Dan Levy & Bob Ivry, *Alt-A Mortgages Next Risk for Housing Market as Defaults Surge*, Bloomberg, Sept. 12, 2008, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=arb3xM3SHBVk.

187. Syncora Guarantee, a monoline insurer, sued J.P. Morgan Securities, LLC, as successor to Bear Stearns & Co., Inc., in 2011 in connection with an RMBS underwritten by Bear Stearns and exclusively collateralized by GreenPoint-originated loans. After sustaining

large losses due to the poor performance of GreenPoint loans, Syncora hired an independent consultant to "reunderwrite" 1,431 GreenPoint loans, 400 of which were randomly selected without regard to payment status. Over 92% of the 1,431 loans contained misrepresentations, and over 85% of the randomly selected 400 loans contained misrepresentations. The misrepresentations uncovered included the following:

- Rampant fraud, primarily involving misrepresentation of the borrower's income, assets, employment, or intent to occupy the property as the borrower's residence (rather than as an investment), and subsequent failure to so occupy the property;

- Failure by the borrower to accurately disclose his or her liabilities, including multiple other mortgage loans taken out to purchase additional investment property;

- Inflated and fraudulent appraisals; and

- Pervasive violations of GreenPoint's own underwriting guidelines without adequate, or any, compensating factors, and in disregard of prudent mortgage lending practices, including loans made to borrowers (i) who made unreasonable claims as to their income, (ii) with multiple, unverified social-security numbers, (iii) with credit scores below the required minimum; (iv) with debt-to-income and loan-to-value ratios above the allowed maximums, or (v) with relationships to the applicable originator or other non-arm's-length relationships.

See Complaint, *Syncora Guar. Inc. v. J.P. Morgan Secs. LLC*, No. 651566/2011 (N.Y. Sup. Ct. June 6, 2011). Syncora's lawsuit survived a combined motion to dismiss and motion for summary judgment. *See* Decision and Order, *Syncora Guar. Inc. v. J.P. Morgan Secs. LLC*, Doc. 50, No. 651566/2011 (N.Y. Sup. Ct. May 2, 2012).

188. GreenPoint's own employees have corroborated the findings of Syncora. A confidential witness in *Federal Home Loan Bank of Indianapolis v. Banc of America Mortgage Securities, Inc.*, stated that (1) GreenPoint employees faced intense pressure to close loans at any cost; (2) GreenPoint managers overrode employees' decisions to reject loans and approved loans based upon inflated incomes; (3) GreenPoint approved loans that contained exceptions for which

there were no reasonable compensating factors; and (4) GreenPoint failed to adhere to sound underwriting guidelines. This confidential witness was a senior loan underwriter at GreenPoint from October 1997 through August 2007. *See* Complaint, *Fed. Home Loan Bank of Indianapolis v. Banc of Am. Mortgage Secs., Inc.*, No. 49D051010PL045071 (Ind. Sup. Ct. Oct. 15, 2010) ("FHLB Indianapolis").

189. According to that confidential witness, sales staff and managers at GreenPoint received bonuses based on the number of loans closed. As she said, "sales had tremendous authority" at GreenPoint, and "[t]hey were in business to make more money. They would try to find any way to close a loan." *Id*. ¶ 266.

190. Between 2005 and 2007, the confidential witness said that stated income loans became increasingly popular and GreenPoint managers approved loans based upon inflated incomes she believed should not have been approved. She saw a lot of loans with stated "income that was more than could be justified by the borrower's employment." When she denied loans because she believed the income was inflated, sometimes the underwriting managers, operations managers, and the regional operations manager overrode her decisions. *Id*. ¶ 267.

191. More often than not, the confidential witness believed that her managers overrode her denials due to the incentives they received based upon loan volume. As she said, "They were making the decision because they had to hit certain sales numbers." She knew of such targets because of comments made in operations meetings about the company needing to meet certain goals. *Id*. ¶ 268.

192. In *Allstate Bank v. J.P. Morgan Chase, N.A.*, Allstate, an RMBS investor, sued J.P. Morgan, the RMBS underwriter, for misrepresentations in RMBS offering documents. Allstate's complaint relied on several confidential witnesses. One confidential witness, who was

an underwriting analyst at GreenPoint from 2003 to 2007, stated that GreenPoint reviewed only 10% of the loans it originated for fraud. He thought this was a "mistake" because the fraud and misrepresentations uncovered in the 10% sample indicated that many more loans likely contained fraud. But the remaining 90% of the loans were not reviewed. Am. Complaint, *Allstate Bank v. J.P. Morgan Chase, N.A.*, No. 11-cv-1869, at ¶ 485 (S.D.N.Y. May 10, 2012).

193. That confidential witness also stated that sales personnel ran GreenPoint, and senior management was comprised of people from sales who were incentivized to push the volume of mortgage loans, not adherence to the underwriting guidelines or due diligence. Managers' bonuses were tied to production volume, and they were not penalized if loans were later found to be fraudulent or if the borrower defaulted on the first payment. He stated that GreenPoint's management deliberately overlooked misrepresentations from mortgage loan brokers, particularly if the broker brought in a high volume of loans. Problem brokers were rarely suspended, and even when they were, there was never a review of the loans they originated that were already in the pipeline. *Id*. ¶ 486.

194. Another confidential witness was a Wholesale Account Manager at GreenPoint from 2004 to 2006. That confidential witness stated that GreenPoint employees understood that if a mortgage loan could eventually be sold to Wall Street, GreenPoint was to approve and fund the mortgage loan. The majority of the loan products originated in the confidential witness's office were stated income and asset loans and pay-option ARMs. Despite the risk inherent in these products, the sales force "never learned of negative loan performance" and their compensation was not tied to loan performance. *Id*. ¶ 487.

195. Another confidential witness was an Underwriting Supervisor at GreenPoint from 2005 to 2006 who supervised five Underwriters and three Conditions Specialists. That

confidential witness stated that GreenPoint management authorized exceptions to loan underwriting guidelines to approve applications, even when there were no compensating factors justifying the exceptions. The confidential witness knew that management overrode decisions to refuse funding in locations known for fraud and property flipping, even when evidence of fraud was found. According to the confidential witness, “if the borrower is breathing and could sign loan documents, they could get a loan” from GreenPoint. *Id*. ¶ 488.

196. Allstate’s complaint also alleged that many of GreenPoint’s loans were granted by the over 18,000 brokers approved to transact with GreenPoint – a large enough number that GreenPoint could exercise no realistic degree of control. Typically, new brokers were actively monitored for only the first five to seven loans submitted, usually during only the first 90 days of being approved. *Id*. ¶ 490.

197. GreenPoint’s pervasive disregard of underwriting standards resulted in its inclusion among the worst ten originators in the 2008 “Worst Ten in the Worst Ten” Report. GreenPoint was identified 7th worst in Stockton, California, and 9th worst in both Sacramento, California, and Las Vegas, Nevada. In the 2009 “Worst Ten in the Worst Ten” Report, GreenPoint was listed as 3rd worst in Modesto, California; and 4th worst in Stockton, Merced, and Vallejo-Fairfield-Napa, California.

9. Impac

198. Impac Funding Corp. and Impac Mortgage Holdings, Inc. (“Impac”) is a mortgage company that acquires, purchases, and sells mortgage loans. It is a California corporation headquartered in Irvine, California. Impac originated or contributed a material portion of the loans in the mortgage pools underlying the trusts and sponsored some of the trusts.

199. Massachusetts Mutual Life Ins. Co. (“Mass Mutual”), an RMBS investor like the

CCUs, sued Impac regarding RMBS that Impac sponsored. Mass Mutual conducted a forensic analysis of loans underlying an RMBS it had purchased. The analysis revealed that 48% of the loans tested had appraisals inflated by 10% or more, and 34% of the loans tested had LTVs that were 10 or more points more than represented. Additionally, 15.45% of the loans that had been represented to be owner occupied were determined not to be owner occupied. *See* Complaint, *Massachusetts Mut. Life Ins. Co. v. Impac Funding Corp.*, No. 11-cv-30127, at ¶¶ 87-88, 95 (D. Mass. May 6, 2011).

200. As conservator for Fannie Mae and Freddie Mac, the Federal Housing Finance Agency ("FHFA") sued Bear Stearns for alleged material misstatements and omissions in certain RMBS offering documents concerning RMBS purchased by Fannie Mae and Freddie Mac. *See* Am. Complaint, *FHFA v. JP Morgan*, No. 11-cv-6188 (S.D.N.Y. June 13, 2012).

201. In connection with this lawsuit, the FHFA conducted a forensic review of loans backing an RMBS that contained a significant number of loans from Impac. This review consisted of an analysis of the loan origination file for each loan, including the documents submitted by the individual borrowers in support of their loan applications, as well as an analysis of information extrinsic to each loan file, such as the borrower's motor vehicle registration documentation with pertinent information indicating a borrower's assets or residence, and other information that was available at the time of the loan application, as well as the borrower's filings in bankruptcy proceedings and other sources of information. *Id.* ¶ 362.

202. The FHFA reviewed 535 loan files from the group of loans. Impac originated 13.56% of the loans in that group. The FHFA's review revealed that 98% of the loans (523 out of 535) were not underwritten in accordance with the underwriting guidelines or otherwise breached the representations contained in the transaction documents. Of the 523 loans that did

not comply with the underwriting guidelines, none had sufficient compensating factors to warrant an exception. *Id.* ¶¶ 359, 367.

203. Of the 535 loans reviewed, 89 loans (or 25.2 percent) revealed an incorrect calculation of the borrower's debts which, when corrected, caused the debt-to-income ratio to exceed the applicable underwriting guidelines for the product type. *Id.* ¶ 386.

10. Morgan Stanley Mortgage Capital

204. Morgan Stanley Mortgage Capital, Inc. ("MSMC"), now known as Morgan Stanley Mortgage Capital Holdings, LLC ("MSCH"), did not originate residential mortgages itself. Rather it purchased closed, first-lien and subordinate-lien residential mortgage loans for securitization or for its own investment from other lenders. MSMC acquired residential mortgage loans through bulk purchases and through purchases of single loans through its conduit loan purchase program.

205. MSMC and MSCH sponsored one of the trusts.

206. MSMC has been the subject of numerous investigations and lawsuits alleging that MSMC systematically abandoned originator underwriting guidelines in pursuing profits. Not only do these investigations and lawsuits contain accounts from confidential witnesses and former employees, but many complaints contain detailed information based on forensic reviews of individual loans. These lawsuits in conjunction with the poor performance of the underlying loans and the public information concerning wide-spread issues among all originators was more than sufficient to provide Defendant with notice that large numbers of loans contributed by MSMC, including loans in the trusts, breached the associated representations and warranties.

207. On June 24, 2010, the Attorney General of the State of Massachusetts entered into an Assurance of Discontinuance with "Morgan Stanley & Co. Incorporated together with its

affiliates involved in the mortgage financing and securitization business" concerning its practices of buying and securitizing loans, primarily from New Century Financial Corp. and its subsidiaries. Press Release, *Morgan Stanley to Pay $102 Million for Role in Massachusets Subprime Mortgage Meltdown Under Settlement with AG Coakley's Office*, Attorney General of Massachusetts, (June 24, 2010) *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2010/attorney-general-martha-coakley-reaches-102.html. The Attorney General found the following:

- As part of its process for "purchasing and securitizing subprime loans, [Morgan Stanley] engaged in a number of reviews of the quality of the originators' lending practices and loans. These included, inter alia, determining whether the subprime loans were originated in accordance with the originators' underwriting guidelines and assessing compliance with applicable laws ('credit and compliance diligence'), and examining property values ('valuation diligence'). These reviews increasingly demonstrated shortcomings in some of New Century's lending practices and problems with a large number of individual subprime loans."

