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THE PRUDENTIAL INSURANCE COMPANY OF AMERICA; PARK PLACE COMMERCE INVESTMENTS, LLC; COMMERCE STREET INVESTMENTS, LLC; PRU ALPHA FIXED INCOME OPPORTUNITY MASTER FUND I, L.P.; PRUDENTIAL TRUST COMPANY; and PRUDENTIAL INVESTMENT PORTFOLIOS 2,

Plaintiffs,

-against-

GOLDMAN, SACHS & COMPANY; GOLDMAN SACHS MORTGAGE COMPANY; and GS MORTGAGE SECURITIES CORPORATION,

Defendants.

SUPERIOR COURT OF NEW JERSEY
LAW DIVISION, ESSEX COUNTY

Civil Action

DOCKET NO. L-6335-12

COMPLAINT AND JURY DEMAND

SUPERIOR COURT OF NEW JERSEY
LAW DIVISION
ESSEX VICINAGE
AUG 2012
FINANCE DIVISION
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Plaintiffs, The Prudential Insurance Company of America, Park Place Commerce Investments, LLC, Commerce Street Investments, LLC, Pru Alpha Fixed Income Opportunity Master Fund I, L.P., Prudential Trust Company, and Prudential Investment Portfolios 2 (together, "Prudential"), by and through their attorneys Lowenstein Sandler PC and Quinn Emanuel Urquhart & Sullivan LLP, , bring this action against Goldman, Sachs & Company, Goldman Sachs Mortgage Company, and GS Mortgage Securities Corporation (together, "Defendants" or "Goldman"), and allege as follows:

NATURE OF ACTION

1. This action arises out of Goldman's fraudulent sale of residential mortgage-backed securities ("RMBS," "Securitizations" or the "Certificates") to Prudential. Prudential invested more than $270 million dollars in RMBS Certificates it purchased from Goldman in reliance on Goldman's representations regarding the investment quality, i.e., credit risk, of those Certificates. The credit quality of the Certificates was tied directly to the credit quality of the pools of residential mortgages underlying them (the "Mortgage Loans"). That is because the cash flow generated by the payment of these Mortgage Loans is the main source of revenue for payments due to the purchasers of the Certificates. The RMBS sold to Prudential were, *to use Goldman's own words*, "junk," "dogs," "crap," and "lemons." Goldman dubbed the purchasers of these crap Certificates "muppets."

2. To sell securities it knew were "crap," Goldman made numerous material misrepresentations to Prudential about the credit worthiness of the Mortgage Loans and, hence, the Certificates. Each one of Goldman's representations concerning the criteria used in selecting the mortgage loans was critical in determining the credit risk associated with the Mortgage Loans and therefore the investment risk of the Certificates. These material misrepresentations were repeated in numerous documents including registration statements, prospectuses, prospectus

supplements, free writing prospectuses, term sheets, and other draft and final written materials (both herein, and in the Exhibits, referred to as the "Offering Materials") provided to Prudential in connection with the sale of the Certificates. Misrepresentations about any one of these criteria changed the investment risk profile of the Mortgage Loans and the Certificates for one simple reason – they increased the likelihood that a borrower would default. For example:

(i) ***Underwriting guidelines.*** The Offering Materials represented that the Mortgage Loans were originated according to certain established underwriting guidelines. These guidelines were purportedly intended to ensure that only loans that the borrower could afford to repay would be included in the Mortgage Loans underlying the Certificates. In fact, Goldman knew that lenders that originated and sold Mortgage Loans had systematically abandoned the stated underwriting guidelines. Because the stated underwriting guidelines were not followed, the risk of default and non-payment of the Mortgage Loans in the pools was materially higher than it would have been had the underwriting guidelines been followed.

(ii) ***Purpose and Use of Exceptions.*** The Offering Materials represented that loans that did not meet certain criteria were approved as "exceptions" only if the loans possessed countervailing features that "made up" for negative aspects of the risk profile. In fact, "exceptions" were not based on legitimate compensating factors, and instead were simply used as a way to increase loan volume by circumventing the applicable underwriting guidelines.

(iii) ***Owner Occupancy Statistics.*** It is a truism in the mortgage business that the owner of a home where the borrower actually lives is much less likely to default on the payment of the mortgage on the borrowers primary residence than on rental or vacation properties . The Goldman Offering Materials made specific representations regarding the percentage of borrowers with Mortgage Loans in the pools who would be actually occupying the property being mortgaged—a key risk factor. Analytical tools recently made available to investors confirm that a much lower percentage of the Mortgage Loans in the pools were on homes which the owners occupied. Stated another way, compared to Goldman's representations in the Offering Materials, a much higher percentage of the Mortgage Loans in the pools were sold to borrowers who did not live in the homes that secured the mortgages in question. Because of this there was and is a much higher risk of default.

(iv) ***Loan-to-Value Ratios.*** One of the most important metrics in assessing the credit risk of a mortgage relates to the amount of the loan compared to the value of the property. Common sense dictates that the more skin the borrower has in the game, the less likely it is that he will default. The Offering Materials represented that the Mortgage Loans had minimum loan-to-value ("LTV") and combined loan-to-value ("CLTV") ratios. The LTV and CLTV represent the amount of the borrower's obligation as compared to the value of the property which serves as collateral. The CLTV is the LTV after all loans are considered, not just the first mortgage. The importance of these risk metrics is obvious. Statistics prove borrowers who have substantial equity in their homes are less likely to default. Logic dictates that the larger the equity "cushion" that borrowers have, the greater the likelihood of repayment of the loan and the greater the chance the lender will be made whole after a foreclosure. Analytical tools recently made available to investors confirm that the Offering Materials vastly overstated the value of the collateral being included in the loan pools, and hid additional liens on the properties.

(v) ***Assignment of Mortgage Loans to the Trusts.*** The Offering Materials represented (a) that the underlying Mortgage Loans had been validly assigned to the RMBS trusts (the "Trusts") that issued the Certificates, and (b) that the Trusts, acting through loan servicers or the trustees, would have the ability to foreclose in the event of borrower defaults on the loans. But in fact, as reflected in Prudential's loan-level analysis of the chain of title of 9,252 Mortgage Loans underlying its securities, Goldman did not actually assign over ***40%*** of these Mortgage Loans to the Trusts. Of the Mortgage Loans that were assigned to the Trusts, over ***58%*** were not properly assigned as represented in the Offering Materials. Goldman's misrepresentations and failures related to the transfer of title have harmed Prudential.

3. These and other key representations were false – and Goldman knew it at the time they were made. As the United States Senate Permanent Subcommittee on Investigations ("SPSI") found in its April 2011 report, "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse" ("SPSI Report"), Goldman was "***keenly aware*** of the poor quality of many of the loan pools," and thus it "***knew*** [the loan pools] were likely to incur abnormally high rates of default." (SPSI Report at 487, 513 (emphasis added).) High rates of default among the Mortgage Loans in the pools meant there was less cash flow available to pay the Certificateholders.

4. As the SPSI found, Goldman "underwrote securities using loans from subprime lenders known for issuing high risk, poor quality mortgages, and then sold risky securities to investors across the United States and around the world." (*Id.* at 11.) Many of the loans came from lenders such as New Century, Fremont, Wells Fargo and Aegis Mortgage Corp.—who rank among the Office of the Comptroller of the Currency's "Worst Ten in the Worst Ten" list of mortgage loan originators. (*Id.* at 239.) Goldman knew that these now-notorious lenders were selling loans which did not meet their stated underwriting guidelines. Goldman would securitize them anyway. Once the Mortgage Loans were pooled, Goldman sold Prudential and others Certificates collateralized by these loans.

5. Goldman retained a third party due diligence firm called Clayton Holdings to review the loan files of the Mortgage Loans. Clayton Holdings' reports – which were transmitted to Goldman – confirm that Goldman was aware, on almost a real-time basis, of how many loans failed to meet the stated underwriting guidelines. Yet Goldman "waived" those defects and put the defective Mortgage Loans into pools of loans which were securitized such as those at issue here.

6. As the U.S. real estate market started to decline, Goldman embarked on a plan to reduce its own exposure to the U.S. housing market. Not so with the investing public. Goldman "kept right on packaging up, underwriting, and selling mortgage-related securities" to unsuspecting investors like Prudential. (William D. Cohan, *Money and Power: How Goldman Sachs Came to Rule the World*, 2011.) Goldman did so because, by misrepresenting the quality of the loans, it was able to reap millions in fees for the numerous roles it played along the securitization chain.

7. There was another factor that drove Goldman to keep selling RMBS. Goldman was able, through the process of securitization, to move the loans off of its own books—and off the books of lenders who were indebted to Goldman. Goldman provided many mortgage originators with "warehouse" lines of credit. The mortgage originators owed Goldman billions. That gave Goldman incentive to move the originators' mortgages down the securitization pipeline, create RMBS certificates, sell them to the public, and thus ensure that the originators could repay Goldman's lines of credit. As the Financial Crisis Inquiry Commission ("FCIC") found in its January 2011 report ("FCIC Report"), Goldman, through its cheap warehouse financing of subprime loans and other fraudulent business practices, "multiplied the effects of the collapse in subprime." (FCIC Report at 142.)

8. Goldman not only benefitted from the fees the securitizations generated, but also from a scheme to profit even more when the real value of the RMBS was revealed. Specifically, *Goldman was making outside bets against many of the same assets and asset types at the very same time it was securitizing them.* Not surprisingly, Goldman "failed to disclose to clients that, at the same time it was recommending investments in Goldman RMBS and collateralized debt obligation ("CDO") securities, it was committing billions of dollars to short the same types of securities, as well as their underlying assets, and even some of the lenders whose mortgage pools were included or referenced in the securities." (SPSI Report at 513, 618.)

9. Goldman was able to engage in such profiteering because it was in a unique position to know the true quality of the loans it was packaging into securities such as the Certificates here. Goldman's longstanding relationships with industry participants, and its warehouse lending agreements, gave it a direct window into the originators' abandonment of underwriting standards. Tellingly, only when the securitization market started to dry up did Goldman confront these lenders with its knowledge of their poor practices. That Goldman forced the same lenders at issue here to repurchase loans Goldman was stuck with (despite its best efforts) is graphic evidence that the mortgage originators relevant to this case knew they were churning out defective loans. That Goldman knew to specifically target the same lenders at issue in this case for repurchase demands is evidence that Goldman knew those lenders had abandoned their underwriting guidelines. Nonetheless, Goldman *continued to try to securitize these lenders' loans even as it was forcing them to repurchase the loans left on Goldman's books*. This confirms Goldman's own systematic abandonment of its underwriting and securitization guidelines and blatant disregard for the financial interests of purchasers like Prudential.

10. Prudential purchased more than $270 million of Certificates from Goldman across sixteen different securitizations from February 11, 2004 to December 17, 2008. All were purchased in reliance on Goldman's misrepresentations and omissions. These purchases are further detailed in the Exhibits to this Complaint, all of which are incorporated herein.

Securitization	Total Investment
Fremont Home Loan Trust 2004-A	$15,000,000
GSAMP Trust 2004-AR2	$15,365,000
GSAMP Trust 2004-FM1	$5,000,000
GSAMP Trust 2004-FM2	$12,695,000
GSAMP Trust 2004-WF	$10,000,000
FFML Trust 2005-FF2	$7,500,000
GSAMP Trust 2005-HE4	$5,000,000
GSAMP Trust 2005-HE6	$20,532,000
GSAMP Trust 2005-WMC2	$8,224,000
GSAMP Trust 2006-FM1	$17,000,000
GSAMP Trust 2006-HE1	$14,000,000
GSAMP Trust 2006-HE2	$68,178,000
GSAMP Trust 2006-HE3	$25,547,000
GSAMP Trust 2006-HE6	$20,148,000
GSAMP Trust 2006-HE7	$7,500,000
GSAMP Trust 2007-HE2	$20,000,000

11. The GSAMP Trust 2007-HE2, among many other Goldman securitizations, merited specific mention in the SPSI Report. The 2007-HE2 Trust was collateralized primarily by mortgages originated by New Century. According to the SPSI, "Goldman approved this securitization even though it knew at the time that New Century's subprime loans were performing poorly, many of the New Century loans in Goldman's inventory were problematic, and New Century was in financial difficulty." (SPSI Report at 488.) In fact, Goldman approved this securitization in April 2007, the same month that New Century declared bankruptcy! (*Id.*) The SPSI Report found that if Goldman had not securitized the New Century loans, it would have likely had to liquidate the warehouse accounts containing them and either sell the loan

pools or keep the high risk loans on its own books. (*Id.*) Goldman chose instead to pass on these losses to purchasers of the Certificates. Similarly, the SPSI Report notes that one banker said of the GSAMP 2006-HE3 Securitization: "this bond sucks but we are short 20MM." (SPSI Report at 330.)

12. The systemic (but hidden) abandonment of the disclosed underwriting guidelines led to soaring default rates in the Mortgage Loans underlying the Certificates, which in turn led to catastrophic losses in their market value. The delinquency rates on the Mortgage Loans underlying Prudential's investments are astronomical, far above the delinquency rate one would expect from loans that met the stated loan criteria. Moreover, despite the fact that all of the Certificates at issue in this suit started out with high AAA or AA ratings, all but three have been downgraded to "junk" by at least one of the major rating agencies. Not surprisingly, their market value has plummeted. The drastic drop in market value of these Certificates, which is indicative that the value is far less than what Prudential paid, and the spike in delinquency rates, was not caused by the downturn in the U.S. housing market, but rather by faulty underwriting of the Mortgage Loans themselves. As Senator Carl Levin summarized:

> Investment banks such as Goldman Sachs were not simply market-makers, they were self-interested promoters of risky and complicated financial schemes that helped trigger the crisis. They bundled toxic mortgages into complex financial instruments, got the credit rating agencies to label them as AAA securities, and sold them to investors, magnifying and spreading risk throughout the financial system, and all too often betting against the instruments they sold and profiting at the expense of their clients.

(SPSI Press Release, dated April 24, 2010.)

PARTIES

13. ***The Plaintiffs.*** Plaintiff Prudential Insurance Company of America ("Prudential Insurance") is an insurance company formed under the laws of, and domiciled in, the State of New Jersey, with its principal place of business in Newark, New Jersey. Prudential Insurance is

a wholly-owned subsidiary of Prudential Holdings, LLC, which is a Delaware limited liability company. Prudential Holdings, LLC is a wholly-owned subsidiary of Prudential Financial, Inc., which is a New Jersey corporation.

14. Plaintiff Park Place Commerce Investments, LLC ("Park Place Commerce Investments") is a company formed under the laws of, and domiciled in, the State of Delaware, with its principal place of business in Wilmington, Delaware.

15. Plaintiff Pru Alpha Fixed Income Opportunity Master Fund I, L.P. ("Pru Alpha") is a Cayman Islands Exempted Limited Partnership with its principal place of business at 2 Gateway Center, Third Floor, Newark, New Jersey 07102. Pru Alpha is a wholly-owned subsidiary of Prudential Investment Management, Inc., and ultimately Prudential Financial, Inc.

16. Plaintiff Commerce Street Investments, LLC ("Commerce Street Investments") is a company formed under the laws of, and domiciled in, the State of Delaware, with its principal place of business at 751 Broad Street, Newark, NJ 07102.

17. Plaintiff Prudential Trust Company is a corporation formed under the laws of Pennsylvania, with its principal place of business at 30 Scranton Office Park, Scranton, Pennsylvania 18507. Prudential Trust Company is a wholly-owned subsidiary of Prudential Investment Management, Inc., and ultimately Prudential Financial, Inc. Prudential Trust Company serves as Trustee for two of the Prudential funds which purchased Certificates of the GSAMP 2006-HE3 Trust: Institutional Core Plus Bond Fund of the Prudential Trust Company Master Commingled Investment Fund for Tax Exempt Trusts and Prudential Total Return Bond Fund, Inc.

18. Plaintiff Prudential Investment Portfolios 2 is a is a Delaware statutory trust with a principal place of business at Gateway Center Three, 100 Mulberry Street, Newark NJ 07102.

It is an open -ended management investment company registered with the Securities and Exchange Commission and is comprised of the following funds: Prudential Core Short-Term Bond Fund and Prudential Core Taxable Money Market Fund.. Through its Prudential Core Short Term Bond Fund, which is managed by Prudential Investments LLC, Prudential Investment Portfolios 2 owns Certificates in GSAMP 2004-FM1, GSAMP 2005-HE6, GSAMP 2006-HE6, and GSAMP 2006-HE7.

19. Prudential made the purchases described in Exhibits A - R. These purchases were all made from New Jersey, and the decisions to purchase, including reliance on the Offering Materials, also took place in New Jersey.

20. ***The Defendants.*** All of the Defendants in this action are part of the same corporate family, and acted together to control the entire process of the creation, marketing, and sale of the Certificates at issue here, including buying and pooling together mortgage loans, underwriting securities, and selling the securities to Prudential and other investors. From 2004 to 2008, Goldman was a major player in the mortgage market. Its business activities included buying and selling mortgage-related securities on behalf of itself and its clients, and amassing billions of dollars worth of proprietary mortgage-related holdings. In 2006 and 2007 alone, it created and underwrote 93 RMBS and 27 mortgage-related CDO securitizations, totaling approximately $100 billion.

21. As discussed below, the process of issuing an RMBS securitization involves several entities, but their efforts are joint. The Goldman sponsor, depositor, and underwriter Defendants each had different roles in the securitization process and all worked together to create, market, and issue the Certificates. Each defendant is prominently identified on the front

of the Offering Materials. Thus, they all "spoke" in those materials, and are jointly responsible for the material misstatements and omissions therein.

22. Defendant Goldman, Sachs & Company is a New York limited partnership with its principal place of business in New York, New York. Defendant Goldman, Sachs & Company was either the sole, or lead underwriter for the Certificates. In that role, Goldman, Sachs & Co. had responsibility for underwriting and managing the securitizations' sale of Certificates to Prudential and other investors, including screening the Mortgage Loans for compliance with the applicable underwriting guidelines. Defendant Goldman, Sachs & Co. was obligated to perform sufficient due diligence to ensure that the Offering Materials, including without limitation the relevant prospectus supplements, did not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

23. Defendant Goldman Sachs Mortgage Company is a New York limited partnership with its principal place of business in New York, New York. Goldman Sachs Mortgage Company is an affiliate of Goldman, Sachs & Company, and was the sponsor and/or seller for all but one of the Certificates. (For GSAMP 2006-HE2, Credit-Based Asset Servicing and Securitization (CBASS) was the Seller.) In that role, Goldman Sachs Mortgage Company pooled mortgage loans in the securitizations and sold, transferred, or otherwise conveyed title to those loans to the depositor pursuant to Pooling and Servicing Agreements.

24. Defendant GS Mortgage Securities Corporation is a Delaware corporation with its principal place of business in New York, New York. Defendant GS Mortgage Securities Corporation, which is an affiliate of Goldman, Sachs & Company, served as the depositor for all of the Securitizations.

25. ***Relevant Non-Parties.*** Non-party The Goldman Sachs Group, Inc. is a Delaware corporation with its principal executive office in New York, New York. The Goldman Sachs Group, Inc., itself and through its subsidiaries, engaged in mortgage lending and other real estate finance-related businesses, including mortgage lending, securities dealing, and insurance underwriting. It is the corporate parent of all of the Defendants. The Goldman Sachs Group, Inc., is a limited partner in Goldman Sachs Mortgage Company and controls the general partner of Goldman Sachs Mortgage Company.

26. Avelo Mortgage, L.L.C. served as servicer for some of the Mortgage Loans, including those securitizations where it is identified as a servicer on Exhibit A. Avelo's role as servicer is established through Pooling and Servicing Agreements ("PSAs"), which are governed by New York law. It is an affiliate, through common parent ownership, of Goldman Sachs Mortgage Company.

27. At all relevant times, Goldman committed the acts, caused or directed others to commit the acts, or permitted others to commit the acts alleged in this Complaint. Any allegations about acts of Defendants means that those acts were committed through their officers, directors, employees, agents, and/or representatives while those individuals were acting within the actual or implied scope of their authority.

28. None of the causes of action in this Complaint seek relief from any bankrupt entity.

JURISDICTION AND VENUE

29. Pursuant to N.J. Ct. R. 4:4-4(a)(6), this Court has jurisdiction over Goldman because Goldman transacts business in New Jersey and because Goldman committed acts in New Jersey causing injury to plaintiffs.

30. Venue is proper in this County pursuant to N.J. Ct. R. 4:3-2(a) because each cause of action arose, in part, in Essex County; because Prudential resides within this county and has its principal places of business here; and because the causes of action set forth in this Complaint arose in New Jersey.

BACKGROUND

A. The Mechanics of Mortgage Securitization

31. Mortgage pass-through securities, or certificates, represent interests in a pool of mortgage loans. The securities, called certificates, are "shares" of the pool that are sold to investors. The pass-through securities entitle the holder to principal and interest payments from the pool of mortgages. Although the structure and underlying collateral may vary by offering, the basic principle of pass-through securities remains the same: The cash flow received from the borrowers with mortgages in the pool is "passed through" to the certificateholders as payments are made by the underlying mortgage borrowers.

32. The initial step in creating a mortgage pass-through certificate is the generation of the loans by the initial **Originators**. Loans are then pooled into groups by a Goldman "**Sponsor**" or "**Seller**." The "sponsor" of a mortgage-backed security ("MBS") is often a Wall Street investment bank. Here, the "sponsor" was, predominantly, Goldman Sachs Mortgage Company. In order to ensure that it had access to sufficient numbers of loans to feed its securitization machine, in many cases Goldman would provide a warehouse line of credit to the loan Originator. The warehouse line provided the funds to the Originator that were loaned to the ultimate borrower. For GSAMP 2006-HE2, where CBASS served as the Seller, Goldman did just that and provided CBASS with a warehouse line of credit. (GSAMP 2006-HE2 Pro. Supp. at S-41.)

33. After pooling the loans, the Sponsor transfers them to the "**Depositor**." The Depositor is typically a special-purpose affiliate of the Sponsor, that exists solely to receive and then pass on the rights to the pools of loans. It is also often controlled directly by the same officers and directors who run the Sponsor. The Depositor GS Mortgage Securities Corporation is a wholly-owned subsidiary of the Sponsor, Goldman Sachs Mortgage Company, and has no business operations other than securitizing mortgage assets and related activities. (*see, e.g.*, GSAMP 2006-FM1 Pro. Supp. at S-51.)

34. Upon acquisition, the Depositor transfers, or deposits, the acquired pool of loans to an "issuing trust." The Depositor then securitizes the pool of loans in the issuing trust so that the rights to the cash-flows from the pool can be sold to investors. The securitization transactions are structured such that the risk of loss is divided among different levels of investment, or "tranches." Tranches consist of multiple series of related securities offered as part of the same offering, each with a different level of risk and reward. Any losses on the underlying loans—whether due to default, delinquency, or otherwise—are generally applied in reverse order of seniority. As such, the most senior tranches of pass-through securities receive the highest credit ratings because they are the least risky. Junior tranches, being less insulated from risk, typically obtain lower credit ratings, but offer greater potential returns.

35. Once the tranches are established, the issuing trust passes the securities or certificates back to the Depositor, who becomes the "**Issuer**" of the securities. The Depositor then passes the securities to one or more underwriters, who offer and sell the securities to investors in exchange for cash that is passed back to the depositor, minus any fees owed to the underwriters.

36. The underwriter plays a critical role in the securitization process by purchasing the securities from the issuing trust through the Depositor and then selling them to investors. The underwriter provides information about the loans in the pools and the certificates that potential investors like Prudential rely on in deciding whether to purchase the securities.

37. Because the cash flow from the loans in the collateral pool of a securitization is the main source of payments to holders of the certificates issued by the trust, the credit quality of the certificates depends directly upon the credit quality of the loans in the collateral pool. The credit quality of the loans in the pool is far and away the most important factor in an investor's decision to purchase a certificate.

38. The most important information about the credit quality of the loans is contained in the "loan files" that the mortgage originator develops while making the loans. For residential mortgage loans, each loan file normally contains documents including (a) the borrower's application for the loan; (b) verification of the borrower's income, assets, and employment; (c) references; (d) credit reports on the borrower; (e) a statement of the occupancy status of the property (owner occupied, rental or vacation home); and (f) an appraisal of the property that will secure the loan and provide the basis for measures of credit quality, such as LTV ratios. The loan file also typically contains the record of the investigation by the loan originator of the documents and information provided by the borrower, as well as the detailed notes of the underwriter setting forth the rationale for making each loan.

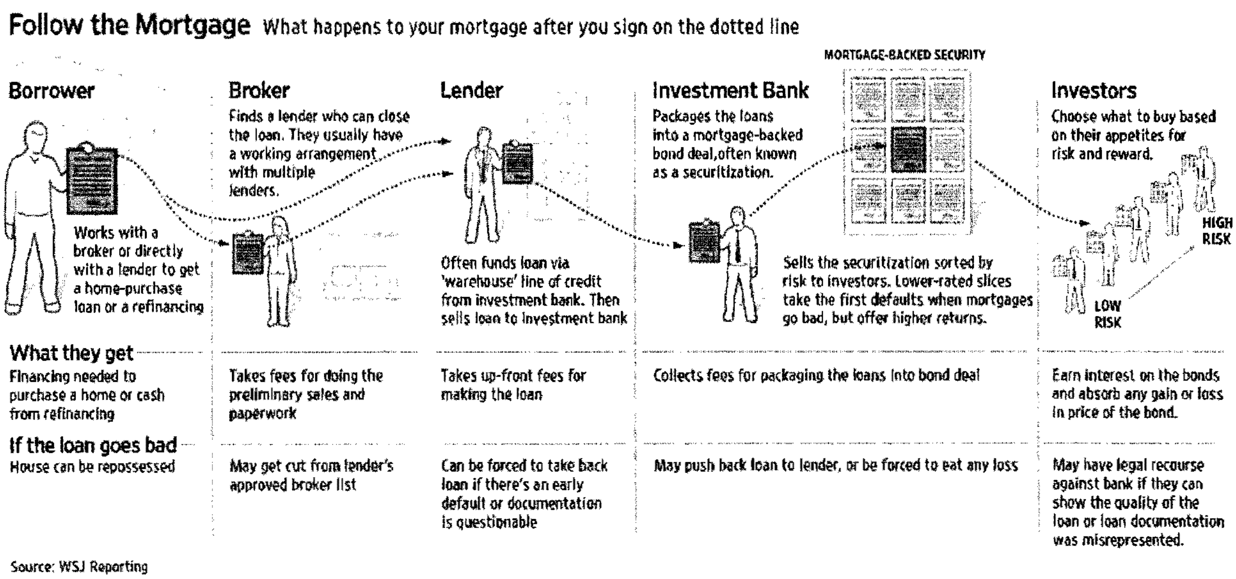
B. <u>Investors Were Not Given Access to the Thousands of Loans in the Loan Pools</u>

39. Investors like Prudential were *not* given access to the loan files. Rather, they had to rely upon the representations made by Goldman in the Offering Materials. The collateral pool for each securitization usually includes thousands of loans. The loan pools in the offerings

which Prudential purchased ranged from 2,800 to 10,300. Instead of each potential investor reviewing thousands of loan files, the Sponsor, Depositor and underwriter are responsible for gathering, verifying, and presenting to potential investors accurate and complete information about the credit quality and characteristics of the loans that are deposited in the trust. In accordance with industry standards, this involves performing due diligence on the loan pool and the Originators to ensure the representations being made to investors are accurate.

40. Investors, like Prudential, rely on the description of the quality and nature of the loans in the offering materials.

41. The *Wall Street Journal* has summarized the securitization process as follows:



C. Securitization of Mortgage Loans: The Traditional Model

42. Traditionally, mortgage originators (usually banks) financed their mortgage business through customer deposits. They made mortgage loans and retained ownership of the loans they originated. The Originator received and retained the mortgage payment streams. When an Originator held a mortgage through the term of the loan, the Originator also bore the risk of loss if the borrower defaulted and the value of the collateral was insufficient to repay the

loan. As a result, the Originator had a strong economic incentive to verify the borrower's creditworthiness through prudent underwriting, and to obtain an accurate appraisal of the value of the underlying property before making the mortgage loan.

43. Mortgage loan securitization, however, shifted the traditional "originate to hold" model to an "originate to distribute" investment model, in which originators sell residential mortgages and transfer credit risk to investors through the issuance and sale of RMBS. Under the new model, originators no longer hold the mortgage loans to maturity. Instead, by selling the mortgages to investment banks, which sell securities collateralized by the mortgages to investors, the originators obtain the funds to make more loans. The new model completely changed the economic incentives for originators of mortgages. Securitization enables Originators to earn most of their income from transaction and loan-servicing fees, rather than from the spread between interest rates paid on deposits and interest rates received on mortgage loans. Originators made hundreds of millions on these fees. Thus, securitization gives Originators an incentive to increase the number of mortgages they issue regardless of credit quality because they got paid regardless. The investor's primary protection from abuse comes from contractual terms, adherence to solid underwriting standards, and good business practices legally obligating Originators to underwrite loans in accordance with their stated policies and to obtain accurate appraisals of the mortgaged properties.

44. Traditionally, most mortgage securitizations were conducted through the major Government Sponsored Enterprises (the "Agencies"), *i.e.*, the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Government National Mortgage Association ("Ginnie Mae"). The Agencies purchased loans from originators and securitized the loans. The Agency securitizations had high credit

quality because the Agencies required the underlying loans to be originated in accordance with strict underwriting guidelines. Most non-Agency mortgage securitizations traditionally also had relatively high credit quality because they typically complied with the Agencies' underwriting standards.

D. The Systemic Abandonment Of Underwriting And Appraisal Standards In The Mortgage Securitization Industry

45. During the 1980s and 1990s, the mortgage securitization business grew rapidly, making it possible for mortgage originators to make more loans than would have been possible using only funds from bank deposits. Originators during this early growth period generally made loans in accordance with their stated underwriting and appraisal standards and provided accurate information about the loans, borrowers, and mortgaged properties to the Wall Street banks that securitized the loans. In turn, the Wall Street banks provided accurate information about the loans, borrowers, and properties to RMBS investors.

46. Unbeknownst to investors, the game fundamentally changed in the early 2000s. While both Originators and Wall Street banks, through the 1990s, played by the well documented rules and complied with their obligations to underwrite loans responsibly and provide accurate information to RMBS investors, this ceased to be the case in the following decade. The history of the recent market collapse was investigated by the FCIC, which "reviewed millions of pages of documents, interviewed more than 700 witnesses, and held 19 days of public hearings in New York, Washington, D.C., and communities across the country," and concluded:

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

FCIC Report at xi, xvi.

47. With historically low interest rates decreasing the profits of traditional lending and securitization through Fannie Mae or Freddie Mac, Wall Street banks looked for new ways to profit. Banks began to focus on creating products outside the traditional lending guidelines and expanding the number of borrowers who could purportedly qualify for loans, while also charging those borrowers much higher fees than they would have paid on conforming Fannie Mae or Freddie Mac loan terms. As a result, the number of loans that were riskier than those that could be securitized through Fannie Mae or Freddie Mac skyrocketed. For instance, according to an April 7, 2010 report by the FCIC, loans that did not conform to Fannie Mae and Freddie Mac guidelines grew from around $670 billion in 2004 to over $2 trillion in 2006.

48. Such an enormous rise in mortgage volume over a short period of time created problems with loan funding capital and risk allocation. As the FCIC put it: "[U]nder the radar, the lending and financial services industry had mutated." (FCIC Report at 7.) It found that "[s]ecuritization and subprime originations grew hand in hand," as "[t]he nonprime mortgage securitization process created a pipeline through which risky mortgages were conveyed and sold throughout the financial system. This pipeline was essential to the origination of the burgeoning numbers of high-risk mortgages." (FCIC Report at 70, 125.)

49. In other words, the shift towards non-traditional loans sparked a growing focus on the "originate to distribute" model. What has now become clear is that, because the risk of non-payment was transferred to investors, Originators, Underwriters, and others in the securitization chain were incentivized to pump out as many loans as possible, the more exotic (and thus generally more lucrative fees), the better—as long as they could be sold. Originators and Securitizers were willing to abandon sound underwriting practices because they offloaded the

risk onto investors like Prudential. They did so by misrepresenting the loan collateral to ensure the securities' marketability. As the FCIC concluded: "The originate-to-distribute model undermined responsibility and accountability for the long-term viability of the mortgages and mortgage-related securities and contributed to the poor quality of mortgage loans." (FCIC Report at 125.)

50. The underwriters of the offerings and Originators of the underlying mortgage loans make large amounts of money from the fees and other transaction revenues associated with their efforts to create and sell mortgage-backed securities. These fees and revenues are generally calculated as a percentage of the securitization's principal balance, and can amount to millions of dollars in the context of large transactions. From 2000 through 2008, Wall Street banks had learned that they could earn much more from arranging and selling mortgage-backed securities than they could make by simply making loans and selling them. The securitization business was a gold mine for the investment banks that were able to control significant market share.

51. Underwriters of RMBS offerings like those at issue typically would collect between 0.2% to 1.5% in discounts, concessions, or commissions. On the sixteen offerings at issue here, these commissions would have yielded Goldman millions of dollars in underwriting fees alone. By providing warehouse loans and serving as a sponsor and depositor of the offerings, Goldman earned even more. It was, in part, the fees Goldman was receiving for its promised underwriting, diligence, and oversight that kept Goldman in the business of acquiring mortgage loans from originators for securitization, even after Goldman became aware that the loans being provided by these mortgage originators did not meet basic, prudent underwriting practices – the ones described in the Offering Materials.

52. Because the underlying loans were on non-traditional terms, banks could offer investors higher rates of return on the securitized pools, even as the deal's structure (such as, for instance, including "extra" mortgage loans in the collateral pool) purportedly made the investments safe. Unknown to investors like Prudential, however, the securities were much riskier than disclosed because Goldman misrepresented many facts concerning the Mortgage Loans.

53. For instance, Goldman: (1) overstated how many loans were on owner-occupied homes (owner-occupied properties have lower risks), (2) understated the loan pools' average LTV and CLTV ratios (suggesting the borrowers had more of an equity "cushion" than they did), (3) misrepresented the loans' adherence to standard underwriting practices, and (4) failed to inform investors such as Prudential that high numbers of defective loans were "waived" into the mortgage pools (making representations regarding the quality of the underwriting process even more misleading). Each misrepresentation and omission created an additional, hidden layer of risk well beyond that known to be associated with an "adjustable rate mortgage" or a "home equity loan" in the abstract.

54. Since the payment streams from borrowers ultimately fund payments to investors, if enough loans in the pool default, investors will not be paid the interest returns promised and may even lose their principal. The true value of the Certificates obviously becomes be lower as the higher risk is discovered—as evidenced by, among other things, a drop in market value as the true risk profile of the underlying mortgage pool is revealed. As such, any representation bearing on the riskiness of the underlying mortgage loans was material to investors, including Prudential. In short, by misrepresenting the true risk profile of the underlying loan pools, Goldman defrauded investors like Prudential.

