170. Venue is proper in this Court under CPLR Section 503(a) because one or more of the parties reside in New York County and Plaintiffs designate New York County as the place of trial for this action. Venue is proper in this Court under CPLR Section 503(b) because BNYM, a trustee, is deemed a resident of New York County by virtue of its appointment as trustee of trusts formed under New York law and because BNYM resides in this County. Venue is also proper in this Court pursuant to CPLR Section 503(c) because BNYM is a domestic New York corporation authorized to transact business in the State of New York with its principal office located in New York County.

V. PRESUIT DEMAND ON BNYM IS NOT REQUIRED AND WOULD BE FUTILE

171. The "no action" clauses in the governing agreements do not apply to this lawsuit because the claims at issue are brought against BNYM in its capacity as trustee, not against a third party. The PSAs expressly permit suits against the trustee, stating that no provision of the agreements "shall be construed to relieve the Trustee . . . from liability for its own negligent action, its own negligent failure to act, or its own willful misconduct."

172. Additionally, under the TIA and New York law, "no action" clauses do not apply to this action, which is brought derivatively on behalf of the Trusts, against the Trustee, BNYM, for its own wrongdoing. BNYM is not being asked to initiate a suit in its own name as Trustee to enforce rights and obligations under the governing agreements. Rather, this action asserts claims against BNYM for breaching its contractual, statutory, and common law obligations and for acting with negligence when performing its duties. Because this is not an action, suit or proceeding that BNYM is capable of bringing in its own name as trustee under the governing agreements, the "no action" clause does not apply.

173. Compliance with the "no action" clause's pre-suit requirements also would have been futile. The no action clause (if it applied) would require Plaintiffs to demand that BNYM initiate proceedings against itself and to indemnify BNYM for its own liability to the Trusts, an "absurd" requirement that the parties did not intend. *See Cruden v. Bank of New York*, 957 F.2d 961, 968 (2d Cir. 1992).

174. Plaintiffs have the right to bring this suit derivatively on behalf of the Trusts under New York Business Corporation Law Section 626. This suit should be brought derivatively because, as described herein, the Trusts have suffered injury as a result of BNYM's breach of its contractual, statutory and common law duties to the Trusts.

VI. BACKGROUND - THE TRUSTEE'S ROLE AS GATEKEEPER IN THE SECURITIZATION PROCESS

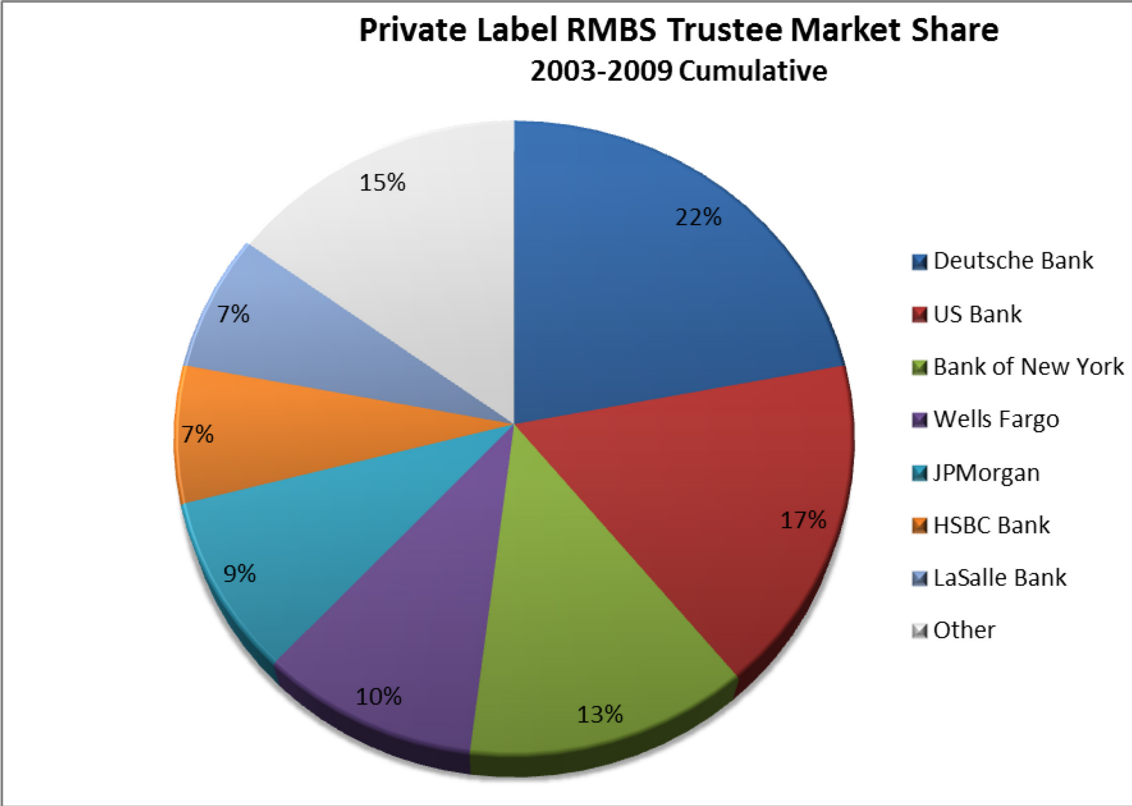
175. Residential mortgage-backed securities provide investors with an interest in the income generated by one or more designated pools of residential mortgages. The actual securities themselves represent an interest in an "issuing trust" that holds the designated mortgage pools. The corpus of the trust – like the Trusts at issue here – consists entirely of the underlying mortgage loans.

176. The TIA requires that a trustee be appointed for all bond issues over $10 million so that the rights of investors are not compromised. In a RMBS transaction, the "issuer" appoints the trustee, who is the only independent party to the PSAs. Accordingly, the trustee serves the critical role of an independent party with access to all relevant information, including the mortgage loan files, that investors reasonably understand is under an affirmative duty to take action to protect the interests of the trusts and their beneficiaries, the certificateholders. As part of the RMBS transaction, the trustee is assigned "all right, title and interest" in the underlying mortgage loans. The PSAs require the trustee, or its agent, to take physical possession of the

mortgage loans, ensure that each mortgage loan was properly conveyed and certify that the documentation for each loan was accurate and complete.

177. The trustee is contractually responsible for the transactions of the "issuing trust." The trustee is responsible for administering the trust for the benefit of investors, including guaranteeing that the transactions are administered in accordance with the related documentation, following compliance and performance-related matters and handling cash and information processing for the investors. A trustee must work closely with the issuer and servicer to protect the welfare of the trust. In contrast to the roles of issuer or servicer, which can be combined, the trustee's sole purpose is to represent the investor and, therefore, must be an independent entity without any conflicts of interest. The PSAs contractually obligate the trustee to oversee and manage the servicer, including granting the trustee the power to replace the servicer for its failure to act in accordance with the servicer's contractual obligations.

178. Although the structure and underlying collateral of the mortgages may vary from trust to trust, they all function in a similar manner: the cash flow from interest and principal payments is "passed through" to the trust and distributed to certificateholders in the order laid out in the securitization agreements, commonly referred to as the cash-flow "waterfall." The duties and responsibilities of the trustee are identical in all RMBS transactions – namely to represent the trusts and their investors as an independent third party. Between 2003 and 2009, private label RMBS offerings totaled more than $3 trillion. However, only a handful of major American financial institutions served as trustees and contractually agreed to perform the vitally important gatekeeping functions to protect certificateholders, including BNYM which held the third largest market share during this period.



179. The process of securitizing mortgages into RMBS involves a number of steps, each critical and necessary to finalize the securitization and sale to investors. First, a "sponsor" creates a loan pool from mortgages it originated, or from mortgages the sponsor has purchased from other financial institutions. The sponsor has the right to force the seller to repurchase or replace loans that do not meet represented quality standards after purchasing a mortgage pool.

180. Second, the sponsor transfers the loans to a "depositor," which segments the cash flows and risks in the loan pool among different levels of investment or "tranches." Generally, cash flows from the loan pool are applied in order of seniority, going first to the most senior tranches. In addition, any losses to the loan pool due to defaults, delinquencies, foreclosure or otherwise, are applied in reverse order of seniority, and are generally applied first to the most junior tranches.

181. Third, the depositor transfers the mortgage pool to the issuing trust so that it can be used as collateral for RMBS that will be issued and sold to investors. The depositor then passes the RMBS to the underwriters for sale to investors in exchange for payment.

182. The "servicer" is appointed by the sponsor and is a contractual party to the PSAs. The servicer is often an affiliate of the sponsor or an affiliate of an originator of a substantial portion of the loans in the trust. The servicer collects payments from the underlying borrowers. After collection, the servicer sends the funds to the trustee who then makes payment to the certificateholders. Mortgage defaults reduce the available principal and interest payments to be paid to the trust and passed through to investors. Mortgage delinquencies similarly reduce the available principal and interest to be paid to the trust and distributed to investors.

183. Accordingly, if an underlying borrower does not timely make the required payments to the servicer, the servicer may have to take action to mitigate or minimize the losses that occur to the trust, including foreclosing on the property and providing property maintenance to maximize the return on the investment to the trust and its beneficial owners – the certificateholders. Foreclosures will result in higher losses to the trust (and therefore to the RMBS investors) if the value of the collateral is lower than anticipated. For these reasons, proper loan origination and underwriting of the mortgages underlying the RMBS, and proper and timely loan servicing and oversight are essential to the quality of the RMBS and the timely receipt of principal and interest payments to the trust.

VII. BNYM'S CONTRACTUAL OBLIGATIONS

184. The Trusts' rights and BNYM's contractual duties, as Trustee for the Trusts at issue in this action are set forth in the relevant securitization agreements, including the Mortgage Loan Purchase and Sale Agreements ("MLPAs") (or similar documents) and the governing agreements.

185. The contractual provisions relevant to this action 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.

A. The Mortgage Loan Purchase And Sale Agreement

186. The MLPA is a contract between either the originator and the sponsor, or the sponsor and the depositor. The MLPA governs the terms of the sale of the mortgage loans acquired for securitization. In its capacity as "seller" under the MLPA, the originator or sponsor makes extensive representations and warranties concerning the characteristics, quality, and risk profile of the mortgage loans.

187. The seller's typical representations and warranties in the MLPAs 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 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 seller's representations and warranties, the mortgage loans are worth less and are much riskier than represented.

188. Under the MLPAs, upon discovery or receipt of notice of any breach of the seller'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 seller is obligated to cure the breach in all material respects. The MLPAs do not specify what constitutes

"discovery" of a breach or what evidence must be presented to the seller in providing notice of a breach.

189. If a breach is not cured within a specified period of time, the seller is obligated to either substitute the defective loan with a loan of adequate credit quality, or repurchase the defective loan at a specified purchase price (the "Repurchase Price") equal to the outstanding principal balance and all accrued but unpaid interest on the loan to be paid to the Trust. For breaches related to a mortgage loan or acquired property already sold from the Trust (for example, as a result of foreclosure), the seller must pay to the Trust the amount of the Repurchase Price that exceeds the net liquidation proceeds received upon the sale of the mortgage loan or acquired property.

190. The repurchase provisions ensure that the Trust need not continue to hold mortgage loans for which the seller breached its representations and warranties. Thus, the repurchase provisions transfer from the Trusts to the sellers the risk of any decline, or further decline, in the value of those mortgage loans.

191. Under the MLPAs, 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 interests of the Certificateholders in the loans. The seller's cure, substitute and repurchase obligations do not require any showing that the seller's breach of representations caused any realized loss in the related mortgage loan in the form of default or foreclosure, or that the demanding party prove reliance on servicing and origination documents.

192. Upon the sale of the mortgage loans to the Trust, the rights under MLPAs, including the sellers' representations and warranties concerning the mortgage loans, were

assigned to BNYM, as Trustee for the benefit of the Trust and all the Certificateholders, in accordance with the PSAs.

B. The Pooling And Servicing Agreements

193. The PSAs are contracts between, among others, the depositor, the servicer, and BNYM, as Trustee, which govern the Trusts that issued certificates. The PSAs for each of the Trusts are substantially similar and memorialize (i) the transfer and conveyance of the mortgage loans from the depositor to the Trust; (ii) the Trusts' issuance of beneficial certificates of interests in the Trusts to raise the funds to pay the depositor for the mortgage loans; and (iii) the terms of those certificates.

1. BNYM's Duties And Obligations Under The PSAs

194. The PSAs set forth BNYM's contractual duties and obligations, which are identical or substantially identical for each Trust governed by a PSA. Specifically, each of the PSAs require BNYM to oversee and enforce the sellers' and the servicers' obligations. In performing these contractual obligations, BNYM is required to act in the best interests of and for the protection of the Trusts and their Certificateholders. Certificateholders, unlike the trustee, have no direct contact with the sellers and servicers and have no ability to influence or examine the servicers' decisions. Moreover, under the PSAs, Certificateholders do not have the right to directly enforce the sellers' representations and warranties or the servicers' duties, absent satisfaction of the collective action provisions. Thus, Certificateholders must rely on BNYM to protect their interests.