- Based on an internal analysis run by Morgan Stanley, New Century qualified borrowers based on a teaser interest rate, but when the fully indexed rate was taken into consideration, 45% of the borrowers in Massachusetts would not have qualified for the loan.

- Morgan Stanley hired the underwriting firm Clayton to analyze a sample of loans to be purchased to determine whether they were originated in accordance with underwriting guidelines. Although Clayton's analysis showed that New Century increasingly stretched "underwriting guidelines to encompass or approve loans not written in accordance with the guidelines," Morgan Stanley continued to buy such loans under pressure from New Century to avoid losing New Century's business to another loan buyer.

- During the period from 2006-2007, only 9% of those loans that were granted pursuant to exceptions had adequate compensating factors to offset the exception. Further, Morgan Stanley waived exceptions on a large number of loans Clayton found to be generated in violation of guidelines without adequate compensating factors.

- Although Morgan Stanley had a stated policy not to purchase or securitize loans with a combined LTV ratio of greater than 100%, the reality was about a third of the loans securitized by Morgan Stanley in 2006-2007 had a CLTV greater than 100%.

- Morgan Stanley determined that New Century did not adequately evaluate the borrower's income on "stated income" loans.

- Despite Morgan Stanley's awareness of problems at New Century, it continued to fund, purchase, and securitize New Century loans.

208. Under the Assurance of Discontinuance, Morgan Stanley agreed to institute procedures to ensure that loans it securitized conformed to underwriting guidelines and to pay $102 million to settle the charges against it. *Id.*

209. In September 2011, MSCH entered into a similar Assurance of Discontinuance with the Attorney General of the State of Nevada following an investigation into the origination practices of originators (primarily New Century) who originated loans that MSCH purchased and sold via securitizations, including whether the originators misrepresented interest rates to borrowers, inflated appraisals, and failed to disclose payment shock to borrowers following expiration of the initial teaser interest rate. Under the agreement, Morgan Stanley agreed to provide relief to consumers valued between $21 million and $40 million and to institute a process to review loans purchased for securitization to ensure compliance with the law. *Available at*

http://media.lasvegassun.com/media/pdfs/blogs/documents/2011/09/27/morgandoc092711.pdf.

210. MSMC/MSCH has also been the subject of numerous civil lawsuits alleging it did not adequately conduct due diligence on loans it purchased and securitized.

211. For instance, in *Central Mortgage Co. v. Morgan Stanley Mortgage Capital Holdings, LLC*, No. 5140 (Del. Chanc. Jan. 29, 2010), a servicer of loans sued MSCH (as successor in interest to MSMC) on several contract and fraud theories regarding the plaintiff's purchase of the servicing rights to thousands of loans from MSCH. The complaint alleged that plaintiff paid a premium for the right to service the loans, because MSCH had represented that

they were "agency" loans, or loans originated under Fannie Mae and/or Freddie Mac guidelines. The complaint alleged that the loans experienced high rates of delinquency. According to the complaint, a representative of Morgan Stanley admitted the loans had not been screened at Morgan Stanley's internal due diligence facility and were of poorer quality than originally represented. Fannie Mae and Freddie Mac made repurchase requests regarding the loans. After initially honoring the repurchase requests, MSCH eventually stopped doing so notwithstanding its contractual obligations. The complaint alleged that the plaintiff reviewed the loans and found numerous fields in the mortgage loan schedules that were inaccurate.

212. In *FHFA v. Morgan Stanley, et al.*, No. 11-cv-06739 (S.D.N.Y. Sep. 2, 2011), the FHFA, as conservator of Fannie Mae and Freddie Mac, sued Morgan Stanley & Co., Inc., several of its subsidiaries, including Morgan Stanley Mortgage Capital Holdings LLC d/b/a Morgan Stanley Mortgage Capital, Inc., and others alleging that the defendants falsely represented that the mortgages collateralizing certain RMBS sold to Fannie Mae and Freddie Mac "complied with certain underwriting guidelines and standards, and presented a false picture of the characteristics and riskiness of those loans." FHFA alleged that its analysis of a sampling of the loans revealed that a statistically significant rate of owner occupancy and LTV ratios were false. The case was settled in 2014 for $1.25b. Press Release, *FHFA Announces $1.25 Billion Settlement with Morgan Stanley* (Feb. 7, 2014) *available at* http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-$1-25-Billion-Settlement-With-Morgan-Stanley.aspx.

213. Likewise, in *MBIA Ins. Co. v. Morgan Stanley, et al.*, No. 29951/2010 (N.Y. Sup. Ct. Dec. 6, 2010), the monoline insurer MBIA sued Morgan Stanley, Morgan Stanley Mortgage Capital Holdings, LLC, and Saxon Mortgage Services, Inc., alleging that its review of loan files

securitized by the defendants revealed breaches of representations and warranties including an extraordinarily high incidence of material deviations from the underwriting standards that defendants represented would be followed. The parties settled the case in December 2011.

214. According to the FCIC Report, Morgan Stanley devoted minimal resources to due diligence on the loans it securitized. For instance, the head of due diligence was based not in New York but rather in Boca Raton, Florida, and he had, at any one time, only two to five individuals reporting to him directly—and they were actually employees of a personnel consultant, Equinox. FCIC Report at 168.

215. According to the report, internal Clayton documents show that a startlingly high percentage of loans reviewed by Clayton for Morgan Stanley were defective, but were nonetheless included by Morgan Stanley in loan pools. According to Clayton's data 37% (or 23,154) of the 62,940 loans it reviewed for Morgan Stanley failed to conform to Morgan Stanley's stated underwriting standards. Of the 37% of loans identified by Clayton as non-compliant, Morgan Stanley "waived in" 56% (or 20% of the total pool).

11. National City

216. National City Mortgage Co. was a division of National City Bank which was a wholly owned subsidiary of National City Corporation. Collectively these entities are referred to as "National City." National City originated or contributed a material number of loans the mortgage pools underlying the trusts.

217. In 2008, investors brought a securities fraud class action lawsuit against National City alleging that National City misrepresented the quality of its mortgage loans. *See* Am. Class Action Complaint, *In Re National City Corp. Sec., Derivative & ERISA Litig.*, No. 08-nc-70004 (N.D. Ohio June 13, 2008). On August 8, 2011, it was announced that the case had settled for

$168 million.

218. National City faced another class action lawsuit in 2010 alleging, among other things, that National City did not adhere to its underwriting standards. *See* Second Am. Class Action Complaint, *Argent Classic Convertible Arbitrage Fund (Bermuda) Ltd. and Argent Classic Convertible Arbitrage Fund L.P. v. National City Corp.*, No. 08-nc-70016 (N.D. Ohio Feb. 19, 2010). On November 30, 2010, the case settled for $22.5 million.

219. Evidence of misconduct on the part of National City employees can also be found in the complaint filed in *Royal Park Investments SA/NV v. Merrill Lynch, Pierce, Fenner & Smith Inc. et al.*, No. 652607/2012 (N.Y. Sup. Ct. Dec. 14, 2012). For example, in October 2011, in Providence, Rhode Island, National City Loan Officer Juan Hernandez pled guilty to participating in a fraudulent lending scheme. Hernandez pled guilty to fraudulently obtaining loans from National City and other lenders by using "straw purchasers" and providing false information to qualify borrowers for loans they would not have otherwise qualified for. From October 2006 through August 2007, Hernandez prepared false loan applications for phony borrowers containing falsified borrower incomes and debts, and misrepresenting that the properties would be owner occupied when they were not. *Id.* ¶ 361.

220. Hernandez was joined in the fraud by Miguel Valerio, a National City Loan Processor. Valerio also pled guilty to the fraudulent scheme in December 2011. *Id.* ¶ 362.

221. Similarly, in the Cleveland, Ohio area, in February 2011, at least two National City employees were indicted for lending fraud, along with 15 other co-conspirators. Loren Segal and Krystal Hill, both National City employees, were indicted for assisting in a fraudulent lending scheme that spanned from March 2005 through November 2007. The scheme included using straw purchasers, inflated appraisals, falsified borrower incomes, fake bank statements,

and false verifications of borrowers' funds. Both Segal and Hill pled guilty to participating in the scheme. *Id*. ¶ 363.

222. National City's systemic failure to follow its underwriting guidelines and evaluate its borrowers' true repayment abilities, and the fraudulent loans that followed, required the parent company, National City Corporation, to take a charge of $4.2 billion in the first quarter of 2008 for its defective loans. Moreover, National City's abject failure to follow its underwriting guidelines led to the SEC investigating National City's underwriting standards in 2008. In addition, in mid-2008, National City Corporation entered into a confidential agreement with the OCC, "effectively putting the bank on probation," according to a Wall Street Journal article published on June 6, 2008. Damian Paletta *et al.*, *National City is Under Scrutiny*, Wall Street Journal, June 6, 2008, *available at* http://online.wsj.com/articles/SB121271764588650947.

12. New Century

223. New Century Mortgage Corporation and NC Capital Corporation were subsidiaries of New Century Financial Corp. (collectively "New Century"). New Century was founded in 1995 in Irvine, California, and grew to be one of the nation's largest subprime lenders—originating $60 billion in loans in 2006 alone. New Century originated or contributed a material portion of the loans in the mortgage pools underlying the trusts.

224. New Century failed amid revelations that its books contained numerous accounting errors, government investigations and a liquidity crisis when its Wall Street backers pulled the financial plug on loan funding. The circumstances leading to its collapse tell the story of a company that was far more concerned with originating mortgages to fuel the securitization machine than in the quality of those mortgages.

225. A June 2, 2008 article in the Columbus Dispatch summarized New Century's

reputation in the industry:

> The California-based mortgage company catered to the riskiest borrowers, even those with credit scores as low as 500. Its brokers cut deals by asking few questions and reviewing even fewer documents, investigators say.
>
> Homeowners struggling to pay their existing mortgages signed up for what they believed to be redemption: a new loan. They were unaware of the warnings from lending and legal experts that New Century loaned money with a devil-may-care-attitude.
>
> New Century typified the book-'em-at-any-cost mentality that fueled the national mania for high-rate mortgages, commonly called subprime.

Jill Riepenhoff & Doug Haddix, *Risky Refinancings Deepen Financial Hole*, Columbus Dispatch, June 2, 2008, at 1A.

226. The article continued:

> Lending experts and consumer advocates say New Century was the poster child for the subprime tsunami – a company that relaxed lending standards so much that even borrowers with fresh bankruptcies and foreclosures could get a mortgage.

Id.

227. New Century's foreclosure rates reflected its inattention to underwriting standards. Indeed, New Century appeared in the OCC's 2008 "Worst Ten in the Worst Ten" Report in every housing market highlighted. Incredibly, New Century appeared in the top five in every market—1st in Las Vegas, Nevada and Riverside, California; 2nd in Cleveland, Ohio, Denver, Colorado, Sacramento, California and Stockton, California; 3rd in Bakersfield, California and Detroit, Michigan; and 5th in Miami, Florida and Memphis, Tennessee.

228. When the OCC issued its updated 2009 "Worst Ten in the Worst Ten" Report, New Century rose to the top three in every one of the ten worst markets, holding 1st place in Reno, Nevada; Bakersfield, California; Riverside-San Bernardino, California; and Fort Myers-Cape Coral, Florida; 2nd place in Modesto, California; Las Vegas, Nevada; Merced, California; Stockton-Lodi, California; and 3rd place in Fort Pierce-Port St. Lucie, Florida; and Vallejo-

Fairfield-Napa, California.