55. As the FCIC found:

> 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 (emphasis added).

SUBSTANTIVE ALLEGATIONS

I. THE OFFERING MATERIALS' UNTRUE STATEMENTS OF MATERIAL FACT AND OMISSIONS

A. Goldman's Misrepresentations Regarding Underwriting Standards and Practices

56. Consistent with its roles as Sponsor and/or Seller and underwriter of the Certificates, Goldman represented to investors in the Offering Materials that the Mortgage Loans were "originated" or "acquired" in accordance with stated underwriting guidelines. For example, according to the Prospectus Supplement for GSAMP 2006-FM1, Goldman stated that "[t]he mortgage loans were originated or acquired generally in accordance with the underwriting guidelines described in this prospectus supplement" (GSAMP 2006-FM1 Pro. Supp. at S-33.) Similar representations are made in each of the other Certificates' Prospectus Supplements. See, e.g., GSAMP 2005-HE4 Pro. Supp. at S-30 ("The Fremont mortgage loans and Conduit mortgage loans were originated or acquired generally in accordance with the underwriting guidelines described in this prospectus supplement under the headings 'The Mortgage Loan Pool – Fremont Underwriting Guidelines,' and '—Goldman Sachs Mortgage Conduit Program Underwriting Guidelines,' respectively.").

57. For example, the Prospectus for GSAMP 2006-HE7 (and other Offering Materials which contained similar representations) reassured investors that:

- "The lender or an agent acting on the lender's behalf applies the underwriting standards to evaluate the borrower's credit standing and repayment ability, and to evaluate the value and adequacy of the mortgaged property as collateral." GSAMP 2006-HE7 Prospectus dated October 6, 2006, at 29.

- "In general, the lender may require that a prospective borrower fill out a detailed application designed to provide to the underwriting officer pertinent credit information. As a part of the description of the borrower's financial condition, the lender may require the borrower to provide a current list of assets and liabilities and a statement of income and expense as well as an authorization to apply for a credit report, which summarizes the borrower's credit history with local merchants and lenders and any record of bankruptcy. The lender may obtain employment verification from an independent source (typically the borrower's employer). The employment verification reports the length of employment with that organization, the current salary and whether it is expected that the borrower will continue such employment in the future. If a prospective borrower is self employed, the lender may require the borrower to submit copies of signed tax returns. The lender may require the borrower to authorize verification of deposits at financial institutions where the borrower has demand or savings accounts. In determining the adequacy of the mortgaged property as collateral, the lender will generally obtain an appraisal to determine the fair market value of each property considered for financing." *Id.*

- "[T]he lender makes a determination as to whether the prospective borrower has sufficient monthly income available (as to meet the borrower's monthly obligations on the proposed mortgage loan and other expenses related to the mortgaged property such as property taxes and hazard insurance)." *Id.*

58. The Offering Materials also made specific representations about the underwriting criteria of certain third-party Originators from whom Goldman purchased the Mortgage Loans. Goldman reassured investors that the Originators from which it had acquired loans (either through bulk purchases or through its conduit program) had, in fact, adhered to their own underwriting standards. This representation was of vital importance, because it reflected Goldman's own verification of the loan-origination practices, which investors like Prudential were not in a position to assess.

59. For example, for the GSAMP 2006-FM1 securitization, Goldman acquired all of the loans from Fremont Investment and Loan. To reassure Prudential and other investors that the loans had been made in accordance with reasonable underwriting criteria, Goldman represented, among other things, that:

> Mortgage loans are underwritten in accordance with Fremont's current underwriting programs , referred to as the Scored Programs ("SCORED PROGRAMS"), subject to various exceptions as described in this section. Fremont began originating mortgage loans pursuant to Scored Programs in 2001 and the Scored Programs have been the exclusive type of origination programs beginning in 2004. Fremont's underwriting guidelines are primarily intended to assess the ability and willingness of the borrower to repay the debt and to evaluate the adequacy of the mortgaged property as collateral for the mortgage loan. The Scored Programs assess the risk of default by using credit scores obtained from third party credit repositories along with, but not limited to, past mortgage payment history, seasoning on bankruptcy and/or foreclosure and loan-to-value ratios as an aid to, not a substitute for, the underwriter's judgment.

GSAMP 2006-FM1 Prospectus Supplement dated April 25, 2006 at S-40.

The Offering Materials further described: (1) "Risk Categories," including maximum debt to income ratios, and minimum Credit Scores; (2) borrower eligibility criteria depending on whether the borrower who received credit grades ranging from "A+" to "D;" and (c) appraisal procedures which required that initial appraisals be "provided by qualified independent appraisers licensed in their respective states." (*Id.* at S-41 to S-43.)

60. The Offering Materials for GSAMP Trust 2006-HE3 made similar representations regarding SouthStar Funding LLC's underwriting criteria. Goldman represented, among other things, that "SouthStar's guidelines are intended to evaluate the borrower's ability to repay the mortgage loan, evaluate the borrower's credit and evaluate the value and adequacy of the collateral. SouthStar does not approve mortgage loans based solely on the value of the collateral." (GSAMP 2006-HE3 Pro. Supp. at S-47.) Goldman put its own stamp of approval on

the loans, telling investors that Goldman "believed" that originators like SouthStar applied the described underwriting guidelines. (GSAMP 2006-HE7 at S-45; see also GSAMP 2006-HE3 at S-34.)

61. With respect to the loans Goldman acquired through the GS Conduit Program, Goldman represented in the Offering Materials, including the materials for GSAMP 2006-HE3, that it "purchase[] mortgage loans originated by the original loan sellers if the mortgage loans generally satisfy the sponsor's underwriting guidelines." (*Id.* at S-8.) The underwriting criteria for the GS Conduit Program are described in each of the Prospectuses for the Certificates, and include a detailed discussion of Goldman's underwriting guidelines, borrower credit applications, documentation guidelines, debt-to-income and loan-to-value thresholds, and appraisal standards. (*See, e.g., id.* at 30-33.)

62. For example, Goldman represented that

- "All of the mortgage loans that GSMC may acquire through its conduit program will be acquired generally in accordance with the underwriting criteria described in this section. In certain instances, compensating factors demonstrated to the mortgage loan originator by a prospective borrower may warrant GSMC to make certain exceptions to these guidelines. In such instances GSMC would purchase a mortgage loan that did not completely conform to the guidelines set out below."
- "[E]ach borrower applying for a mortgage loan must complete a credit application. The credit application is designed to provide the originating lender with relevant credit information about the prospective borrower such as information with respect to the borrower's assets, liabilities, income . . . credit history, employment history and personal information."
- "Based on the data referred to above . . . the originating lender makes a determination about whether the borrower's monthly income (if required to be stated) will be sufficient to enable the borrower to meet its monthly obligations on the mortgage loans and other expenses related to the property."

Id. at 30-33.

63. The underwriting process used to originate the pools of Mortgage Loans underlying Prudential's Certificates was crucial to Prudential and other investors because, as discussed above, the quality of loans in the pool determines the risk of no payment on the certificates backed by those loans. If a prudent underwriting process was not followed, the chances that the loans had riskier features than Goldman claimed would greatly increase, making the entire loan pool much riskier and thus more prone to default and market losses. A systemic underwriting failure would decrease the reliability of *all* the information investors have about the loans, and thus would significantly increase the perceived and actual risk to investors. Thus the true value of the Certificates would be substantially lower if accurate data was provided.

64. One key component of the underwriting standards is information regarding a borrower's income, such as the ratio of a borrower's debt to his or her income. This was material to Prudential because it represents a borrower's ability to afford, the mortgage payments at issue, and thus directly implicates the likelihood of default. See, e.g., GSAMP Trust 2006-FM1 Pro. Supp. at S-29 (Goldman represented that borrowers were required to furnish "a current list of assets and liabilities and a statement of income and expense as well as an authorization to apply for a credit report, which summarizes the borrower's credit history with local merchants and lenders and any record of bankruptcy."); *id.* at S-30 (regarding loans obtained through the GS Conduit Program, Goldman represented that its underwriting included an analysis of whether the "borrower's monthly income (if required to be stated) will be sufficient to enable the borrower to meet its monthly obligations on the mortgage loan and other expenses related to the property, including property taxes, utility costs, standard hazard insurance and other fixed and revolving obligations other than housing expenses."); *id.* at S-40 (representing that Fremont's underwriting criteria "are primarily intended to assess the ability and willingness of the borrower

to repay the debt and to evaluate the adequacy of the mortgaged property as collateral for the mortgage loan.")

65. As set forth in Exhibits C-R, similar representations were made in all of the Offering Materials.

66. Goldman's representations regarding its and its Originators' underwriting practices were false and misleading. The Mortgage Loans underlying Prudential's Certificates did not comply with the underwriting standards the Offering Materials described because those standards were systemically ignored by Goldman and by its originators. They disregarded borrowers' actual repayment ability, income and the value and adequacy of mortgaged property that was used as collateral.

67. That the loans were systematically generated without regard to the stated underwriting guidelines is confirmed by Prudential's loan-level analysis of the Mortgage Loans at issue here, statistics regarding Goldman's "waiver" of guidelines, the collateral pool's dismal performance, internal e-mails and documents reflecting Goldman's own discovery of borrower misrepresentations and underwriting defects, recent revelations regarding the practices of the originators at issue here, and other facts set forth more fully below.

B. <u>Goldman's Misrepresentations Regarding Due Diligence Results</u>

68. Goldman's representations regarding the underwriting process were understood by investors, including Prudential, to mean that Goldman had taken appropriate measures to ensure that non-compliant loans would not be included in the mortgage pools.

69. Goldman, however, did not disclose that: (1) Goldman in many instances failed to perform adequate due diligence before securitization; (2) when Goldman was informed from its quality review processes that a substantial percentage of loans in the collateral pools were defective, it nonetheless waived the defects as to a substantial percentage of these loans; (3)

Goldman instead used its analysis of the loans to negotiate a lower price for the loan pools, or even an outright cash payment, while retaining the defective loans for inclusion in the loan pools; and (4) Goldman improperly failed to adjust its due diligence procedures (such as by increasing its sampling size or refusing to continue to work with problem originators) when its due diligence identified a high number of non-conforming loans.

70. That Goldman was not performing its represented due diligence responsibilities, and instead was knowingly including loans flagged as being defective, has been confirmed by the recent release of documents from Goldman's third-party due diligence firm, Clayton Holdings, internal e-mails and documents, and other facts set forth below.

71. Goldman's failure to disclose that high numbers of loans had been identified by the due diligence process, and yet "waived" into the collateral pools anyway was a fraudulent omission, and rendered its underwriting disclosures false and misleading.

C. Goldman's Misrepresentations Overstated Owner-Occupancy Statistics

72. The Offering Materials also represented that a high number of loans in the pools were issued on owner-occupied properties, as compared to investment properties or second homes.

73. Owner-occupancy statistics were material to Prudential because high owner-occupancy rates should have made the Certificates safer investments than certificates backed by second homes or investment properties. Homeowners who reside in mortgaged properties pose less risk of default than owners who purchase homes as investments or vacation homes. This is because such owners are likely to have made investments in improving the property; purchased furnishings for their homes; have children enrolled in the local school system; and are otherwise incentivized to fulfill their mortgage terms rather than default. If a property is foreclosed upon,

losing possession of an owner-occupied property means losing the roof over your head, whereas foreclosure on an investment property or second home simply means losing an investment.

74. The Offering Materials contained detailed statistics regarding the Mortgage Loans in the collateral pool, including the reported owner-occupancy characteristics of the Mortgage Loans. For example, the Offering Materials for GSAMP 2005-HE6 Trust claimed that among the 1201 loans in the Group II collateral pool, 99.58% were purportedly for owner-occupied properties; the Offering Materials for GSAMP 2006-FM1 Trust claimed that among the 2,730 loans in the Group II collateral pool, 89.08% were purportedly for owner-occupied properties; and the Offering Materials for GSAMP 2004-FM2 Trust claimed that among the 622 loans in the Group III collateral pool, 91.81% were purportedly for owner-occupied properties.

75. As set forth in Exhibits C-R, similar representations were made in all of the Offering Materials. These representations were false and misleading. In truth, a much lower percentage of the loans were owner-occupied. Occupancy was being misrepresented first by the originator to get the borrower approved for the loan, then by Goldman to investors to get the loan sold as securities. This is confirmed by a loan-level analysis of the specific Mortgage Loans at issue here, and other facts set forth below.

D. <u>Goldman's Misrepresentations Regarding the Appraisal Process</u>

76. Goldman represented that the properties being mortgaged would be subject to particular appraisal practices. Such representations are material, because the reliability of the process used to value the property bears directly on the reliability of the valuation itself.

77. For example, the Offering Materials for GSAMP 2006-HE3 represented that all appraisals would "conform to the Uniform Standards of Professional Appraisal Practice" and that

> An appraisal is generally conducted on each mortgaged property by the originating lender. The appraisal must be conducted in accordance with established appraisal procedure guidelines acceptable to the originator in order to

> determine the adequacy of the mortgaged property as security for repayment of the mortgaged loan. . . All appraisals must be on forms acceptable to Fannie Mae and/or Freddie Mac . . . Appraisers may be staff licensed appraisers employed by the originator or independent licensed appraisers selected in accordance with established appraisal procedure guidelines acceptable to the originator. Generally, the appraisal procedure guidelines require the appraiser or an agent on its behalf to inspect the property personally and verify whether the property is in good condition and that, if new, construction has been substantially completed. The appraisal generally will be based upon a market data analysis of recent sales of comparable properties and, when deemed applicable, an analysis based on income generated from the property or a replacement cost analysis based on the current cost of constructing or purchasing a similar property.

GSAMP 2006-HE3 Pro. Supp. at S-32.

78. The Offering Materials further represented that appraisal procedures "[c]omply with rules of regulators set forth by state and federal agencies." (*Id.* at S-48 to S-49.)

79. Similarly, the Prospectus Supplement for GSAMP 2004-FM1 represented that:

> The originator's underwriting guidelines are applied in accordance with a procedure which complies with applicable federal and state laws and regulations and require an appraisal of the mortgaged property; and if appropriate, a review appraisal. Generally, appraisals are provided by qualified independent appraisers licensed in their respective states. Review appraisals may only be provided by appraisers approved by the originator. In some cases, the originator relies on a statistical appraisal methodology provided by a third-party. Qualified independent appraisers must meet minimum standards of licensing and provide errors and omissions insurance in states where it is required to become approved to do business with the originator. Each uniform residential appraisal report includes a market data analysis based on recent sales of comparable homes in the area and, where deemed appropriate, replacement cost analysis based on the current cost of constructing a similar home. The review appraisal may be a desk, field review or an automated valuation report that confirms or supports the original appraiser's value of the mortgaged premises.

GSAMP 2004-FM1 Pro. Supp. at S-29.

80. Goldman knew that the appraisals underlying the Mortgage Loans did not follow the processes disclosed in the Offering Materials. Instead, the appraisals were designed merely to generate a value high enough to justify loan approval. This is confirmed by a loan-level analysis of the specific Mortgage Loans at issue here, and other facts set forth below.

E. Goldman's Misrepresentations Understated the Loan-to-Value and Combined Loan-to-Value Ratios

81. As discussed above, the LTV ratio is the ratio of a Mortgage Loan's original principal balance to the appraised value of the mortgaged property. The related CLTV ratio takes into account other liens on the property. These ratios were material to Prudential and other investors because higher ratios are correlated with a higher risk of default. A borrower with a small equity position in a property has less to lose if he or she defaults on the loan. There is also a greater likelihood that a foreclosure will result in a loss for the lender if the borrower fully leveraged the property. LTV and CLTV ratios are commonly used metrics for analysts and investors to evaluate the price and risk of mortgage-backed securities.

82. The Offering Materials contained detailed statistics regarding these ratios for the Mortgage Loans in the collateral pool. For example, the Offering Materials for GSAMP 2006-FM1 Trust represented that only 1.94% of the Group II Mortgage Loans had original LTV ratios in excess of 90%. It also represented that no loan in this Trust had an LTV ratio above 100%.

83. As set forth in Exhibits C-R, similar representations were made in all of the Offering Materials. These representations were false and misleading. The underlying data was being manipulated in order to get loans approved, making the stated LTV and CLTV ratios baseless. Goldman knew that the appraisal process was being actively manipulated, so the Originators could keep churning out loans to borrowers that could not afford them, and thus knew that the reported appraisal values did not, in fact, reasonably reflect the value of the mortgaged properties. Goldman thus knew that the LTV ratios reported in the Offering Materials were not reliable indicators of the quality of the loans. The CLTV ratios also sometimes omitted the effect of additional liens on the underlying properties, rendering them even less accurate. That the LTV and CLTV statistics were false and misleading is confirmed by

a loan-level analysis of the specific Mortgage Loans at issue here, by testimony showing widespread appraisal fraud, and other facts set forth below.

F. Goldman's Misrepresentations Regarding Assignment to the Trusts

84. A fundamental step in the mortgage securitization process is the transfer of title to the mortgage loans that collateralize each securitization. Title is generally transferred from the loan Originator, to the seller, to the Depositor, and then to the issuing trust for the securitization. This transfer is necessary for the trust to be entitled to enforce the mortgage loans if a borrower defaults. Each of these transfers must be valid under applicable state law in order for the trust to have good title to the mortgage loans.

85. Two documents relating to each mortgage loan must be validly transferred to the trust as part of the securitization process—a promissory note and a security instrument (either a mortgage or a deed of trust). Generally, state laws and the Pooling and Servicing Agreements, the contracts that govern the administration of RMBS trusts, require the promissory note and security instrument to be transferred by endorsement, in the same way that a check can be transferred by endorsement, or by sale. In addition, state laws generally require that the trustee have physical possession of the original, manually signed note in order for the loan to be enforceable by the trustee against the borrower in case of default.

86. Goldman represented that it would properly transfer title to the Mortgage Loans to each Trust. For example, in the Offering Materials for GSAMP 2005-HE4, Goldman represented that it would "sell . . . to the trust, all right, title and interest in and to each Mortgage Loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date . . ." (GSAMP 2005-HE4 Pro. Supp. at 51.) The corresponding Pooling and Servicing Agreement likewise provided that "[t]he Depositor, concurrently with the execution and delivery hereof, hereby sells, transfers, assigns, sets over and otherwise conveys to the

Trustee for the benefit of the Certificateholders . . . all the right, title and interest of the Depositor in and to the Trust Fund [which includes the Mortgage Loans] . . ." (GSAMP 2005-HE4 PSA, Aug. 1, 2005, § 2.01). The Offering Materials and PSAs for each of the Securitizations at issue here had the same or similar representations.

87. Goldman made detailed representations about the documents that would be transferred to the Trustees in connection with the transfer and assignment of the Mortgage Loans. For example, in the GSAMP 2005-WMC2 Offering Materials, Goldman stated that in connection with the sale of the Mortgage Loans, the Depositor would deliver to the Trust's custodian on or before the closing date, *inter alia*: (1) the original mortgage note with all riders endorsed without recourse in blank by the last endorsee, including all intervening endorsements showing a complete chain of endorsement from the originator to the last endorsee; (2) the related original mortgage with all riders and evidence of its recording or, in certain limited circumstances, a copy of the mortgage certified by the originator, escrow company, title company, or closing attorney; (3) the intervening mortgage assignment(s), or copies of them certified by the applicable originator, escrow company, title company, or closing attorney, if any, showing a complete chain of assignment from the originator of the related mortgage loan to the last endorsee; and (4) a mortgage assignment in recordable form, which, if acceptable for recording in the relevant jurisdiction, may be included in a blanket assignment or assignments, of each mortgage from the last endorsee in blank. (GSAMP 2005-WMC2 Pro. Supp. at 52-53.). The Offering Materials for each of the securitizations at issue here had the same or similar representations.

88. Applicable state trust law generally requires strict compliance with the trust documents, including the PSA, and failure to comply strictly with the timeliness, endorsement,

physical delivery and other requirements of the PSA with respect to the transfers of notes and mortgages results in void transfers and lack of good title.

89. The Offering Materials noted that "[t]he mortgages or assignments of mortgage for some of the Mortgage Loans have been or may be recorded in the name of Mortgage Electronic Registration Systems, Inc. or MERS," rather than the mortgages being assigned directly to the trustee. (GSAMP 2005-WMC2 Pro. Supp. at 26.) Nonetheless, Goldman assured investors that the transfer of mortgages through the MERS system was sufficient to ensure that the Mortgage Loans could be foreclosed upon in the event of a borrower's default. For example, the GSAMP 2005-WMC2 PSA provides that "the Servicer shall take all reasonable actions as are necessary at the expense of the Depositor to cause the Trust to be shown as the owner of the related Mortgage Loan on the records of MERS for the purpose of the system of recording transfers of beneficial ownership of mortgages maintained by MERS." (GSAMP 2005-WMC2 PSA, Nov. 1, 2005, § 2.01.) The Offering Materials for each of the securitizations at issue here had the same or similar representation.

90. Goldman knew that the assignments of title to the underlying Mortgage Loans did not follow the process disclosed in the Offering Materials. Many of the titles were never assigned to either the Trusts nor to MERS—and many of those that have been nominally so assigned are defective, given the title chain is missing key intervening assignments. Given that ownership of title is a fundamental part of the securitization process, this was a material omission. But it also rendered affirmatively false many of Goldman's representations above. For instance, that the assignments were often incomplete and did not result in the Trusts possessing "all of [the] right, title and interest in and to each Mortgage Loans." (GSAMP 2005-HE4 Pro.

Supp. at 51.) This is confirmed by a loan-level analysis of the specific Mortgage Loans at issue here and other facts discussed below.

G. Goldman's Misrepresentations Regarding Credit Ratings

91. Each tranche of the Prudential Certificates received a credit rating indicating the rating agencies' view of its risk profile. The ratings were material to reasonable investors, including Prudential, because the ratings provided additional assurances that investors would receive the expected interest and principal payments. The Certificates would have been unmarketable to investors like Prudential and would not have been issued but for the provision of these ratings, as every prospectus stated that, "[i]n order to be issued, the Offered Certificates must be assigned" certain, specified ratings from the rating agencies. (*See, e.g.*, GSAMP 2006-FM1 Pro. Supp. at S-119.)

92. The initial ratings given to all but one of the Certificates were AAA or AA (or Aaa and Aa), the two highest ratings available. According to S&P's Web site: "An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong." And an obligation rated "AA" by S&P has a "very strong capacity to meet financial commitments."

93. The Offering Materials represented that the ratings came from analysis done by the rating agencies to assess the likelihood of delinquencies and defaults in the underlying mortgage pools. For example, the Offering Materials for GSAMP Trust 2006-FM1 represented: "A securities rating addresses the likelihood of the receipt by a certificateholder of distributions on the mortgage loans. The rating takes into consideration the characteristics of the mortgage loans and the structural, legal and tax aspects associated with the certificates." *Id.* at S-119; see also *id.* at 127 ("It is a condition to the issuance of the securities of each series offered by this prospectus and by the related prospectus supplement that the nationally recognized statistical

rating agency or agencies specified in the prospectus supplement shall have rated the securities in one of the four highest rating categories. Ratings on mortgage-backed securities address the likelihood of receipt by securityholders of all distributions on the underlying mortgage loans or other assets. These ratings address the structural, legal and issuer-related aspects associated with such securities, the nature of the underlying mortgage loans or other assets and the credit quality of the guarantor, if any.") The Offering Materials for each of the Certificates made materially identical representations. *See also* Exhibits C-R.

94. These representations were false and misleading. The rating agencies were fed baseless and false statistics regarding the loans (including the same statistics and misrepresentations discussed herein). This is proven by a statistical analysis of the Mortgage Loans at issue here. This made representations regarding the ratings process false (as a rigged process does not "address the likelihood of receipt by" Prudential) and rendered the "ratings" themselves similarly false and misleading, as they only represented the credit agencies' analysis of a non-existent mortgage pool that had no relation to that truly underlying Prudential's Certificates.

H. Goldman's Misrepresentations Regarding Underwriting Exceptions

95. Whether Goldman and/or the originators were making case-by-case (rather than bulk) exceptions to the otherwise-applicable underwriting guidelines was material to Prudential and other investors. A disclosed guideline is factually irrelevant—and indeed misleading—from a risk-analysis perspective if large numbers of loans were peremptorily excused from those standards *en masse*.

96. Goldman represented that it and the originators made only case-by-case exceptions to the disclosed underwriting standards, based on compensating factors that balanced out the risks of a loan application and thereby improved the quality of a loan application. For

example, the Offering Materials for GSAMP Trust 2006-HE3 represented that, for the Conduit Program, "[i]n certain instances, compensating factors demonstrated to the mortgage loan originator by a prospective borrower may warrant [Goldman Sachs Mortgage Company] to make certain exceptions to these [underwriting] guidelines." (*See, e.g.*, GSAMP 2006-HE3 Pro. Supp. at 30.) Similarly, for the Fremont mortgage loans, the Prospectus Supplement for GSAMP 2006-FM1 represented that "On a case by case basis, Fremont may determine that, based upon compensating factors, a prospective mortgagor not strictly qualifying under the underwriting risk category guidelines described below is nonetheless qualified to receive a loan, i.e., an underwriting exception. Compensating factors may include, but are not limited to, low loan-to-value ratio, low debt to income ratio, substantial liquid assets, good credit history, stable employment and time in residence at the applicant's current address. It is expected that a substantial portion of the mortgage loans may represent such underwriting exceptions." (*See, e.g.*, GSAMP 2006-FM1 Pro. Supp. at 41.)

97. As set forth in Exhibits C-R, similar representations were made in all of the Offering Materials. These representations were false and misleading. Loans were routinely granted outside of the stated guidelines, without regard to whether there were any purported "compensating factors" justifying a lending or underwriting exception. This is evidenced by, among other things, the high percentage of Goldman loans identified by the third-party due diligence firm Clayton Holdings that both failed the given underwriting guidelines and that did not show any "countervailing features," and the numerous facts showing underwriting abandonment by many of the key originators at issue here.

II. EVIDENCE THAT ALL OF GOLDMAN'S REPRESENTATIONS WERE UNTRUE AND MISLEADING

A. Evidence of the Securities' High Default Rates and Plummeting Credit Ratings

98. The drastic rise in default rates on the Mortgage Loans underlying Prudential's Certificates is itself evidence that the underwriting practices Goldman represented were, in fact, violated. The Certificates were supposed to be long-term, stable investments. Yet, as seen in the following chart, they have already experienced payment problems at an astronomical rate, well beyond what should have occurred for loan pools that had been properly underwritten and contained loans that actually had the characteristics Goldman's Offering Materials claimed.

Trust	Tranche	Loan Pool[1]	Delinquent Loans as a Percentage of Current Loans	Written-Off Loans as a Percentage of Original Loans	Delinquent or Written-Off Loans as a Percentage of Original Loans
GSAMP 2007-HE2	A2B	Group II	50.30%	37.60%	59.40%
GSAMP 2006-HE7	A2D	Group II	49.80%	36.20%	54.10%
GSAMP 2006-HE3	A2D	Group II	52.00%	39.70%	52.90%
GSAMP 2006-HE2	A3, A2, M2	Aggregate pool	51.40%	30.80%	45.70%
GSAMP 2006-HE1	A2D	Group II	51.10%	30%	44.50%
GSAMP 2006-FM1	A2D	Group II	59.60%	42.70%	53.70%
GSAMP 2005-WMC2	M1	Group I	49.00%	32%	42.10%
GSAMP 2005-WMC2	M1	Group II	48.70%	35%	44.20%
GSAMP 2005-HE4	M2	Group I	50.70%	22.90%	32.60%
GSAMP 2005-HE4	M2	Group II	50.10%	26.40%	35.90%
GSAMP 2004-WF	M1	Group I	35.80%	9.50%	12.40%
GSAMP 2004-WF	M1	Group II	38.30%	9.20%	12.30%
GSAMP 2004-AR2	M1	Group I	52.90%	10.00%	15.90%
GSAMP 2004-AR2	M1	Group III	55.10%	8.80%	14.40%
GSAMP 2005-HE6	M2, M3	Group I	45.20%	25.30%	36.20%
GSAMP 2005-HE6	M2, M3	Group II	48%	35.90%	44.00%

[1] Because it is common in RMBS securitizations for a pool of Mortgage Loans to be divided into Groups and for one or more of the Groups to support the Certificates issued by the related Trust, the "Loan Pool" column identifies which Group of Mortgage Loans in the related Trust supports the specific Certificate purchased by Prudential.

Trust	Tranche	Loan Pool[1]	Delinquent Loans as a Percentage of Current Loans	Written-Off Loans as a Percentage of Original Loans	Delinquent or Written-Off Loans as a Percentage of Original Loans
FFML 2005-FF2	M2	Group I	47.40%	11.80%	19.70%
FFML 2005-FF2	M2	Group II	52.40%	13.50%	21.40%
GSAMP 2006-HE6	A3	Aggregate pool	74.5%	35.5%	62.13%

Overall, approximately 22% of the Mortgage Loans underlying the Certificates that Prudential invested in have already had to be written off, and approximately 49% of the remaining loans are currently 30, 60, or 90 or more days delinquent—all within a few years of when the loans were made.

99. Relatedly, the ratings given to the Certificates have significantly deteriorated. At the time of purchase, Prudential's investments were all initially investment grade. Because of the systemic abandonment of underwriting standards and the resulting inclusion of highly risky or outright fraudulent Mortgage Loans in the collateral pools backing the Certificates, as seen in the following table, the majority of Prudential's Certificates have been downgraded to "junk-bond" ratings, at least by one of the rating agencies which rated the deal. With the exception of two Certificates (GSAMP 2005-HE6, M3 and GSAMP Trust 2006-FM1, A2D), most serious downgrades (*i.e.*, to non-investment grade) did not take place until March 2009 or later.

Certificate	Initial Rating	Current Rating
Fremont Home Loan Trust 2004-A, M1	AA (S&P)	B
GSAMP Trust 2004-AR2, M1	Aa1 (Moody's)	A2
GSAMP Trust 2004-FM1, M2	A2 (Moody's)	Ca*+
GSAMP Trust 2004-FM2, M1	Aa2 (Moody's)	B3*+
GSAMP Trust 2004-WF, M1	Aa2 (Moody's)	A2*+
GSAMP Trust 2005-HE4, M2	Aa2 (Moody's)	B2
GSAMP Trust 2005-HE6, M2	AA+ (S&P)	B-
GSAMP Trust 2005-HE6, M3	AA (S&P)	CC
GSAMP Trust 2005-WMC2, M1	AA+ (S&P)	CC
GSAMP Trust 2006-FM1, A2D	AAA (S&P)	CCC
GSAMP Trust 2006-HE1, A2D	Aaa (Moody's)	Ba1
GSAMP Trust 2006-HE2, A2	Aaa (Moody's)	B1
GSAMP Trust 2006-HE2, A3	Aaa (Moody's)	Caa2
GSAMP Trust 2006-HE2, M2	AA+ (S&P)	CC
GSAMP Trust 2006-HE3, A2D	Aaa (Moody's)	Ca
GSAMP Trust 2006-HE7, A2D	AAA (S&P)	CCC
GSAMP Trust 2007-HE2, A2B	AAA (S&P)	CCC
FFML 2005-FF2, M2	Aa2 (Moody's)	A3
GSAMP 2006-HE6, A3	AAA (S&P)	CCC

100. These downgrades underscore the fact that the investment-grade ratings reported in the Offering Materials were unjustifiably high and misstated the true credit risk of the RMBS purchased by Prudential.

101. Defaults are usually caused by a large and unexpected disruption to a borrower's income. In a properly underwritten pool of loans, there should not be a large spike of defaults occurring shortly after origination, because it is unlikely that many borrowers would all incur a sudden and unexpected change to their payment ability so soon after purchasing a home. However, when borrowers are put into loan products they cannot actually afford, they quickly and predictably fall behind on their payments. As such, high, early rates of default and delinquency—such as the high rates here—are cogent evidence that the loans were not properly underwritten.

102. The defaults and related drop in value thus are due to Goldman's wrongdoing, and not because of the general change in economic conditions. "Investment banks were the driving force behind the structured finance products that provided a steady stream of funding for lenders originating high risk, poor quality loans and that magnified risk throughout the U.S. financial system. *The investment banks that engineered, sold, traded, and profited from mortgage related structured finance products were a major cause of the financial crisis.*" (SPSI Report at 11 (emphasis added).)

B. Loan-Level Evidence Proves That Representations About the Percentage of the Mortgaged Properties That Were Owner-Occupied Were Overstated

103. Using techniques that only recently became available to investors, Prudential tested Goldman's representations on a loan-level basis for thousands of loans across all of the Securitizations.

104. For each offering, Prudential analyzed approximately 800 randomly-selected loans from within the collateral pool (the total number of loans sampled for all of the Trusts thus numbering nearly 13,000). This sample size is more than sufficient to provide statistically-significant data to demonstrate the degree of misrepresentation of the Mortgage Loans' characteristics. Analyzing data for each Mortgage Loan in each Offering would have been unnecessary for purposes of Prudential's pleading. Statistical sampling is an accepted method of establishing reliable conclusions about broader data sets, and is routinely used by courts, government agencies, and private businesses. As the size of a sample increases, the reliability of its estimations of the total population's characteristics increases as well. Experts in residential mortgage-backed securities cases have found that a sample size of just 400 loans can provide statistically significant data.

105. To determine whether a given borrower actually occupied the property as claimed, Prudential's analysis looked at various factors, including an investigation of tax information for the sampled loans. One would expect that a borrower residing at a property would have the tax bills sent to that address, and would take all applicable tax exemptions available to residents of that property. If a borrower had his or her tax records sent to another address, that is good evidence that that borrower did not actually reside at the mortgaged property. If a borrower declined to make certain tax exemption elections that depend on the borrower living at the property, that also is strong evidence the borrower was living elsewhere.

106. A review of credit records was also conducted. One would expect that people have bills sent to their primary address. If a borrower was telling creditors to send bills to another address, even six months after buying the property, that is good evidence the borrower was living elsewhere.

107. A review of property records was also conducted. It is less likely that a borrower lives in any one property if in fact that borrower owns multiple properties. It is even less likely the borrower resides at the mortgaged property if a concurrently owned separate property did not have its own tax bills sent to the supposedly owner-occupied property included in Goldman's mortgage pool.

108. A review of other lien records was also conducted. If the property was subject to additional liens but those materials were sent elsewhere, that is good evidence the borrower was not living at the mortgaged property. If the other lien involved a conflicting declaration of residency, that too would be good evidence that the borrower did not live in the subject property.

109. Though the ability to gather such information for large numbers of loans and run these tests was only recently made available to investors like Prudential, these tests draw from

data contemporaneous with the transactions at issue. They thus are evidence that a then-existing fact—owner occupancy—was misrepresented.

