SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

CIFG ASSURANCE NORTH AMERICA, INC., Plaintiff, -against- BANK OF AMERICA, N.A., BANC OF AMERICA FUNDING CORPORATION, and MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. (f/k/a BANC OF AMERICA SECURITIES, LLC), Defendants.	Index No. ___________ COMPLAINT

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Plaintiff CIFG Assurance North America, Inc. ("CIFG"), by and through its attorneys, Quinn Emanuel Urquhart & Sullivan, LLP, for its Complaint against Bank of America, N.A. ("BOA"), Banc of America Funding Corporation ("BAFC"), and Merrill Lynch, Pierce, Fenner & Smith, Inc. ("MLPF&S"), as successor-in-interest to Banc of America Securities, LLC ("BAS") (collectively, "Defendants" or "Bank of America"), alleges as follows:

NATURE OF THE ACTION

1. This action arises out of the fraudulent acts and breaches of contract of Bank of America in connection with five financial guaranty insurance policies issued by CIFG. The policies at issue relate to two structured transactions arranged by Bank of America, which in turn were backed by 22 residential mortgage-backed securities (the "Original RMBS," backed by the "Mortgage Loans" or "Loans"). Bank of America had these securities in its inventory because it had been unable to sell them when it served as underwriter on the Original RMBS offerings. Bank of America knew of the poor quality of the Mortgage Loans, and knew the unsold Original RMBS were a ticking time bomb on the Bank's books. Unable to sell the securities piecemeal, the Defendants hatched a new plan of financial engineering: they would fraudulently re-package the securities into new transactions BAFC 2006-R1 (the "R-1 Certificates") and BAFC 2006-R2 (the "R-2 Certificates") (collectively, the "Certificates"), re-tranche and re-rate them, and then re-market them to investors via a structure called a Re-REMIC (which stands for Re-securitized Real Estate Mortgage Investment Conduit).

2. To make the Re-REMIC marketable to investors, Defendants induced CIFG to provide over $150 million of financial guaranty insurance.[1] With the credit protection provided

[1] For the BAFC 2006-R1 deal, CIFG issued Policy Nos. CIFG NA-997, CIFG NA-998, and CIFG NA-999, effective May 31, 2006. These policies provided $121,416,000 in financial guarantees for the Class A-1, A-2, and A-3 Certificates. For the BAFC 2006-R2 deal, CIFG issued Policy Nos. CIFG-1293 and CIFG-1294, effective October 31, 2006. These policies

by CIFG's Policies, the Certificates became marketable to investors, and CIFG would bear the risk of loss should the underlying Original RMBS falter.

3. Prior to agreeing to issue the Policies, CIFG conducted careful and extensive due diligence to attempt to determine the risk profile of the Certificates and estimate the likelihood of default (*i.e.*, the likelihood it would have to pay out on the Policies) ("CIFG's Initial Diligence"). For instance, CIFG took loan-level data provided by Defendants and used it to conduct multiple "stress tests" to see how the Loans, as described by Defendants, would perform under various assumed scenarios. It did extensive modeling to determine how cash would flow from the Loans through the Original RMBS to the Certificates under these various scenarios. It looked at the historical performance of RMBS with features similar to those Defendants described as underlying the deals here. It reviewed all of the documents supplied by Defendants, including the term sheets, prospectuses, prospectus supplements, and ratings for the Original RMBS; the Offering Memoranda and "shadow ratings" for the Certificates; and the loan tapes for the Mortgage Loans underlying the Original RMBS and, ultimately, the Certificates. It also engaged in intensive discussions with Defendants about these deals, and gathered what it could from third-party sources. All of this information fed into CIFG's risk-modeling process, which went above and beyond standard industry practices. Defendants even assured CIFG that it had all the information it needed to analyze the deals.

4. All of CIFG's Initial Diligence was, in retrospect, a waste of time. Even the most thorough risk analysis process is only as good as the information on which it is based. In this case, Defendants fed CIFG garbage data—falsely representing that the Mortgage Loans had

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provided $56,430,000 in financial guarantees for the Class A-1 and A-2 Certificates. All of the policies at issue have substantially the same terms and are referred to herein as the "Policies."

certain features vastly different from what they truly had.[2] These false representations made the Loans, and the Certificates backed by them, appear less risky than they actually were. Because CIFG did not have access to the "loan files" and other information available to Defendants, there was simply no way for CIFG to even attempt to discover that the data Defendants provided was false. There was thus no way for CIFG to know, despite its rigorous testing of the information that was made available, that it was being fraudulently induced to issue policies on securities far riskier than what it signed up for. For instance:

(a) Defendants falsely represented that the Mortgage Loans underlying the Original RMBS and the Certificates were originated in accordance with stated underwriting guidelines. In fact, the originators of the Mortgage Loans, including BOA, had systematically abandoned their underwriting standards. Simply looking at rows of data in loan tapes would not have revealed that originators were falsifying that very data, and in many other ways approving loans that were far outside the stated guidelines. Because adherence to the underwriting guidelines affects the reliability of all of the data, and because the stated guidelines reflect at the most fundamental level the quality of the supporting loan pool, Defendants' failure to disclose the systemic underwriting abandonment materially skewed CIFG's risk assessment. CIFG would not have issued the Policies had it known that the stated guidelines had been systematically ignored.

(b) Defendants falsely represented that the Mortgage Loans had certain loan-to-value ("LTV") ratios. LTV ratios are a commonly used metric in the industry, and Defendants knew that CIFG's risk modeling and assessment of the risk profile of the Certificates

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[2] These representations were contained in prospectuses, prospectus supplements, pooling and servicing agreements, and other documentation for the Original RMBS, draft and final offering memoranda and documentation for the Certificates, term sheets, loan data tapes, credit ratings, and other communications (the "Offering Materials").

depended on the accuracy of such information. They also knew that, without the loan files containing the property addresses and the actual appraisal reports, CIFG had no way of knowing that these ratios were not accurate, but instead were the product of intentionally inflated appraisals. CIFG would not have issued the Policies had it known that the LTV ratios had been so manipulated.

(c) Defendants falsely represented that a given percentage of the Mortgage Loans would be occupied by the borrowers. Owner-occupancy is a commonly used metric in the industry to gauge a borrower's ability or likelihood to repay, and Defendants knew that CIFG's risk modeling depended on the accuracy of such information. They also knew that CIFG had no way of even attempting to discover that far fewer properties were occupied by the borrowers than what was represented to CIFG. Because the false occupancy data materially skewed the results of its risk modeling and significantly understated the risk profile of the Certificates, CIFG would not have issued the Policies had it known that the owner-occupancy statistics had been falsified.

(d) Defendants falsely represented that (i) the underlying Mortgage Loans had been validly assigned to the RMBS trusts (the "Trusts") that issued the Original RMBS (or to MERS), and (ii) 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 CIFG's Forensic Review of the chain of title of the Mortgage Loans, Defendants did not actually assign over ***58%*** of these Mortgage Loans to the Trusts. And of the Mortgage Loans that were assigned to the Trusts, over ***25%*** were *not properly assigned,* as represented in the Offering Materials. Because a proper transfer of title is necessary for the Trust to be entitled to enforce the Mortgage

Loans if a borrower defaults, CIFG would not have issued the Policies had it known that title to the Mortgage Loans had not been properly transferred.

(e) The Original RMBS were given their own credit ratings, and CIFG was given information regarding what the Certificates would have been rated without the protection provided by the Policies (this is known as a "shadow credit rating"). Defendants fraudulently omitted, however, that the ratings had been procured by Defendants through the provision of false data about the Loans to the rating agencies. Just as CIFG had no way of knowing the data provided to it was false, nor did it know the ratings were similarly based on a set of baseless data. Because credit ratings are a commonly used indicator of potential risk, CIFG would not have issued the Policies had it known that the original and shadow ratings had been knowingly procured through the provision of garbage data.

5. Defendants provided this false data to use in CIFG's Initial Diligence because they knew that if the true risk features of these transactions were revealed, CIFG would not have issued the Policies, and the Certificates would have been unmarketable. This would have left the Original RMBS on Defendants' books, leaving them exposed to the risks created by their own shoddy origination and securitization practices. Rather than accepting the risks Defendants' own practices created, they knowingly fed CIFG false data to fraudulently induce it to issue the Policies. Had CIFG known that its extensive Initial Diligence was based on sham numbers, and therefore the risk profile of the Certificates was significantly understated, CIFG never would have issued the Policies.

6. Not only did Defendants provide CIFG with false data, but they explicitly assured CIFG that it had all of the information it needed to properly model and underwrite the transactions, and to decide whether to insure the Certificates. In fact, as discussed further herein,

Defendants failed to disclose numerous material facts to CIFG, and made affirmative misrepresentations about the quality of the underlying collateral. BAS and BAFC also made false promises concerning the Certificates to CIFG in the transaction documents.

7. CIFG was able to discover only very recently that its risk assessment had been based on false and baseless data. For instance, the falsity of Defendants' representations has been recently revealed by numerous governmental and other investigations—investigations that made public documents (such as internal emails) that were previously hidden from parties such as CIFG. The falsity of Defendants' representations has also been revealed through a forensic analysis of the Mortgage Loans directly at issue (the "2012 Forensic Review"). But the technology enabling that analysis was not available until very recently.

8. CIFG's loan-level analysis has revealed that across all of the Original RMBS, a staggering ***64.37%*** of the Mortgage Loans contained at least one material defect. This means that ***over 31,000*** of the Mortgage Loans underlying the Certificates were materially defective:

Original RMBS	Tranche	Number of Mortgage Loans in the Loan Pool	Percentage of Loans With a Material Defect	Number of Mortgage Loans With a Material Defect
BAFC 2005-06	B1, B2, B3	918	84.88%	779
BAFC 2005-07	2A4, 2B1, 2B2, 2B3	1,002	18.00%	180
BAFC 2005-07	A17	460	75.74%	348
BAFC 2005-07	4A4, XB1, XB2, XB3	354	67.83%	240
BAFC 2005-08	B1, B2, B3	1,051	67.96%	714
BAFC 2006-01	B1, B2, B3	232	48.34%	112
BAFC 2006-01	XB1, XB2, XB3	667	70.60%	471
BAFC 2006-04	B2	519	58.10%	302
BOAA 2005-09	B3	2,566	81.00%	2,078
BOAA 2005-11	B2, B3	2,411	84.25%	2,031
BOAA 2005-12	4A4	118	94.12%	111
BOAA 2006-01	B1, B2, B3	2,258	86.50%	1,953
BOAA 2006-05	B1, B2	2,274	82.63%	1,879
BOAA 2006-06	B1, B2	1,260	84.88%	1,069
BOAMS 2005-09	B2, B3	984	95.38%	939
BOAMS 2005-10	B1, B2, B3	999	94.75%	947

Original RMBS	Tranche	Number of Mortgage Loans in the Loan Pool	Percentage of Loans With a Material Defect	Number of Mortgage Loans With a Material Defect
BOAMS 2005-11	B1, B2, B3	765	93.94%	719
CWALT 2006-17T1	M4	715	44.53%	318
CWALT 2006-21CB	M2, B1	2,551	38.13%	973
CWALT 2006-26CB	M3, M4, B1	1,884	35.00%	659
CWALT 2006-29T1	M1, M3, M4, M5	1,083	47.75%	517
CWALT 2006-J1	B2	2,700	39.25%	1,060
CWHL 2005-29	M, B1, B2	485	51.35%	249
FHAMS 2006-FA4	B2A, B2B, B3A	1,656	50.38%	834
FHAMS 2006-FA5	B2, B3, B4	1,321	47.00%	621

9. These defect rates are likely just the tip of the iceberg—CIFG does not yet have access to the Defendants' loan files or internal documents. Rather, CIFG has been limited in its investigation to what is publicly available. Discovery is likely to uncover additional problems, as only then will CIFG be able to fully test Defendants' other representations, such as those regarding Bank of America's adherence to underwriting guidelines, the income, employment, and housing history verification processes purportedly used, the qualifications of the appraisers, compliance with state laws, FICO score requirements, and other features that all were part of the stated underwriting guidelines.

10. Defendants knew of, or recklessly disregarded, the falsity of the data they fed to CIFG (and the rating agencies). They knew of, or recklessly disregarded, the fact that such data did not reasonably relate to the true nature and risk profile of the securities they induced CIFG to insure. Defendants nonetheless made the misrepresentations to CIFG in order to induce it to issue the Policies—thereby making the Certificates marketable, allowing Defendants to move the risk created by their shoddy practices off their own books.

11. Defendants knew the data was false because they operated at every level in these transactions. BOA was the sole originator and servicer for nine of the Original RMBS, and the

seller/sponsor for fourteen. With one exception, BAS was the underwriter for all of the Original RMBS. BAFC served as the depositor for five. Overall, with one lone exception, at least one Defendant was directly involved in each Original RMBS. Through these various roles, including through their contacts with every possible player in the mortgage space (including mortgage originators, third-party due diligence firms, rating agencies, trustees, and investors), Defendants gained unique and exclusive knowledge about the quality and risk of the Mortgage Loans, and thus knowledge about the value of the Original RMBS.

12. After fraudulently inducing CIFG to enter into Insurance and Indemnification Agreements ("I&I Agreements"), BAS and BAFC then breached these Agreements. BAS and BAFC made specific representations in the I&I Agreements that all of the material they were providing to CIFG was accurate and not misleading. By instead providing false and misleading information, and omitting to provide information necessary to make this information not misleading, BAS and BAFC breached their contracts with CIFG. In addition, BAS and BAFC committed to providing shadow credit ratings for the Certificates. Instead they obtained credit ratings for notional certificates with radically different credit characteristics based on false and misleading information.

13. The dismal performance of the Certificates confirms the efficacy of Defendants' fraudulent scheme. For the R-1 Certificates, CIFG has paid and will be obligated to pay future claims in excess of *$113 million* as a result of losses of *over 93% of the original insured par*. For the R-2 Certificates, CIFG has paid and will be obligated to pay future claims in excess of *$59 million* as a result of losses of *over 98% of the original insured par*. These damages were a direct result of the fraud perpetrated by Defendants and Defendants' breaches of contract, as detailed below.

THE PARTIES

14. CIFG is a New York stock insurance company with its corporate headquarters and principal place of business at 850 Third Avenue, New York, New York 10022.

15. Defendant BOA is a nationally chartered bank with substantial business operations and offices at the Bank of America Tower, One Bryant Park, New York, New York 10036.

16. Defendant MLPF&S is being sued in its capacity as successor-in-interest to BAS. BAS was a Delaware limited liability corporation with its principal place of business in New York, New York. On November 1, 2010, BAS merged into MLPF&S, with MLPF&S as the surviving corporation. MLPF&S is a Delaware corporation and a Securities and Exchange Commission ("SEC")-registered broker-dealer with its principal place of business at 4 World Financial Center, 250 Vesey Street, New York, New York. This merger followed Bank of America Corporation's acquisition in January 2009 of MLPF&S as part of its acquisition of Merrill Lynch & Co. Defendant MLPF&S is liable as a matter of law as successor to BAS by virtue of its status as the surviving entity in its merger with BAS.

17. Defendant BAFC is a Delaware corporation with substantial business operations and offices at the Bank of America Tower, One Bryant Park, New York, New York 10036.

18. At all relevant times, Defendants 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 the corporate 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.

JURISDICTION AND VENUE

19. Jurisdiction is proper pursuant to CPLR §§ 301 and 302. Almost all activity pertaining to the Agreements and Policies at issue occurred in New York. Each of the Defendants maintains offices, derives substantial revenue from, and/or regularly transacts or has transacted business within the State.

20. Venue is proper pursuant to CPLR § 503. CIFG is a resident of New York County, New York.

FACTUAL ALLEGATIONS

I. BACKGROUND ON THE CERTIFICATES

A. The Mechanics of Mortgage Securitization

21. The Original RMBS underlying the Certificates represent interests in a pool of mortgage loans; they are "shares" in the pool that are sold to investors. The RMBS certificates entitle the holder to payments from the pool of mortgages. Although the structure and underlying collateral may vary by offering, the basic principle of RMBS pass-through certificates remains the same: as borrowers make payments on the loans in the mortgage pool, that cash flow is "passed through" to the certificate holders based on their share of the pool.

22. The "sponsor" for the securities (also typically referred to prior to 2006 as the "seller") puts together the RMBS transaction. The sponsor originates the loans or acquires them from other mortgage originators. Then, a "depositor" acquires an inventory of loans from the "sponsor" or "seller." The types of loans in the inventory may vary, but typically include conventional, fixed-rate or adjustable-rate mortgage loans, secured by first liens, junior liens, or a combination of first and junior liens, with various lifetimes to maturity. Upon acquisition, the depositor transfers, or deposits, the acquired pool of loans to an "issuing trust."

23. The issuing trust then "securitizes" the pool of loans so that the rights to the cash flows from the pool can be sold to investors in the form of certificates. The securitization transactions are structured such that the risk of loss is divided among different levels of investment, or "tranches." Any losses on the underlying loans—whether due to default or otherwise—are generally applied in reverse order of seniority. As such, the most senior tranches of certificates receive the highest credit ratings. Junior tranches, being less insulated from risk, typically obtain lower credit ratings, but offer greater potential returns.

24. 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, which prepare offering documents and market and sell the securities to investors.

25. Defendants here went one level beyond the standard RMBS securitization, taking previously securitized RMBS and re-packaging these securities into new structures called Re-REMICs. The securitization process for a Re-REMIC is similar to that of an RMBS. First, a bank or sponsoring entity gathers unsold RMBS held on its books and transfers the pool of RMBS to a depositor. The depositor then "deposits" the RMBS into an issuing trust, which issues securities based on the pool of RMBS, so that the rights to the cash flows from the RMBS (and by consequence from the mortgage loans underlying the RMBS) go to investors, who purchase certificates issued by the Re-REMIC.

26. As with an RMBS securitization, a Re-REMIC transaction is structured so that the risk of loss is divided among tranches. Any losses on the underlying loans in turn cause losses on the underlying RMBS, and those losses in turn are applied to the Re-REMIC certificates, generally in reverse order of seniority.

27. In order to get higher credit ratings for the Re-REMIC certificates, a depositor can secure financial guaranty insurance to "wrap" the certificates. This insurance guarantees the repayment of principal and interest on certain tranches of the Re-REMIC certificates, thus protecting the holder of such certificates against certain losses. The insurance guarantee lowers the risk of losses to the holder of those certificates, allowing them to obtain a higher credit rating and increasing their marketability.

28. Once the tranches are established, the issuing trust passes the Re-REMIC certificates back to the depositor, which becomes the issuer of the securities. The depositor then sells the securities to one or more underwriters (sometimes called the "initial purchaser"), which market and sell the securities to investors. As with RMBS, the underwriter will prepare an offering memorandum describing the attributes of the Re-REMIC certificates and the underlying collateral supporting repayment. The underwriter bears the risk of loss on any securities not sold to investors.

B. The Rise of Mortgage Loan Securitizations

29. Traditionally, mortgage originators financed their mortgage business through customer deposits, retained ownership of the loans they originated, and directly received the mortgage payment streams over the life of the loan. 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 if 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.

30. Mortgage loan securitization, however, shifted the traditional "originate to hold" model to an "originate to distribute" model, in which originators sold residential mortgages and

transferred credit risk to investors through the issuance and sale of RMBS. Under the new model, originators no longer held the mortgage loans to maturity, and therefore were no longer at risk of loss if a mortgage loan did not perform as expected (or as advertised). Instead, by selling the mortgages (in transactions often structured and carried out by investment banks) to trusts, which provided their securities to investors, the originators obtained the funds to make more loans and transferred the risk of loss to the trust and ultimately to investors. Securitization also enabled originators to earn extra income from transaction and loan-servicing fees. In addition, the originators received revenues up front, rather than receiving them slowly over the life of the mortgage loan.

31. The originators' capacity to produce more loans was further expanded as the investment banks responsible for shepherding the loans through the securitization process began offering "warehouse loans." These loans ensured that the originators had sufficient capital to make loans, with the expectation that the loans would then be transferred to the investment bank for it to securitize. This helped ensure that the investment bank had a reliable pipeline of loans to securitize.

32. Thus, the "originate to distribute" model gave originators an incentive to increase the number of mortgages they issued and sold, regardless of credit quality. This is because originators had a reliable source of capital to do so, could earn more fees from the transaction, and could reduce their own risk by getting the loans off their books. However, contractual terms, adherence to solid underwriting standards, and sound business practices obligated originators to underwrite loans in accordance with their stated policies and to obtain accurate appraisals of the mortgaged properties.

33. During the 1980s and 1990s, the mortgage securitization business grew rapidly, allowing mortgage originators to make more loans than would have been possible using only the traditional primary source of funds from deposits. Originators during that 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 generally provided accurate information about the loans, borrowers, and properties to RMBS investors.

C. The Systemic Violation of Underwriting and Related Standards in the Mortgage Securitization Industry

34. Unbeknownst to insurers like CIFG, the game fundamentally changed in the 2000s. While both originators and Wall Street banks, through the 1990s, generally played by the rules and complied with their obligations to underwrite loans responsibly and provide accurate information to RMBS investors and insurers, this ceased to be the case in the following decade.

35. The history of this disastrous change in the market was investigated by the Financial Crisis Inquiry Commission ("FCIC"), created by Section 5 of the Fraud Enforcement and Recovery Act of 2009. The FCIC "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 issued a report in January 2011 (the "FCIC Report"). The FCIC Report concluded that, as a result of the practices of Defendants and other Wall Street banks and participants:

> 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.)

36. 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 increase fees and generate revenue. Investment banks and loan originators 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 higher fees than they would have paid on conforming loans. According to an April 2010 FCIC report, loans that did not conform to Fannie Mae and Freddie Mac underwriting guidelines grew from around $670 billion in 2004 to over $2 trillion in 2006. As discussed above, these transactions were often carried out with capital provided by the investment banks, which would then take the loans and arrange for their securitization.

37. The shift towards non-traditional loans converged with the "originate to distribute" model. Originators, underwriters, and others in the securitization chain were incentivized to pump out as many loans as possible, as long as they could transfer the risk of non-payment to investors. As we now know, the way that many originators—encouraged and financed by Wall Street investment banks—increased mortgage loan volume for non-traditional loan products was to compromise on underwriting and origination standards. Originators and securitizers, like Defendants, were willing to abandon sound underwriting practices and to misrepresent 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.)

38. 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 large transactions. From 2000 through 2008, Wall Street banks learned that they could generate significantly more revenue from arranging and packaging mortgage loans into RMBS, than by only making mortgage loans to borrowers. The securitization business was a gold mine for investment banks able to control significant market share.

39. Underwriters of RMBS offerings like those at issue here typically would collect between 0.2% and 1.5% in discounts, concessions, or commissions. These commissions would have yielded Defendants hundreds of millions of dollars in underwriting fees in connection with the securitizations at issue in this Complaint. By providing warehouse loans and serving as a sponsor and depositor of the offerings, Defendants earned even more. The fees Defendants were receiving for their promised underwriting, diligence, and oversight kept Defendants in the business of acquiring mortgage loans from originators for securitization, even while Defendants were aware that the loans being provided by these originators did not comport with basic underwriting practices. Investment banks such as Defendants profited from their vast knowledge and experience derived from originating and packaging mortgage loans by setting up proprietary trading desks to generate additional revenue by trading RMBS for their own account.

D. Misrepresenting the Loan Features (Including to Insurers) Keeps the System Running

40. Spurred on by the economic incentives behind the originate-to-distribute model, Defendants originated and securitized ever-increasing volumes of residential mortgage loans from 2003 onward. To accomplish this volume growth, Defendants abandoned sound underwriting practices, jettisoned sound quality control practices, ignored warnings from their due diligence processes, and knowingly securitized defective loans.

41. But, because the payment streams from borrowers ultimately fund the repayment to investors, if enough loans in the pool default, investors will not be paid the interest promised and may even lose their principal. And insurance companies providing "wrap" policies would in turn have to cover such losses. Therefore, to accomplish the conflicting goals of increasing volume, while also retaining none of the risk for themselves, Defendants resorted to misrepresenting origination practices and the characteristics of the mortgage loans. Investors would not buy, and insurers would not provide policies covering transactions backed by loans like those securitized by Defendants here if they knew the loans' true risk profile.

42. Thus, as more fully laid out below, Defendants: (1) misrepresented that the original lenders ("Originators") had adhered to a given set of underwriting guidelines; (2) failed to disclose how many defective loans caught by due diligence were being "waived" into the securitization anyway; (3) understated the properties' LTV ratios (suggesting the borrowers had more of an equity "cushion" than they did); (4) overstated how many of the Mortgage Loans were owner-occupied (owner-occupied properties generally have lower risks); (5) omitted that both the original ratings on the RMBS and the shadow ratings on the Certificates were procured through the provision of garbage data to the ratings agencies; and (6) misrepresented the servicing standards that were being applied to the Mortgage Loans.

43. Each of Defendants' misrepresentations and omissions increased the risk profile embedded into the Certificates, and thus into the Policies. Because these misrepresentations were contained in the very data Defendants represented should be used to analyze the Policies, CIFG's Initial Diligence was contaminated by Defendants' fraud. For instance, data such as owner-occupancy and LTV ratios are used by CIFG—and everyone else in the industry—to help gauge risk. They are fundamental features that feed into CIFG's risk models. Defendants'

provision of false statistics—all in the same direction (to make the Mortgage Loans seem less risky)—necessarily directly impacted CIFG's analysis of the risk profile of these transactions.

44. Defendants knew that CIFG would not issue the Policies if it knew the true characteristics of the Mortgage Loans underlying the Certificates, and that CIFG's risk assessment would determine that the Certificates were of suspect creditworthiness. This is why they proceeded to feed CIFG false and baseless data, and why they falsely represented that CIFG had all the information it needed for its Initial Diligence.

E. Defendants Operated on Every Level of the Securitization Process

45. In the years preceding the transactions at issue in this case, Defendants developed a system to extract maximum profits from every step of the mortgage origination and securitization process, and constructed an enterprise to control every step of this process. A significant part of this system was engaging in RMBS securitizations, such as those that created the Original RMBS backing the Certificates, and trading in the securities they created.