229. The U.S. Bankruptcy Court for the District of Delaware presiding over New Century's bankruptcy case appointed Michael J. Missal ("the Examiner") to examine "any and all accounting and financial statement irregularities, errors and misstatements" in connection with New Century's practices and procedures. The Examiner engaged a law firm, forensic accountants, and financial advisors to assist in his investigation and reporting. Final Report of Michael J. Missal, *In re: New Century TRS Holdings, Inc.*, No. 07-bk-10416 (D. Del. Feb. 29, 2008) (the "Examiner's Report") *available at* http://www.klgates.com/files/upload/Final_Report_New_Century.PDF.

230. The Examiner concluded that New Century "engaged in a number of significant improper and imprudent practices related to its loan originations, operations, accounting and financial reporting processes." Examiner's Report at 2. The Examiner summarized the following findings:

- "New Century had a brazen obsession with increasing loan originations, without due regard to the risks associated with that business strategy. Loan originations rose dramatically in recent years, from approximately $14 billion in 2002 to approximately $60 billion in 2006. The Loan Production Department was the dominant force within the Company and trained mortgage brokers to originate New Century loans in the aptly named 'CloseMore University.' Although a primary goal of any mortgage banking company is to make more loans, New Century did so in an aggressive manner that elevated the risks to dangerous and ultimately fatal levels." *Id*. at 3.

- "The increasingly risky nature of New Century's loan originations created a ticking time bomb that detonated in 2007. Subprime loans can be appropriate for a large number of borrowers. New Century, however, layered the risks of loan products upon the risks of loose underwriting standards in its loan originations to high risk borrowers." *Id*.

- "More than 40% of the loans originated by New Century were underwritten on a stated income basis. These loans are sometimes referred to as 'liars' loans' because borrowers are not required to provide verification of claimed income, leading a New Century employee to tell certain members of Senior Management in 2004 that 'we are unable to actually determine the borrowers' ability to afford a loan.'" *Id*.

- "New Century also made frequent exceptions to its underwriting guidelines for borrowers who might not otherwise qualify for a particular loan. A Senior Officer of New Century warned in 2004 that the 'number one issue is exceptions to guidelines.' Moreover, many of the appraisals used to value the homes that secured the mortgages had deficiencies." *Id*. at 3-4.

- "Senior Management turned a blind eye to the increasing risks of New Century's loan originations and did not take appropriate steps to manage those risks. New Century's former Chief Credit Officer noted in 2004 that the Company had "no standard for loan quality. Instead of focusing on whether borrowers could meet their obligations under the terms of the mortgages, a number of members of the Board of Directors and Senior Management told the Examiner that their predominant standard for loan quality was whether the loans New Century originated could be initially sold or securitized in the secondary market." *Id*. at 4.

- "Senior Management was aware of an alarming and steady increase in early payment defaults ('EPD') on loans originated by New Century, beginning no later than mid-2004. The surge in real estate prices slowed and then began to decrease, and interest rates started to rise. The changing market conditions exacerbated the risks embedded in New Century's products, yet Senior Management continued to feed eagerly the wave of investor demands without anticipating the inevitable requirement to repurchase an increasing number of bad loans. Unfortunately, this wave turned into a tsunami of impaired and defaulted mortgages. New Century was not able to survive and investor suffered mammoth losses." *Id*.

231. Brad Morrice, New Century's CEO beginning in 2006, acknowledged that "bad appraisals were a frustrating source of concern and the main cause of loan 'kickouts,'" *i.e.*, a rejection of certain loans by investors, and that "improper appraisals were the biggest contributors to losses when loans went bad." *Id*. at 61-62.

232. From 2003 to 2006, New Century peddled riskier and riskier products, yet failed to employ underwriting safeguards that might have mitigated the inherent risk associated with such products. For instance, from March 2003 to June 2005, the percentage of interest-only loans New Century originated leapt from 0% to 38.49%. And from 2004 to 2005, the percentage of interest-only adjustable-rate loans rose from 19.3% to 29.6% of the total volume of New

Century's originations and purchases. New Century qualified borrowers based on their ability to pay the initial interest rate rather than the interest plus principal amortization, which was added after the first several years. *Id*. at 57, 125-26.

233. Likewise, from 2004 through 2006, New Century increasingly sold "stated income" loans—with such loans representing at least 42% of New Century's total loan volume. "Stated income" loans involve no documentation regarding a borrower's income; instead, the loan is made based on the borrower's statement as to the amount of his or her income. Stated income loans are often referred to in the industry as "liars' loans," because of the ease with which unscrupulous borrowers or mortgage brokers can overstate income. *Id.* at 58. New Century actively discouraged its employees from even seeking to verify whether a prospective borrower's stated income was reasonable. *Id*. at 127 n.314.

234. The Examiner identified several "red flags" that indicated the poor quality of New Century's loans and that New Century was not adhering to its underwriting guidelines. Specifically, the Examiner noted that "defective appraisals, incorrect credit reports and missing documentation" had led to a high number of kick-outs by investors, all of which "suggested that New Century's loan origination processes were not consistently producing loans that met New Century's underwriting standards and investor guidelines." *Id*. at 109.

235. The Examiner found:

> New Century's Senior Management recognized that the Company had serious loan quality issues beginning as early as 2004. For example, in April 2004, New Century's Chief Credit Officer reported that 'the QA [quality assurance] results [pertaining to the loan origination processes] are still at unacceptable levels' and that 'Investor Rejects [kickouts] are at an incline as well.' Two months later, in June 2004, the head of Secondary Marketing remarked in an e-mail that 'we have so many issues pertaining to quality and process!'"

Id. at 110.

236. In 2005, New Century began internal audits of its loan origination and production processes. An audit of the Sacramento wholesale fulfillment center revealed several “high risk” problems, including that 45% of the loans reviewed had improper RESPA disclosures, 42% did not have approval stipulations fully satisfied, 39% had noted exceptions regarding the calculation or verification of income, and 23% had appraisal exceptions or problems. *See id*. at 152.

237. Further adding to the problem was that exceptions were frequently granted to underwriting guidelines, but “New Century had no formal exceptions policy.” *Id*. at 174.

238. With no policy in place, granting exceptions was arbitrary. Despite upper management’s awareness of the tremendous problems regarding loan quality, the Examiner concluded that “New Century continued to focus on generating greater quantities of ever riskier loans, devoting little effort to such basic issues as making sure that the Company’s loan origination and underwriting policies and procedures were followed to avoid kickouts of loans offered for sale.” *Id*. at 111.

239. The Examiner reported:

> New Century’s loan originations grew at an enormous rate from 2000 through 2006, becoming the second largest subprime lender by the end of 2004 and remaining one of the largest in 2005. The Production Department was highly motivated and effective in originating such loans and apparently resisted changes that might have limited loan production volume. While both the Quality Assurance and Internal Audit Departments identified loan quality problems, and kick-out and EPD rates confirmed many of these problems, the Production Department devoted its resources to generating high volumes of loans, with relatively little attention to loan quality.

Id. at 113.

240. New Century consistently prioritized the origination of new loans over virtually all other concerns, including loan quality. Despite after-the-fact assertions by some company spokespeople that such disregard was anomalous, New Century leaders articulated priorities demonstrating that the disregard was systematic. For example, Patrick Flanagan, who until 2006

was New Century's Head of Loan Production and Secondary Marketing, "emphasized maintaining New Century's loan production even when field audits revealed loan quality problems." *Id*. at 89. Even after Flanagan left the company, New Century's prioritization of volume, rather than quality, continued.

241. The Examiner noted that New Century's Quality Assurance Department would run audit reports after loans were funded to determine if the loan file evidenced compliance with New Century's underwriting guidelines. "The Quality Assurance audit results tended to identify the same sorts of problems as identified in the kickout reports, such as faulty appraisals, undocumented exceptions to underwriting guidelines and missing documentation from loan files." Despite this, "since such post-funding audits did not directly affect profitability, some in Management discounted their importance." *Id*. at 137.

242. The Examiner's Report contained pages of findings that management ignored the loan quality issue and resisted efforts to implement strategies that would improve the quality of loans. For instance, the Examiner reported that management had determined a way to identify underwriters whose actions led to a high number of defective loans in October 2005, but failed to implement the effort until much later. *See id*. at 169 n.337.

243. The Examiner's Report found that loan quality trends "worsened dramatically" at New Century in 2006 and early 2007. Although New Century belatedly tried to improve loan quality late in 2006, it was "too little too late" and even as late as December 2006, "the same sorts of problems, including defective appraisals and missing documentation continued to be the main reasons for investors kicking out increasing quantities of New Century loans." *Id*. at 157-58.

244. The Examiner concluded, "New Century knew from multiple data sources that its

loan quality was problematic, starting no later than 2004. Yet . . . the Board of Directors and Senior Management before 2006 took few steps to address the troubling loan quality trends." *Id.* at 175.

245. On April 7, 2010, Patricia Lindsay, former Vice President of Corporate Risk at New Century, who worked for the company from 1997 through December 2007, corroborated the Examiner's findings in her testimony before the FCIC. She testified that at New Century, risk managers were often viewed as a roadblock rather than a resource and that:

> Account executives, who were New Century employees who brought loans in from brokers, were primarily compensated on commission of closed loans that they brought in. . . . Many of the sales managers and account executives lacked any real estate or mortgage experience. They were missing the depth of experience necessary to make an informed lending decision. These same sales managers had the ability to make exceptions to guidelines on loans, which would result in loans closing with these exceptions, at times over the objections of seasoned appraisers, underwriters or risk personnel. Some of the best sales managers had underwriting backgrounds and were more closely aligned with risk management and better at understanding potential problems, but this was the exception and not the rule.

Hearing on Subprime Lending and Securitization and Gov't Sponsored Enterprises Before the Fin. Crisis. Inquiry Comm'n (Apr. 7, 2010) (testimony of Patricia Lindsay, former Vice President of Corporate Risk, New Century).

246. She also testified to systematic problems in the appraisal process:

> In my experience at New Century, fee appraisers hired to go to the properties were often times pressured into coming in "at value," fearing if they didn't, they would lose future business and their livelihoods. They would charge the same fees as usual, but would find properties that would help support the needed value rather than finding the best comparables to come up with the most accurate value.

Id.

247. Ms. Lindsay noted that at the end, New Century's approach to lending lacked "common sense"—that the business became "volume driven and automated" with a broker being able to get a loan pre-approved in "12 seconds or less." *Id*.

248. The FCIC found that New Century "ignored early warnings that its own loan quality was deteriorating and stripped power from two risk-control departments that had noted the evidence." FCIC Report at 157. The FCIC reported that New Century's Quality Assurance staff "had found severe underwriting errors," while New Century's Internal Audit department "identified numerous deficiencies in loan files," with seven out of nine reviews of the company's loan production department resulting in "'unsatisfactory'" ratings. *Id.* Instead of making efforts designed to bring the company into compliance with its underwriting guidelines, New Century's management directed that the negative results be removed from the company's loan performance tracking system, that the Quality Assurance department be dissolved, and that the Internal Audit department's budget be cut. *Id.*

249. In December 2009, the SEC filed a complaint charging three former New Century executives with securities fraud. *See SEC v. Morrice, et al.*, No. 09-cv-01426 (C.D. Cal. Dec. 7, 2009). The SEC's complaint alleges that the New Century executives misled investors as to the deterioration of New Century's loan portfolio, including dramatic increases in early default rates and loan repurchases/repurchase requests. On July 30, 2010, the SEC announced it had accepted offers to settle the case, subject to court approval, with defendants agreeing to (1) pay over $1.5 million in disgorgement and civil penalties; (2) be permanently enjoined from further securities law violations; and (3) a five-year ban on serving as an officer or director of a public company.