195. The PSAs require the depositor to deliver to and deposit with, or cause to be delivered to and deposited with, BNYM, the mortgage files, which must at all times be identified in the records of BNYM as being held by or on behalf of the Trust. Furthermore, the PSAs require BNYM to acknowledge receipt of the mortgage files on behalf of the Trust and to

acknowledge that all mortgage pool assets, mortgage files and related documents and property held by it at any time are held by it as trustee of the Trust.

196. Once the mortgage files are in BNYM's possession, the PSAs require BNYM 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 of the mortgage loans. BNYM is required to review each mortgage file within a certain time period after the "Closing Date" and deliver to the depositor a certification that all documents required have been executed and received.

197. If BNYM identifies any defect in a mortgage loan file for an underlying mortgage loan contained in a Trust, BNYM must promptly notify either the servicer or depositor, and that party shall promptly notify the applicable seller of the defect and take appropriate steps on behalf of the Trust to enforce such seller's obligation to correct or cure the defect or repurchase or substitute such mortgage loan.

a) Duty To Provide Notice Of Breaches And To Enforce Putback Rights

198. Under the PSAs, BNYM is entrusted to ensure that 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 sellers in the MLPAs. The Trusts were assigned all of the rights under the MLPAs pertaining to the mortgage loans, including the right to put back loans that breached the sellers' representations and warranties.

199. To protect the Trusts and all Certificateholders, the PSAs require BNYM to give prompt written notice to all parties to the PSA upon its discovery of a breach of a representation or warranty made by the seller in respect of 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 with respect to the breach.

b) BNYM's Duties Regarding The Servicers

200. Under the PSAs, BNYM, as Trustee, has certain duties and obligations with respect to monitoring the servicers, whose authority and responsibilities are delegated by BNYM. In particular, the PSAs set forth BNYM'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 period. The PSAs identify several types of failures by the servicer that may give rise to an Event of Default. Such failures include, breach of servicer representations and warranties and failure to observe or perform in any material respect any other covenants or agreements, which continues unremedied for no more than thirty to sixty days after written notice of such failure shall have been given to the servicer by the trustee requiring the same to be remedied, or knowledge of such failure by a "Servicing Officer" of the servicer, whichever is earlier.

201. The remedies for uncured servicer Events of Default include termination of the servicer and reimbursement for trust assets lost as a result of the servicers' violations. As detailed herein, BNYM did not perform its duties to monitor the servicers and did not initiate any action against the servicers for the benefit of the Trusts and Certificateholders.

c) Duties Upon Knowledge Of An Event Of Default

202. The PSAs impose additional obligations upon BNYM once a responsible officer of BNYM has knowledge of the occurrence of an Event of Default. *First*, BNYM must give written notice to the relevant servicer of the occurrence of such an event within the specified time period after BNYM obtains knowledge of the occurrence. *Second*, within sixty to ninety days after the occurrence of any Event of Default, BNYM is required to provide written notice to

all Certificateholders of the Event of Default, unless the Event of Default has been cured or waived. *Third*, and most importantly, the PSAs require BNYM to exercise the rights and powers vested in it by the PSA 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.

203. BNYM's failure to give notice to the servicers of an Event of Default does not prevent the triggering of an Event of Default should BNYM's failure result from its own negligence or willful misconduct.

2. The Servicers' Duties And Obligations Under The PSAs

204. The PSAs also establish the servicers' duties and obligations to the Trusts and all Certificateholders. In essence, the servicers' contractual role is to manage the mortgage loans for the benefit of the Trust and its Certificateholders.

a) Duty To Provide Notice Of Breaches And To Enforce Putback Rights

205. The PSAs require the servicers to notify all parties to the PSAs if the servicers discover a breach of any of the seller's representations and warranties that adversely and materially affects the value of the mortgage loan or the interests of the Trusts. The PSAs generally require the servicers, on behalf of the Trusts, to enforce the sellers' obligation to repurchase, substitute, or cure such defective mortgage loans or mortgage loan files.

206. The servicers are greatly disincentivized to enforce these contractual duties related to the sellers' repurchase obligations. The servicer is selected by the sponsor, and therefore risks losing future business and becoming adverse to the seller if it vigilantly enforces the seller's repurchase obligations. Additionally, the servicers often are affiliates of the sellers because in connection with the sale of a loan pool, the seller typically retains the loan servicing rights for its own servicing division. In addition, due to the fact that the servicers' affiliates, in

their capacity as sellers, likewise sold loans in breach of specific representations and warranties to other RMBS Trusts and face similar repurchase liability, the servicers were disincentivized from enforcing these contractual duties.

207. Consequently, it is crucial that the trustee monitor the servicer to ensure that the servicer is enforcing the Trusts' repurchase rights against the sellers so that the Trusts hold mortgage loans of the same credit quality and characteristics as bargained for. Moreover, where the servicers fail to enforce the Trusts' repurchase rights, the trustee must step in and exercise the Trusts' rights.

b) Duty To Perform Prudent And Customary Servicing Practices

208. The PSAs require the servicers to service and administer the mortgage loans for and on behalf of the Trusts and the Certificateholders (i) in the same manner in which they service and administer similar mortgage loans for their own portfolio or for other third parties, giving due consideration to customary and usual standards of practice of prudent institutional mortgage lenders servicing similar loans, (ii) with a view to maximizing the recoveries with respect to such mortgage loans on a net present value basis, and (iii) without regard to, among other things, the right of the servicers to receive compensation or other fees for its services under the PSA, the obligation of the servicers to make servicing advances under the PSA, and the servicers' ownership, servicing or management for others of any other mortgage loans.

209. In truth, the servicers' financial interests in managing the Trusts' loans often diverge from those of the Trusts. Servicers typically pay upfront for mortgage servicing rights. To make a profit, servicers must recoup their outlay based on their net servicing income (*i.e.*, gross servicing income minus servicing costs). The amount of servicers' compensation in the form of servicing fees, float, and retained interests varies based on factors beyond the servicers'

control, particularly mortgage prepayment speeds, which are largely a function of interest rates. Accordingly, a servicer's ability to maximize its net servicing income depends in large part on its ability to levy ancillary fees and to control servicing costs. For this reason, servicers are incentivized to aggressively pursue ancillary fees and to pursue loss mitigation strategies that minimize costs, even if they are inconsistent with – or contrary to – the interests of the Trusts and the Certificateholders.

210. Accordingly, it is essential that trustees monitor servicers' servicing activities to ensure that servicers: (i) maintain accurate and adequate loan and collateral files so as not to prejudice the interests of the Trusts and the Certificateholders in the mortgages by fostering uncertainty as to the timely recovery of collateral; and (ii) avoid incur unnecessary servicing fees to maintain mortgaged property.

c) <u>Duty To Perform Prudent Foreclosure Practices</u>

211. The PSAs require the servicers to use their best efforts, consistent with accepted servicing practices, to foreclose upon or otherwise comparably convert the ownership of properties securing the mortgage loans as they come into and continue in default and as to which no satisfactory arrangements can be made for collection of delinquent payments. Moreover, the PSAs contemplate that foreclosures and liquidations of defaulted mortgages will proceed forthwith and in accordance with applicable law, provided the documentation is in order, as a matter of fairness to all parties.

212. In truth, the servicers' financial interests in managing loans often diverge from those of the Trusts. For example, to minimize the costs of foreclosures, servicers from 2007 through 2010 pervasively cut corners in the discharge of their servicing duties at the expense of the accuracy, reliability and currency of loan documents and information.

213. Thus, it is essential that trustees monitor servicers' activities subsequent to borrower defaults to ensure the servicers function in a way that maximizes value for the Trusts and the Certificateholders.

d) <u>Duty To Perform Prudent Servicing Advances</u>

214. The PSAs provide that the servicers may recover servicing advances. Servicers are required to advance monthly principal and interest ("P&I") and taxes and insurance payments on delinquent loans. Servicers also advance legal fees, maintenance, and preservation costs on properties that have already been foreclosed and become wholly owned by the Trust (or "REO"), rather than sold to a third party. Servicers are able to recover these advances from the net proceeds of the property when sold.

215. Under the PSAs, the servicer's advancing obligations are subject to a deemed non-recoverability standard where the servicer has the right to curtail additional advances based on a reasonable analysis that the servicer could not otherwise recover its advances based on projected, probable net liquidation proceeds. Thus, if a servicer believes that the P&I advances will exceed the net proceeds of a foreclosure on the mortgaged property, the servicer generally has the right to cease making the P&I advances and to look to the rest of the Trust's loan pool for recovery of any excess paid. This means that servicers' P&I advances are functionally the most senior claim on the Trusts and the servicers get paid <u>first</u> before any certificateholder. As explained by Ocwen Financial Corporation ("Ocwen"), a major subprime servicer: "Most of our advances have the highest reimbursement priority (*i.e.*, they are on 'top of the waterfall') so that we are entitled to repayment [from loan proceeds] before any interest or principal is paid on the

bonds."[3] In the majority of cases, the servicer may recover advances in excess of loan proceeds from pool-level proceeds. Additionally, under the PSAs, the servicers are only entitled to recoup customary, reasonable and necessary out-of-pocket costs and expenses incurred in the performance by the servicer of its servicing obligations.

216. In practice, servicers are incentivized to abuse their advancing obligations by incurring unnecessary or inflated expenses related to delinquent loans because those advances are the senior-most claims on the Trusts and will almost always be recoverable.

217. Thus, it is critical that trustees monitor the servicers and, in particular, servicing advances to ensure servicers do not manipulate the recoverable and "reasonable and necessary" designations to their own advantage and to the Trusts' detriment.

C. The Indentures And Sale Servicing Agreements

218. Indentures and Sale Servicing Agreements govern the minority of Trusts that issued mortgage-backed notes. The Indentures are contracts between, among others, the Trust, as issuer, and BNYM, as Trustee. In this agreement, the issuer (*i.e.*, the trust) pledges the mortgage loan assets of the trust to BNYM, the Indenture Trustee. BNYM accepts the pledge of the mortgage loans and holds the assets of the Trust in trust for the Noteholders. The Trust, in turn, issues the notes to investors.

219. The Indentures set forth duties on the part of the Trust as issuer. Such duties, which must be punctually performed and observed, include taking all action necessary or advisable to cause the Trust or the Indenture Trustee to: (i) enforce any of the rights to the

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[3] Ocwen, Annual Report (Form 10-K) at 40 (Mar. 13, 2008), *available at* http://www.sec.gov/Archives/edgar/data/873860/000101905608000419/ocn_10k07.htm.

mortgage loans; and (ii) preserve or defend title to the Trust Estate and the rights of the Indenture Trustee and the Noteholders in such Trust Estate against the claims of all persons and parties.

220. The Indentures set forth BNYM's contractual duties and obligations, which are substantially similar if not identical to BNYM's contractual duties and obligations in the PSAs. For example, as pledgee of the mortgage loans, BNYM, as Indenture Trustee, has the benefit of the representations and warranties made by the sellers in the MLPAs. If a responsible officer of BNYM has actual knowledge of any breach of representation or warranty made by the seller in the MLPA, BNYM shall promptly notify the seller of the breach and the sellers' obligation to cure such defect or repurchase or substitute for the related mortgage loan.

221. Like the PSAs, the Indentures impose similar obligations on the trustee following an "Event of Default." However, pursuant to the Indenture, only the conduct of the issuer, the Trust, can constitute an Event of Default. An Event of Default occurs under the Indenture, when, among other things, a default occurs in the observance or performance of any covenant or agreement of the Trust made in the Indenture, and such default is not cured within a specified period of time after notice is given to the Trust by BNYM or to the Trust and BNYM by a requisite number of Noteholders. The Indentures define a "default" as "[a]ny occurrence which is or with notice or the lapse of time or both would become an Event of Default."

222. Once BNYM has actual knowledge of an Event of Default, BNYM must enforce the rights of the Noteholders, whether for the specific performance of any covenant, agreement or right under the Indenture, or to enforce any other proper remedy or legal or equitable right vested by law. In carrying out these post-Event of Default duties, BNYM must exercise its rights and obligations under the Indenture using the same degree of care and skill as a prudent person would, under the circumstances, in the conduct of his or her own affairs.

223. The SSAs are contracts between, among others, the depositor, the trust (typically a Delaware statutory trust), as issuer, BNYM, as Indenture Trustee, and the master servicer. The SSAs contain substantially similar if not identical provisions to the PSAs. Like the PSAs, the SSAs call for the depositor's conveyance of mortgage loans to the Trust in which the notes participate and establish the rights and obligations of the master servicer for the notes.

224. Like the PSAs, the SSAs for each of the Trusts are substantially similar and provide for nearly identical obligations on the part of master servicers with respect to servicing the mortgage loans, including covenants (i) to provide notice of seller breaches; (ii) to administer the mortgage loans consistently with industry practice, (iii) to use reasonable efforts to collect all payments owed on the mortgage loans, including with respect to foreclosure, and to follow the same collection procedures it follows for servicing mortgage loans in its own portfolio, and (iv) to make proper servicing advances.

225. The SSAs also define "Master Servicer Events of Default," which include a failure to observe or perform material covenants and agreements set forth in the SSA to be performed by the master servicer, which materially affects the rights of the Noteholders, and such failure continues unremedied for a specified period after written notice was given. If a Servicer Event of Default occurs under the SSA which a responsible officer of BNYM, as Indenture Trustee, has received written notice or has actual knowledge of, BNYM must immediately terminate the Master Servicer and either substitute in as master servicer or find a successor. BNYM must also give prompt written notice to all Noteholders of Servicer Events of Default.