46. Each of the Original RMBS transactions involved a multi-step process whereby the Mortgage Loans were (1) originated, (2) warehoused, (3) pooled, (4) offered to investors, (5) traded, and (6) serviced.

47. The following charts demonstrate some of the roles of Defendants in each of the Original RMBS underlying the Certificates:

BAFC 2006-R1

Original RMBS	Originator	Seller / Sponsor	Depositor	Underwriter	Servicer
BAFC 2005-06	Various (Including Washington Mutual Bank ("WaMu") and Wells Fargo Bank, N.A. ("Wells Fargo"))	**BOA**	**BAFC**	**BAS**	Wells Fargo
BAFC 2005-07	Various (Including Wells Fargo)	**BOA**	**BAFC**	**BAS**	Wells Fargo

Original RMBS	Originator	Seller / Sponsor	Depositor	Underwriter	Servicer
BAFC 2005-08	Various (Including WaMu and Wells Fargo)	**BOA**	**BAFC**	**BAS**	Wells Fargo
BAFC 2006-01	Various (Including **BOA**, WaMu and Wells Fargo)	**BOA**	**BAFC**	**BAS**	Wells Fargo
BOAA 2005-09	**BOA**	**BOA**	Banc of America Mortgage Securities, Inc. ("BAMSI")	**BAS**	**BOA**
BOAA 2005-11	**BOA**	**BOA**	BAMSI	**BAS**	**BOA**
BOAA 2005-12	**BOA**	**BOA**	BAMSI	**BAS**	**BOA**
BOAA 2006-01	**BOA**	**BOA**	BAMSI	**BAS**	**BOA**
BOAMS 2005-09	**BOA**	**BOA**	BAMSI	**BAS**	**BOA**
BOAMS 2005-10	**BOA**	**BOA**	BAMSI	**BAS**	**BOA**
BOAMS 2005-11	**BOA**	**BOA**	BAMSI	**BAS**	**BOA**
CWHL 2005-29	Countrywide Home Loans, Inc. ("CWHL")	CWHL	CWMBS, Inc.	**BAS;** Countrywide Securities Corp.	Countrywide Home Loans Servicing, L.P. ("CWHLS")

BAFC 2006-R2

Original RMBS	Originator	Seller / Sponsor	Depositor	Underwriter	Servicer
BAFC 2006-04	Various (including WaMu and Wells Fargo)	**BOA**	**BAFC**	**BAS**	Wells Fargo
BOAA 2006-05	**BOA**	**BOA**	BAMSI	**BAS**	**BOA**
BOAA 2006-06	**BOA**	**BOA**	BAMSI	**BAS**	**BOA**
CWALT 2006-17T1	CWHL	CWHL	CWALT, Inc.	**BAS;** Credit Suisse Securities (USA) LLC	CWHLS
CWALT 2006-21CB	CWHL	CWHL	CWALT, Inc.	**BAS;** Citigroup Global Markets, Inc.	CWHLS
CWALT 2006-26CB	CWHL	CWHL	CWALT, Inc.	**BAS**	CWHLS
CWALT 2006-29T1	CWHL	CWHL	CWALT, Inc.	**BAS;** Barclays Bank PLC	CWHLS
CWALT 2006-J1	CWHL; American Home Mortgage Corp.; First National Bank of Nevada	CWHL	CWALT, Inc.	Countrywide Securities Corp.	CWHLS
FHAMS 2006-FA4	First Horizon Home Loan Corp. ("FHHL")	FHHL	First Horizon Asset Securities, Inc.	**BAS;** UBS Securities LLC	FHHL
FHAMS 2006-FA5	FHHL	FHHL	First Horizon Asset Securities, Inc.	**BAS;** Greenwich Capital Markets, Inc.; FTN Financial Securities, Corp.	FHHL

48. As is clear from the above tables, Defendants dominated nearly every facet of the Original RMBS securitizations and knew of critical facts about the nature and true value of the Original RMBS (and thus the Certificates)—facts that Defendants either hid from, or misrepresented to, CIFG.

49. *Origination*: As originator, BOA knew first-hand that the Mortgage Loans had been approved with a total disregard for proper underwriting standards. In addition to originating loans, BOA purchased some Mortgage Loans for securitization from third parties. In acquiring thousands of Mortgage Loans from third-party originators, BOA conducted its own due diligence on the acquired loans. BOA investigated whether the Mortgage Loans complied with designated underwriting guidelines and qualified for BOA's own acquisition protocols. BOA had direct, first-hand knowledge that other originators, like Countrywide, had systemically abandoned proper underwriting practices.

50. *Warehousing*: After originating or acquiring Mortgage Loans, BOA warehoused them until such time as it possessed enough collateral to proceed to securitization. BOA was at risk for any losses arising during the warehouse period—*i.e.*, if a Mortgage Loan became delinquent or defaulted before it could be securitized, BOA could potentially suffer a loss. BOA thus had a powerful incentive to securitize the Mortgage Loans as quickly as possible. Even though BOA knew, or recklessly disregarded, that many of the warehoused Mortgage Loans were underwritten improperly, tainted by fraud, or not performing, BOA nevertheless chose to include these defective Mortgage Loans in the Original RMBS and not to disclose these facts to investors and insurers like CIFG.

51. *Securitization*: Defendants were each involved in the securitization of the Original RMBS. As such, Defendants: (a) assembled the pools of Mortgage Loans; (b) lined up

the proper entities to act as seller, sponsor, and depositor; (c) conducted due diligence and/or hired third-party experts to examine the loans; (d) secured credit ratings for the securitizations from one or more rating agencies; (e) prepared offering documents describing the mortgage loan pools pursuant to their obligations under the federal securities laws; and (f) marketed the newly-minted Original RMBS to investors.

52. *Offering*: BAS was an underwriter for all of the Original RMBS backing the R-1 Certificates, and all but one of the Original RMBS backing the R-2 Certificates. It was therefore responsible for offering and marketing nearly all of the Original RMBS to investors. The Original RMBS were issued pursuant to registration statements, prospectuses, and prospectus supplements prepared by Defendants and filed with the SEC. Because those documents made numerous representations about the characteristics of the Mortgage Loans underlying the Original RMBS, BAS, as underwriter, was responsible for conducting due diligence on the Mortgage Loans (whether they were originated by BOA or by other lenders, such as Countrywide) to ensure that the Mortgage Loans were originated in accordance with the stated underwriting guidelines. In doing so, BAS gained critical information regarding the characteristics of the Mortgage Loans and knew that BOA and other lenders had originated the Loans in total disregard for stated underwriting guidelines.

53. *Trading*: As underwriter, BAS was obligated to purchase the Original RMBS and market them to institutional investors. Any unsold bonds would remain on its books and BAS would assume the risk of loss. BAS also maintained an active trading desk, through which it bought and sold bonds, including RMBS. Given its role as underwriter and its active participation in secondary RMBS trading, BAS had a pulse on the market and it knew of the problems with the underlying RMBS certificates at issue here. Specifically, BAS knew from

their market contacts (that CIFG, which did not engage in trading, did not have) that these certificates could not be sold without incurring substantial losses and that they were ticking time bombs on BAS's books. When BAS was unable to trade these toxic securities, it came up with a scheme to offload them by re-securitizing them into Certificates insured by CIFG.

54. *Servicing*: Even after some of the Original RMBS had been issued and sold to investors, BOA continued to be involved as a servicer, responsible for collecting homeowners' payments on the Mortgage Loans and remitting these payments to the trustees of the Original RMBS after deducting a monthly servicing fee. The servicers for the Original RMBS have a duty to report any fraudulent activities or other issues that would render a Mortgage Loan ineligible for incorporation in a securities offering. The servicer is required to report key information about the loans to the trustee. BOA failed to discharge diligently its duties as servicer for the Original RMBS, repeatedly failing to exercise its right to remove defective Mortgage Loans from the Original RMBS on behalf of the trust and investors. None of these facts were included in the prospectus supplements because if BOA had informed the market, the rating agencies, or CIFG that they had abandoned prudent servicing practices, the Original RMBS and Certificates would be unsellable (and ultimately uninsurable). Instead, Defendants chose to keep this information to themselves in order to continue the stream of profits.

55. *Securitizing the Re-REMIC*: By 2006, BAS faced a dilemma: It had a growing inventory of unsold RMBS certificates on its books. Yet, Defendants knew that these securities could not be sold as standalone RMBS certificates. To avoid losses on these investments, Defendants devised a scheme to re-package the Original RMBS into Re-REMICs, and to fraudulently induce CIFG to issue financial guaranty insurance covering the resulting Certificates.

56. BAFC served as the depositor for both Re-REMICs at issue, pooling together the unwanted Original RMBS and transferring them to trusts: Banc of America Funding 2006-R1 Trust for the R1 Certificates, and Banc of America Funding 2006-R2 Trust for the R2 Certificates. BAS served as the sponsor/seller, helping to shepherd the deal, procuring shadow credit ratings, and acquiring insurance from CIFG. BAS also served as the underwriter (or "initial purchaser"), performing due diligence, preparing offering memoranda, and marketing the Re-REMIC to investors.

II. <u>DEFENDANTS' MATERIAL MISREPRESENTATIONS</u>

57. As discussed above, CIFG's Initial Diligence included the use of numerous stress tests and other modeling techniques to assess the risk profile and creditworthiness of the Certificates. It also involved a more qualitative review of the data provided to it, and consideration of the other representations that Defendants made. Defendants knew that CIFG did not have access to the underlying loan files, did not have access to the information available to Defendants, and was reliant on Defendants to provide the information required to conduct CIFG's Initial Diligence. Defendants affirmatively represented to CIFG that CIFG was given all the material information needed to assess the riskiness of the Certificates. Defendants purported to do so by providing information in many different forms—but never disclosed that the data being provided was false or that any risk assessment conducted with such data would underestimate the true level of risk embedded in the Certificates. Defendants provided the false data intending to skew the results of CIFG's risk modeling and other analysis, and intending that CIFG underestimate the true risk profile of the Certificates. CIFG would not have issued the Policies if it had known such key risk features as the underwriting guidelines used, occupancy

rates, and LTV ratios were being misrepresented, and that its risk assessment was undermined by inaccurate and misrepresented data.

58. CIFG's Initial Diligence included consideration of information from the Offering Materials for the Original RMBS. The Offering Materials were provided by Defendants with the intent that CIFG would rely on them in making its decision on whether to insure the Certificates. The Offering Materials contained detailed descriptions of the mortgage pools underlying the Certificates, including (but not limited to) the type of loans, the number of loans, the aggregate scheduled principal balance of the loans, the underwriting guidelines purportedly used to originate the loans (and the purported compliance therewith), the purported original LTV ratios, the borrowers' debt-to-income ratios, the property types, owner-occupancy data, and information regarding the geographic concentration of the mortgaged properties.

59. Defendants also gave CIFG term sheets, loan tapes, and other tables, which contained detailed information on the Mortgage Loans underlying the Certificates. The term sheets contain aggregated information for all of the Mortgage Loans underlying the Original RMBS proposed to be included in each Certificate, including aggregate data on the LTV ratios, owner-occupancy status, and delinquency status.

60. The loan tapes are spreadsheets containing data for each Mortgage Loan underlying the Original RMBS. The data contained on these spreadsheets include per-loan LTV ratios, owner-occupancy status, and the city, state, and zip code where the property is located. The loan tapes do not include the street address of the property or anything that would identify the borrower, thus making CIFG all the more dependent on Defendants to accurately describe the characteristics of the properties and borrowers. They also do not include any of the underlying

documents from the loan files. Defendants also gave CIFG other summaries, containing, among other things, the credit ratings of the Original RMBS and the proposed Certificates.

61. Defendants also provided Pooling and Servicing Agreements applicable to the Original RMBS, which contained representations as to the servicing practices employed with respect to the Mortgage Loans.

62. In addition, Defendants made representations to CIFG, both orally and in writing, when CIFG was considering whether to insure the Certificates. Jonathan Hartwig, a Vice President in the Global Structured Finance Group at BAS, and Grant Follansbee and Mahesh Raghavendra, mortgage and RMBS traders for BAS and BOA, were among the individuals who were in frequent communication with CIFG concerning BAFC 2006-R1 and BAFC 2006-R2.

63. ***BAFC 2006-R1.*** On February 21, 2006, Jonathan Hartwig sent CIFG data on the Original RMBS to be included in BAFC 2006-R1. On February 22, 2006, Hartwig sent CIFG loan tapes containing information on the Mortgage Loans that served as collateral for the Original RMBS supporting the R-1 Certificates, the prospectuses and prospectus supplements describing the Original RMBS, and tables showing the credit ratings on the Original RMBS. It is now apparent that much of the loan-level data in the loan tapes sent to CIFG by Hartwig was false, and the credit ratings on the Original RMBS were not indicative of their true credit quality. The specific representations in the prospectuses and prospectus supplements sent to CIFG by Hartwig concerning the origination, underwriting, and servicing of the Mortgage Loans have also been recently revealed as being false.

64. On February 28, 2006, Hartwig emailed CIFG a description of the structure of the proposed transaction, and discussed the credit enhancement, or default protection, built into the Certificates. That same day, Hartwig sent an email to CIFG falsely stating that, "I think you

have all the data you need for your modeling," and pressing CIFG for a decision on whether it would issue the policy. BAS knew or recklessly disregarded that this representation was false. This statement left no doubt that Bank of America intended CIFG to rely on the false information Defendants had provided as the basis for its assessment of the risk profile of the Certificates, and to believe that the information was comprehensive and that no necessary information was missing.

65. As part of its Initial Diligence, CIFG analyzed the data that had been provided in order to assess the risk profile and creditworthiness of the Certificates. And, on March 2, 2006, after repeated inquiries by BOA's trading desk, CIFG provided a preliminary (or "indicative") pricing estimate for the proposed transaction.

66. From March through May 2006, as part of its risk assessment and credit underwriting process, CIFG communicated with Defendants regarding the structure and composition of the R-1 Certificates. On March 31, 2006, Follansbee provided CIFG with another collateral summary on the Mortgage Loans that would back the R-1 Certificates, intending that CIFG formulate its risk assessment based on the information provided.

67. Throughout this period, Defendants were also in close contact with the credit rating agencies and CIFG concerning the ratings to be assigned to the R-1 Certificates. For example, on April 13, 2006, Follansbee sent CIFG a spreadsheet showing the ratings each tranche of the Certificates would receive from Fitch and Moody's. Defendants subsequently sent several updated versions of this table prior to the closing of the deal on May 31, 2006. They also obtained and provided to CIFG a "shadow credit rating" letter from Moody's, which stated what the credit rating on the Certificates would be without CIFG's insurance. While the letter is dated May 31, 2006 (the day the deal closed), Defendants discussed the rating and made

representations to CIFG about it well in advance of closing. Defendants knew that CIFG's risk assessment, underwriting process, and willingness to insure the Certificates was conditioned on issuance of these shadow credit ratings. Without them, CIFG would have been unable to issue the policy. Defendants knew that obtaining and providing to CIFG false shadow ratings was necessary to assure CIFG that the risk profile of the Certificates was low, and to further their scheme to induce the issuance of the Policies.

68. ***BAFC 2006-R2.*** Less than two months after the 2006-R1 deal closed, Defendants solicited CIFG to issue a financial guaranty policy covering a second Re-REMIC transaction. This second transaction followed a similar trajectory to the first. On July 14, 2006, Hartwig sent CIFG loan tapes, prospectuses, prospectus supplements, credit rating information, and other tables and summaries, including the credit ratings applicable to the Original RMBS, for CIFG's Initial Diligence. On July 21, CIFG and representatives of Defendants had a conference call to discuss pricing. On July 24, Hartwig sent an additional loan tape to CIFG. On July 26, Raghavendra sent additional loan tapes relating to the relevant Mortgage Loans. Based on the information provided by Defendants, CIFG conducted its rigorous credit analysis and agreed to insure the R-2 Certificates. The transaction closed on or around October 31, 2006.

A. Defendants' Misrepresentations Regarding Loan Underwriting Standards and Practices

69. The prospectuses and prospectus supplements for each of the Original RMBS state that the Mortgage Loans were originated in accordance with the prudent underwriting guidelines described in those documents. Originating loans in accordance with the specified underwriting standards is crucial because good underwriting ensures that borrowers are able to repay the principal and interest on the Mortgage Loans, and that the collateral is sufficient to support the Loans. CIFG's due diligence and risk assessment was based on the assumption that

the Mortgage Loans were originated in accordance with the stated guidelines. CIFG considered mortgage loans originated without regard to the applicable guidelines to be more likely to default, and therefore the risk profile of securities backed by defectively originated mortgage loans would be significantly higher.

70. Defendants' representations regarding loan underwriting standards and practices pertaining to the Mortgage Loans are excerpted in Exhibits C-X, which are incorporated herein by reference. For example, the Prospectus for FHAMS 2006-4 stated that:

> All of the mortgage loans have been originated generally in accordance with the following underwriting guidelines . . . [that] are applied to evaluate the prospective borrower's credit standing and repayment ability and the value and adequacy of the mortgaged property as collateral.

(FHAMS 2006-4 Prospectus Supplement at S-30.) Similarly, the Prospectus for CWHL 2005-2 stated that "[a]ll of the mortgage loans in the trust fund will have been originated or acquired by Countrywide Home Loans in accordance with its credit, appraisal and underwriting standards." (CWHL 2005-2 Prospectus Supplement at S-22.)

71. Even when loans were acquired from a third-party originator, Defendants represented that the third-party sellers had applied underwriting guidelines consistent with the general guidelines described in the Prospectus and that any material differences would be described in the Prospectus Supplement. For example, the Prospectus Supplement for BAFC 2005-06 provided details on the underwriting standards applied by the three major originators whose loans were included in that offering. (*Id.* at S-40-42 (RFC), S-43 (WaMu), and S-44-45 (Wells Fargo).)

72. Where the third-party originator had material differences in their underwriting guidelines, the Prospectus Supplement generally explained those guidelines. For example, in BAFC 2005-08, the Prospectus Supplement contained information about the underwriting

guidelines for GMAC Mortgage Corp., Sun Trust Mortgage, Inc., Washington Mutual, and Wells Fargo Bank. (BAFC 2005-08 Prospectus Supplement at S-54-58.)

73. Defendants further represented that any "exceptions" to the stated underwriting standards were made on a case-by-case basis, and only when "compensating factors" were present that made up for the risks created by the loan otherwise being outside the guidelines. For instance, the Offering Materials for BOAMS 2005-10 represented: "A Mortgage Loan may be considered to comply with a set of underwriting standards, even if one or more specific criteria included in such underwriting standards were not satisfied, *if other factors compensated for the criteria that were not satisfied* or the Mortgage Loan is considered to be in substantial compliance with the underwriting standards." (BOAMS 2005-10 Prospectus at 22.) Similarly, the Offering Materials for CWALT 2006-J1 represented: "Exceptions to Countrywide Home Loans' underwriting guidelines may be made *if compensating factors are demonstrated by a prospective borrower*." (CWALT 2006-J1 Prospectus Supplement at S-58.)

74. Even the loans generated pursuant to "alternative" programs were represented to meet specific standards. For example, the Prospectus Supplement for BOAA 2005-09 provided that all of the loans were "originated using Bank of America's 'Alternative A' underwriting guidelines." (BOAA 2005-09 Prospectus Supplement at 21.)

75. Defendants also represented that, under Bank of America's own "alternative" underwriting programs, compensating factors were required to be met. For example, the Prospectus for BOAA 2005-09 provided that the Stated Income Program was limited to borrowers with a "strong credit and asset base," "steady employment," and either "complex sources of income" or "rapidly expanding incomes." It also was purportedly limited to applicants with a minimum credit score and two years of continuous employment with the same

employer or in the same line of work. Further safeguards required "[a] verbal certification of employment confirming the applicant's date of employment, job status and title". (BOAA 2005-09 Prospectus at 26-27.)

76. The Offering Materials for each Original RMBS contain substantially similar, or identical, statements of material fact concerning adherence to specific underwriting standards and practices applied to the Mortgage Loans, including the use of exceptions only on a case-by-case basis, based on a demonstration of compensating factors. These statements are excerpted in Exhibits C-X.

77. Defendants' misrepresentations concerning the underwriting standards were highly material to CIFG. Proper mortgage loan underwriting is a fundamental component in assessing the credit risk—and, ultimately, the potential losses—that are associated with mortgages. Proper underwriting helps minimize the risk to investors and insurers that borrowers will default on mortgages. Minimizing borrower defaults is critical because each borrower default negatively impacts the flow of payments to the investors in the Original RMBS and, ultimately, to the investors in the Certificates. A mortgage loan pool consisting of improperly originated mortgage loans has a much different risk profile than a pool of properly originated loans. Because CIFG is obligated to cover losses to investors based on payment shortfalls, defective mortgage loan underwriting has a direct and material impact on CIFG.

78. Defendants' misrepresentations concerning adherence to stated underwriting guidelines thus hid the fact that the Certificates had a much higher risk profile than represented. This induced CIFG to issue Policies based on its misguided belief that its Initial Diligence was predicated on accurate data. Had CIFG known that Defendants' representations were false, that its extensive Initial Diligence was based on Defendants' sham data, and that the risk profile of

the Certificates was significantly higher than could have been determined through its risk underwriting process, CIFG never would have issued the Policies.

B. Defendants' Misrepresentations Regarding Due Diligence Results

79. Defendants' representations regarding the underwriting process were understood reasonably by CIFG to mean that Defendants had taken appropriate measures and had sufficient controls in place to ensure non-compliant loans would not be included in the mortgage pools underlying the Original RMBS, and ultimately, the Certificates. In addition, Defendants affirmatively represented that they had conducted reviews of samples of the Mortgage Loans to determine whether they complied with the stated underwriting standards or whether compensating factors existed. For example, the BAFC 2006-4 Prospectus stated that BOA "conducts a post-purchase review of a sampling of all mortgage loans acquired from another lender to determine whether agreed upon requirements were met." (BAFC 2006-4 Prospectus Supplement at S-36; *see also* Exhibits C-X.) Similarly, the FHAMS 2006-FA4 Prospectus stated that First Horizon would perform "sample quality assurance reviews to determine whether the mortgage loans in any mortgage pool were underwritten in accordance with applicable standards." (FHAMS 2006-FA4 Prospectus at 34.) The same was true on the Original RMBS involving Countrywide, where the Prospectus stated that Countrywide, when acquiring loans from a correspondent lender, "conducts a quality control review of a sample of the mortgage loans." (CWALT 2006-J1 Prospectus Supplement at S-57.)

80. Defendants, however, did not disclose that: (a) when Defendants learned through their quality review process that a substantial percentage of loans in the collateral pools did not meet the stated guidelines and did not have any "compensating factors," they nonetheless "waived" the defects as to a significant percentage of the loans; (b) Defendants used their analysis of the loans to negotiate a lower price for the loan pools, or even an outright cash

payment from the third-party originator, while retaining the defective loans for inclusion in the loan pools and without passing along any of the discounts meant to compensate for the defects; and (c) Defendants improperly failed to adjust their due diligence procedures (such as by increasing their sampling size or refusing to continue to work with problem originators) when their due diligence identified a high number of non-compliant loans. These fraudulent misstatements and omissions rendered misleading many of Defendants other affirmative misrepresentations, such as those regarding the Originators' adherence to the stated underwriting guidelines.

81. Had CIFG known the truth about Defendants' "due diligence" processes, and that the Certificates had a significantly higher risk profile because of such diligence failures, it never would have issued the Policies.

C. <u>Defendants' Misrepresentations Regarding Loan-to-Value Ratios and the Appraisal Process</u>

82. The LTV ratio is the ratio of a mortgage loan's original principal balance to the appraised value of the mortgaged property. LTV ratios are a standard industry measurement of the borrower's equity in a property, and are a critical indicator of the borrower's ability to afford and repay the loan. Loans with an LTV ratio greater than 100% are loans where the borrower is underwater (*i.e.*, has "negative equity" in the home). In such circumstances, the likelihood of default is dramatically increased because a borrower with negative equity may be much more likely to engage in a "strategic default"—*i.e.*, to walk away from the mortgage debt and home, despite the fact that the borrower may have the financial ability to continue to repay the loan. For the same reason, loans where the borrower has less than 20% equity are more likely to default than loans where the borrower's equity is at least 20% or greater. A borrower with 20%

equity in the home has more "skin in the game," and is therefore less likely to default than a borrower with less than 20% equity.

83. In addition, borrowers who do not have available cash for a down payment, and who therefore have less equity in their properties, are also more likely to have less cash available for interest and principal payments during the life of the loan. LTV ratios also relate to the amount of the loan that could be expected to be recovered in the event of a foreclosure. For these reasons, Defendants provided CIFG with LTV statistics to use as a basis for its modeling to assess the risk profile of the Certificates, as part of its Initial Diligence.

84. The Offering Materials presented detailed LTV ratio data for the Mortgage Loans, including the number of Mortgage Loans within specified ranges and a weighted-average LTV ratio. Defendants also stated that there were maximum LTV ratios, based on the relevant underwriting guidelines and documentation program used. It was typically represented that no Mortgage Loan had an LTV ratio above 100%. These representations are excerpted in Exhibits C-X.

85. Importantly, the Offering Materials omitted to state that the appraised values used to calculate LTV ratios were inflated because of the intense pressure Defendants placed on appraisers in order to increase origination volume, and that Defendants did not genuinely believe the appraisal values used to calculate the LTV ratios. As discussed in detail below, CIFG's 2012 Forensic Review has demonstrated that the LTV ratios were materially understated in each of the Original RMBS.

86. The prospectus supplement for each Original RMBS also describes the valuation methods purportedly employed by appraisers to arrive at appraised values for the mortgaged properties. These appraised values were used to calculate the LTV ratio data. For example, the

Prospectus for BOAMS 2005-09 claimed that "[t]o determine the adequacy of the mortgaged property as collateral, generally an independent appraisal is made of each mortgaged property considered for financing . . . The evaluation is based on the appraiser's estimate of value, giving appropriate weight to both the market value of comparable housing, as well as the cost of replacing the mortgaged property." (BOAMS 2005-09 Prospectus at 25.) These representations for each Original RMBS are excerpted in Exhibits C-X.