110. The results of Prudential's loan-level analysis of true owner-occupancy rates on the Mortgage Loans underlying its Certificates are set forth below and are further detailed in the Exhibits. Failing multiple of the tests described above is strong evidence that the borrowers did not in fact reside at the mortgaged properties. The results thus show that, despite Goldman's representations, a much higher percentage of borrowers did not occupy the mortgaged properties:

Trust	Tranche	Loan Pool	Represented Percentage of Owner-Occupied Properties	Actual Percentage of Owner-Occupied Properties	Overstatement of Owner-Occupied Properties
GSAMP 2007-HE2	A2B	Group II	92.13%	81.07%	11.06%
GSAMP 2006-HE7	A2D	Group II	92.90%	82.68%	10.22%
GSAMP 2006-HE3	A2D	Group II	95.87%	85.61%	10.26%
GSAMP 2006-HE2	A3, A2, M2	Aggregate pool	91.90%	83.35%	8.55%
GSAMP 2006-HE1	A2D	Group II	94.90%	83.32%	11.58%
GSAMP 2006-FM1	A2D	Group II	89.08%	75.36%	13.72%
GSAMP 2005-WMC2	M1	Group I	95.90%	83.53%	12.37%
GSAMP 2005-WMC2	M1	Group II	96.01%	86.02%	9.99%
GSAMP 2005-HE4	M2	Group I	90.06%	80.24%	9.82%
GSAMP 2005-HE4	M2	Group II	94.79%	82.94%	11.85%
GSAMP 2004-FM2	M1	Group I	85.06%	75.02%	10.04%
GSAMP 2004-FM2	M1	Group II	86.85%	77.82%	9.03%
GSAMP 2004-FM2	M1	Group III	91.81%	78.04%	13.77%
FHLT 2004-A	M1	Group I	89.26%	81.76%	7.50%
FHLT 2004-A	M1	Group II	88.01%	79.47%	8.54%
FHLT 2004-A	M1	Group III	91.76%	82.31%	9.45%
GSAMP 2004-WF	M1	Group I	96.47%	83.45%	13.02%
GSAMP 2004-WF	M1	Group II	95.75%	86.85%	8.90%
GSAMP 2004-AR2	M1	Group I	85.80%	77.82%	7.98%
GSAMP 2004-AR2	M1	Group III	89.08%	79.10%	9.98%
GSAMP 2005-HE6	M2, M3	Group I	91.70%	79.96%	11.74%
GSAMP 2005-HE6	M2, M3	Group II	99.58%	84.44%	15.14%
GSAMP 2004-FM1	M2	Aggregate pool	88.31%	77.36%	10.95%
FFML 2005-FF2	M2	Group I	96.60%	85.88%	10.72%
FFML 2005-FF2	M2	Group II	98.46%	87.73%	10.73%
GSAMP 2006-HE6	A3	Aggregate pool	93.74%	85.96%	7.78%

111. The consistency of these misrepresentations across the offerings confirms that the underwriting problems within the Mortgage Loans and the Certificates were systemic. As such,

Prudential's loan-level analysis not only shows that the specific owner-occupancy statistics were false and misleading, but also supports the conclusion that the Offering Materials' representations regarding the originators' adherence to the given underwriting guidelines were also false and misleading.

112. Further, the consistency of the results shows that these were not simply borrowers that changed their mind. Rather, Goldman and the originators knew that borrowers were misrepresenting their intent to live at the property, because Goldman, the originators, and the borrowers all knew it would help shuffle the loan through the approval and securitization process.

C. Evidence That The LTV And CLTV Ratios Were Materially Misrepresented

113. Using techniques and methodologies that only recently became available to investors, Prudential had the underlying property valued, at the time of origination, using data contemporaneous with the original valuation that Goldman would have done, by an industry-standard automated valuation model ("AVM"). AVMs are routinely used in the industry as a way of valuing properties during prequalification, origination, portfolio review, and servicing. AVMs have become so ubiquitous that their testing and use is specifically outlined in regulatory guidance, and is discussed in the 2010 Dodd-Frank Act.

114. AVMs rely upon data similar to what appraisers use—primarily county assessor records, tax rolls, and data on comparable properties. AVMs produce independent, statistically-derived valuation estimates by applying modeling techniques to these data. The AVM that Prudential used incorporates a database of ***500 million*** mortgage transactions covering zip codes that represent more than 97% of the homes in the United States, occupied by more than 99% of the population. Independent testing services have determined that this AVM is the most accurate of all such models.

115. The results of this analysis for each Certificate are set forth in the Exhibits. Applying the AVM to the available data for the loans underlying the Certificates shows that the value used by Goldman in the represented LTVs were materially and consistently inflated. This caused the disclosed LTV and CLTV ratios to be lower than they really were. In other words, the owners were represented to have more of an equity "cushion" than they really did, and the prospects for recovery of any funds upon a foreclosure were represented to be much higher than they really were.

116. As with owner-occupancy, though the availability to gather such information and run these tests was only recently made available to investors like Prudential, these tests draw from data contemporaneous with the transactions at issue. They thus are evidence that the LTV and CLTV ratios were misrepresented at the time the representations were made.

117. For sampled loans that had sufficient information to test, the LTV ratio for over 16% had true LTV ratios more than ***10%*** higher than what Goldman purportedly calculated. More than 4% were understated by more than 25%. The CLTV ratios were similarly understated. Over 20% were understated by 10% or more, while approximately 7% ***were understated by 25% or more.*** These overvaluations affected numerous statistics in the Offering Materials.

118. The Offering Materials made representations about the percent of loans that had LTV ratios higher than 90%. LTV ratios in excess of 90% provide the lender little value cushion to protect against borrower default and loss upon foreclosure. Consequently, an accurate disclosure of the number is important to investors assessing the riskiness of the security. However, the AVM indicates that a higher percentage of the loans had LTV ratios higher than 90%:

Trust	Tranche	Loan Pool	Percentage of Loans Represented to Have LTVs of 90% or Greater	Actual Percentage of Loans With LTVs of 90% or Greater	Understatement of Percentage of Loans With LTVs of 90% or Greater
GSAMP 2006-HE7	A2D	Group II	11.37%	38.70%	27.33%
GSAMP 2006-HE3	A2D	Group II	7.09%	33.48%	26.39%
GSAMP 2006-HE2	A3, A2, M2	Aggregate pool	5.97%	32.55%	26.58%
GSAMP 2006-HE1	A2D	Group II	8.95%	32.71%	23.76%
GSAMP 2006-FM1	A2D	Group II	1.94%	41.25%	39.31%
GSAMP 2005-WMC2	M1	Group I	4.88%	31.92%	27.04%
GSAMP 2005-WMC2	M1	Group II	5.56%	30.04%	24.48%
GSAMP 2005-HE4	M2	Group I	10.41%	36.77%	26.36%
GSAMP 2005-HE4	M2	Group II	8.73%	36.40%	27.67%
FHLT 2004-A	M1	Group I	23.36%	40.68%	17.32%
FHLT 2004-A	M1	Group II	10.88%	32.97%	22.09%
FHLT 2004-A	M1	Group III	22.25%	45.95%	23.70%
GSAMP 2004-WF	M1	Group I	19.18%	39.63%	20.45%
GSAMP 2004-WF	M1	Group II	14.71%	32.85%	18.14%
GSAMP 2004-AR2	M1	Group I	37.85%	63.07%	25.22%
GSAMP 2004-AR2	M1	Group III	35.40%	57.38%	21.98%
GSAMP 2005-HE6	M2, M3	Group I	17.65%	39.70%	22.05%
GSAMP 2005-HE6	M2, M3	Group II	10.91%	37.86%	26.95%
GSAMP 2004-FM1	M2	Aggregate pool	11.31%	33.25%	21.94%
FFML 2005-FF2	M2	Group I	16.91%	39.66%	22.75%
FFML 2005-FF2	M2	Group II	16.99%	51.79%	34.80%
GSAMP 2006-HE6	A3	Aggregate	17.52%	31.15%	13.98%

119. The Offering Materials also made representations about how many of the Mortgage Loans had LTV ratios greater than 100%, meaning the size of the loan is greater than the value of the property. (This is known as being "underwater," where a borrower owes more on the property than it is worth.) Loans with LTV ratios over 100% not only provide the lender no equity cushion, but in fact leave the lender with inadequate collateral from the outset of the loan. Prudential's analysis has found that, despite Goldman's representations, many of the Mortgage Loans had LTV ratios greater than 100%:

Trust	Tranche	Loan Pool	Percentage of Loans Represented to Have LTVs of 100% or Greater	Actual Percentage of Loans With LTVs of 100% or Greater	Understatement of Percentage of Loans With LTVs of 100% or Greater
GSAMP 2006-HE7	A2D	Group II	0.00%	19.91%	19.91%
GSAMP 2006-HE3	A2D	Group II	0.00%	13.61%	13.61%
GSAMP 2006-HE2	A3, A2, M2	Aggregate pool	0.00%	13.83%	13.83%
GSAMP 2006-HE1	A2D	Group II	0.00%	15.96%	15.96%
GSAMP 2006-FM1	A2D	Group II	0.00%	20.07%	20.07%
GSAMP 2005-WMC2	M1	Group I	0.00%	11.74%	11.74%
GSAMP 2005-WMC2	M1	Group II	0.00%	14.65%	14.65%
GSAMP 2005-HE4	M2	Group I	0.00%	17.42%	17.42%
GSAMP 2005-HE4	M2	Group II	0.00%	17.62%	17.62%
FHLT 2004-A	M1	Group I	0.00%	24.29%	24.29%
FHLT 2004-A	M1	Group II	0.00%	17.58%	17.58%
FHLT 2004-A	M1	Group III	0.00%	27.03%	27.03%
GSAMP 2004-WF	M1	Group I	0.00%	18.29%	18.29%
GSAMP 2004-WF	M1	Group II	0.00%	16.79%	16.79%
GSAMP 2004-AR2	M1	Group I	0.00%	38.07%	38.07%
GSAMP 2004-AR2	M1	Group III	0.00%	31.15%	31.15%
GSAMP 2005-HE6	M2, M3	Group I	0.00%	18.21%	18.21%
GSAMP 2005-HE6	M2, M3	Group II	0.00%	18.45%	18.45%
GSAMP 2004-FM1	M2	Aggregate pool	0.00%	19.66%	19.66%
FFML 2005-FF2	M2	Group I	0.00%	17.63%	17.63%
FFML 2005-FF2	M2	Group II	0.00%	20.54%	20.54%
GSAMP 2006-HE6	A3	Aggregate	0.00%	18.25%	18.25%

120. The Offering Materials also contained CLTV ratios of the underlying loans. A CLTV ratio should take into account the total value of the liens on the property, and thus is more commonly used when the underlying Mortgage Loans are secured by second lien mortgages. The AVM again found that the Offering Materials' statistics were false and misleading. For example, the true number of loans with CLTV's in excess of 90% was understated:

Trust	Tranche	Loan Pool	Percentage of Loans Represented to Have CLTVs of 90% or Greater	Actual Percentage of Loans With CLTVs of 90% or Greater	Understatement of Percentage of Loans With CLTVs of 90% or Greater
GSAMP 2007-HE2	A2B	Group II	30.21%	64.66%	34.45%
GSAMP 2006-HE7	A2D	Group II	31.23%	66.67%	35.44%
GSAMP 2006-HE3	A2D	Group II	32.91%	79.91%	47.00%
GSAMP 2006-HE2	A3, A2, M2	Aggregate pool	11.50%	66.00%	54.50%

Trust	Tranche	Loan Pool	Percentage of Loans Represented to Have CLTVs of 90% or Greater	Actual Percentage of Loans With CLTVs of 90% or Greater	Understatement of Percentage of Loans With CLTVs of 90% or Greater
GSAMP 2006-HE1	A2D	Group II	19.38%	76.60%	57.22%
GSAMP 2006-FM1	A2D	Group II	24.07%	80.11%	56.04%
GSAMP 2005-WMC2	M1	Group I	30.00%	71.83%	41.83%
GSAMP 2005-WMC2	M1	Group II	43.15%	73.99%	30.84%
GSAMP 2005-HE4	M2	Group I	25.28%	66.45%	41.17%
GSAMP 2005-HE4	M2	Group II	27.78%	70.50%	42.72%
GSAMP 2004-FM2	M1	Group I	33.64%	67.69%	34.05%
GSAMP 2004-FM2	M1	Group II	24.56%	51.22%	26.66%
GSAMP 2004-FM2	M1	Group III	8.18%	60.24%	52.06%
GSAMP 2005-HE6	M2, M3	Group I	27.24%	65.37%	38.13%
GSAMP 2005-HE6	M2, M3	Group II	24.48%	82.52%	58.04%
GSAMP 2004-FM1	M2	Aggregate pool	34.60%	68.69%	34.09%
GSAMP 2006-HE6	A3	Aggregate pool	18.77%	40.5%	21.73%

121. The Offering Materials made representations about the percent of loans that had CLTVs higher than 100%. Just as with LTVs, CLTVs in excess of 100% provide the lender no cushion to protect against borrower default and loss upon foreclosure. Using both the AVM to recalculate the value of the property and researching the existence of additional, hidden liens revealed that a much higher percentage of the loans had CLTVs higher than 100%:

Trust	Tranche	Loan Pool	Percentage of Loans Represented to Have CLTVs of 100% or Greater	Actual Percentage of Loans With CLTVs of 100% or Greater	Understatement of Percentage of Loans With CLTVs of 100% or Greater
GSAMP 2007-HE2	A2B	Group II	0.00%	48.06%	48.06%
GSAMP 2006-HE7	A2D	Group II	0.00%	49.44%	49.44%
GSAMP 2006-HE3	A2D	Group II	0.00%	60.04%	60.04%
GSAMP 2006-HE2	A3, A2, M2	Aggregate pool	0.00%	49.11%	49.11%
GSAMP 2006-HE1	A2D	Group II	0.00%	53.46%	53.46%
GSAMP 2006-FM1	A2D	Group II	0.00%	60.04%	60.04%
GSAMP 2005-WMC2	M1	Group I	0.00%	51.17%	51.17%
GSAMP 2005-WMC2	M1	Group II	0.00%	52.38%	52.38%
GSAMP 2005-HE4	M2	Group I	0.00%	47.74%	47.74%
GSAMP 2005-HE4	M2	Group II	0.00%	52.87%	52.87%
GSAMP 2004-FM2	M1	Group I	0.00%	46.92%	46.92%
GSAMP 2004-FM2	M1	Group II	0.00%	30.49%	30.49%

Trust	Tranche	Loan Pool	Percentage of Loans Represented to Have CLTVs of 100% or Greater	Actual Percentage of Loans With CLTVs of 100% or Greater	Understatement of Percentage of Loans With CLTVs of 100% or Greater
GSAMP 2004-FM2	M1	Group III	0.00%	28.92%	28.92%
GSAMP 2005-HE6	M2, M3	Group I	0.00%	42.09%	42.09%
GSAMP 2005-HE6	M2, M3	Group II	0.00%	67.96%	67.96%
GSAMP 2004-FM1	M2	Aggregate pool	0.00%	46.36%	46.36%
GSAMP 2006-HE6	A3	Aggregate pool	0.00%	28.63%	28.63%

122. Prudential also analyzed the weighted average CLTV of the Mortgage Loans in each pool and has found that the weighted average CLTV in most of the deals was overstated:

Trust	Tranche	Loan Pool	Represented Weighted Average CLTV	Actual Weighted Average CLTV	Understatement of Weighted Average CLTV
GSAMP 2007-HE2	A2B	Group II	80.89%	100.54%	19.65%
GSAMP 2006-HE7	A2D	Group II	80.33%	97.43%	17.10%
GSAMP 2006-HE3	A2D	Group II	82.92%	104.91%	21.99%
GSAMP 2006-HE2	A3, A2, M2	Aggregate pool	77.80%	95.46%	17.66%
GSAMP 2006-HE1	A2D	Group II	82.42%	102.93%	20.51%
GSAMP 2006-FM1	A2D	Group II	91.79%	106.08%	14.29%
GSAMP 2005-WMC2	M1	Group I	81.23%	98.73%	17.50%
GSAMP 2005-WMC2	M1	Group II	83.05%	99.70%	16.65%
GSAMP 2005-HE4	M2	Group I	81.97%	97.44%	15.47%
GSAMP 2005-HE4	M2	Group II	83.02%	99.07%	16.05%
GSAMP 2004-FM2	M1	Group I	83.98%	96.99%	13.01%
GSAMP 2004-FM2	M1	Group II	82.58%	90.65%	8.07%
GSAMP 2004-FM2	M1	Group III	83.10%	93.35%	10.25%
GSAMP 2005-HE6	M2, M3	Group I	83.28%	96.82%	13.54%
GSAMP 2005-HE6	M2, M3	Group II	83.24%	104.36%	21.12%
GSAMP 2004-FM1	M2	Aggregate pool	84.47%	99.10%	14.63%
GSAMP 2006-HE6	A3	Aggregate pool	81.29%	100.57%	19.28%

123. The consistency of these misrepresentations confirms that the underwriting problems among the Mortgage Loans underlying the Certificates were systemic. As such, Prudential's loan-level analysis not only shows that the specific LTV and CLTV statistics were false and misleading, but also supports the conclusion that the Offering Materials'

representations regarding the originators' adherence to the given underwriting guidelines was also false and misleading.

124. The consistency and scale of these misrepresentations also confirms that the appraisers, originators, and Defendants knew the appraisals being used were not reasonable indicators of the properties' value, but were inflated figures generated to shepherd the loans through the approval and securitization process. These results (and other facts discussed herein) demonstrate that the factual representations relating to appraisal practices were false. Independent appraisers following the stated practices would not consistently generate appraisals that deviate so significantly (and so consistently upward) from the values found using an industry-standard AVM. Instead of following the disclosed appraisal processes, the appraisers worked with Defendants and other mortgage loan Originators to generate appraisal values that were not meant to approximate the actual value of the property, but to justify issuance of the mortgage loan.

125. The consistency of Defendants' misrepresentations also supports the conclusion that Defendants *knew* the appraisals were being intentionally inflated. Such is confirmed by Defendants' emails and other communications that have come to light during government investigations. It is also confirmed by Defendants' efforts to rid themselves of declining mortgage-based assets and transfer the risk of those losses onto unsuspecting investors.

D. Evidence That Goldman's Representations Concerning The Mortgage Loans' Chain Of Title Were Systemically False

126. Goldman's representations about the valid transfer of title of the Mortgage Loans to the Trusts were false. In many instances, the collateral did not properly secure the underlying Mortgage Loans and the Trusts could not foreclose on delinquent borrowers because Goldman

either lost, failed to timely create, or failed to timely deliver the paperwork necessary to prove title to the mortgages.

127. Contrary to its representations, Goldman did not properly assign large numbers of the Mortgage Loans to the Trusts. In its rush to securitize loans and thereby offload risky collateral onto investors such as Prudential, Goldman did not comply with the strict rules governing assignment of mortgages and the transfer of promissory notes and loan files. Goldman lost much of the paperwork relating to the Mortgage Loans underlying the securitizations, or made no attempt to assign the Mortgage Loans and deliver the original mortgage notes to the issuing trusts, as represented.

128. As part of its loan-level analysis of the Mortgage Loans underlying its Certificates, Prudential also examined if the chain of mortgage assignments was complete with respect to the Mortgage Loans. The review demonstrates that Goldman's representations regarding the title for the Mortgage Loans were false and misleading, and that Goldman fraudulently failed to disclose problems in the chain of title for the Mortgage Loans.

129. As discussed in Section IV, this analysis could not have been performed by investors before 2010, because investors were not able to identify the specific properties at issue at the time. Nor was it industry practice for investors to do an independent loan-level assessment of the accuracy of the representations made in the Offering Materials—Prudential reasonably relied upon Goldman to represent the Mortgage Loans correctly in the Offering Materials.

130. The review demonstrates, for each Securitization, (a) how many Mortgage Loans are currently held by the RMBS trust; (b) how many are held in the MERS electronic-recording system; (c) how many are still held in the originator's name; and (d) how many were assigned to a third party. Loans that are still held by the originator, or were assigned to a third party other

than the Trust or MERS, violate Goldman's representations that the loans would be assigned to the Trust (or, in some cases, would be held by MERS).

Trust	Tranche	Loan Pool	Loans Assigned To a Third Party (Other Than MERS)	Loans Still Held in the Originator's Name	% of Sampled Loans Assigned to a Third Party or Still Held in the Originator's Name
GSAMP 2007-HE2	A2B	Group II	74	33	15.29%
GSAMP 2006-HE7	A2D	Group II	37	40	11.90%
GSAMP 2006-HE3	A2D	Group II	37	39	13.60%
GSAMP 2006-HE2	A3, A2, M2	Aggregate pool	25	18	8.78%
GSAMP 2006-HE1	A2D	Group II	15	15	5.00%
GSAMP 2006-FM1	A2D	Group II	40	34	10.48%
GSAMP 2005-HE4	M2	Group I	24	30	23.08%
GSAMP 2005-HE4	M2	Group II	37	21	15.63%
GSAMP 2004-FM2	M1	Group I	3	201	84.10%
GSAMP 2004-FM2	M1	Group II	8	265	81.98%
GSAMP 2004-FM2	M1	Group III	6	133	85.28%
FHLT 2004-A	M1	Group I	2	218	83.02%
FHLT 2004-A	M1	Group II	3	268	84.95%
FHLT 2004-A	M1	Group III	0	91	81.98%
GSAMP 2004-WF	M1	Group I	4	258	91.29%
GSAMP 2004-WF	M1	Group II	5	220	90.36%
GSAMP 2004-AR2	M1	Group I	98	122	82.09%
GSAMP 2004-AR2	M1	Group III	18	58	85.39%
GSAMP 2005-HE6	M2, M3	Group I	9	14	4.70%
GSAMP 2005-HE6	M2, M3	Group II	7	1	5.13%
GSAMP 2004-FM1	M2	Group I	6	342	88.78%
GSAMP 2004-FM1	M2	Group II	3	263	88.96%
FFML 2005-FF2	M2	Group I	57	299	75.11%
FFML 2005-FF2	M2	Group II	14	111	69.44%
GSAMP 2006-HE6	A3	Aggregate pool	30	65	15.13%

131. Even among Loans that were assigned to the Trusts, a large number were still missing intervening assignments:

Trust	Tranche	Loan Pool	Number of Loans Assigned To a Trust (not including MERS)	Number of Loans Assigned To a Trust But Missing Intervening Assignments	Percentage Loans Assigned To a Trust But Missing Intervening Assignments
GSAMP 2007-HE2	A2B	Group II	156	126	80.77%
GSAMP 2006-HE7	A2D	Group II	148	108	72.97%
GSAMP 2006-HE3	A2D	Group II	160	110	68.75%
GSAMP 2006-HE2	A3, A2, M2	Aggregate pool	228	133	58.33%

Trust	Tranche	Loan Pool	Number of Loans Assigned To a Trust (not including MERS)	Number of Loans Assigned To a Trust But Missing Intervening Assignments	Percentage Loans Assigned To a Trust But Missing Intervening Assignments
GSAMP 2006-HE1	A2D	Group II	177	125	70.62%
GSAMP 2006-FM1	A2D	Group II	241	154	63.9%
GSAMP 2005-HE4	M2	Group I	34	17	50%
GSAMP 2005-HE4	M2	Group II	68	45	66.18%
GSAMP 2004-FM2	M1	Group I	7	3	42.86%
GSAMP 2004-FM2	M1	Group II	15	4	26.67%
GSAMP 2004-FM2	M1	Group III	7	4	57.14%
FHLT 2004-A	M1	Group I	4	1	25%
FHLT 2004-A	M1	Group II	9	4	44.44%
FHLT 2004-A	M1	Group III	5	1	20%
GSAMP 2004-WF	M1	Group I	19	2	10.53%
GSAMP 2004-WF	M1	Group II	19	1	5.26%
GSAMP 2004-AR2	M1	Group I	47	3	6.38%
GSAMP 2004-AR2	M1	Group III	13	3	23.08%
GSAMP 2005-HE6	M2, M3	Group I	165	158	95.76%
GSAMP 2005-HE6	M2, M3	Group II	49	47	95.92%
GSAMP 2004-FM1	M2	Group I	12	2	16.67%
GSAMP 2004-FM1	M2	Group II	13	2	15.38%
FFML 2005-FF2	M2	Group I	117	3	2.56%
FFML 2005-FF2	M2	Group II	55	3	5.45%
GSAMP 2006-HE6	A3	Aggregate pool	299	147	49.16%

132. In sum, among the 9,252 Loans for which sufficient data were available to conduct this analysis, 562 loans were improperly assigned to a third party (other than MERS) and 3,159 were still held in the originator's name—an over ***40%*** defective rate. Further, of the loans that were nominally assigned to the Trust, over ***58%*** are missing necessary intervening assignments. Each of these loans also represent breaches of Goldman's representations.

133. As with the occupancy and appraisal analysis discussed above, the consistency and size of Goldman's title-related misrepresentations confirms that, in addition to the originators, Goldman itself systemically abandoned sound underwriting and securitization practices.

134. Goldman also defrauded Prudential by stating that an assignment to MERS ensured that each Trust could foreclose upon the underlying collateral; these representations were false. As multiple courts have held, because the actual mortgage note is typically not transferred to MERS, no interest is acquired by it and it cannot bring a foreclosure action. *See, e.g., Bank of New York v. Silverberg*, 86 A.D.3d 274 (N.Y. App. Div. 2d Dep't 2011). In February 2011, MERS instructed its lender members to stop foreclosing in the name of MERS in light of overwhelming authority that beneficial ownership of an underlying mortgage cannot be transferred to MERS. Goldman's representations in the Offering Materials that MERS would be the "beneficial owner" of each Mortgage were false. As MERS Recommended Foreclosure Procedure 8 provides, "MERS does not create or transfer beneficial interests in mortgage loans or create electronic assignments of the mortgage."

E. Evidence That Goldman's Due Diligence Identified Loans That Did Not Meet The Stated Underwriting Guidelines

135. In connection with its purchase of the Mortgage Loans from the loan originators, and consistent with industry practice, Goldman performed due diligence to determine the quality of the loans it was purchasing.

136. Specifically, Goldman relied on its own teams of underwriters as well as on third party due diligence firms (such as Clayton Holdings or The Bohan Group) which were tasked with reviewing whether the loans met Goldman's own standards. Goldman conducted due diligence to determine whether the mortgage loans complied with Goldman-created or approved underwriting guidelines. To make this determination, Goldman employed underwriters who reviewed a sample of the purchased loans to confirm that they both conformed to the representations made by the Originators and complied with the company's own credit policies.

137. One of the primary reviewers Goldman used was Clayton Holdings. As the FCIC found: "Because of the volume of loans examined by Clayton during the housing boom, the firm had a unique inside view of the underwriting standards that originators were actually applying – and that securitizers were willing to accept." (FCIC Report at 166.) Those standards were not what were disclosed in the Goldman Offering Materials. During 2006 and the first half of 2007, Clayton reviewed 911,039 loans issued by originators for securitization by its clients (including Goldman). According to the FCIC Report, only 54% of the nearly one-million loans reviewed by Clayton Holdings "met guidelines." (FCIC Report at 166.)

138. For each loan pool it was hired to review, Clayton checked for: (1) adherence to seller-credit underwriting guidelines and client-risk tolerances; (2) compliance with federal, state and local regulatory laws; and (3) the integrity of electronic loan data provided by the seller to the prospective buyer. This review was commonly referred to as a "credit and compliance review."

139. Underwriters reviewed the loan files, compared electronically stored tape data with hard copy or scanned file data to verify loan information, identified discrepancies in key data points, and graded loans based on seller guidelines and client tolerances. This included answering such questions as whether the "loans meet the underwriting guidelines," whether they "comply with federal and state laws, notably predatory-lending laws and truth-in-lending requirements," and whether "the reported property values [were] accurate." (*Id.* at 166.) It also "critically" analyzed whether, to the extent a loan was deficient, there were any "compensating factors." (*Id.*)

140. Each day, Clayton generated reports for Goldman, and the loan seller, that summarized Clayton's review findings, including summaries of the loan files that suffered from

exceptions to the relevant underwriting standards. Clayton provided its findings in exceptional detail, and despite the restrictions put on Clayton's activities, Clayton managed to identify a high number of defective loans. Once Clayton identified such problems, the seller had the option to attempt to cure them by providing missing documentation or otherwise explaining to Clayton why a loan complied with the underwriting standards. If additional information was provided, Clayton re-graded the loan. Once this process was complete, Clayton provided the Underwriters and Sponsors with final reports.

141. Clayton gave loans one of three grades—Grade 3 loans "failed to meet guidelines and were not approved," while Grade 1 loans "met guidelines." Tellingly, ***only 54 percent of the nearly one-million loans reviewed by Clayton Holdings "met guidelines,"*** a number that its former president admitted was evidence "there [was] a quality control issue in the factory" for mortgage-backed securities. (*Id.* at 166.) The former president also testified that Clayton's clients often waived in loans to preserve their business relationship with the loan Originator, because a high number of rejections might lead the Originator to sell the loans to a competitor.

142. Recently released internal Clayton documents show that, contrary to Goldman's representations, a high percentage of loans reviewed by Clayton for Goldman were defective, but were nonetheless included by Goldman in loan pools sold to Prudential and other investors. According to an internal Clayton Holdings "Trending Report" made public by the government in conjunction with testimony given in September 2010, Goldman Sachs was informed that 23% of the loans Clayton reviewed for Goldman "failed to meet guidelines" and lacked any compensating features. Yet, ***Goldman "waived in" to its pools 29% of those non-conforming loans that Clayton had identified as being outside the guidelines.*** According to a report in the Los Angeles Times on March 17, 2008, employees of Clayton and other mortgage appraisal

firms reportedly "raised plenty of red flags about flaws so serious that mortgages should have been rejected outright – such as borrower's incomes that seemed inflated or documents that looked fake – but the problems were glossed over, ignored or stricken from reports." (E. Scott Reckard *Sub-prime mortgage watchdogs kept on leash* Los Angeles Times March 17, 2008.)

143. This high rejection and waiver rate—from the same time when many of the Securitizations at issue here were being assembled and sold—further confirms that the Mortgage Loans did not in fact meet the stated underwriting guidelines, and were not subject to any purported "compensating factors." Further, the hidden "waiver" of rejected loans that were not subject to any compensating factors was a fraudulent omission and rendered Goldman's disclosures regarding its underwriting and due diligence processes even more misleading.

144. As the FCIC report concluded:

> [M]any prospectuses indicated that the loans in the pool either met guidelines outright or had compensating factors, even though Clayton's records show that only a portion of the loans were sampled, and that of those that were sampled, a substantial percentage of Grade 3 Event loans were waived in.
>
> . . . .
>
> [O]ne could reasonably expect [the untested loans] to have many of the same deficiencies, and at the same rate, as the sampled loans. ***Prospectuses for the ultimate investors in the mortgage-backed securities did not contain this information, or information on how few of the loans were reviewed, raising the question of whether the disclosures were materially misleading, in violation of the securities laws.***

Id. at 167, 170 (emphasis added).

F. Evidence That The Ratings Could Not Be Relied Upon

145. Many investors—particularly insurance companies like Prudential—have investment guidelines which restrict the amount of money that can be placed in investments below investment grades because they have a limited ability to carry these investments as assets

on their books. Almost all the Certificates Prudential purchased from Goldman were AAA or AA rated. Those ratings were false and misleading. It was a classic case of garbage in, garbage out.

146. Goldman fed the same misrepresentations found in the Offering Materials to the ratings agencies which were designed to manufacture false, unreliable ratings. This not only rendered false Goldman's representations about how the ratings process really functioned, but also assured that the ratings themselves failed to reflect the actual risk underlying the Certificates.

147. Because ratings were based primarily on information provided by Goldman, it was critical that the information be true and accurate. The SPSI Report noted:

> For RMBS, the "arranger"—typically an investment bank—initiated the rating process by sending to the credit rating agency information about a prospective RMBS and data about the mortgage loans included in the prospective pool. The data typically identified the characteristics of each mortgage in the pool including: the principal amount, geographic location of the property, FICO score, loan to value ratio of the property, and type of loan . . . .

SPSI Report at 251.

148. Susan Barnes, the North American Practice Leader for RMBS at S&P from 2005 to 2008, confirmed that the rating agencies relied upon investment banks like Goldman to provide accurate information about the loan pools:

> The securitization process relies on the quality of the data generated about the loans going into the securitizations. ***S&P relies on the data produced by others and reported to both S&P and investors about those loans . . . . S&P does not receive the original loan files for the loans in the pool.*** Those files are reviewed by the arranger or sponsor of the transaction, who is also responsible for reporting accurate information about the loans in the deal documents and offering documents to potential investors.

SPSI hearing testimony, April 23, 2010 (emphasis added).

149. As the SPSI found, Goldman and other banks used "financial engineering" of credit ratings to give high risk assets the veneer of safety and low risk. (SPSI Report

at 30.) The "financial engineering" came in numerous forms, including pressuring the rating agencies for favorable ratings and playing the rating agencies off one another with the threat of withholding future business if the sponsoring bank was not given favorable treatment. As detailed in the SPSI report:

> At the same time Moody's and S&P were pressuring their RMBS and CDO analysts to increase market share and revenues, the investment banks responsible for bringing RMBS and CDO business to the firms were pressuring those same analysts to ease rating standards. Former Moody's and S&P analysts and managers interviewed by the Subcommittee described, for example, how investment bankers pressured them to get their deals done quickly, increase the size of the tranches that received AAA ratings, and reduce the credit enhancements protecting the AAA tranches from loss. They also pressed the CRA analysts and managers to ignore a host of factors that could be seen as increasing credit risk. Sometimes described as "ratings shopping," the analysts described how some investment bankers threatened to take their business to another credit rating agency if they did not get the favorable treatment they wanted. The evidence collected by the Subcommittee indicates that the pressure exerted by investment banks frequently impacted the ratings process, enabling the banks to obtain more favorable treatment than they otherwise would have received.

SPSI Report at 278.

150. As one S&P director put it in an August 8, 2006 email: "[Our RMBS friends have] become so beholden to their top issuers for revenue [that] they have all developed a kind of Stockholm syndrome which they mistakenly tag as Customer Value creation." (*Id.* at 277.) Ratings analysts who complained about the pressure, or did not do as they were told, were quickly replaced on deals or terminated.

151. Summarizing the intense pressure investment banks put on ratings analysts to provide favorable ratings, Richard Michalek, a former Moody's VP and Senior Credit Officer, testified before the SPSI that "[t]he willingness to decline to rate, or to 'just say no,' to proposed transactions, steadily diminished over time. That unwillingness to say no grew in parallel with the company share price and the proportion of total firm revenues represented by structured

finance transactions . . . coincident with the steady drive toward commoditization of the instruments we were rating . . . . The threat of losing business . . . even if not realized, absolutely tilted the balance away from independent arbiter of risk towards captive facilitator of risk transfer. . . . The message from management was, 'must say yes.'" *See also* Written Statement of Eric Kolchinsky, Managing Director, Moody's Derivatives Group ("Managers of rating groups were expected by their supervisors and ultimately the Board of Directors . . . to build, or at least maintain, market shares. It was an unspoken understanding that loss of market share would cause a manager to lose his or her job;" "[L]owering credit standards . . . was one easy way for a managing director to regain market share.")