VIII. THE TRUSTS SUFFERED FROM PERVASIVE BREACHES OF REPRESENTATIONS AND WARRANTIES BY THE ORIGINATORS

226. Each of the Trusts' loan pools contained high percentage of loans that materially breached the sellers' representations and warranties, which adversely affected the value of those mortgage loans and the Trusts' and Certificateholders' rights in those mortgage loans. Specifically, the representations and warranties regarding the originators' compliance with underwriting standards and practices, owner occupancy statistics, appraisal procedures, LTV and combined LTV ("CLTV") ratios were systemically and pervasively false. The falsity of these representations and omissions is demonstrated by the high default rates of the mortgage loans, the plummeting credit ratings of the RMBS and certificates, the results of investors' forensic reviews and re-underwriting of loans within the Trusts in other litigation, and evidence highlighting the originators' abandonment of underwriting standards.

A. High Default Rates Of The Mortgage Loans And Plummeting Credit Ratings Are Indicative Of Massive Seller Breaches

227. The extremely high default rates of the mortgage loans within the Trusts and the decline in the credit ratings of the RMBS to below investment grade are strong evidence of the originators' misrepresentation of the credit quality and characteristics of the mortgage loans they sold to the Trusts.

228. The Trusts have experienced payment problems significantly beyond what was expected for loan pools that were properly underwritten, and which contained loans that actually had the characteristics originators represented and warranted. For example, as of January 1, 2009, an average 21.6% of the mortgage loans in the Trusts were delinquent. Within certain RMBS sponsor labels, such as Merrill-label Trusts, over 34% of the relevant mortgage loans were delinquent. Moreover, 70 individual Trusts had delinquency rates over 30%, as of January 2009.

229. Not only have the mortgage loans experienced extraordinary rates of delinquency and default, but the ratings of the RMBS supported by them have significantly deteriorated. Because of the high delinquency, foreclosure, and default rates of the underlying mortgage loans, approximately 75% of all certificates within the Trusts have been downgraded.

230. The economic downturn cannot explain the abnormally high percentage of defaults, foreclosures, and delinquencies observed in the loan pools ultimately backing the certificates. 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 delinquencies. The significant rating downgrades experienced by the RMBS are also strong evidence that they were improperly underwritten, and that they did not have the credit risk characteristics the sellers represented and warranted.

B. The Systemic Disregard Of Underwriting Standards Was Pervasive During The Relevant Period

231. During the height of the mortgage and securitization boom in the United States market between 2004 and 2008, originators of residential mortgage loans sold and securitized loans in RMBS in violation of their stated underwriting guidelines and in breach of the representations and warranties provided to the purchasers of the loan pools.

232. Government reports and investigations and newspaper reports have uncovered the extent of pervasive abandonment of underwriting standards. The Permanent Subcommittee on Investigations in the United States Senate ("PSI") released a report detailing the causes of the financial crisis. Using Washington Mutual Bank ("WaMu") 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.[4]

233. 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 subsequent collapse of the mortgage market and wider economy.[5] 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 crises 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.

234. 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. The FCIC Report found "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. Early Payment Default is a significant indicator of pervasive disregard for underwriting standards. The FCIC Report noted that mortgage fraud "flourished in an environment of collapsing lending standards . . ." *Id*.

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[4] *Wall Street And The Financial Crisis: Anatomy Of A Financial Collapse*, United States Senate Permanent Subcomm. On Investigations, 112th Cong. 50 (2011).

[5] *Final Report Of The National Commission Of The Causes Of The Financial And Economic Crisis In The United States*, Fin. Crisis Inquiry Comm'n ("FCIC Report") (2011).

235. Recent landmark settlements between the government and major financial institutions have further detailed the systemic and pervasive disregard of underwriting standards by lenders during the relevant time period, and have confirmed that these practices infiltrated the Trusts. For example, on November 19, 2013, the Justice Department, along with federal and state regulators, announced a $13 billion settlement with JPMorgan − the largest settlement with a single entity in American history − to resolve federal and state civil claims arising out of the packaging, marketing, sale and issuance of 1,128RMBS offerings by JPMorgan, Bear Stearns and Washington Mutual prior to January 1, 2009, including 45 of the Trusts. As part of the settlement, JPMorgan acknowledged that it regularly included loans within the securitizations "***that did not comply*** with the originator's underwriting guidelines" and breached the originator's representations and warranties.

236. On July 14, 2014, the Justice Department, together with federal and state regulators, announced a $7 billion settlement with Citigroup Inc. to resolve federal and state civil claims related to Citigroup's conduct in the packaging, securitization, marketing, sale and issuance of 633 RMBS offerings issued prior to January 1, 2009, including 41 of the Trusts. The settlement included an agreed upon statement of facts wherein Citigroup acknowledged that that significant percentages of the mortgage loans within the securitizations contained material defects.

C. There Is Evidence Of Widespread Breaches Of Representations And Warranties By The Specific Originators That Sold Loans To The Trusts

237. Much like other RMBS trusts of the same vintage, the Trusts have been materially and adversely impacted by the loan origination industry's rampant underwriting failures. The originators' systemic and pervasive sale to the Trusts of residential mortgage loans in breach of representations and warranties is confirmed through several federal and state government

investigations and published reports, well publicized news reports, and public and private enforcement actions that have described rampant underwriting failures throughout the period in which the Trusts were created and, more specifically, failures by the same originators whose mortgage loans were sold to the Trusts.

238. A summary of testimonial and documentary evidence as to each of the major originators of the mortgage loans to the Trusts is set forth below.

1. Countrywide

239. Countrywide Financial Corporation and related entities ("Countrywide") were among the largest sellers of mortgage loans sold to the Trusts, originating approximately $27.1 billion. Countrywide also sponsored approximately $20.1 billion in loans for eighteen of the Trusts. Due to the poor credit quality of the loans, the Countrywide-label Trusts have suffered severe collateral write-downs. As of July 1, 2014, the Countrywide-label Trusts have suffered approximately $5.6 billion in realized losses.

240. It is beyond dispute that Countrywide was one of the most notorious and worst loan originators and securitizers, routinely abandoning all underwriting standards and requirements while pumping hundreds of billions of dollars of toxic loans into the United States RMBS securitization market.

241. Countrywide's default rates reflected its approach to underwriting. In November 2008, the Office of the Comptroller of the Currency ("OCC") researched the ten metropolitan areas with the highest foreclosure rates and identified ten lenders in each area with the most foreclosed loans. Countrywide appeared on the top ten list in six of the ten markets: 4th in Las Vegas, Nevada; 8th in Sacramento, California; 9th in Stockton, California and Riverside, California; and 10th in Bakersfield, California and Miami, Florida. When the OCC issued its updated 2009 "Worst Ten in the Worst Ten" Report, Countrywide appeared on the top ten list in

every market, holding 1st place in Las Vegas, Nevada; 2nd in Reno, Nevada; 3rd in Merced, California; 6th in Fort Myers-Cape Coral, Florida, Modesto, California, and Stockton-Lodi, California; 7th in Riverside-San Bernardino, California and Fort Pierce-Port St. Lucie, Florida; 8th in Vallejo-Fairfield-Napa, California; and 9th in Bakersfield, California. *See* 2009 "Worst Ten in the Worst Ten" Report.

242. Countrywide's abandonment of its underwriting standards and deplorable origination practices have been exposed by highly publicized government investigations and reports. For example, the FCIC Report noted that 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, [these same executives 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." FCIC Report at xxii. The Countrywide executives' concerns regarding its defective loan pools came to full fruition. The FCIC Report states that in January 2011, Bank of America reached a deal with Federal National Mortgage Association ("Fannie") and Federal Home Loan Mortgage Corporation ("Freddie"), settling claims relating to ineligible Countrywide-originated loans with a payment of more than $2.5 billion. And, from 2007 through 2010, Fannie "put back" $6.9 billion in loans to Bank of America, despite the fact that its random sample review of 2% to 5% of the loan pools revealed higher rates for delinquent loans. *See* FCIC Report at 225.

243. The Senate Report similarly addressed Countrywide's systemic violations of underwriting guidelines resulting in billions of dollars of defective loans originated during the same time period as the Countrywide loans securitized in the Trusts. For example, the Senate Report disclosed that after reviewing certain loans purchased from Countrywide, Goldman Sachs

personnel found that about 50% of the loans reviewed were candidates for "return to the lender." Senate Report at 487.

244. Countrywide's origination practices have also been the focus of regulatory enforcement actions. For example, on June 4, 2009, the SEC filed an enforcement action against the three most senior Countrywide executives, including Chief Executive Officer ("CEO") Angelo Mozilo ("Mozilo"), charging them with fraudulently misleading investors by representing that Countrywide had issued loans primarily to "prime" or low risk borrowers, when it had actually originated increasingly risky loans that senior executives knew would result in substantial defaults and delinquencies. The investigation and enforcement action uncovered telling evidence regarding the quality and characteristics of Countrywide-originated loans. For example, in a March 28, 2006 email sent by Mozilo to Countrywide's President David Sambol and others, Mr. Mozilo stated that Countrywide's 100% loan-to-value (also known as 80/20) subprime product is "the most dangerous product in existence and there can be nothing more toxic . . ." On October 15, 2010, the SEC announced that Mozilo would pay a then record $22.5 million penalty to settle the SEC charges.

245. Countrywide's origination practices have also been the focus of several private RMBS lawsuits initiated by investors, including in many of the Trusts at issue. For example, on August 8, 2011, American International Group, Inc. ("AIG") and various of its affiliates filed a highly publicized securities fraud action against Bank of America Corporation and several acquired entities concerning Bank of America, Merrill Lynch and Countrywide sponsored RMBS offerings. *AIG v. Bank of America, et al.*, No. 652199/2011 (N.Y. Sup. Ct.). The action involved at least six Trusts that are the subject of this action that contain high percentages of Countrywide-originated loans: CWHEL 2006-D, CWL 2006-S10, CWL 2006-S8, CWL 2006-S9, CWL 2007-

S1 and CWL 2007-S2. AIG alleges that Countrywide systemically ignored its stated underwriting guidelines and misrepresented LTV ratios, CLTV ratios, and owner occupancy levels for the loans sold to these Trusts.

246. Countrywide-originated loans have been the subject of numerous putback demands as a result of pervasive and systemic breaches of representations and warranties. As of October 2010, Bank of America, which acquired Countrywide in January 2008, had received more repurchase requests than any other bank, due almost exclusively to Countrywide's systematic abandonment of sound underwriting practices.

247. Likewise, on June 29, 2011, Bank of America announced an $8.5 billion settlement with BNYM, as trustee, resolving, among other things, all claims that Countrywide violated the representations and warranties when it sold loans pertaining to over 530 RMBS trusts. On August 4, 2011, New York Attorney General Eric T. Schneiderman ("NYAG") moved to intervene and object to Bank of America's proposed $8.5 billion settlement with BNYM "to protect the marketplace and the interests of New York investors," in part because the NYAG's investigation found that Countrywide and Bank of America "face Martin Act liability because there are repeated false representations in the Governing Agreements [for RMBS] that the quality of the mortgages sold into the Trusts would be ensured."

248. In January 2014, after a nine-week trial in which Countrywide's high-risk, poor quality home loans were scrutinized, New York Supreme Court Justice Barbara Kapnick partially approved the settlement, resolving putback claims for 530 Countrywide RMBS trusts.

249. Loan file reviews of Countrywide-originated loans sold to the Trusts during the period 2004 through 2008 conducted by investors provide direct evidence of Countrywide's pervasive and systemic breaches of representations and warranties. For example, Principal Life

Insurance Company and various of its affiliates filed a complaint in *In re Countrywide Financial Corp. Mortgage-Backed Securities Litigation*, Nos. 11-ML-02265-MRP, 12-CV-4317-MRP, 2012 WL 8505599 (C.D. Cal. Aug. 20, 2012) against Countrywide concerning fourteen securitizations − including GSCC 2006-1, which is one of the Trusts − which contained a high percentage of Countrywide-originated loans. Principal performed a loan level review of a large sample of loans from this offering and found that 32.8% of loans sampled had understated LTV/CLTV ratios by more than 10 percentage points, 28.1% of loans were assigned to a party other than the Trust and owner occupancy was overstated by 12.7%.

250. In *Minnesota Life Insurance Company v. Countrywide Financial Corporation, et. al.*, No. 62-CV-12-4832, 2012 WL 2057921 (D. Minn. June 7, 2012), the plaintiff insurers filed a complaint against Countrywide concerning sixteen RMBS issued by Countrywide, including one of the Trusts (CWL 2006-S6), which contained a high percentage of Countrywide originated loans and is one of the Trusts. The insurers performed a loan level review of a large sample of loans from this offering and found that the actual percentage of loans with an LTV/CLTV above 100% was 43.5%; the actual percentage of loans with an LTV/CLTV of 90.01% or greater by loan balance was understated by approximately 17.5%; and owner occupancy was overstated by approximately 12 %.