87. Defendants knew, contrary to their representations, that the appraisals used in the Offering Materials were not generated in accordance with the procedures described therein. Instead, valuations were inflated to meet the value that was needed to get the loan approved. Defendants, appraisers, and originators thus knew that the LTV ratios were not reasonable indicators of the riskiness of the Mortgage Loans, and thus knew that the information on the loan tapes was false.

88. CIFG's credit analysis relied on the purported accuracy of the LTV ratios and other information provided by Defendants in assessing the risk of the Certificates. Defendants understood these facts and intended that CIFG would rely on this information to assess the creditworthiness of the Certificates and determine whether to issue the Policies. Had CIFG known that these representations were false, and that its extensive Initial Diligence was thus based on sham numbers, it never would have issued the Policies.

D. Defendants' Misrepresentations Regarding Owner-Occupancy Statistics

89. The Offering Materials for the Original RMBS made very specific representations about the purportedly high number of owner-occupied properties being included in the loan pools. These representations were provided to CIFG to use as a basis for its modeling to assess the risk profile of the Certificates, as part of its Initial Diligence. For example, the Prospectus Supplement for BOAMS 2005-09 specified that of the 984 loans included in the security, 900

were used as the primary residence of the borrower. (BOAMS 2005-09 Prospectus Supplement at S-48.) These statistical representations of fact for each Original RMBS are further excerpted in Exhibits C-X.

90. Owner-occupancy statistics concerning the Mortgage Loans were material to CIFG because they form part of the basis for CIFG's assessment and modeling of the risk profile of the transactions. Homeowners who reside in mortgaged properties are less likely to default than owners of investment properties or vacation homes. Variations in owner-occupancy rates materially change the risk profile of a transaction

91. As set forth below, CIFG now knows (although it did not know, and could not have known, at the time) that these representations were false and misleading. In truth, a much lower percentage of the Loans were owner-occupied. Occupancy was misrepresented: (i) to get the borrower approved for the loan; (ii) to investors to sell the Original RMBS; (iii) to the rating agencies to obtain misleading shadow ratings; and finally again (iv) to CIFG to provide insurance for the Certificates. Had CIFG known that these representations were false, that its extensive Initial Diligence was based on sham numbers, and that its risk assessment therefore underestimated the creditworthiness of the Certificates, CIFG never would have issued the Policies.

E. Defendants' Misrepresentations Regarding Transfer of Title

92. A fundamental step in the mortgage securitization process is the transfer of title to the mortgage loans that collateralize each securitization. Title is transferred from the loan originator, 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.

93. 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 Pooling and Servicing Agreements ("PSAs"), which are contracts that govern the administration of RMBS trusts, require the promissory note and security instrument to be transferred by sale or by endorsement, in the same way that a check can be transferred by endorsement. 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.

94. Defendants represented to CIFG in the Offering Materials that they would properly transfer title to the Mortgage Loans to each Trust. For example, in the PSA for BOAA 2005-9, Defendants represented that:

> The Depositor concurrently with the execution and delivery hereof, hereby sells, transfers, assigns, sets over and otherwise conveys to the Trustee on behalf of the Trust for the benefit of the Certificateholders, without recourse, all the right, title and interest of the Depositor in and to the Mortgage Loans, including all interest and principal received on or with respect to the Mortgage Loans.

(BOAA 2005-9 PSA, July 28, 2005, at § 2.01(a).) The Offering Materials and/or PSAs for each of the Original RMBS had the same or similar representations.

95. Defendants 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 Prospectus Supplement for BOAMS 2005-9 , Defendants stated:

> In connection with the transfer and assignment of the Mortgage Loans to the Trustee, the Depositor will deliver or cause to be delivered to the Trustee, or a custodian for the Trustee, among other things, with respect to each Mortgage Loan (collectively, the "Mortgage File"): the original Mortgage Note endorsed without recourse in blank or to the order of the Trustee (or its nominee) or an affidavit signed by an officer of the Seller certifying that the related original Mortgage Note has been lost; the original or a certified copy of the Mortgage with evidence of recording indicated thereon (except for any Mortgage not returned from the public recording office, which will be delivered to the

> Trustee as soon as the same is available to the Depositor); except as described below, an assignment in recordable form of the Mortgage (or a copy, if such assignment has been submitted for recording); and if applicable, any riders or modifications to such Mortgage Note and Mortgage.

(BOAMS 2005-9 Prospectus Supplement, Sept. 26, 2005, at S-53). The Offering Materials and/or PSAs for each of the Original RMBS had the same or similar representations.

96. PSAs generally require the transfers of mortgage loans to the trust to be completed within a strict time limit after formation of the trust in order to ensure that the trust is properly formed. For example, the PSA for BAFC 2006-4 represented that Defendants would transfer the Mortgage Loans and deliver the Mortgage Loan files to the trustee "[c]oncurrently with the execution and delivery hereof." (BAFC 2006-4 PSA, June 29, 2006, at § 2.01.) The PSAs and/or Offering Materials for each of the Original RMBS had the same or similar representations.

97. 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.

98. Defendants also represented to CIFG that each Mortgage Loan reflected a valid lien, such that the Trust could foreclose upon the mortgage in the event of a borrower's default. For example, the Prospectus for CWALT 2006-J1 represented that "each mortgage loan is secured by a valid first lien on, or a first perfected security interest with respect to, the mortgaged property." (CWALT 2006-J1 Prospectus, Jan. 25, 2006, at 27.) The PSAs and/or Offering Materials for each of the Original RMBS had the same or similar representations.

99. The Offering Materials noted that, in some cases, the depositor may record mortgages "in the name of Mortgage Electronic Registration Systems, Inc. ('MERS')" rather

than assigning them directly to the trustee. (BOAA 2006-5 Prospectus, May 23, 2006, at 83.) Nonetheless, Defendants assured investors and insurers like CIFG 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 BOAA 2006-5 Prospectus Supplement states that, "[i]f a Mortgage has been recorded in the name of MERS or its designee . . . the Servicer will be required to take all actions as are necessary to cause the Trust to be shown as the owner of the related Mortgage Loan on the records of MERS for purposes of the system of recording transfers of beneficial ownership of mortgages maintained by MERS." (*Id.*) The Offering Materials for many of the Original RMBS had the same or similar representation.

100. Defendants knew that the assignments of title to the underlying Mortgage Loans would not and did not follow the process disclosed in the Offering Materials. Many of the titles were never assigned to either the Trusts or to MERS—and many of those that have been nominally so assigned are defective, given the title chain is missing key intervening assignments. Given transfer of title is a fundamental part of the securitization process, this was a material omission. But it also rendered affirmatively false many of Defendants' representations above. For instance, the assignments were often incomplete and did not result in the Trusts possessing "all the right, title and interest of the Depositor in and to the Mortgage Loans." (BOAA 2005-9 PSA, July 28, 2005, at § 2.01(a).) This is confirmed by a loan-level analysis of the specific Mortgage Loans at issue here and other facts, as set forth below.

F. <u>Defendants' Misrepresentations Regarding Credit Ratings</u>

101. Credit ratings were assigned to both the Original RMBS and the Certificates by the three major credit rating agencies, S&P, Moody's, and Fitch. Each credit rating agency uses its own scale with letter designations to designate various levels of risk. In general, AAA ratings are at the top of the credit rating scale and are intended to designate the safest investments. C

and D ratings are at the bottom of the scale and refer to investments that are currently in default and exhibit little or no prospect for recovery. RMBS with credit ratings between AAA through BBB- were generally referred to as "investment grade."

102. For almost a hundred years, investors like pension funds, municipalities, insurance companies, and university endowments have relied heavily on credit ratings to assist them in assessing the riskiness of a security and the likelihood of repayment. In addition, a variety of U.S. statutes and regulations explicitly reference and are keyed off credit ratings, lending credibility to the credit ratings process. For example, the amount of risk-based capital that a bank may hold is determined in part by the credit ratings of its investments. Some investors, like pension funds, are prohibited from buying assets that are below investment grade. It would have been virtually impossible for Defendants to market the Original RMBS and the Certificates without securing a credit rating.

103. Credit ratings were one of many important risk assessment tools relied on by CIFG, and CIFG required a minimum shadow rating of BBB- as a condition of issuing its policies. Defendants fully understood the importance of credit ratings and shadow ratings to CIFG. In fact, Defendants knew that CIFG would rely on the credit ratings of the Original RMBS, as well as the shadow ratings of the Certificates, to validate its own assessment of the risk related to the Certificates.

104. Defendants represented that the credit ratings would reflect the agencies' analysis of the loans actually backing the Certificates. For instance, the Offering Materials for BOAMS 2005-10 represented that "[r]atings on the pass-through certificates address the likelihood of receipt by certificateholders of payments required under the Pooling Agreement. Moody's, S&P's, and Fitch's ratings take into consideration the credit quality of the Mortgage Pool . . ."

(BOAMS 2005-10 Prospectus Supplement at S-108.) In other words, Defendants represented that the provided ratings would reflect the judgment of the rating agencies as applied to the factual aspects of the Mortgage Loans and Certificates that would be actually delivered.

105. Eventually, each tranche of the Original RMBS did receive a credit rating, and each tranche of the Certificates at issue received a credit rating, purportedly reflecting the rating agencies' assessment of its risk profile. In addition, in the course of putting together each Re-REMIC, Defendants obtained and provided to CIFG "shadow ratings," showing the credit ratings that would be given to the Certificates in the absence of CIFG's bond insurance.

106. Unbeknownst to CIFG, Defendants had deliberately fed the rating agencies baseless and false statistics regarding the Mortgage Loans (including the same statistics and other representations discussed herein). This made Defendants' representations regarding the functioning of the ratings process false, as the credit ratings did not reflect the agencies' judgment of the risks actually presented by the Mortgage Loans, Original RMBS, or Certificates at all—but rather, their judgment as applied to a hypothetical set of loans, RMBS, and certificates with features far different from what was CIFG was induced to insure. It also means that Defendants did not genuinely believe that the original or shadow credit ratings reflected the actual risk of the Original RMBS or the Certificates. Had CIFG known that the credit ratings had been procured through the use of sham numbers, and therefore did not accurately reflect the creditworthiness of the Original RMBS or the Certificates, it never would have issued the Policies.

G. Defendants' Misrepresentations Regarding Servicing

107. In inducing CIFG to issue the Policies, Defendants also provided to CIFG the Pooling and Servicing Agreements ("PSAs") governing the Original RMBS. The PSAs, the prospectuses, and the prospectus supplements contain numerous representations related to the

servicing of the Mortgage Loans backing the Original RMBS and the Certificates, including representations that the Mortgage Loans will be serviced in compliance with the applicable PSAs. These representations are excerpted for each Original RMBS in Exhibits C-X.

108. Many of the PSAs state the following, in these or substantially similar terms:

> Servicer shall service and administer the Mortgage Loans, all in accordance with the terms of this Agreement, Customary Servicing Procedures, applicable law and the terms of the Mortgage Note.

109. "Customary Servicing Procedures" are defined in many of the PSAs as follows, or in substantially similar terms:

> [P]rocedures (including collection procedures) that the Servicer customarily employs and exercises in servicing and administering mortgage loans for its own account and which are in accordance with accepted mortgage servicing practices of prudent lending institutions servicing mortgage loans.

110. It is now clear that the underlying Mortgage Loans were not only improperly originated, but were poorly serviced without regard for reasonable servicing standards. BOA—as the servicer for nine of the Original RMBS—had unique insight into the servicing of the Mortgage Loans, but it failed to disclose the myriad servicing problems to CIFG. Defendants fully understood that whether or not the Mortgage Loans were being properly serviced was important to CIFG. Whether payments on the Mortgage Loans were being collected on a timely basis, and whether rights and remedies were being adequately pursued, affected the creditworthiness of the Original RMBS and the Certificates. Defendants provided the PSAs to CIFG in order to create the appearance that they were properly servicing the Mortgage Loans. However, these representations too were false and part of Defendants' scheme to fraudulently induce CIFG to issue the Policies.

111. Had CIFG known that the servicers were not properly servicing the Loans, and that the risk profile of the Certificates was greatly increased due to improper servicing, it would

never have issued the Policies. Servicing failures greatly increase the risks of losses on the Mortgage Loans (and thus, greatly increase CIFG's exposure on the Policies), given the Servicer's role is to: (a) protect the interests of the trust, the investors and the guarantor by ensuring that the payments on the mortgage loans are made in a timely fashion; (b) attempt to remedy any defective mortgage loan; and (c) work with borrowers to cure delinquencies and defaults. A failure to properly service loans can significantly affect the payment streams received by the trusts, thereby triggering CIFG's insurance coverage unnecessarily.

III. EVIDENCE THAT DEFENDANTS' REPRESENTATIONS TO CIFG WERE FALSE

112. Defendants' representations and omissions regarding compliance with underwriting standards and practices, due diligence results, owner-occupancy statistics, appraisal procedures, LTV ratios, loan servicing, transfers of title, and credit ratings were all untrue. The falsity of these representations and omissions is demonstrated by the high default rates of the Mortgage Loans, the plummeting credit ratings of the Original RMBS and the Certificates, the results of CIFG's 2012 Forensic Review, evidence highlighting the loan originators' abandonment of underwriting standards, the results of third-party due diligence, and evidence that Defendants engineered inflated credit ratings for both the Original RMBS and the Certificates.

A. High Default Rates of the Mortgage Loans and Plummeting Credit Ratings of the Original RMBS and the Certificates

113. The extremely high default rates of the Mortgage Loans and the decline in the credit ratings of the Original RMBS to below investment grade are themselves cogent evidence of Defendants' misrepresentation of the quality of the Mortgage Loans underlying the Certificates.

114. The Certificates have already experienced payment problems significantly beyond what was expected for certificates backed by loan pools that were properly underwritten, and which contained loans that actually had the characteristics Defendants' claimed. These payment issues are exponentially greater than what any reasonable financial risk assessment would have predicted using the data available at the time—because that data (provided by Defendants) did not reflect the true characteristics of the Mortgage Loans. For example, across all of the Original RMBS, ***19.78%,*** of the relevant Mortgage Loans have had to be written off for a loss or are currently delinquent. And in CWALT 2006-17T1 and CWALT 2006-29T1, an astounding ***40%*** and ***39.52%*** respectively, of the relevant Mortgage Loans have had to be written off for a loss or are currently delinquent. Of the Mortgage Loans that are currently active, ***21.04%*** are delinquent. Such performance problems are seen across all of the Original RMBS—and, given the similarly high current delinquency rates, only promise to get worse:

Original RMBS	Tranche(s)	Written Off or Delinquent Loans as a Percentage of Original Pool	Currently Delinquent Loans, as Percentage of Remaining Pool
BAFC 2005-06	B1, B2, B3	9.69%	12.20%
BAFC 2005-07	2A4, 2B1, 2B2, 2B3	10.38%	10.48%
BAFC 2005-07	A17	7.61%	10.00%
BAFC 2005-07	4A4, XB1, XB2, XB3	7.34%	8.80%
BAFC 2005-08	3A5	11.39%	14.81%
BAFC 2005-08	B1, B2, B3	11.42%	13.90%
BAFC 2006-01	B1, B2, B3	10.78%	11.82%
BAFC 2006-01	XB1, XB2, XB3	10.04%	9.92%
BAFC 2006-04	B2	23.51%	23.90%
BOAA 2005-09	B3	12.63%	13.58%
BOAA 2005-11	4A4	23.44%	26.53%
BOAA 2005-11	B2, B3	16.51%	16.62%
BOAA 2005-12	4A4	22.03%	26.47%
BOAA 2006-01	B1, B2, B3	16.87%	17.47%
BOAA 2006-05	B1, B2	23.04%	24.71%
BOAA 2006-06	B1, B2	24.05%	25.28%
BOAMS 2005-09	B2, B3	5.59%	9.70%
BOAMS 2005-10	B1, B2, B3	9.31%	13.30%
BOAMS 2005-11	B1, B2, B3	10.59%	15.53%

Original RMBS	Tranche(s)	Written Off or Delinquent Loans as a Percentage of Original Pool	Currently Delinquent Loans, as Percentage of Remaining Pool
CWALT 2006-17T1	M4	40.00%	36.42%
CWALT 2006-21CB	M2, B1	23.48%	26.39%
CWALT 2006-26CB	M3, M4, B1	32.22%	34.44%
CWALT 2006-29T1	M1, M3, M4, M5	39.52%	40.43%
CWALT 2006-J1	B2	26.01%	27.07%
CWHL 2005-29	M, B1, B2	22.27%	24.60%
FHAMS 2006-FA4	B2A, B2B, B3A	20.83%	20.18%
FHAMS 2006-FA5	B2, B3, B4	22.10%	21.56%

115. Not only have the Mortgage Loans experienced extraordinary rates of delinquency and default, but the ratings of the Original RMBS supported by them have significantly deteriorated. All of the Original RMBS received investment grade ratings at issuance and maintained these ratings at the time CIFG decided to issue the Policies and enter into the I&I Agreements. Predominantly because of the high delinquency, foreclosure, and default rates of the underlying Mortgage Loans, the ratings given to the Original RMBS have been significantly downgraded. None are now rated as investment grade. The following table illustrates how the Original RMBS underlying the Certificates have been drastically downgraded:

Original RMBS	Tranche	Ratings at Issuance (S&P/Moody's/Fitch)	Current Ratings (S&P/Moody's/Fitch)
BAFC 2005-06	B1	-/-/AA	-/-/C
	B2	-/-/A	-/-/D
	B3	-/-/BBB	-/-/D
BAFC 2005-07	2A4	-/Aa1/AAA	-/Caa3/CCC
	2B1	-/Aa2/-	-/C/-
	2B2	-/A2/-	-/C/-
	2B3	-/Baa2/-	-/C/-
	3A17	-/Aa1/AAA	-/Caa3/B
	4A4	-/Aa1/AAA	-/Ca/BB
	XB1	-/-/AA	-/-/C
	XB2	-/-/A	-/-/D
	XB3	-/-/BBB	-/-/D
BAFC 2005-08	3A5	AAA/-/AAA	CCC/-/CCC

Original RMBS	Tranche	Ratings at Issuance (S&P/Moody's/Fitch)	Current Ratings (S&P/Moody's/Fitch)
	B1	-/-/AA	-/-/D
	B2	-/-/A	-/-/D
	B3	-/-/BBB	-/-/D
BAFC 2006-01	B1	-/-/AA	-/-/D
	B2	-/-/A	-/-/D
	B3	-/-/BBB	-/-/D
	XB1	-/-/AA	-/-/D
	XB2	-/-/A	-/-/D
	XB3	-/-/BBB	-/-/D
BAFC 2006-04	B2	A/-/-	D/-/-
BOAA 2005-09	B3	-/-/BBB	-/-/D
BOAA 2005-11	4A4	-/Aa1/AAA	-/C/C
	B2	-/A2/A	-/C/D
	B3	-/Baa2/BBB	-/WR/D
BOAA 2005-12	4A4	-/Aaa/AAA	-/C/C
BOAA 2006-01	B1	-/-/AA	-/-/D
	B2	-/-/A	-/-/D
	B3	-/-/BBB	-/-/D
BOAA 2006-05	B1	-/Aa3/AA	-/C/D
	B2	-/A3/A	-/C/D
BOAA 2006-06	B1	-/-/AA	-/-/D
	B2	-/-/A	-/-/D
BOAMS 2005-09	B2	A/-/-	CC/-/-
	B3	BBB/Baa2/-	D/C/-
BOAMS 2005-10	B1	-/-/AA	-/-/C
	B2	-/-/A	-/-/D
	B3	-/-/BBB	-/-/D
BOAMS 2005-11	B1	-/-/AA	-/-/C
	B2	-/-/A	-/-/D
	B3	-/-/BBB	-/-/D
CWALT 2006-17T1	M4	-/-/A	-/-/D
CWALT 2006-21CB	M2	A-/A3/A	D/WR/D
	B1	BBB/Baa2/BBB+	D/C/D
CWALT 2006-26CB	M3	A/A2/A+	D/C/D
	M4	-/-/A	-/-/D
	B1	BBB/Baa2/BBB+	D/C/D
CWALT 2006-29T1	M1	AA-/Aa3/AA+	D/C/D
	M3	A-/A3/A+	D/C/D
	M4	-/-/A	-/-/D
	M5	BBB/Baa2/A-	D/C/D
CWALT 2006-J1	B2	BBB/Baa3/-	D/C/-
CWHL 2005-29	M	-/-/AA	-/-/D
	B1	-/-/A	-/-/D
	B2	-/-/BBB	-/-/D
FHAMS 2006-FA4	B2A	AA-/A1/AA-	D/C/D
	B2B	A/A3/A	D/C/D
	B3A	BBB+/Baa2/BBB+	D/C/D
FHAMS 2006-FA5	B2	-/-/AA	-/-/D
	B3	-/-/A	-/-/D
	B4	-/-/BBB+	-/-/D

116. Similarly, the ratings on the Certificates themselves have been drastically downgraded since issuance. In both deals, all of the insured Certificates were given AAA ratings, the highest rating possible, by all three credit ratings agencies. Yet, the Certificates are now rated as C or CC, below investment grade.

117. The economic downturn cannot explain the abnormally high percentage of defaults, foreclosures, and delinquencies observed in the loan pools ultimately backing the Certificates. Loan pools that were properly underwritten and containing loans with the represented characteristics would have experienced substantially fewer payment problems and substantially lower percentages of defaults, foreclosures, and delinquencies. The significant rating downgrades experienced by the Certificates and Original RMBS are also strong evidence that they were improperly underwritten, and that they did not have the credit risk characteristics Defendants claimed. The defaults are due to Defendants' wrongdoing, and not because of a shift in the economy.

B. CIFG's 2012 Forensic Review, Using Techniques and Databases Not Available at the Time the Policies Were Issued

118. Although CIFG still does not have access to the loan files for the Mortgage Loans, CIFG was recently able to test certain of Defendants' representations regarding the Mortgage Loans (the "2012 Forensic Review"). Even now, it is not industry standard to engage in such a review, but it was not even possible at the time of CIFG's Initial Diligence. As discussed more in Section V, the databases needed for outsiders (such as insurers like CIFG, and investors who purchased RMBS) to reference and cross-reference the numerous data points required to conduct an analysis of mortgage loans were not available until beginning in 2009, and truly not available until 2010.

119. For instance, to "test" the accuracy of an appraisal, obviously one needs to know what property is being mortgaged. But, despite all the descriptive data provided in loan tapes, property addresses were not typically included. It takes an extremely large and sophisticated database to cross-reference numerous bits of data (such as zip code, lien date, and other hints) to identify the thousands of properties underlying a given RMBS. Even with the property addresses in hand, it further takes an extremely large and sophisticated database to "test" representations made about the properties against third-party sources (such as sales data of comparable homes in the area, etc.), again for thousands of loans at a time. Only years after CIFG's Initial Diligence did the databases become large and sophisticated enough to make that analysis possible for an insurer like CIFG. In other words, though the 2012 Forensic Review results pull from data contemporaneous to the transactions at issue and thus provide a valid "test" of their accuracy, such a review could not have been performed as part of CIFG's Initial Diligence.

120. As part of its 2012 Forensic Review, CIFG examined the accuracy of the risk metrics Defendants presented in the Offering Materials given to CIFG in order to conduct its risk assessment of the Certificates. The 2012 Forensic Review confirms that Defendants misrepresented material characteristics of the mortgage loan pools for the Original RMBS underlying the Certificates.

121. In its 2012 Forensic Review, CIFG attempted to analyze approximately 400 defaulted loans and approximately 400 randomly sampled loans from within the specific group or groups of loans supporting each of the Original RMBS backing the Certificates. This sample size is more than sufficient to provide statistically significant data to demonstrate the degree of misrepresentation of the Mortgage Loans' characteristics. Statistical sampling is an accepted method of establishing reliable conclusions about broader data sets, and is routinely used by

courts, government agencies, scholars, and private businesses. Experts in RMBS cases have found a sample size of just 400 loans can provide statistically significant data, regardless of the size of the actual loan pool, because it is unlikely so large a sample would yield results vastly different from results for the entire population.

122. The results of CIFG's 2012 Forensic Review show that the Offering Materials materially misrepresented the Mortgage Loans' risk metrics and, notably, did so systematically and significantly in the same direction: that is, across every risk metric, the Offering Materials significantly *understated* the risk of the Loans.

1. Loan-to-Value Ratios Represented by Defendants Were False

123. CIFG's 2012 Forensic Review of the Mortgage Loans at issue here shows that Defendants' representations regarding the Loans' LTV ratios were false and misleading. Though not feasible for an insurer to do at the time, as part of its 2012 Forensic Review, CIFG used an industry-standard automated valuation model ("AVM") to value a large sample of the Mortgage Loans. AVMs are routinely used in the industry as a way of valuing properties during prequalification, origination, portfolio review, and servicing. AVM use is specifically outlined in regulatory guidance and discussed in the Dodd-Frank Act.

124. AVMs employ 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 this data. The AVM CIFG used incorporates a database of 500 million mortgage transactions, covering zip codes representing more than 97% of the homes, occupied by more than 99% of the population, in the United States. Independent testing services have determined that this AVM is the most accurate of all such models.

125. The results of this analysis for each of the Original RMBS is set forth in the Exhibits. Applying the AVM to the available data for the Mortgage Loans shows the appraisal values used by Defendants in the represented LTV ratios were materially and consistently inflated. This caused the disclosed LTV ratios to be lower than they really were, *i.e.*, Defendants represented that borrowers had more of an equity "cushion" than really existed, and that prospects for recovery of funds upon a foreclosure were much greater than accurate data supported. In other words, though it could not have learned of this at the time, the 2012 Forensic Review revealed that CIFG's Initial Diligence was based on sham numbers, materially skewing CIFG's risk analysis and fraudulently inducing it to issue the Policies.

126. Although the tests used in the 2012 Forensic Review and the independent data fed into them only recently became available to CIFG, these tests draw from data contemporaneous with the transactions at issue. Thus, although CIFG could not have run these tests when the Policies were issued (or any other time until 2010), the results are evidence that the LTV ratios were misrepresented at the time the representations were made. Importantly though, the tests still do not incorporate the type of information (such as loan files and Defendants' internal policies and procedures) that Defendants could access but CIFG could not. As discussed further in Section V, CIFG did not and does not have access to this information.