152. The SPSI Report detailed specific pressure exerted by Goldman bankers on ratings analysts. Michalek informed the SPSI that Goldman played the rating agencies off each other:

> Goldman Sachs was well known by the lawyers in the [Structured Products Derivatives Group] for consistently producing as their "preferred form of document" the most "risk seller friendly" precedent [*i.e.*, the most favorable to Goldman Sachs], even if it had been drafted by a law firm other than the firm working for Goldman at the time. . . . While Goldman Sachs was not the only investment bank that used the practice of rotating law firms, in part to gain access to the broadest selection of precedent documentation and thereby the greatest potential for finding a precedent that supported Goldman's preferred language, ***they were the only bank I knew of that employed someone whose primary job was – to put it politely – arbitrage the rating agencies.*** It was not difficult to know where Moody's stood in terms of the relative conservatism of our modeling assumptions and drafting requests; Goldman was very prompt when informing us that "S&P doesn't require that."

Written Statement of Richard Michalek (emphasis added).

153. Michalek testified before the SPSI that he was explicitly told by certain banks that he was "not welcome" on certain deals and that, in at least one instance, he was told that "a CDO team leader at Goldman Sachs also asked, while praising the thoroughness of my work, that after

four transactions he would prefer another lawyer be given an opportunity to work on his deals." (SPSI Report at 286.)

154. On April 11, 2006, a Moody's analyst told colleagues, "I am getting serious pushback from Goldman on a deal that they want to go to market with today" because the deal is "coming out worse when compared to the last . . . deal." (SPSI Hearing Ex. 4/23-36.) Similarly, after a Goldman banker objected to a rating issued by S&P, stating "[w]e therefore cannot settle for the most conservative alternative as I believe you are suggesting," the S&P analyst carved out an exception to its ratings methodology. (SPSI Report at 282.)

155. On April 11, 2008, an article in the Wall Street Journal confirmed that Moody's switched analysts on Goldman deals after the bank complained. According to Mark Froeba, a former Moody's senior VP, "the fear was real, not rare and not at all healthy. You began to hear of analysts, even whole groups of analysts, at Moody's who had lost their jobs because they were doing their jobs, identifying risks and describing them accurately." (*Id.* at 275.)

156. In this pressurized environment where the only acceptable ratings were the ones favored by the investment banks, Goldman was able to essentially pre-determine the ratings by feeding data it knew was false into the ratings system. Goldman's improper pressure upon the rating agencies to provide undeserved ratings rendered misleading Goldman's promises that the various tranches within a particular offering would obtain a certain initial rating and that those ratings would reflect the actual credit quality of the Certificate. Goldman failed to disclose that it, like other investment banks, routinely trampled upon the agencies' independence and provided the agencies with false and misleading data. As Goldman knew, the rating agencies relied on these data, and that the ratings based on these data would not reflect the true credit risk associated with each tranche and Offering.

G. Originator-Specific Evidence That the Mortgage Loans Were Generated Outside The Disclosed Guidelines

157. As the SPSI Report found, Goldman "underwrote securities using loans from subprime lenders known for issuing high risk, poor quality mortgages, and sold risky securities to investors across the United States and around the world." (SPSI Report at 11.) Many of the loans came from now-notorious lenders such as WMC Mortgage Corp., Wells Fargo, First Franklin, Aegis Mortgage Corp., New Century, and Fremont — among the Office of the Comptroller of the Currency's "Worst Ten in the Worst Ten" list of originators, ranked by default rates. (SPSI Report at 239.) Moody's "later calculated that, in 2006 alone, Long Beach, New Century, and Fremont were responsible for 24% of the residential subprime mortgages backed securities issued, but 50% of the subsequent credit rating downgrades of those securities . . . [E]ach of these lenders issued billions of dollars in high risk, poor quality home loans." (*Id.* at 239.) Even when securitizers kicked defective loans out of collateral pools, some of these originators, like Fremont and New Century, were known to put those defective loans into different mortgage pools for other securitizations, presumably hoping that the defects would be overlooked in the next pool's sampling. (FCIC Report at 168.)

158. That Goldman purchased loans from mortgage lenders who had systematically abandoned their stated guidelines is confirmed by the facts discussed below. Loans generated in accordance to the stated guidelines would not have experienced the levels of default seen among the loans underlying Prudential's certificates, would not have had key features consistently and substantially misrepresented, and would not have triggered so many due diligence flags. The fact that the originators here had systematically abandoned their underwriting standards is further confirmed by governmental investigations, statements provided by former employees, and many other facts set forth below.

159. In sum, the originators simply made as many loans as they possibly could, regardless of the borrower's ability to repay the loan, including by:

- Coaching borrowers to falsely inflate their income on loan applications to appear to qualify for mortgage loans that the borrowers could not afford to repay;
- Falsely inflating a prospective borrower's income to qualify the borrower for a loan he or she could not afford to repay;
- Steering borrowers to loans that exceeded their borrowing capacity;
- Encouraging borrowers to borrow more money than they could afford by guiding them to "stated income" loans—loans on which the borrowers could simply make up, or "state," inflated incomes that would not be verified;
- Approving borrowers based on "teaser rates" for loans, despite knowing that the borrower would not be able to afford the payment when the loan rate adjusted; and
- Allowing non-qualifying borrowers to be approved for loans they could not afford under exceptions to the underwriting standards based on so-called "compensating factors" when such "compensating factors" did not in fact exist or did not justify approving the loans.

160. The Senate Permanent Subcommittee on Investigations concluded that "from 2004 to 2007, in exchange for lucrative fees, Goldman Sachs helped lenders like Long Beach, Fremont and New Century securitize high risk, poor quality loans, obtain favorable credit ratings for the resulting [RMBSs], and sell the RMBS securities to investors, pushing billions of dollars of risky mortgages into the financial system." (SPSI Report at 377.)

(2) New Century/NC Capital Corporation

161. This originator and its affiliate, NC Capital Corporation, were responsible for about 72% of the loans in GSAMP Trust 2007-HE2. (GSAMP 2007-HE2 Pro. Supp. at S-38.)

162. Once one of the nation's largest mortgage origination companies, New Century collapsed and filed for bankruptcy on April 2, 2007. Formed in 1996, New Century grew rapidly

to become one of the country's largest subprime lenders, reporting $56.1 billion in mortgage loans in 2005.

163. In order to maintain high origination volumes, New Century ignored problems with borrower credit risk and collateral value and looked the other way while mortgage brokers overstated borrower income and appraised values. Almost 50% of the loans it originated used a stated income or no income verification approach, which allowed borrowers to inflate their income and qualify for loans which they had little ability to pay. New Century also pressured appraisers to inflate the value of many properties regardless of the actual value of the underlying property so the loans would be approved and funded. New Century's bankruptcy examiner report, which was issued in February 2008, found "serious loan quality issues at [New Century] beginning as early as 2004" and numerous "red flags" relating to loan quality. As with many originators, New Century's loan production department was far more concerned with originating large quantities of loans than with ensuring their quality. When New Century's audit committee began identifying potential problems with its risk management systems, New Century's senior management failed to respond. (*See* "New Century Financial: Lessons Learned," *Mortgage Banking*, October 2008.)

164. On February 29, 2008, after reviewing extensive documentary evidence and conducting over 100 interviews, court-appointed Bankruptcy Examiner Michael J. Missal issued a detailed report on the various deficiencies at New Century. These deficiencies included lax mortgage standards and a failure to follow its own underwriting guidelines. Among his findings, the Examiner reported:

- "New Century had a brazen obsession with increasing loan originations, without due regard to the risks associated with that business strategy. . . . The Loan Production Department was the dominant force within the Company and trained mortgage brokers to originate New Century Loans in the aptly named 'CloseMore

University.' Although a primary goal of any mortgage banking company is to make more loans, New Century did so in an aggressive manner that elevated the risks to dangerous and ultimately fatal levels." (Examiner's Report 3.)

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

- "New Century . . . layered the risks of loan products upon the risks of loose underwriting standards in its loan originations to high risk borrowers." (*Id.*)

- Certain senior managers at New Century in 2004 were told by a New Century employee that when underwriting stated income loans, "we are unable to actually determine the borrowers' ability to afford a loan."

- In 2004, the number and severity of the exceptions to underwriting standards employed by New Century to originate greater volume was described by one Senior Officer as the "number one issue" facing New Century.

- By 2004, New Century Senior Management became aware of spiking increases in Early Payment Default ("EPD") rates—where a borrower fails to make even the first several payments on a loan—suggesting that the loan should never have been originated in the first place. In every month following March 2006, the EPD rate exceeded 10%, reaching to as high as 14.95% by year end.

- Up until 2005 New Century used a DOS-based underwriting system which, according to a New Century manager interviewed by the Bankruptcy Examiner, enabled employees to "finagle anything."

Final Report of Michael J. Missal, Bankruptcy Examiner, *In re New Century TRS Holdings, Inc.*, No. 07-10416 (KJC) (Bankr. Del. Feb. 29, 2008).

165. The Bankruptcy Examiner's investigation revealed that New Century's primary standard for loan quality was, contrary to its representations in the offering documents detailed in the attached Exhibits, whether the loan could be sold in the secondary market to investors like Prudential, not whether a borrower could meet the obligations under the terms of the loan.

166. As described in the Bankruptcy Examiner's Report, in New Century's wholesale division—which accounted for the vast majority (approximately 85%) of New Century's loan

originations—the regional managers who had lending authority could override the internal appraiser's decisions. Moreover, the regional managers' compensation was not tied to loan quality, but was rather based on the volume of loans originated, providing incentive to inflate appraisal values in order to increase origination of New Century loans.

167. A 2005 internal audit disclosed in the Bankruptcy Examiner's Report revealed that 18 of 77 (or 23%) of the loans reviewed at one New Century Sacramento fulfillment center had "exceptions with either the appraisal conducted or the review of the appraisal submitted with broker-provided loans or the review appraisal conducted by New Century's Appraisal Department." The results of the audit were not an anomaly. According to the Bankruptcy Examiner, the results of New Century's own loan quality audits of underwriting procedures, account manager review/approval, appraisals and funding "were dismal." As reported by the Bankruptcy Examiner, of nine branches audited by New Century in 2005, none were rated satisfactory, seven were rated unsatisfactory and two were rated as needs improvement.

168. The Bankruptcy Examiner's Report determined that New Century's representations that it "designed its underwriting standards and quality assurance standards to make sure that loan quality was consistent and met its guidelines" were "not supportable." Indeed, New Century's statements regarding its "improved underwriting controls and appraisal review process" have been held by federal courts to be false or misleading statements of material fact.

169. New Century's Loan Production Department was the dominant force within the company and mortgage brokers were trained to originate loans in a department which came to be known as "Closemore University." Loan originations rose dramatically at New Century, from approximately $14 billion in 2002 to approximately $60 billion in 2006. According to the

Bankruptcy Examiner's Report, New Century's Chief Credit Officer said that in 2004 New Century had "no standard for loan quality."

170. The Bankruptcy Examiner highlighted the severity of New Century's improper conduct: "The Examiner recognizes that the subprime mortgage market collapsed with great speed and unprecedented severity, resulting in all of the largest subprime lenders either ceasing operations or being absorbed by larger financial institutions. Taking these events into consideration and attempting to avoid inappropriate hindsight, the Examiner concludes that New Century engaged in a number of significant improper and imprudent practices related to its loan originations, operations, accounting and financial reporting processes."

171. These findings demonstrate that representations in the GSAMP 2007-HE2 Prospectus supplement touting New Century's underwriting standards were false. Among other misrepresentations, New Century did not issue mortgages based on a good faith assessment of "the borrower's ability to repay the mortgage loans," "the value of the mortgaged property," and the "adequacy of the property as collateral for the mortgage loan." New Century did not make "case by case exceptions" to its underwriting guidelines based on "compensating factors" and it did not ensure that mortgage properties which secured its loans were "appraised by qualified independent appraisers." (GSAMP 2007-HE2 Pro. Supp. at S-54.)

172. Instead, as the Bankruptcy Examiner found, New Century had engaged in a number of harmful mortgage practices, including "increasing loan originations, without due regard to the risks associated with that business strategy"; risk layering in which it issued high risk loans to high risk borrowers, including originating in excess of 40% of its loans on a stated income basis; allowing multiple exceptions to underwriting standards; and utilizing poor risk

management practices that relied on the company's selling or securitizing its high risk mortgages rather than retaining them." (SPSI Report at 236.)

173. On December 7, 2009, the SEC charged three of New Century's top officers with violations of the federal securities laws, and claimed that "New Century's business was anything but 'good' and it soon became evident that its lending practices, far from being 'responsible,' were the recipe for financial disaster." SEC Complaint, ¶ 3. The SEC Complaint further details the falsity of New Century's assurances to the market about its "adhere[nce] to high origination standards in order to sell [its] loan products in the secondary market," and its policy to "only approve subprime loan applications that evidence a borrower's ability to repay the loan." *Id.*, ¶¶ 19-20. Claims asserted against New Century for making false or misleading statements of material fact regarding New Century's purported prudent underwriting guidelines have already been sustained under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, and Section 11 of the Securities Act of 1933.

174. Patricia Lindsay, a former Vice President of Corporate Risk at New Century, testified before the FCIC in April 2010 that, beginning in 2004, underwriting guidelines had been all but abandoned at New Century. Lindsay further testified that New Century systematically approved loans with 100 percent financing to borrowers with extremely low credit scores and no supporting proof of income. According to Lindsay, appraisers "fear[ed]" for their "livelihoods" if they failed to provide New Century with a lofty valuation of their collateralized property. As a result, New Century's appraisers "would find properties that would help support the needed value rather than finding the best comparables to come up with the most accurate value."

175. In 2008, the OCC identified New Century as *the* worst subprime lender in the country based on the delinquency rates of the mortgages it originated in the ten metropolitan

areas between 2005 and 2007 with the highest rates of delinquency. *See* "Worst Ten in the Worst Ten," Office of the Comptroller of Currency, November 13, 2008. Further, the FCIC Report (at 157) singled out New Century:

> New Century—once the nation's second-largest subprime lender—ignored early warnings that its own loan quality was deteriorating and stripped power from two risk-control departments that had noted the evidence. In a June 2004 presentation, the Quality Assurance staff reported they had found severe underwriting errors, including evidence of predatory lending, federal and state violations, and credit issues, in 25% of the loans they audited in November and December 2003. In 2004, Chief Operating Officer and later CEO Brad Morrice recommended these results be removed from the statistical tools used to track loan performance, and in 2005, the department was dissolved and its personnel terminated. The same year, the Internal Audit department identified numerous deficiencies in loan files; out of nine reviews it conducted in 2005, it gave the company's loan production department "unsatisfactory" ratings seven times. Patrick Flanagan, president of New Century's mortgage-originating subsidiary, cut the department's budget, saying in a memo that the "group was out of control and tries to dictate business practices instead of audit."

176. On June 16, 2012, the Federal Housing Finance Agency ("FHFA") made public a forensic review of more than one hundred loans originated by New Century.

177. The FHFA forensic review revealed that *77%* of the New Century loans were not underwritten in accordance with New Century's underwriting guidelines or otherwise breached the representations contained in the transaction documents. In particular, and by way of example, the review showed instances where there was no evidence that New Century tested the reasonableness of the borrower's stated income for the employment listed on the application as required by the applicable underwriting guidelines. In addition, the review demonstrated that the borrower, in fact, falsely inflated his or her income on the application, resulting in lower than actual debt to income ratios ("DTI"). Such misrepresentations were material to the originator's decision to lend because the DTI ratio is an important measure of the borrower's ability to repay the loan. Had the loan underwriter performed a reasonableness test as required by the applicable

underwriting guidelines, the unreasonableness of the borrower's stated income would have been evident.

178. For example:

- A loan that closed in May 2006 with a principal balance of $310,250 was originated by New Century as a stated income loan and was included in the NCHET 2006-2 Securitization. The loan application stated that the borrower was employed as a construction worker earning $6,800 per month. The borrower's stated income exceeded the Bureau of Labor Statistic's 90th percentile salary for a construction worker in the same geographic region, which should have been a red flag to the underwriter that the income was overstated. Moreover, in the Statement of Financial Affairs filed by the borrower as part of a 2007 Chapter 13 Bankruptcy, the borrower reported total income of $17,170 for 2006, resulting in a monthly income $1,431. There was no evidence in the file that the underwriter tested the reasonableness of the stated income. A recalculation of DTI based on the borrower's verified income yielded a DTI of 212.61 percent, which exceeds the guideline maximum allowable DTI of 50 percent. The loan defaulted and the property was liquidated in a foreclosure sale, resulting in a loss of $273,719, which is over 88 percent of the original loan amount.

- A loan that closed in May 2006 with a principal balance of $216,000 was originated by New Century as a stated income loan and was included in the NCHET 2006-2 Securitization. The loan application stated that the borrower was self-employed as a realtor earning $14,000 per month. The borrower's stated income exceeded CBSalary.com's 90th percentile salary for a small business owner, the most analogous occupation, in the same geographic region, which should have been a red flag to the underwriter that the borrower's income was overstated. Moreover, the loan file contained post-closing loan modification documents, including the Borrower's 2006 tax return for the same employer at the time of loan origination, which reflected earnings for the borrower of $1,864 per month. There was no evidence in the file that the underwriter tested the reasonableness of the stated income. A recalculation of DTI based on all evidence uncovered by the forensic review, yielded a DTI of 364.08 percent, which exceeds the guideline maximum allowable DTI of 50 percent. The loan defaulted and the property was liquidated in a foreclosure sale, resulting in a loss of 121,937, which is over 56 percent of the original loan amount.

179. Similarly, the FHFA review revealed that New Century failed to incorporate all of a borrower's monthly obligations into its evaluations, precluding it from properly assessing the borrower's ability to repay the loan. The following are examples where New Century's

underwriting process either failed to incorporate all of the borrower's debt or the monthly debt obligations were incorrectly calculated. Properly calculated, the borrower's actual DTI ratio exceeded the limits established by New Century's guidelines. For example:

- A loan that closed in March 2006 with a principal balance of $442,000 was originated by New Century as a stated income loan and was included in the NCHET 2006-2 Securitization. The forensic review revealed that the underwriter improperly excluded the monthly mortgage insurance payment of $118 along with two mortgage loans with total monthly payments of $2,206, and the underwriter improperly calculated the borrower's hazard insurance and taxes. A recalculation of the DTI based on all evidence uncovered by the forensic review resulted in an increase from 49.84 percent to 215.79 percent, which exceeds the guideline maximum of 50 percent. The loan defaulted and the property was liquidated in a foreclosure sale, resulting in a loss of $248,501, which is over 56 percent of the original loan amount.

- A loan that closed in March 2006 with a principal balance of $130,500 was originated by New Century as a stated income loan and was included in the NCHET 2006-2 Securitization. The forensic review revealed that the borrower obtained a mortgage prior to the closing of the subject loan, which resulted in an additional monthly payment of $2,747.00. Although this loan was not listed on the application for the subject loan, there were eight credit inquiries listed on the origination credit report for the previous 90 days. There is no evidence in the file that the underwriter investigated the credit inquiries or took the additional debt obligations into account in originating the loan. Moreover, the borrower failed to include the monthly mortgage insurance of $57 per month. A recalculation of the DTI that includes the borrower's undisclosed debt and monthly mortgage insurance resulted in an increase from 46.68 percent to 181.06 percent, which exceeds the guideline maximum of 50 percent. The loan defaulted and the property was liquidated in a foreclosure sale, resulting in a loss of $134,223, which is over 102 percent of the original loan amount.

180. Relatedly, the FHFA's review showed the following examples where the borrower's credit report contained numerous credit inquiries which should have put New Century on notice for potential misrepresentations of debt obligations, and the resulting impact on the DTI ratio. Had New Century properly addressed these irregularities, the undisclosed liabilities would have been discovered. Failure to investigate these issues prevented the loan

underwriting process from appropriately qualifying the loan and evaluating the borrower's ability to repay the loan. For example:

- A loan that closed in May 2006 with a principal balance of $156,478 was originated by New Century as a stated income loan and was included in the NCHET 2006-2 Securitization. A credit report included in the origination file dated prior to closing shows eight credit inquiries within the previous 90 days, including numerous inquiries from mortgage lenders and servicers. There was no evidence in the origination file that the loan underwriter researched these credit inquiries or took any action to verify that such inquiries were not indicative of undisclosed liabilities of the borrower. Moreover, the borrower obtained another mortgage prior to the closing of the subject loan, which resulted in an additional monthly payment of $1,509. A recalculation of the DTI based on all evidence uncovered in the forensic review resulted in an increase in DTI from 48.25 percent to 76.77 percent, which exceeds the guideline maximum of 50 percent. The loan defaulted and the property was liquidated in a foreclosure sale, resulting in a loss of $1,815.

- A loan that closed in May 2006 with a principal balance of $100,251 was originated by New Century as a stated income loan and was included in the NCHET 2006-2 Securitization. A credit report included in the origination file dated prior to closing shows nine credit inquiries within the previous 90 days, including numerous inquiries from mortgage lenders and servicers. There was no evidence in the origination file that the loan underwriter researched these credit inquiries or took any action to verify that such inquiries were not indicative of undisclosed liabilities of the borrower. Moreover, the borrower obtained another mortgage prior to the closing of the subject loan, which resulted in an additional monthly payment of $1,688. The additional mortgage was not listed on the application for the subject loan. A recalculation of the DTI based on all evidence uncovered in the forensic review resulted in an increase from 38.93 percent to 80.17 percent, which exceeds the guideline maximum of 50 percent. The loan defaulted and the property was liquidated in a foreclosure sale, resulting in a loss of $74,295, which is over 74 percent of the original loan amount.

(3) Fremont

181. Fremont originated 100% of the loans in GSAMP Trust 2004-FM1, GSAMP Trust 2006-FM2, GSAMP Trust 2006-FM1 and FHLT 2004-A and a smaller percentage of the loans in GSAMP Trust 2005-HE4, GSAMP Trust 2005-HE6 and GSAMP Trust 2006-HE3.

182. According to the Senate Permanent Subcommittee:

> Fremont Investment & Loan was once the fifth largest subprime mortgage lender in the United States. At its peak in 2006, it had $13 billion in assets, 3,500 employees, and nearly two dozen offices. Fremont Investment & Loan was neither a bank nor a thrift, but an "industrial loan company" that issued loans and held insured deposits. . . . . In June 2008, Fremont General Corporation declared bankruptcy under Chapter 11 . . . .

SPSI Report at 237-38.

183. The SPSI Report singled out Goldman as being one of Fremont's primary customers despite knowing that Fremont originated poor quality loans:

> In a November 2006 exchange of emails, for example, two Goldman sales representatives were discussing trying to sell Fremont RMBS securities to a client. One salesperson forwarded to the other the client's explanation of why it did not want to buy the securities and its low opinion of Fremont's loan pools: ***'Fremont refused to make any forward looking statements so we really got nothing from them on the crap pools that are out there now.'***
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> . . .
>
> Despite these and other indications of Fremont's poor quality loans, Goldman continued to underwrite and market securities backed by Fremont loans. In an internal February 2007 memorandum to its Mortgage Capital Committee, Goldman wrote that it had a 'significant relationship with Fremont,' based upon past securitizations, whole loan purchases, and warehouse fees. In March 2007, at the same time it was sending millions of dollars in loan repurchase requests to Fremont, Goldman securitized over $1 billion in Fremont subprime loans in one of its warehouse accounts, originating GSAMP Trust 2007-FM2.
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> . . .
>
> Goldman marketed and sold the Fremont securities to its customers, while at the same time purchasing $15 million in CDS contracts referencing some of the Fremont securities it underwrote . . . . [B]y August 2009, every tranche in the GSAMP securitization had been downgraded to junk status.

SPSI Report at 515-16 (emphasis added).

184. As reported in the *New Yorker*: "Fremont was among the worst of the subprime offenders, using all the now familiar practices: targeting people with bad credit, ignoring traditional standards for underwriting home loans, paying third-party brokers handsomely to bring in gullible customers, and then infecting the larger financial system by selling off the

hazardous loans. 'We ordered them out of the business,' she said. 'And they weren't happy about it.'" (Ryan Lizza, *The Contrarian: Sheila Bair and the White House financial debate*, New Yorker, July 6, 2009.) On June 18, 2008, Fremont filed for bankruptcy.

185. The FDIC, in its Order to Cease and Desist in the action styled *In the Matter of Fremont Investment & Loan, Brea, California*, Docket No. FDIC-07-035b, concluded that Fremont had been, among other things: "engaging in unsatisfactory lending practices, . . . marketing and extending [ARM] products to subprime borrowers in an unsafe and unsound manner, . . . approving borrowers without considering appropriate documentation and/or verification of their income, . . . approving loans or 'piggyback' loan arrangements with loan-to-value ratios approaching or exceeding 100 percent of the collateral . . . [and] making mortgage loans without adequately considering the borrower's ability to repay the mortgage according to its terms."

186. On December 9, 2008, the Supreme Judicial Court of Massachusetts affirmed a preliminary injunction that prevented Fremont from foreclosing on thousands of loans issued to Massachusetts residents. As a basis for its unanimous ruling, the Supreme Judicial Court found that the record supported the conclusion that "Fremont made no effort to determine whether borrowers could 'make the scheduled payments under the terms of the loan," and that "Fremont knew or should have known that [its lending practices and loan terms] would operate in concert essentially to guarantee that the borrower would be unable to pay and default would follow." (*Commonwealth v. Fremont Inv. & Loan*, 897 N.E.2d 548, 556 (Mass. 2008).) The terms of the preliminary injunction were made permanent by the June 9, 2009 settlement.

187. On June 9, 2009, Massachusetts Attorney General Martha Coakley announced a $10 million settlement with Fremont that resolved charges "that the company was selling risky

loan products that it knew was designed to fail, such as 100% financing loans and 'no documentation loans." As alleged in the Attorney General's complaint:

> Fremont issued thousands of subprime loans, with multiple layers of risk, through mortgage brokers who regularly provided Fremont with false information that Fremont intentionally, recklessly or negligently failed to verify or audit . . . . Fremont knew or should have known substantial numbers of its subprime loans, especially absent prompt refinancing, would foreseeably fail and result in foreclosure, but nonetheless made the loans to promptly package and sell to the secondary market.

Commonwealth of Massachusetts v. Fremont Investment & Loan, Case No. No. SUCV 2007-4373, dated October 4, 2007, at ¶2.

188. Roger Ehrnman, Fremont's former regulatory compliance and risk manager, substantiated the findings of the Massachusetts Attorney General and the FDIC when he told the FCIC that Fremont repeatedly attempted to place rejected loans into the pools of mortgages that were to be sold to investors and "had a policy of putting loans into subsequent pools until they were kicked out three times." (FCIC Report at 168.)

189. Confidential Witness 1 ("CW1") was a Senior Loan Processor at Fremont from 2001 through May 2007. CW1's job was to gather the documents necessary to satisfy the "stipulations" required by Fremont's underwriters (such as paystubs, tax returns, and appraisals). CW1 felt a sense of urgency and a pressure to close loans, and to possibly compromise lending standards, because of the "catch-22" created by the fact that underwriters and loan processors were only given bonuses on how many loans were closed—not how many were reviewed. In gathering documents, CW1 had suspicions about incomes being claimed, such as "a waitress [that] was making an obscene amount of money." Nonetheless, "we had to accept it." The high claims of income, according to CW1, became a joke amongst personnel in the lending center. According to CW1, another "joke" amongst Fremont's lending center personnel was inflated

appraisals. It was "obvious" that many appraisers were "not impartial" and engaged in "a lot of shady stuff."

190. Confidential Witness 2 ("CW2") was a loan processor at Fremont from 2002 to 2004, and a Senior Account Manager for Fremont in 2006. CW2's duties included ensuring that the needed documents were included in the loan file. There was not only a quota of loans that the underwriters had to hit, but they were paid for every extra loan, and the entire team got paid even more if they collectively closed a given number of loans. According to CW2, there were "some dubious loans" at the time, and underwriters would be "persuaded" to approve loans they were unsure about. Appraisals could "get a little sticky," and CW2 had heard of instances where comparable sales were left off because they did not assist the needed appraisal.

191. Confidential Witness 3 ("CW3") was a Compliance Analyst at Fremont in 2005 and 2006 that was responsible for investigating suspicious activity. CW3 noted that Fremont had very high loan production goals for its lending centers, but its compliance staffing was "very low." CW3 formed the conclusion that management's understanding and interest in risk and compliance matters was "fairly low." Overall, the percentage of files CW3 examined that had compliance-related shortcomings was "pretty high," suggesting a "structural process problem." He could not help but notice that many large loans were being granted to borrowers claiming assets in the form of automobiles and jewelry—yet, suspiciously, little cash in the bank.

192. On information and belief, former Fremont employees will testify that:

- Fremont's Regulatory Risk Management group submitted numerous, repeated adverse written findings to senior Fremont executives in 2005 and 2006, which highlighted, among other things, unfair and deceptive acts, poor underwriting, and problematic incentive compensation;
- Fremont filed repeated Suspicious Activity Reports ("SARs") regarding broker fraud as to certain brokers, but Fremont executives would not end its relationships with the identified brokers;

- Fremont underwriters were instructed that Fremont's underwriting policies were merely a "guide," and broad use of exceptions to the policies was promoted in order to drive loan quantity. Indeed, between 2005 and 2007, an estimated 30% of Fremont's loans had some sort of exception, partly because anyone from an assistant manager on up had the authority to approve exceptions;

- Fremont would convert borrowers who were rejected under full documentation loan applications to "stated income" loans—with a higher reported income than previously documented—so that the loans were ultimately approved;

- Fremont underwriters would ignore obviously fraudulent documents when approving loans, and when information could not be falsified—such as pay stubs—Fremont underwriters would simply remove it from the application files.

- Fremont underwriters would call appraisers and directly request that they inflate their appraisal values in order to close a deal;

- Fremont experienced rampant fraud with regard to appraisals, such as appraisals that were incomplete, did not match the address of the property, or described the home as owner-occupied, when it was rented;

193. Senator Carl Levin, at an SPSI hearing, identified Fremont as a lender "known for poor quality loans" underlying Goldman's securitizations. (*Wall Street and the Financial Crisis: The Role of Credit Rating Agencies* (Apr. 23, 2010).) Senator Levin described how an analyst with S&P raised concerns about the quality of Fremont-originated loans in a Goldman RMBS offering:

> In January 2007, S&P was asked to rate an RMBS being assembled by Goldman Sachs using subprime loans from Fremont Investment and Loan, a subprime lender known for loans with high rates of delinquency. On January 24, 2007, an analyst wrote seeking advice from two senior analysts: "I have a Goldman deal with subprime Fremont collateral. Since Fremont collateral has been performing not so good, is there anything special I should be aware of?" One analyst responded: "No, we don't treat their collateral any differently." The other asked: "are the FICO scores current?" "Yup," came the reply. Then "You are good to go." In other words, the analyst didn't have to factor in any greater credit risk for an issuer known for poor quality loans . . . .

194. The above facts confirm that Goldman's claim in the Offering Materials that Fremont "verif[ies] the income of each applicant," applies "quality control procedures," and

issued loans based on good faith evaluations of "the ability and willingness of the borrower to repay debt" and "adequacy of the mortgaged property as collateral for the mortgage loan" were all false and that Goldman knew it. See Exhibits C, D, J and L.

(4) Aames

195. A portion of the Mortgage Loans in GSAMP 2006-HE3 (approximately 15%) and GSAMP 2006-HE7 (approximately 22%) were purchased from Aames Capital Corporation.

196. Prior to its 2006 acquisition by Accredited Home Lenders Holding Co., Aames Capital Corporation and its affiliates originated, sold and serviced subprime residential mortgages under the names "Aames Home Loans." In 2006, Aames was purchased by Accredited Home Lenders, Inc. Accredited, like all of the other originators discussed above, has been the target of lawsuits arising from its subprime origination practices and violations of reasonable underwriting and appraisal standards. Allegations include that senior managers in Accredited sales divisions frequently overruled decisions by their underwriters to reject loans in order to continue to pump out mortgages and increase profits. The number of overrides became so large that the originators were forced to institute a system to track such overrides and to note when loans were made "as a business decision over the recommendation of the underwriter."

197. Accredited similarly allowed corporate underwriters and sales managers to override the decisions of licensed property appraisers in order to ensure that loans were closed. Frequently, when an appraisal reviewer would conclude that an appraisal had been inflated and reject a loan application, the account executive who submitted the loan application would appeal the rejection to a sales manager who, without valid reason, would then issue an override. Overrides were so frequent that (although unbeknownst to Prudential) by June 2006, over 10% of Accredited's total loans resulted from management overrides.

198. A senior underwriter at Accredited from October 2006 through March 2007 in its Irvine, California office, stated that he was frequently pressured by senior managers to make exceptions to the company's standard underwriting procedures.

199. On May 1, 2009, Accredited filed for bankruptcy. In bankruptcy filings, Accredited has disclosed that it faces more than $200 million in repurchase claims.

200. Violations of underwriting and appraisal standards were also commonplace at Aames in an effort to reach monthly production targets. Aames' aggressiveness extended to making loans to low-income, elderly borrowers without regard to their ability to continue to fund the ongoing mortgage payment as long as the potential borrower purportedly had substantial equity in the property. A mailer sent to elderly low-income borrowers indicates the company's aggressiveness. The mailer highlighted that "[e]ven if you have credit problems, we can probably still help you out. That's because it's your equity, not your income or credit that matters most." As discussed in further detail below, when Goldman began seeking to put back low-quality mortgages to originators, a substantial amount of them were put back to Accredited, which likely included Aames mortgages.

201. An independent appraiser from Florida who was approved by originators, including Aames, stated that she was told by brokers and/or lenders that: "WE NEED THIS NUMBER, OR YOU WILL NEVER WORK FOR US AGAIN." In order to stay in business she gave the valuations the broker or lender demanded, even if it required driving 20 miles away for a comparable sale.

202. The above facts confirm that the Offering Materials make false claims about the quality of Aames' underwriting guidelines, including that "Aames Funding's underwriting

guidelines were designed to assess the borrower's creditworthiness and the adequacy of the real property as collateral for the loan." (GSAMP 2006-HE7 Pro. Supp. at S-48.)

(5) NovaStar

203. The SPSI found that Goldman in 2006 and early 2007 had specific concerns about the credit quality of the loans issued by NovaStar. Yet Goldman stuffed substantial quantities of its loans, approximately 19%, into the collateral pool of GSAMP Trust 2006-HE7.

204. On April 2, 2008, NovaStar disclosed that more than half a dozen regulators and law enforcement authorities, including the FBI, the SEC, the Federal Trade Commission ("FTC"), the United States Department of Justice ("DOJ"), the United States Department of Housing and Urban Development ("HUD"), the United States Department of Labor, and the Office of the Attorney General of New York State, had requested information regarding NovaStar's origination and underwriting practices.

205. Other reports confirm that NovaStar granted loans to borrowers who did not have a realistic chance of repaying them, and misled borrowers about the fact NovaStar was placing them in products ill-suited to their financial situations. For instance, the *New York Times* reported of a couple caught in the trap of a misrepresented adjustable-rate mortgage:

> 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.
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> . . .
>
> 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."