250. The Attorney General for the Commonwealth of Massachusetts also investigated New Century's faulty origination practices with the following findings:

- New Century unlawfully qualified borrowers for adjustable rate mortgages by using "teaser" rates instead of using the "fully indexed rates" as required by law. Assurance of Discontinuance at 13, *In re: Morgan Stanley & Co. Incorporated*, No. 10-2538 (Mass. Super. Ct. June 24, 2010), *available at* http://www.mass.gov/ago/docs/press/2010/2010-06-24-ms-settlement-attachment3.pdf.

- New Century engaged in “sloppy underwriting for many loans and stretching of underwriting guidelines to encompass or approve loans not written in accordance with the guidelines.” *Id*. at 9.

- New Century successfully pressured Morgan Stanley into buying loans which both parties knew did not comply with the underwriting guidelines. *Id*. at 10.

- “31% of the New Century loans on properties checked via BPOs . . . and securitized by Morgan Stanley in 2006 and 2007 had []LTV ratios . . . that were greater than 100%.” *Id*. at 13.

- “As early as October 2005, Morgan Stanley’s diligence team determined . . . that the stated income on a number of New Century loans was unreasonable. In early 2006, a Morgan Stanley employee commented that stated income credit was not adequately evaluated by New Century. . . . On average, the stated income of these borrowers was approximately 42% higher than the income of fully documented borrowers.” *Id*. at 13-14.

251. Private litigation has also illustrated the fact that New Century failed to comply with its stated underwriting guidelines. In *Cambridge Place Investment Management Inc. v. Morgan Stanley & Co., Inc.*, No. 10-2741 (Mass. Super. Ct. July 9, 2010), confidential witnesses stated that: the company abandoned underwriting guidelines to approve more loans; employees were told to do whatever they had to in order to increase volume; and loans that were not initially approved by underwriters were often later approved by superiors.

13. Option One

252. Option One Mortgage Corp. (“Option One”) was a national mortgage lender formerly owned by H&R Block, Inc., until its assets were sold to American Home Mortgage Servicing, Inc. in April 2008. Option One originated or contributed a material portion of the loans in the mortgage pools underlying the trusts and also sponsored some of the trusts.

253. In November 2008, the OCC issued a report identifying the “Worst Ten” mortgage originators in the “Worst Ten” metropolitan areas. The worst originators were defined as those with the largest number of non-prime mortgage foreclosures for 2005-2007 originations.

Option One was ranked as the sixth-worst mortgage originator by number of foreclosures in the worst-affected metropolitan areas.

254. Reflecting the terrible quality of its loans, Option One has since been named as a defendant in a wave of lawsuits alleging that it engaged in a pattern of fraudulent and otherwise improper lending practices. Cambridge Place, a RMBS investor, sued Morgan Stanley and other Wall Street banks alleging violations of the Massachusetts Securities Act arising from the Wall Street banks' offers and sales of RMBS. Cambridge Place's complaint relied on several confidential witnesses. These former employees with first-hand knowledge confirmed that Option One violated its stated standards for underwriting and appraisals. *See* Am. Complaint, *Cambridge Place Inv. Mgmt., Inc. v. Morgan Stanley & Co.*, No. 10-2741 (Mass. Super. Oct. 14, 2011).

255. For example, a former underwriter at Option One in Atlanta, Georgia from 2005 to 2006, referred to as CW 52, said that if an underwriter denied a loan and an account executive complained, the loan was escalated to the branch manager, who then got in touch with the underwriter. With account executives, "the biggest screamer and shaker of trees gets the most fruit." For a "top-producing" account executive, any red flags that may have been present in the loan file being considered would be "overlooked" and the loan file would invariably be pushed through successfully. CW 52 estimated that at least 50% of the total loan volume in Option One's Atlanta branch was approved in this manner. CW 52 also stated that a loan applicant could tell "a straight up lie" about his or her income, but the false information would be overlooked and the loan would be approved, despite CW 52's initial rejection of the application. *Id*. ¶ 242.

256. Similarly, CW 53, an underwriter at Option One's Marietta, Georgia office in 2005, reported that Option One approved stated income loans "knowing good and well that those

people did not make that much money in the position they were in." Likewise, CW 54, an underwriter for Option One in Hawaii from November 2004 to January 2006, stated that "the overwhelming majority of stated income loans were crafted," meaning that the borrowers were not making "anywhere near" what they claimed. However, CW 54 stated that he felt pressured to push loans through because every loan generated income and because, "[i]f you applied any level of rational thought, you were frowned upon." *Id*. ¶ 243.

257. Former employees also revealed that falsified mortgage appraisals were another ubiquitous facet of Option One's questionable origination practices. With respect to artificially inflated appraisals, CW 52 stated that "[o]f course [loan appraisers] inflated values" and that if an underwriter questioned the appraised value, the account executive and branch manager would override the underwriter's objection, as with any other red flag in a loan file. Similarly, CW 55 stated that the appraisals "were all bad." He considered the appraisals borderline fraudulent, not merely incompetent, but was unable to prevent loans based on the flawed appraisals. He explained, "Our job is supposed to be stopping bad loans, but no one stopped them." When CW 55 objected to loans because of flawed appraisals, the loan officer would complain to the branch manager, who would complain to the Appraisals Department at headquarters in Irvine, California, and on up the chain until someone high enough in the Underwriting and Sales Department would ultimately approve the loan. *Id*. ¶ 244.

258. Option One was motivated to violate its underwriting and appraisal standards in order to increase the volume of loans it could sell to Wall Street banks to be securitized. CW 56, an Assistant Vice President of Option One from 2005 to 2007, worked in the Correspondent Lending department, which purchased loans from small mortgage companies. CW 56 stated that Option One purchased loans that raised concerns under the stated guidelines and that when he

raised such concerns he was essentially told, "Shut up. Wall Street will buy it: don't worry about it." *Id*. ¶ 245.

259. Similarly, CW 57, who was an underwriter at Option One in Pleasanton, California from October 2005 to October 2007, stated that "[i]f [a borrower] had a FICO and a pulse, they could get a loan" from Option One. CW 57 also stated the following:

> I caught blatant fraud, and the [account executive] would still fight for it. [The account executives and managers] would fight me because they didn't care. They knew they were going to sell it on the secondary market, and they didn't care because it wasn't their money. They were going to get paid regardless.... At Option One they didn't have a portfolio; they sold everything, so they didn't care.... [Option One] didn't have to worry about it, because once they're done with these crappy loans, they'd sell them off. They were the investors' problem.

Id. ¶ 246.

260. The *Cambridge Place* suit survived a motion to dismiss, with the court holding that the allegations paint a "particularized and compelling portrait of a dramatic loosening of underwriting standards on the part of the originators." *Cambridge Place Inv. Mgmt., Inc. v. Morgan Stanley & Co.*, 10-2741, 2012 WL 5351233, *13 (Mass. Super. Ct. Sept. 28, 2012).

261. Option One has also been the subject of state and federal investigations. On June 3, 2008, the Massachusetts Attorney General filed an action against Option One, and its past and present parent companies, for their unfair and deceptive origination and servicing of mortgage loans. Complaint, *Commonwealth v. H&R Block, Inc.*, No. 08-2474 (Mass. Super. Ct. June 3, 2008).

262. According to the Massachusetts Attorney General, since 2004, Option One had "increasingly disregarded underwriting standards ... and originated thousands of loans that [Option One] 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 [Option One's] residential subprime loans to the secondary market." *Id*. ¶ 4.

263. The Massachusetts Attorney General alleged that Option One's agents and brokers "frequently overstated an applicant's income and/or ability to pay, and inflated the appraised value of the applicant's home." *Id*. ¶ 8. Option One also "avoided implementing reasonable measures that would have prevented or limited these fraudulent practices." *Id*. Option One's "origination policies employed from 2004 through 2007 have resulted in an explosion of foreclosures." *Id*. ¶ 1.

264. On November 24, 2008, the Superior Court of Massachusetts granted a preliminary injunction in the case, which prevented Option One from foreclosing on thousands of loans issued to Massachusetts residents. *Commonwealth v. H&R Block, Inc.*, 2008 WL 5970550 (Mass. Super. Ct. Nov. 24, 2008).

265. On October 29, 2009, the Appeals Court of Massachusetts affirmed the preliminary injunction. *Commonwealth v. Option One Mortgage Co.*, 2009 WL 3460373 (Mass. App. Ct. Oct. 29, 2009).

266. On August 9, 2011, the Massachusetts Attorney General announced that H&R Block, Inc., Option One's parent company, had agreed to settle the suit for approximately $125 million. Press Release, *H&R Block Mortgage Company Will Provide $125 Million in Loan Modifications and Restitutions*, Massachusetts Attorney General (Aug. 9, 2011), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2011/option-one-settlement.html.

14. Paul Financial

267. Paul Financial, LLC ("Paul Financial") originated or contributed a material portion of the loans in the mortgage pools underlying the trusts.

268. Paul Financial has been the subject of numerous investigations and lawsuits

alleging that Paul Financial systematically abandoned its underwriting guidelines in the pursuit of profits. These investigations and lawsuits uncovered ample evidence that mortgage loans originated by Paul Financial breached the associated representations and warranties. Not only do these investigations and lawsuits contain accounts from confidential witnesses and former employees, but many complaints contain detailed information based on forensic reviews of individual loans.

269. For example, according to an amended complaint filed in New York state court in *Royal Park Investments NA/SV v. Merrill Lynch, Pierce, Fenner & Smith Inc. et al.*, No. 652607/2012 (N.Y. Sup. Ct. Nov. 7, 2012), a former Paul Financial Underwriting Assistant from 2004 through 2007 stated that "[a] lot of people were lying about their incomes." Because Paul Financial allowed borrowers to simply state their income without investigation, it ended up making loans to many borrows who could not afford the payments. Am. Complaint, *Royal Park Investments NA/SV v. Merrill Lynch, Pierce, Fenner & Smith Inc. et al.*, No. 652607/2012, at ¶ 484 (N.Y. Sup. Ct. Nov. 7, 2013).

270. Moreover, the same employee stated that often when borrowers failed to qualify for loans, Paul Financial switched them to a different loan program for approval. As with other lenders at the time, Paul Financial thus qualified borrowers for loans they could not afford. The amended complaint states that usually the change to a different loan program was to one where it was easier for the borrowers to submit false information on a loan application. *Id.* ¶ 489.

271. According to the amended complaint, Paul Financial did not conduct the appropriate due diligence to assess whether the borrower's incomes were accurate. In addition, Paul Financial simply ignored egregious examples of false information on loan applications. The complaint details how a Paul Financial Post-Closing and Broker Service Representative, who

worked for the company from October 2003 until June 2005, stated that he witnessed times where stated income applicants working with a mortgage broker were declined loans because of insufficient income. Yet after the mortgage broker heard from Paul Financial what the income requirement was, the applications would come back with the higher stated amount that qualified the borrowers for the loan. Paul Financial approved these loans. This employee stated that 70% to 80% of the loans he witnessed were stated income loans and that income inflation was common. *Id*. ¶ 486.

272. The same employee also stated that real estate appraisers working on Paul Financial loans typically appraised the property at the exact purchase price, which was a common lender tactic. The Paul Financial employee stated that Paul Financial often felt that the appraisals were inflated. *Id*. ¶ 488.

273. According to the amended complaint, a different employee, a Paul Financial Broker Service Representative and Account Executive, who worked for Paul Financial from 2005 through 2007, confirmed that Paul Financial routinely accepted inflated reported incomes and allowed mortgage brokers to submit revised incomes for previously denied loans. *Id*. ¶ 487.