127. Defendants made representations in the Offering Materials about the percentage of Loans that had LTV ratios of 80% or higher. *See* Exhibits C-X. LTV ratios in excess of 80% provide the lender little equity cushion to protect against borrower default and loss upon foreclosure. Consequently, an accurate disclosure is important to investors and insurers like CIFG in assessing the security's riskiness. Because such techniques as those used in the 2012 Forensic Review were not feasible at the time of the deals, CIFG's Initial Diligence was forced

to use the data provided by Defendants in deciding whether to issue the Policies. However, CIFG's 2012 Forensic Review revealed that a much greater percentage of the Mortgage Loans actually had LTV ratios higher than 80%, as shown below:

Original RMBS	Tranche	Represented Percentage of Loans with an LTV Ratio of 80% or Greater	Actual Percentage of Loans with an LTV Ratio of 80% or Greater	Percentage Understatement
BAFC 2005-06	B1, B2, B3	5.59%	38.46%	32.87%
BAFC 2005-07	2A4, 2B1, 2B2, 2B3	14.37%	39.61%	25.24%
BAFC 2005-07	A17	4.78%	32.58%	27.80%
BAFC 2005-07	4A4, XB1, XB2, XB3	0.85%	34.38%	33.53%
BAFC 2005-08	3A5	7.60%	26.92%	19.32%
BAFC 2005-08	B1, B2, B3	5.04%	39.86%	34.82%
BAFC 2006-01	B1, B2, B3	1.72%	49.48%	47.76%
BAFC 2006-01	XB1, XB2, XB3	1.65%	42.24%	40.59%
BAFC 2006-04	B2	2.31%	54.49%	52.18%
BOAA 2005-09	B3	8.50%	41.67%	33.17%
BOAA 2005-11	4A4	1.56%	53.68%	52.12%
BOAA 2005-11	B2, B3	8.50%	47.56%	39.06%
BOAA 2005-12	4A4	0.00%	51.06%	51.06%
BOAA 2006-01	B1, B2, B3	9.03%	42.45%	33.42%
BOAA 2006-05	B1, B2	10.95%	53.62%	42.67%
BOAA 2006-06	B1, B2	13.02%	49.73%	36.71%
BOAMS 2005-09	B2, B3	0.71%	31.57%	30.86%
BOAMS 2005-10	B1, B2, B3	1.60%	38.03%	36.43%
BOAMS 2005-11	B1, B2, B3	1.18%	30.50%	29.32%
CWALT 2006-17T1	M4	3.78%	69.77%	65.99%
CWALT 2006-21CB	M2, B1	7.06%	54.06%	47.00%
CWALT 2006-26CB	M3, M4, B1	6.37%	53.08%	46.71%
CWALT 2006-29T1	M1, M3, M4, M5	3.39%	71.55%	68.16%
CWALT 2006-J1	B2	5.00%	47.65%	42.65%
CWHL 2005-29	M, B1, B2	1.24%	53.43%	52.19%
FHAMS 2006-FA4	B2A, B2B, B3A	5.25%	45.13%	39.88%
FHAMS 2006-FA5	B2, B3, B4	5.60%	51.29%	45.69%

128. The Offering Materials also made misrepresentations about the number of Mortgage Loans in the subject loan pools that had LTV ratios greater than 90%. LTV ratios in excess of 90% provide the lender even less value cushion to protect against borrower default and loss upon foreclosure. Again, based on the 2012 Forensic Review, the actual numbers are far higher than represented:

Original RMBS	Tranche	Represented Percentage of Loans with an LTV Ratio of 90% or Greater	Actual Percentage of Loans with an LTV Ratio of 90% or Greater	Percentage Understatement
BAFC 2005-06	B1, B2, B3	2.29%	16.52%	14.23%
BAFC 2005-07	2A4, 2B1, 2B2, 2B3	0.00%	18.83%	18.83%
BAFC 2005-07	A17	3.04%	12.36%	9.32%
BAFC 2005-07	4A4, XB1, XB2, XB3	0.56%	7.81%	7.25%
BAFC 2005-08	3A5	1.26%	11.54%	10.28%
BAFC 2005-08	B1, B2, B3	1.62%	21.74%	20.12%
BAFC 2006-01	B1, B2, B3	0.43%	27.84%	27.41%
BAFC 2006-01	XB1, XB2, XB3	0.15%	19.47%	19.32%
BAFC 2006-04	B2	0.58%	25.00%	24.42%
BOAA 2005-09	B3	1.91%	23.74%	21.83%
BOAA 2005-11	4A4	0.52%	27.37%	26.85%
BOAA 2005-11	B2, B3	2.74%	23.41%	20.67%
BOAA 2005-12	4A4	0.00%	21.28%	21.28%
BOAA 2006-01	B1, B2, B3	1.42%	22.92%	21.50%
BOAA 2006-05	B1, B2	5.54%	25.44%	19.90%
BOAA 2006-06	B1, B2	2.86%	26.61%	23.75%
BOAMS 2005-09	B2, B3	0.00%	14.13%	14.13%
BOAMS 2005-10	B1, B2, B3	0.30%	18.79%	18.49%
BOAMS 2005-11	B1, B2, B3	0.13%	13.25%	13.12%
CWALT 2006-17T1	M4	0.14%	32.89%	32.75%
CWALT 2006-21CB	M2, B1	2.47%	24.36%	21.89%
CWALT 2006-26CB	M3, M4, B1	1.59%	23.46%	21.87%
CWALT 2006-29T1	M1, M3, M4, M5	0.28%	38.08%	37.80%
CWALT 2006-J1	B2	2.30%	21.76%	19.46%
CWHL 2005-29	M, B1, B2	0.41%	22.02%	21.61%
FHAMS 2006-FA4	B2A, B2B, B3A	0.91%	21.03%	20.12%
FHAMS 2006-FA5	B2, B3, B4	1.36%	21.20%	19.84%

129. In nearly every Original RMBS, Defendants also represented that none of the Mortgage Loans had LTV ratios exceeding 100%, meaning that, in these RMBS, not one loan exceeded the value of the property. An LTV ratio of greater than 100% is known as being "underwater," where a borrower owes more money on the property than it is actually worth. Such loans offer the mortgage holder zero equity margin and leave the mortgage holder with inadequate collateral from the moment the loan is originated.

130. Despite these representations by Defendants, CIFG's 2012 Forensic Review found a substantial number of Mortgage Loans that had an LTV ratio greater than 100%. The table below illustrates these misrepresentations.

Original RMBS	Tranche	Represented Percentage of Loans with an LTV Ratio of 100% or Greater	Actual Percentage of Loans with an LTV Ratio of 100% or Greater
BAFC 2005-06	B1, B2, B3	0.00%	8.82%
BAFC 2005-07	2A4, 2B1, 2B2, 2B3	0.00%	9.09%
BAFC 2005-07	A17	0.00%	11.24%
BAFC 2005-07	4A4, XB1, XB2, XB3	0.00%	1.56%
BAFC 2005-08	B1, B2, B3	0.00%	11.59%
BAFC 2006-01	B1, B2, B3	0.00%	8.25%
BAFC 2006-01	XB1, XB2, XB3	0.00%	7.92%
BAFC 2006-04	B2	0.00%	12.18%
BOAA 2005-09	B3	0.82%	12.12%
BOAA 2005-11	4A4	0.00%	13.68%
BOAA 2005-11	B2, B3	0.50%	10.73%
BOAA 2005-12	4A4	0.00%	12.77%
BOAA 2006-01	B1, B2, B3	0.09%	8.59%
BOAA 2006-05	B1, B2	0.13%	12.22%
BOAA 2006-06	B1, B2	0.63%	12.37%
BOAMS 2005-09	B2, B3	0.00%	8.83%
BOAMS 2005-10	B1, B2, B3	0.00%	11.19%
BOAMS 2005-11	B1, B2, B3	0.00%	7.00%
CWALT 2006-17T1	M4	0.00%	15.95%
CWALT 2006-21CB	M2, B1	0.00%	11.75%
CWALT 2006-26CB	M3, M4, B1	0.00%	8.77%
CWALT 2006-29T1	M1, M3, M4, M5	0.00%	19.67%
CWALT 2006-J1	B2	0.00%	9.19%
CWHL 2005-29	M, B1, B2	0.00%	8.30%
FHAMS 2006-FA4	B2A, B2B, B3A	0.00%	9.74%
FHAMS 2006-FA5	B2, B3, B4	0.00%	9.46%

131. The Offering Materials provided to CIFG also misrepresented the weighted average LTV ratio of the Mortgage Loans in each pool. This is demonstrated in the following table:

Original RMBS	Tranche	Represented Weighted Average LTV Ratio	Actual Weighted Average LTV Ratio	Percentage Understatement
BAFC 2005-06	B1, B2, B3	65.97%	75.62%	9.65%
BAFC 2005-07	2A4, 2B1, 2B2, 2B3	72.58%	76.28%	3.70%
BAFC 2005-07	A17	67.15%	80.46%	13.31%
BAFC 2005-07	4A4, XB1, XB2, XB3	66.79%	72.26%	5.47%
BAFC 2005-08	3A5	67.76%	69.49%	1.73%
BAFC 2005-08	B1, B2, B3	67.94%	79.58%	11.64%
BAFC 2006-01	B1, B2, B3	70.98%	80.41%	9.43%
BAFC 2006-01	XB1, XB2, XB3	67.30%	78.41%	11.11%
BAFC 2006-04	B2	68.69%	83.16%	14.47%
BOAA 2005-09	B3	71.15%	78.30%	7.15%
BOAA 2005-11	4A4	70.91%	87.98%	17.07%
BOAA 2005-11	B2, B3	72.37%	83.64%	11.27%
BOAA 2005-12	4A4	70.74%	80.82%	10.08%
BOAA 2006-01	B1, B2, B3	72.28%	76.24%	3.96%
BOAA 2006-05	B1, B2	73.47%	81.81%	8.34%
BOAA 2006-06	B1, B2	73.46%	83.75%	10.29%
BOAMS 2005-09	B2, B3	63.18%	71.90%	8.72%
BOAMS 2005-10	B1, B2, B3	68.07%	77.41%	9.34%
BOAMS 2005-11	B1, B2, B3	66.37%	72.07%	5.70%
CWALT 2006-17T1	M4	73.89%	90.18%	16.29%
CWALT 2006-21CB	M2, B1	71.76%	80.78%	9.02%
CWALT 2006-26CB	M3, M4, B1	70.42%	80.46%	10.04%
CWHL 2005-29	M, B1, B2	72.99%	81.53%	8.54%
FHAMS 2006-FA4	B2A, B2B, B3A	69.23%	79.08%	9.85%
FHAMS 2006-FA5	B2, B3, B4	71.09%	80.07%	8.98%

132. Not only were the appraisals (and thus, the LTV ratios) objectively baseless (as evidenced by the AVM data and other facts set forth below), but they were not subjectively believed either. The consistency and size of these misrepresentations confirms that Defendants, the originators, and the appraisers knew—such as, for instance, through Defendants' access to the loan files and their ongoing due diligence processes—that the appraisals being used were not reasonable indicators of the properties' value, but were inflated figures generated to maneuver the loan through the approval and securitization process. That they were not believed is further supported by confidential witness testimony, testimony given in connection with the government's investigation into the causes of the economic crisis, and other facts discussed further below.

133. For instance, Alan Hummel, Chair of the Appraisal Institute, in his testimony before the Senate Committee on Banking noted that the dynamic of financial dependence between appraisers and underwriters created a "terrible conflict of interest," where appraisers "experience systemic problems of coercion" and were "ordered to doctor their reports" or they might be "placed on exclusionary or 'do-not-use' lists."

134. Richard Bitner, a former executive of a lender for 15 years, testified in April 2010 that "the appraisal process [was] highly susceptible to manipulation," and that the rise in property values was in part due to the industry's "acceptance of overvalued appraisals."

135. Similarly, Patricia Lindsay, a former wholesale lender, testified 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. "Fearing" for their "future business and their livelihoods," the appraisers would choose properties "that would help support the needed value rather than finding the best comparables to come up with the most accurate value."

136. 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.'"

137. These facts, and the results of CIFG's 2012 Forensic Review, also demonstrate that Defendants' factual representations relating to appraisal practices were false. For instance, independent appraisers following the disclosed practices would not systematically generate appraisals that deviate so significantly (and so consistently upward) from what an unbiased, industry-standard AVM using similar data found. Additionally, contrary to the representations in the Offering Materials, sales prices of comparable homes in the area were not used to determine

the appraisal values. Instead, the data and other facts set forth herein support the conclusion that the properties chosen for analysis were not comparable in size or location, but rather were selected to reach an inflated appraisal value. The appraisers worked with 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.

138. The consistency of these misrepresentations across the Original RMBS reflects the systematic nature of the abandonment of sound underwriting practices within the Mortgage Loans. As such, CIFG's 2012 Forensic Review not only shows that the specific LTV statistics were false and misleading, but also proves that the Offering Materials' representations regarding the Loans' compliance with the stated underwriting guidelines were themselves false and misleading.

139. Defendants intentionally supplied these false data points knowing that CIFG would use them to assess the creditworthiness of the Certificates. Defendants knew, for instance, that these statistics were part of industry-standard risk modeling techniques. Defendants used the false data to induce CIFG to issue the Policies. Defendants provided false and inaccurate data, knowing that CIFG would use the corrupt data as the basis of its risk assessment of the Certificates. As a result, the actual risk profile of the Certificates was significantly higher than the risk profile based on the inaccurate data. CIFG would not have issued the Policies had it known that these key statistics, which were fed into its Initial Diligence processes, had been falsified and the actual risk profile of the Certificates was significantly higher than what the data suggested.

2. Owner-Occupancy Levels Represented by Defendants Were False

140. Defendants represented in the Offering Materials that the mortgage pools underlying the Original RMBS had a higher percentage of borrowers living in the mortgaged properties than was actually the case. Again, though the 2012 Forensic Review was able to test the accuracy of these representations, that analysis could not have been done at the time. Rather, at the time the Policies were issued, CIFG was forced to and did use the occupancy data provided by Defendants in performing its Initial Diligence.

141. Using databases and techniques not available at the time, as part of the 2012 Forensic Review, CIFG utilized borrower- and property-specific public records to test whether a given borrower actually occupied the property as claimed by Defendants. Contemporaneous property tax records were analyzed to determine whether: (a) the borrower received his property tax bill for the mortgaged property at the address of the mortgaged property; and (b) the borrower took a property tax exemption on the mortgaged property that is only available for owner-occupied properties. A borrower is likely to have a tax bill sent to his or her primary residence to ensure his or her ability to make timely payment. However, if a borrower has tax records sent to a different address, the borrower likely does not actually reside at the mortgaged property. And if a borrower declined to make certain tax exemption elections dependent on the borrower residing at the property, such evidence demonstrates that the borrower does not live at the mortgaged property.

142. The 2012 Forensic Review included analyzing public records to determine if the borrower owned any other properties during the same time period in which he or she owned the securitized property. These records were then examined to determine whether the borrower consistently identified the securitized property as his or her mailing address for property tax bills

on each concurrently owned property. Inconsistencies in tax bill mailing addresses for concurrently owned properties also strongly suggest that the securitized property was not, in fact, owner-occupied.

143. The 2012 Forensic Review also included a review of lien records on concurrently owned properties to determine whether the borrower indicated that any property other than the securitized property was owner-occupied. The test examines all liens originated after the securitized mortgage and compares owner-occupancy representations with those in the Offering Materials. It is strong evidence that the borrower does not reside at the mortgaged property if liens on concurrently owned properties indicate that those properties are owner-occupied.

144. The 2012 Forensic Review also examined the mailing addresses identified for liens on concurrently owned properties to determine whether the address of the securitized property is listed as the mailing address for bills and other correspondence between the borrower and the lienholders. If the securitized property address is not identified, that is also a clear indication that the securitized property is not owner-occupied.

145. Finally, the 2012 Forensic Review included a review of credit records to help determine whether a given borrower occupied the mortgaged property. Specifically, the review investigated whether creditors were reporting the securitized property's address as the borrower's mailing address six months after the origination of the loan. Within six months of closing on a mortgage, one would expect the borrower to have changed his or her billing address with each of his or her creditors. If the borrower was telling creditors to send bills to another address even six months after buying the property, it is likely the borrower was living at a different location.

146. Although the ability to gather such information for large numbers of loans and run these tests (despite not knowing at the outset what the property address is) was only recently made available to insurers like CIFG, these tests draw primarily from data contemporaneous with the transactions at issue. Thus, though CIFG could not have run these tests at the time it issued the Policies (or any other time until within the last few years), the results are evidence that a then-existing fact—owner-occupancy—was misrepresented. Further, even though this recently available technique draws on contemporaneous information, and provides a robust test of Defendants' representations for pleading purposes, it still does not incorporate the type of information that Defendants could access but CIFG could not.

147. For purposes of this pleading, in assessing the accuracy of Defendants' representations in the Offering Materials regarding owner-occupancy, CIFG considered a property to be misrepresented only when a purportedly owner-occupied property failed multiple owner-occupancy tests in the 2012 Forensic Review. Despite this high threshold, CIFG's investigation revealed systemic misrepresentations of owner-occupancy within each mortgage pool.

148. The results of CIFG's 2012 Forensic Review of actual owner-occupancy rates on the Mortgage Loans underlying the Certificates are set forth below and in Exhibits C-X, which are incorporated herein by reference. CIFG's loan-level analysis demonstrates that Defendants drastically overstated the percentage of owner-occupied properties secured by mortgage loans in the collateral pools. Overall, Defendants falsely represented the number of owner-occupied properties in each Original RMBS by up to 17%. The table below illustrates these misrepresentations:

Original RMBS	Tranche	Represented Percentage of Owner-Occupied Properties	Actual Percentage of Owner-Occupied Properties	Percentage Overstatement
BAFC 2005-06	B1, B2, B3	94.23%	81.79%	12.44%
BAFC 2005-07	A17	93.04%	79.74%	13.30%
BAFC 2005-07	4A4, XB1, XB2, XB3	95.20%	83.11%	12.09%
BAFC 2005-08	3A5	93.67%	84.87%	8.80%
BAFC 2005-08	B1, B2, B3	96%	84.96%	11.04%
BAFC 2006-01	B1, B2, B3	98.71%	88.15%	10.56%
BAFC 2006-01	XB1, XB2, XB3	96.10%	84.95%	11.15%
BAFC 2006-04	B2	96.34%	79.67%	16.67%
BOAA 2005-09	B3	46.61%	40.32%	6.29%
BOAA 2005-11	4A4	80.73%	68.70%	12.03%
BOAA 2005-11	B2, B3	46.45%	39.99%	6.46%
BOAA 2005-12	4A4	83.05%	67.60%	15.45%
BOAA 2006-01	B1, B2, B3	54.52%	45.03%	9.49%
BOAA 2006-05	B1, B2	58.84%	49.37%	9.47%
BOAA 2006-06	B1, B2	57.14%	47.88%	9.26%
BOAMS 2005-09	B2, B3	91.46%	78.02%	13.44%
BOAMS 2005-10	B1, B2, B3	92.39%	82.78%	9.61%
BOAMS 2005-11	B1, B2, B3	93.07%	81.62%	11.45%
CWALT 2006-17T1	M4	88.67%	73.86%	14.81%
CWALT 2006-21CB	M2, B1	89.34%	74.24%	15.10%
CWALT 2006-26CB	M3, M4, B1	79.14%	66.32%	12.82%
CWALT 2006-29T1	M1, M3, M4, M5	90.55%	75.88%	14.67%
CWALT 2006-J1	B2	78.48%	67.41%	11.07%
CWHL 2005-29	M, B1, B2	96.08%	78.98%	17.10%
FHAMS 2006-FA4	B2A, B2B, B3A	65.94%	58.16%	7.78%
FHAMS 2006-FA5	B2, B3, B4	67.22%	58.48%	8.74%

149. The consistency of these results shows that the divergence between Defendants' representations and reality was not due to phenomena such as borrowers changing their minds about where to live. Instead, these results reflect the fact that the originators and Defendants knew borrowers were misrepresenting their intent to live at the property. Defendants did so in order to maneuver the loans through an approval and securitization process that was represented to exclude such loans.

150. The consistency and size of these misrepresentations across the Original RMBS also confirms that the abandonment of sound underwriting practices within the Mortgage Loans was systemic. CIFG's 2012 Forensic Review thus not only reveals that the specific owner-

occupancy statistics were false and misleading, but also proves that the Offering Materials' representations regarding adherence to underwriting guidelines were false and misleading.

151. Defendants intentionally supplied these false data points knowing CIFG would use them to assess the creditworthiness of the Certificates. Defendants knew, for instance, that these statistics were part of industry-standard risk modeling techniques. Defendants used the false data to induce CIFG to issue the Policies. Defendants provided false and inaccurate data, knowing that CIFG would use the corrupt data as the basis of its risk assessment of the Certificates. As a result, the actual risk profile of the Certificates was significantly higher than the risk profile based on the inaccurate data. CIFG would not have issued the Policies had it known that these key statistics, which were fed into its Initial Diligence processes, had been falsified and the actual risk profile of the Certificates was significantly higher than what the data suggested.

3. Defendants' Transfer of Title Representations Were False

152. Defendants' representations about the valid transfer of title to 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 Defendants or the other Originators lost, failed to timely create, or failed to timely deliver the paperwork necessary to prove title to the Mortgages.

153. Contrary to their representations, Defendants and the Originators did not properly assign large numbers of the Mortgage Loans to the Trusts. In their rush to securitize loans and thereby offload risky collateral onto investors and insurers like CIFG, Defendants did not comply with the strict rules governing assignment of mortgages and the transfer of promissory notes and loan files. Defendants and the other Originators lost much of the paperwork relating to the

Loans underlying the Original RMBS, or made no attempt to assign the Mortgage Loans and deliver the original mortgage notes to the issuing trusts, as represented.

154. As part of its loan-level forensic analysis of the Mortgage Loans, CIFG examined the chain of mortgage assignments with respect to the Mortgage Loans. The review demonstrates that Defendants' representations regarding title to the Mortgage Loans were false and misleading, and that Defendants fraudulently failed to disclose problems in the chain of title to the Mortgage Loans.

155. As discussed above, this analysis could not have been performed by CIFG before 2010, because it was not able to identify the specific properties at issue at the time. CIFG reasonably relied upon Defendants to represent that the Mortgage Loans had been validly assigned in the Offering Materials.

156. CIFG's review demonstrates, for each of the Original RMBS, (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 Defendants' representations that the Loans would be assigned to the Trust (or, in some cases, would be held by MERS).

Original RMBS	Tranche(s)	Number of Loans Still Held in the Originator's Name	Number of Loans Assigned To a Third Party (Other Than MERS)	Percentage of Sampled Loans Assigned to a Third Party or Still Held in the Originator's Name
BAFC 2005-06	B1, B2, B3	432	33	72.77%
BAFC 2005-07	2A4, 2B1, 2B2, 2B3	14	0	66.67%
BAFC 2005-07	A17	102	1	88.79%
BAFC 2005-07	4A4, XB1, XB2, XB3	67	1	94.44%
BAFC 2005-08	3A5	32	1	89.19%
BAFC 2005-08	B1, B2, B3	306	4	80.94%
BAFC 2006-01	B1, B2, B3	25	0	60.98%
BAFC 2006-01	XB1, XB2, XB3	271	5	87.90%

Original RMBS	Tranche(s)	Number of Loans Still Held in the Originator's Name	Number of Loans Assigned To a Third Party (Other Than MERS)	Percentage of Sampled Loans Assigned to a Third Party or Still Held in the Originator's Name
BAFC 2006-4	B2	22	11	20.37%
BOAA 2005-09	B3	719	13	97.21%
BOAA 2005-11	4A4	140	7	92.45%
BOAA 2005-11	B2, B3	588	20	88.63%
BOAA 2005-12	4A4	91	0	95.79%
BOAA 2006-01	B1, B2, B3	617	15	92.40%
BOAA 2006-5	B1, B2	539	33	85.37%
BOAA 2006-6	B1, B2	607	14	88.97%
BOAMS 2005-09	B2, B3	719	13	97.21%
BOAMS 2005-10	B1, B2, B3	707	10	97.95%
BOAMS 2005-11	B1, B2, B3	564	6	95.96%
CWALT 2006-17T1	M4	18	15	7.66%
CWALT 2006-21CB	M2, B1	11	13	3.42%
CWALT 2006-26CB	M3, M4, B1	18	14	4.35%
CWALT 2006-29T1	M1, M3, M4, M5	24	31	7.20%
CWALT 2006-J1	B2	15	10	11.26%
CWHL 2005-29	M, B1, B2	9	15	5.74%
FHAMS 2006-FA4	B2A, B2B, B3A	29	42	11.47%
FHAMS 2006-FA5	B2, B3, B4	29	35	10.26%

157. Even among Loans that were assigned to the Trusts, a large number were still missing intervening assignments. For example, for CWALT 2006-17T1, of the 701 Mortgage Loans for which sufficient data was available to conduct this analysis, just 207 were assigned to the Trust. But even of those 207 Loans, 89—***43%***—were missing intervening assignments. Similarly, for FHAMS 2006-FA4, 22 of the 45 Loans that were assigned to the Trust—***over 48%***—were missing intervening assignments. Across all of the Original RMBS, and ultimately the Certificates, over 25% of the Loans assigned to the Trusts were in fact missing intervening assignments.

158. In sum, among the 12,123 Loans for which sufficient data was available to conduct this analysis, 6,715 Loans were still held in the originator's name and 362 were improperly assigned to a third party (other than MERS)—an ***over 58%*** defect rate. Further, of

the Loans that were nominally assigned to the Trust, ***over 25%*** are missing necessary intervening assignments.

159. Evidence of Defendants' failed attempts to foreclose on many homes while using invalid paperwork represents an attempt to cover up the problems like those seen in these Certificates. The Federal Reserve System, the U.S. Office of the Comptroller of the Currency (the "OCC"), and the Office of Thrift Supervision ("OTS") issued a report in April 2011 regarding foreclosure processing by 14 mortgage servicers, including Bank of America. Their Interagency Review of Foreclosure Policies and Practices found "critical weaknesses in servicers' foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third-party vendors, including foreclosure attorneys." Their report found that Bank of America and other banks lacked sufficient oversight of the foreclosure process, evidenced by problems with affidavits and notarization.