Gretchen Morgenson, *Looking for The Lenders' Little Helpers*, N.Y. TIMES, July 12, 2009.

206. Investor Michael Burry studied NovaStar's underwriting practices, as reported by *The Pitch* in May 2010:

> 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.
>
> 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.

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/.

(6) Ameriquest Mortgage Company

207. Ameriquest (through its affiliate Argent Mortgage Company, LLC) originated the Mortgage Loans underlying the GSAMP 2004-AR2 securitization.

208. Ameriquest was frequently referred to as "one of the nation's worst subprime sharks." (Michael Hudson, *Data shows Deutsche Bank was key patron of questionable mortgage lenders,* iWatch News, (Apr. 18, 2011), *available at* http://www.iwatchnews.org/2011/04/18/4173/data-shows-deutsche-bank-was-key-patron-questionable-mortgage-lenders.)

209. In her January 14, 2010 testimony before the FCIC, Illinois Attorney General Lisa Madigan testified that Ameriquest had "engaged in the kinds of fraudulent practices that other predatory lenders subsequently emulated on a wide scale: inflating home appraisals; increasing the interest rates on borrowers' loans or switching their loans from fixed to adjustable interest rates at closing; and promising borrowers that they could refinance their costly loans into loans with better terms in just a few months or a year, even when borrowers had no equity to absorb another refinance." (FCIC Report at 12, fn. 51.)

210. Ed Parker, the former head of Ameriquest's Mortgage Fraud Investigations Department, also testified before the FCIC. Mr. Parker informed the Commission that he had detected fraud at the company within one month of starting his job there in January 2003, but that senior management had done nothing with his reports. Mr. Parker testified that he had heard that other departments were complaining that he "looked too much" into the loans. (*Id.* at 12.) In November 2005, Mr. Parker was downgraded from "manager" to "supervisor," and he was laid off in May 2006.

211. Ameriquest has been sued by mortgage borrowers who blame the lender's lax underwriting standards for their loan delinquency.

212. In one lawsuit against Ameriquest, the plaintiff alleges that loan officers at a Brooklyn, New York, branch of Ameriquest coerced her into signing a loan. Unbeknownst to the plaintiff, Ameriquest created fake tax returns, employment records, and a 401(k) to make it appear that the loan was affordable. Other court filings allege that Ameriquest doctored loan documents or overstated borrowers' income in connection with the loans of 40 borrowers.

213. Institutional investors have also entered the fray, accusing Ameriquest of violating its own underwriting standards in originating loans that it later sold. For instance, Wachovia Bank, N.A., filed a lawsuit against Ameriquest, alleging that Ameriquest had not complied with repurchase requests on loans with fraudulent files. According to Wachovia's complaint, the 135 nonperforming loans sold to Wachovia on December 29, 2005, contained incorrect credit scores, incorrect employment status, and misstatements regarding the type of home that was being financed. In addition, the complaint alleges that the loans were not underwritten pursuant to the underwriting procedures that Ameriquest agreed to apply. The widespread nature of such practices was confirmed by former Ameriquest employees in a National Public Radio broadcast. A former Ameriquest loan officer in Tampa, Florida, recalled that in order to sell a loan "at any cost," managers (1) encouraged loan officers to conceal the actual cost and interest rates on loans and (2) would white out numbers on W2s and bank statements and fill in bigger amounts basically to qualify people for loans that they couldn't afford, a practice called "taking the loan to the art department." According to the National Public Radio broadcast, these practices were not isolated, were confirmed by former employees from Ameriquest offices around the country, and were widespread as early as 2003.

214. In July 2008, Orson Benn, a former vice president of Argent, Ameriquest's affiliate, who was in charge of overseeing the state of Florida for the mortgage company, was

convicted of mortgage fraud stemming from his approval of fraudulent loan applications. Benn, who "taught" mortgage brokers "how to doctor credit reports, coached them to inflate income on loan applications, and helped them invent phantom jobs for borrowers," was sentenced to 18 years in prison for his role in more than $550 million in fraudulent loans that were "bundl[ed]" and sold "to investors."[2] Benn testified that because Argent was securitizing the mortgages and was not dependent on the borrowers' ability to repay the loans, the accuracy of individual loan applications was not a priority. *Id.*

215. On June 22, 2011 nine former Argent account managers, supervisors, and underwriters were indicted in Ohio for falsifying documents in order to approve loans that did not meet Argent's underwriting standards.[3] The indicted Argent employees are alleged to have "helped coach mortgage brokers about how to falsify loan documents so that they misstated the source or existence of down payments as well as borrower's incomes and assets" and then "approved the loans knowing that the company's own lending rules had not been satisfied."[4] According to Cuyahoga County Prosecutor, in applications for at least 100 loans "the buyers, with the assistance of mortgage brokers and account managers from Argent or other representatives from Argent, misstated one of more of the following: the amount of their assets, their income, the source of or existence of any down payment, the existence of a legitimate seller carryback mortgage, and/or basic and fundamental financial information regarding their financial condition, in order to gain approval for the loan amounts requested in these applications." Press Release, Cuyahoga County Prosecutor, *supra.*

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[2] Jack Dolan, Matthew Haggman, and Rob Barry, "Home Loan Racket Flourished in Florida," *The Miami Herald*, Jan. 29, 2009.

[3] "Nine Former Argent Mortgage Company Account Managers, Supervisors and Underwriters Indicted," Press Release, Cuyahoga County Prosecutor, June 22, 2011.

[4] Mark Gillispie, "Former Employees of Subprime Mortgage Lender Indicted by Cuyahoga County Grand Jury," *The Plain Dealer*, June 23, 2011.

216. Also indicted were two appraisers who worked with Argent to falsify the appraised values for the subject properties. *Id.* In November 2011, Angela Pasternak, one of the indicted Argent account managers was subsequently indicted a second time for "approv[ing] exceptions knowing that loan applications contained false income information and bogus credit scores."[5]

217. Other former Argent employees have repeatedly discussed the failure of Argent to follow its underwriting guidelines. For example, Jacquelyn Fishwick, a former Argent underwriter and account manager, has stated that "Argent employees played fast and loose with the rules" and that she "personally saw some stuff [that she] didn't agree with," including Argent "account managers remov[ing] documents from files and creat[ing] documents by cutting and pasting them."[6] According to the same article, "[a]ll kinds of people [who] were in on the scam, from buyers and sellers of real estate to the mortgage brokers, appraisers and title officials who facilitated this massive fraud." *Id.*

218. Similarly, Steve Jerigan, a fraud investigator for Argent has called into question the company's appraisal practices. Jerigan has described a particularly telling instance when he went to investigate a new subdivision for which Argent had made a number of loans. According to Jerigan, the addresses on the loans led to the middle of a cornfield and an identical fake picture had been included in each file. In short, he quickly discovered that the loans were based on fabrications.[7]

219. When Citigroup acquired Argent in 2007, Richard Bowen, the Chief Underwriter in Citigroup's Consumer Lending Group, performed a review of Argent. Bowen found that

[5] Mark Gillispie, "Argent Mortgage Worker Gets Indicted Again In Suspected Mortgage Fraud Case," *The Plain Dealer*, November 15, 2011. Ms. Pasternak's attorney has stated that she was following the directives of supervisors. *Id.*

[6] "Subprime House of Cards," *Cleveland Plain Dealer*, May 11, 2008.

[7] Michael W. Hudson, "Silencing the Whistle-Blowers," *The Investigative Fund*, May 10, 2010.

"large numbers" of Argent's loans were "not underwritten according to the representations that were there." FCIC Hearing Transcript, Apr. 7, 2010, p. 239.

(7) WMC Mortgage Corp.

220. WMC originated the Mortgage Loans underlying the GSAMP 2005-WMC2 securitization.

221. WMC employed reckless underwriting standards and practices that resulted in a huge number of foreclosures, ranking WMC fourth in the report presented to the FCIC in April 2010 identifying the "Worst Ten" mortgage originators in the "Worst Ten" metropolitan areas. *See* OCC Press Release, "Worst Ten in the Worst Ten."

222. 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 (the "Statement of Charges") against WMC and its principal owners individually. (*See* Statement of Charges, No. C-07-557-08-SC01, Washington State Department of Financial Institutions, Division of Consumer Services, June 4, 2008.) The Statement of Charges alleged that at least 76 of 86 loans originated by WMC as late as October 6, 2006 were defective or had otherwise been originated in violation of Washington state law. (*Id.*) 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. (*Id.*)

223. A review by a mortgage-backed securities trustee holding WMC loans—and thus, by someone who, unlike Prudential, has access to WMC's actual loan files—also found that

many of them were defective. The trustee found that WMC's such basic representations as that no fraud had taken place, and that the loans complied with WMC's underwriting guidelines, "were false when made." A review of 200 loan files (some of which were from a co-originator, EquiFirst, also at issue in this case) found a 75% error rate.

224. For example, the trustee's re-underwriting found that a Mortgage Loan originated by WMC was plagued with misrepresentations of the borrower's income, debt liabilities and occupancy status. In particular, whereas the borrower stated on his loan application that he earned $14,782 per month performing "account analysis," the borrower's income tax returns for the 2005 and 2006 years made it unambiguously clear that he was a taxi driver with a monthly income of only $1,548. Further, the borrower's credit report disclosed two additional mortgages in the amount of $435,000, or an additional monthly liability of $3,094, which the borrower failed to disclose on his loan application. Finally, contrary to the borrower's representations, the property he sought to purchase with the loan in question was not the borrower's primary residence, and as a result, the rental obligations of the borrower's actual primary residence added another $2,200 of monthly debt liabilities. In sum, if the borrower's characteristics were viewed in a true and accurate light, the borrower's debt to income ratio ("DTI") rose from an acceptable 34.9% to an incredible 761.7%.

225. According to the trustee's review of the related loan file and other information, another Mortgage Loan originated by WMC likewise contained numerous misrepresentations of the borrower's income, the co-borrower's income, and the borrower's undisclosed debt liabilities. Specifically, instead of her stated $9,200 monthly income as a billing manager, the borrower actually worked as an optometric technician, making $2,405 per month. Similarly, the co-borrower misrepresented his income and occupation to be $8,800, earned as a grade check,

rather than the actual $2,843, earned as a laborer. Moreover, in the same month the borrower closed this loan, the borrower had also refinanced another, unrelated property, which increased her debt liabilities by over $100,000. The borrower's loan application did not reflect the refinancing and the associated DTI increase. Even without the additional debt obligation resulting from the refinancing, the borrower's actual DTI increased from a reasonable 31.7% percent to an impermissible 108.8%.

226. Based on the trustee's re-underwriting of a large sample of loans—the same type of loans, generated by the same originator, at roughly the same time as at issue in this case—the trustee had "compelling reason to believe that the vast majority" of the WMC loans it held were infected with similar frauds. The consistency of the trustee's findings with Prudential's own loan-level analysis of the specific WMC loans at issue in this case, as well as its consistency with the findings of the Washington State Department of Financial Institutions, confirms that WMC's underwriting problems were systemic.

227. On January 20, 2012, the *L.A. Times* reported that the FBI and United States Department of Justice have been investigating possible mortgage origination fraud at WMC. According to the *L.A. Times*, "the government is asking whether WMC used falsified paperwork, overstated income and other tactics to push through questionable loans"; "the FBI's San Francisco office … has been looking into WMC's business practices for nearly two years"; and "the bureau has examined individual WMC loan files and has begun contacting former employees about how the lender handled the sales of mortgages to investors." (Michael Hudson and E. Scott Reckard, "GE Lending Unit Said to be Target of U.S. Probe," *L.A. Times* (January 20, 2012), *available at* http://articles.latimes.com/2012/jan/20/business/la-fi-mortgage-probe-20120120.)

228. Former WMC employees have also provided first-hand evidence that WMC not only abandoned its underwriting standards and practices, but that WMC and its employees engaged in out-and-out fraud to increase profits and commissions. These employees provided this evidence in interviews with *iWatch News,* which acts as an online publication dedicated to investigative and accountability reporting for the Center for Public Integrity, one of the oldest and largest non-partisan, non-profit investigative news organizations. Dave Riedel, a former compliance manager at WMC who supervised a quality-control team of a dozen or more people in Southern California, told *iWatch News* that WMC "sales reps intent on putting up big numbers used falsified paperwork, bogus income documentation and other tricks to get loans approved and sold off to Wall Street investors." (Michael Hudson, "Fraud and folly: The untold story of General Electric's subprime debacle," *iWatch News* (January 6, 2012, last updated January 23, 2012), *available at* http://www.iwatchnews.org/2012/01/06/7802/fraud-and-folly-untold-story-general-electric-s-subprime-debacle.)

229. Reidel and his team uncovered numerous examples of fraud committed by WMC employees. "These included faking proofs of loan applicants' employment and faking verifications that would-be home buyers had been faithfully paying rent for years rather than, say, living with their parents. Some employees also fabricated borrowers' incomes by creating bogus W-2 tax forms ...." In 2005, Riedel and his team became particularly concerned about a sales manager who oversaw the funding of hundreds of loans each month. Riedel told *iWatch News* that "[a]n audit of those loans... found that many of the deals showed evidence of fraud or other defects such as missing documents." Riedel brought these concerns to WMC's management, which took no disciplinary action against the sales manager. Later, Riedel informed a visiting GE compliance official of the audit and of WMC's failure to respond. As

apparent payback for alerting management to the fraud he uncovered, Riedel lost his office and staff and was demoted.

230. In May of 2006, Riedel presented GE officials with results of an internal audit of loans that investors had asked WMC to repurchase, which indicated that "78 percent of them had been fraudulent" and "nearly four out of the five loan applications backing these mortgages had contained misrepresentations about borrower's incomes or employment." Upon information and belief, WMC made no changes to its origination practices, procedures, or internal control in response to Riedel's presentation.

231. Gail Roman, a former loan auditor at WMC's regional offices in Orangeburg, NY, informed *iWatch News* that she "dug up persuasive evidence of inflated borrower incomes and other deceptions on loan applications," but "[m]anagement ignored [her] reports and approved the loans anyway." Roman reported that WMC "didn't want to hear what you found . . . .[e]ven if you had enough documentation to show that there was fraud or questionable activity."

232. Victor Argueta, a former risk analyst at WMC, told *iWatch News* that "one top sales staffer escaped punishment even though it was common knowledge he was using his computer to create fake documents to bolster applicants' chances of getting approved." These documents included bank statements, W-2s and "'[a]nything to make the loan look better than what was the real story.'" In another instance, Argueta reported to management that certain salespeople "were putting down fake jobs on borrowers' loan applications" and "listing their own cell phone numbers so they could pose as the borrowers' supervisors and 'confirm' that the borrowers were working at the made-up employers." Despite's Argueta's report, WMC's management took no action against the offending salespeople.

(8) Encore Credit Corporation

233. Encore originated 16.41% of the Mortgage Loans underlying the GSAMP 2006-HE2 securitization.

234. Encore was strictly a subprime lender, which specialized in "nonconforming" borrowers and focused on Alt-A and subprime loans, including "interest-only" loans and ARMs.

235. Encore (later known Performance Credit Corp.) was acquired by Bear Stearns in 2007. As reported in the FCIC Report, "only a month after the purchase of Encore, the Securities and Exchange Commission wrote in an internal report, 'Bear's mortgage business incurred significant risk losses . . . risk managers note[d] that these events reflect a more rapid and severe deterioration in collateral performance than anticipated in ex ante models of stress events.'" (FCIC Report at 281.)

236. In October 2008, the California Corporations Commissioner issued an order revoking Encore's license (at that time, known as Performance Credit Corp.), after a regulatory examination found that the company's financial statements had not been kept up to date, and the company lacked sufficient net worth. Encore's lending practices have also been subject of many civil actions, including ones in which borrowers were granted summary judgment on their truth-in-lending claims arising from a loan originated by Encore.

237. In her testimony to the FCIC, Vicki Beal, Senior Vice President of the due-diligence firm Clayton, was asked whether there were "some loan originators who just weren't as good as [the] others." She identified, among others, Encore.

238. In May 2009, Encore was listed on the Center for Public Integrity's list of top 25 subprime lenders responsible for the subprime economic meltdown based on the over $22 billion in high-risk, high-interest loans originated between 2005 and 2007.

(9) First NLC Financial Services, LLC

239. First NLC originated 20.87% of the Mortgage Loans underlying the GSAMP 2005-HE6 securitization.

240. First NLC was one of the top subprime residential mortgage lenders in the United States. The company was sold in 2007 to an affiliate of the private equity firm Sun Capital Partners. In January of 2008, the company announced that it had ceased loan origination, and filed for bankruptcy later that month.

241. In 2000, First NLC's first full year of operations, its loan origination volume sat at $308.9 million. First NLC was able to expand its loan originations over the next six years, originating over $7.4 billion in mortgage loans in 2006 alone.

242. First NLC accomplished this growth by abandoning its underwriting guidelines and sound business practices, as confirmed by numerous investigations, as well as its own bankruptcy filings.

243. For instance, First NLC settled accusations with the Pennsylvania Department of Banking based on writing mortgages from an unlicensed location.

244. An investigation by the Washington Department of Financial Institutions, Division of Consumer Services found that First NLC did not maintain proper books and records in violation of the state Consumer Loan Act. This was based on First NLC's repeated failures to locate loan files that the government had requested for examination. The failure to even be able to produce loan files requested by a government agency evidences the complete breakdown that occurred within First NLC's operations.

245. Of the loan files First NLC was able to actually produce, the Washington Department of Financial Institutions found that ***22%*** demonstrated on their face that lending-law

violations had occurred. Engaging in lending-law violations represent an obvious failure to generate loans within the stated guidelines.

246. A final order was entered against First NLC revoking its license to conduct business in the state of Washington and prohibiting it from participating in any other consumer loan companies for a period of five years.

247. A similar investigation by the California Department of Corporations also found that First NLC was "conducting residential mortgage lending and/or servicing business . . . in such an unsafe and injurious manner as to render further operations hazardous to the public or to customers." The Department of Corrections also later found that First NLC had not maintained and filed the lending reports required by state law, such as an Independent Auditor's Report on Internal Controls. The company was ordered to cease lending and servicing activities in the state and later had its license revoked.

248. Before closing, First NLC disclosed large loss provisions, and was increasing its reserves, in response to costs associated with the expected need for the company to buyback defective loans. Nonetheless, First NLC was forced to close its doors after being asked by Wall Street banks that had securitized its loans to buy back millions of dollars worth of loans due to breaches of First NLC's representations and warranties. Indeed, the bankruptcy filings revealed that the top seven unsecured creditors—six of them, banks that were heavily involved in the securitization of mortgage loans, like Goldman here—all had claims arising out of breaches of First NLC's representations and warranties.

249. Those buyback requests included ones by Goldman Sachs Mortgage Corp. ($5.03 million), HSBC Mortgage Services ($2.96 million), Deutsche Bank Securities Inc. ($2.15 million), and US Bank Corporate Trust Services.

(10) Wells Fargo

250. Wells Fargo originated 100 percent of the loans in GSAMP 2004-WF. Wells Fargo's poor underwriting practices have been the subject of numerous suits and investigations by investors and government actors.

251. For example, in March 2009, RMBS investors filed suit against Wells Fargo, alleging that it had misrepresented its underwriting guidelines and loan quality. In denying in part a motion to dismiss, the court found that plaintiffs had adequately pled that "variance from the stated [underwriting] standards was essentially [Wells Fargo's] norm" and that this conduct "infected the entire underwriting process." *In re Wells Fargo Mortgage-Backed Certificates Litig.*, 712 F. Supp. 2d 958, 972 (N.D. Cal. 2010). Wells Fargo subsequently agreed to settle the investors' claims.

252. In July 2009, the Attorney General of Illinois filed a lawsuit, *People v. Wells Fargo & Co.*, No. 09-CH-26434 (Ill. Cir. Ct. 2009), alleging that Wells Fargo "engaged in deceptive practices by misleading Illinois borrowers about their mortgage terms." The complaint describes that borrowers were placed into loans that were "unaffordable and unsuitable," and that Wells Fargo "failed to maintain proper controls to ensure that borrowers were not placed into mortgages that were riskier or more expensive than the mortgage loans for which they were qualified."

253. In April 2010, the City of Memphis filed a complaint in *Memphis v. Wells Fargo Bank*, No. 09-CV-02857 (W.D. Tenn. 2009), alleging that Wells Fargo "failed to underwrite African-American borrowers properly." A similar lawsuit was filed by the City of Baltimore, *Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A.*, No. 08-CV-00062 (D. Md. 2008). The *City of Memphis* and *City of Baltimore* complaints include sworn declarations from many former Wells Fargo employees providing evidence of predatory lending and abandonment

of underwriting guidelines. For instance, Camille Thomas, a loan processor at Wells Fargo from January 2004 to January 2008, stated under oath that loans were granted based on inflated appraisals, which allowed borrowers to get larger loans than they could afford due to the impact on the LTV calculation and some loans were even granted based on falsified income documents. Similarly, another affidavit by Doris Dancy, a credit manager at Wells Fargo from July 2007 to January 2008, stated that managers put pressure on employees to convince people to apply for loans, even if the person could not afford the loan or did not qualify for it. She was also aware that loan applications contained false data used to qualify customers for loans.

254. The FCIC interviewed Darcy Parmer, a former employee of Wells Fargo, who worked as an underwriter and a quality assurance analyst from 2001 until 2007. Ms. Parmer confirmed that, during her tenure, Wells Fargo's underwriting standards were loosening, adding that they were being applied "on the fly" and that "[p]eople were making it up as they went." She also told the FCIC that 99 percent of the loans she would review in a day would get approved, and that, even though she later became a "fraud analyst," she never received any training in detecting fraud. The FCIC's January 2011 Report described how "hundreds and hundreds and hundreds of fraud cases" that Ms. Palmer knew were identified within Wells Fargo's home equity loan division were not reported to FinCEN.[8] In addition, according to Ms. Palmer, at least half the loans she flagged for fraud were nevertheless funded over her objections.

255. In July 2011, the Federal Reserve Board issued a consent cease and desist order and assessed an $85 million civil money penalty against Wells Fargo & Co. and Wells Fargo Financial, Inc. According to the Federal Reserve's press release, the order addressed in part allegations that "Wells Fargo Financial sales personnel falsified information about borrowers'

[8] FinCEN is the Financial Crimes Enforcement Network, a bureau within the Treasury Department that collects and analyzes information regarding financial fraud.

incomes to make it appear that the borrowers qualified for loans when they would not have qualified based on their actual incomes." The Federal Reserve Board also found that the poor practices of Wells Fargo were fostered by Wells Fargo Financial's incentive compensation and sales quota programs, and the lack of adequate controls to manage the risks arising from those programs.

(11) **First Franklin**

256. First Franklin originated 100% of the loans in FFML 2005-FF2.

257. First Franklin was a prolific originator of risky, higher-yielding loans. The collapse of the residential real-estate market has brought to light First Franklin's abysmal lending practices, as borrowers who could never afford the loans they received from First Franklin defaulted in droves. Statistics compiled by Standard & Poor's in 2010 place the performance of First Franklin-originated loans at or near the very bottom of the list of major issuers for the 2006 and 2007 loan vintages. U.S. Closed-End Second-Lien RMBS Performance Update: May 2010 Distribution Date, Standard & Poor's Ratings Direct, June 24, 2010, at 6-8. The FHFA recently sued Merrill Lynch, First Franklin's parent, for securities law violations in connection with various securitizations whose loans were originated or acquired by First Franklin during the same time period in which FFML 2005-FF2 was securitized. (*See* First Amended Complaint, *FHFA v. Merrill Lynch & Co., Inc. et al.*, 11-CV-06202-DLC (S.D.N.Y.).)

258. Specifically, the FHFA conducted a forensic analysis of loans in the following securitizations which were originated or acquired by First Franklin: FFML 2006-FF18, FFML 2007-FF2, FFMER 2007-1, FFMER 2007-2, FFMER 2007-3, and FFMER 2007-4.

259. FHFA's forensic analysis showed that First Franklin routinely breached its underwriting guidelines. Of the 2,688 loans reviewed, 1,859 did not comply with the applicable underwriting guidelines. Although the Prospectus Supplements represented that the existence of

compensating factors may warrant an exception to the applicable underwriting guidelines on a case-by-case basis, none of these 1,859 loans evidenced that sufficient compensating factors were considered at the time of origination to justify or support such an exception. A 70 percent breach rate, in any event, could not possibly be explained by the proper application of such exceptions.

260. For example, of the 2,688 loans reviewed from the FFML 2006-FF18, FFML 2007-FF2, FFMER 2007-1, FFMER 2007-2, FFMER 2007-3, and FFMER 2007-4, Securitizations, 660 were "Stated Income" loans. Of these, the forensic review determined that 226 loans (34.2%) had stated incomes in excess of the 75th percentile of the Bureau of Labor Statistics income levels for each borrower's line of work, and 178 of those loans (26.9%) even exceeded the 90th percentile for the Bureau of Labor Statistics income levels.

261. The forensic review revealed numerous instances where there was no evidence that the loan underwriter analyzed the reasonableness of the borrower's stated income for the employment listed on the loan application as required by the applicable underwriting guidelines. In fact, the forensic review verified that borrowers misrepresented their income on the applications. This misrepresentation resulted in a miscalculation of the borrower's DTI. Had the loan underwriter performed an evaluation of the income stated on the application by the borrower as required by the applicable underwriting guidelines, including evaluating the borrower's stated occupation, geographic region of employment, years of experience, and education level, the unreasonableness of the borrower's stated income would have been evident.

262. The FHFA found numerous breaches of other underwriting representations, including (a) repeated examples of underwriter error or negligence; (b) incorrect calculations of

debt and debt-to-income ratios in excess of stated guidelines; (c) failures to follow up on unexplained credit inquiries; and (d) disregard of occupancy fraud.

263. The FHFA's analysis of another First Franklin securitization, FFML 2006-FF11 yielded similar results. (*See* Amended Complaint, *FHFA v. HSBC North America Holdings Inc., et al.*, 11 Civ. 6189 (DLC) (S.D.N.Y.).) Substantially all of the mortgage loans in the FFML 2006-FF11 Securitization were originated by First Franklin. A forensic review of 449 randomly selected loans from the FFML 2006-FF11 Securitization revealed that more than 95 percent of the loans reviewed were not underwritten in accordance with the underwriting guidelines or otherwise breached the representations contained in the transaction documents.

264. Likewise, the FHFA forensically analyzed the First Franklin-originated loans underlying several securitizations in its Amended Complaint against Goldman, Sachs & Co. (*See* Amended Complaint, *FHFA v. Goldman, Sachs & Co., et al.*, 11 Civ. 6198 (DLC) (S.D.N.Y.).) Specifically, a review of 578 loans selected from the FFML 2006-FF13 trust, for which Goldman Sachs Mortgage Company served as sponsor, GS Mortgage Securities Corp. as the depositor, and Goldman, Sachs & Co. as the lead underwriter, revealed that 93.4% of the loans reviewed were not underwritten in accordance with First Franklin's underwriting guidelines or otherwise breached the representations contained in the transaction documents. Similarly, a forensic review of 250 loans selected from the GSAMP 2006-FM3 securitization, for which Goldman Sachs Mortgage Company served as sponsor, GS Mortgage Securities Corp. as the depositor, and Goldman, Sachs & Co. as the lead underwriter, revealed that approximately 99.6% of the reviewed loans were not underwritten in accordance with First Franklin's guidelines.

265. For example, the review revealed instances where there was no evidence that First Franklin tested the reasonableness of the borrower's stated income for the employment listed on the application as required by First Franklin's underwriting guidelines. In addition, the forensic review verified the borrower actually misrepresented his or her income on the loan application. This misrepresentation resulted in a miscalculation of the borrower's DTI. By way of example:

- A loan that closed in July 2006 with a principal amount of $141,520 was originated under First Franklin's No Income Verification Loan Program and included in the FFML 2006-FF13 Securitization. The loan application stated that the borrower was a maintenance technician earning $4,600 per month in Isanti, MN. The borrower's stated income exceeded the U.S. Bureau of Labor Statistics' 90th percentile salary for a maintenance technician in the borrower's geographic region, which should have put a reasonably prudent underwriter on notice for potential misrepresentation. There is no evidence in the file that the underwriter tested the reasonableness of the stated income. Had the underwriter done so, the misrepresentation of income would have been uncovered. Moreover, based on information in the borrower's bankruptcy documents filed in December 2007, the borrower reported monthly income of $1,795 in 2006, the year of the subject loan closing. A recalculation of DTI based on all evidence uncovered in the forensic review was 105.19 percent, which grossly exceeds the guideline maximum of 50.49 percent. The loan defaulted and the property was liquidated, resulting in a loss of $52,470, which is 37 percent of the original loan amount.

- A loan that closed in July 2006 with a principal amount of $148,000 was originated under First Franklin's No Income Verification Loan Program and included in the FFML 2006-FF13 Securitization. The loan application stated that the borrower was a personal banker earning $4,200 per month in Milwaukee, WI. The borrower's stated income exceeded the U.S. Bureau of Labor Statistics' 90th percentile salary for a personal banker in the borrower's geographic region, which should have put a reasonably prudent underwriter on notice for potential misrepresentation. There was no evidence in the file that the underwriter tested the reasonableness of the stated income. Had the underwriter done so, the misrepresentation of income would have been uncovered. Moreover, based on information in the borrower's bankruptcy documents filed in August 2007, the borrower reported monthly income of $1,805 in 2006, the year of the subject loan closing. A recalculation of DTI based on all evidence uncovered in the forensic review was 329.91 percent, which grossly exceeds the guideline maximum of 50.49 percent. The loan defaulted and the property was liquidated, resulting in a loss of $166,889, which is over 100 percent of the original loan amount.

266. Similarly, the FHFA's review of Goldman's First Franklin securitizations revealed examples where First Franklin did not adequately question the borrower's intended occupancy of the subject property. Although the FFML 2006-FF13 and GSAMP 2006-FM3 Prospectus Supplements each reported that 100 percent and 89.25 percent, respectively, of the loans in the reviewed loan groups were for owner-occupied properties, a significant number of the loan files that FHFA reviewed indicated facts or circumstances that would have put a reasonable loan underwriter on notice of potential occupancy misrepresentations. First Franklin's lack of compliance with its underwriting process in this regard materially increased the credit risk of the loan and the portfolio because investment and second home properties generally have a higher rate of default and higher loss severities than owner-occupied primary residences. By way of example:

- A loan that closed in July 2006 with a principal amount of $51,200 was originated as a First Lien under the First Franklin's Full Documentation Loan Program and included in the FFML 2006-FF13 Securitization. The borrower indicated on the occupancy statement that the subject property was to be owner occupied. The HUD 1 contained rent credit and security deposit credits. There were two appraisals in the loan file. The first appraisal ordered by the broker indicated the subject was tenant occupied and the second appraisal ordered by the lender indicated the subject was owner occupied. Additionally, the purchase contract reflected the subject had an active lease. No evidence in the file indicates that the underwriting process addressed this inconsistency, and the loan was underwritten as if the property was owner occupied. The loan defaulted and the property was liquidated, resulting in a loss of $67,831, which is over 100 percent of the original loan amount.

- A loan that closed in August 2006 with a principal amount of $369,000 was originated by Fremont as a stated income loan and included in the GSAMP 2006-FM3 Securitization. The loan was originated as a refinance of a single family residence and included in the GSAMP 2006-FM3 Securitization. The underwriting guidelines for this loan required that the borrower occupy the subject property. The loan was represented as being

> for an owner occupied residence. However, a Statement of Financial Affairs, filed by the borrower as part of a 2008 bankruptcy proceeding, indicates that the borrower's primary address was not the subject property during the three years prior to the bankruptcy. Further, a forensic review of the loan file, including a search of public records revealed that the borrower did not activate utilities at the subject property address, a copy of the homeowner's insurance for the subject property indicated the borrower's listed home address was not the subject property, and the borrower signed an occupancy affidavit at closing that indicated the borrower did not intend to occupy the property. No evidence in the file indicates that the loan underwriter addressed or challenged the borrower's claim that he intended to reside at the subject property. The loan defaulted and the property was liquidated, resulting in a loss of $372,471.21, which is over 100 percent of the original loan amount.

267. The FHFA also found scores of examples in which the forensic review confirmed that First Franklin's underwriting process failed to incorporate all of a borrower's debt. When properly calculated, the borrower's actual DTI exceeded the applicable limit per the underwriting guidelines. For example:

- A loan that closed in July 2006 with a principal amount of $164,000 was originated under First Franklin's Full Documentation/12 Month Bank Statement Loan Program and included in the FFML 2006-FF13 Securitization. The loan underwriter approved the borrower with a 54.76 percent DTI by including consumer debts totaling $105 per month. The loan application included in the origination loan file, and dated prior to closing, evidenced an additional mortgage in the amount of $112,500 with payments of $1,105 per month, resulting in the borrower's actual monthly obligations being $1,210 per month. There was no evidence in the file that the loan underwriter took this additional debt obligation into account in originating the loan. A recalculation of the DTI that includes the borrower's undisclosed debt was 71.11 percent, which grossly exceeds the applicable underwriting guideline maximum of 55.49 percent. The loan defaulted and the property was liquidated, resulting in a loss of $85,643, which was 52 percent of the original loan amount.

- A loan that closed in August 2006 with a principal amount of $131,300 was originated by Fremont as a stated income loan and included in the GSAMP 2006-FM3 Securitization. A forensic review of the loan file reveals that the underwriter improperly excluded the monthly mortgage on the borrower's primary residence of $1,255 when calculating the borrower's debts. A recalculation of the DTI based on all evidence uncovered by the forensic review results in an increase from 39.41 percent

> to 154.25 percent, which exceeds the guideline maximum of 50 percent. The loan defaulted and the property was liquidated, resulting in loss of $148,492, which is over 113 percent of the original loan amount.

268. Finally, the FHFA forensic review uncovered many examples of instances where the borrowers' credit reports indicated numerous credit inquiries that should have put First Franklin on notice for potential misrepresentations of debt obligations to be included in the borrowers' DTI calculation. In each of these instances there was no evidence in the origination loan file that First Franklin researched these credit inquiries, which would have been contained in the borrower's credit report, or took any action to verify that such inquiries were not indicative of undisclosed liabilities of the borrower. Had the loan underwriter properly addressed these irregularities, the undisclosed liabilities would have been discovered. Failure to investigate these issues prevented the loan underwriting process from appropriately qualifying the loan and evaluating the borrower's "repayment ability."

(12) Meritage

269. Meritage Mortgage Corporation originated or acquired over 27% of the loans in GSAMP 2005-HE6 and over 11% of the loans in GSAMP 2006-HE3.