274. Finally, the amended complaint alleges that Paul Financial simply lent money to nearly any borrower regardless of repayment ability. The complaint states that the former Paul Financial Broker Service Representative and Account Executive reported that "it was extremely rare to get loans declined" at Paul Financial. *Id*. ¶ 490.

15. RBS/Greenwich Capital

275. The Royal Bank of Scotland Group PLC ("RBS"), through its affiliate RBS Financial Products, Inc. (f/k/a Greenwich Capital Financial Products, Inc.), sponsored a significant number of the trusts.

276. RBS's poor mortgage securitization practices have been the subject of government investigations, reports and significant RMBS investor lawsuits. The FCIC Report noted that Clayton acted as a due diligence provider for RBS's RMBS offerings. According to testimony provided to the FCIC, for the loans Clayton tested for RBS from at least January 1, 2006 through June 30, 2007, Clayton informed RBS that at least 17% of the loans it tested did not comply with the underwriting guidelines, did not have compensating factors otherwise meriting approval, and/or had defective appraisals. Notwithstanding its receipt of such notice, RBS then knowingly and deliberately waived well over half of those defective loans (53%) into their RMBS Offerings. *See* Clayton All Trending Report at 6, *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0923-Clayton-All-Trending-Report.pdf.

277. In *FHFA v. RBS*, the FHFA performed a forensic analysis of sixty-eight RBS-sponsored securitizations and/or RBS-underwritten securitizations. Am. Complaint, *FHFA v. Royal Bank of Scotland Group PLC, et al.*, No. 11-cv-01383 (D. Conn. Feb. 1, 2012). The FHFA found that "at least 3.12 percent of the mortgage loans for each Securitization had an LTV ratio over 100 percent, and for most Securitizations this figure was much larger." *Id*. ¶ 113. The FHFA also found that "the Prospectus Supplement for each Securitization was grossly inaccurate, understating the percentage of non-owner occupied properties by at least six percent, and for many Securitizations by ten percent or more." *Id*. ¶ 107.

278. Additional forensic analyses of RBS securitizations have confirmed RBS's widespread securitization of breaching loans. *See, e.g.*, *Royal Park Investments SA/NV v. Royal Bank of Scotland Group PLC, et al.*, No. 653541/2013 (N.Y. Sup. Ct. Oct. 11, 2013) (forensic review demonstrated pervasive breaches of representations and warranties concerning compliance with underwriting guidelines, owner occupancy, LTV ratios and assignment of title).

16. WMC Mortgage Corp.

279. WMC Mortgage Corp. ("WMC") originated or contributed a material portion of the loans in the mortgage pools underlying the trusts.

280. In 2004, when General Electric ("GE") purchased it from a private equity firm, WMC was the sixth-largest subprime lender in the country. WMC specialized in nonprime loans and jumbo loans of up to $1 million.

281. On January 20, 2012, the Huffington Post reported that the FBI and the Department of Justice were investigating possible fraud at WMC.

282. Another article published that same day on iwatchnews.org elaborated on the investigation. According to the article, "the government is asking whether WMC used falsified paperwork, overstated borrowers' income and other tactics to push through questionable loans" with the probe focused on whether "senior managers condoned improper practices that enabled fraudulent loans to be sold to investors." The article reports the following:

> The FBI's San Francisco office indicated that it has been looking into WMC's business practices for nearly two years, according to one of the people who has knowledge of the investigation. The bureau has examined individual WMC loan files and has begun contacting former employees about how the lender handled the sale of mortgages to investors, this person said.

Michael Hudson, *Feds investigating possible fraud at GE's former subprime unit*, iwatchnews.org, Jan. 20, 2012, *available at* http://www.publicintegrity.org/2012/01/20/7908/feds-investigating-possible-fraud-ge-s-former-subprime-unit.

283. Another iwatchnews.org article was a lengthy report on GE's purchase of WMC and the practices of WMC's sales staff to push through loans at any cost. According to the article, several ex-employees claim that many WMC sales staff "embraced fraud as a tool for pushing through loans that borrowers couldn't afford" and that WMC ignored reports of loans

supported by falsified documents and inflated incomes. The article continued:

> Dave Riedel, a former compliance manager at WMC, says sales reps intent on putting up big numbers used falsified paperwork, bogus income documentation and other tricks to get loans approved and sold off to Wall Street investors.
>
> One WMC official, Riedel claims, went so far as to declare:
> "Fraud pays."
> . . .
>
> [Riedel] supervised a quality-control team of a dozen or more people who watched over WMC's lending in a broad area of Southern California where salespeople were pushing subprime loans as well as "Alt-A" mortgages, another type of risky home loan.
>
> The team, Riedel says, found many examples of fraud committed by in-house staffers or the independent mortgage brokers who helped bring in customers to the lender. These included faking proofs of loan applicants' employment and faking verifications that would-be home buyers had been faithfully paying rent for years rather than, say, living with their parents.
>
> Some employees also fabricated borrowers' incomes by creating bogus W-2 tax forms, he says. Some, he says, did it old-school, cutting and pasting numbers from one photocopy to another. Others, he says, had software on their computers that allowed them to create W-2s from scratch.
> . . .
>
> While Dave Riedel was fighting battles inside WMC's California headquarters, Gail Roman was losing battles on the other side of the country.
>
> Roman worked as a loan auditor at WMC's regional offices in Orangeburg, N.Y. She and other colleagues in quality control, she says, dug up persuasive evidence of inflated borrower incomes and other deceptions on loan applications.
>
> It did little good. Management ignored their reports and approved the loans anyway, she says.
>
> "They didn't want to hear what you found," Roman told iWatch News. "Even if you had enough documentation to show that there was fraud or questionable activity."
>
> If GE made any progress against fraud at WMC, Roman says, she didn't notice it. Fraud was as bad at WMC in 2006 as it was when she started at the lender in 2004, she says.
>
> "I didn't really see much of a change," Roman says.
>
> Victor Argueta, the former risk analyst, says he didn't see much change either.

Meetings would be held. Executives from GE would agree fraud was a problem and something needed to be done. “But the next month it was business as usual,” Argueta says.

. . .

Argueta says one top sales staffer escaped punishment even though it was common knowledge he was using his computer to create fake documents to bolster applicants’ chances of getting approved.

“Bank statements, W-2s, you name it, pretty much anything that goes into a file,” Argueta says. “Anything to make the loan look better than what was the real story.”

In one instance, Argueta says, he sniffed out salespeople who were putting down fake jobs on borrowers’ loan applications — even listing their own cell phone numbers so they could pose as the borrowers’ supervisors and “confirm” that the borrowers were working at the made-up employers.

Management gave him a pat on the back for pointing out the problem, he says, but did nothing about the salespeople he accused of using devious methods to make borrowers appear gainfully employed.

Nightmare loans

Roman and Argueta weren’t alone in their concerns, according to other ex-employees who spoke on the condition they remain anonymous, because they still work in banking and fear being blackballed within the industry.

“It was ugly,” one former fraud investigator at WMC recalls. “I would have nightmares about some of the things I’d find in a file. I’d wake up in the middle of the night going, ‘Oh my God, how did this happen?’ ”

A former manager who worked for WMC in California claims that company officials transferred and essentially demoted her after she complained about fraud, including the handiwork of a sales rep who used an X-Acto knife to create bogus documents, cutting numbers from one piece of paper and pasting them onto another, then running the mock-up through a photocopier.

. . .

By early 2006, Dave Riedel had begun to rebuild his career inside WMC.

He helped put together a presentation in May 2006 aimed at giving GE officials a sense of how serious WMC’s fraud problems were. Riedel says an audit of soured loans that investors had asked WMC to repurchase indicated that 78 percent of them had been fraudulent; nearly four out of five of the loan applications backing these mortgages had contained misrepresentations about borrowers’ incomes or employment.

Michael Hudson, *Fraud and folly: The untold story of General Electric's subprime debacle*, iwatchnews.org, Jan. 6, 2012, *available at* http://www.publicintegrity.org/2012/01/06/7802/fraud-and-folly-untold-story-general-electric-s-subprime-debacle.

284. On the radio program This American Life, broadcast May 9, 2008, reporter Alex Blumberg interviewed a WMC sales manager who made over a million dollars a year by making loans to "people [who] didn't have a pot to piss in." Blumberg reported that the manager "didn't worry about whether the loans were good. That's someone else's problem." *This American Life: The Giant Pool of Money*, Chicago Public Radio (May 9, 2008), *available at* http://www.thisamericanlife.org/radio-archives/episode/355/transcript.

285. In June 2008, the Washington State Department of Financial Institutions filed a "Statement of Charges and Notice of Intention to Enter an Order to Revoke License, Prohibit From Industry, Impose Fine, Order Restitution and Collect Investigation Fees" against WMC and its owners. The Statement of Charges stemmed from an investigation that found WMC had originated loans with unlicensed or unregistered mortgage brokers, understated amounts of finance charges on multiple loans, understated amounts of payments made to escrow companies, understated annual percentage rates by almost 5%, and committed numerous other violations of Washington State deceptive and unfair practices laws. In July 2009, WMC entered a consent order under which it agreed to pay fines, restitution and the costs of the investigation to settle the matter. *Available a*t http://www.dfi.wa.gov/CS%20Orders/C-07-557-09-CO02.pdf.

286. WMC's lack of underwriting landed it fourth on the OCC's 2009 "Worst Ten of the Worst Ten" list.

C. A High Number of Borrower Delinquencies and Defaults on Mortgages in the Trusts' Loan Pools and Enormous Trust Losses Are Further Evidence of the Originators' Systematic Disregard of Underwriting Standards

287. Apart from the multiple, highly-publicized RMBS lawsuits and the numerous government investigations on both a state and federal level, there are various other indications that the trust's loan pools included large numbers of mortgage loans that materially breached the responsible party's representations and warranties, including the following: 1) the trusts' high default and delinquency rates; and 2) the trusts' enormous cumulative losses. A summary of the trusts' default and delinquency rates and the trusts' cumulative losses is attached as Exhibit C. Defendant should have carefully investigated these issues, notified certificateholders of the issues, and taken action to address these issues.

1. The Trusts Suffered from High Delinquency and Default Rates

288. Residential mortgages are considered delinquent if no payment has been received for over 30 days after payment is due. Residential mortgages where no payment has been received for over 90 days (or three payment cycles) are considered to be in default.

289. By January 2009, Defendant and its responsible officers witnessed a significant rise in reported default and delinquencies in the loan pools backing the trusts with many defaults and delinquencies occurring within months of the loans' origination. As many commentators have noted, such rapid and numerous defaults indicate loans that should not have been made. For example, a November 2008 Federal Reserve Board study attributed the general rise in defaults, in part, to "[d]eteriorating lending standards," and posited that "the surge in early payment defaults suggests that underwriting . . . deteriorated on dimensions that were less readily apparent to investors." Christopher J. Mayer et al., *The Rise in Mortgage Defaults*, at 15-16 Fed. Reserve Bd. Fin. & Econ. Discussion Series, Paper No. 2008-59.

290. By 2009 at the latest, these massive numbers of defaults and delinquencies should have alerted Defendant to carefully investigate whether the loans sold into the trusts complied with the responsible parties' representations and warranties and to take action to address any issues. Loan pools that were properly underwritten and containing loans with the represented characteristics would have experienced substantially fewer payment problems and substantially lower percentages of defaults, foreclosures, and delinquency.

291. These default and delinquency rates were communicated to Defendant monthly through the service reports and trustee remittance reports. By January 2009, 21 out of the 27 trusts were reporting default and delinquency rates of over 10%, with more than a quarter of all the trusts reporting delinquency rates of over 40%. The average default and delinquency rate of the trusts by January 2009 was over 31%. By January 2010, this average was over 38%.