160. The OCC issued a Consent Order dated April 13, 2011, which identified problems with Bank of America's loan servicing and its "initiation and handling of foreclosure proceedings." The OCC found, in part, that Bank of America "litigated foreclosure proceedings and initiated non-judicial foreclosure proceedings without always ensuring that either the promissory note or the mortgage document were properly endorsed or assigned and, if necessary, in the possession of the appropriate party at the appropriate time." Bank of America agreed to enter into a compliance program, which would include:

> processes to ensure that the Bank has properly documented ownership of the promissory note and mortgage (or deed of trust) under applicable state law, or is otherwise a proper party to the action (as a result of agency or other similar status) at all stages of foreclosure and bankruptcy litigation, including appropriate transfer and delivery of endorsed notes and assigned mortgages or deeds of trust at the formation of a residential mortgage-backed security, and lawful and verifiable endorsement and successive assignment of the note and mortgage or deed of trust to reflect all changes of ownership .

(Consent Order No. 11-029-B-HC, *In the Matter of Bank of America, N.A*. (U.S. Treas. Dept., Comptroller of the Currency, Apr. 13, 2011).)

161. Bank of America also agreed to a plan to ensure proper controls and oversight of the Bank's activities with respect to MERS, including "ensur[ing] that all mortgage assignments and endorsements with respect to mortgage loans serviced or owned by the Bank out of MERS' name are executed only by a certifying officer authorized by MERS and approved by the Bank."

162. As a direct result of its misconduct, in September 2010, Bank of America and its affiliates had to suspend foreclosures in 23 States while it determined if the paperwork was processed correctly and affidavits by staff members were indeed legitimate. On October 9, 2010, Bank of America halted home foreclosures in all 50 States as it reviewed foreclosure paperwork, reflecting the grave impact of Bank of America's wrongdoing regarding transfers of title and foreclosures.

163. In States providing for non-judicial foreclosures, Bank of America utilizes a subsidiary, ReconTrust Company, N.A. ("ReconTrust"), to foreclose on homeowners. On August 4, 2011, the Attorney General for the State of Washington filed an action against ReconTrust, alleging that the company "systematically conceals, misrepresents or inaccurately divulges the true parties to the mortgage transaction," including misrepresenting Bank of America's ownership of mortgage notes. (*Washington v. ReconTrust Co., N.A.* (King County, Wa. Aug. 4, 2011), pp. 6-7.)

164. A July 19, 2011 *Reuters* report confirmed that Bank of America and other banks "continue to file questionable foreclosure documents with courts and county clerks." The article explains that in recent months, "servicers have filed thousands of documents that appear to have been fabricated or improperly altered, or have sworn to false facts."

165. State Attorneys General are also currently investigating the wrongdoing of Bank of America and other entities that have attempted to cover up the widespread failure to properly assign mortgage loans in seeking to foreclose on properties. Upon information and belief, the Attorneys General have uncovered significant evidence of wrongdoing by Defendants.

166. Defendants' representations in the Offering Materials that the MERS system was sufficient to ensure that the Mortgage Loans could be foreclosed upon in the event of a borrower's default was false. As multiple courts have held, because the actual mortgage note is typically not transferred to MERS, MERS is a nullity. In February 2011, MERS instructed its lender members to stop foreclosing in the name of MERS in light of the overwhelming authority that beneficial ownership of an underlying mortgage cannot be transferred to MERS. To the extent that Defendants represented in the Offering Materials that MERS would be the "beneficial owner" of each Mortgage, those representations 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."

C. Other Evidence Highlighting the Falsity of Defendants' Representations Regarding Adherence to Stated Underwriting Guidelines

167. In addition to statistical evidence of Defendants' misrepresentations, recently uncovered documents, testimony, and analyses confirm that representations made about the adherence of Defendants and their originators to the underwriting standards outlined in the Offering Materials given to CIFG were false. A summary of testimonial and documentary evidence as to each of the major originators of the Mortgage Loans underlying the Certificates is set forth below.

1. <u>Bank of America</u>

168. As reflected in the table in Section I.E, BOA originated all of the Mortgage Loans backing 10 of the Original RMBS underlying the Certificates. In pursuit of even greater profits, between 2004 and 2007, BOA abandoned its underwriting guidelines in an attempt to increase the volume of loans it originated. In order to keep pace with the market and to fuel the pipeline of mortgage loans for its own highly profitable securitizations, BOA departed from its own underwriting standards.

169. In January 2011, the FCIC issued its final report, which detailed, among other things, the collapse of mortgage underwriting standards and subsequent collapse of the mortgage market and wider economy. The FCIC Report stated that, in 2005, examiners from the Federal Reserve and other agencies conducted a confidential "peer group" study of mortgage practices at six companies, including BOA. According to Sabeth Siddique, then head of credit risk at the Federal Reserve Board's Division of Banking Supervision and Regulation, the study "showed a very rapid increase in the volume of these irresponsible loans, very risky loans. A large percentage of the[] loans issued were subprime and Alt-A mortgages, and the underwriting standards for these products had deteriorated." (FCIC Report, at 172.)

170. BOA was one of the most aggressive competitors in the mortgage market. Indeed, in a June 13, 2005 e-mail from Angelo Mozilo (founder and Chief Executive Officer of Countrywide) to David Sambol (Chief Operating Officer of Countrywide), Mr. Mozilo complained that *even Countrywide could not match* some of BOA's riskier products: "This is the third deal in the last 10 days that BofA has offered that is impossible to beat. In fact *the other two were substantially worse* than this one. It appears to me that *BofA is making an aggressive move into mortgages once again*." (Emphasis added).

171. BOA also participated in "warehouse lending" to ensure that it had access to a steady stream of mortgage loans to securitize and sell to investors. In 2001, BOA sold EquiCredit, the division of BOA that, at the time, was primarily responsible for making subprime loans. In order to guarantee that it could still obtain sufficient mortgages to pool into its RMBS securitizations, BOA began to directly fund originating banks, including Countrywide and New Century Mortgage Corporation. BOA was the leading participant in the warehouse lending channel, with nearly 26% market share by 2009. (10/5/10 BOA press release, "Bank of America Exits First Mortgage Wholesale Channel.")

172. In addition, BOA sought to expand its share of the mortgage securities market by aggressively pursuing mortgage originators, including Option One, Accredited, and GMAC Mortgage; offering to pay more for their mortgages than competing Wall Street banks; and offering to perform less due diligence than its competitors. At the same time, BOA knew that the originating banks were churning out risky loans with a high likelihood of default. As Ken Lewis, then CEO of Bank of America Corp. (BOA's parent corporation) proclaimed on its 2007 second quarter earnings call, "*Broker [loans] tends to be toxic waste*."

173. In May 2011, the New York Attorney General announced that it was investigating BOA's mortgage-related securitization activities. The New York Attorney General's investigation found that BOA "face[s] Martin Act liability because there are repeated false representations in the Governing Agreements [for RMBS] that the quality of the mortgages sold into the Trusts would be ensured." In addition, BOA faces liability for "persistent illegality" in violation of Executive Law § 63(12) for "repeatedly breached representations and warranties regarding loan quality."

174. According to confidential witnesses interviewed prior to the filing of this Complaint (discussed more fully below), BOA regularly approved loans to unqualified borrowers, approved loan applications that it *knew* contained false information, and even went so far as to **"*doctor the numbers*"** to get loans approved. BOA regularly used exceptions to approve loans even when it was clear that the borrower lacked the ability to pay. Indeed, BOA had an entire division—the so-called "Plan C" group—dedicated to approving problem loans that, according to a former BOA Mortgage Underwriter, "*should not have been funded under any circumstances*." When BOA's underwriters *knew* that loan applications contained false information, they were told by their superiors to *approve the loans anyway*. For example, a former BOA Loan Processor/Junior Underwriter was told that she "*didn't have to consider evidence*" that directly contradicted borrowers' claims about their income. BOA employees also used their "close relationships" with appraisers to manipulate appraisal figures, and according to a former BOA Loan Officer, went so far as to "*doctor the numbers*" in loan applications in order to get loans approved.

175. Because BOA and the other originators had systematically abandoned their underwriting guidelines, Defendants' representations about the Mortgage Loans' adherence to those guidelines were false. And because Defendants had originated or conducted due diligence on those Mortgage Loans, Defendants knew those representations were false.

2. <u>Countrywide</u>

176. As reflected in the table in Section I.E, Countrywide originated all of the loans underlying five of the Original RMBS, and also contributed Loans into the CWALT 2006-J1 deal. Facts showing Countrywide systematically abandoned the stated guidelines support the conclusion that it did so with respect to the Mortgage Loans at issue here, and that Defendants'

representations regarding Countrywide's adherence to the guidelines were thus false. And, based on their extensive due diligence and participation in the mortgage market, Defendants knew those representations were false.

177. During the relevant period, Countrywide was the single largest U.S. mortgage lender and one of the largest subprime lenders. It has since come to light, however, that Countrywide's remarkable growth from 2003 to 2007 was fueled by its unbridled pursuit of increasing mortgage loan origination volume, regardless of borrowers' qualifications or ability to repay. During a conference call with analysts in 2003, co-founder Angelo Mozilo stated that his goal for Countrywide was to "dominate" the mortgage market and "to get our market share to the ultimate 30% by 2006, 2007." Unbeknownst to investors and insurers at the time, Countrywide chose to reach for this goal by systematically departing from its credit risk and underwriting standards.

178. Materials and statements only recently made public have revealed that, in order to meet its volume and market share goals, Countrywide employed a policy of matching any product that a competitor was willing to offer. A former finance executive at Countrywide explained that: "To the extent more than 5 percent of the [mortgage] market was originating a particular product, any new alternative mortgage product, then Countrywide would originate it . . . . [I]t's the proverbial race to the bottom."

179. One way Countrywide sought to "win" that race was to routinely abuse the "exceptions" process. Indeed, Countrywide's automated Exception Processing System was referred to as the "Price Any Loan" system, and was established specifically to routinely grant exceptions to the publically disclosed underwriting guidelines, even where there were no compensating factors present. Countrywide's own internal, recently released documents show

that staggering numbers of its loans were purportedly granted based on "exceptions." In 2005, a Countrywide Managing Director wrote that the actual (but hidden) purpose of the "exception" policy was to "keep pace with fast changing markets," and to retroactively justify the grant of loans that were approved but then later "determined to be outside" the underwriting guidelines. Countrywide's then-Chief Risk Officer, John McMurray, also wrote in 2005 that underwriting exceptions were generally being granted "at terms more aggressive than our guidelines," suggesting that it was an appropriate time to "revisit our approach to exceptions."

180. Another way Countrywide sought to "win" the race to the bottom was through the systematic abuse of "low-doc" loans. According to numerous statements given by former employees and borrowers (but unbeknownst to investors or insurers), these products were not given to well-heeled borrowers who wished their finances to remain private, as they were traditionally designed to be used for. Rather, these "low-doc" products were being used as a tool to circumvent Countrywide's underwriting guidelines. That is, when a loan officer knew an application would not be approved based on the borrower's actual financial position, the officer steered the borrower into low-documentation products, and either falsified the applications themselves, or coached borrowers on how to do so, in order to obtain an approval.

181. Internal Countrywide e-mails released by the SEC in connection with its lawsuit against Countrywide's executives, and thus only available in 2009, confirm that Countrywide systematically deviated from its underwriting guidelines at the exact same time as the loans at issue here were being generated. Further, many of the materials below, and others since made public by the SEC, involve the exact same type of loans included in the Original RMBS.

182. For instance, in a "lessons learned" analysis prepared by Countrywide itself in November 2007, the company admitted that: (a) "our systems never caught up with the risks";

(b) "not enough people had an incentive to manage risk"; (c) the company's "decentralized" control scheme had the downside of "fewer risk controls and less focus on risk"; (d) "we allowed the model to outrun its critical support infrastructure in investment and credit risk management"; and (e) "structure and capabilities of Secondary not in-sync with production."

183. Other recently released evidence confirms that Countrywide's abandonment started much earlier. In September 2004, Countrywide's CEO Mr. Mozilo had voiced his concern over the "clear deterioration in the credit quality of loans being originated," observing that "the trend is getting worse."

184. In an April 14, 2005 e-mail (again, only made available recently), Frank Aguilera, a Countrywide Managing Director, noted a "significant concentration of similar exceptions." Mr. Aguilera continued: "The continued concentration in these same categories indicates either a) inadequate controls in place to mange [sic] rogue production units or b) general disregard for corporate program policies and guidelines."

185. In a series of early 2006 emails from Mr. Mozilo to other top Countrywide executives (only recently revealed), Mr. Mozilo stated that certain problem loans were caused by "errors of both judgment and protocol"; that loans had been originated "with serious disregard for process [a]nd compliance with guidelines"; and that "I have personally observed a serious lack of compliance within our origination system."

186. Countrywide's own internal studies (made public by the SEC in 2009) confirm that loans were being generated outside the guidelines. According to the SEC, Countrywide's Credit Risk Committee found in May 2007 that "loans continue[d] to be originated outside guidelines." Another internal study around the same time found that 12% of the loans analyzed were "severely unsatisfactory." And a study covering Countrywide loans from 2006 and 2007

conducted by the Chief Risk Officer found that "borrower repayment capacity was not adequately assessed." A study done by Mr. Aguilera found that "exception" loans were performing 2.8 times worse than loans generated in-guidelines. Mr. Aguilera wrote at the time: "The results speak towards our inability to adequately impose and monitor controls on production operations."

187. In February 2007, Countrywide executives again found that exceptions continued to be used at an unacceptably high rate. Mr. Aguilera stated that any "[g]uideline tightening should be considered purely optics with little change in overall execution unless these exceptions can be contained." The levels he was seeing were described as "exceed[ing] any imaginable comfort level." In a September 2007 e-mail, Mr. McMurray expressed his opinion that "the exception process has never worked properly."

188. In addition to abandoning its underwriting standards, Countrywide regularly engaged affiliated appraisers, including appraisal businesses that were owned or controlled by Countrywide, rather than the purported independent appraisers that it represented were used. This created a conflict of interest. As originator and securitizer of the loans, Countrywide had an incentive to inflate the value of properties because doing so would result in lower LTV ratios. A lower LTV ratio would allow a loan to be approved when it otherwise would not be, and would appear less risky to investors and insurers. In practice, Countrywide's appraisals were not intended to determine the adequacy of the collateral in the event of a default, but rather to ensure that a large volume of mortgages were rapidly originated, underwritten, and securitized, with no regard to the value of the collateral.

189. Indeed, Syncora Insurance Company, a former monoline insurer for Countrywide, sued Countrywide and gained access to its loan origination files. Syncora's analysis of the loan

files found that "the vast majority of appraisals were performed by a Countrywide affiliate, LandSafe, Inc. ('LandSafe'); and Syncora's review of non-performing loans revealed that LandSafe appraisers 'consistently and significantly exceeded contemporaneous sale prices for comparable properties in the same location,' artificially reducing CLTV ratios." (Amended Complaint, *Syncora Guarantee Inc. v. Countrywide Home Loans et al.*, No. 650042/09, at 43-44 (Sup. Ct. N.Y. County, filed May 6, 2010).)

190. According to Capitol West Appraisals, LLC, a company that has provided real estate appraisals to mortgage brokers and lenders since 2005, Countrywide engaged in a pattern and practice of pressuring even non-affiliated real estate appraisers to artificially increase appraised values. Capitol West stated that Countrywide officers pressured it to increase appraised values for three separate loan transactions. When Capitol West refused to vary the appraised values from what it independently determined was appropriate, Countrywide retaliated by blacklisting it.

191. This abuse of the appraisal process was also confirmed by Mark Zachary, a former Regional Vice President of Countrywide, who has claimed in public interviews that he was fired for airing his concerns about Countrywide's underwriting practices. According to Mr. Zachary, he informed Countrywide executives that there was a problem with appraisals, in that the appraisers were being pressured to inflate the appraised value by 6% to allow homeowners to 'roll up' all their closing costs into the loan. According to Mr. Zachary, Countrywide performed an audit that corroborated his story.

192. Because Countrywide had systematically abandoned its underwriting guidelines, Defendants' representations about the Mortgage Loans' adherence to those guidelines were false.

And because Defendants had conducted due diligence on those Mortgage Loans, Defendants knew those representations were false.

3. Washington Mutual Bank

193. As reflected in the table in Section I.E, Washington Mutual Bank ("WaMu") originated many of the Mortgage Loans in the BAFC 2005-06, BAFC 2005-08, and BAFC 2006-01 Original RMBS backing the BAFC 2006-R1 Certificates. It also originated many of the Mortgage Loans in the BAFC 2006-04 Original RMBS backing the BAFC 2006-R2 Certificates. In these deals, it was often one of the larger originators that were identified for the relevant loan groups. For instance, it originated 32.53% of the loans in Group 3 of BAFC 2005-8, and 17.56% of the loans in BAFC 2006-04.

194. Facts showing WaMu systematically abandoned the stated guidelines support the conclusion that it did so with respect to the Mortgage Loans at issue here, and that Defendants' representations regarding WaMu's adherence to the guidelines were thus false. And, based on their extensive due diligence and participation in the mortgage market, Defendants knew those representations were false.

195. WaMu pervasively violated its stated underwriting and appraisal standards, even in its purportedly prime mortgage business. The Senate Permanent Subcommittee on Investigations ("SPSI") spent more than two years investigating the financial crisis. It issued a report based on four Senate hearings held in April 2010, over 150 interviews and depositions, and a review of tens of millions of pages of documents, many of which were recently disclosed in connection the SPSI report. One of the hearings, held on April 13, 2010, focused on WaMu. The SPSI showed how WaMu originated and sold hundreds of billions of dollars in loans to Wall Street Banks in return for big fees, polluting the financial system with toxic mortgages. Based

on previously hidden WaMu documentation, employee interviews, and other investigations, the SPSI reached the following findings of fact, among others:

- *High Risk Lending Strategy*. WaMu executives embarked upon a high risk lending strategy and increased sales of high risk home loans to Wall Street, because they projected that high risk home loans, which generally charged higher rates of interest, would be more profitable for the bank than low risk home loans.

- *Shoddy Lending Practices*. WaMu used shoddy lending practices riddled with credit, compliance, and operational deficiencies to make tens of thousands of high risk home loans that too often contained excessive risk, fraudulent information, or errors.

- *Steering Borrowers to High Risk Loans*. WaMu and Long Beach too often steered borrowers into home loans they could not afford, allowing and encouraging them to make low initial payments that would be followed by much higher payments, and presumed that rising home prices would enable those borrowers to refinance their loans or sell their homes before the payments shot up.

- *Destructive Compensation*. WaMu's compensation system rewarded loan officers and loan processors for originating large volumes of high risk loans, paid extra to loan officers who overcharged borrowers or added stiff prepayment penalties, and gave executives millions of dollars even when its high risk lending strategy placed the bank in financial jeopardy.

196. These findings were based in part on such documents as an internal presentation given to WaMu executives, which examined 187 loan files—and found "confirmed fraud" in 115 of them. (PSI Report at 85.) Seventy-one percent "had credit evaluation or loan decision errors." (*Id.*) Almost one-third ''had appraisal discrepancies or issues that raised concerns." Eighty of the loans were identified as having "[a] lack of reasonableness of income [claims]." (*Id.*)

197. A recently revealed 2005 internal WaMu investigation found that 78% of the funded retail broker loans reviewed in the investigation of certain loan channels contained fraud. A presentation regarding the investigation indicated that the loan fraud primarily involved "misrepresentation of loan qualifying data," including misrepresentations of income and employment, false credit letters, and appraisal issues, such as:

> Loan #0694256827[:] Misrepresentation [of] the borrower's identification and qualifying information were confirmed in every aspect of this file, including: – Income – SSN – Assets – Alternative credit reference letters – Possible Strawbuyer or Fictitious borrower[.] The credit package was found to be completely fabricated. Throughout the process, red flags were over-looked, process requirements were waived, and exceptions to policy were granted.

Following this investigation, WaMu's Risk Mitigation Team recommended "firm action." Confirming WaMu's willingness to abandon its guidelines, despite "a sustained history of confirmed fraud findings over the past three years," virtually none of the recommendations proposed as part of the investigation were implemented.

198. A 2008 WaMu memorandum (again only recently made public as part of the investigations into WaMu's collapse) confirmed that even years after the 2005 study, the employees working in the same previously studied loan center "consistently described an environment where production volume rather than quality and corporate stewardship were the incented focus." The follow-up investigation found that 62% of yet another sample of loans contained misrepresentations and suspected loan fraud.

199. In 2008, WaMu also found that controls intended to prevent the sale of fraudulent loans to investors were "not currently effective," and there was no "systematic process to prevent a loan . . . confirmed to contain suspicious activity from being sold to an investor." In other words, even where a loan was marked with a red flag indicating fraud, that did not stop the loan from being sold to investors.

200. Driving this disregard for underwriting standards was WaMu's compensation plans, which incentivized sales associates and underwriters to abandon underwriting guidelines by rewarding quantity over quality. Diane Kosch, a Quality Control Supervisor at WaMu, was told by her supervisor that she should spend only 15 minutes per loan file. She did not feel that this was a sufficient amount of time to properly review a loan file. However, because QA

Controllers received a bonus on the basis of the number of loans they reviewed, she said some of her colleagues spent only 10 minutes on each file. Often, when she tried to stop the approval of a loan, it would be referred to management and approved anyway. According to Ms. Kosch, good QA Controllers were treated like "black sheep" and hated because they got in the way of volume bonuses.

201. A recently revealed 2008 internal study by WaMu, entitled "AIG/UG and OTS Allegation of Loan Frauds Originated by [name redacted]," found that WaMu's compensation practices were likely to lead to unsound practices. Because the compensation model tied volume and speed of loan closing to a sales associate's compensation, "the temptation to advise the borrower on means and methods to game the system may occur. Our compensation and reward structure is heavily tilted for these employees toward production of closed loans."

202. James G. Vanasek, WaMu's former Chief Credit Officer/Chief Risk Officer, testified to the SPSI that WaMu's compensation structure encouraged its employees to assist in mortgage fraud. "Because of the compensation systems rewarding volume versus quality and the independent structure of the originators, I am confident at times borrowers were coached to fill out applications with overstated incomes or net worth to meet the minimum underwriting requirements . . . . Not surprisingly, loan originators constantly threatened to quit and go to Countrywide or elsewhere if the loan applications were not approved."

203. Incredibly, although WaMu agents were rewarded for high volume origination of high risk loans, they were not penalized for loans that defaulted or were deemed to be fraudulent. As early as 2003, the OTS found that WaMu's "annual review and monitoring process for wholesale mortgage brokers was inadequate, as management did not consider key performance indicators such as delinquency rates and fraud incidents." This was confirmed by the SPSI

Report, which also found that brokers were not rated according to the number of loans that had to be denied, or whether the broker was included on any industry watch lists for suspected misconduct. According to a recently released June 2007 OTS Asset Quality Memo, in 2007, WaMu had only 14 full-time employees overseeing 34,000 third-party brokers that were doing business with WaMu nationwide. By allowing so few employees to oversee so many brokers, WaMu ensured that there was insufficient oversight to confirm that guidelines were being followed.

204. In a November 2, 2008 *New York Times* article entitled, "Was There a Loan It Didn't Like?," former WaMu Senior Mortgage Underwriter Keysha Cooper, who started at WaMu in 2003 and left in 2007, explained that "[a]t WaMu it wasn't about the quality of the loans; it was about the numbers . . . . They didn't care if we were giving loans to people that didn't qualify. Instead, it was how many loans did you guys close and fund?" According to the article, "[i]n February 2007, . . . the pressure became intense. WaMu executives told employees they were not making enough loans and had to get their numbers up . . . ." Ms. Cooper concluded, "I swear 60 percent of the loans I approved I was made to. . . . If I could get everyone's name, I would write them apology letters."

205. Confirming its willingness to abandon its underwriting guidelines, clear signs of fraud in stated income applications were ignored by WaMu employees. For instance, according to another *New York Times* article from late 2008, John D. Parsons, a WaMu mortgage processing supervisor, reported that he "was accustomed to seeing baby sitters claiming salaries worthy of college presidents, and schoolteachers with incomes rivaling stockbrokers," but he rarely questioned them. Because of the "real estate frenzy" that was occurring, WaMu "was all about saying yes." In one instance, a borrower claimed a six-figure income as a mariachi singer.

Mr. Parsons could not verify the singer's income, so he had him photographed in front of his home dressed in his mariachi outfit. The photo went into his WaMu file and the loan was approved.

206. Similarly, Nancy Erken, a former WaMu loan consultant in Seattle, told the *Seattle Times* in December 2009 that "[t]he big saying was 'A skinny file is a good file.'" She would "take the files over to the processing center in Bellevue and they'd tell me 'Nancy, why do you have all this stuff in here? We're just going to take this stuff and throw it out,'" she said. Fay Chapman, WaMu's Chief Legal Officer from 1997 to 2007, relayed that, on one occasion, "[s]omeone in Florida made a second-mortgage loan to O.J. Simpson, and I just about blew my top, because there was this huge judgment against him from his wife's parents." When Ms. Chapman asked how they could possibly foreclose it, "they said there was a letter in the file from O.J. Simpson saying 'the judgment is no good, because I didn't do it.'"

207. Even products that required backup documentation (such as bank statements) were not immune to WaMu's abandonment. A former sales associate in WaMu's Westlake Village loan office confessed to the SPSI that, if "it was too late to call the borrower," the "sales associates would take [bank] statements from other [loan] files and cut and paste the current borrower's name and address" onto the old bank statements. "[D]uring that crunch time some of the Associates would 'manufacture' asset statements from previous loan docs."

208. Notwithstanding the fact that, according to regulatory agencies, including the Federal Deposit Insurance Corporation ("FDIC") and the OTS, "prime" loans should have been available only to borrowers with FICO scores of 660 or above, WaMu regularly made loans to borrowers with FICO scores well below this standard. Highly experienced mortgage underwriters were shocked by how lenient WaMu was in its lending. WaMu's supposedly "A

paper" (*i.e.*, prime loans) consisted of loans made to borrowers with credit scores in the 500s, high LTV ratios, and Option ARM loans. A recently disclosed WaMu training document for subprime loan production employees, entitled "Specialty Lending UW [Underwriter] HLCA [Home Loans Credit Authority] Training," revised September 26, 2007, makes clear that, regardless of a borrowers' credit history or actual potential to repay a loan, if the borrower WaMu targeted for one of its "prime" loans had a FICO score over 619, that borrower was considered a "prime" borrower.