251. In *Texas County and District Retirement System v. J.P. Morgan Securities LLC, et al.*, No. D-1-GN-14-000998, 2014 WL 1335434 (Tex. Dist. Apr. 3, 2014), Texas County and District Retirement System filed a complaint against Countrywide and others, to recover $64 million in damages suffered on RMBS, including one of the trusts (CWHL 2005-4), which contained a high percentage of Countrywide originated loans. The insurers performed a loan level review of a large sample of loans from this offering and found that the actual percentage of

loans with an LTV/CLTV above 100% was 11%; the actual percentage of loans with an LTV/CLTV of 80% or greater by loan was understated by approximately 34%; and owner occupancy was overstated by approximately 7%.

2. First Horizon

252. First Horizon, through its two subsidiaries, First Horizon Home Loan Corporation (which focused on nationwide origination) and First Tennessee Bank N.A. (which focused on Tennessee origination), originated approximately $27.1 billion of residential mortgage loans sold to the Trusts, representing approximately 17% of all of the Trusts' mortgage loan collateral. First Horizon also acted as the sponsor for seventy-nine Trusts, sponsoring approximately $27.1 billion in mortgage loans. The First Horizon-label Trusts have been plagued by incredibly poor performing loans. In total, the seventy-nine Trusts have suffered collateral write downs of over $1.7 billion.

253. The First Horizon-label Trusts' poor performance can easily be explained through First Horizon's well publicized abandonment of underwriting guidelines. First Horizon's faulty origination practices have been confirmed by its own public statements, RMBS lawsuits, governmental investigations and other sources that have described underwriting failures by First Horizon throughout 2004 and 2008.

254. For instance, as stated in First Horizon's 2008 Annual Report (*available at* http://ir.fhnc.com/annuals.cfm): "In addition to the negative aspects of asset quality on FHN's loan portfolio, increased repurchase and makewhole claims from agency and private purchasers of loans originated and subsequently sold by FHN hampered earnings as FHN recorded $148.5 million in charges for its obligations related to these assets." In First Horizon's 2010 Annual Report (*available at* http://ir.fhnc.com/annuals.cfm), First Horizon admitted that it had "observed loss severities ranging between 50 percent and 60 percent of the principal balance of the

repurchased loans and rescission rates between 30 and 40 percent of the repurchase and make-whole requests."

255. First Horizon has been charged with abandoning its underwriting standards in order to maintain and grow its volume of loan originations. In January 2010, the Department of Housing and Urban Development ("HUD") began an investigation of First Tennessee Bank because it found "indicators of fraud" in loans insured by the Federal Housing Administration ("FHA"). HUD noticed "a significant number of claims, a certain loan underwriting volume, a high ratio of defaults and claims compared to the national average, and claims that occurred earlier in the life of the mortgage." According to HUD, "[t]hese are key indicators of problems at the origination or underwriting stages." In October 2010, HUD released the findings of its investigation. Among other things, HUD found excessive debt-to-income ratios without adequate compensating factors, inadequate documentation, unverified assets, and incorrect certifications. HUD has recommended civil enforcement actions to recover damages.

256. Additionally, on August 26, 2013, it was reported that the Justice Department and Urban Development opened an investigation into First Horizon's deviation from stated underwriting standards related to certain FHA-insured mortgages it originated.

257. In addition to the government investigations, shareholders in June 2010 charged First Horizon with abandoning its underwriting standards, failing to disclose the true risks and losses as a result of such unlawful origination activities, and failing to implement and follow controls designed to minimize risk and loss in a derivative action. *See Reid v. First Horizon Nat'l, Corp., et al.*, No. 10-cv-02413 (W.D. Tenn. June 2, 2010). Though the complaint was dismissed on statute of limitations grounds, its allegations corroborate Plaintiffs' claim here that First Horizon systematically failed to adhere to its underwriting guidelines.

258. First Horizon-originated loans have been the subject of numerous RMBS lawsuits, including actions regarding some of the Trusts. For example, on February 17, 2011, the Federal Home Loan Bank of Atlanta ("FHLB-Atlanta") filed suit against Bank of America, JPMorgan, UBS and these banks' affiliates for recovery of losses on the $6 billion in RMBS it purchased from these investment banks across thirty securitizations, including FHASI 2006-AR4, one of the Trusts that was 100% originated by First Horizon. *Fed. Home Loan Bank Atlanta v. Countrywide Fin. Corp., et. al.*, No. 11-cv-00489 (N.D. Ga. Feb. 17, 2011). FHLB-Atlanta alleged that First Horizon had abandoned its underwriting standards in connection with the loans it supplied for FHASI 2006-AR4 and misrepresented the LTV ratios and owner occupancy status pertaining to the loans.

259. Forensic investigations and loan level reviews conducted by investors confirm the pervasive breaches of representations and warranties in First Horizon-label RMBS. For example, on October 15, 2010, Federal Home Loan Bank of Indianapolis ("FHLB-Indianapolis") filed a securities fraud action against a Bank of America affiliate for recovery of losses on nearly $3 billion in RMBS in thirty-one securitizations, including FHASI 2004-7, which is one of the Trusts. *Fed. Home Loan Bank v. Banc of America Mortg. Sec., Inc., et al.*, No. 1:10-cv-01463 (S.D. Ind. Nov. 15, 2010). FHLB-Indianapolis performed a loan level review of a large sample of loans from this offering and found that 8.82% of loans had a greater than 100% LTV ratio (contrary to First Horizon's representation that no loans had an LTV of greater than 100%); loans with greater than 90% LTV were understated by 32.8%; and loans with greater than 80% LTV were understated by 31.91%.

260. On September 2, 2011, the Federal Housing Finance Agency ("FHFA") filed an action against First Horizon, alleging that First Horizon misrepresented the quality of the

underlying mortgage loans, the creditworthiness of the borrowers and the practices used to originate such loans in connection with five First Horizon-sponsored securitizations, including FHAMS 2005-AA10 and FHAMS 2006-AA1, which are two of the Trusts. *FHFA v. First Horizon Nat'l Corp.*, 11 CIV 6193 (S.D.N.Y.). The FHFA's loan level review demonstrated that First Horizon understated the percentage of non-owner-occupied properties for these Trusts by over 6%. The FHFA alleged that, in contrast to First Horizon's representation that none of the mortgage loans in the Trusts had LTV ratios over 95%, approximately 10% percent of the mortgage loans for these two securitizations had LTV ratios over 95 percent.

261. In *CIFG v. Bank of America*, No. 654028/2012 (N.Y. Sup. Ct.), the plaintiff CIFG Assurance North America, Inc. ("CIFG"), a New York-based monoline insurer, wrote insurance relating to two structured transactions arranged by Bank of America, which in turn were backed by twenty-two securitizations, including six Countrywide-label securitizations and two First Horizon-label securitizations. One of the First Horizon securitizations was FHAMS 2006-FA4, which is one of the Trusts. Of the 1,656 loans reviewed, CIFG found that 834 loans (or 50.38%) contained at least one material defect. CIFG similarly found that First Horizon had understated the actual amount of loans with LTV ratios of: (i) 80% or greater by more than 39%; (ii) 90% or greater by more than 20%; and (ii) 100% or greater by more than 9%. CIFG further found that First Horizon overstated the actual percentage of owner occupied properties by more than 7%, and that more than 11% of the sampled loans were assigned to third party and still held in the originator's name instead of to the Trust.

262. In *FDIC v. Chase Mortgage Finance Corp., et al.*, No. 12-cv-6166 (S.D.N.Y.), the Federal Deposit Insurance Corporation ("FDIC") filed an action against various investment banks in connection with its purchase of eleven RMBS, including FHAMS 2007-FA2, which is

one of the Trusts. The FDIC performed a loan level review of a large sample of loans from this offering and found that 27% of the loans had LTV ratios in excess of 105% and 17% of the loans misrepresented the owner occupancy status.

3. Nationstar

263. Nationstar was another significant originator and sponsor of mortgage loans pooled into the Trusts, originating approximately $13.1 billion in mortgage loans and sponsoring approximately $4.8 billion across five of the Trusts. Nationstar, founded in 1997, was formerly known as Centex Home Equity Corporation ("Centex"). In March 2006, Fortress Investment Group ("Fortress"), a large hedge fund, purchased Centex for $575 million. Shortly after the purchase, Fortress changed Centrex's name to Nationstar. The Nationstar-label Trusts have also been afflicted by abject performance as a result of the poor credit quality of the loan pools. As of May 1, 2014, the five Nationstar-label Trusts have suffered realized losses of approximately $1.2 billion, signifying that over 25% of the Trusts' original loan collateral has been written off.

264. Nationstar was one of the ten largest subprime lenders in the country, originating $4.4 billion in the first quarter of 2007 before the market evaporated. The company provided non-prime mortgages and home loans directly to consumers and indirectly through mortgage brokers and bankers. Much of Nationstar's success came as a result of the company's loose underwriting standards and lending practices. Nationstar routinely provided loans to borrowers without regard for their ability to repay, required little or no documentation for loans, and used fraudulently inflated appraisals. These risky lending practices resulted in serious financial trouble for Nationstar after the subprime market went bust. In September 2007, Nationstar announced that it was shutting down its wholesale loan origination business for good.

265. As a result of its loose lending practices, Nationstar became the target of a number of consumer lawsuits. For example, in September 2008, a class action was filed in San Diego

Superior Court, alleging that Nationstar and its predecessor Centex had coerced the plaintiffs into entering bad loans that destroyed plaintiffs' credit and resulted in numerous foreclosures. *See Richter v. Nationstar Mortg., LLC*, No. 37-2008-00092170-CU-BT-CTL (Cal. Super. Ct. Sept. 23, 2008). The complaint claimed that Nationstar knew that its San Diego branch manager, Cindy Kelly, was fraudulently selling unregistered securities to customers and that Nationstar encouraged her to ignore sound underwriting guidelines and to complete loan applications using false and incomplete information. Moreover, the defendants had promised borrowers that excess proceeds from their loans would be used as investments in Stonewood Consulting, Inc., a fraudulent investment firm that later became the target of an SEC proceeding in the Central District of California.

266. Similarly, in September 2010, a complaint was filed in the State of Florida's Circuit Court in Sarasota County, alleging violations of Truth in Lending Act of 1968 ("TILA") based on Nationstar's failure to disclose material terms of the plaintiffs' mortgage. *McClendon v. Nationstar Mortg., LLC*, No. 2010 CA 009303 NC (Fl. Cir. Ct. Sept. 3, 2010). The borrowers claimed that Nationstar failed to verify their ability to repay the loan before extending them credit and that the loan application contained no information about the plaintiffs' monthly income. As a result, plaintiffs were saddled with a multitude of miscellaneous fees and ended up with a loan that they could not afford.

267. Nationstar-originated loans have also been subject of several significant RMBS actions. For example, on December 29, 2011, plaintiff Stichting Pensioenfonds ABP ("ABP") sued Credit Suisse Group AG and various of its affiliates in connection purchases of certificates from ten securitizations, including ABSC 2006-HE6, which Nationstar was a significant

originator. ABP alleged that Nationstar systemically abandoned its underwriting guidelines and appraisal standards.

268. Forensic investigations and loan level reviews conducted by investors confirm the pervasive breaches of representations and warranties in Nationstar-label RMBS, including in at least one of the Trusts. For example, in *Phoenix Light SF Ltd., et al. v. The Royal Bank of Scotland Group, PLC, et al.*, Index No. 653060/2013, 2013 WL 5232276 (N.Y. Sup. Ct.), plaintiffs performed an industry-accepted historical valuation analysis on the actual loans underlying NSTR 2007-B, a securitization in which 100% of the underlying mortgage loans were originated or acquired by Nationstar, which is one of the Trusts. Plaintiffs determined that 23% of the loans within the securitization had an LTV ratio over 100%, contrary to Nationstar's representation that no loans had an LTV ratio exceeding 100%.

4. <u>NovaStar</u>

269. NovaStar, the now-defunct Missouri-based subprime mortgage lender, originated and sponsored more than $11.6 billion of home loans in several of the Trusts. The NovaStar-label Trusts have been plagued by poor performance. As of July 1, 2014, the NovaStar-label Trusts have suffered over $1.5 billion in realized losses, representing nearly 13% of the Trusts' total original face value. Media reports and highly publicized lawsuits demonstrate that NovaStar routinely and systematically disregarded its own underwriting standards and guidelines in order to generate more loan origination business and increase its profits.