292. Properly underwritten loans would have experienced far fewer payment problems and substantially lower percentages of defaults, foreclosures, and delinquencies even during an economic downturn.

2. The Trusts Suffered Huge Losses

293. Realized losses are the losses incurred regarding any liquidated mortgage loan or any mortgage loan charged off by the servicer. The realized losses equal the portion of the stated principal balance remaining unpaid after applying all net liquidation proceeds to the mortgage loan.

294. By January 2009, the trusts' extraordinary losses should have raised a red flag to Defendant to carefully investigate whether the mortgage loans sold to the trusts complied with the responsible parties' representations and warranties. In particular, large realized losses are indicative of severe deficiencies in the appraisal and valuation process. As an example, SABR

2006-FR3 trust was reporting losses in January 2009 of over $131 million, which equates to over 13% of the trust's original total par value.

295. By January 2009, the total combined cumulative losses for the trusts (with reported figures) exceeded $1 billion, with the trusts reporting an average loss of over $43 million. By January 2011, the total reported cumulative losses for the trusts were over $3.6 billion.

296. The immense losses are strong evidence that the originators systematically disregarded the underwriting standards and that many mortgages in the pool were not written in adherence to the underwriting guidelines in breach of the representations and warranties.

D. The Collapse of the Certificates' Credit Ratings Is Further Evidence of Systematic Disregard of Underwriting Guidelines

297. RMBS are generally divided into slices or tranches, each of which represents a different level of risk. RMBS certificates denote the particular tranches of the security purchased by the investor.

298. The credit rating for an RMBS reflects an assessment of the creditworthiness of that RMBS and indicates the level of risk associated with that RMBS. Standard & Poor's ("S&P") and Moody's Investors Service, Inc. ("Moody's") are the credit rating agencies that assigned credit ratings to the RMBS in this case.

299. The credit rating agencies use letter-grade rating systems as shown in Table 2 (*infra*).

Table 2
Credit Ratings

Moody's	S&P	Definitions	Grade Type
Aaa	AAA	**Prime (Maximum Safety)**	**INVESTMENT GRADE**
Aa1 Aa2 Aa3	AA+ AA AA-	**High Grade, High Quality**	
A1 A2 A3	A+ A A-	**Upper Medium Grade**	
Baa1 Baa2 Baa3	BBB+ BBB BBB-	**Medium Grade**	
Ba2 Ba3	BB BB-	**Non-Investment Grade, or Speculative**	**SPECULATIVE GRADE**
B1 B2 B3	B+ B B-	**Highly Speculative, or Substantial Risk**	
Caa2 Caa3	CCC+	**In Poor Standing**	
Ca	CCC CCC-	**Extremely Speculative**	
C	-	**May be in Default**	
-	D	**Default**	

300. Moody's purportedly awards the coveted "Aaa" rating to structured finance products that are "of the highest quality, with minimal credit risk." Moody's Investors Services, Inc., Moody's Rating Symbols & Definitions at 6 (August 2003), *available at* http://www.rbcpa.com/Moody's_ratings_and_definitions.pdf. Likewise, S&P rates a product "AAA" when the "obligor's capacity to meet its financial commitment on the obligation is extremely strong." Standard & Poor's, Ratings Definitions, *available at* https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1019442&SctArtId=147045&from=CM&nsl_code=LIME.

301. In fact, RMBS could not be sold unless they received one of the highest

"investment grade" ratings on most tranches from one or more credit rating agencies, because the primary market for RMBS is institutional investors, such as the CCUs, that were generally limited at the time to buying only securities with the highest credit ratings. *See, e.g.*, NCUA Credit Risk Management Rule, 12 C.F.R. § 704.6(d)(2) (2010) (prohibiting corporate credit unions from investing in securities rated below AA-).

302. The vast majority of the certificates owned by the CCUs were initially rated triple-A at issuance. A triple-A rated product "should be able to withstand an extreme level of stress and still meet its financial obligations." *Understanding Standard & Poor's Rating Definitions*, June 3, 2009, at 14. By the end of 2008, 12 of 47 certificates—a staggering 25%—had been downgraded to junk status by at least one credit rating agency. By 2009, this figure had increased to over 61%. A complete list of the downgrades for the certificates is set forth in Exhibit D.

303. The high initial credit ratings reflected the risk associated with properly originated and underwritten mortgage loans and were based on the credit risk characteristics the responsible parties represented and warranted to the credit rating agencies. Consequently, the total collapse in the credit ratings of the RMBS certificates the CCUs purchased, typically from triple-A to non-investment speculative grade, put Defendant on notice that it was required to carefully investigate whether the trusts contained defective loans, notify certificateholders of any defaults, and take appropriate action.

VII. ADDITIONAL EVIDENCE SHOWS THAT DEFENDANT KNEW OF DEFAULTS

A. In Its Capacity as an RMBS Servicer for Other Trusts, Defendant Discovered Extensive Responsible Party Breaches of Representations and Warranties

304. Wells Fargo and its affiliated entities also served as servicers and/or master

servicers for numerous other RMBS trusts. In its capacity as servicer and/or master servicer, Defendant learned that many of the loans originated and sponsored by the same parties involved in the trusts at issue in this Complaint were performing poorly. For example, in its capacity as servicer and/or master servicer for those trusts, one of Defendant's duties was to prepare monthly reports for the trustees detailing the poor performance of the loans. Also, as servicer and/or master servicer, Defendant knew that the credit rating agencies had downgraded trusts as a result of the poor quality of the originators' and sponsors' loan pools because it was responsible for communicating with the ratings agencies. As servicer and/or master servicer, Defendant reviewed the loan files of the mortgage loans, discovering systematic, widespread breaches of representations and warranties in the loan pools.

305. As a servicer for various trusts, Defendant was also responsible for modifying loans and enforcing mortgages in foreclosure proceedings. Such tasks would have invariably led to the discovery that title to a substantial number of mortgages was not perfected.

306. Because of its experience as servicer to other RMBS trusts, Defendant knew that these same defective underwriting and securitization practices affected the trusts committed to its care, and had an obligation to investigate the issue carefully.

B. Defendant Received Written Notice of Systematic, Widespread Breaches of Representations and Warranties from Monoline Insurers

307. Monoline insurance is credit enhancement that involves purchasing insurance to cover losses from any defaults. Many RMBS trusts were insured by monoline insurers. The responsible parties made representations and warranties concerning the underwriting standards of the loans in the governing agreements for the insured RMBS, and the governing agreements for the insured RMBS transactions have a repurchase procedure through which the monoline insurers must provide notice of a breach of representation and warranty to the responsible party

and the other parties to the agreement, including the trustee.

308. Monoline insurers have filed many complaints against responsible parties for representations and warranty breaches in connection with other RMBS trusts to which Defendant serves either as master servicer, servicer, or trustee. Prior to filing suit against the responsible parties, the monoline insurers often obtained and carried out forensic loan level reviews of the loans at issue. *See, e.g., CIFG Assurance N. Am., Inc. v. Goldman Sachs & Co., et al.*, No. 652286/2011 (N.Y. Sup. Ct. Aug. 16, 2011); *CIFG Assurance N. Am., Inc. v. GreenPoint Mortg. Funding, Inc.*, No. 653449/2012 (N.Y. Sup. Ct. Mar. 3, 2013); *Ambac Assurance Corp. v. Nomura Credit & Capital, Inc. et al.*, No. 651359/2013 (N.Y. Sup. Ct. May 15, 2013); *CIFG Assurance N. Am., Inc. v. Bank of Am., N.A., et al.*, No. 654028/2012 (N.Y. Sup. Ct. Nov. 20, 2012); *Assured Guaranty Corp. v. EMC Mortg. LLC*, No. 12-cv-01945 (S.D.N.Y. Mar. 15, 2012); *Assured Guaranty Mun. Corp. v. DLJ Mortg. Capital*, No. 652837/2011 (N.Y. Sup Ct. Oct. 17, 2011); *Assured Guaranty Mun. Corp. v. UBS Real Estate Sec. Inc.*, No. 12-cv-01579 (S.D.N.Y. Mar. 05, 2012); *Ambac Assurance Corp. v. EMC Mortg. LLC*, No. 651013/2012 (N.Y. Sup. Ct. Aug. 14, 2012); *Assured Guaranty Mun. Corp. v. GMAC Mortg., LLC, et al.*, No. 12-cv-03776 (S.D.N.Y. May 11, 2012).

309. For example, in *Ambac Assurance Corp. v. EMC Mort. LLC, et al.*, No. 651013/2012 (N.Y. Sup. Ct. Aug. 14, 2012), the plaintiff, a monoline insurer, insured transactions arranged by Bank of America and backed by Bank of America securitizations. The plaintiff alleged that Bank of America knew of the poor quality of the mortgage loans and it provided inaccurate data that made the loans seem less risky, including with respect to LTV, CLTV, and owner occupancy.

310. The plaintiff's loan level analysis showed that hundreds of reviewed loans

contained at least one material defect. Among the loans reviewed were loans backing the GPMF 2006-AR2 trust for which Wells Fargo acts as the trustee. The analysis found that 45 of the 50 GPMF 2006-AR2 loans reviewed breached their associated representations and warranties. Am. Complaint, *Ambac Assurance Corp. v. EMC Mortg. LLC, et al.*, No. 651013/2012 (N.Y. Sup. Ct. Aug. 14, 2012), ¶ 19.

311. Because of the monoline insurers' breach notices and lawsuits, Defendant knew that these same defective underwriting and securitization practices likely affected other trusts containing loans originated and securitized by these same originators and sponsors, and had an obligation to investigate that issue carefully for trusts committed to its care.

C. Global RMBS Repurchase Investigations and Settlements Alerted Defendant to Systematic, Widespread Breaches of Representations and Warranties

312. RMBS certificateholders have initiated numerous mortgage repurchase directions, compelling trustees to demand that responsible parties repurchase the mortgage loans due to breaches of representations and warranties. Defendant was the trustee for many of the RMBS subject to these directions.

313. On December 16, 2011, for example, several institutional mortgage investors in hundreds of RMBS trusts sponsored by J.P. Morgan, or its affiliates, issued written instructions to Defendant along with U.S. Bank, BNYM, HSBC, and Deutsche Bank National Trust Company, as trustees, to open investigations into large numbers of ineligible mortgages in the loan pools backing the trusts and deficient loan servicing practices. The notices covered over $95 billion of RMBS sponsored by J.P. Morgan from 2005 to 2007.

314. The investors sought the repurchase of large quantities of loans originated by many of the same lenders that also originated loans sold to the trusts; and securitized by the same investment banks and financial institutions that sponsored the trusts. J.P. Morgan offered to settle

the claims for $4.5 billion less than two years later. Defendant approved the settlement and an Article 77 proceeding is pending. *In the matter of the application of U.S. Bank National Association, et al.*, No. 652382/2104 (N.Y. Sup. Ct. Aug. 3, 2014).

315. Similarly, on January 31, 2012, a group of major institutional mortgage investors in several dozen Morgan Stanley-sponsored RMBS trusts demanded that U.S. Bank, Deutsche Bank National Trust Company, and Defendant, as trustees, investigate ineligible mortgages in the loan pools securing those trusts and deficient servicing of the loans. The notices covered more than $25 billion of RMBS issued by Morgan Stanley from 2005 to 2007.

316. The investors sought the repurchase of large quantities of loans originated by many of the same lenders that also originated loans sold to the trusts; and securitized by the same investment banks and financial institutions that sponsored the trusts.