209. Part of WaMu's abandonment was the systemic abuse of purported "exceptions," even when the loan did not have any "compensating factors." Those with direct experience in WaMu's underwriting operations have confirmed that purported "exceptions" were, in fact, the rule. For example, in testimony before the SPSI, Mr. Vanasek admitted that adherence to policy "was a continual problem at Washington Mutual where line managers particularly in the mortgage area not only authorized but encouraged policy exceptions." Mr. Vanasek further testified that "[e]arlier in my career at the bank, I conducted three meetings with groups of underwriters in the mortgage area at three different locations, and I asked them one simple question: Can you make the decisions that you arrive at hold? And the answer was universally no, because the loans were always escalated up, so if they declined a loan, it was escalated to a higher level, a marketing officer who would ultimately approve."

210. WaMu's quality-control processes were supposed to prevent such abandonment from taking place. But a recently surfaced internal newsletter dated October 31, 2005, revealed that WaMu risk managers were instead told they needed to "shift (their) ways of thinking" away from acting as a "regulatory burden" on the company's lending operations and toward being a "customer service" that supported WaMu's five-year growth plan. This was confirmed by Ms.

Kosch, who said that "[m]ost of the time everything that we wanted to stop the loan for went above our heads to upper management." "It was the Wild West," said Steven M. Knobel, founder of an appraisal company, Mitchell, Maxwell & Jackson, which did business with WaMu until 2007.

211. WaMu's abandonment also included the routine use of falsely inflated appraisals. WaMu was required to maintain an appropriate real estate appraisal program that complied with OTS regulations and guidance. In a guidance document published in 2005, the OTS specifically prescribed that "[l]oan production staff should not select appraisers." The document further explained that the use of a pre-approved appraiser list was permissible only if the list was not under the control of the loan production staff. WaMu's appraisal practices flouted these requirements. In spring 2006, in response to the threat of stricter federal enforcement of appraisal standards, WaMu closed its internal appraisal office and hired two appraisal management companies, eAppraiseIT and Lender's Service, Inc. ("LSI"). But then WaMu rigged the appraiser selection process at the two companies to ensure that appraisals still came in "on value," that is, at a value high enough for WaMu to close the loan.

212. Internal documents produced in the New York Attorney General's suit against eAppraiseIT, and its parent First American, paint a damning picture of WaMu's appraisal practices. WaMu handpicked appraisers willing to inflate appraisal values and blacklisted high-quality appraisers who refused. WaMu returned appraisals it considered too low to eAppraiseIT for "reconsideration," and directed eAppraiseIT to assign the "reconsideration" duties to former WaMu employees. When a regional eAppraiseIT office refused, WaMu moved its business in the region to eAppraiseIT's competitor.

213. For instance, in a recently released August 9, 2006 email, eAppraiseIT's President complained to WaMu's executives about the pressure: "The Wamu internal staff . . . admonish us to be certain we solve the [reconsideration of value ("ROV")] issue quickly or we will all be in for some pretty rough seas." Just a week later, on August 15, 2006, eAppraiseIT's Executive Vice President told its President that WaMu loan officers often pressured their internal appraisal field managers for an "extra few thousand" or to "tell them specifically what they needed"—a practice that blatantly violated applicable law.

214. In an August 10, 2010 sworn affidavit, the Chief Appraiser at eAppraiseIT, Peter Gailitis, confirmed that WaMu constantly pressured eAppraiseIT to give high appraisal values. "[T]he pressure from WaMu sales staff to 'hit value' continued throughout the time I was with [eAppraiseIT]. . . . Requests from WaMu loan officers to increase values would come in various forms; in emails or in ROV requests there would be a statements [sic] to the effect of 'we need X value' or 'we need to hit' a certain value in order to make the deal go through. I was also contacted directly by WaMu management representatives regarding value issues and 'noise' from the retail division."

215. The OTS investigated WaMu's appraisal practices and found many instances of improper appraisals, some of which are documented in the SPSI Report. For example, after reviewing 225 loan files, "[n]umerous instances were identified where, because of undue influence on the appraiser, values were increased without supporting documentation." The OTS investigation concluded that WaMu's appraisal practices constituted "unsafe or unsound banking practices."

216. Because WaMu had systematically abandoned its underwriting guidelines, Defendants' representations about the Mortgage Loans' adherence to those guidelines were false.

And because Defendants had conducted due diligence on those Mortgage Loans, Defendants knew those representations were false.

4. First Horizon

217. As reflected in the table in Section I.E, First Horizon Home Loan Corporation ("First Horizon") originated all of the loans in two of the Original RMBS backing the BAFC 2006-R2 Certificates. Facts showing that First Horizon systematically abandoned the stated guidelines support the conclusion that it did so with respect to the Mortgage Loans at issue here, and that Defendants' representations regarding First Horizon's adherence to the guidelines were thus false. And, based on their extensive due diligence and participation in the mortgage market, Defendants knew those representations were false.

218. First Horizon itself was forced to admit its poor underwriting, because many entities to which it sold loans forced the company to buy them back. As stated in its 2008 Annual Report, available at http://ir.fhnc.com/annuals.cfm: "In addition to the negative aspects of asset quality on FHN's loan portfolio, increased repurchase and make-whole claims from agency and private purchasers of loans originated and subsequently sold by FHN hampered earnings as FHN recorded $148.5 million in charges for its obligations related to these assets." In its 2010 Annual Report (available at http://ir.fhnc.com/annuals.cfm), First Horizon admitted that it had "observed loss severities ranging between 50 percent and 60 percent of the principal balance of the repurchased loans and rescission rates between 30 and 40 percent of the repurchase and make-whole requests."

219. In July 2008, *Dow Jones* reported that Stephanie Jones, a former First Horizon corporate security investigator, alleged that the company "habitually ignored cases of mortgage and banking fraud committed by high-producing loan officers, and even concealed incidents by

altering official filings sent to bank regulators." (Marshall Eckblad, "Complaint Alleges First Horizon Concealed Mortgage Fraud," *Dow Jones Newswires*, July 2, 2008.) According to Ms. Jones, First Horizon "allowed loan officers—as long as they were raking in the money—to do whatever they wanted." (*Id.*) Ms. Jones alleges that "she uncovered approximately 50 cases of mortgage fraud at First Horizon" and that First Horizon managers engaged in a "systematic effort . . . to conceal [the] mortgage fraud she uncovered." (*Id.*)

220. At one First Horizon branch in Idaho, Ms. Jones uncovered fraud by a loan officer who "conceded he had illegally altered loan documents, but told Jones that 'everyone in the branch [wa]s doing it.'" (*Id.*) When Ms. Jones proceeded to investigate the other employees at the branch, she found that they "routinely . . . inflated borrowers' income on applications." (*Id.*) Ms. Jones then reported her findings to her supervisor, who she stated "didn't want me to pursue it." (*Id.*) Additionally, Ms. Jones alleges that Suspicious Activity Reports "would come back changed" from one of First Horizon's directors of corporate security, who "typically removed from the reports any references to fraud committed by loan officers and typically directed the allegations toward loan applicants instead." (*Id.*)

221. In January 2010, U.S. Department of Housing and Urban Development ("HUD") Inspector General Kenneth M. Donohue subpoenaed First Horizon's successor company, First Tennessee, regarding failed loans issued by First Horizon that resulted in claims paid out by the Federal Housing Administration's ("FHA") mortgage insurance fund. According to FHA Commissioner David Stevens, First Horizon's data presented "key indicators of problems at the origination or underwriting stages." (*See* Eric Snyder, First Tennessee Bank Mortgage Loan Records Subpoenaed, The Nashville Business Journal, dated Jan. 13, 2010, available at http://www.bizjournals.com/nashville/stories/2010/01/11/daily17.html.)

222. A report released by HUD on September 27, 2010, based on a review of 18 loans originated by First Horizon, concluded that 28% of the loans were not written in accordance with HUD/FHA underwriting regulations and were not made to qualified borrowers. Specific examples of underwriting deficiencies evident from HUD's review of the loan files included: (1) excessive debt-to-income ratios without adequate compensating factors; (2) inadequate gift fund documentation or verification of receipt of gift funds; and (3) failure to verify or document whether borrowers met the minimum cash investment requirement. The report recommended that HUD should "pursue remedies under the Program Fraud Civil Remedies Act" and/or civil money penalties as a result of these underwriting violations. (*See* U.S. Department of Housing and Urban Development, Office of Inspector General, Memorandum No. 2010-NY-1807, First Tennessee Bank, N.A., Memphis, TN, Did Not Properly Underwrite a Selection of FHA Loans, dated Sept. 27, 2010, available at http://www.hud.gov/ offices/oig/reports/files/ig1021807.pdf.)

223. In January 2012, both the FDIC and the Federal Home Loan Bank of San Francisco requested information on the loans underlying a total of 20 First Horizon securitizations from the years 2005 and 2006 because of significant concerns regarding underwriting irregularities at the company. (*See* First Horizon National Form 10-Q, dated May 8, 2012, at 35- 36, available at http://www.sec.gov/Archives/edgar/data/36966/000119 312512218524/d340174d10q.htm.)

224. Because First Horizon had systematically abandoned its underwriting guidelines, Defendants' representations about the Mortgage Loans' adherence to those guidelines were false. And because Defendants had conducted due diligence on those Mortgage Loans, Defendants knew those representations were false.

5. **Wells Fargo**

225. As reflected in the table in Section I.E, Wells Fargo was another principal originator in four of the Original RMBS. Indeed, it contributed most of the Mortgage Loans in certain pools—95.10% of Groups 1-3 and all of Group 4 in BAFC 2005-07, for example, and 67.11% of Groups 1 and 2 in BAFC 2005-06.

226. Facts showing that Wells Fargo systematically abandoned the stated guidelines support the conclusion that it did so with respect to the Mortgage Loans at issue here, and that Defendants' representations regarding its adherence to the guidelines were thus false. And, based on their extensive due diligence and participation in the mortgage market, Defendants knew those representations were false.

227. In March 2009, RMBS investors filed suit against Wells Fargo, alleging that it had misrepresented its underwriting guidelines and loan quality. (*See In re Wells Fargo Mortgage-Backed Certificates Litig*., No. 09-cv-01376 (N.D. Cal. 2009).) In denying in part a motion to dismiss, the court found that plaintiffs had adequately pled that "variance from the stated [underwriting] standards was essentially [Wells Fargo's] norm," and that this conduct "infected the entire underwriting process." (*In re Wells Fargo Mortgage-Backed Certificates Litig.*, 712 F. Supp. 2d 958, 972 (N.D. Cal. 2010).) Wells Fargo agreed to settle the investors' claims.

228. Further, a number of government actors have announced investigations of Wells Fargo's lending practices. 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 details how borrowers were placed into loans that were "unaffordable and unsuitable," and how Wells Fargo "failed to maintain proper controls."

229. The City of Memphis and the City of Baltimore have both filed suit against Wells Fargo over their mortgage practices. (*Memphis v. Wells Fargo Bank*, No. 09-cv-02857 (W.D. Tenn. 2009); *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, which provide evidence of predatory lending and abandonment of underwriting guidelines.

230. For instance, Camille Thomas was a loan processor at Wells Fargo from January 2004 to January 2008. As a loan processor, she was responsible for handling the paperwork involved in the loan, including processing the file for review and approval by the underwriters. In her affidavit, Ms. Thomas stated that: (a) there was "a lot of pressure on credit managers to close loans"; (b) putting borrowers into loans they could not afford "was possible to do" because managers had "lots of discretion that allowed them to engage in predatory practices. I know this happened because I processed the paperwork and saw the loan files"; (c) managers knew exactly what needed to be put in an application to generate a loan approval (and thus, they knew how to manipulate the system to generate an approval, even if the loan should not actually be granted); (d) managers made commissions or bonuses based on loan volume and whether they met quotas set by the company; (e) borrowers were not informed that their loans were adjustable-rate mortgages with low "teaser rates," or about prepayment penalties, potential violations of lending laws, which would also be undisclosed violations of any commercial lenders' origination guidelines; (f) 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 (g) some loans were even granted based on falsified income documents.

231. Another affidavit was filed by Doris Dancy, a credit manager at Wells Fargo from July 2007 to January 2008. She stated in her sworn affidavit that she would shake her head in disbelief and ask herself "how could that happen" when she saw, to her shock, people with high debt-to-income ratios and terrible credit scores approved for loans that she knew would result in the borrower losing his or her home. She also 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. Her district manager used the bonus system to pressure employees to make loans that should not have been made. Further, loans were given to borrowers without explanation of the details of the loan.

232. Michael Simpson, a credit and branch manager at Wells Fargo from 2002 to 2008, also submitted an affidavit. According to Mr. Simpson, Wells Fargo was "very aggressive" in mortgage lending, and "turned a blind eye and made loans anyhow." The culture was "completely results driven." According to Mr. Simpson, Wells Fargo employees did not tell customers about the fees and costs associated with closing a loan—again, potential violations of lending laws, and thus also violations of the underwriting guidelines. Mr. Simpson further confirmed that Wells Fargo's bonus system was "lucrative" for those employees generating the loans.

233. Mario Taylor, a Wells Fargo credit manager from June 2006 to February 2008, submitted an affidavit stating that borrowers were pushed into products "regardless of whether they were qualified for the loan or could pay back the loan." Pushing people into products they were not qualified for is a facial violation of the underwriting guidelines; ensuring that borrowers

could repay the loans is the point of the underwriting guidelines in the first place. In addition, according to Mr. Taylor, borrowers were not told that their loans were adjustable-rate mortgages with low initial "teaser rates," were not told about prepayment penalties, and were not told about their obligation to pay taxes and insurance as part of their monthly payments—again, all potential lending law violations that would also represent breaches of the underwriting guidelines. Further, loans were granted based on false income data. According to Mr. Taylor, Wells Fargo had a "loan optimizer" that enabled managers to know exactly what data needed to be submitted to generate a loan approval. Finally, Mr. Taylor confirmed that Wells Fargo employees were heavily incentivized by the bonus structure to generate large volumes of loans.

234. The FCIC's investigation supports the affidavits of these former Wells Fargo employees. 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% 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 were identified within Wells Fargo's home equity loan division were not reported to FinCEN.[3] In addition, according to Ms. Palmer, at least half the loans she flagged for fraud were nevertheless funded, over her objections.

235. 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

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

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' 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 resulting from these programs.

236. In addition, Wells Fargo and RELS Valuation, an appraisal entity jointly owned by an affiliate of Wells Fargo Bank, have been sued in Phoenix, Arizona, and San Francisco, California, over the illegal practice of pressuring and intimidating appraisers into using techniques that produce appraisals to meet Wells Fargo's objectives, even when the use of such techniques is improper and violates industry standards.

237. For instance, Don Pearsall is the sole proprietor of the appraisal company Sound Appraisal. According to Sound Appraisal's amended complaint in *Sound Appraisal v. Wells Fargo Bank N.A.*, 4:09-cv-01630 (N.D. Cal. Oct. 29, 2009), Mr. Pearsall visited a mortgaged property for Wells Fargo and found it uninhabitable. Mr. Pearsall was pressured to modify the report to say that a remodel had been completed, but refused because the remodel had *not* been completed. He was later told that he took the Uniform Standards of Appraisal Practice "too seriously," and was subsequently "blacklisted." According to the amended complaint, while previously Wells Fargo/Rels Valuation accounted for 25 to 35 percent of Sound Appraisal's income, after Mr. Pearsall's refusal, it received no more work.

238. Because Wells Fargo had systematically abandoned its underwriting guidelines, Defendants' representations about the Mortgage Loans' adherence to those guidelines were false.

And because Defendants had conducted due diligence on those Mortgage Loans, Defendants knew those representations were false.

6. **<u>American Home Mortgage Corp.</u>**

239. American Home Mortgage Corp. ("American Home") originated 49.63% of the Group 1 and 34.89% of the Group 2 Mortgage Loans in the CWALT 2006-J1 deal, which backed the BAFC 2006-R2 Certificate. Facts showing that American Home systematically abandoned the stated guidelines support the conclusion that it did so with respect to the Mortgage Loans at issue here, and that Defendants' representations regarding its adherence to the guidelines were thus false. And, based on their extensive due diligence and participation in the mortgage market, Defendants knew those representations were false.

240. Before filing for bankruptcy, American Home was the tenth largest retail mortgage lender in the United States during the height of the mortgage lending boom.

241. The SEC brought fraud charges against American Home's former top executives for their role in misleading investors about the company's systematic disregard for sound underwriting standards, and for its use of the risky lending practices that ultimately led to its demise. American Home was anything but the "prime" lender it represented itself to be. Instead, it routinely issued high-risk loans to borrowers with poor credit in order to drive growth and capture additional yield. American Home's former CEO paid $2.5 million to settle the SEC's fraud charges.

242. Federal prosecutors have convicted one American Home sales executive, Kourash Partow, of mortgage fraud. (*See* Judgment in a Criminal Case, *United States v. Partow*, Case No. 3:06-CR-00070-08-HRH, Aug. 31, 2007; *see also United States v. Partow,* 283 Fed. Appx. 476 (9th Cir. 2008).) Mr. Partow admitted that he would falsify clients' income or assets in

order to get loans approved. However, after his conviction, Mr. Partow, who worked for Countrywide before joining American Home, sought a lighter sentence on the grounds that his former employers (Countrywide and American Home) both had knowledge of the loan document inaccuracies and, in fact, encouraged manipulation by intentionally misrepresenting the performance of loans and the adequacy of how the loans were underwritten. (Glenn R. Simpson, "Loan Data Focus of Probe, Countrywide Files May Have Included Dubious Information," *The Wall Street Journal* (March 22, 2008); Richard Greenberg and Chris Hansen, "'If you had a pulse, we gave you a loan,'" *Dateline NBC* (available at www.msnbc.com (updated March 22, 2009)).)

243. A recently published internal American Home "Credit Update" presentation from October 2005 made clear that American Home's underwriting guidelines were so relaxed as to be rendered meaningless. Specifically, the Credit Update sets forth a new "interpretation" of the guidelines that included: (a) not requiring verification of income sources on stated income loans; (b) reducing the minimum amount of time from which the borrower could be in bankruptcy or credit counseling; (c) reducing the required documentation for self-employed borrowers; and (d) broadening the acceptable use of second and third loans to cover the full property value.

244. An internal American Home e-mail sent on November 2, 2006 (made public in June 2008), from Steve Somerman, an American Home Senior Vice President of Product and Sales Support in California and co-creator of American Home's "Choice Point Loans" program, to loan officers nationwide, stated that American Home would make a loan to virtually any borrower, regardless of the borrower's ability to verify income, assets or even employment. The e-mail specifically encouraged loan officers to make a variety of loans that were inherently risky and extremely susceptible to delinquencies and default, including: (a) stated income loans,

where both the income and assets of the borrower were taken as stated on the credit application without verification; (b) "NINA" or No Income, No Asset loans, which allowed for loans to be made without any disclosure of the borrower's income or assets; and (c) "No Doc" loans, which allowed loans to be made to borrowers who did not disclose their income, assets or employment history. (*See* Complaint, *In re American Home Mortgage Securities Litigation*, No. 07-md-1898 (TCP) (E.D.N.Y. June 3, 2008).)

245. Edmund Andrews, an economics reporter for the *New York Times*, recounted his own experience using American Home as a lender. According to Mr. Andrews, he was looking to purchase a home in 2004, and his real estate agent referred him to a loan officer at American Home. The American Home loan officer began by asking Mr. Andrews how large of a loan he needed. Andrews, who had a monthly take home pay of $2,777, advised the loan officer that he had hefty child support and alimony payments to an ex-wife. Mr. Andrews would be relying on his then-unemployed fiancée to earn enough money to meet his monthly obligations—including the mortgage. Mr. Andrews reported:

> As I quickly found out, American Home Mortgage had become one of the fastest-growing mortgage lenders in the country. One of its specialties was serving people just like me: borrowers with good credit scores who wanted to stretch their finances far beyond what our incomes could justify. In industry jargon, we were "Alt-A" customers, and we usually paid slightly higher rates for the privilege of concealing our financial weaknesses.
>
> I thought I knew a lot about go-go mortgages. I had already written several articles about the explosive growth of liar's loans, no-money-down loans, interest-only loans and other even more exotic mortgages. I had interviewed people with very modest incomes who had taken out big loans. Yet for all that, I was stunned at how much money people were willing to throw at me.
>
> [The American Home loan officer] called back the next morning. "Your credit scores are almost perfect," he said happily. "Based on your income, you can qualify for a mortgage of about $500,000."
>
> What about my alimony and child-support obligations? No need to mention them. What would happen when they saw the automatic withholdings in my

> paycheck? No need to show them. If I wanted to buy a house, [the American Home loan officer] figured, it was my job to decide whether I could afford it. His job was to make it happen.
>
> "I am here to enable dreams," he explained to me long afterward. [The American Home loan officer]'s view was that if I'd been unemployed for seven years and didn't have a dime to my name but I wanted a house, he wouldn't question my prudence. "Who am I to tell you that you shouldn't do what you want to do? I am here to sell money and to help you do what you want to do. At the end of the day, it's your signature on the mortgage—not mine."

(Edmund L. Andrews, *My Personal Credit Crisis*, N.Y. Times (May 17, 2009).)

246. The American Home loan officer steered Mr. Andrews to a stated-income loan so that he would not have to produce paychecks or tax returns that would reveal his alimony and child support obligations. The loan officer wanted to limit disclosure of Mr. Andrews's alimony and child support payments when an existing mortgage showed up under Mr. Andrews's name. Although his ex-wife was solely responsible for that mortgage under the terms of the couple's separation agreement, the only way Mr. Andrews could explain that fact would be to produce the agreement, which would also reveal his alimony and child support obligations. According to Mr. Andrews:

> [The American Home loan officer] didn't get flustered. If Plan A didn't work, he would simply move down another step on the ladder of credibility. Instead of "stating" my income without documenting it, I would take out a "no ratio" mortgage and not state my income at all. For the price of a slightly higher interest rate, American Home would verify my assets, but that was it. Because I wasn't stating my income, I couldn't have a debt-to-income ratio, and therefore, I couldn't have too much debt. I could have had four other mortgages, and it wouldn't have mattered. American Home was practically begging me to take the money.

(*Id.*) American Home ultimately approved Andrews's application. Not surprisingly, Andrews was unable to afford his monthly mortgage payments.

247. On information and belief, former American Home employees will confirm the widespread problems with its appraisal process within American Home. For instance, a

American Home Vice President from March 2003 through May 2007 has reportedly recounted the problem of appraisal fraud within American Home, noting that the company's loan officers pressured appraisers to come up with the "right number," *i.e.*, an inflated number the loan officers wanted to justify a loan (or a larger loan). And the owner of a small Midwest residential real estate appraisal firm in Illinois, utilized by American Home in over 100 transactions, has reportedly stated that the company's mortgage brokers would call him and say, "I need this number." He was frequently threatened: "Either give us this home value or you will never do business for us again."

248. Similarly, an independent appraiser from Florida approved by American Home was reportedly told by the company's brokers, "We need this number, or you will never work for us again." In order to stay in business, she gave the valuations its brokers and loan officers demanded, even if it required driving 20 miles away for a "comparable" sale. And another independent appraiser from California who worked with American Home reportedly stated that its loan officers demanded inflated numbers from him. Lenders told him to either give them the numbers that they wanted, or the appraiser would be "done" and blackballed by every lender doing business in the state. In some cases, this appraiser valued houses for $100,000 more than they were worth in areas so bad that he would merely drive by and take pictures of the house.

249. Because American Home had systematically abandoned its underwriting guidelines, Defendants' representations about the Mortgage Loans' adherence to those guidelines were false. And because Defendants had conducted due diligence on those Mortgage Loans, Defendants knew those representations were false.

D. Third-Party Due Diligence Results

250. In connection with the securitization of the Mortgage Loans, Defendants performed due diligence to determine the quality of the loans they were purchasing and

securitizing. Specifically, Defendants relied on their 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 and deciding whether the loans met the stated credit and underwriting standards. To make this determination, Defendants' underwriters would review a sample of the purchased loans.

251. One of the primary third-party reviewers Defendants used was Clayton. 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.)

252. Clayton contract underwriters reviewed the loan files, compared 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.) The contract underwriters also "critically" analyzed whether, to the extent a loan was deficient, there were any "compensating factors." This review was commonly referred to as a "credit and compliance review." (*Id*.)

253. As explained in an FCIC interview, "Clayton had a methodology of ranking loans with a 1, 2 or a 3. . . . [A] 1 meant that the loan was consistent with the standards to which they were comparing it, a 2 meant that it was not consistent but there were other factors that would generally speaking and compensate for the deviation from the standard, and *3 meant that it was inconsistent with the standard and there weren't compensating factors that they believed would*

justify the deviation from the standard." (William Buell FCIC Interview Transcript September 15, 2010, at 46.) Clayton's Vice President Vicky Beal agreed that a "3" flagged a loan for the client as "definitely not okay." (Vicki Beal FCIC Interview Transcript, July 22, 2010, at 52.)

254. Clayton generated regular reports for Defendants and others in the securitization chain (such as any unaffiliated underwriters) that summarized Clayton's review findings, including summaries of the loan files that were outside the relevant underwriting standards. 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 Defendants with final reports.

255. According to the FCIC Report, only 54% of the loans reviewed by Clayton Holdings "met guidelines." (FCIC Report at 166.) Former President of Clayton, Keith Johnson, said that "54% to me says there [was] a quality control issue in the factory" for mortgage-backed securities. Mr. Johnson also testified that Clayton's clients often waived in loans to preserve their business relationship with the loan originator.