270. On information and belief, Meritage originated numerous poor quality loans in a rush to generate profits with little regard for sound underwriting practices. Specifically, as disclosed in publicly filed pleadings, in March 2005, during a monthly, internal Meritage conference call, one item of discussion was the fact that certain market conditions were working against Meritage, thereby reducing its already thin profits. Senior executives at NetBank (Meritage's parent) directed Meritage executives to "push the volume" of the subprime loans, meaning that they should relax underwriting standards in order to generate more profits from subprime loans. Meritage thus embarked upon a strategy that de-emphasized risk controls and emphasized volume. This strategy aimed at increasing Meritage's profits by volume rather than

through quality. Managers within the NetBank finance team were astonished by how low Meritage had allowed the quality of loans and underwriting to become, even providing subprime home loans to people who had gone bankrupt.

271. Meritage's poor underwriting practices have been the subject of an Audit Report prepared by the Office of Inspector General, Department of the Treasury, dated April 23, 2008, titled "SAFETY AND SOUNDNESS: Material Loss Review of NetBank, FSB" (the OIG Audit Report"). That Report presents, among other things, the results of the OIG 's review of the failure of NetBank, FSB -- a failure that the FDIC estimates will cost the Deposit Insurance Fund some $108 million. Specifically, the OIG Audit Report found that large losses related to NetBank's mortgage banking operations and commercial lease portfolio were among the significant causes of NetBank's failure: "NetBank responded to declining gains on the sale of loans by attempting to maintain high loan volumes at the expense of the quality of loan originations. This resulted in an increase in repurchase requests from the buyers of the sold loans. The thrift repurchased $182 million of mortgage loans in 2006 and recorded related loss provisions totaling $78.1 million."

(13) Aegis Mortgage Corporation

272. Aegis Mortgage Corporation ("Aegis") originated or acquired over 12% of the loans in GSAMP 2007-HE2. Aegis was founded in 1993 with a $500,000 investment. Initially, Aegis was a privately held mortgage banking company owned by three individuals. By 1998, the company was generating $1 billion in annual loan volume. In 1998 and 1999, Cerberus Capital Management, LP made a $45 million investment in Aegis, enabling the company to increase its subprime business.

273. With this substantial cash injection, Aegis acquired two extremely distressed mortgage production operations – UC Lending and New America. These and subsequent acquisitions enabled Aegis to grow from 150 employees in nine locations in 1999 to 3,800

employees in over 100 locations in 2005. By 2006, Aegis was ranked as the 13th-largest subprime lender in the country, generating close to $20 billion in annual originations. In eight years, the company's subprime originations grew by 1,750%.

274. High-fee, high-risk mortgages fueled Aegis' astronomic growth. As the need for these mortgages increased, loan underwriting standards were loosened to the point of near abandonment by 2006. A large portion of the loans Aegis originated during this time were purchased from unlicensed mortgage brokers. Because investment banks purchased Aegis' loans, underwriting standards were disregarded and quantity became more important than quality. Aegis' Divisional head of underwriting, Helen Spavile, bullied the understaffed East Coast underwriting department in Jacksonville, Florida, to approve whatever loans were sent there for approval, resulting in the guidelines being ignored and the loans approved. On August 13, 2007, the company was forced to file for bankruptcy protection.

(14) MILA, Inc.

275. Mortgage Investment Lending Associates, Inc ("MILA") originated or acquired approximately 19% of the loans in GSAMP 2006-HE3; 14% of the loans in GSAMP 2006-HE2; and 25% of the loans in GSAMP 2006-HE1. MILA was principally in the business of making subprime loans. By the end of 2004, and because of increasingly ill-advised and risky lending practices, MILA was functionally insolvent.

276. Specifically, by the end of 2004, its revenue as a percentage of loan sales and repurchased loans as a percentage of loan sales were worsening at an accelerating rate. Like other originators, MILA made representations and warranties regarding its loans' compliance with underwriting guidelines and other critical loan risk metrics. If a loan breached these representations and warranties, MILA promised that it would repurchase the loan. MILA repurchased loans of $2,718,671 in 2002, $8,260,655 in 2003, and ***$37,660,332 in 2004***. MILA

projected that its loan repurchases as a percentage of total loan sales would triple in 2005 through 2007.

277. To survive financially, it needed a dramatic increase in available cash on hand, profitability and a means of reversing the alarming growth in bad loans it was required to repurchase. Ultimately, however, MILA collapsed on April 20, 2007 and ceased to be a going concern.

III. EVIDENCE THAT GOLDMAN KNEW ITS REPRESENTATIONS WERE UNTRUE AND MISLEADING

278. The Certificates Prudential purchased from Goldman that are at issue in this lawsuit have all suffered severe financial performance problems. This was as a direct result of the failure of the Mortgage Loans to comply with represented underwriting standards. Prudential's analysis revealed that the representations concerning the underlying loans were consistently misrepresented by large margins. The consistency of the terrible financial performance of the Certificates here is strong evidence that Goldman had to have known representations concerning the Mortgage Loans were false. It is not credible to believe that Goldman—which had a direct window into the lax origination practices of the Mortgage Loans—did not know that the representations regarding them were false when made. This is not just to say that Goldman *must* have known—it is to show that Goldman *did* in fact know.

B. Evidence Regarding Goldman's Due Diligence

(1) Goldman's Due Diligence Benefitted From A Direct Window Into The Originators' Practices

279. In connection with its purchase of the Mortgage Loans from the Originators, and consistent with industry practice, Goldman performed due diligence to determine the quality of the loans it was purchasing. Specifically, Goldman operated quality assurance and risk management departments tasked with discovering whether the loans met the stated standards

stated in the Offering Materials. Goldman conducted due diligence on the Originators it was purchasing loans from and on the loans included in each offering to determine compliance with the approved underwriting guidelines.

280. To make a determination about the quality of the loans and of the originators, Goldman employed a team of underwriters who reviewed a sample of the purchased loans to confirm that they both conformed to the representations made by the originators and complied with the stated credit policies.

281. In an April 23, 2010 report to regulators titled, "Goldman Sachs: Risk Management and the Residential Mortgage Market," Goldman said that when it structured or underwrote RMBS it "engaged in a due diligence process to examine (i) the counterparty, (ii) loan level credit, (iii) compliance and (iv) property valuation." Goldman also stated that," [i]n connection with our underwriting of residential mortgage-related securities, Goldman Sachs had a process to examine the management, relevant policies and procedures, underwriting standards, creditworthiness and other aspects of each mortgage originator before the firm began purchasing loans for securitization;" and that the "firm also employed internal and third-party resources to conduct due diligence on the individual loans in the pools backing the securities in our RMBS offerings, including reviewing selected loan files, verifying compliance with state and federal lending statutes, and selective review of property appraisals against comparable values." (Goldman Sachs: Risk Management and the Residential Mortgage Market p. 3-4.)

282. Goldman acquired the Mortgage Loans which it put in pools and securitized through two primary channels: bulk acquisitions in the secondary market and the GS Conduit Program. Goldman's Offering Materials represented that, in both channels, Goldman conducted due diligence on the lenders who originated the loans and carefully inspected their underwriting

standards: "Prior to acquiring any mortgage loans, GSMC will conduct a review of the related mortgage loan seller. GSMC's review process consists of reviewing select financial information for credit and risk assessment and underwriting guideline review, senior level management discussion and background checks. The scope of the mortgage loan due diligence will depend on the credit quality of the mortgage loans." (GSAMP 2006-FM1 Pro. Supp. at S-50.)

283. According to the Offering Materials, the "underwriting guideline review considers mortgage loan origination processes and systems. In addition, such review considers corporate policy and procedures relating to state and federal predatory lending and high cost lending laws, origination practices by jurisdiction, historical loan level loss experience, quality control practices, significant litigation and material investors." (*Id.*) " Similar misrepresentations are made in the Offering Materials for all the Certificates.

284. Goldman also stated that it re-underwrote sample pools of the loans it purchased to ensure compliance with underwriting guidelines. According to the Offering Materials for GSAMP 2006-FM1, "[w]e may elect to re-underwrite some of the mortgage loans based upon our own criteria." (GSAMP 2006-FM1 Prospectus at 29; *see also id.* at 29 ("[w]e may, in connection with the acquisition of mortgage loans, re-underwrite the mortgage loans based upon criteria we believe are appropriate depending to some extent on our or our affiliates' prior experience with the lender and the servicer, as well as our prior experience with a particular type of loan or with loans relating to mortgaged properties in a particular geographical region. A standard approach to re-underwriting will be to compare loan file information and information that is represented to us on a tape with respect to a percentage of the mortgage loans we deem appropriate in the circumstances.").) Similar representations are made in the Offering Materials for all of the Certificates. *See also* SPSI Report at 483 ("Goldman, either directly or through a

third party due diligence firm, routinely conducted due diligence review of the mortgage loan pools it bought from lenders or third party brokers for use in its securitizations.") Thus, it is impossible to believe Goldman could have conducted this due diligence on the Mortgage Loans in the pools without concluding that a very high percentage of the Mortgage Loans in the pools did not comply with the underwriting standards disclosed in the Offering Materials.

285. Goldman participated in mortgage sale auctions held by the originators. Goldman typically set the criteria for the loans it wished to buy and was given access to loan files. Before the auction, the mortgage originators would provide bid sheets that would specify, among other things, the percentage of the loans on which Goldman would be permitted to conduct due diligence. The originators also provided Goldman with an electronic loan tape that described characteristics of the mortgages being auctioned, including owner occupancy rates, loan-to-value ratios and other statistics relevant to the borrower's ability to repay.

286. Based upon this information, Goldman prepared its bid at loan auctions and determined the prices at which it would purchase loans. If Goldman won the auction, it would be allowed to conduct additional due diligence on the loans before the settlement date. Based on the number of problem loans found, Goldman or a due diligence firm it hired for this purpose extrapolated the total percentage of problem loans likely contained in the pool. This information was a factor considered by Goldman in determining the price Goldman offered for the pool.

287. Goldman was directly or indirectly involved in the process at each step of the way. Indeed, Goldman often provided funds used by the originators to give a loan to the homebuyer – the very first step in the RMBS process. Goldman provided "warehouse" lines of credit to originators[9] which were used by originators to fund the mortgages they were granting;

[9] *See, e.g.*, GSAMP Trust 2006-FM1 Pro. Supp. at S-49 ("GSMC provides warehouse and repurchase financing to mortgage lenders. . . .").

Goldman's warehouse loan was then repaid when the originator's loan pool was sold to Goldman for securitization. As the FCIC found:

> Under Paulson's leadership, Goldman Sachs had played a central role in the creation and sale of mortgage securities. From 2004 through 2006, the company provided billions of dollars in loans to mortgage lenders; most went to the subprime lenders Ameriquest, Long Beach, Fremont, New Century, and Countrywide through warehouse lines of credit, often in the form of repos. During the same period, Goldman acquired $53 billion of loans from these and other subprime loan originators, which it securitized and sold to investors. From 2004 to 2006, Goldman issued 318 mortgage securitizations totaling $184 billion (about a quarter were subprime), and 63 CDOs totaling $32 billion; Goldman also issued 22 synthetic or hybrid CDOs with a face value of $35 billion between 2004 and June 2006.

FCIC Report at 142.

288. Consequently, Goldman's longstanding relationships with the problematic originators, and its various roles in the securitization chain, made it uniquely positioned to know the Originators had abandoned their underwriting guidelines.

289. These warehouse lines gave Goldman the inside track on acquiring the loans that were generated by Goldman funds. They allowed Goldman to control the origination practices of these lenders and gave Goldman an inside look into the true quality of the loans which were originated. As one publication explained, warehouse lenders like Goldman have "detailed knowledge of the lender's operations." (Kevin Connor, *Wall Street and the Making of the Subprime Disaster*, November 2007 at 11.)

290. Because of its financial arrangements with the mortgage originators to which it provided warehouse funding , Goldman was financially incentivized to purchase loans that secured its warehouse lines regardless of their quality and the results of Goldman's due diligence. If the loans were not purchased, the warehouse lines would not be repaid. Therefore, Goldman was incentivized to allow defective mortgages to remain in the securitizations because: (1) mortgage originators would not maintain a relationship with a bank that consistently kicked

out large numbers of loans; and (2) the securitization became smaller as loans were kicked out, thus decreasing the underwriting fees and other fees.

(2) Defendants' Meaningless Due Diligence

291. Goldman's own due diligence revealed that a significant percentage of loans failed to meet the applicable underwriting standards, yet they were included in the securitization pools anyway. Documents recently released by Goldman's third-party due diligence firm, Clayton, confirm that was Goldman's *modus operandi.*

292. Due to strong demand, Originators had bargaining power over the Wall Street banks, seeking to purchase mortgages and sponsor securitizations. One way originators exercised this bargaining power was to insist that investment banks limit their due diligence to small percentages of loans before purchase. If an investment bank chose to exclude a large number of loans from a pool (*e.g.*, because the loans failed to conform to the mortgage originator's guidelines or did not contain adequate documentation), it risked being excluded from future loan purchases. As a result, the Wall Street banks, including Goldman, performed increasingly cursory due diligence on the loans they securitized.

293. Clayton's Senior Vice President Vicki Beal explained to the FCIC that firms like hers were "not retained by [their] clients to provide an opinion as to whether a loan is a good loan or a bad loan." (FCIC Report at 166.) Rather, as described by the FCIC's January 2011 report, their review was intended to cover three areas: "credit, compliance, and valuation." (*Id.*) This included answering such questions as whether the "loans meet the underwriting guidelines," "comply with federal and state laws, notably predatory-lending laws and truth-in-lending requirements," and "[w]ere the reported property values accurate." (*Id.*) The review also analyzed whether, to the extent a loan was deficient, there were any "compensating factors." (*Id.*)

294. Some deviations from the stated underwriting guidelines were relatively benign, such as a credit score that was slightly below the acceptable range (*i.e.*, 680 score required, 670 actual). Other deviations, such as lack of an appraisal, unreasonable stated income for the job stated, or missing critical documents in a HUD-1 form, were considered more severe. Once Clayton identified deviations, the seller had the option to attempt to cure them by providing missing documentation or otherwise explaining to Clayton why a loan complied with the underwriting standards. If additional information was provided, Clayton re-graded the loan. Once this process was complete, Clayton provided the underwriters with final reports.

295. The type and scope of due diligence that firms like Clayton conducted were dictated by their clients based on their individual objectives. Clients generally asked for some small fraction—typically about 10 to 20% of the total pool of loans—to be analyzed. Clayton did not evaluate property values or engage in detailed due diligence. By narrowly instructing such third-party due diligence firms, banks like Goldman could limit their analysis and avoid any broad conclusions as to whether there was a high percentage of non-compliant loans in the pool. According to September 2010 testimony before the FCIC by Clayton's former president, D. Keith Johnson, Clayton was just a "potted plant."

296. Ultimately, the entire due diligence process yielded very little meaningful data. There was minimal filtering of bad loans, little resolution of the types of red flags that should have led Goldman to reject loan pools from sellers, and no indication that there was any thorough evaluation of loan pools for their lack of documentation.

297. Goldman's disclosures to their investors significantly understated or withheld information that would have allowed investors to assess what due diligence had been conducted or the results of such diligence, especially because Clayton had only conducted diligence on a

small sample of the total. In many instances, instead of kicking loans with underwriting exceptions out of the pools, Goldman and other investment banks simply included the loans in the acquired pools, and used the reports which Clayton and other due diligence firms generated to negotiate a lower purchase price for the loan pool. According to the September 2010 FCIC testimony of D. Keith Johnson, the investment banks would use the exception report to force a lower price for itself, and not to benefit investors at all:

> I don't think that we added any value to the investor, the end investor, to get down to your point. I think our only value was done in negotiating the purchase between the seller and securitizer. Perhaps the securitizer was able to negotiate a lower price, and could continue to maximize the line. We added no value to the investor, to the rating agencies.

FCIC Staff Interview with D. Keith Johnson, Sep. 2, 2010.

298. In other words, rather than reject defective loans from collateral pools, or cease doing business with consistently failing originators, investment banks like Goldman would instead use the Clayton data simply to insist on a lower price from the loan originators, leaving more room for its own profits while the defective loans were hidden from investors such as Prudential in securitization pools. Goldman further sought to leverage this information in its warehouse lending business. Goldman used the discovery of poor lending practices to increase its profits—by charging higher warehouse fees to those originators identified as being problematic. *See* SPSI Report, at 484 n. 2038 (citing Goldman email dated Feb. 2, 2007 which discussed proposal to charge higher warehouse fees to mortgage originators with higher EPD [early payment default] and "drop out" rates, including Fremont and New Century). In light of the fact that Clayton was operating under extreme pressure from its clients to allow as many loans as possible to remain in the securitization pools and to conduct increasingly cursory reviews, the high rejection and waiver rates are even more damning for Goldman. Based upon

such pressure on Clayton, Goldman knew the true rates of defects were actually much higher than Clayton reported, and that it was allowing in even more defective loans than Clayton's Trending Reports have since revealed.

(3) Third-Party Due Diligence Data Confirms Goldman Was Made Aware, On A Daily Basis, of Problems with Non-Performing Loans

299. As discussed above, according to an internal Clayton "Trending Report" made public by the government in conjunction with testimony given in September 2010, ***Goldman Sachs was informed that 23% of the loans Clayton reviewed for Goldman "failed to meet guidelines."*** These loans were *not* subject to any proper "exceptions," as they did not have any "compensating factors." Rather, these loans were plainly defective.

300. With such a high failure rate, the proper response would be to reject the pool outright, and to seriously investigate whether that originator could be considered a trusted source of loans in the future. Even assuming Goldman incredibly believed a 23% failure rate could be chalked up to "sampling error" (due to the fact that Clayton Holdings did not review every loan in a pool), the proper response would be to increase the sample size to test that hypothesis.

301. Goldman did neither. It not only continued to work with problematic originators, but, rather than expanding the sample size to truly investigate the problems, it simply disregarded, and did not disclose, the red flags Clayton's results showed. ***According to Clayton's "Trending Report," Goldman "waived in" to its pools 29% of those toxic loans that Clayton had identified as being outside the guidelines.***

302. As high as these numbers are, they are likely understated and almost certainly do not reflect the true percentage of bad loans put into the mortgage pools. This is because Goldman provided Clayton with only a sample of loans, rather than all of the loans it was

considering acquiring. Had diligence been conducted on all of the loans, it is very likely that far more non-compliant loans would have been discovered.

303. These high percentages of non-compliant loans were identified despite Defendants pressuring Clayton and other third party due diligence firms to provide reports in a very short time frame, with only limited re-verification of data, and to approve as many loans as possible. Thus, on information and belief, the percentage of loans securitized by Goldman that were truly problematic was in fact much higher than the astounding rates Clayton's reports indicate these firms managed to discover.

304. Clayton's "Trending Report" provides compelling evidence that Goldman knew it was securitizing defective loans and selling the resulting securities to investors like Prudential. According to the September 2010 testimony of Clayton's Vice President Vicki Beal, through its numerous roles of underwriter, sponsor, and depositor, Goldman was made fully aware ***on a daily basis*** that a significant percentage of its loans failed to meet stated underwriting guidelines, but were being included in the pools underlying securities sold to investors, like the Certificates sold to Prudential.

305. It wasn't merely through "trending reports" that Goldman learned of its loans' non-compliance with underwriting guidelines. Instead, Goldman's third-party due diligence firms like Clayton and Bohan gave Goldman *daily* reports indicating exactly how many loans failed to meet the guidelines—*and* which lacked any purported "compensating factors." Documents that were made public by the government's investigation confirmed that Goldman was being informed that many of the loans they had reviewed were defective—but Goldman knowingly approved them for use in securitizations anyway. That Goldman was receiving *daily* reports regarding how many loans were defective confirms it acted knowingly in securitizing the

defective Mortgage Loans at issue here.

306. Clayton prepared a wide range of reports for banks such as Goldman. These reports generally took the form of: (i) daily reports, which contain a variety of information regarding the characteristics of a particular mortgage loan on a daily basis; (ii) final reports, which reflect all of the information contained in the daily reports for a mortgage loan, including any grade changes, waivers, and comments; and (iii) trending reports, which track the performance and treatment of a mortgage loan over time. The information contained in the daily, final, and trending reports includes, but is not limited to, information regarding: (i) whether a loan complied with the applicable underwriting guidelines; (ii) whether a loan was eligible for an exception to the applicable underwriting guidelines, including whether any compensating factors applied, and any comments; (iii) the borrower's assets; (iv) documentation missing from the loan application; (v) the status and condition of the underlying property; (vi) the disposition of the loan, including any transfers or foreclosure; and (vii) whether the loan complied with applicable laws and regulations. Clayton made each of these types of reports, as well as any other loan-specific information, available at the request of its clients, such as Goldman.

307. Clayton's clients were generally only given read access to Clayton's reports. An exception was made for waivers. Clients such as Goldman were given passwords to access Clayton's reports in order to waive loans that did not meet the applicable underwriting standards into securitizations. If a client made a waiver call, the date and time on which it was made would be reflected in Clayton's reports.

308. The high rejection and waiver rates are made even more concerning by the fact that Clayton was under extreme pressure to give as many loans as possible a pass, and conducted

increasingly cursory reviews. Thus, Goldman knew the true rates of defects were actually much higher, and that it was allowing in even more defective loans than Clayton's Trending Reports, and other reports, have since revealed. This, as well as the fact Goldman had knowledge of the high rates at which the loans it was securitizing were being rejected, is confirmed by the testimony of numerous confidential witnesses.

309. Confidential Witness 4 ("CW4") was an Underwriting Project Lead at Clayton from 2003 until October 2006. According to CW4, the task of a Project Lead included having direct dealings with representatives from clients, such as Defendants. At various times, CW4 also worked as a QC Underwriter, reviewing the work conducted by other underwriters.

310. In CW4's view, the quality and experience of Clayton's underwriters decreased as Clayton hired more and more underwriters during the real estate boom. Many underwriters were in their 20s, and some even in their late teens, without much, if any, underwriting experience.

311. According to CW4, the review process typically began with receipt of a "loan tape," which contained data on what the loans' features were supposed to be, i.e., whether they were owner-occupied or not, what their LTV ratios were, the documentation process used to grant the loan, etc. The purpose of Clayton's diligence, in CW4's view, was to ensure that the actual loan files supported the descriptions of the loans contained in the "loan tapes," and to evaluate the loans to ensure that the loan fell within the underwriter's guidelines. Loans graded as "3s" were to be kicked from the loan pools.

312. During CW4's tenure at Clayton, "a lot of 3s were changed to 2s and 1s." Loans that were missing documentation that was later supplied by the lender or the client could be re-graded during a "stip clearing" process—but sometimes this new documentation appeared as if by "miracle." According to CW4, others were simply waived in. And, even when

"compensating" factors were purportedly found to justify a "2" grade, rather than a "3" grade, CW4 characterized many of these factors as "almost wishful thinking" and "pretty weak." CW4 estimates that 80% of loans initially graded "3" were ultimately re-graded.

313. CW4 understood that Clayton was not supposed to assign too many failing grades to loans so as not to "upset" the client (such as Goldman) and the lender that was selling the loans, which could lead to business being taken to Clayton's competitors. This was conveyed to Clayton by the clients, the lenders which had originated the loans, and even by other Project Leads. This point was made explicitly by one client, which told CW4 to "get this fucking guy out of here," after a Clayton underwriter who was an expert on appraisals was kicking out too many loans based on problems with the appraisals.

314. From CW4's perspective, representatives of the purchasers saw Clayton as irrelevant, given the larger objective of securitizing the loans. As such, they were not interested in the real quality of the loans being reviewed. In fact, one client representative colorfully admitted that he did not "give a flying [expletive] about DTI [debt-to-income ratios]" and other characteristics of the loans. Another client similarly told Clayton to "get this [expletive] done and get out of here, and don't make a big deal" about any issues, even though CW4 had found problems such as inflated appraisals and missing documents.

315. While at Clayton, CW4 typically reviewed 8 to 10 loans a day. Later, CW4 was pressured to increase that to 21 loans per day. CW4 protested that this afforded an insufficient amount of time to review each loan. CW4 was further instructed to simply "get the deal done." This made CW4 feel that the due diligence reviews were "just going through the motions," performing only a cursory review of loans. CW4 admitted that Clayton "did a bad job on stated incomes," as borrowers with "average jobs" were approved based on claims of making $300,000

to $400,000 per year. CW4 also admitted that many of the appraisals suffered from "bad comps."

316. CW4 singled out a borrower's debt profile as something that was only given a cursory review. For instance, when it came to detailing a borrower's history of late payments, Clayton personnel were told to just "ballpark it." And aspects of a borrower's debt—such as car payments—were simply ignored based on assumptions about the borrower's behavior.

317. Other former Clayton and Bohan employees have confirmed that the high rejection and waiver rates just scratched the surface of the problems in the origination pipeline. For instance, according to Confidential Witness 5 ("CW5"), who worked at Clayton reviewing loans from 2003 to 2006, reviewers were not given much time to review loan files—as little as half an hour for home equity loans and only 40 to 60 minutes for standard mortgages. Further limiting CW5's review (and thus making the high rejection rates all the more astounding) was the fact that CW5 was not authorized to conduct any independent outside confirmation, but only to mechanically check to see that the files contained, for example, a list of three other properties. According to CW5, Clayton's analysis was further handicapped by the fact that reviewers were expected to know how to apply differing guidelines depending on the client. In addition, a loan file had to have four deviations from the applicable guidelines before it was even considered for rejection. And even then, the loan was not immediately rejected, but rather simply elevated for further review.

318. Confidential Witness 6 ("CW6") was a Contract Underwriter at Clayton from 2003 to 2004, and a Transaction Specialist there from 2005 to 2007. CW6's team would underwrite loans, including by visiting a client's offices to conduct the review. CW6 confirmed that reports were run daily that would provide notes on the reasons for low grades, and that these

reports were usually sent to the client. According to CW6, clients sometimes would call to discuss low grades given to certain loans. If the client still wanted to buy the loan, the grade would sometimes be changed, sometimes based on the receipt of additional documents that supposedly cured the deficiency, but also sometimes merely by agreement.

319. Similarly, Confidential Witness 7 ("CW7") worked for Clayton as a Contract Underwriter. Like CW5, CW7 stated that reviewers were only given 45 minutes to an hour to approve or reject a loan file. Also like CW5, CW7 recalled a lot of pressure to approve loans. According to CW7, Clayton's team leaders had the ability to "fix" CW7's findings, and CW7 was told to keep CW7's mouth shut rather than raising questions.

320. Another former Clayton Contract Underwriter, Confidential Witness 8 ("CW8"), further confirmed that unreasonable loans were regularly included in loan pools under clients' directions. CW8 recalled instances in which borrowers working at fast food chains claimed to have incomes as high as $10,000 a month. Even though underwriters "kicked" these patently unreasonable loans, according to CW8, the clients would still purchase them. CW8 explained that the attitude toward stated income loans was that the asserted incomes "*could* be true," and thus were acceptable.

321. CW8, who had previously worked as an appraiser earlier in his career, also stated that he regularly encountered what he believed to be inflated appraisals in the loans he reviewed. Thus, when he reviewed a loan with a particularly high LTV ratio, he "always kicked it." Invariably, however, the Project Lead at Clayton informed him that the high LTV ratio was fine and instructed him not to reject the loan.

322. Confidential Witness 9 ("CW9") was a Senior Project Lead at Clayton from 2004 to 2009. In this role, CW9 oversaw teams of underwriters assigned to review samples of loan

pools being considered for purchase by clients. CW9's due diligence teams reviewed loan pools originated by, among others, Fremont. CW9 again confirmed that Clayton's clients received daily reports on the progress of reviews, as well as a final report summarizing the total results at the end of a project. CW9 even stated that certain clients could access the reports in real-time using Clayton's software application. The reports reflected the results of CW9's teams' review of the loans as against the underwriting guidelines they were given to apply. The reviews CW9 supervised sometimes would take place at the client's location, because some clients did not want the loan files to leave their premises. CW9 also confirmed that Clayton was asked to review only a sample of the loans—and often the client dictated what loans made up that "sample."

323. According to CW9, at the end of a review, a "stipulation clearing" process was undertaken in which loans were re-reviewed to see if grade "3s" could be promoted to grade "2s" or grade "1s," such as through the provision of supplemental documentation in the loan file. In other situations, however, clients simply waived the requirements that necessitated the "3" grade, and the loan was re-graded. According to CW9, there was often "no rhyme or reason" offered by the client as to why the waivers were being provided. Rather, underwriters would simply make the grade change in the system. CW9 harbored doubts about whether the borrowers could and would repay the loans. CW9 stated that loans were approved by way of accepting clearly unreasonable income claims.

324. Confidential Witness 10 ("CW10") was the Director of Client Service Management at Clayton from October 2001 until December 2005, and a Vice President of Business Development from December 2005 until October 2007. In these roles, CW10 oversaw due diligence on both conduit and bulk loan pools that Clayton reviewed.

325. CW10 recalled several instances in which loan originators would progressively apply pressure up the hierarchy until either Clayton or the banks yielded and accepted loans that had been graded as non-compliant. According to CW10, if the originator could not persuade the Clayton Team Lead to re-grade a defective loan, the originator would contact CW10. If CW10 resisted, the originator would contact the bank's asset manager, who would apply pressure on CW10 to re-grade the rejected loan. Frequently, the pressure to accept a rejected loan would come directly from a bank's trading desk, which needed a certain number of loans to complete a deal it had structured. If Clayton refused to re-grade the loan, the bank's traders would "flip their lid." On numerous occasions, CW10 was directly contacted by asset managers and traders from banks who would "pound" on him until he re-graded a loan.

326. While noting that pressure from the originator or bank representative often caused Clayton to re-grade a rejected loan, CW10 explained that even loans that received the highest grade were suspect because the lender's or bank's guidelines were extremely loose. As such, borrowers with credit scores as low as 560 met the guidelines, despite no verifiable source of income. According to CW10, the banks were "buying [expletive] loans because the guidelines allowed [expletive] loans."

327. Confidential Witness 11 ("CW11") described a similar fast-pace review process as discussed above with Clayton. Specifically, underwriters were expected to review 10 to 12 loans per day, which meant that the reviewers "didn't get into the meat of the loan." Indeed, the time constraints often meant that the review was limited to "data entry" because the reviewers had to take everything at "face value." CW11 said that Team Leads instructed reviewers not to look closely at appraisals, credit reports, asset or income documents, or at the reasonableness of stated income or assets.

328. According to CW11, Bohan Team Leads and Quality Control Underwriters could change loan scores without the underwriter's knowledge. When CW11 would bring discrepancies to a Team Lead's attention, CW11 would sometimes be told "not to worry" because the "loans were pretty much purchased" already, and thus the reviewers "just need[ed] to get the audit done." The most common problems CW11 could recall were FICO scores that were lower than guidelines required, DTI and LTV ratios higher than the guidelines allowed, suspect income calculations, and Truth-in-Lending Disclosure violations. The loans looked like "garbage" to CW11.

329. Confidential Witness 12 ("CW12") worked as a Deal Manager at Bohan during the 1990s and into 2006. In that role, CW12 communicated with clients to help determine how to configure the Bohan Risk Analysis Information Network ("BRAIN") to reflect the underwriting parameters the client wanted tested, and would communicate with the underwriters on how to run those tests. Clients often gave Bohan looser guidelines than used by the originators, and on top of that would instruct Bohan not to give a "3" grade unless the loan failed the applicable guidelines by a certain margin of error.

330. CW12 would email the day's results to the client nightly. According to CW12, clients would change grade "3" loans to grade "2" loans "constantly." An example that CW12 had "no doubt" happened, or certainly something similar, was that a housekeeper might claim an income of $100,000 and Bohan would grade the loan "3" because of the income's unreasonableness. Nonetheless, the client would change it to a "2." A review with 40 percent grade "3" loans was not abnormal, according to CW12. The reasons why a loan was given a "3" grade was to be noted in the reports, so that the client could see why a given loan failed.

331. Melissa Toy and Irma Aninger, two contract risk analysts who reviewed loan files for Bohan from 2004 to 2006, have stated that their supervisors overrode the majority of their challenges to shaky loans on behalf of Goldman and other firms:

> They couldn't recall specific examples involving loans bought by Goldman, but they said their supervisors cleared half-million-dollar loans to a gardener, a housekeeper and a hairdresser.
>
> Aninger, whose job was to review the work of other contract analysts, said that she objected to numerous applications for loans that required no income verification, her supervisor would typically tell her, "You can't call him a liar ... You have to take (his) word for it."
>
> "I don't even know why I was there," she said, "because the stuff was gonna get pushed through anyway."
>
> Toy said she concluded that the reviews were mostly "for appearances," because the Wall Street firms planned to repackage "bogus" loans swiftly and sell them as bonds, passing any future liabilities to the buyers. The investment banks and mortgage lenders each seemed to be playing "hot potato," trying to pass the risks "before they got burned," she said.
>
> "There was nobody involved in this who didn't know what was going on, no matter what they say," she said. "We all knew."

Greg Gordon, *Why did Goldman stop scrutinizing loans it bought?*, McClatchy Washington Bureau, November 1, 2009.

332. In short, all of this testimony confirms that the third party due diligence firms were under a tremendous amount of pressure to give passing grades to as many loans as possible, and were given very little information or time to grade the loans. This makes the high non-conforming rates seen in the deals Clayton handled for Goldman all the more revealing. Had prudent due diligence been conducted, the rates of non-conforming loans would likely have been even higher.

333. This testimony further confirms that clients such as Goldman had direct access to Clayton and Bohan's data, and thus knew in near real-time how many loans were defective. The

testimony confirms that the high "waiver" rates seen in Clayton's "Trending Reports" evidence a conscious decision by Goldman to include into its securitizations loans that its due diligence had specifically identified as failing to meet the stated underwriting guidelines.

C. <u>Goldman Capitalized On Its Unique Knowledge of Weakness in the RMBS Market At The Expense Of Investors</u>

(1) When It Was Still Selling RMBS Goldman Realized that the Subprime Market Was in Trouble

334. In the years leading up to and through 2006, Goldman was one of the most prolific—and profitable—players in the subprime mortgage business, having securitized over $53 billion in mortgages from 2004 to 2006. (FCIC Report at 142.) In 2006 alone, Goldman underwrote 93 RMBS, garnering fees of $1 million to $8 million for each deal, and over $1 billion in total from all of its mortgage-related businesses. (SPSI Report at 398, 475; Gretchen Morgenson, *Reckless Endangerment* at 339-40 (2011).) By 2006, Goldman held over $6 billion worth of subprime mortgage-related assets on its books. (SPSI Report at 398.)