317. As trustee, Defendant has received many breach notices from RMBS investors, indicating widespread and systemic violations of representations and warranties by the responsible parties. Defendant knew similar issues likely affected the other RMBS trusts committed to its care, and had an obligation to investigate the issue carefully.

D. Defendant Initiated Repurchase Actions Against Responsible Parties

318. Defendant was also involved in many repurchase claims for other RMBS trusts that involved the same originators, sponsors, sellers, and servicers as the trusts. Based on its involvement in these repurchase actions, which alleged widespread, systematic breaches of representations and warranties, Defendant had an obligation to investigate that issue carefully for all trusts committed to its care and take action as appropriate.

319. In particular, Defendant’s participation in two repurchase actions in 2009 demonstrates its knowledge of widespread breaches of representations and warranties by some of

the same responsible parties as at issue here. In Lehman's bankruptcy action, for example, Defendant filed claims alleging breaches of representations and warranties in approximately 80 RMBS trusts. Lehman only originated some of the mortgage loans in those trusts, but the alleged breaches of representations and warranties concerned all of them. In fact, other solvent originators had made representations and warranties as to those mortgage loans and were accordingly liable. Despite its knowledge that the systemic breaches in the loans extended well beyond those originated by Lehman, Defendant has not pursued representation and warranty claims against many of the other originators.

320. Defendant also filed claims in the bankruptcy action against New Century, a prominent originator for the trusts at issue herein, alleging breaches of representations and warranties with regard to several trusts. These claims were resolved when Defendant entered into a stipulation on November 4, 2009. Yet even as highly publicized reports continued to expose New Century's improper origination practices, revealing breaches in thousands of mortgage loans, Defendant failed to take any action against other responsible parties to enforce any repurchase obligations.

321. In other instances, Defendant has appointed special trustees to handle repurchase actions on its behalf. In *Law Debenture Trust Company of New York v. WMC Mortg. LLC,* No. 12-cv-1538 (D. Conn Oct. 26, 2012), Defendant appointed Law Debenture Trust Company of New York to prosecute repurchase claims on its behalf. The complaint alleges that over 80% of the loans examined breached their associated representations and warranties. According to the complaint, Wells Fargo provided notice of breaching loans to the responsible party on September 16, 2011, May 30, 2012, and June 7, 2012 and concurrently demanded repurchase of the loans. *Id*. ¶ 62.

322. Defendant also acted as master servicer for numerous trusts for which repurchase actions have been filed. For example, in *Deutsche Alt-A Sec. Mortgage Loan Trust, Series 2006-OA1 v. DB Structured Products, Inc.*, 958 F. Supp. 2d 488 (S.D.N.Y. 2013), the trustee (HSBC) brought suit against the responsible party to enforce the repurchase obligation over 323 loans that breached their associated representations and warranties. Since defendant acted as the master servicer for this trust, it too would have been notified of such breaches.

323. Defendant's involvement in repurchase litigation, particularly the forensic reviews conducted in connection with that litigation, shows that Defendant knew that such widespread, systemic breaches of representations and warranties likely affected all of the trusts committed to its care, and had an obligation to investigate that issue carefully and take action to protect the trusts.

E. Defendant Knew of Pervasive and Systemic Breaches as a Result of RMBS Litigation Brought by Investors and Government Agencies Against Defendant

324. Defendant's knowledge of pervasive breaches of representations and warranties by the originators and sponsors at issue herein is also demonstrated by Defendant and its affiliates' involvement in significant RMBS litigation and settlements in its capacity as loan originator, securitization sponsor, and underwriter.

325. In March 2009, RMBS investors filed suit against Defendant, alleging that it misrepresented its underwriting guidelines and loan quality in connection with the sale of over $36 billion in Wells Fargo-label RMBS. In denying in part a motion to dismiss, the court found that plaintiffs had adequately pled that "variance from the stated [underwriting] standards was essentially [Wells Fargo's] norm," and that this conduct "infected the entire underwriting process." *In re Wells Fargo Mortgage-Backed Certificates Litig.*, 712 F. Supp. 2d 958, 972 (N.D.

Cal. 2010). Wells Fargo agreed to settle the investors' claims.

326. On April 28, 2011, The Union Central Life Insurance Company sued one of Defendant's affiliates as sponsor for misrepresenting the quality of mortgage loans underlying Wells Fargo securities. *See The Union Central Life Ins. Co. v. Credit Suisse First Boston Mortg. Sec. Corp.*, No. 11-cv-02890 (S.D.N.Y.). Wells Fargo and the plaintiff reached a confidential settlement in February 2012.

327. In January 2012, institutional investors in RMBS trusts sponsored by Defendant's affiliates issued written instructions to U.S. Bank and HSBC, as trustees, to open investigations into breaches of representations and warranties and servicing breaches in trusts backed by over $19 billion in loans originated or securitized by Defendant and its affiliates.

328. In August 2012, the FDIC, as receiver for the defunct Alabama-based Colonial Bank ("Colonial"), sued Defendant's affiliates and twelve other large banks for misrepresentations in connection with the sale of RMBS to Colonial. The complaint alleged that Defendant's affiliates made material misrepresentations in the offering documents regarding loan-to-value ratios, owner occupancy rates, compliance with appraisal standards, and loan issuance practices. *See FDIC As Receiver For Colonial Bank v. Chase Mortg. Fin. Corp., et al.*, No. 12-cv-6166 (S.D.N.Y. Aug. 10, 2012).

329. Because of this deluge of litigation directed at Defendant and its affiliates as sponsors, servicers, and originators Defendant knew that these same defective underwriting and securitization practices affected the trusts committed to its care, and had an obligation to investigate that issue carefully.

VIII. DEFENDANT FAILED TO ADHERE TO ITS STATUTORY AND CONTRACTUAL DUTIES AFTER MASTER SERVICER AND SERVICER DEFAULTS AND EVENTS OF DEFAULT

A. The Master Servicers and Servicers Defaulted on their Duty to Notify the Trustee of Breaches of the Mortgage Loan Representations and Warranties

330. Under the governing agreements, master servicers and servicers typically are required to notify the trustee, among others, upon discovery of a breach of representations and warranties with respect to a mortgage loan that materially and adversely affects the loan or the interests of the certificateholders in the loans.

331. For example, the MLMI 2005-HE3 PSA states:

> **Upon discovery by any of the Depositor, the Servicer, the Trustee or the Custodian** of a breach of any of such representations and warranties that adversely and materially affects the value of the related Mortgage Loan, Prepayment Charges or the interests of the Certificateholders, **the party discovering such breach shall give prompt written notice to the other parties.**

PSA Section 2.03(c) (emphasis added). The servicer is a party to the MLMI 2005-HE3 PSA and thus required to provide notice of any breaches.

332. In the course of their duties, the master servicer and servicers to the trusts became aware of the overwhelming and widespread problems with the underlying mortgage loans due to the shoddy origination and underwriting practices detailed above.

333. Sometimes the master servicers and/or servicers modified mortgage loans held by the trusts. Because the loan modification process involves analysis of the underlying origination and mortgage loan files and any supplemental information provided by the borrower, the master servicers and/or servicers must have been put on notice of breaches of representations and warranties. The master servicers and/or servicers failed to notify the trustee or take action based on these breaches.

334. In addition, in the course of fulfilling its duties to foreclose on certain mortgage

loans when appropriate, the master servicers and servicers also became aware of breaches of representations and warranties but failed to notify the trustee.

335. These breaches materially affected the mortgage loans and the interests of the certificateholders as the breaches made it far more likely that the loans would underperform.

336. Under the governing agreements, any failure of the master servicers and/or servicers to observe or perform any covenants or agreements under the governing agreements, including the duty to notify the trustee of breaches of representations and warranties, after notice and lapse of time, constitutes an event of default.

337. PSA Section 7.01 states:

> "Event of Default," wherever used herein, means any one of the following events:
> . . .
> (ii) any failure by the Servicer to observe or perform in any material respect any other of the covenants or agreements on the part of the Servicer contained in this Agreement or any representation or warranty shall prove to be untrue, which failure or breach shall continue unremedied for a period of 60 days after the date on which written notice of such failure shall have been given to the Servicer by the Trustee or the Depositor . . . .

B. Defendant Knew of the Master Servicer and Servicer Defaults

338. As described above, Defendant and its responsible officers should have carefully investigated the widespread breaches of representations and warranties reported in the media, governmental investigations, private litigation and the servicing reports and monthly remittance reports and taken appropriate action.

339. Defendant, as a prolific servicer, also knew that the master servicers and servicers were discovering breaches of representations and warranties and failing to notify the applicable parties.

340. Defendant and its affiliates acted as master servicer and servicer to numerous RMBS trusts. In 2010, the Federal Reserve, the OCC, the FDIC, and the OTS conducted on-site

reviews of foreclosure processing at fourteen federally regulated mortgage servicers, including Defendant.

341. In April 2011, the investigating agencies issued a report titled "Interagency Review of Foreclosure Policies and Practices." The report found, among other things, that the servicers failed to evaluate "compliance with applicable laws and regulations, court orders, pooling and servicing agreements, and similar contractual arrangements." Based on the deficiencies identified in the report, the investigating agencies initiated enforcement actions against each of the servicers subject to the report. *Available at* http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf.

342. Ally/GMAC, Aurora Bank, Bank of America, PNC, and U.S. Bank were all subjects of the investigation. These entities and their affiliates and acquired companies (including Countrywide and National City) acted as master servicer and servicer to the overwhelming majority of the trusts.

343. Thus, Defendant knew – based on an investigation that it was subject to – that servicers failed to implement proper quality control, audit and compliance standards and thus failed to adhere to the notification requirements in the governing agreements.

344. Defendant and its responsible officers also received servicing reports and monthly remittance reports that revealed widespread modifications, large losses and write-downs, and poor loan quality. Through these reports, Defendant, based on its role in the RMBS, knew that there were widespread breaches of representations and warranties that the master servicers and servicers had discovered but failed to give the required notification.

345. This failure by the master servicer and servicers to notify the Defendant of defective loans and other associated problems constituted an event of default, yet rather than

adhere to its statutory and contractual obligations upon such a default, Defendant ignored the master servicer and servicer misconduct.

346. Defendant failed to exercise its rights under the governing agreements after becoming aware of such breaches, defaults, and/or Events of Default by failing to do the following: provide notice of such breaches, defaults, and/or Events of Default to the master servicers and/or servicers; protect the interests of the certificateholders in the trusts; enforce repurchase obligations; make prudent decisions concerning remedies after breaches, defaults and/or Events of Default; and enforce the obligations of the master servicers and/or servicers.

347. Defendant failed to exercise the same skill and care as prudent persons would exercise in the same circumstances in enforcing its rights and powers under the governing agreements.

IX. DEFENDANT FAILED TO ENSURE PROPER MORTGAGE LOAN DOCUMENTATION AND THUS FAILED TO FORCE THE RESPONSIBLE PARTIES TO CURE, SUBSTITUTE OR REPURCHASE INADEQUATELY DOCUMENTED LOANS

348. The governing agreements require that Defendant, or its agent, take physical possession of the mortgage files and that the note and mortgage are endorsed and assigned to Defendant. Under the governing agreements, Defendant was required to review each of the loan files and to certify that the documentation for each loan was accurate and complete.

349. Defendant had a duty, under the governing agreements, to review the mortgage files and create an exception report identifying mortgage loans with incomplete mortgage files. Those loans had to be cured, repurchased, or substituted by the responsible parties.

350. Upon information and belief, Defendant accepted incomplete files without requiring the responsible parties to cure document defects or substitute or repurchase loans.