270. For example, as illustrated in a July 12, 2009 article in *The New York Times*, NovaStar regularly originated loans for borrowers who did not have a realistic capacity to repay the loans:

> The Jordans are fighting a foreclosure on their home of 25 years that they say was a result of an abusive and predatory loan made by NovaStar Mortgage Inc. A lender that had been cited by the Department of Housing and Urban Development

> for improprieties, like widely hiring outside contractors as loan officers, NovaStar ran out of cash in 2007 and is no longer making loans.
>
> * * *
>
> The facts surrounding the Jordans' case are depressingly familiar. In 2004, interested in refinancing their adjustable-rate mortgage as a fixed-rate loan, they said they were promised by NovaStar that they would receive one. In actuality, their lawsuit says, they received a $124,000 loan with an initial interest rate of 10.45 percent that could rise as high as 17.45 percent over the life of the loan.
>
> Mrs. Jordan, 66, said that she and her husband, who is disabled, provided NovaStar with full documentation of their pension, annuity and Social Security statements showing that their net monthly income was $2,697. That meant that the initial mortgage payment on the new loan – $1,215 – amounted to 45 percent of the Jordans' monthly net income.
>
> The Jordans were charged $5,934 when they took on the mortgage, almost 5 percent of the loan amount. The loan proceeds paid off the previous mortgage, $11,000 in debts and provided them with $9,616 in cash.
>
> Neither of the Jordans knew the loan was adjustable until two years after the closing, according to the lawsuit. That was when they began getting notices of an interest-rate increase from Nova- Star. The monthly payment is now $1,385.
>
> "I got duped," Mrs. Jordan said. "They knew how much money we got each month. Next thing I know I couldn't buy anything to eat and I couldn't pay my other bills."[6]

271. Similarly, investor Michael Burry studied NovaStar's underwriting practices, as reported by *The Pitch* in this May 13, 2010 article:

> One of the subprime-loan originators that Burry studied was NovaStar, a company that started in Westwood and later moved into an office building off Ward Parkway. NovaStar specialized in making home loans to people with shaky credit.
>
> Burry noticed when NovaStar began issuing loans of increasingly crappy quality. From early 2004 to late 2005, the number of NovaStar borrowers taking out interest-only loans - *no money down*! - nearly quintupled.

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[6] Gretchen Morgenson, *Looking for The Lenders' Little Helpers*, N.Y. Times (July 12, 2009), *available at* http://www.nytimes.com/2009/07/12/business/12gret.html?_ r=0.

> The charade lasted until home prices stopped growing at an unprecedented clip and sketchy borrowers began to default on their tricked-out loans.
>
> * * *
>
> NovaStar, a company that the *New York Times* labeled "Exhibit A" for anyone interested in the goofy lending practices which precipitated the housing collapse, was eventually delisted from the New York Stock Exchange.[7]

272. On August 3, 2010, *The Wall Street Journal* reported that, among other things, NovaStar touted its "Credit Score Override Program" for loan approval where it "ignored the rules" to qualify more borrowers:

> Deutsche's disparate dealings with two investor clients in February 2007 illustrate how it played both sides of the mortgage-securities market.
>
> That month, a time when the U.S. housing and mortgage markets were beginning to crack, Deutsche was helping put together bond deals backed by subprime mortgages.
>
> They included loans originated by NovaStar Financial Inc., a Missouri subprime lender that Deutsche had financed. A promotional flier from NovaStar in 2003 said, "Ignore the Rules and Qualify More Borrowers with our Credit Score Override Program!" As housing boomed, NovaStar thrived.
>
> But on Feb. 20, 2007, NovaStar reported a quarterly loss and said it was tightening the spigot on new loans. It was another piece of evidence the long-rising housing market was headed the other way. That evening, a senior Deutsche trader received an email from a hedge-fund manager with the subject line "Novastar" and the message: "It is like the plague."[8]

273. NovaStar's pervasive and systematic disregard of underwriting standards has been the subject of several significant RMBS actions. For example, NovaStar faces a class action suit that alleges it systematically disregarded its underwriting guidelines when originating mortgages

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[7] David Martin, *Hailed as a Rebel Reformer, KC Fed Chief Tom Hoenig is Really Neither*, The Pitch (May 13, 2010), *available at* http://www.pitch.com/2010-05-13/news/kc-fed-chief-tom-hoenig-is-no-rebel/.

[8] Carrick MollenKamp and Serena Ng, *Dual Role in Housing Deals Puts Spotlight on Deutsche*, *WSJ* (Aug. 3, 2010), *available at* http://online.wsj.com/article/SB10001424052748703900004575325232441982.

in 2006 and 2007 that were subsequently securitized into RMBS. *See* Second Amended Class Action Complaint, *N.J. Carpenters Health Fund v. NovaStar Mortg. Funding Corp., et al.*, No. 08-cv-5310, ECF No. 117 (S.D.N.Y. May 18, 2011) ("N.J. Carpenters SAC"). The N.J. Carpenters SAC includes statements concerning NovaStar's systematic disregard of its underwriting guidelines from former NovaStar employees who worked in the NovaStar mortgage origination business. These former employees include a former Vice President of Operations, Quality Control Auditors and Supervisors, Senior Underwriters, Account Managers, and Account Executives. *See id*. ¶57.

274. Former Account Managers, Underwriters, and Quality Control Auditors reported that the pressure to increase the volume of loan production led to the systematic disregard of NovaStar's underwriting guidelines in mortgage loan origination. *See id*. ¶70. When NovaStar Underwriters and Quality Control Auditors alerted supervisors about loans that were initially rejected because of suspicious or fraudulent documentation, NovaStar management would routinely override these initial loan rejections and approve the loans. *See id*. ¶71. For Full Documentation loans, NovaStar Underwriters would reject loan applications where employment could not be adequately verified. In many cases, NovaStar management overrode the initial rejection, disregarding the questionable verification of employment in order to approve the loan application. *See id*. ¶75. The N.J. Carpenters SAC noted that Full Documentation loan applications regularly included unreasonably inflated income. For instance, many loan application files reported income for several housekeepers in South Florida upwards of $200,000 a year. *See id*. ¶77. For Stated Income loans, inflated income was commonplace. Reported income in Stated Income loans was apparently far from reasonable in relation to the applicant's employment. *See id*. ¶80. When underwriters denied loan applications because of unreasonable

stated income, NovaStar management disregarded the initial rejection and subsequently approved in spite of the unreasonable reported income. *See id*. ¶81.

275. Similarly, on November 28, 2011, the National Credit Union Administration Board ("NCUA"), as liquidating agent for U.S. Central Federal Credit Union and FORWestern Corporate Federal Credit Union ("Credit Unions"), filed an action against Wachovia Capital Markets, LLC (n/k/a Wells Fargo Securities, LLC), the underwriter and seller of certain RMBS purchased by the Credit Unions. The NCUA alleged that NovaStar had systemically abandoned its stated underwriting guidelines, which led it to make untrue representations regarding its adherence to stated underwriting guidelines, the borrower's capacity and likelihood to repay the mortgage loan, LTV ratios and the occupancy type of the properties securing the mortgages.

276. Several of the Trusts in which NovaStar served as the sole or primary originator have been the focus of significant RMBS litigation. For example, in *Cambridge Place Investment Management Inc. v. Morgan Stanley & Co., Inc., et al.*, the plaintiff filed an action against several investment banks in $2.4 billion in RMBS it purchased from defendants, including NHEL 2004-4 and NHEL 2005-1, two deals in the Trusts. In its pleadings, plaintiff alleged that NovaStar made untrue statements concerning the loans' conformity with stated underwriting standards, that appraisal standards were applied to evaluate the value and adequacy of the mortgaged properties as collateral, and the loan-to-value ratios, debt-to-income ratios, and purported occupancy status of the loans. *See Cambridge Place Inv. Mgmt. Inc. v. Morgan Stanley & Co., Inc.*, No. 10-2741, 2010 WL 3001725 (Mass. Sup. Ct. July 9, 2010); *Cambridge Place Inv. Mgmt. Inc. v. Morgan Stanley & Co., Inc.*, No. 11-0555 (Mass. Sup. Ct. Feb. 11, 2011).

5. Popular, Inc.

277. Popular, Inc. ("Popular"), operating through Banco Popular North America and its wholly owned subsidiaries Equity One, Inc. and Popular Financial Holdings, wholesale subprime lenders, was one of the largest mortgage loan sellers to the Trusts. Popular originated over $11.6 billion in mortgage loans, and sponsored over $7.1 billion in loans sold to fifteen of the Trusts. The Popular-label Trusts have also performed very poorly, incurring realized losses of $910.5 million, meaning that nearly 13% of these Trusts' original loan balance has been written off.

278. Highly publicized RMBS lawsuits involving the same Trusts as to which Popular sold loans demonstrate that Popular systematically breached representations and warranties regarding the quality and characteristics of the loans. For example, in *Cambridge Place Investment Management, Inc. v. Morgan Stanley & Co., Inc., et al.*, *supra*, the investor plaintiff alleged that Popular made untrue statements concerning the loans' conformity with stated underwriting standards, that appraisal standards were applied to evaluate the value and adequacy of the mortgaged properties as collateral, and the loan-to-value ratios, debt-to-income ratios, and purported occupancy status of the loans, for the loans sold to POPLR 2005-5, one of the Trusts at issue.

279. Similarly, on April 21, 2011, an investor plaintiff alleged that Popular made untrue statements concerning the loans' conformity with stated underwriting guidelines in connection with its sale of "exceptionally poor quality loans" Securitized in POPLR 2006-D, one of the Trusts. In support of these allegations, the plaintiff noted that the credit downgrades within the securitization, and highlighted the fact that within five years of the RMBS trust issue, over 32% of the Trust's loans were severely delinquent, had been foreclosed on or were subject to bankruptcy proceedings. *See Bayerische Landesbank, New York Branch v. Deutsche Bank, AG, et al.*, No. 651264/2012 (N.Y. Sup. Ct. Apr. 18, 2012).

280. Forensic investigations and loan level reviews conducted by investors confirm the pervasive breaches of representations and warranties in Popular-label RMBS, including some of the Trusts. For example, in *FHFA v. The Royal Bank Scotland Group PLC, et al*., No. 3:11-CV-01383 (S.D.N.Y. Feb. 1, 2012), the FHFA performed an analysis of the loans underlying POPLR 2005-5, one of the Trusts. The FHFA determined that Popular had understated the percentage of non-owner occupied properties by over 12%. FHFA similarly determined that Popular had underreported the numbers of borrowers with an LTV Ratio of 80% or greater by approximately 23%. Moreover, the FHFA concluded that the true percentage of loans with an LTV ratio over 100% was 17.3%, contrary to Popular's representation that no loan had an LTV ratio over 100%.

281. Likewise, in *Phoenix Light SF Ltd., et al. v. The Royal Bank of Scotland Group PLC, et al*., 2013 WL 5232276 *supra*, plaintiffs performed an industry-accepted historical valuation analysis on the actual loans underlying POPLR 2006-E, one of the Trusts and a securitization in which 100% of the underlying mortgage loans were originated or acquired by Popular. Plaintiffs determined that over 41% of the loans within the securitization had an LTV ratio over 100%, contrary to Popular's representation that no loans had an LTV ratio over 100%.

6. <u>GreenPoint, Inc.</u>

282. GreenPoint is another prolific originator of mortgage loans sold to the Trusts – originating approximately $4.4 billion in mortgage loans. It is well documented that GreenPoint systematically disregarded its underwriting standards, granted exceptions in the absence of compensating factors, required less documentation, and granted no-documentation or limited-documentation loans to individuals without sound credit histories.

283. Indeed, in November 2008, *Business Week* magazine reported that GreenPoint's employees and independent mortgage brokers targeted borrowers who were less able to afford the loan payments they were required to make, and many of the borrowers had no realistic ability

to pay back the loans. Likewise, GreenPoint was identified by the OCC as the seventh worst mortgage lender in Stockton, California, and the ninth worst in both Sacramento, California, and Las Vegas, Nevada. In the OCC's 2009 "Worst Ten in the Worst Ten" Report, GreenPoint was listed as third worst in Modesto, California, fourth worst in Stockton, Merced, and Vallejo-Fairfield-Napa, California, sixth worst in Las Vegas, Nevada; and ninth worst in Reno, Nevada.

284. Loan-file reviews of GreenPoint-originated loans sold to RMBS trusts during the period 2004 through 2008 conducted by monoline insurers and RMBS trustees have confirmed GreenPoint's pervasive breaches of mortgage loan representations and warranties. Monoline insurer MBIA's forensic review of loan files pertaining to a Bear Stearns securitization primarily containing GreenPoint-originated mortgage loans revealed a breach rate of *88%*. In a similar action against GreenPoint, monoline insurer CIFG Assurance North America, Inc. reviewed 110 loans and found that 90 (or 82%) of the loans failed to comply with one or more of the representations and warranties. *See CIFG Assurance N. Am., Inc. v. GreenPoint Mortg. Funding, Inc.*, Index No. 653449/2012 (N.Y. Sup. Ct. Mar. 4, 2013) Compl. ¶38.

285. Similarly alarming breach rates in securitizations containing GreenPoint-originated mortgage loans have been confirmed in RMBS trustee putback lawsuits. For example, in *U.S. Bank National Association v. GreenPoint Mortgage Funding, Inc.*, Index No. 600352/2009 (N.Y. Sup. Ct. filed Apr. 22, 2009), a consultant's investigation concluded that 93% of the loans that GreenPoint sold contained errors, omissions, misrepresentations, and negligence related to origination and underwriting. The investigation found that GreenPoint loans suffered from serious defects including pervasive breaches of representations and warranties concerning credit scores debt-to-income and LTV ratios, and the borrower's intent to occupy the mortgaged property.

286. Despite finding these severe deficiencies in the GreenPoint loan pools at issue in that case, HSBC has done nothing to protect Certificateholders against the same deficiencies in GreenPoint loan pools underlying the Trusts at issue here.