335. As the public learned in 2010, in 2005 and into 2006, Goldman began to have an increasingly pessimistic view of the subprime mortgage market. Goldman's sophisticated and powerful proprietary computer models analyzed trends in the performance of the hundreds of thousands of mortgages that collateralized its RMBS. The results were startling. Goldman's models showed that the true market value of RMBS had declined up to 70% from their face amounts. Those models showed that RMBS were not the safe investment reflected in the Goldman Offering Materials or in the AAA or AA ratings those Certificates received from the ratings agencies. In his book, *Money and Power: How Goldman Sachs Came to Rule the World*, William D. Cohan explained:

> Goldman's RMBS model could analyze all the underlying mortgages and value the cash flows, as well as what would happen if interest rates changed, if prepayments were made, or if the mortgages were refinanced. The model could

> also spit out a valuation if defaults suddenly spiked upward . . . . [Goldman's] proprietary model was telling [Goldman] that it would not take much to wipe out the value of tranches of a mortgage-backed security that had previously looked very safe, at least in the estimation of the credit-rating agencies that had been paid (by Wall Street) to rate them investment grade. By tweaking the various assumptions based on events that seemed increasingly likely, [Goldman's] models were showing a marked decrease in the value of mortgage-related securities. Goldman's models said even if you don't believe housing prices are going to go down, even if we apply low-probability scenarios about it going negative . . . there's no way this stuff can be worth anywhere near one hundred [cents on the dollar] . . . . [Goldman's] models had them pegged anywhere between 30 cents and 70 cents . . . .

Money and Power, at 494-5.

336. According to a former Goldman employee, these models as well as other information in Goldman's exclusive possession showed it "the writing on the wall in this market as early as 2005" ("Banks bundled bad Debt, Bet Against It and Won", New York Times, December 23, 2009) and into "the early summer of 2006." (SPSI Report at 398.) According to Goldman's Michael Swenson, head of the Mortgage Department's Structured Products Group, during the summer of 2006, it became clear that "market fundamentals in subprime" were going to have a "very unhappy ending." (*Id.*)

337. To reduce its massive financial exposure to the subprime mortgage market (and profit from that exclusive knowledge), Goldman began exploring ways to rid itself of subprime assets and to offload this risk onto investors. One tactic that Goldman used was to "put back" hundreds of millions of dollars worth of defective mortgages to originators known for producing shoddy mortgages, and to force the originators to repurchase them. Many of the originators who were the targets of this "put back" campaign were the very same originators whose loans Goldman contemporaneously put into Prudential's securitizations, such as New Century and Fremont.

338. Goldman also used its exclusive knowledge of the defects in these loans to profiteer on the backs of its investors and customers. These profiteering strategies included (a) creating and selling RMBS and CDOs which were stuffed with underperforming subprime assets taken off of Goldman's balance sheet (many from the shoddy originators to whom Goldman "put back" bad mortgages), and (b) shorting those very same securities so that Goldman stood to make money if the value of those securities declined. When the subprime market entered into a full blown crisis in 2008, as Goldman anticipated, Goldman tactics garnered Goldman hundreds of millions of dollars in profits. Goldman's actions present compelling evidence of Goldman's complete abandonment of its customers' interests in its drive to rid itself of declining and defective mortgage assets. (See SPSI Report at 475 (in 2006, Goldman "sold the mortgage related assets in its inventory; returned poor quality loans to the lenders from which they were purchased and demanded repayment; limited new RMBS securitizations; sold or securitized the assets in its RMBS warehouse accounts; limited new CDO securitizations to transactions already in the pipeline; and sold assets from discontinued CDOs.").)

(2) Goldman's Targeted Campaign To "Put Back" Defective Loans To Originators Demonstrates That It Knew The Targeted Originators' Loans Violated Underwriting Guidelines

339. Goldman reduced its subprime exposure in 2006, in part, by forcing mortgage originators to buy non-conforming mortgages back. Under its agreements with originators, Goldman had the right to force the originators to repurchase mortgages which did not comply with underwriting guidelines. These agreements typically required originators to warrant that their loans were underwritten according to standard guidelines and conformed to certain characteristics, including the accuracy of the mortgage loan schedule, the absence of fraud by the originator or mortgagor, and compliance with federal and state laws. If a representation was breached, Goldman (as Sponsor) could demand that the Originator repurchase the defective loans

as required by the mortgage purchase agreement. Goldman hired third party re-underwriting firms to assist in this "put back" process and to find defects in the loans which would then be used as a basis to require their repurchase. If, for example, Goldman could prove that the borrower's credit scores were lower than required, it could force the originator to buy that mortgage back.

340. Goldman's 2006 "put back" campaign was targeted at the Originators whose loans Goldman knew were most likely to yield underwriting breaches upon examination. Goldman had unique insight into the quality of the loans purchased from originators, arising from diligence on the originators themselves as well as their loans. Goldman knew that the originators who issued the most defective loans were, among others, Fremont, New Century, Aames, and NovaStar, among others (that very same originators whose loans were put into Prudential's securities). Goldman knew based on its many years of dealing with these originators that their loans were the worst on its books and thus the most likely to yield put back claims.

341. Internal Goldman emails prove the correctness of this prediction. For example, the SPSI's 2011 report published a December 14, 2006 email from Goldman's Daniel Sparks which told colleagues, "stay focused and aggressive on ***MLN [Mortgage Lenders Network]*** (warehouse customer and originator we have EPDs [early payment defaults] to that is likely to fail)" (SPSI Report at 405 (emphasis added).) On January 8, 2007, Daniel Sparks wrote to colleague, "I just can't see how any originator in the industry is worth a premium. ***I'm also a bit scared of [A]ccredited*** [Aames' parent company] and ***[N]ew [C]entury***, and I'm not sure about taking a bunch of new exposures." (SPSI Report at 484 n. 2036 (emphasis added).)

342. On February 2, 2007, Sparks identified other prime targets of Goldman's repurchase campaign. He said that his "team is working on putting loans in the deals back to the originators (***New Century,*** WAMU, ***and Fremont*** – all real counterparties) as there seem to be issues potentially including ***some fraud at origination***, but resolution will take months and be contentious." (*Id.* at 484 (emphasis added).)

343. On March 7, 2007, Sparks continued emphasizing Goldman's priority in ridding itself of loans issued by certain originators. He described Goldman's exposure as follows:

> As for the big 3 originators – ***Accredited, New Century and Fremont***, our real exposure is in the form of put-back claims. Basically, if we get nothing back we would lose around $60mm vs loans on our books (we have a reserve of $30mm) and the loans in the [CDO and RMBS] trusts could lose around $60mm (we probably suffer about 1/3 of this in ongoing exposures) . . . .

Id. at 485 (emphasis added).

344. After completing a review of one New Century pool, a Goldman analyst in March 2007 recommended putting back 26% of the pool because of the extensive nature of the problems found therein, including "material occupancy misrepresentations" and possible fraud at origination. (SPSI Report at 485.) In March 2007, following an analysis of a pool of loans originated by Fremont, Goldman concluded that about 50% of the 200 files reviewed "look to be repurchase obligations." (*Id.* at 486.) Goldman made it a "priority" to re-underwrite and put back loans purchased from NovaStar, Accredited, Fremont and New Century. (*Id.* at 485.)

345. On March 8, 2007, Mr. Sparks noted in an email to senior executives, "New Century remains a problem" due to loans experiencing early payment defaults and informed them that the Mortgage Department had "liquidated a few deals and could liquidate a couple more." (SPSI Report at 535.)

346. In total, between 2006 and 2007, Goldman made approximately $475 million in repurchase claims to the originators and others for loans in its inventory. Goldman made about

$34 million in repurchase requests to Long Beach and at least $21 million to Accredited. (*Id.* at n. 2053.) All told, Goldman recovered approximately $82 million from this campaign (*Id.* at 483.)

(3) Goldman Embarked On a Campaign to Reduce Its Inventory of Subprime Assets By Securitizing Them and Selling Them to Investors.

347. Starting in as late as 2005, Goldman also embarked on a strategic effort to reduce its exposure to subprime assets either by selling them off outright, or resecuritizing them into RMBS or CDOs. This strategy reflected the directive of Goldman's Chairman and CEO, Lloyd Blankfein, who told his mortgage and structured finance team to "clean[] up [Goldman's] books," and "sell off cats and dogs." (SPSI Report at 480.) Goldman's mortgage and structured products units carried out these orders by embarking on a massive sales campaign to rid itself of existing subprime inventory or by bundling that existing inventory into new RMBS or CDOs for sales to investors.

348. On December 5, 2006, Goldman's Daniel Sparks wrote to his colleagues, "Subprime market getting hit hard – hedge funds hitting street, wall street journal article. At this point we are down $20 mm today. Structured exits are the way to reduce risk. Our prior structured trade closes today. We are focusing on way to do it again much faster."

349. On December 14, 2006, Goldman's Kevin Gasvoda, head of the Residential Whole Loan Trading group, instructed his colleagues to sell RMBS securities in Goldman's inventory, focusing on RMBS securities issued from Goldman-originated securitizations. SPSI Report at 408 ("[P]ls refocus on retained new issue bond positions and move them out . . . [W]e don't want to be hamstrung based on old inventory. Refocus efforts and move stuff out even if you have to take a small loss.").

350. On December 15, 2006, Goldman's David Viniar wrote that his "basic message was let's be aggressive distributing" subprime mortgage-related assets "because there will be very good opportunities as the market goes into what is likely to be even greater distress and we want to be in position to take advantage of them." (*Id.* at 405.) One day earlier, in the same e-mail chain, his colleague Daniel Sparks wrote that, as a follow up to mortgage team meeting, Goldman would "distribute as much as possible on bonds created from new loan securitizations and clean previous positions." (*Id.*)

351. In an email dated December 20, 2006, a Goldman trader wrote to her supervisors, "[w]e have been thinking collectively as a group about how to move some of the risk. While we have made great progress moving the tail risks – ssr and equity – we think it is critical to focus on the mezz risk that has been built up over the past few months."

352. On March 3, 2007, Mr. Sparks made notes after a telephone call, "Things we need to do . . . Get out of everything." (SPSI Report at 480.)

353. On March 7, 2007, Daniel Sparks told Goldman's Firmwide Risk committee that it was "'[g]ame [o]ver' – accelerating meltdown from subprime lenders such as Fremont and New Century"; "that "[t]he Street is highly vulnerable;" "[c]urrent strategies are to 'put back' inventory, where applicable, or liquidate positions"; and that "[t]he Mortgage business is currently closing down every subprime exposure possible." (*Id.*)

354. On March 8, 2007, in an email to senior management, Sparks listed a number of "large risks I worry about." At the top of the list was "CDO and Residential loan securitization stoppage – either via buyer strike or dramatic rating agency change." (*Id.* at 481.) As the SPSI reported, "Mr. Sparks was worried about Goldman's being left with a large inventory of unsold and unsaleable subprime mortgage related assets when the market finally collapsed." (*Id.*.)

355. On March 9, 2007, Goldman's Daniel Sparks wrote: "Our current largest needs are to execute and sell our new issues—CDO's and RMBS—and to sell our other cash trading positions . . . . I can't overstate the importance to the business of selling these positions and new issues." (Hearing on Wall Street and the Financial Crisis: the role of Investment Banks Ex. 76.) As the public learned in the FCIC's Report, by January 2007, "Daniel Sparks, the head of Goldman's mortgage department, extolled Goldman's success in reducing its subprime inventory, writing that the team had 'structured like mad and traveled the world, and worked their tails off to make some lemonade from some big old lemons." (FCIC Report. at 236.)

356. The SPSI Report found that Goldman structured CDO offerings that "went beyond its role as market maker for clients seeking to buy or sell mortgage related securities, traded billions of dollars in mortgage related assets for the benefit of the firm without disclosing its proprietary positions to clients, and instructed its sales force to sell mortgage related assets, including high risk RMBS and CDO securities that Goldman Sachs wanted to get off its books" (SPSI Report at 377.) These "high risk assets" included many of the very same assets that Goldman sold to Prudential. Two such CDOs, the Hudson CDO 1 and 2, were specifically discussed in the SPSI report. They either individually or both contained numerous securities that Goldman sold to Prudential: GSAMP 2005-HE4, GSAMP 2006-HE1, GSAMP 2006-HE3. Senator Carl Levin described the Hudson CDOs as "filled with toxic subprime assets that Goldman had selected, assembled and sold . . . . Goldman cashed in at the expense of its clients." (Senator Carl Levin's Senate Floor Speech on Ending Conflicts of Interest in the Financial System, May 24, 2010.) According to the Senate Subcommittee, "Goldman Sachs magnified the impact of toxic mortgages on financial markets by re-securitizing RMBS securities in collateralized debt obligations (CDOs), referencing them in synthetic CDOs, selling the CDO

securities to investors, and using credit default swaps and index trading to profit from the failure of the same RMBS and CDO securities it sold." (SPSI Report at 377.) The United States District Court for the Southern District of New York recently declined to dismiss fraud claims brought against Goldman on behalf of a putative class of investors in Hudson CDOs 1 and 2 that made virtually identical allegations to those here regarding Goldman's de-risking strategy. *See Dodona I, LLC v. Goldman, Sachs & Co. et al.*, No. 10-cv-74987 (S.D.N.Y. Mar. 21, 2012) (Marrero, J.).

357. In sum, Prudential purchased many of the securitizations at issue in this complaint during this massive house-cleaning by Goldman. And as Goldman knew, but Prudential did not, those securitizations would perform abysmally. See Exhibits C-R. This comes as no surprise to Goldman. ***Goldman internally characterized these offerings as "junk," "monstrosities," "dogs," "lemons," "crap,"*** and other pejoratives. (FCIC Report at 235-36.) ***Nevertheless, it congratulated itself for successfully offloading such "junk" onto others, like Prudential.*** As the Senate Subcommittee found, "[a]fter Goldman Sachs decided to reduce its mortgage holdings, the sales force was instructed to try to sell some of its mortgage related assets, and the risks associated with them, to Goldman Sachs clients. In response, Goldman Sachs personnel issued and sold to clients RMBS and CDO securities containing or referencing high risk assets that Goldman Sachs wanted to get off its books." (*Wall Street and the Financial Crisis: The Role of Investment* Banks, April 26, 2010, p. 8.) Internal Goldman personnel described what they were doing as "distribut[ing] junk that nobody was dumb enough to take first time around." (SPSI Report at 543 n. 2374.)

(4) Goldman "Shorts" the Very Same Investments It Sold to Its Unsuspecting Clients, Making Hundreds of Millions of Dollars in Profits

358. Through 2006 and 2007, Goldman used its shorting strategy as a way to reduce its own mortgage risk while it continued to create and sell mortgage-related products to its clients. Goldman's shorting strategy included the purchase of credit default swap protection on the very same RBMS certificates it created and sold into the market. Goldman bet that the RMBS would decline in value and/or default. If so, its swap counterparty would be required to pay Goldman. Goldman entered into swaps worth hundreds of millions of dollars during this time period, where it bet on the "short" side of the transaction, while its counterparty went "long."

359. As the SPSI Report found, Goldman did just that on a securitization it underwrote in the spring of 2006, Long Beach Mortgage Loan Trust 2006-A. By then, Long Beach was known to Goldman as one of the worst originators in the business, one which routinely flouted its underwriting guidelines. Goldman knew this based on its extensive business ties to Washington Mutual and Long Beach. They had collaborated on at least $14 billion in loan sales and securitizations. In February 2006, Long Beach had a $2 billion warehouse account with Goldman, the largest of Goldman's warehouse accounts at that time. Despite knowing what it did about Long Beach's underwriting practices and reckless origination, Goldman underwrote the offering which was backed by Long Beach mortgages. Goldman also took out a swap, betting those same securities would decline.

360. In less than a year after it was arranged, a Goldman analyst reported in February 2007 that all of Goldman's 2006 subprime second lien RMBS securities were deteriorating in performance but "deals backed by Fremont and Long Beach have underperformed the most." (SPSI Report at 488.)

361. On May 17, 2007, a trader on the Mortgage Department's ABS Desk wrote to his supervisor about additional losses in the Long Beach securitization: "[B]ad news … [The loss] wipes out the m6s [mezzanine tranche] and makes a wipeout of the m5 imminent. … [C]osts us about 2.5 [million dollars]. … [G]ood news ... [W]e own 10 [million dollars] protection at the m6 … [W]e make $5 [million]." (SPSI Report at 514.)

362. As explained by the SPSI Report, "In other words, Goldman lost $2.5 million from the unsold Long Beach securities still on its books, but gained $5 million from the CDS contract shorting those same securities. Overall, Goldman profited from the decline of the same type of securities it had earlier sold to its customers." (*Id.* at 514.) That Goldman made money first by taking fees for underwriting the transaction, then again later by betting on its failure, is evidence it knew the Long Beach loans underlying the deal were among the "junk" it was so happy to offload onto investors.

363. This was not an isolated incident. According to the SPSI, Goldman did the same thing with another securitization, GSAMP Trust 2007-FM2, which it created in March 2007, again backed by Fremont, one of the same lenders at issue here. It securitized over $1 billion in Fremont subprime loans (*id.* at 515), although at the same time Goldman was making millions of dollars in repurchase demands upon Fremont based on defects found in the mortgages. As the SPSI reported:

> In an internal February 2007 memorandum to its Mortgage Capital Committee, Goldman wrote that it had a 'significant relationship with Fremont,' based upon past securitizations, whole loan purchases, and warehouse fees. In March 2007, at the same time it was sending millions of dollars in loan repurchase requests to Fremont, Goldman securitized over $1 billion in Fremont subprime loans in one of its warehouse accounts, originating GSAMP Trust 2007-FM2.

Id. at 515-16.

364. GSAMP Trust 2007-FM2 has since been downgraded to junk status. Goldman, however, purchased $15 million in CDS contracts referencing some of the Fremont securities it underwrote, betting against these very same securities. As the SPSI reported:

> Goldman marketed and sold the Fremont securities to its customers, while at the same time purchasing $15 million in CDS contracts referencing some of the Fremont securities it underwrote. Seven months later, by October 2007, the ratings downgrades had begun; by August 2009, every tranche in the GSAMP securitization had been downgraded to junk status.

SPSI Report at 516.

365. Similarly, in March 2007, Goldman securitized and underwrote GSAMP Trust 2007-HE2, a deal it sold to Prudential. It contained nearly $1 billion in subprime loans from Goldman's warehouse account, more than 70% of which were purchased from New Century. (SPSI Report at 486-88.) Earlier in the month, a Goldman review had discovered that 26% of a different New Century loan pool was deficient and needed to be returned to New Century for a refund (in total, Goldman made about $67 million in repurchases requests to New Century). Even New Century's bankruptcy did not stop Goldman from going ahead with the transaction. According to the SPSI, "[t]he securitization was approved for issuance in April 2007, the same month New Century declared bankruptcy." (*Id.* at 488.)

366. In total, in 2006, Goldman made a massive $9 billion bet that the same type of assets it was pushing onto investors like Prudential would tank. (*Id.* at 419.) The $9 billion short bet was placed in 2006 by Goldman's mortgage department, the same department that oversaw the sale of the Certificates to Prudential. Goldman's net short position in 2007 rose as high as $13.9 billion. (*Id.* at 430.)

367. Josh Birnbaum, Goldman's managing director in the Structured Product Trading Group gave a similar appraisal in his 2007 self-performance review, stating, "Given how much ABX we had purchased through the broker market in 2006, the world would think [Goldman]

was very long for the foreseeable future." (SPSI Report at 412 n. 1669.) Birnbaum concluded that Goldman needed to "flip [its] risk" and that Goldman "should not only get flat, but get VERY short." (SPSI Report at 387-88.)

368. Another Goldman mortgage securities trader who reported to Swenson and Birnbaum, Deeb A. Salem, similarly stated in his 2007 self-performance review (dated September 6, 2007) as follows (capitalized emphasis in original):

> In May, while we were remained as negative as ever on the fundamentals in sub-prime, the market was trading VERY SHORT, and was susceptible to a squeeze. We began to encourage this squeeze, with plans of getting very short again, after the short squeezed caused capitulation of these shorts. The strategy seemed do-able and brilliant, but once the negative fundamental news kept coming in at a tremendous rate, we stopped waiting for the shorts to capitulate, and instead just reinitiated shorts ourselves immediately.

SPSI Report at 425.

369. When the subprime market entered into full blown crisis, as Goldman anticipated, Goldman garnered hundreds of millions of dollars in profits. On November 18, 2007, Goldman's CEO Lloyd Blankfein wrote to some senior Goldman officials, "Of course we didn't dodge this mortgage mess. We lost money, then made more than we lost because of shorts." (*Id.* at 470.)According to Goldman's Form 8-K filed with the SEC on December 18, 2007, it turned out very well for Goldman. The Form 8-K announced the firm's financial results for the fourth quarter of 2007 and the fiscal year ended November 30, 2007, stating that Goldman "achieved record net revenues, net earnings and diluted earnings per common share in 2007." Specifically, Goldman reportedly earned $11.6 billion for that fiscal year, up from $9.54 billion for the fiscal year ended November 26, 2006.

370. As the SPSI found, Goldman "sold RMBS and CDO securities to its clients without disclosing its own net short position against the subprime market or its purchase of CDS

contracts to gain from the loss in value of some of the very securities it was selling to its client." (*Id.* at 9; *see also id.* at 513.) A leading structured finance expert reportedly called Goldman's practice "the most cynical use of credit information that I have ever seen," and compared it to "buying fire insurance on someone else's house and then committing arson." (Gretchen Morgenson, *Banks Bundled Bad Debt, Bet Against It and Won*, N.Y. TIMES, December 23, 2009.) As a recent magazine article explained, "Goldman was like a car dealership that realized it had a whole lot full of cars with faulty brakes. Instead of announcing a recall, it surged ahead with a two-fold plan to make a fortune: first, by dumping the dangerous products on other people, and second, by taking out life insurance against the fools who bought the deadly cars." Matt Taibbi, *The People vs. Goldman Sachs*, Rolling Stone, May 26, 2011, *available at* http://www.rollingstone.com/ politics/news/the-people-vs-goldman-sachs-20110511.

(5) The Goldman Defendants Worked Hand In Glove to Implement These Risk Reduction Strategies

371. The Goldman Defendants worked together to effectuate the tactics described above. They had numerous overlapping employees, giving each Defendant actual knowledge of the Goldman's scheme to rid itself of toxic subprime assets and to offload those risks onto unsuspecting investors like Prudential. For example, Daniel Sparks, head of The Goldman Sachs Group, Inc.'s Mortgage Department, was also the CEO and Director of GS Mortgage Securities Corporation. Kevin Gasvoda, the head of the Mortgage Department's Residential Whole Loan Trading Desk (which oversaw the purchase of mortgages and constructed and sold RMBS securitizations (SPSI Report at 477)), was a director of GS Mortgage Securities Corporation. Similarly, Michelle Gill, who worked on Goldman's "put back" campaign, was a vice president of GS Mortgage Securities Corporation and a managing director of The Goldman Sachs Group, Inc.

372. Each of these executives played critical roles in establishing and implementing Goldman's de-risking strategies in 2006 and 2007. For example, in February 2007, Gasvoda issued a directive or "axe" to the Goldman sales force to sell the remaining RMBS securities from Goldman-originated RMBS securitizations. (*Id.* at 408.) On February 9, 2007, the sales force reported a substantial number of sales, and Mr. Gasvoda replied: "Great job syndicate and sales, appreciate the focus." (*Id.*) Ms. Gill was responsible, in part, for Goldman's "put back" campaign in 2006, including the review of faulty Fremont loans. (*Id.* at 484.) Each worked under Sparks, who managed and coordinated Goldman's putback and other de-risking efforts. The Goldman Defendants' overlapping personnel and intertwined business strategies meant that each provided material advice and assistance in the fraudulent scheme perpetrated on Prudential and each benefitted in financial and other ways from the sale of the Certificates to Prudential.

D. <u>Numerous Government Investigations Have Confirmed Goldman Acted With Scienter</u>

373. Goldman is the subject of numerous criminal and regulatory probes related to its mortgage underwriting practices. These investigations further confirm that Goldman's misrepresentations were not mere isolated, innocent mistakes, but the result of the company's reckless or intentional misconduct.

374. For example, Goldman's misconduct prompted the Attorney General of Massachusetts to examine whether Goldman:

- failed to ascertain whether loans purchased from originators complied with the originators' stated underwriting guidelines;
- failed to take sufficient steps to avoid placing problem loans into securitization pools;
- failed to correct inaccurate information in securitization trustee reports concerning repurchases of loans; and

- failed to make available to potential investors certain information concerning allegedly unfair or problem loans, including information obtained during loan due diligence and the pre-securitization process, as well as information concerning Goldman Sachs' practices in making repurchase claims relating to loans in and out of securitizations.

375. Goldman settled with the Commonwealth of Massachusetts, paying it $60 million. (FCIC Report at 226.) In announcing the settlement, the Massachusetts Attorney General stated that Goldman did not take "sufficient steps to avoid placing problem loans in securitization pools." Goldman was also required to forgive all or portions of the balances on many loans it had bought and securitized, which resulted in tens of millions of dollars in additional expenses to Goldman.

376. The SPSI concluded that Goldman "***knowingly*** sold high risk, poor quality mortgage products to clients around the world, saturating financial markets with complex, financially engineered instruments that magnified risk and losses when their underlying assets began to fail." (SPSI Report at 476 (emphasis added); *see also id.* at 513 ("Goldman originated and sold RMBS securities ***that it knew*** had poor quality loans that were likely to incur abnormally high rates of default." (emphasis added).)

377. On July 15, 2010, the SEC announced that Goldman had agreed to pay $550 million to settle SEC charges that Goldman misled investors in a subprime mortgage product just as the U.S. housing market was starting to collapse. In agreeing to the SEC's largest-ever penalty paid by a Wall Street firm, Goldman also acknowledged that its marketing materials for the subprime product contained incomplete information. See Goldman Sachs to Pay Record $550 Million to Settle SEC Charges 38 Related to Subprime Mortgage CDO, SEC Litig. Release No. 21592 (July 15, 2010)., available at http://www.sec.gov/litigation/litreleases/2010/lr21592.htm (noting that the marketing materials

for the transactions at issue contained "incomplete information," which was a "mistake" not to disclose)

378. In May 2011, the New York Attorney General announced that it had opened an investigation into Goldman's origination and securitization businesses. In June 2011, the Manhattan District Attorney's Office issued a subpoena to Goldman in connection with its investigation of Goldman's mortgage-backed securities. Both investigations are ongoing.

379. Even more recently, on September 1, 2011, the Federal Reserve Board sanctioned Goldman Sachs for "a pattern of misconduct and negligence relating to deficient practices" in its former mortgage unit, Litton Loan Servicing LP., including those involving "robo-signing"—a practice that often results in defective foreclosures. As a result of this sanction, Goldman must retain an independent consultant to review certain foreclosure proceedings initiated by Litton. The Federal Reserve has also announced that it believes monetary sanctions are appropriate against Goldman and plans to announce monetary penalties. Goldman's "pattern of misconduct" is further evidence that Goldman Sachs knew of the weakness in the mortgage loans collateralizing the Securitizations and had both an ability and willingness to exploit it.

E. <u>Further Evidence that Goldman Knew the Appraisals Were Inflated</u>

380. The appraised value of a mortgaged property is a key component in the stated LTV and CLTV ratios. Goldman knew at the time it sold RMBS Certificates to Prudential that the appraisals were false and baseless, and thus did not genuinely believe at the time the disclosed statistics were accurate. This is supported by the consistency of the wide disparities between reported and actual LTV and CLTV information for Prudential's Certificates, discovered through the use of loan-level, contemporaneous information. It is also supported by evidence of the other systemic problems at issue here, testimony and investigations into the

originators at issue here, confidential witness testimony detailed above, and other testimony that has been provided by industry insiders.

381. For instance, Richard Bitner, a former executive of a subprime lender for fifteen years, testified in April 2010 before the FCIC that "the appraisal process [was] highly susceptible to manipulation," and that the rise in property values was in part due to "the subprime industry's acceptance of overvalued appraisals." Similarly, Patricia Lindsay, a former wholesale lender, testified before the FCIC that in her experience appraisers were "often times pressured into coming in 'at value,' *i.e.*, at least the amount needed for the loan to be approved. The appraisers 'fearing' their 'future business and their livelihoods' would choose properties 'that would help support the needed value rather than finding the best comparables to come up with the most accurate value.'" And Jim Amorin, President of the Appraisal Institute, testified in April 2009 that "in many cases, appraisers are ordered or severely pressured to doctor their reports to convey a particular, higher value for a property, or else never see work from those parties again . . . . [T]oo often state licensed and certified appraisers are forced into making a 'Hobson's Choice.'"

382. The FCIC's January 2011 report recounts the similar testimony of Dennis J. Black, an appraiser with twenty-four years of experience who held continuing education services across the country. "He heard complaints from appraisers that they had been pressured to ignore missing kitchens, damaged walls, and inoperable mechanical systems. Black told the FCIC, 'The story I have heard most often is the client saying he could not use the appraisal because the value was [not] what they needed.' The client would hire somebody else." (FCIC Report at 91.)

383. Such testimony provides further evidence that Goldman—as an industry insider with a unique window into the quality of the underlying mortgage loans by virtue of its role as sponsor and depositor in many of the Securitizations—knew at the time it made representations

to Prudential regarding the strength of the Certificates and the underlying mortgage loans, that such representations were false when made.

384. Recently, Greg Smith, an executive director and head of the firm's U.S. equity derivatives business in various parts of the globe, published a public resignation letter in the *New York Times* in which he lamented that, at Goldman, "the interests of the client continue to be sidelined in the way the firm operates and thinks about making money." More specifically, Smith criticized the very de-risking strategy alleged in this Complaint: "What are three quick ways to become a leader? a) Execute on the firm's 'axes.' which is Goldman-speak for ***persuading your clients to invest in the stocks or other products that we are trying to get rid of because they are not seen as having a lot of potential profit.*** b) 'Hunt Elephants.' In English: ***get your clients – some of whom are sophisticated, and some of whom aren't – to trade whatever will bring the biggest profit to Goldman.***" (Emphasis added.)

IV. PRUDENTIAL'S DETRIMENTAL RELIANCE AND DAMAGES

385. Prudential typically purchased senior classes of mortgage-backed securities (*i.e.*, those rated AAA/Aaa or AA/Aa by the rating agencies Standard & Poor's and Moody's Investors Service). That is because under statutory accounting insurance companies can only carry "safe" investment-grade assets on their books. Prudential purchased the Certificates to generate income and total return through safe investments. Prudential also purchased these securities with the expectation that the investments could be—and indeed some were—purchased and sold on the secondary market.

386. Prudential invested in the Certificates as part of a broader plan to invest in a diverse array of carefully underwritten RMBS. Its purchase decisions were based on due diligence done on multiple levels, by various people. For instance, Prudential's investment

manager has credit research analysts specifically tasked with analyzing potential risks. The research analysts' recommendations have never been overridden with respect to RMBS.

387. Purchasers of certificates had no right to inspect the Mortgage Loans. Rather, in making the investments, Prudential relied upon Goldman's representations and assurances regarding the quality of the mortgage collateral underlying the Certificates, including the quality of the underwriting processes related to the underlying Mortgage Loans. Prudential received, reviewed, and relied upon the Offering Materials, which described in detail the Mortgage Loans underlying each offering. Offering Materials containing the representations outlined above and in the Exhibits (or materially similar counterparts thereto) were obtained, reviewed, and relied upon in making the purchase.

388. As part of its business practice, Prudential reviewed draft Offering Materials and term sheets as well as the final Offering Materials. Prudential also reviewed other materials such as the related Pooling and Servicing Agreements, and any documents related to insurance-based credit enhancements on the securities. Such materials (or materially similar counterparts thereto) were made available prior to purchase.

389. Specifically, but without limitation, prior to purchasing mortgage-backed securities Prudential reviewed and considered the underwriting guidelines of the originators and/or conduits involved. Prudential gained an understanding of the purported processes in the Offering Materials at issue here, and also understood them from its review of similar offering materials issued by and about Goldman over the course of the many years Prudential has been purchasing residential mortgage backed securities. For instance, representations such as that the guidelines would be followed, that the guidelines were intended to, in some reasonable way, assess the borrower's capacity for repayment, and that "exceptions" would only be made when

"compensating factors" exist, are common to many of Goldman's securitizations, including those at issue here. The consistency of these core representations reinforces the reasonability of Prudential's actual reliance on the Offering Materials at issue here, as well as the fraudulent nature of Goldman's key omission of facts regarding its systemic underwriting abandonment.

390. Prudential would also review, prior to purchase, the specific representations made about the Mortgage Loans—such as whether the loans were backed by owner-occupied properties, and the loan's LTV and CLTV ratios. At no point did Goldman disclose to Prudential that these statistics were misrepresented.

391. Prudential fully explored all information made available to investors before purchasing residential mortgage-backed securities. Indeed, Prudential also often visited originators' offices on-site. Prudential also regularly attended industry conferences and met with originators and underwriters who attended.

392. Prudential continued to monitor its investments after purchase, including with respect to the Certificates here. However, Prudential did not and could not have reasonably uncovered the misrepresentations at issue here prior to purchase—and, indeed, did not know of the wrongdoing alleged herein until recently. As noted above, most Certificates held their investment grade ratings through 2009 or later, and Prudential did not take any material credit rated "write-downs" on these securities until July 2008. Documents and testimony about Goldman's intentional misrepresentation of the underwriting standards were not revealed until the results of the FCIC, SPSI, and other investigations were announced during 2010-2011.

393. As discussed above, the Offering Materials contained certain information purporting to describe the Mortgage Loans. More detailed information was contained in "loan tapes." But these loan tapes were often not made available to investors. Even if they were, they

would still not provide investors with the information necessary to discover the fraud. This is because the loan tapes are simply rows of numerical data—data that, as alleged above, was itself false. Thus, without the loan *files* containing the backup materials standing behind those numerical descriptions—documents that were never made available to investors and which could not have been given to Prudential without violating rules regarding the selective dissemination of material, non-public information—even having the loan *tapes* full of (false) data would not have revealed the fraud.

394. Still without access to the loan files, investors such as Prudential have only recently been able to test underwriters' representations about the risk attributes of the underlying loans. For instance, investors might be provided a table claiming that one property was owner-occupied, had an LTV ratio of 75%, and the borrower had a debt-to-income ratio of 30%. Simply seeing that loan-by-loan breakdown, however, in no way informed investors that the originators had disregarded their guidelines, or were making underwriting "exceptions" (such as those for high-LTV loans) without regard to whether there were "compensating factors."

395. Investors like Prudential were not given loan files containing full documentation that would have shed light on whether Goldman's claims had a reasonable basis in fact. Indeed, the materials provided to investors often did not even include the specific property addresses, nor did they identify the consumers tied to the loans. There was thus no practical way, until recently, for investors to "look behind" the tables of numbers in order to assess whether those numbers were actually reflective of the mortgage loans being securitized. Thus, prior to May 2009, as explained below, the only information investors could obtain on the nature of the mortgage loans was what they were told in the Offering Materials.

396. As noted above, using currently available technology, Prudential has employed a "loan-level analysis" for the purposes of this Complaint that tests the representations at issue. However, it was not until well after the purchases at issue here that investors were offered the ability to access proprietary databases, developed by a data vendor over the course of many years and at significant cost, that would allow them to determine the accuracy of the loan-level information provided in the Offering Materials. It was only through such databases that enough data could be linked together, through the use of proprietary algorithms, that investors could even identify the specific loans underlying RMBS offerings. Without knowing a property's address, investors obviously could not know anything about the property's actual value other than what they were told in the Offering Materials. Thus, prior to the development of these informational services, there was no publicly-available means of consistently identifying the specific loans underlying RMBS offerings, and thus no way of verifying the representations made to investors about the features of those loans.