256. Recently released internal Clayton documents (known as "Trending Reports") show that, contrary to Defendants' representations, a startlingly high percentage of loans reviewed by Clayton for Defendants were defective, but were nonetheless included in the Original RMBS. During the timeframe summarized by the Trending Report (2006-2007), Defendants were informed that 30% of the more than 10,000 loans Clayton had reviewed for them "failed to meet guidelines." Nonetheless, Defendants intervened to "waive" 27% of those rejected loans into RMBS anyway. This is the same period during which many of the Original

RMBS were being securitized, and confirms that Defendants were systematically securitizing defective loans, including the Original RMBS underlying the Certificates insured by CIFG.

257. Clayton identified these high percentages of problem loans despite, as discussed below, underwriters, such as BAS, pressuring it to complete its reviews in a very short time frame, and with only limited re-verification of data. On information and belief, the percentage of loans securitized by Defendants that were truly problematic was in fact much higher than the astounding rates Clayton's reports indicate.

258. With such high failure rates, the proper response would be to reject the pool outright, and seriously investigate whether that originator could be considered a trusted source of loans in the future. Even assuming Defendants incredibly believed the high rates could be chalked up to 'sampling error' (due to the fact that Clayton did not review every loan in a pool), the proper response would be to increase the sample size to test that hypothesis or to cease doing business with the problematic originators. Defendants did neither. Instead, Defendants purchased and securitized the loans, without any further attempt to root out problematic loans in the larger pool.

E. Loan-File Reviews By Those With Access Confirm Defendants' Abandonment Was Systemic

259. As discussed above, CIFG's analysis of the underlying Mortgage Loans has found widespread and severe misrepresentations. Third parties with access to the complete loan files for certain Bank of America and Countrywide securitizations have performed additional analysis of the mortgage loans underlying those offerings. These include, among others, American International Group ("AIG"), MBIA Insurance Corporation ("MBIA"), Syncora Insurance Company ("Syncora"), and the Federal Housing Finance Agency ("FHFA"). Their analyses provide additional strong evidence that essential characteristics of the Mortgage Loans

underlying the Certificates were misrepresented and omitted material information, and that the problems in Defendants' underwriting practices were systemic.

260. Using a third-party vendor, AIG reviewed available loans using the same underwriting guidelines that the lenders purportedly used to originate the loans and that Bank of America misrepresented in the Offering Materials. AIG reviewed over 4,500 loan files from 11 offerings. Many of these offerings featured the same parties, structure, timing and disclosures as the Original RMBS underlying the Certificates.

261. For instance, AIG analyzed eight RMBS from the BAFC shelf—BAFC 2006-7, BAFC 2006-E, BAFC 2006-J, BAFC 2007-1, BAFC 2007-2, BAFC 2007-3, BAFC 2007-C and BAFC 2007-D. Here, the Original RMBS include several from the BAFC shelf—BAFC 2005-6, BAFC 2005-7, BAFC 2005-8, BAFC 2006-1, and BAFC 2006-4. All of these BAFC Offerings were created during the same time period, by the same entities, and pursuant to the same structure, timing and disclosures.

262. Similarly, AIG analyzed BOAMS 2006-B. The Certificates that CIFG insured contain several RMBS from the BOAMS shelf—BOAMS 2005-9, BOAMS 2005-10, and BOAMS 2005-11. In all of these RMBS, Defendant BOA acted as seller, sponsor, servicer, and originator, Banc of America Mortgage Securities, Inc. acted as depositor, and Defendant BAS acted as underwriter. Thus, on information and belief, the findings of AIG, made upon a review of the Defendants' own loan files, apply equally to the Certificates at issue here.

263. AIG's review revealed violations of underwriting guidelines in over 90% of the loans in each RMBS tested, including blatant misrepresentations of income, employment, and owner-occupancy. BOA was a sponsor and/or underwriter in all of these deals. Representative examples include:

- ***Misrepresentation of Employment.*** The borrower stated on the loan application that she had been self-employed as a builder for 25 years, earning $35,000 per month, and the co-borrower stated that he was also self-employed as a builder earning $30,000 per month. The borrower also listed on the application that she had been the owner of her building/construction business for 25 years; however, she was born in 1971, which would have made the borrower ***10 years old*** when she became the owner of the business. Additionally, the loan file contained letters of incorporation for both the borrower's and co-borrower's businesses with inception dates of 9/28/1993 and 2/26/2002, respectively. A reasonably prudent underwriter should have noticed that the age discrepancy was a red flag and questioned the validity of the information contained on the loan application. The loan defaulted.

- ***Misrepresentation of Employment.*** In a loan originated by Bank of America, the borrower stated on the loan application that he had been employed as a software engineer for three years, earning $10,902 per month. There was no evidence that the underwriter requested or obtained verification of his employment. In fact, the originating lender conducted a post-closing audit, which concluded that the borrower was never employed with the company and the ***employer identification numbers were invalid***. In 2009, the borrower completed a financial statement which stated he worked for a pool service company for the prior three years—dating back to the time the subject loan closed. The loan defaulted.

- ***Misrepresentation of Income.*** On his loan application, the borrower stated he received $6,045 per month in retirement and social security income. The loan file contained the borrower's retirement pay statement and social security statement. Both ***documents were altered*** to cover the income amounts. Additionally, the loan file contained a mortgage loan worksheet signed by the borrower which indicated a total gross monthly income of $3,438. The lender's guidelines required a borrower's employment history to be verified for the 24 months preceding the loan closing under the Stated Income Program. There was no evidence in the loan file that the underwriter requested or obtained a current verification of the borrower's pension income as required. The loan defaulted.

- ***Misrepresentation of Income***. The borrower stated on the application that she was self-employed as a personal chef with a monthly income of $10,166.67, or $122,000.00 annually. The borrower's tax returns, ***contained in the loan file***, showed a gross income for the entire year of 2007 of $3,126.00 for services as a personal chef, and $27,225 as a self-employed personal assistant. The borrower earned monthly income that was $675 *less* than the amount of the subject loan mortgage payment in the year following the mortgage closing. The borrower made only one payment on the mortgage, and defaulted.

- ***Misrepresentation of Debt Obligations***. The application failed to disclose that the borrower simultaneously closed on a second mortgage, originated by the ***same lender***, in the ***same condominium*** complex. Public records show that the borrower took a mortgage on the same day as the subject loan for $414,000, with a monthly payment of $4,995 for a property located in Dallas, Texas. The origination

underwriter failed to include that monthly payment in the borrower's DTI ratio for the subject loan, resulting in an imprudent underwriting decision. A recalculation of DTI based on the borrower's undisclosed debt, and recalculated income of $1,200 per month, yields a DTI of ***1,129%***, which exceeds the guideline maximum allowable DTI of 55%. The loan defaulted.

- In one file, the borrower stated on her loan application that she was an owner of a liquor store for 13 years, and stated her monthly income as $23,000 a month. $23,000 a month for an owner of a liquor store is unreasonable and should have put the underwriter on notice for potential misrepresentation. The borrower filed a Chapter 13 bankruptcy with the Central District of California Bankruptcy Court in October 2008. Per the Statement of Financial Affairs, the borrower reported that she was retired and earned income of $14,400 annually or $1,200 per month for the year of 2006.

- ***Excessive DTI***. The lender's guidelines permitted a maximum allowable DTI of 55% for a stated income loan when the subject property was an investment property. The DTI was not accurate because the borrower's income for the year of the subject loan closing, 2006, was a ***loss*** of $200,684, or a monthly loss of $16,724 per month. The borrower's total monthly debt was $7,878, meaning that the DTI could not be calculated because the income was ***negative***. The loan defaulted.

- ***Underwriting Guidelines Breach***. The lender's guidelines prohibited a loan amount greater than $400,000 for loans approved with a C or CC risk grade. The subject loan was approved as a C risk grade with a 5 x 30 rating due to unsatisfactory mortgage payments in the last 12 months on the borrower's secondary mortgage. Despite this requirement, the subject loan closed in the amount of $740,000, which exceeds the guideline maximum of $400,000. The loan defaulted.

264. Of the loan files reviewed, 264 were originated by Bank of America, and these loans independently reflected breach rates in excess of 90%.

265. AIG also obtained the loan files for certain Countrywide securitizations. A review of 188 Countrywide-originated loans revealed violations of underwriting guidelines in *over 90%* of them, including blatant misrepresentations of employment, and breaches of guidelines. Representative examples include:

- ***Misrepresentation of Employment.*** The borrower represented on the loan application that he had been employed for 15 years as a general manager. However, the loan application reflected that the borrower's employer had the same address as the subject property. Furthermore, the individual identified in the loan file as having provided verbal verification of the borrower's employment was the borrower's spouse. In addition, the origination credit report reflected that the borrower was

actually a nanny. These red flags should have put a reasonably prudent underwriter on notice of the possibility that the borrower's employment was misrepresented. The loan defaulted.

- ***Misrepresentation of Employment.*** The loan application stated that the borrower had been self-employed as the owner of a construction business for 10 years. The origination credit report did not reflect the borrower having an employment history at the business listed on the loan application. In addition, the loan file contained a bank statement for a business checking account that reflected a different business name than the business listed on the loan application. An audit search of public records reflected that the borrower's business stated on the loan application was dissolved in 1999. The loan defaulted.

- ***Failure to Determine Reasonable Ability to Repay.*** The borrower stated on the loan application that he made $4,720 per month as a landscape laborer and an additional $4,000 per month as a landscaper. An income of nearly $9,000 per month for a landscaper is unreasonable and should have put a reasonably diligent underwriter on notice. Moreover, the borrower's total verified assets were a seasoned amount of $5,259, an amount insufficient to cover the three month housing payment reserve requirement set forth in the underwriting guidelines. The loan defaulted.

266. MBIA also had access to some of the complete loan files for certain Countrywide securitizations. Its analyses provide additional strong evidence that essential characteristics of the Mortgage Loans underlying the Certificates were misrepresented, and that the problems in the Defendants' underwriting practices were systemic.

267. MBIA is a New York-based monoline insurer that wrote insurance on certain Countrywide mortgage-backed securities offerings. MBIA conducted an investigation into Countrywide's loan files after it was asked to make payments to certain investors. MBIA's analysis included 17 Countrywide RMBS. Many of the offerings that MBIA reviewed featured the same parties, structure, timing and disclosures as the Original RMBS underlying the Certificates. MBIA also found that the defective loans span Countrywide's securitizations from 2004 to 2007, demonstrating the consistency of Countrywide's disregard for its own underwriting guidelines over this period, which encompasses the period at issue in this case.

Thus, the offerings that MBIA analyzed are probative of problems underlying the Certificates insured by CIFG.

268. In carrying out its review of Countrywide loan files, MBIA found that 91% of the defaulted or delinquent loans in those securitizations contained material deviations from Countrywide's underwriting guidelines. MBIA's report showed that the loan applications frequently: (i) "lack key documentation, such as verification of borrower assets or income"; (ii) "include an invalid or incomplete appraisal"; (iii) "demonstrate fraud by the borrower on the face of the application"; or (iv) "reflect that any of borrower income, FICO score, debt, DTI [debt-to-income,] or CLTV [combined loan-to-value] ratios, fails to meet stated Countrywide guidelines (without any permissible exception)." Because Countrywide's violation of its underwriting guidelines was a systemic problem, MBIA's findings are equally applicable to all of CIFG's Countrywide Original RMBS.

269. Syncora, another insurance company that insured Countrywide's securitizations, has conducted a similar re-review analysis of defaulted loans in the securitizations that it insured to determine whether the loans had been originated in accordance with Countrywide's representations. Syncora found that *75% of the loans it reviewed "were underwritten in violation of Countrywide's own lending guidelines*, lack any compensating factors that could justify their increased risk, and should never have been made." Syncora's review is probative of the problems underlying the Certificates insured by CIFG because it again shows Countrywide's failures during this key period of 2004 to 2007 were systemic.

270. Syncora gave examples of individual loans that diverged from Countrywide's guidelines. The individual defective loans analyzed by Syncora reflected a long list of misstatements by Countrywide. Many loans violated the DTI ratios and LTV ratios set forth in

Countrywide's underwriting guidelines, without adequate compensating factors to justify the increased risk of default, due in part to borrowers' exaggerated incomes and exaggerated property values. Loan amounts routinely exceeded the maximum amounts permitted under the Company's guidelines for each given borrower, based on a borrower's credit score, documentation, and property values. Countrywide also improperly issued loans to borrowers when their loan files lacked adequate documentation of income, assets, credit, employment, cash reserves, or property values.

271. FHFA, which also had access to thousands of Bank of America's loan files, performed a forensic review of 2,441 loan files for two offerings underwritten by BAS. The forensic review consisted of an analysis of the loan origination file for each loan, including the documents submitted by the individual borrowers in support of their loan applications. FHFA also analyzed information extrinsic to each loan file, such as the borrower's motor vehicle registration, documentation with pertinent information indicating the borrower's assets or residence, and other information that was available at the time of the loan application, as well as the borrower's filings in bankruptcy proceedings and other sources of information.

272. FHFA's loan-file review found that *over 80%* of the loan files reviewed did not adhere to the applicable underwriting guidelines or otherwise represented breaches of the relevant representations and warranties contained in the transactional documents. These breaches included:

- Failure to test the reasonableness of borrowers' stated income, contributing to material misrepresentations of income;
- Failure to investigate properly the borrower's intention to occupy the subject property when red flags surfaced in the origination process that should have alerted the underwriter that the property was not intended as a primary residence;

- Failure to calculate properly the borrower's outstanding debt, causing the DTI ratio to exceed the maximum allowed under the underwriting guidelines; and

- Failure to investigate properly red flags on the borrower's credit reports for potential misrepresentations of outstanding debt that should have alerted the underwriter that potential misrepresentations of outstanding debt existed.

273. For example:

- A loan that closed in May 2007 with a principal balance of $108,000 was originated as a stated income loan. The borrower stated earnings of $6,000 per month as a dietary technician. There is no evidence in the file that the loan underwriter tested the reasonableness of the stated income. The borrower's stated income exceeded the Bureau of Labor Statistics' 90th percentile for a dietary technician in the same geographic area during the time period of the loan application by more than 1.5 times. Moreover, in the Statement of Financial Affairs filed as part of the borrower's declaration of bankruptcy, the borrower reported a monthly income in 2007 of $932. Had the loan underwriting process tested the reasonableness of the borrower's stated income, the misrepresentation of income would have been uncovered. A recalculation of DTI based on the borrower's true income yields a DTI of 206.71%, a figure more than four times the guideline maximum of 50%. The loan defaulted, and the property was liquidated in a foreclosure sale, resulting in a loss of $103,169, over 95% of the original loan amount.

- A loan that closed in May 2007 with a principal balance of $385,000 was originated as a stated income loan. The borrower stated earnings of $6,850 per month as a nurse. There is no evidence in the file that the underwriter tested the reasonableness of the stated income. The borrower's stated income exceeded the Bureau of Labor Statistics' 90th percentile for a nurse in the same geographic area during the time period of the loan application by more than 1.5 times. Moreover, in the Statement of Financial Affairs filed as part the borrower's declaration of bankruptcy, the borrower reported a monthly income in 2007 of $2,833, and the borrower's 2007 W-2 form reflected earnings of $30,178 annually, or $2,515 per month. Had the loan underwriting process tested the reasonableness of the borrower's stated income, the misrepresentation of income would have been uncovered. A recalculation of DTI based on the borrower's income, as reflected in the 2007 W-2 Form, yields a DTI of 134.69%, greatly exceeding the guideline maximum of 50%. The loan defaulted, and the property was liquidated in a foreclosure sale, resulting in a loss of $343,350, over 89% of the original loan amount.

- A loan that closed in May 2007 with a principal balance of $333,000 was originated as a stated income loan. The borrower stated earnings of $6,623 per month as a cosmetologist. There is no evidence in the file that the underwriter tested the reasonableness of the stated income. The borrower's stated income exceeded the Bureau of Labor Statistics' 90th percentile for a cosmetologist in the same geographic region during the time period of the loan application by more than 1.2 times.

Moreover, the borrower's 2006 and 2007 tax returns reveal that the borrower reported a monthly income in 2006 of $1,054, and monthly income in 2007 of $1,328. Had the loan underwriting process tested the reasonableness of the borrower's stated income, the misrepresentation of income would have been uncovered. A recalculation of DTI based on the borrower's true income yields a DTI ratio of 226.72%, greatly exceeding the guideline maximum of 50%. The loan defaulted, and the property was liquidated in a foreclosure sale, resulting in a loss of $379,330, over 113% of the original loan amount.

- A loan that closed in October 2006 with a principal balance of $276,000 was originated as a stated income loan. There is no evidence in the file that the underwriter tested the reasonableness of the stated income. The borrower stated an income of $10,000 per month as a language interpreter. The borrower's stated income exceeded the Bureau of Labor Statistics' 90th percentile for a language interpreter in the same geographic area during the time period of the loan application by more than 2.5 times. Moreover, in the Statement of Financial Affairs filed as part of the borrower's declaration of bankruptcy, the borrower reported a monthly income in 2006 of $1,144. Had the loan underwriting process tested the reasonableness of the borrower's stated income, the misrepresentation of income would have been uncovered. A recalculation of the DTI based on the borrower's true income yields a DTI of 289.86%, a figure exceeding by nearly six times the guideline maximum of 50%. The loan defaulted, and the property was liquidated in a foreclosure sale, resulting in a loss of $250,993, over 90% of the original loan amount.

- A loan that closed in November 2006 with a principal balance of $350,000 was originated as a stated income loan. The borrower stated an income of $10,400 per month as a reflexologist. There is no evidence in the file that the underwriter tested the reasonableness of the stated income. The borrower's stated income exceeded the Bureau of Labor Statistics' 90th percentile for a reflexologist in the same geographic area during the time period of the loan application. Moreover, in the Statement of Financial Affairs filed as part of the borrower's declaration of bankruptcy, the borrower reported a monthly income in 2006 of $30. Had the loan underwriting process tested the reasonableness of the borrower's stated income, the misrepresentation of income would have been uncovered. A recalculation of the DTI ratio based on the borrower's true income yields a DTI ratio of 1,343.36%, a figure exceeding by 26 times the guideline maximum of 50%. The loan defaulted, and the property was liquidated in a foreclosure sale, resulting in a loss of $224,089, over 64% of the original loan amount.

274. In addition, the Illinois Attorney General reviewed the sales of Countrywide loans by an Illinois mortgage broker and found that *the vast majority of the loans had inflated incomes stated in the documentation, almost all without the borrowers' knowledge.* This study covered the time period of 2004 to 2007, again encompassing the same time period during which

Countrywide was generating the loans at issue here. Likewise, a review of 100 Countrywide stated-income loans by the Mortgage Asset Research Institute revealed that *60% of the income amounts were inflated by more than 50%*, and 90% of the loans had inflated income figures of at least 5%. Again, this is highly probative of the problems underlying the Countrywide Original RMBS as it covers the time period of 2004 to 2007.

F. Defendants Engineered Inflated Credit Ratings

275. As explained above, Defendants obtained and provided to CIFG credit ratings for both the Original RMBS and the Certificates, as well as shadow ratings for the Certificates. Throughout this process, Defendants failed to disclose that the credit ratings had been obtained based on materially false, misleading, and incomplete information. Defendants provided false data to the rating agencies in order to pre-determine the ratings the Original RMBS and the Certificates would receive.

276. Defendants had huge incentives to procure favorable ratings on the Original RMBS and the Certificates. Because investors would be reluctant to purchase unrated RMBS, the ratings were important to marketing the Original RMBS. And when the Original RMBS were securitized into the Certificates, those underlying ratings informed the quality and ratings of the Certificates. The ratings given to the Certificates were equally essential. This is because CIFG would not and could not insure securities that had ratings below BBB. Defendants also knew that the ratings given to CIFG would be used by it to confirm what CIFG's own Initial Diligence was uncovering about the riskiness of the Policies.

277. Defendants engineered inflated ratings on the Original RMBS and the Certificates, by providing false data to the rating agencies with the intent to defraud investors and CIFG. This false data overestimated the credit quality of the Mortgage Loans, which skewed the ratings in Defendants' favor. Each credit rating agency uses a model to assess the

creditworthiness and assign ratings to the different tranches of a securitization. The inputs to the credit rating agencies' models include, among other things, the debt-to-income ratios, LTV ratios, owner-occupancy status, and home values corresponding to the mortgage loans backing each of the underlying RMBS.

278. Just as CIFG relied on Defendants to provide accurate information concerning the credit quality of the underlying mortgage pools in considering whether to issue the Policies, the rating agencies relied on Defendants to provide them with accurate information on which to conduct their analyses and base their ratings. Defendants provided false data to the rating agencies to procure original and shadow ratings with the intent to defraud investors and CIFG.

279. The SPSI report, discussed above with respect to its findings as to WaMu, includes express Congressional findings of fact on the "inflated credit ratings" Defendants procured and used to sell their RMBS products. It describes the flow of information from Defendants to the rating agencies:

> 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 . . . In addition to data on the assets, the arranger provided a proposed capital structure for the financial instrument, identifying, for example, how many tranches would be created, how the revenues being paid into the RMBS or CDO would be divided up among those tranches, and how many of the tranches were designed to receive investment grade ratings. The arranger also identified one or more "credit enhancements" for the pool to create a financial cushion that would protect the designated investment grade tranches from expected losses.

(SPSI Report, at 250-251.) (Notably, this flow of information was similar to that used to provide information to CIFG.)

280. In her testimony to the SPSI, Susan Barnes, the North American Practice Leader for RMBS at S&P from 2005 to 2008, highlighted the importance of accurate information to the credit ratings process:

> 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*. At the time that it begins its analysis of a securitization, S&P received detailed data concerning the loan characteristics of each of the loans in the pool—up to 70 separate characteristics for each loan in a pool of, potentially, thousands of 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.

(Emphasis added.)

281. Defendants fed the rating agencies the same false data that they provided to CIFG in the Offering Materials. The rating agencies then input this false data into their quantitative models to assess the credit risk associated with the Original RMBS and the Certificates, project likely future defaults, and ultimately determine the risk profile and ratings on the Original RMBS and the Certificates. As a result, Defendants essentially pre-determined the ratings by feeding bad data into the ratings system. By providing data that overestimated the credit quality and value of the underlying Mortgages Loans, Defendants guaranteed that the ratings on the Original RMBS and the Certificates would be inflated. The underwriting guidelines provided to the rating agencies further contributed to the inflation of the ratings, because Defendants did not inform the rating agencies that they had abandoned compliance with the guidelines, or that they had ignored the results of their own and the third-party due diligence processes by "waiving" in loans flagged as being defective.

282. In a non-public meeting on September 10, 2007, a transcript of which was released to the public on October 22, 2008, senior executives at Moody's confirmed that the rating agencies relied on data that they now know to be false:

> "At the end of the day, we relied on reps and warrantees that no loans were originated in violation of any state or federal law. We know that's a lie. If none were originated in violation of any predatory lending law, we know that's a lie. So what are you going to do about it? We can't rely on what people tell us anymore, and so we've got to figure out, do we rely on third party oversight?"
>
> "It's actually quite interesting that we're being asked to figure out how much everybody lied. That's really what we're being asked to do."

283. Thus, in order to procure the Policies, Defendants knowingly procured and promoted fraudulent ratings that overstated the actual credit quality of the Original RMBS and the Certificates—ratings that Defendants did not genuinely believe.

G. Defendants' Servicing Failures

284. Defendants' representations as to the servicing practices applicable to the Mortgage Loans were false and misleading because Defendants knew that the actual servicing did not conform to the stated practices. Had CIFG known that the Mortgage Loans were not being properly serviced, it would never have issued the Policies.

285. For example, all of the Countrywide-label Original RMBS backing the R2 Certificates insured by CIFG are part of a recent multibillion-dollar settlement agreement between investors and BOA. The settlement resolves BOA's liability to investors for repurchase claims and servicing failures with respect to the mortgage loans that back certain RMBS, including the Countrywide-label Original RMBS backing the R2 Certificates insured by CIFG.

286. According to public statements by BOA, the June 29, 2011 proposed settlement agreement includes an $8.5 billion cash payment to investors. BOA has publically described this multibillion-dollar cash settlement, combined with other related "mortgage actions," as

"important steps in putting representations and warranties . . . risk behind us." In addition to the $8.5 billion cash payment, BOA has agreed as part of the settlement "to implement certain servicing standards and address documentation deficiencies." (Addressing Legacy Mortgage Issues, BOA Presentation, June 29, 2011.) Although BOA has not publically admitted any wrongdoing, the multibillion-dollar size of the settlement itself speaks volumes.

287. Further proof of BOA' s abandonment of reasonable servicing standards is found in its failure to identify issues relating to underwriting errors and fraud in the underlying Mortgage Loans to the relevant trustees, notwithstanding the high probability that such issues exist. Servicers have an obligation under relevant industry standards to observe and report evidence obtained during servicing that relates to underwriting violations and fraud or misrepresentation in the mortgages they are servicing. For example, the BOAA 2005-12 Prospectus Supplement provides that:

> Each Servicer will deliver annually to the Trustee or Master Servicer . . . an Officer's Certificate stating that (i) a review of the activities of such Servicer during the preceding calendar year and of performance under the applicable Pooling and Servicing Agreement or Underlying Servicing Agreement has been made under the supervision of such officer, and (ii) to the best of such officer's knowledge, based on such review, such Servicer has fulfilled all its obligations under the applicable Pooling and Servicing Agreement.

(BOAA 2005-12 Prospectus Supplement at 56.) The servicer is also supposed to conduct "an examination of certain documents and records relating to a random sample of the mortgage loans being serviced by such Servicer pursuant to such Pooling and Servicing Agreement." (*Id.*)

288. As servicer for nine of the Original RMBS, BOA had an obligation to report such information to the relevant trustee to facilitate contractual demands that the loans be transferred out of the capital collateralizing the Original RMBS. Yet, upon information and belief, BOA has failed to identify a single instance of fraud or underwriting violation to the trustees. Given the size of collateral pools involved, it is simply not credible to assume that no such issues have been

identified in the pools. A more accurate assumption is that BOA failed to report such issues because, as the seller, it may have been forced to repurchase such Mortgage Loans from the trust. Once again, BOA shirked its contractual duty to the trusts and investors, and acted to protect itself by shifting risk to others.