7. Wells Fargo

287. Wells Fargo originated approximately $3.4 billion of residential mortgage loans sold to the Trusts. Wells Fargo's origination practices have been the subject of numerous governmental investigations and reports and private RMBS lawsuits. For example, the FCIC Report issued in January 2011 revealed, for the first time, findings in a confidential 2005 "peer group" study conducted by examiners from the Federal Reserve and other agencies of mortgage practices at six companies, including Wells Fargo. Notably, the study observed "a very rapid increase in the volume of [] irresponsible loans, very risky loans" by Wells Fargo and these five other lenders, and that a "large percentage of their loans issued were subprime and Alt-A mortgages, and the underwriting standards for these products had deteriorated." FCIC Report at 172. The FCIC Report further revealed for the first time that Freddie Mac "put back" $1.2 billion in ineligible mortgage loans to Wells Fargo during 2009 and 2010, while Fannie Mae put back $2.3 billion ineligible mortgage loans to Wells Fargo from 2007 through 2010. *Id.* at 225.

288. Wells Fargo's systemic violations of representations and warranties regarding the credit quality of the loans it originated have been the subject of several highly publicized RMBS lawsuits. For instance, in *In re Wells Fargo Mortgage-Backed Certificates Litigation,* No. 09-CV-01376 (N.D. Cal. Mar. 27, 2009), the court found that the private investor 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, 971-72 (N.D. Cal. Apr. 22, 2010). In 2011, Wells Fargo agreed to pay $125 million to settle the litigation. The FDIC made

similar allegations in *FDIC v. Chase Mortgage Finance Corp., et al.*, No. 12-cv-6166 (S.D.N.Y. Aug. 10, 2012), contending that Wells Fargo and other originators overstated the values of properties such that virtually every representation about the loan-to-value ratios of the loans was untrue or misleading.

289. The results of loan file reviews conducted by investors have further confirmed Wells Fargo's abandonment of their underwriting standards and pervasive and systemic breach of material representations and warranties regarding quality and characteristics of the loans it originated. For example, in *FHFA v. Citigroup Inc., et al.*, the FHFA reviewed 1,851 loan files in the CMLTI 2006-WF1 and CMLTI 2006-WF2 securitizations. Wells Fargo originated all of the loans in these two trusts. The FHFA found that a stunning 79% of the reviewed mortgage loans in these securitizations were not underwritten in accordance with the underwriting guidelines or otherwise breached the representations contained in the transaction documents. *FHFA v. Citigroup Inc., et al.*, No. 11-cv-6196 (S.D.N.Y. June 28, 2012) Amended Compl. ¶136.

290. In addition, there is ample public evidence of Wells Fargo's failure to originate loans in compliance with federal and state law. For example, on July 20, 2011, the Federal Reserve announced that it had levied a record $85 million fine against Wells Fargo for pushing borrowers with good credit into expensive subprime mortgages and falsifying loan applications. Similarly, in late 2012, the U.S. Attorney for the Southern District of New York claimed that Wells Fargo engaged in a "longstanding and reckless trifecta of deficient training, deficient underwriting and deficient disclosure, all while relying on the convenient backstop of government insurance." *Manhattan U.S. Attorney Files Mortgage Fraud Lawsuits Against Wells Fargo Bank, N.A. Seeking Hundreds of Millions of Dollars in Damages for Fraudulently Certified Loans*, U.S. Attorney's Office Southern District of New York (Oct. 9, 2012).

291. Further, on January 5, 2012, it was widely publicized that a group of institutional investors provided notice to U.S. Bank and HSBC, as trustees, of breach of seller representations and warranties in loan pools securing approximately $19 billion of RMBS issued by various affiliates of Wells Fargo in forty-eight trusts from the WFALT, WFMBS and WMLT shelves, as well as deficient servicing of those loans ("January 5, 2012 Notice"). In the January 5, 2012 Notice, the investor group issued instructions to U.S. Bank and HSBC to open an investigation into the problems of ineligible mortgages in RMBS pools and deficient servicing of those loans.

8. First Franklin

292. First Franklin, a subsidiary of Merrill Lynch (which was purchased by Bank of America), originated approximately $3.34 billion in mortgage loans included in the Trusts at issue here, and sponsored over $3 billion in mortgage loans sold to three Trusts. During the mortgage and securitization boom, First Franklin systemically originated loans in breach of the representations and warranties it provided to the purchasers of its loans.

293. First Franklin's abandonment of its underwriting standards and poor origination practices are well documented through government investigations and reports, investor litigation, insurer actions, and news media sources. For example, the OCC's "Worst Ten in the Worst Ten" list included First Franklin as the *fifth worst originator* based on 2005-2007 loan originations as of March 29, 2009. Moreover, the Senate Report identified First Franklin as one of five mortgage originators to which Goldman Sachs directed the most repurchase requests for breaches of representations and warranties concerning underwriting loan quality. *See* Senate Report at 487, n.2051.

294. On September 2, 2011, the FHFA sued Merrill Lynch and its subsidiary First Franklin, among others, for $24.8 billion, for misrepresenting the quality of mortgage-backed securities sold to Fannie Mae and Freddie Mac. *See FHFA v. Merrill Lynch & Co., Inc., et al.*,

No. 1:11-cv-06202 (S.D.N.Y. Sept. 2, 2011). This action, along with similar actions initiated by the FHFA, was covered by the national media. *See, e.g., FHFA Sues 17 Banks Over Massive Mortgage Losses At Fannie and Freddie*, Forbes (Sept. 2, 2011).

295. Similarly, on August 8, 2011, AIG sued First Franklin, among others, for $10 billion, alleging that First Franklin and others falsely asserted that the underlying mortgage-backed securities' collateral mortgages were issued according to objective underwriting guidelines, when in fact, the defendants encouraged borrowers to falsify loan applications, pressured property appraisers to inflate home values, and ignored obvious red flags in the underwriting process. *See AIG, et al., v. Bank of America Corp., et al.,* Index No. 652199/2011 (N.Y. Sup. Ct. Aug. 8, 2011).

296. On April 16, 2012, bond insurer Ambac Assurance Corp. ("Ambac") sued Bank of America, accusing the company's First Franklin and Merrill Lynch units of misrepresentations concerning mortgage-backed securities. *See Ambac Assurance Corp., et al. v. First Franklin Fin. Corp., et al.*, Index No. 651217/2012 (N.Y. Sup. Ct. Apr. 16, 2012). Ambac reviewed 1,750 loans in the securitization and found that representations and warranties were breached *in 94% of the loans*. *Id.* Ambac further alleged that First Franklin originated most of the loans, and that the misrepresentations included underwriting practices and the due diligence done on the pooled loans, and at the loan level, such as borrowers' incomes and employment. The national media reported on these types of bond insurer actions. *See, e.g., Ambac Sues Bank of America Over Mortgage-Based Securities*, Bloomberg (Apr. 16, 2012); *Ambac Backed $856M In Bad MBS Due To Merrill's Tricks: Suit*, Law360 (Apr. 16, 2012).

9. <u>Fremont</u>

297. Fremont originated approximately $2.8 billion in loans included in the Trusts at issue here. As detailed below, Fremont systemically originated loans in violation of its

underwriting guidelines and in breach of the representations and warranties. By 2009-2011, this became readily apparent to all players in the RMBS industry, including Deutsche Bank. Fremont's systemic and pervasive origination of defective loans was well documented through government investigations, investor litigation, and national news reports. For example, the OCC's "Worst Ten in the Worst Ten" list included Fremont as *the sixth worst mortgage originator* based on 2005-2007 loan originations as of March 29, 2009.

298. Beginning in 2009, Fremont's origination practices have been the subject of numerous governmental investigations and reports. For example, the FCIC Report discusses how the credit rating agency Moody's Investors Service ("Moody's") created an independent surveillance team in 2004 in order to monitor previously rated deals. The Moody's surveillance team began to see 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 remarked that Moody's had never had to put on watch deals rated in the same calendar year. In 2007, in an unprecedented move, 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.

299. According to the FCIC Report, when securitizers 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.

300. The Senate Report also paints Fremont in a negative light, noting that Fremont was a lender "well known within the industry for issuing poor quality loans." Senate Report at 11. In March of 2007, Fremont, once the nation's fifth-largest subprime mortgage lender, stopped originating subprime loans after receiving a cease and desist order from the FDIC. *Id.* at 45, 237; FCIC Report at 233. The cease and desist letter "exposed the existence of unsafe and unsound subprime lending practices" by Fremont when it determined that Fremont had been operating with "a large volume of poor quality loans" and maintained "unsatisfactory lending practices." Senate Report at 45, 238. Finally, in June of 2008, shortly after the FDIC filed a second public enforcement action against the bank, Fremont declared bankruptcy. *Id.* at 238.

301. In June of 2009, the Attorney General of Massachusetts reached a $10 million settlement with Fremont in order to redress, among other things, Fremont's predatory lending practices. *Attorney General Martha Coakley Reaches $10 Million Settlement with Subprime Lender Fremont Investment and Loan*, Attorney General of Massachusetts Press Release (June 9, 2009). According to the Attorney General Office's complaint, Fremont was selling risky loan products that it knew were designed to fail, such as 100% financing loans and "no documentation" loans. *See Massachusetts v. Fremont Inv. & Loan and Fremont Gen. Corp.*, No. 07-4373 (Sup. Ct. Mass. Oct. 4, 2007).

302. In an amended complaint filed by the FHFA on December 21, 2011, *FHFA v. UBS Americas, Inc. et al.*, No. 11-cv-05201 (S.D.N.Y. Dec. 21, 2011), 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. Amended Compl. ¶333; *See also NCUA v. UBS Sec., LLC*, No. 13-cv-6731 (S.D.N.Y. Sept. 23, 2013) Compl. ¶176. On July 25, 2013, the FHFA announced that it had reached an agreement to settle the case for $885 million. *FHFA Announces Settlement with UBS*, Federal Housing Finance Agency Press Release (July 25, 2013).

303. Investor litigation also exposed Fremont's improper origination practices. In *Cambridge Place Investment Management Inc. v. Morgan Stanley et al.*, No. 10-2741 (Sup. Ct. Mass. July 9, 2010), plaintiffs based much of their case on sixty-three confidential witnesses who testified in court documents about the reckless lending practices that dominated the subprime market during the real estate boom. Fremont, according to the lawsuit, regularly approved loans with unrealistic stated incomes − such as pizza delivery workers making $6,000 a month. *Id.* Compl. at ¶175; *See also NCUA v. UBS Sec., LLC*, No. 13-cv-6731, Compl. at ¶175.

10. <u>WMC</u>

304. WMC originated approximately $2.5 billion in loans included in the Trusts at issue here.[9] As detailed below, WMC systemically originated loans in violation of its underwriting guidelines and in breach of the representations and warranties. By 2009 through 2011, this became readily apparent to all players in the RMBS industry, including Deutsche

[9] General Electric Capital ("GE") purchased WMC from a private-equity firm in 2004. While home prices peaked in June 2006, it wasn't until a year later that GE finally decided to unload WMC after it lost almost $1 billion in 2007.

Bank. WMC's systemic and pervasive origination of defective loans was well documented through government investigations, investor and insurer litigation, and national news reports. For example, the OCC's "Worst Ten in the Worst Ten" list included WMC, a subsidiary of GE Money Bank, FSB, as *the second worst mortgage originator* based on 2005-2007 loan originations as of March 29, 2009.

305. On Sept. 2, 2011, the FHFA sued GE alleging that the company made inaccurate statements about the quality of loans underlying the securities, including those issued in 2005 by WMC. *See Fed. Hous. Fin. Agency v. Gen. Elec. Co.*, No. 11-cv-07048 (S.D.N.Y. Oct. 6, 2011). In *FHFA as Conservator for the Federal Home Loan Mortgage Corp. v. WMC Mortgage LLC,* No. 13-cv-00584 (S.D.N.Y. Jan. 25, 2013), the FHFA's allegations that WMC misrepresented approximately $1 billion in mortgages it pooled and sold were sustained by the court. Investigations in 2011, 2012 and 2013 identified problems among at least 55% of the loans, and these problems include loan documentation that understated credit risk by overvaluing properties or misstating their purpose. These FHFA actions were widely publicized. *See, e.g., GE Says FHFA Filed Mortgage-Security Suit Without Warning*, Bloomberg (Sept. 7, 2011); *FHFA Says Settlement Reached With GE In Mortgage Case*, Reuters (Jan. 23, 2013).

306. Bond insurance companies also filed actions to recoup losses arising from WMC's fraudulent loan originations. For example, in *PMI Mortgage Insurance Co., et al v. WMC Mortgage Corp., et al*., No. BC381972 (L.A. Sup. Ct. Jan. 4, 2008), WMC and GE were sued for loans made in violation of the stated underwriting standards. There, a review of loans found "a systemic failure by WMC to apply sound underwriting standards and practices." Reviewing a sample of the nearly 5,000 loans in the pool, PMI identified 120 "defective" loans for which borrowers' incomes and employment were incorrect or where the borrower's intention

to live in the home was incorrect. *The New York Times* reported on this action. *See If Everyone's Finger-Pointing, Who's to Blame?* N.Y. Times (Jan. 22, 2008).