397. In May 2009, an early form of informational service, called TrueLTV, was first made public. It allowed investors, for the first time (but even then, at significant cost) to determine what specific properties were actually being included in the RMBS collateral pool. For instance, the database compares the property zip code, loan amount, and date of origination (high-level information provided in the Offering Materials) and compares those points across other databases to see if there is a "match" in the same zip code. This is a simplified explanation; the actual algorithm used is proprietary. But the point here is that it typically takes an enormous database to effectively attempt to identify the property being included in the collateral pool.

398. Investors like Prudential would need the specific property address in order to verify representations made in the Offering Materials, such as LTV ratios. Prudential is not aware of any other similar service or process that could have reasonably provided this information prior to May 2009.

399. Though the identification of the property addresses was available in May 2009 through the TrueLTV service, that service did not have the data elements necessary to evaluate owner occupancy claims. The data sets necessary to test occupancy claims were added in 2010 and included in a new service called Reps and Warranties. Only through the Reps and Warranties service, released in 2010, was it possible to compare the property addresses against other borrower information to validate the occupancy claims made in the Offering Materials. Prudential is not aware of any other similar service or process that could have reasonably provided this information prior to 2010.

400. In purchasing the Certificates, Prudential justifiably relied on Goldman's misrepresentations and omissions of material fact detailed above, including the misstatements and omissions in the Offering Materials. Goldman systemically abandoned its underwriting and securitization guidelines, and the disclosed characteristics of the Mortgage Loans in fact bore no reasonable relationship to the actual characteristics of the Loans.

401. But for the misrepresentations and omissions in the Offering Materials, Prudential would not have purchased or acquired the Certificates that it ultimately did, because those representations and omissions were material to its decision to acquire the Certificates, as described above.

402. The false and misleading statements of material facts and omissions of material facts in the Offering Materials directly caused Prudential damage, because the Certificates were

in fact far riskier than Goldman had described them to be. The loans underlying the Certificates experienced defaults and delinquencies at very high rates due to Goldman's abandonment of the disclosed underwriting guidelines. The poor collateral performance resulted in downgrades to the Certificates' ratings, which made them unmarketable at anywhere near the prices Prudential paid, thus confirming that Prudential paid far more for the Certificates than the value it actually received.

403. Prudential has incurred substantial losses in market value and lost principal and interest payments, due to the poor quality of the collateral underlying the Certificates and Goldman's failure to properly transfer title to the loans. Because of the declining collateral base, it is likely that Prudential will not realize the full payments it expected. This is reflected in the significantly diminished market value for these securities, which, again, is a strong indicator that the true value of the Certificates was far less than what Prudential paid.

404. The disclosure of irregularities in Goldman's underwriting practices, and increased risk regarding future cash flow and problems with transfer of title, have further fed the substantial decline in market value of the Certificates. Prudential purchased the Certificates not only for their income stream, but also with an expectation of possibly reselling the Certificates on the secondary market. Prudential thus viewed market value as a critical aspect of the Certificates it purchased. Prudential incurred substantial losses on the Certificates due to a drastic decline in market value attributable to the misrepresentations. Prudential has already incurred substantial losses on Certificates it sold on the secondary market.

405. Prudential's losses have been much greater than they would have been if the Certificates and the loans underlying them were as Goldman described them to be. For example, the fact that the loans were not backed by owner-occupied properties at their claimed rate made

them more prone to default. Owners who do not occupy their properties are more likely to default on their loans, which made the Certificates poorer investments, accelerated the Certificates decline in value, and greatly worsened Prudential's losses.

406. In fact, the loans underlying the Certificates have experienced default and delinquency at extraordinarily high rates due to the abandonment of the disclosed underwriting guidelines. These rates of default are much higher than what a pool of loans that had the features Goldman described would have experienced in the same economic conditions. Further, the higher default rates have made it unlikely that Prudential will receive the full payments originally expected.

407. The high rates of default due to the abandonment of Goldman's underwriting guidelines signal increased risk in the Certificates. The diminished prospect of continued cash flows dictates that the Certificates are less valuable than they would have been but for the misrepresentations. Prudential is seeking recovery for past and current damages either through a damage award or rescission.

408. As the court explained in *In re Countrywide*, the failure to properly transfer title to the mortgage loans that collateralized investors' securities also harmed Prudential, because such a failure can reduce the securities' cash flow and decrease their market value:

> If title is not transferred properly, then the trustee cannot foreclose on a defaulted loan. An RMBS purchaser may be harmed either directly or indirectly in such a scenario. First, an RMBS purchaser may be directly harmed if the trustee is unable to foreclose on a loan and the trust therefore receives nothing (rather than the foreclosure value). Second, if the market realizes that, due to title transfer problems, RMBS that contain defaulted loans will pay less than anticipated, the market should discount RMBS containing defaulted or likely-to-default loans by an appropriate amount. In either event, a purchaser would not have become aware of the damages portion of its claim until it became clear that title transfer problems were widespread and preventing foreclosures.

In re Countrywide, No. 11-ML-02265 (C.D. Cal. Mar. 9, 2012), Order at 11.

409. Upon information and belief, Prudential's securities have been affected by problems with transfers of title, with reductions in payment streams on the securities and their market value. The failure to assign the Mortgage Loans to each Trust in a manner sufficient to allow the Trust to foreclose upon the underlying property in the event of a default, has affected the flow of funds into the RMBS Trusts and thus to Prudential. Those payment problems have also reduced the price that other investors are willing to pay for the securities.

410. Even in the context of the real estate crisis, the Certificates would have much higher value had the securities been as represented by Goldman in its Offering Materials, because their mortgage pools would not have defaulted at nearly the same high rate. This decreased value is evidenced collectively by, but need not be measured solely by, among other things: (a) the high rates of default and delinquency of the Mortgage Loans; (b) the Certificates' plummeting ratings; (c) lower-than-expected past and projected cashflow and (d) lower market value.

411. The primary evidence supporting Prudential's damages is secondary-market pricing. Though the secondary market may have temporarily "seized up" during the height of the financial crisis, today there is a functioning, liquid, secondary market for mortgage-backed securities such as the Certificates. Numerous brokers are active in, and have trading desks specifically dedicated to, the secondary market for RMBS, including without limitation Barclays, Bank of America, Citigroup, Deutsche Bank, Goldman Sachs, Royal Bank of Scotland, JPMorgan, Nomura, and Morgan Stanley.

412. Indeed, Prudential has already sold its GSAMP 2005-HE6 M3, GSAMP 2005-WMC2 M1, and GSAMP 2006-HE2 M2 Certificates on the secondary market.

413. In April 2011, the *Wall Street Journal* recently reported that "AIG Bonds are in Demand," and found that the Federal Reserve Bank of New York's "much anticipated" auction of $1.5 billion in subprime bonds was "deemed successful by industry participants . . . . Industry participants said dealers saw solid interest from investors." According to a CEO quoted by the article, "[t]he overwhelming majority of the list [of bonds] traded at more than the estimated price, indicating healthy demand by dealers and investors."

414. The liquidity of the market has continued since then, with the *Wall Street Journal* reporting in March 2012 that investors were "[b]ullish" on subprime mortgage bonds. According to the report, in the first two months of 2012, "investors bought $42.4 billion and sold more than $50 billion [of RMBS] through dealers." Those numbers continued in March 2012, when "[i]nvestors bought $21.3 billion in subprime and other risky residential mortgage bonds through Wall Street dealers . . . , exceeding the $20.4 billion they sold." This data was released by the Financial Industry Regulatory Authority, or Finra, which began reporting data on the volume of RMBS trades in mid-2011.

415. Prudential viewed market value as a critical aspect of the Certificates it purchased. Prudential has lost much of the market value in these securities—much more than it would have lost if the Certificates had been backed by loans of the quality Goldman represented.

416. In short, defaults were much higher than they would have been if the Mortgage Loans had been properly underwritten; this revealed that the true value of the Certificates was a significant discount to what Prudential paid. This is evidenced by the drop in market value of the securities. Loans which were properly underwritten would have withstood the same economic conditions much better than those Goldman offloaded onto Prudential. Securities backed by

loans with the features Goldman describes would currently have a much higher value than Prudential's Certificates, and thus Prudential was damaged by Goldman's wrongdoing.

417. Prudential's damages here are separate and severable from any losses Prudential may have sustained by the economic downturn, and such could be measured through the discovery process. For instance, but without limitation, upon discovery of the full extent of Goldman's misrepresentations, expert testimony may compare the performance of the *actual* Certificates and/or loan pools here, with the performance of securities and/or loan pools that had the features described in the Offering Materials, as one potential measure of Prudential's damages. However, it is well beyond Prudential's pleading burden to perform such analysis here, and in any event the full extent of Goldman's misrepresentations is unknown as Prudential does not have access to the loan files.

V. DEFENDANTS' CONCEALMENT OF THEIR MISCONDUCT

A. Recent Results of Various Governmental Investigations and New Availability of Key Information

418. The key information cited and relied upon herein did not generally become available to Prudential until, at the earliest, mid-2009, and often later. This key information includes, for example the FCIC report (January 2011), and information associated with the FCIC Report, such as documents and testimony relating to Clayton (September 2010-January 2011).

419. In addition, as noted above, Prudential could not have performed a loan-level analysis until 2010, which should have provided evidence of Goldman's misrepresentations regarding the specific Mortgage Loans at issue here.

B. Recent Downgrade of the Certificates Below Investment Grade

420. As discussed above, eventually all but three of the Certificates that Prudential purchased from Goldman's Offerings have been downgraded to non-investment grade by at least

one rating agency. The following chart summarizes the dates of downgrade to below investment grade:

Certificate	Non-Investment Grade Downgrade Date(s)
Fremont Home Loan Trust 2004-A, M1	3/21/2011 (Moody's) 9/30/2009 (S&P)
GSAMP Trust 2004-FM1, M2	3/17/2011 (Moody's)
GSAMP Trust 2004-FM2, M1	3/17/2011 (Moody's)
GSAMP Trust 2005-HE4, M2	6/21/2010 (Moody's) 8/4/2009 (S&P) 6/12/2009 (Fitch)
GSAMP Trust 2005-HE6, M2	3/13/2009 (Moody's) 8/4/2009 (S&P)
GSAMP Trust 2005-HE6, M3	10/23/2008 (Moody's) 8/4/2009 (S&P)
GSAMP Trust 2005-WMC2, M1	3/13/2009 (Moody's) 8/4/2009 (S&P)
GSAMP Trust 2006-FM1, A2D	10/23/2008 (Moody's) 8/4/2009 (S&P)
GSAMP Trust 2006-HE1, A2D	9/17/2010 (Moody's)
GSAMP Trust 2006-HE2, A2	3/13/2009 (Moody's)
GSAMP Trust 2006-HE2, A3	3/13/2009 (Moody's)
GSAMP Trust 2006-HE2, M2	3/13/2009 (Moody's) 8/4/2009 (S&P)
GSAMP Trust 2006-HE3, A2D	3/13/2009 (Moody's) 8/11/2011 (S&P)
GSAMP Trust 2006-HE7, A2D	3/13/2009 (Moody's) 8/4/2009 (S&P)
GSAMP Trust 2007-HE2, A2B	3/13/2009 (Moody's) 9/30/2009 (S&P)
GSAMP 2006-HE6	3/13/2009 (Moody's) 8/4/2009 (S&P) 6/12/2009 (Fitch)

421. As this chart reflects, virtually all of Prudential's Certificates retained strong credit ratings by all the rating agencies through at least March 2009. Indeed, none of the Certificates were downgraded below investment grade by the credit rating agencies until October 2008, when Moody's downgraded two securitizations (GSAMP Trust 2006-FM1, A2D, and GSAMP Trust 2005-HE6, M3) . The other rating agencies did not issue similar downgrades

until later, and several of the Certificates continued to receive investment grade ratings well into 2011.

422. Thus, information that put or would have put Prudential on notice of the legal violations at issue here was affirmatively concealed by Goldman and did not emerge in a substantial way prior to March 2009.

FIRST CAUSE OF ACTION
(Common-law Fraud/Fraudulent Inducement Against All Defendants)

423. Prudential realleges each allegation above as if fully set forth herein.

424. This count is against all Defendants. It is against each Defendant only for those transactions in which it played a role, as set forth above and in the Exhibits.

425. Each Defendant made, authorized or caused the representations at issue, which are identified and summarized above and further identified in the Exhibits.

426. The material representations set forth above were fraudulent, and Defendants' representations fraudulently omitted material statements of fact.

427. Each of the Defendants knew their representations and omissions were false and/or misleading at the time they were made. Each made the misleading statements with an intent to defraud Prudential.

428. Defendants had reason to expect that Prudential was among the class of persons who would receive and rely on such representations, and intended that their misleading statements would induce Prudential to purchase the Certificates.

429. Prudential justifiably relied on Defendants' false representations and misleading omissions.

430. Had Prudential known the true facts regarding the Defendants' underwriting practices and quality of the loans making up the securitizations, it would not have purchased the Certificates as it ultimately did.

431. As a result of the foregoing, Prudential has suffered damages according to proof. In the alternative, Prudential hereby demands rescission and makes any necessary tender of the Certificates. /

SECOND CAUSE OF ACTION
(Aiding and Abetting against All Defendants)

432. Prudential realleges each allegation above as if fully set forth herein.

433. This is a claim for aiding and abetting fraud brought against all Goldman Defendants arising from the intentional and substantial assistance each rendered to the others to advance the fraud on Prudential.

434. Defendant Goldman Sachs & Co. assisted in the preparation of the Offering Materials, and acted as broker-dealer with regard to the issuance and underwriting of the Certificates, including in marketing and selling the Certificates to Prudential.

435. Goldman Sachs Mortgage Company, as sponsor and/or seller, substantially assisted Defendants' fraud by choosing which mortgage loans would underpin Prudential's Certificates and packaging them into pools that would be deposited with the Trusts. It also assisted by waiving into the collateral pools of the Trusts loans previously rejected by Clayton and Bohan, despite the lack of compensating factors. It also extended warehouse lines of credit to mortgage originators that it knew had shoddy standards with the intent of later purchasing and securitizing those loans to purchasers, such as Prudential. Goldman Sachs Mortgage Company's action in assisting the origination, and also purchasing, of poorly underwritten loans was integral in the fraud.

436. Likewise, GS Mortgage Securities Corp., as depositor for the trusts related to Prudential's Certificates, substantially assisted Defendants' fraud by issuing the Registration Statements that were used to offer publicly the Certificates. As the issuer of the Certificates, GS Mortgage Securities Corp. was an integral part of Defendants' sale of the Certificates to Prudential.

437. Each Defendant had unique access to the loan files, and therefore was aware of the extreme weakness of the loans. In fact, Goldman, during the same period it was selling many of the Certificates to Prudential, was also *shorting* those same Certificates and engaging in put back requests with originators and other parties based upon the weakness of the underlying loans. Accordingly, Defendants were aware that the representations and omissions in the Offering Materials were fraudulent.

438. Indeed, all of the de-risking strategies described above (including the shorting and repurchasing strategies which Goldman pursued in 2006 through 2007 in order to reduce its subprime exposure) were conceived and then implemented by each of the Defendants in their roles as underwriter, sponsor and depositor of the Certificates. Defendants employed those strategies to create, market, and sell the Certificates to investors, including Prudential. The de-risking strategies described above were executed, by among others, Goldman employees who wore multiple hats among the Goldman entities. This gave each of the Goldman Defendants direct knowledge of the fraudulent sale of the Certificates. Through overlapping personnel, strategies and intertwined business operations, and the fluid transfer of information among the Defendants, each of the Goldman Defendants knew of the fraud perpetrated on Prudential. Each Defendant acted in concert to defraud Prudential. The central role of Goldman Sachs Mortgage Company and GS Mortgage Securities Corp. in Goldman, Sachs & Co.'s vertically integrated

sales strategy substantially assisted Defendants in their fraud. Goldman Sachs Mortgage Company, as the purchaser of the underlying mortgage loans, worked closely with GS Mortgage Securities Corp., as the vehicle for securitizing the mortgage loans, which in turn worked closely with Goldman, Sachs & Co., as the distribution arm for the Certificates that were collateralized by those mortgage loans and then sold to Prudential. Goldman Sachs Mortgage Company and GS Mortgage Securities Corp. worked hand-in-glove to provide Goldman, Sachs & Co. with Certificates that it could fraudulently sell to Prudential.

439. Defendants could not have perpetrated their fraud without the substantial and material assistance of each other defendant, and they all provided financial, strategic, and marketing assistance for their scheme. Defendants are highly intertwined and interdependent businesses and each benefited from the success of the scheme. Through the fraudulent sale of the Certificates to Prudential, the Goldman Defendants were able to materially improve their financial condition by reducing their exposure to declining subprime-related assets and garnering thousands of dollars in fees from the structuring and sale of the Certificates.

440. Each of the defendants knew of the fraud perpetrated by the other defendants. Each knew of the representations and omissions made by the others. Each also knew that the representations and omissions made by each of the other defendants were false and/or misleading at the time they were made. As discussed above, Defendants were all highly interdependent businesses with overlapping management and a constant flow of information among Defendants. All of the defendants had actual knowledge of, and substantially assisted in, the fraudulent scheme to securitize each of the trusts at issue and market and sell the Certificates to investors, including Prudential, without disclosing the truth about those investments.

441. As a direct, proximate, and foreseeable result of the Goldman Defendants' conduct, Prudential has suffered and will continue to suffer harm.

<u>THIRD CAUSE OF ACTION</u>
(Negligent Misrepresentation against All Defendants)

442. Prudential realleges each allegation above as if fully set forth herein.

443. This count is against all defendants. It is against each Defendant only for those transactions in which it played a role, as set forth above and in the Exhibits.

444. Because Defendants arranged the Securitizations, and originated or acquired, underwrote, and serviced most of the underlying Mortgage Loans, they had unique and special knowledge about the loans in the offerings. In particular, they had unique and special knowledge and expertise regarding the quality of the underwriting of those loans, as well as the servicing practices employed as to such loans.

445. Because Prudential could not evaluate the loan files for the Mortgage Loans underlying its Certificates, and because Prudential could not examine the underwriting quality or servicing practices for the Mortgage Loans in the offerings on a loan-by-loan basis, it was heavily reliant on Defendants' unique, special, and superior knowledge regarding the Mortgage Loans when determining whether to make each investment in the Certificates. Prudential was entirely reliant on Defendants to provide accurate information regarding the loans in engaging in that analysis. Accordingly, Defendants were uniquely situated to evaluate the economics of each offering.

446. Going back over many years covering these numerous purchases, Prudential relied on Defendants' unique, special, and superior knowledge regarding the quality of the underlying Mortgage Loans and their underwriting when determining whether to invest in the Certificates at issue in this action. Prudential's longstanding relationship with Defendants,

coupled with Defendants' unique and special knowledge about the underlying loans, created a special relationship of trust, confidence, and dependence between Defendants and Prudential.

447. Defendants were in the business of providing information for use by others, including Prudential. Specifically, but without limitation, Defendants were in the business of providing information by way of the Offering Materials so that investors could rely on them in deciding whether to invest in the securities being offered. This information was for the use of a small class of large, institutional investors.

448. Defendants were aware that Prudential relied on their unique, special, and superior knowledge, expertise, and experience and depended upon them for accurate and truthful information in making the decision to invest in each of the Certificates. Defendants were also aware that the representations regarding the underwriting standards, as well as those regarding the characteristics of the Mortgage Loans, would be used for the particular purpose of deciding whether to invest in those Certificates. Defendants also knew that the facts regarding their compliance with their underwriting standards were exclusively within their knowledge.

449. Based on their expertise, superior knowledge, and relationship with Defendants, Defendants owed a duty to Prudential to provide complete, accurate, and timely information regarding the Mortgage Loans and the offerings. Defendants breached their duty to provide such information to Defendants.

450. Defendants breached their duty to provide such information to Prudential by making misrepresentations that induced Prudential's investment in the offerings. The misrepresentations are set forth above and in the Exhibits. At the time Defendants made these misrepresentations, they were, at a minimum, negligent in their due diligence and/or understanding of the extent to which the Mortgage Loans underlying the Certificates complied

with the underwriting guidelines and had the characteristics represented in the Offering Materials. Thus, Defendants were at the very least negligent in making statements that were false, misleading, and incorrect. Such information was known or reasonably should have been known by Defendants, and was not known or readily knowable by Prudential. In addition, Defendants knew that Prudential was acting in reliance on that information.

451. Prudential reasonably relied on the information Defendants did provide and was damaged as a result of these misrepresentations. Had Prudential known the true facts regarding Defendants' underwriting practices and the quality of the loans making up the offerings, it would not have purchased the Certificates as it ultimately did.

452. As a result of the foregoing, Prudential has suffered damages according to proof.

FOURTH CAUSE OF ACTION
(New Jersey Civil RICO, N.J.S.A. 2C:41-1 *et seq.*)

453. Prudential realleges each allegation above as if fully set forth herein.

454. For the purposes of this Count Four, Prudential alleges that Defendants acted with the knowledge and intent required to violate the statutes identified as racketeering activity below and/or were willfully blind to or deliberately ignorant of the falsity of the information they conveyed to Prudential.

455. Defendants violated the New Jersey Civil RICO statute by committing or conspiring amongst themselves and others to commit a pattern of racketeering activity in violation of N.J.S.A. 2C:41-2(c) and -2(d).

The Enterprise

456. Defendants have committed a pattern of racketeering activity through their agreement to participate in and actual participation in an association-in-fact enterprise comprised of the persons and entities that acquired thousands of residential mortgage loans and then

processed the underlying loans into mortgaged-backed securities so that the Defendants could sell certificates at inflated values to investors such as Prudential on the basis of false and fraudulent Offering Materials (the "Goldman Enterprise").

457. The Goldman Enterprise included at least the following persons, businesses, or other legal entities that played the following discrete and well-defined roles in Goldman's carefully planned, highly organized scheme:

(a) Goldman Sachs Mortgage Company, which acted as the Seller and/or Sponsor for the Securitizations purchased by Prudential;

(b) GS Mortgage Securities Corporation, which acted as Depositor and/or Seller of the Securitizations;

(c) Goldman Sachs & Company, which acted as the Underwriter of the Securitizations; and

(h) Non-party Goldman Sachs Group, Inc. which formed the other Goldman entities to perform specific tasks required to originate or acquire mortgages, securitize those mortgages, and then sell securities to Prudential and other investors in order to maximize corporate profits. Goldman Sachs Group, Inc. also had the ability to direct and did in fact direct, purposefully engage in, assist, and/or further the Goldman Enterprise, as it funded the activities of the other members of the Enterprise, managed and supervised the operations of the Enterprise; set the methods for the Enterprise (including the intentional increase in the sale of residential mortgaged-backed securitizations and deliberate indifference to, or circumvention of, stated underwriting guidelines); directed the goals of the Enterprise, which included the maximization of short-term profits and fees from the sale of residential mortgaged-backed securities through the use of false and fraudulent Offering Materials; and received and consolidated the funds generated by the Enterprise's activities.

458. The members of the Goldman Enterprise played specific and well-defined roles in the process of originating and then securitizing loans into residential mortgage-backed securities, as described above.

459. The members of the Goldman Enterprise shared the common purpose of obtaining pecuniary gain, including money, in connection with the fraudulent sale of inflated mortgaged-backed securities to investors, including Prudential.

460. At all relevant times, the Goldman Enterprise was and remains engaged in trade or commerce in activities affecting trade or commerce in connection with the sale and purchase of securities in the State of New Jersey.

461. The Goldman Enterprise is an enterprise within the meaning of N.J.S.A. 2C:41-1(c).

The Pattern of Racketeering Activity

462. The members of the Goldman Enterprise engaged in a pattern of racketeering activity consisting of two or more separate and distinct acts of racketeering activity. Defendants committed this pattern of racketeering activity during at least 2004 to 2007 and beyond, and in connection with but not limited to the Securitizations in which Prudential purchased Certificates. The acts of racketeering include, but are not limited to, those set forth below:

a. Violations of the New Jersey Uniform Securities Act (N.J.S.A. 49:3-47 *et seq.*)

463. Under N.J.S.A. 49:3-52(b), it is "unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly [t]o make any untrue statement of a

material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading."

464. Similarly, under N.J.S.A. 49:3-52(a) and -52(c), it is unlawful for any person to offer, sell or purchase a security by employing "any device, scheme, or artifice to defraud" or by engaging "in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person."

465. Defendants are "persons" within the meaning of N.J.S.A. 49:3-49(i).

466. The Certificates purchased by Prudential are "securities" within the meaning of N.J.S.A. 49:3-49(m).

467. Defendants and the Trusts (although not named as defendants) qualify as offerors or sellers of the Certificates in the Securitizations because they issued, marketed, and/or sold the Certificates to Prudential and other members of the public for their own financial benefit within the meaning of N.J.S.A. 49:3-49(j)(1)-(2).

468. Defendants and the Trusts offered and sold the Certificates in the Securitizations to Prudential in the State of New Jersey within the meaning of N.J.S.A. 2C:1-3.

469. As identified above and in the Exhibits, on two or more occasions, in violation of N.J.S.A. 49:52(a), (b), and (c), Defendants made numerous material misstatements in the Offering Materials used to sell Prudential the Certificates in the Securitizations. In addition, Defendants made numerous omissions of fact that made the Offering Materials false and misleading.

470. As alleged in detail above and in the Exhibits, the Offering Materials in the Securitizations created and utilized by Defendants and the Trusts were materially false and misleading because, among other things, they misrepresented the underwriting standards

applicable to the mortgage loans backing the Certificates, misrepresented the owner-occupancy information for the loans, misrepresented the LTV and CLTV ratios and appraisal information for the loans, and misrepresented information relevant to the credit ratings process for the Certificates.

471. Defendants knew that the Offering Materials included untrue statements of material fact and misleading omissions.

472. In the alternative, Defendants recklessly and consciously disregarded a substantial and unjustifiable risk that the Offering Materials in the Securitizations included untrue statements of material fact and misleading omissions. Given the nature of this risk, the access of Defendants to the loan files for the mortgages underlying the Certificates, and the central role each entity played in the mortgage securitization process, the disregard by Defendants of the risk that the Offering Materials were materially misleading or fraudulent constituted a gross deviation from the standard of conduct that a reasonable person would observe in the same situation.

473. Defendants made these misrepresentations and omissions with the purpose and intent of convincing Prudential to purchase the Certificates in the Securitizations.

474. Prudential did not know, and in the exercise of due diligence could not have known, of the untruths and omissions.

475. Goldman Sachs Mortgage Company is not only liable as primary violator, it is also jointly and severally liable because it controlled one or more of the primary violators, including with respect to the Securitizations.

476. GS Mortgage Securities Corporation is not only liable as a primary violator, it is also jointly and severally liable because it controlled one or more of the primary violators, including with respect to the Securitizations.

477. Defendants' violations of N.J.S.A. 49:3-52(a), -(b), and -(c), as well as 49:3-70(a) and -(b), constitute racketeering activity pursuant to N.J.S.A. 2C:41-1(a)(p).

b. Deceptive Business Practices (N.J.S.A. 2C:21-7i)

478. On two or more occasions, Defendants committed, attempted to commit, solicited another to commit, conspired to commit, or engaged in intentional acts involving deceptive business practices.

479. As alleged in detail above and in the Exhibits, Defendants in the course of their business made false or misleading statements in the Offering Materials connected with the offer and sale of Certificates in the Securitizations, or omitted material information required by law to be disclosed therein.

480. Defendants knew that the Offering Materials included those untrue statements of fact or material omissions.

481. The Certificates offered by Defendants and purchased by Prudential on the basis of Defendants' false and misleading Offering Materials are "securities" within the meaning of N.J.S.A. 2C:21-7i.

482. Defendants made these misrepresentations and omissions for the purpose of promoting the sale of securities to Prudential and other investors at inflated values for their own pecuniary gain.

483. Defendants' violations of N.J.S.A. 2C:21-7i constitute racketeering activity pursuant to N.J.S.A. 2C:41-1(a)(o).

c. Theft by Deception (N.J.S.A. 2C:20-4)

484. On two or more occasions, Defendants purposefully committed, attempted to commit, solicited another to commit, conspired to commit, or engaged in acts involving theft by

deception by obtaining the property of another by deceitful means and artful practices with the intention of depriving Prudential and other investors of their property.

485. As alleged in detail above and in the Exhibits, Defendants repeatedly used false and misleading Offering Materials in the Securitizations to induce Prudential to purchase the identified Certificates. By this conduct, Defendants created or reinforced Prudential's false impression of existing facts, including facts relating and directly relevant to the value of the Certificates, which Defendants knew or believed to be false, in violation of N.J.S.A. 2C:20-4(a).

486. Defendants also prevented Prudential from acquiring information pertinent to the disposition of its funds, including information that would have contradicted the false representations of fact in the Offering Materials in the Securitizations, in violation of N.J.S.A. 2C:20-4(b).

487. By failing to amend the materially false and misleading Offering Materials and/or notify Prudential of the true underwriting standards, owner-occupancy statistics, LTV and CLTV ratios, and credit ratings process relevant to the in the Securitizations, Defendants also failed to correct a false impression, which allowed Defendants to hide their enterprise from discovery by Prudential and other investors. Defendants' failure to correct the false impression they created or reinforced in the Offering Materials was in violation of N.J.S.A. 2C:20-4(c).

488. Defendants' repeated and related violations of N.J.S.A. 2C:20-4(a), -4(b), and -4(c) constitute racketeering activity pursuant to N.J.S.A. 2C:41-1(a)(n).

d. Falsifying Records (N.J.S.A. 2C:21-4(a))

489. On two or more occasions, Defendants committed, attempted to commit, solicited another to commit, conspired to commit, or engaged in acts involving falsifying or tampering with records with the intention of deceiving or injuring Prudential and other investors.

490. As alleged in detail above and in the Exhibits, Defendants repeatedly used false and misleading Offering Materials in the Securitizations to knowingly falsify, remove, or conceal material facts relevant to the value of the securities they sold to investors such as Prudential, including but not limited to the pertinent underwriting guidelines, owner-occupancy statistics, LTV and CLTV ratios, due diligence process, and credit ratings connected with the Certificates purchased by Prudential.

491. The Offering Materials created and utilized by Defendants constitute a "writing or record" within the meaning of N.J.S.A. 2C:21-4(a).

492. Defendants' violations of N.J.S.A. 2C:21-4(a) constitute racketeering activity pursuant to N.J.S.A. 2C:41-1(a)(o).

e. *Relatedness of the Acts of Racketeering Activity*

493. The incidents of racketeering activity committed by the Defendant/members of the Goldman Enterprises had, among other things, the same or similar intents, results, victims, and methods of commission.

494. The acts of racketeering activity committed by Defendants relating to the Securitizations involve transactions or purported transactions with or affecting Prudential.

495. The acts of racketeering activity committed by Defendants relating to the Securitizations have the same or similar intents in that they sought to obtain property, including but not limited to Prudential's money, through illegal means.

496. The acts of racketeering activity committed by Defendants relating to the Securitizations have the same or similar results, in that Defendants actually obtained personal property, including but not limited to Prudential's money, through illegal means.

497. The acts of racketeering activity committed by Defendants relating to the Securitizations have the same or similar victims: investors (including Prudential) in Goldman's residential mortgage-backed securities, including the Certificates.

498. The methods by which Defendants committed the incidents of racketeering activity relating to the Securitizations were the same or similar, including by way of example and not limitation, inducing Prudential to pay Defendants hundreds of millions of dollars to purchase residential mortgaged-backed securities on the basis of materially false and misleading Offering Materials.

499. In the Goldman Enterprise, the acts of racketeering committed by the Defendants serving as members thereto are interrelated by distinguishing characteristics and are not isolated incidents. The acts involve the same or similar methods of commission, the same or similar types of misrepresentations or omissions, the same or similar benefits to Defendants, the same or similar injuries to Prudential, and the same or similar efforts by Defendants' to conceal their misconduct.

Defendants' Violations of the New Jersey RICO Statute

500. Defendants violated N.J.S.A. 2C:41-2(c) by associating with an enterprise and conducting or participating, indirectly or indirectly, in that enterprise through a pattern of racketeering activity.

501. Defendants also violated N.J.S.A. 2C:41-2(d) by conspiring with others, including but not limited to the other members of the Goldman Enterprises, to violate N.J.S.A. 2C:41-2(c). In furtherance of that conspiracy, Defendants committed overt acts that include but are not limited to the racketeering activity alleged above.

Proximate Cause of Injury to Prudential by Defendants' New Jersey RICO Violations

502. Defendants' behavior directly targeted Prudential, which purchased the Certificates in the Goldman Securitizations based on the false and fraudulent representations in the Offering Materials. As a result, Prudential purchased securities at falsely inflated values that have experienced significant downgrades, defaults, and delinquencies. Defendants' misrepresentations and omissions have adversely affected both the value of the securities purchased by Prudential and the income flow therefrom. As a result, Prudential's injuries flow directly from acts of racketeering activity committed by Defendants that constitute part of the pattern of racketeering activity.

503. Prudential has been injured by reason of these violations of N.J.S.A. 2C:41-2 and is entitled to recover three times the actual damages it has sustained pursuant to N.J.S.A. 2C:41-4(c).

504. Pursuant to N.J.S.A. 2C:41-4(c), Prudential is also entitled to recover its attorneys' fees in the trial and appellate courts, and its costs of investigation and litigation reasonably incurred.

505. Pursuant to N.J.S.A. 2C:41-4(a), Prudential is also entitled to such other and further relief that this Court may deem just and proper, including but not limited to the dissolution or reorganization of Defendants' RICO enterprise; the denial, suspension, or revocation of Defendants' licenses to do business in the State of New Jersey; and any and all appropriate cease and desist orders necessary to discontinue Defendants' acts or conduct.

PRAYER FOR RELIEF

WHEREFORE Prudential prays for relief as follows:

An award in favor of Prudential against the Goldman Defendants, jointly and severally, for all damages sustained as a result of their wrongdoing, in an amount to be proven at trial, but including at a minimum:

a. Prudential's monetary losses, including loss of market value and loss of principal and interest payments;

b. Treble damages;

c. Rescission and recovery of the consideration paid for the Certificates, with interest thereon. Prudential is prepared to tender the Certificates in the event the Court grants such relief;

c. Attorneys' fees and costs;

d. Prejudgment interest at the maximum legal rate; and

e. Such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

Prudential hereby demands a trial by jury on all issues triable by jury.

DATED: Newark, New Jersey
August 24, 2012

LOWENSTEIN SANDLER PC

By: ______________________

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QUINN EMANUEL URQUHART & SULLIVAN, LLP

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CERTIFICATION PURSUANT TO R. 4:5-1

I hereby certify that the matter in controversy is not the subject of any other action pending in any Court or of a pending arbitration proceeding and that no other action or arbitration proceeding is contemplated.

DAVID W. FIELD

Dated: August 24, 2012

QUINN EMANUEL URQUHART & SULLIVAN, LLP

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