351. Defendant’s failure to take possession of the key mortgage loan documents, its

failure to properly review the mortgage files for missing documents or irregularities, and its failure to demand correction of irregularities caused damage to Plaintiffs.

352. A reasonably prudent trustee who had fulfilled its obligations would have noticed these failures in mortgage loan documentation. Upon information and belief, Defendant breached its statutory and contractual obligations by failing to identify these obvious defects and require correction by the responsible parties.

353. Moreover, by certifying that it had received documentation that, upon information and belief, it had not received, Defendant breached its obligations to the detriment of certificateholders, including Plaintiffs.

354. Defendant failed to act prudently or with due care when it failed to properly review the required documentation, prepared inaccurate certifications, failed to notify the responsible parties about missing required documentation, failed to require action to remedy the inadequate documentation, failed to properly supervise and review custodian conduct, and failed to notify certificateholders of the inadequate documentation and failure to repurchase, substitute, or cure.

355. Upon information and belief, Defendant has failed to exercise due care and to act prudently throughout the life of the trusts. Had Defendant met its contractual and statutory duties to require delivery of mortgage loan files, review the files, give notice, and issue fully accurate and complete certifications, loans with defective or incomplete files would have been cured, repurchased, or substituted. Because those loans were not cured, repurchased, or substituted, many went into default and caused losses to certificateholders.

X. DEFENDANT FAILED TO SATISFY ITS PRE-AND POST-DEFAULT DUTIES

356. Many facts should have caused Defendant to conduct careful investigations into

the trusts and take appropriate action, including the following: 1) the trusts' high default rates and poor performance; 2) breaches of representations and warranties made by the responsible parties; 3) servicer defaults and events of default; 4) incomplete transfer of the mortgage loans; and 5) the failure by sponsors, sellers, originators, issuers, and itself to fulfill the duties and obligations set forth in the governing agreements. Unlike certificateholders, Defendant had the ability under the governing agreements to carefully investigate these issues. Nonetheless, Defendant failed to perform its duties as trustee to provide notice of such failures and to protect the trusts and certificateholders.

357. By 2009, Defendant, based on its access to public information as well as information unavailable to the public, had a statutory and contractual duty to carefully investigate circumstances suggesting that the trusts routinely contained loans that materially breached the responsible parties' representations and warranties, which adversely affected the value of those mortgage loans and the trusts' and certificateholders' interests in those mortgage loans and take appropriate action to address those defaults

358. Defendant also knew of failures on the part of the servicers to observe or perform in material respects their covenants or agreements in the PSAs, including the servicers' and/or master servicers' failure to do the following: (i) give notice to the other parties of responsible party breaches of representations and warranties upon discovery thereof and enforce the responsible parties' repurchase obligations; and (ii) observe or perform the covenants or agreements contained in the governing documents. These breaches by the servicers constituted "Events of Default" as defined by the PSAs. Defendant knew these servicers' breaches were material.

359. In addition, upon information and belief, Defendant failed to take possession of

the original notes and mortgages. Upon information and belief, Defendant failed to fulfill its statutory and contractual obligation to review the mortgage files for irregularities and/or misrepresentations. As a result, Defendant failed to put back loans that did not comply with the applicable representations and warranties.

360. Defendant breached its duties under the TIA and the Streit Act by failing to do the following: (i) carefully and prudently investigate breaches involving the loans in the trusts committed to its care; (ii) notify certificateholders of breaches; and (iii) take any action to enforce the responsible parties' repurchase of the defective mortgage loans.

361. These defaults and/or Events of Default occurred and remained uncured for the requisite period. Thus, under the governing agreements, Defendant was obligated to exercise the rights and powers vested in it by the governing agreements, and to use the same care and skill as prudent persons would exercise or use under the circumstances in the conduct of their own affairs. A prudent person would have taken action to protect the trusts and certificateholders from the known responsible party breaches of representations and warranties by exercising all of its rights under the governing agreements to enforce the responsible parties' repurchase obligations, including conducting a timely, careful and prudent investigation to determine all of the materially breaching mortgage loans and suing the responsible parties for specific performance to compel their repurchase of those loans.

362. Further, Defendant failed to adequately protect the trusts before and after certain trust sponsors and originators filed for bankruptcy or otherwise became insolvent. Defendant failed to adequately and comprehensively pursue relief against relevant parties and failed to provide adequate notice of relevant defaults and "events of default."

363. A prudent person would have taken appropriate steps to ensure all mortgage loan

documentation was completely and accurately transferred to the trusts.

364. A prudent person also would have taken action against the master servicers and servicers upon defaults and events of default, ensured that Defendant was receiving notification of breaches of representations and warranties, and enforced the responsible parties' obligations with respect to breaching mortgage loans.

XI. THE "NO ACTION" CLAUSES DO NOT APPLY

365. The "no action" clauses in the governing agreements do not apply to this lawsuit because the claims are brought against Defendant as trustee, not against a third party. The PSAs expressly permit suits against the trustee, stating that:

> No provision of this Agreement shall be construed to relieve the Trustee from liability for its own negligent action, its own negligent failure to act or its own misconduct, its negligent failure to perform its obligations in compliance with this Agreement, or any liability that would be imposed by reason of its willful misfeasance or bad faith . . . .

PSA Section 8.01.

366. Additionally, under the TIA and New York law, "no action" clauses do not apply to an action against the trustee, as here, for its own wrongdoing. Defendant is not being asked to sue as trustee to enforce rights and obligations under the governing agreements. Rather, this action asserts claims against Defendant for breaching its statutory and contractual obligations.

367. Because this is not an action, suit or proceeding that Defendant is capable of bringing in its own name as trustee under the governing agreements, the "no action" clauses do not apply.

368. Compliance with the "no action" clauses' pre-suit requirements also would have been futile. The no action clauses (if they applied) would require Plaintiffs to demand that Defendant initiate proceedings against itself and to indemnify Defendant for its own liability to the trusts, an absurd result that the parties did not intend. *See Cruden v. Bank of New York,* 957

F. 2d 961, 968 (2d Cir. 1992).

XII. CLAIMS FOR RELIEF

COUNT ONE-VIOLATION OF THE TRUST INDENTURE ACT OF 1939

369. Plaintiffs repeat and reallege each and every allegation set forth in the preceding paragraphs as if fully set forth herein.

370. Congress enacted the TIA to ensure, among other things, that investors in certificates, bonds, and similar instruments have adequate rights against, and receive adequate performance from, the responsible trustees.

371. Each of the PSAs and indentures is an "indenture," and Defendant is an "indenture trustee," within the meaning of the TIA. 15 U.S.C. § 77ccc(7), (10). As noted above, each of the PSAs and indentures is substantially similar and imposes substantially the same duties on Defendant in its capacity as trustee. Moreover, the TIA applies to and is deemed to be incorporated into each of the PSAs and indentures and the related trusts. 15 U.S.C. § 77ddd(a)(1).

372. Defendant violated the TIA in at least four ways. First, TIA Section 315(a) provides that, prior to default (as that term is defined in the indenture), the trustee is liable for any duties specifically set out in the indenture. 15 U.S.C. § 77ooo(a)(1). As set forth above, Defendant failed to comply with a number of duties set out in the indentures, including its duties to carefully review the mortgage files, to notify certificateholders and other parties of deficiencies, to take steps to address those deficiencies, and, most importantly, to enforce the substitution or repurchase of defective loans.

373. Second, TIA Section 315(b) provides that the indenture trustee notify certificateholders of "all defaults known to the trustee, within ninety days after the occurrence

thereof." 15 U.S.C. § 77ooo(b) (citing 15 U.S.C. § 77mmm(c)). As set forth above, Defendant failed to carefully investigate serious known issues with the loans in the trust, or to notify certificateholders of numerous defaults, including the failure of the responsible parties to cure, repurchase, or substitute mortgage loans with defective mortgage files and mortgage loans affected by breaches of representations and warranties.

374. Third, in case of default (as that term is defined in the indenture), the TIA requires that the trustee exercise its rights and powers under the governing agreement as a "prudent man would exercise or use [them] under the circumstances in the conduct of his own affairs." 15 U.S.C. § 77ooo(c). Here, as set forth above, Defendant did nothing after learning of numerous serious issues related to material breaches of representations and warranties and servicer defaults and events of default. A prudent person would have taken action to investigate these issues carefully, pursue repurchase remedies, and cure defective mortgage loans. In addition, a prudent person would have taken action against the responsible parties for the failure to properly execute and deliver mortgage file documents.

375. Finally, the TIA states that "[n]otwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security . . . shall not be impaired or affected without the consent of such holder." 15 U.S.C. § 77ppp(b). Defendant has impaired the ability of the trusts, and consequently the certificateholders, to receive payment in connection with defective mortgage loans for which Defendant failed to take action to correct. In addition, Defendant has impaired the ability of the trusts, and consequently the certificateholders, to receive payment by failing to enforce the repurchase remedy.

376. These breaches materially and adversely affected the interests of the certificateholders because they resulted in the trusts being burdened with large numbers of defective loans that should have been put back to the responsible parties and originators.

377. Defendant is liable to Plaintiffs for damages incurred as a result of its violations of the TIA in an amount to be determined at trial.

COUNT TWO-VIOLATION OF THE STREIT ACT

378. Plaintiffs repeat and reallege each and every allegation set forth in the preceding paragraphs as if fully set forth herein.

379. The Streit Act was enacted to provide for the proper administration of mortgage trusts and requires that the trustee exercise due care in performing its obligations. N.Y. Real Prop. Law § 124.

380. Plaintiffs, as certificateholders and beneficiaries of the trusts, were entitled to the protections afforded under the Streit Act.

381. The certificates are "mortgage investments" subject to the Streit Act. N.Y. Real Prop. Law § 125(1).

382. The PSAs and indentures that established the trusts are "indentures," and Defendant is a "trustee" under the Streit Act. N.Y. Real Prop. Law § 125(3).

383. As described above, Defendant violated the Streit Act by failing to discharge its pre-default duties.

384. Following an event of default, the Streit Act provides that the trustee must exercise the same degree of skill and care in the performance of its duties as a prudent man would under the same circumstances. N.Y. Real Prop. Law § 126(1).

385. In addition, Section 124 of the Streit Act imposes a duty upon the trustee to

discharge its duties under the applicable indenture with due care in order to ensure the orderly administration of the trust and protect the trust beneficiaries' rights. N.Y. Real Prop. Law § 124.

386. As set forth above, Defendant failed to exercise its rights under the PSAs and indentures after becoming aware of numerous defaults, failed to carefully review the mortgage files, failed to notify certificateholders and other parties of deficiencies, failed to take steps to address those deficiencies, and, most importantly, failed to enforce the repurchase, cure, or substitution of defective loans.

387. Defendant is liable to Plaintiffs for damages incurred as a result of its violations of the Streit Act in an amount to be determined at trial.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs pray for relief and judgment as follows:

A. An award of all appropriate damages and/or equitable relief in favor of Plaintiffs against Defendant for breaches of its statutory duties in an amount to be determined at trial, including any applicable pre- or post-judgment interest thereon;

B. Awarding Plaintiffs all reasonable costs and expenses incurred in this action, including attorney's fees, expert fees, and any other properly taxable costs and expenses; and

C. Any other relief that the Court deems just and proper.

XIII. JURY DEMAND

Plaintiffs hereby demand a trial by jury of all issues properly triable.

Dated: December 22, 2014

NATIONAL CREDIT UNION
ADMINISTRATION BOARD,
as Liquidating Agent of U.S. Central Federal Credit Union, Western Corporate Federal Credit Union, Members United Corporate Federal Credit Union, Southwest Corporate Federal Credit Union, and Constitution Corporate Federal Credit Union

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