307. PMI filed another lawsuit against WMC in September 2009 after a review of WMC's mortgage loan files found that WMC "followed few, if any, objective standards or criteria in underwriting [mortgage loans] and showed little concern, if any, for any borrower's ability to repay." *PMI Mortg. Ins. Co. v. WMC Mortg. Corp.*, No. BC381972 (L.A. Super. Ct.). According to PMI's complaint, a review of a sample of thousands of WMC-originated loans revealed that WMC "breached various representations and warranties [attesting that,] *inter alia*, the loan-to-value ratio at the time of origination was greater than 100%; fraud, errors, misrepresentations, or gross negligence took place on the part of WMC . . . ; the loans did not comply with WMC's own underwriting standards at the time of origination; certain documents were missing; and/or WMC had failed to utilize a methodology in underwriting the loans that employed objective mathematical principles designed to determine that, at the time of origination, the borrower had the reasonable ability to make timely payments on the [m]ortgage [l]oans." According to the PMI complaint, the investigation "demonstrate[d] a systemic failure by WMC to apply sound underwriting standards and practices which cuts across all of the [loans in the securitization]." In the defective loans, the investigation discovered "unreasonable stated income and/or misrepresentations of income and/or employment by the borrower." Moreover, nearly a quarter of the loans sampled were shown to contain "misrepresentations of occupancy by the borrower."

308. So-called "putback" actions by Trustees against WMC for breach of contract and damages further show the pervasive and systemic breaches of representations and warranties. In *MASTR Asset Backed Securities Trust 2006-HE3 v. WMC Mortgage Corp., et al.*, No. 11-cv-

02542 (Dist. Minn. Sept. 2, 2011) U.S. Bank, as Trustee, alleged that WMC falsely assured purchasers that the loans were creditworthy, but more than 45% of the $555 million in the original loan balance had been liquidated and more than 30% of the remaining loans were delinquent. A review of a $550 million pool of mortgages booked by WMC and another subprime lender found inflated borrower incomes, missing documents and other "material breaches" in 150 loan files out of a sample of 200 – a "stunning 75 percent failure rate."

309. Similarly, in *J.P. Morgan Mortgage Acquisition Trust, Series 2006-WMC4, by the Bank of New York Mellon, solely in its capacity as the Securities Administrator v. WMC Mortgage LLC*, Index No. 654464/2012 (N.Y. Sup. Ct. Dec. 24, 2012) the plaintiff Trustee alleged that a review revealed more than 3,000 mortgages originated by WMC with "material and adverse" breaches of information regarding characteristics of the loans, including misrepresentations as to the occupancy of the owner and the "defects" included "repeated failure to adhere to sound underwriting practices, a blatant disregard for a borrower's ability to repay the loan, and intentional ignorance of warning signs of fraud"). These types of putback actions against WMC were widely reported on by the national media. *See, e.g., WMC Mortgage, Equifirst Sued by Trustee Over Mortgage Loans*, Bloomberg (Sept. 6, 2011); and *WMC Mortgage Sued By Trust Administrator In N.Y. Court*, Bloomberg (Dec. 21, 2012).

310. WMC's improper loan originating practices have been the subject of investigation and regulatory enforcement actions as well. For example, in June 2008, the Washington State Department of Financial Institutions, Division of Consumer Services 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 Mortgage and its principal owners individually. The Statement of Charges included a review of eighty-six loan

files, which revealed that at least seventy-six loans (or more than 88%) were defective or otherwise in violation of Washington state law. Among other things, the investigation uncovered that WMC had originated loans with unlicensed or unregistered mortgage brokers, understated amounts of finance charges on loans, understated amounts of payments made to escrow companies, understated annual percentage rates to borrowers and committed many other violations of Washington state deceptive and unfair practices laws.

D. The Systemic Disregard Of Prudent Securitization Standards Was Pervasive During The Relevant Period

311. It is equally well documented that between 2004 and 2008, the sponsors that securitized the residential mortgages and transferred them into the RMBS trusts failed to conduct adequate due diligence reviews of the mortgage pools to ensure the mortgage loans were of the same credit quality as represented and complied with federal and state law, as well as that the purported mortgaged property's appraised value was accurate.

312. 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.

313. As made clear in the FCIC Report, in their zeal to keep the securitization machine going and at the behest of originators, RMBS sponsors and their third party due diligence providers failed to analyze adequate sample sizes of the loan pools, sometimes reviewing as little as 2%-3% of the entire loan pools. Moreover, when the sponsors' and their due diligence firms identified high percentages of mortgage loans in their sample reviews as deficient, sponsors pervasively "waived in" mortgage loans to preserve their business relationships with the

originators or to keep the defective loans off their own books. Consequently, by 2011, it was equally apparent to all players in the United States mortgage and securitization industry that the mortgage loans deposited in RMBS trusts issued between 2004 and 2008 materially breached the sponsors' representations and warranties.

E. There Is Evidence Of Widespread Breaches Of Representations And Warranties By The Specific Sponsors Of The Trusts

314. As with other RMBS trusts of the same vintage, the Trusts have been materially impacted by the sponsors' faulty securitization practices. The sponsors' systemic and pervasive sale of residential mortgage loans in the Trusts in breach of representations and warranties is confirmed through several federal and state government investigations and published reports, well publicized news reports, and public and private enforcement actions that have described endemic due diligence failures throughout the period in which the Trusts were created and, more specifically failures by the same sponsors whose mortgage loans were deposited into the Trusts. A summary of testimonial and documentary evidence as to each of the major sponsors of the mortgage loans to the Trusts is set forth below.

1. Bear Stearns

315. Bear Stearns, through its affiliates, sponsored more than $16.9 billion of the loans in the twenty-one of the Trusts under the BALTA, BSABS, and SAMI shelves. By January 1, 2009, it was evident that the credit quality of the underlying loan collateral for the Bear Stearns-label Trusts did not match Bear Stearns' and originators' representations and warranties. At this time, nearly 17% of all the loans in the Bear Stearns-label Trusts were delinquent. Moreover, the Bear Stearns-label Trusts had incurred realized losses of over $73 million. Although the Bear Stearns-label Trusts were marketed to investors as conservative, AAA credit rated investments, as of July 1, 2014, these Trusts have suffered collateral losses of over $334 million.

316. Bear Stearns' poor securitization practices have been well publicized through government reports and private investor and insurer RMBS litigation. Bear Stearns' ultimate goal was to securitize and sell as many loans to RMBS trusts as possible, by whatever means necessary, even if this meant sacrificing quality. As Jo-Karen Whitlock, Senior Vice President of Conduit Operations for EMC Mortgage LLC ("EMC") wrote in an April 4, 2006 email, "[I]f we have 500+ loans in this office we MUST find a way to underwrite them and buy them . . . I was not happy when I saw the funding numbers and I knew that NY would NOT BE HAPPY. I expect to see 500+ each day . . . I'll do whatever is necessary to make sure you're successful in meeting this objective."

317. Likewise, the FCIC Report noted that "Ruhi Maker, a lawyer who worked on foreclosure cases at the Empire Justice Center in Rochester, New York, told Fed Governors Bernanke, Susan Bies, and Roger Ferguson in October 2004 that she suspected that some investment banks – she specified Bear Stearns and Lehman Brothers – were producing such bad loans that the very survival of the firms was put in question. . . . She urged the Fed to prod the Securities and Exchange Commission to examine the quality of the firms' due diligence; otherwise, she said, serious questions could arise about whether they could be forced to buy back bad loans that they had made or securitized." FCIC Report at 15-16.

318. Similarly, the NCUA filed two suits against Bear Stearns on behalf of failed credit unions, alleging that the company, as sponsor, made numerous misrepresentations and omissions of material facts in the offering documents of the securities sold to the failed corporate credit unions. *See Nat'l Credit Union Admin. Bd. v. Bear, Stearns & Co. Inc.*, 12-cv-2781 (D. Kan. Dec. 14, 2012); *Nat'l Credit Union Admin. Bd. v. Bear, Stearns & Co. Inc.*, No. 13-cv-6707 (S.D.N.Y. Sept. 23, 2013). The complaints alleged that Bear Stearns "abandoned" underwriting guidelines

and securitized loans that were "destined from inception to perform poorly." *NCUA Sues J.P. Morgan and Bear, Stearns over $3.6 Billion in Faulty Securities*, NCUA Press Release (Dec. 17, 2012). J.P. Morgan settled such claims against Bears Stearns, and other J.P. Morgan affiliates, for $1.4 billion in November 2013.

319. On August 21, 2013, J.P. Morgan agreed to settle a lawsuit brought by bond-insurer Assured Guaranty Corp. ("Assured Guaranty") regarding misrepresentations by Bear Stearns as sponsor of a securitization for an undisclosed amount. In the complaint, Assured Guaranty alleged that "Bear Stearns concealed the incredibly high breach rates uncovered through the sparse quality control it performed between 2002 and September 2005, which had revealed underwriting defects in 43 percent of the GreenPoint loans reviewed by Bear Stearns' own third-party quality control vendor." *Assured Guaranty Corp. v. EMC Mortg. LLC, et al.*, Index No. 650805/2012 (N.Y. Sup. Ct. Mar. 15, 2012) Compl. ¶14.

320. In a similar suit brought by Ambac against Bear Stearns, the court filings identified multiple emails among Bear Stearns' employees that indicated the company knew the loans it was securitizing were defective. "Bear deal manager Nicolas Smith wrote an e-mail on August 11th, 2006 to Keith Lind, a Managing Director on the trading desk, referring to a particular bond, SACO 2006-8, as 'SACK OF SHIT [2006-]8' and said, 'I hope your [sic] making a lot of money off this trade.'" *E-mails Suggest Bear Stearns Cheated Clients Out of Billions*, The Atlantic (Jan. 25, 2011). "Jeffrey Verschleiser even said in an e-mail that he knew this [due diligence] was an issue. He wrote to his peer Mike Nierenberg in March 2006, '[we] are wasting way too much money on Bad Due Diligence.' Yet a year later nothing had changed. In March 2007, Verschleiser wrote to Nierenberg again about the same due diligence firm, '[w]e are just burning money hiring them.'" *Id*.

321. In *Syncora Guarantee Inc. v. J.P. Morgan Securities LLC*, the plaintiff alleged that: "After observing this initial performance deterioration, Syncora retained an independent third-party consultant to reunderwrite samples of the securitized loans. The consultant performed loan-level analyses of 1,431 mortgage loans in the Transaction, with an outstanding principal balance of $131 million. The results evidence a staggering *92%* overall breach rate. The 1,431 loans reviewed include 400 that Syncora's consultant randomly selected, regardless of their payment status, which had an outstanding principal balance of $28 million. The findings on the random sample were astounding; *85.5%* of these 'random' loans breached one or more of the contractual warranties that EMC had made to Syncora." *Syncora Guarantee Inc. v. J.P. Morgan Securities LLC f/k/a Bear, Stearns & Co. Inc.*, Index No. 651566/2011 (N.Y. Sup. Ct. June 6, 2011) Compl. ¶7.

322. On November 15, 2013, J.P. Morgan announced that it had reached a $4.5 billion agreement with an institutional investor group to settle, among other things, mortgage repurchase claims for 330 RMBS trusts issued by J.P. Morgan, Bear Stearns and Chase. Many of the trusts are of the same vintage and label as Bear Stearns-sponsored Trusts at issue. Notably, this settlement was reached two years after the institutional investor group requested the trustees for the Trusts, including BNYM, open an investigation into potential mortgage repurchase and servicing claims held by the RMBS Trusts on December 15, 2011, and subsequent to the trustees obtaining forbearance agreements on mortgage repurchase claims for these Trusts.

2. <u>UBS</u>

323. UBS, through its affiliate UBS Real Estate Securities, Inc., also sponsored a significant amount of mortgage loans deposited into the Trusts, <u>$11.8 billion</u> in seventeen Trusts under the MALT and MARM shelves. It was clear by January 1, 2009, UBS had dumped large percentages of toxic loans within the UBS-label Trusts. By this time, these securitizations were

averaging delinquency rates of over 16.5%. As a result of these severe delinquencies, the UBS-label Trusts' losses began to mount. For example, between 2009 and 2011 collateral losses among the UBS-label Trusts jumped from approximately $49 million to $208 million. As of July 1, 2014, the UBS-label Trusts had suffered realized losses of <u>$390 million</u>.

324. UBS's deficient due diligence practices are well known. For example, trending reports from outside due diligence provided Clayton Holdings, Inc. "(Clayton") revealed that in the period from the first quarter of 2006 to the first quarter of 2007, 20% of the mortgage loans UBS submitted to Clayton to review in residential mortgage-backed securities groups were rejected by Clayton as falling outside the applicable underwriting guidelines. Of the mortgage loans that Clayton found defective, 33% of the loans were subsequently waived in by UBS without proper consideration and analysis of compensating factors and included in securitizations.

325. Over the past five years, UBS's securitization practices have been the focus in at least nineteen significant RMBS lawsuits, including actions by the FHFA, Federal Home Loan Banks, monoline insurers and RMBS holders. Forensic investigations and loan-level reviews conducted by plaintiffs in these actions have confirmed the pervasive breaches of representations and warranties in UBS-label RMBS. For example, on July 27, 2011, the FHFA filed suit against UBS alleging UBS made untrue or misleading statements regarding the mortgage loans' LTV ratios, owner occupancy status, and/or compliance with underwriting guidelines in connection with sixteen UBS-sponsored securitizations. *See FHFA v. UBS Americas Inc., et al.*, No. 11 CIV. 05201, 2011 WL 7629299 (S.D.N.Y. Dec. 21, 2011). The FHFA's review of at least 1,000 randomly selected mortgage loans from each trust revealed that approximately 78% of the reviewed loans were not underwritten in accordance with the applicable underwriting guidelines.

On July 25, 2013, the FHFA announced that it had reached an agreement to settle the UBS case for $885 million.

326. Similarly, in *Capital Ventures International v. UBS Securities LLC*, No. 11-cv-11937, 2011 WL 7566510 (D. Mass. Nov. 1, 2011), the plaintiff investor conducted a loan level review of MARM 2004-13, a UBS-sponsored securitization, which is one of the Trusts at issue here. The plaintiff investor found that UBS had overstated owner occupancy by nearly 17% and understated the percentage of loans with LTV ratios of 80% or greater by over 21%.

327. The results of these litigants' loan level reviews of UBS securitizations were corroborated by the findings of the Association of Financial Guaranty Insurers ("AFGI"), which wrote to UBS on November 30, 2011, on behalf of its industry members. In the November 30, 2011 letter, the AFGI stated that its members had performed sufficient sampling of loans within UBS securitizations and "*have concluded that well more than half of the 2005/2006/2007 vintage first and second lien residential mortgage loans backing such RMBS were ineligible for securitization*." The AFGI concluded that "[g]iven that a large percentage of the loan pools securitized by UBS are comprised of loans originated by discredited originators (such as IndyMac), well-known to have originated high percentage of fraudulent and other ineligible residential mortgage loans, this high percentage of ineligible loans should not be surprising."

3. Lehman

328. Lehman sponsored $7.6 billion in ten Trusts under the SARM and SASC shelves. Lehman acquired the mortgage loans either from Lehman's own loan origination affiliates and subsidiaries, Aurora and BNC Mortgage ("BNC"), whose underwriting abuses are well documented, or in direct purchases (including in auctions) from third-party loan originators, some of which are among the most notorious lenders, including GreenPoint Mortgage, Countrywide Home Loans, Inc., IndyMac Bank, F.S.B., Wells Fargo, First Franklin, EquiFirst

Mortgage and Aegis Mortgage. By January 2009, it was evident that the credit quality of the underlying loan collateral for the Lehman-label Trusts did not match Lehman's representations and warranties. At this time, approximately 15% of all the loans in the Lehman-label Trusts were delinquent. As a result of these delinquencies, collateral losses increased from $26.8 million in 2009 to $60 million in 2011. As of July 1, 2014, the Lehman-label Trusts had suffered realized losses of $199 million.

329. Lehman's faulty due diligence practices with respect to whether the loans were originated in conformity with representations and warranties is well known to BNYM. Lehman's "due diligence" principally occurred not during the underwriting phase of the offering, but while Lehman was inspecting smaller bulk loans for possible purchase from third-party loan originators after successfully bidding on the loans at auction. Accordingly, at that stage, there was a disincentive for Lehman to reject, or "kick-back," loans as non-compliant with stated guidelines since the originator would be less likely to select Lehman as the winning bidder in future auctions. Indeed, according to the FCIC Report, in connection with securitizing loans, Lehman used Clayton to perform due diligence services. Clayton found that 26% of the total loans underwritten by Lehman failed to meet the underwriting standards, but that Lehman waived its right to reject 37% of these non-conforming loans, and included them in the RMBS it securitized anyway. Further, the motto among Lehman's residential mortgage-backed securities origination sales group became "there are no bad loans only badly priced loans" – meaning loans found not to comply with underwriting guidelines were generally not rejected, but simply negotiated to be purchased more cheaply.

330. Over the past six years, Lehman's securitization practices have been the focus of several, significant RMBS lawsuits. For example, in their Consolidated Securities Class Action

Complaint filed on February 23, 2009, in *In re Lehman Brothers Mortgage-Backed Securities Litigation*, No. 08-CV-6762 (S.D.N.Y.), the class plaintiffs described in detail Lehman's faulty due diligence practices in securitizing loans in in Lehman-label trusts issued under, among other shelves, the SARM and SASC shelves.

331. The results of file reviews conducted by investors further confirmed Lehman's faulty due diligence practices and pervasive and systemic breach of material representations and warranties regarding quality and characteristics of the loans it securitized. For example, in *AIG v. Countrywide Financial Corp.*, Nos. 11-ML-02265/11-CV-10549, AIG reviewed 188 loans originated by Countrywide from the SARM 2006-10 securitization, which demonstrated that that the mortgage pools contain loans rife with fraud and other violations of representations and warranties. Specifically, AIG's review revealed violations of underwriting guidelines in over 90% of the loans, including blatant misrepresentations of employment, and breaches of guidelines.

4. Merrill Lynch

332. Merrill Lynch, through its affiliate Merrill Lynch Mortgage Lending, sponsored $6.5 billion of mortgage loans securitized in ten of the Trusts under the SURF label. It was evident that by January 1, 2009, Merrill Lynch had placed large percentages of toxic loans in the Merrill Lynch-label Trusts. By this time, these securitizations were averaging delinquency rates in excess of 34%. As a result of these severe delinquencies, the Merrill Lynch-label Trusts' losses began to mount. For example, between 2009 and 2011 collateral losses among the Merrill Lynch-label Trusts jumped from approximately $282 million to $461 million. As of July 1, 2014, the Merrill Lynch-label Trusts have sustained collateral losses of approximately $652.5 million.

333. Government reports and RMBS litigation have exposed Merrill Lynch's improper securitization practices. For instance, Clayton's trending reports showed that in the period from

the first quarter of 2006 to the second quarter of 2007, 23% of the mortgage loans that Merrill Lynch submitted to Clayton to review in residential mortgage-backed securities groups were rejected by Clayton as falling outside the applicable underwriting guidelines. Of the mortgage loans that Clayton found defective, 32% of the loans were subsequently waived in by Merrill Lynch without proper consideration and analysis of compensating factors.

334. Similarly, over the past five years, Merrill Lynch's false representations regarding the quality and characteristics of the mortgage loans it securitized have been the focus of several significant RMBS actions, many of which have involved Merrill Lynch-label Trusts. For example, on March 1, 2011, various Allstate entities filed a complaint against Merrill Lynch in connection with its sale of certificates from, among other offerings, SURF 2005-BC3, which is one of the Trusts at issue. After performing its loan level review on SURF 2005-BC3, Allstate concluded that Merrill Lynch had overstated the actual percentage of owner occupied properties by more 10%. Moreover, Allstate found that 12% of the securitization's loans had an actual LTV ratio of 100% or greater, despite Merrill Lynch's representation that no loan had an LTV ratio exceeding 100%.

335. Likewise, on September 2, 2011, the FHFA filed suit against Merrill Lynch in connection with seventy-two Merrill Lynch-sponsored or underwritten securitizations, including OWNIT 2006-1, SURF 2005-AB3, SURF 2005-BC3 and SURF 2005-BC4, each of which are Trusts at issue here. *FHFA v. Merrill Lynch & Co., Inc., et al.*, No. 1:11-cv-06202 (S.D.N.Y. Sept. 2, 2011). The FHFA's review of at least 1,000 randomly selected mortgage loans from each trust revealed that for each securitization Merrill Lynch understated the percentage of non-owner occupied properties by more than 6%, and for some securitizations by more than 10%. In addition, the percentage of mortgage loans with an LTV ratio over 100% was over 10% in 63 of

72 securitizations, and for 20 securitizations over 20% of the mortgages had a true LTV ratio over 100%.

336. In *The Prudential Insurance Company of America v. Bank of America et al.*, No. 2:13-cv-01586 (D. N.J. Mar. 14, 2013), plaintiffs' loan level analysis of the mortgage loans in SURF 2005-BC4, one of the Trusts at issue here, revealed that Merrill Lynch had overstated owner occupied properties by more than 10%; understated the percentage of loans with LTV ratios of greater than 80% by more than 14%; and misrepresented that no loan had an LTV ratio of greater than 100% when in fact over 15% of the loans had an LTV ratio that exceeded 100%.[10]

337. In *CMFG Life Insurance Co., et al. v. Banc of America Sec. LLC, et al.*, No. 13-cv-00579, 2013 WL 4502284 (W.D. Wis. Aug. 15, 2013), the plaintiff investor reviewed loan files from SURF 2005-BC3 and SURF 2005-BC4, two of the Trusts at issue. The plaintiff investor concluded that over 50% of the loans within this trust had LTV ratios at least ten and fifteen percentage points higher than represented by Merrill Lynch, and nearly 50% had LTV ratios at least 25 percentage points higher than as represented. The plaintiff investor similarly found that over 45% of these securtizations' loans had an LTV greater than 100%, despite the fact that Merrill Lynch had represented that no loan's LTV ratio exceeded 100%. The plaintiff investor found that owner occupancy status associated with the loans was misrepresented between 7.36% and 9.41% for these securitizations.

338. Allstate's, FHFA's, and Prudential's loan level reviews of Merrill Lynch-label securitizations have been corroborated by RMBS trustee-led putback actions against Merrill Lynch in its capacity as sponsor relating to substantially similar Merrill Lynch-label

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[10] Plaintiffs in *Prudential v. Bank of America*, No. 2:13-cv-01586 similar alleged that flawed underwriting and due diligence practices led to the securitization and sale of defective loans to ABFC 2005-HE1 and CBASS 2004-CB8, two other Trusts at issue here.

securitizations. For example, in *Merrill Lynch Mortgage Investors Trust, Series 2006-RM4, et al. v. Merrill Lynch Mortgage Lending, Inc., et al.*, Index No. 654403/2012 (N.Y. Sup. Ct. Dec. 18, 2012), U.S. Bank, N.A., as trustee filed an action against Merrill Lynch as sponsor of the MLMI 2006-RM4 and MLMI 2006-RM5 trusts for Merrill Lynch's breach of its repurchase obligations in connection with loans violating representations and warranties. A forensic review of more than 1,000 loans from each of these trusts revealed that at least 73% of the loans in the MLMI 2006-RM4 and 76% of the loans in the MLMI 2006-RM5 trust breached representations and warranties in a manner that materially and adversely affects the value of the mortgage loan and the interest of the certificateholders therein.

5. <u>C-BASS</u>

339. C-BASS was a mortgage investment and servicing company that specialized in the purchase and securitization of subprime mortgages. C-BASS sponsored approximately $4.4 billion in mortgage loans sold to eight of the Trusts. By 2009, it was clear that the C-BASS-label Trusts did not match C-BASS' representations and warranties. By that time 32% of the loans were delinquent. As a result of these severe delinquencies, collateral losses increased from $63 million in 2009 to $113 million in 2011. As of July 1, 2009, the C-BASS-label Trusts have sustained over $595 million in realized losses.

340. C-BASS did not originate loans, but instead served as "Sponsor" of securitizations, often purchasing and securitizing loan pools originated by originators notorious for failing to adhere to underwriting guidelines. Indeed, Fitch Ratings described C-BASS's general business strategy of as one that "targeted investment in 'scratch and dent' sub-performing and nonperforming whole loans, subprime whole loans, subordinate RMBS and servicing rights . . ." Similarly, the American Banker described C-BASS as a firm "best known for buying 'scratch-and-dent' home loans." "Scratch-and-dent loans" are loans or mortgages that have one

or more combination of "defects" stemming from originations made outside a lender's implemented credit guidelines, deficiencies in loan documentation, errors made in following regulatory compliance laws, irregular payment history or borrower defaults.

341. As a significant underwriter of RMBS, C-BASS was a customer of Clayton and its due diligence services. Clayton found that 29% of the total loans underwritten by C-BASS failed to meet the underwriting standards, but that C-BASS waived its right to reject 43% of these non-conforming loans, and included them in the RMBS it securitized anyway.

342. Investor lawsuits have similarly shined the light on C-BASS's faulty securitization practices during the 2004 through 2007 timeframe. For example, in its Amended Complaint filed on March 18, 2010, in *Fulton County Employees' Retirement System v. MGIC Investment Corp.*, No. 08-C-0458 (E.D. Wisc.), a securities fraud class action against MGIC, a controlling shareholder of C-BASS, the class plaintiffs quoted several former senior executives of C-BASS confirming C-BASS's flawed due diligence practices. For example, a senior forensic underwriting analyst at C-BASS from 2004 until mid-2008 charged with reviewing defaulted loans stated "that of the defaulting loans sent to her department, she estimated that 75% of those were fraudulent." Similarly, a Due Diligence Underwriter Contractor for C-BASS from 2004 through 2007 stated "from about 2004 on forward through the 2005 – 2007 timeframe, the quality of loans was falling and consequently the risk component was rising. He explained that occasionally he would find pools of loans that were all 'very poor,' and that 'it looked like they [C-BASS] were just slapping loans together.' He recalled that in some cases the pools were so bad that 80% to 90% of the loans in the pool were 'no good,' noting that the continued decrease in underwriting guidelines [loan quality] resulted from a decrease in the integrity of the seller/originator, such as Countrywide." (Bracketed terms in original.)