289. BOA's failure to service the Mortgage Loans in accordance with the terms of the written requirements in the Offering Materials and PSAs given to CIFG renders those materials untrue and/or misleading in material respects. Notwithstanding its knowledge of material servicing failures relating to the Certificates, and its own complete disregard of the servicing requirements and standards set forth in the PSAs, BOA has at all times relevant to this Complaint failed to inform CIFG of such issues and of its own failures. This belies the servicing representations and warranties contained in the Offering Documents and PSAs. CIFG would never have issued its policies had it known that BOA had abandoned reasonable servicing standards.

IV. DEFENDANTS KNEW THEIR REPRESENTATIONS WERE FALSE

A. Overview

290. This is not a typical fraud and contract case where the misrepresentations were contained in a single offering document or concerned a single event. This was a massive, multiyear scheme covering Defendants' entire securitization operation. CIFG's lawsuit concerns 2 Certificates and 22 Original RMBS. However, CIFG's suit is just the tip of the iceberg. Other monoline insurers (as well as dozens of investors) have brought fraud and breach of contract suits against Defendants covering many more securitizations with a collective value in the tens of billions of dollars.

291. Pre-suit investigations by these plaintiffs, governmental investigations, and post-filing discovery in these lawsuits have unearthed facts that demonstrate beyond a shadow of a

doubt that Defendants engaged in a deliberately illegal scheme in which they packaged and sold billions in RMBS securities based on false representations that the mortgage loans underlying these securities met underwriting guidelines. All the while, they knew facts and had access to information from both internal and paid consultants proving their statements about adherence to underwriting guidelines to have been false and misleading. Not only did Defendants fail to check relevant information; they tried to cover up the evidence for fear that they would be caught. The motive was simple: greed. Defendants made hundreds of millions of dollars they could not have made but for the fraud and breaches of contract alleged herein.

292. Defendants' verification that the mortgage loans complied with published underwriting guidelines was *the* primary purpose of the extensive due diligence Defendants undertook during the securitization process. This due diligence, discussed below, gave Defendants all the information they needed to discover the systemic departure from underwriting guidelines. The evidence, discussed below, demonstrates Defendants had actual knowledge of the falsity of their representations. At a minimum, Defendants were recklessly indifferent to the truth of the statements they made to CIFG. As expounded upon below, this is confirmed by, among other facts: (a) the consistency of the problems; (b) confidential witness testimony from BOA employees, confirming the Bank acted knowingly; (c) Clayton's "Trending Report," showing that due diligence of the type Defendants performed here was catching numerous defective loans—but that Defendants were "waiving" them anyway; and (d) confidential witness testimony confirming, in many other ways, that Defendants' due diligence processes were catching errors of the type at issue here *on a daily basis*—despite that the underwriters were understaffed, undertrained, and pressured to "look the other way" as often as possible.

293. Similarly, the evidence shows that Defendants knew that the specific appraisal and LTV representations contained in the underlying Offering Materials were likewise false. Multiple confidential witnesses show that BOA itself abused the appraisal process. And many other witnesses confirm that appraisal defects were caught and flagged for Defendants on a daily basis by their due-diligence underwriters.

294. The facts also show that Defendants' due diligence process gave them actual, daily knowledge of problems with the owner-occupancy representations. For instance, confidential witnesses confirm that many times the due diligence performed by Defendants revealed, for example, that the borrower worked far, far away from where the mortgaged property was, or that the borrower had secured insurance terms to protect its role as a landlord on the property. Those witnesses also confirm that such problems were included in the due-diligence reports provided to Defendants.

295. In short, this is not a case where Defendants should have been asking more questions or simply should have been more skeptical of the data they were given. They were actually handed evidence on a silver platter. It is implausible to believe that Defendants ignored all the data to which they (but not CIFG) had access. BOA's industry practices, numerous confidential witnesses, and Clayton's "Trending Report" confirm that Defendants performed due diligence that revealed many loan defects. Despite their knowledge of these defects, Defendants deliberately chose to include the defective loans in the Original RMBS and the Certificates to increase their own profits.

B. <u>Facts Showing Defendants' Knowledge of General Underwriting Abandonment by Originators</u>

1. The consistency of the Loans' errors

296. The same evidence discussed above demonstrating the consistent and pervasive falsity of Defendants' representations also supports the conclusion Defendants *knew* their Offering Materials were false. This did not happen with isolated offerings. Rather, the misrepresentations were consistent across a wide spectrum of securitizations. For instance, CIFG's forensic analysis found not just that the characteristics of the Mortgage Loans were misrepresented—but they were *consistently* misrepresented from securitization to securitization. Occupancy rates were misrepresented in the Original RMBS, by as much as ***17.10%***. The number of loans with LTV ratios above 100% was misrepresented across the Original RMBS, by as much as ***19.67%***. Improperly assigned loans account for over ***58%*** of the Mortgage Loans at issue. In short, this was a massive scheme and the misrepresentations were pervasive.

297. The departures from represented guidelines resulted in mortgages being included in the pools which posed high credit risks. This was manifested in skyrocketing default rates—across all of the Original RMBS, ***19.78%*** of the Mortgage Loans are currently delinquent or have already had to be written off for a loss. Of the Mortgage Loans that are currently active, ***21.04%*** are delinquent. While all of the Original RMBS were initially rated "investment grade," ***all*** are now rated "junk."

298. Evidence exists that these problems infected even more of Defendants' securitizations, beyond the Original RMBS at issue here. As described above, loan-file reviews performed by AIG, MBIA, Syncora and FHFA show that Defendants systematically, as a matter of practice, knowingly acquired and securitized loans that had been originated with *virtually no regard* for the borrowers' ability to repay their obligations. For example, AIG found that a

staggering ***90%*** of the over 4,500 Bank of America loans that it re-underwrote did not meet the stated underwriting guidelines. MBIA and Syncora found similarly striking defect rates of ***91%*** and ***75%***, respectively, for the Countrywide RMBS that they analyzed. These results confirm that Defendants' fraudulent practices pervaded their RMBS business during this period.

299. Logic dictates that Defendants could not have purchased, pooled, and securitized so many defective Mortgage Loans without knowing that the Loans had vastly different characteristics than what Defendants represented. Courts have repeatedly recognized that a *consistent pattern* of *large* misstatements can itself be strong evidence of scienter. (*See generally, e.g.*, *EP Medsystems, Inc. v. EchoCath, Inc.*, 235 F.3d 865, 881 (3d Cir. 2000) ("[W]e believe that when multiple promised events fail to occur, there is a point where a strong inference of fraud can be made.").)

2. Defendants' extensive due diligence processes made them aware that the Mortgage Loans did not conform to represented underwriting guidelines

300. That Defendants could not securitize so many Mortgage Loans without knowing the Mortgage Loans did not have the risk profile represented by Bank of America is confirmed by the multiple rounds of due diligence that Defendants themselves conducted, the vertically integrated nature of Defendants' operations, and their prominence and experience in this marketplace. Defendants' unique position in the market gave them a direct window into the gross departure from the underwriting practices they represented they were following.

301. Consistent with industry practice, Defendants performed due diligence to determine the quality of the loans they were originating, purchasing, and securitizing at many different steps. Specifically, Defendants operated quality assurance and risk management departments tasked with discovering whether the Loans met the stated credit and underwriting

standards. Defendants conducted due diligence on the originators, and on the Loans included in each Original RMBS to ensure compliance with the approved underwriting guidelines.

302. Defendants employed a team of in-house underwriters who reviewed samples of purchased loans to verify that they both conformed to the representations made by the originators and complied with the stated credit and underwriting policies.

303. That many of the Loans were originated by BOA makes the issue of Defendants' knowledge all the more clear. This is because BOA itself knew of its own lax origination practices, and the later "securitization" diligence benefitted from a direct window into the lax origination processes that led to the creation of many of the Mortgage Loans. That Defendants were, in fact, reviewing the work of their own affiliate makes it all the less likely that they could have purchased, reviewed, and securitized the Mortgage Loans here without knowing of their defective nature.

304. BAS also served as the underwriter both for the Original RMBS and the Certificates, and BAFC served as the depositor. This vertical integration heightened the already-perverse incentives created by the move to the "originate and distribute" business model. The originator, secure with a pipeline to the market, would have even more incentive to loosen its practices. Those responsible for the securitization, focused on volume, would push them to do so even more. And once the loans were issued, those responsible for securitization would have significant incentives to ignore problem loans because rejecting a loan would saddle an affiliated company with a toxic loan.

305. Even when the loans came from other originators, due diligence was performed on the loans at multiple stages. For instance, BOA conducted due diligence when it purchased loans from third-party originators, and the results of this due diligence were shared with BAFC

and BAS in the process of securitizing the loans. Yet further due diligence was carried out by BAS, as underwriter, to ensure that the information provided to RMBS investors and insurers like CIFG was complete and accurate. Indeed, Defendants represented to CIFG that BOA "conducts a post-purchase review of a sampling of all mortgage loans acquired from another lender to determine whether agreed upon requirements were met. In order to be eligible to sell mortgage loans under a delegated underwriting arrangement, the lender must meet certain requirements including, among other things, certain quality, operational and financial guidelines." (BOAA 2006-6 Prospectus at 31; *see also* Exhibits C-X.) In other words, Defendants represented that they engaged in their own due diligence procedures, regardless of the source of a given Loan.

306. Defendants had extensive business relationships with the Originators; had access to the Originators' mortgage origination personnel and internal information; and conducted due diligence into the Originators through their own personnel and third-party loan review firms. Thus, regardless of the originator, all of these due diligence processes benefitted from a direct window into the lax origination practices at issue. Defendants' reviews would necessarily have revealed the pervasive deficiencies in the Mortgage Loans. Nonetheless, they failed to disclose any of this to CIFG.

307. For instance, BOA participated in loan auctions, in which it purchased loans in bulk from third-party originators with whom it had "warehouse lending" relationships. As discussed above, BOA was the leading participant in the warehouse lending channel, and had extensive warehouse lending commitments to lenders such as Countrywide, which originated loans underlying many of the Original RMBS.

308. Under these "warehouse" relationships, BOA provided money to originators, which in turn used the money to fund mortgages. The originators then sold the loans back to BOA, essentially paying the warehouse loan back by delivering the loans to BOA for securitization. Entering into such relationships helped BOA secure a pipeline of mortgages for its securitization machine. Warehouse loans also gave BOA the ability to monitor the practices of the originator, and gave it an insider's look at the true quality of that originator's operations. As one industry publication explained, warehouse lenders have "detailed knowledge of the lender's operations." (Kevin Connor, *Wall Street and the Making of the Subprime Disaster*, November 2007 at 11.)

309. Warehouse lending relationships pervert the lender's due-diligence incentives. If BOA refused to buy the proffered loans, it could leave the originator unable to pay the warehouse loan and BOA holding the bag. Prior to an auction, originators provided bid sheets to BOA that specified, among other things, the percentage of loans on which BOA would be permitted to conduct due diligence. The originators also provided a loan tape that described characteristics of the mortgages in the loan pool. BOA then performed tests and checks on this information, and prepared its bids. If it won, BOA was allowed to conduct additional due diligence before the settlement date. Rejecting loans would leave a smaller pool to securitize—meaning smaller fees for Defendants' securitization efforts. And rejecting too many loans could even convince originators to stop selling loans to them, cutting off Defendants' pipeline entirely. With hundreds of millions of dollars in profits riding on the RMBS pipeline, BOA had an economic incentive to turn a blind eye toward the pervasive fraud in the origination process, which led to persuasive fraud in BOA's RMBS program.

310. If BOA won its bid, it then had the right to commence full due diligence and quality control. Defendants routinely engaged third-party due-diligence firms, such as Clayton or Bohan, to conduct some of the due diligence steps discussed above. As described in the FCIC Report (at 166), such due-diligence reviews:

311. [F]ell into three general areas: credit, compliance, and valuation. Did the loans meet the underwriting guidelines (generally the originator's standards, sometimes with overlays or additional guidelines provided by the financial institutions purchasing the loans)? Did the loans comply with federal and state laws, notably predatory-lending laws and truth-in-lending requirements? Were the reported property values accurate? And, critically: to the degree that a loan was deficient, did it have any "compensating factors" that offset these deficiencies? For example, if a loan had a higher loan-to-value ratio than guidelines called for, did another characteristic such as the borrower's higher income mitigate that weakness? The due diligence firm would then grade the loan sample and forward the data to its client.

312. Clayton prepared a wide range of reports for BOA, over a period of years. 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.

313. In addition to receiving these daily reports, BOA often had onsite representatives present for the due diligence review. These onsite representatives typically had full access to the data entered into the Clayton Loan Analysis System, which was the program loan reviewers used to keep track of their progress as they went through a file (checking off boxes to indicate, for

instance, that proper supporting documentation had been found in the file). The loan reviewers also used the system to record narrative descriptions in a "notes" field (for example, explaining why loans did not deserve a fully passing grade). Such notes to the file were made for BOA's benefit, explaining whether the loan's failing grade was because of non-compliance with underwriting guidelines, faulty appraisals, "red flags" as to the accuracy of the occupancy representations, or anything else problematic in the loan files. Thus, BOA representatives on-site were usually able to see this entire process unfold in real time, giving BOA even more direct access to information regarding the credit quality and characteristics of the loans.

314. The information contained in the daily, final, and trending reports generally included, but was 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) whether the appraisals were inflated and whether the correct appraisal processes were followed; (iv) the borrower's assets; (v) documentation missing from the loan application; (vi) the status and condition of the underlying property; (vii) the disposition of the loan, including any transfers or foreclosure; and (viii) whether the loan complied with applicable laws and regulations. Clayton typically made each of these types of reports, as well as any other loan-specific information, available at Defendants' request.

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

316. In sum, Defendants typically received *daily* reports indicating exactly how many loans failed to meet the guidelines—*and* which loans lacked any purported "compensating factors." That Defendants were receiving *daily* reports regarding how many loans were defective—on top of their already-extensive due diligence processes—confirms they acted knowingly in securitizing the defective Mortgage Loans at issue here. This is on top of their in-house reviews, their real-time data streams coming from the Clayton Loan Analysis System, and the fact that Defendants often had representatives on-site as these loan files were being reviewed and flagged as having problems.

3. The federal government and other parties have found that Defendants' due diligence process proved they had knowledge of the massive fraud

317. Government data shows that Defendants were *consistently* able to uncover loan defects—but just as consistently, Defendants securitized the defective loans anyway. The FCIC found that ***over 30%*** of the loans reviewed by Clayton for BOA both failed to meet the stated guidelines, and were not subject to any "compensating factors" justifying the use of an "exception."[4] Defendants nonetheless securitized ***over 27%*** of these flagged loans. Based on the systemic nature of the problems that have been uncovered, the overlap in time with the Original RMBS, and the high number of defects in the Mortgage Loans at issue here, it is evident that Defendants' internal and third-party due diligence processes here similarly caught high numbers of defective loans—and yet Defendants fraudulently "waived" them into the Original RMBS anyway.

[4] To be clear, CIFG is not alleging that the Clayton report produced by the FCIC *itself* gave Defendants knowledge, as that report post-dated the transactions at issue. Rather, CIFG alleges that that summary document merely revealed publicly, in summary form, the contents of the *daily, contemporaneous* reports Defendants received as part of their real-time due diligence prior to securitization.

318. Defendants have been investigated by the federal government and sued by many plaintiffs for related wrongdoing arising from RMBS securitization. These lawsuits further confirm that Defendants' misrepresentations were not mere isolated or innocent mistakes that harmed CIFG, but rather the result of the company's reckless or intentional misconduct.

319. As discussed above, the New York Attorney General investigated Defendants' mortgage-related securitization activities and found that Defendants "face Martin Act liability because there are repeated false representations in the Governing Agreements [for RMBS] that the quality of the mortgages sold into the Trusts would be ensured." In addition, Defendants face liability for "persistent illegality" in violation of Executive Law § 63(12) for "repeatedly breached representations and warranties regarding loan quality."

320. FHFA, as Conservator for the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, sued Defendants in September 2011 for selling over $6 billion in RMBS to the Government Sponsored Entities ("GSEs") pursuant to prospectuses and other offering materials that contained misrepresentations. As described by the government, Defendants "falsely represented that the underlying mortgage loans complied with certain underwriting guidelines and standards, including representations that significantly overstated the ability of the borrowers to repay their mortgage loans." The FHFA complaint cites the results of a re-underwriting of over 2,000 loans similar to those backing the Certificates at issue here. FHFA found a "pervasive failure to adhere to underwriting guidelines" among the tested loans.

321. Defendants have also been sued by AIG, MBIA, Syncora and others for wrongdoing related to RMBS. The allegations in those complaints are consistent with the information herein, and the multiplicity of similar allegations from many plaintiffs, including the federal and state government, corroborate the allegation herein that Defendants routinely

acquired and included in securitizations loans that did not meet underwriting standards and other representations to CIFG.

322. The securitizations at issue in the other complaints, and the plaintiffs' analysis of those securitizations, overlaps to some extent with the Original RMBS. The AIG Amended Complaint, for example, includes three Original RMBS that are also named in this Complaint: BAFC 2005-8, BOAA 2005-9, and CWALT 2006-26CB. AIG performed a loan-level analysis of the loans underlying these specific offerings, and found material discrepancies between the description of the loans in Bank of America's Offering Materials and their actual characteristics. For example, AIG found that the Offering Materials for BAFC 2005-8, BOAA 2005-9, and CWALT 2006-26CB materially misrepresented the LTV ratios and owner occupancy statistics for those securitizations.

323. The multiplicity of similar allegations from many plaintiffs, including the government, corroborate the allegation herein that Defendants routinely originated, acquired and included in securitizations loans that did not meet underwriting standards and other representations to CIFG.

4. Confidential witnesses confirm that Defendants knowingly originated defective loans

324. BOA originated many of the loans for its own offerings, and in so doing, abandoned its stated underwriting guidelines and sound underwriting practices—knowing of, and assisting in, the falsification and misrepresentation of both borrower income and appraisals on mortgaged properties. BOA's former employees have confirmed that BOA regularly approved loans to unqualified borrowers, approved loan applications that they *knew* contained false information, and even went so far as to **"*doctor the numbers*"** to get loans approved.

325. BOA employed a multi-step process for loan approval, not to ensure that only compliant mortgage loans were originated, but to increase the chances that a loan would be approved, even if previously rejected. In the first instance, borrower information was entered into BOA's "Desktop Underwriting" system. If a loan was rejected by this automated system, the loan would then be referred to a junior underwriter for manual underwriting. If a junior underwriter was unable to approve the loan, the application would be escalated to a more senior underwriter with greater "exception" authority.

326. Contrary to its representations, BOA granted "exceptions" to stated underwriting criteria without evaluating a borrower's repayment capabilities or considering countervailing compensating factors. Indeed, BOA Confidential Witness 1 ("BOACW1"), a former Loan Processor/Junior Underwriter, who worked for BOA from early 2006 to 2008, revealed that BOA used exceptions to stated underwriting guidelines to approve loans "quite a bit." BOACW1 also noted that use of an exception to approve a loan was not always noted in the loan file.

327. BOA Confidential Witness 2 ("BOACW2"), another former Loan Processor/Junior Underwriter, who worked for BOA from 2003 to 2008, disclosed that *loans were approved even when it was clear that the borrower lacked the ability to repay*. For example, BOACW2 recalled that many times loans were approved where the borrower was left with only $500 in monthly income after the borrower paid his or her monthly mortgage expenses.

328. BOA Confidential Witness 3 ("BOACW3"), a former Loan Officer at BOA from the 1990s up until 2008, revealed that loan officers would submit a loan application for one type of loan product and, if the application was rejected, the loan officer would submit the same

application for a different product, which might also be rejected, only to be re-submitted yet a third time for another product until the loan was ultimately approved.

329. BOA Confidential Witness 4 ("BOACW4"), a former Mortgage Underwriter with BOA from 2005 to 2006, said that BOA and its employees would do "whatever they could do to make loans"—loans that BAS would then securitize and seek to insure with companies like CIFG.

330. Indeed, there was an entire division at BOA dedicated to approving problem loans—BOA's so-called "Plan C" group, which employed alternative underwriting criteria to approve and fund severely credit-blemished loans. The "Plan C" group had even greater exception authority than senior underwriters, and the group's mandate was to find ways to fund loans that were rejected under Bank of America's stated underwriting guidelines—loans that BOACW4 believed "*should not have been funded under any circumstances*." BOA's rationale for approving such loans, according to BOACW4, was that "*if we didn't do it, someone else would*." Thus, BOA was fully engaged in the race to the bottom in mortgage securitizations, abandoning its stated underwriting guidelines along the way.

331. BOA did not just approve loans that never should have been funded in the first place, former employees recounted instances in which they *actually knew* that the income recorded by borrowers on their loan applications was false, but *they were told by their superiors to approve the loans anyway*. BOACW1 recalled situations in which borrowers accidentally submitted information demonstrating that their actual income did not match the income stated on their applications. When this fact was raised with management, BOACW1 was told that stated income loans did not require income verification, so she should not worry about approving the

loan. In effect, Bank of America told its employees *"we didn't have to consider evidence" that directly contradicted borrowers' claims about their income*.

332. Likewise, BOACW3 stated that it was common for borrowers to "*give information that's not right*," and that BOA loan officers should have, but often did not, question and verify the correctness of that information. BOACW3 revealed that BOA loan officers often went so far as to artificially inflate borrowers' incomes and **"*doctor the numbers*"** to get loans approved.

333. BOA pressured appraisers to inflate appraisals on mortgaged properties, which allowed borrowers to take out the loans for which they applied, but skewed the LTV ratios reported to investors and insurers like CIFG. According to BOACW2, it was common knowledge and widely understood inside the company that some BOA loan officers had "close relationships" with appraisers that allowed them to obtain inflated appraisals. In fact, loan officers would often call appraisers and tell them "I need you to come in at this amount." The appraisers would then return with the requested valuation, allowing the loans to be approved. As a result, BOA did not genuinely believe the appraisal values used to calculate the LTV ratios, because it knew that the property values were being purposefully and baselessly inflated in order to increase the amount of money that could be given to borrowers. Nonetheless, Defendants provided these statistics to CIFG in order to induce it to issue the Policies.

334. BOA also enforced a 30-day rule, under which loan officers were required to collect all necessary documentation to close and fund a loan within 30 days. If required documentation was not collected within the 30 days, loan officers were often directed to approve the loan anyway. Indeed, BOACW1 noted several occasions where managers directed her to

close and fund a loan after 30 days, despite the fact that the loan was missing key supporting documentation.

5. Confidential witnesses confirm the due diligence process was well-equipped to catch the errors at issue here—but they were directed to "look the other way"

335. The fact that Defendants consistently securitized third-party loans that they knew were defective is confirmed by Defendants' ***own due diligence practices***. In connection with their purchase of Mortgage Loans from the non-affiliated originators, and consistent with industry practice, Defendants themselves had due diligence procedures in place to determine the quality of the loans they were purchasing and securitizing. Instead of focusing on loan quality, however, Defendants subordinated quality to their goal of originating and securitizing as many loans as possible in order to maximize their fees and profits. Defendants purposefully relaxed their pre-securitization diligence, knowing that this would mean that more and more defective loans would be acquired and securitized, in order to meet their volume targets.

336. Defendants thus clearly knew that, contrary to their representations, loans were routinely made outside of the stated guidelines, without regard to whether there were any purported "compensating factors" justifying a lending or underwriting exception. Similarly, Defendants failed to disclose that many "exceptions" were made without any "compensating factors" present at all. This is evidenced by, among other things, the high percentage of BOA 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.

337. The "waiver" rate revealed by the FCIC's investigation understates the number of defective loans allowed into the Original RMBS. As the RMBS market reached its crescendo in

2006 and 2007, Defendants put firms such as Clayton under extreme pressure to give as many loans as possible a pass, and conducted increasingly cursory reviews. Thus, Defendants knew the true rates of defects were actually much higher, and that it was allowing in even more defective loans than Clayton's data have since revealed. This knowledge—as well as the fact that the due diligence processes were well-equipped to capture the type of errors at issue here—is confirmed by the testimony of numerous confidential witnesses.

338. ***Clayton Confidential Witness 1*** ("CCW1") was an Underwriting Project Lead at Clayton from 2003 until October 2006. According to CCW1, the task of a Project Lead included direct dealings with clients such as Defendants. CCW1 had been particularly involved with BOA, and had formed a close relationship with a particular BOA representative and VP of Structured Products (the "BOA Representative").

339. At various times, CCW1 also worked as a QC Underwriter, reviewing the work conducted by other underwriters. CCW1 confirmed that Defendants' due diligence provider was put under pressure to cut corners, yet still managed to provide Defendants with a daily update as to why scores of loans did not meet the stated underwriting guidelines.

340. In CCW1'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. According to CCW1, this did not mean that the underwriters were flagging too many things—quite the opposite. Not knowing what else to do, on certain projects, Team Leads would tell the inexperienced underwriters to simply copy and paste into Clayton's systems the same exact data that appeared on the loan tape. This confirms that when loans were graded "3" for BOA, they must have been *really* bad loans that fortuitously were likely reviewed by one of

the more experienced underwriters, making the high number of "3s" flagged for Defendants—yet later waived in by them—all the more astonishing.

341. According to CCW1, 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 CCW1'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.

342. During CCW1'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 CCW1, others were simply waived in. Even when "compensating" factors were purportedly found to justify a "2" grade, rather than a "3" grade, CCW1 characterized many of these factors as "almost wishful thinking" and "pretty weak." CCW1 estimates that 80% of loans initially graded "3" were ultimately re-graded. This is on top of CCW1's estimation that "at least 20% - 25%" of the loans initially graded "2" and "1" out of the gates were likely really deserving of a failing grade.

343. CCW1 understood that Clayton was not supposed to assign too many failing grades to loans so as not to "upset" the client (such as Defendants) 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 (including by Defendants), the lenders which had originated the loans, and even by other Project Leads. This point was made explicitly by the BOA

Representative, who told CCW1 to "***get this [expletive] 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.

344. According to CCW1, BOA saw Clayton as irrelevant, given the larger objective of securitizing the loans. The BOA Representative made it clear that BOA was not actually interested in the fundamental quality of the loans being reviewed. For example, the BOA Representative colorfully admitted that he did not "***give a flying [expletive] about DTI [debt-to-income ratios]***" or about whether the loans satisfied credit, character and collateral requirements. According to the BOA Representative, BOA only cared about whether the loans met federal, state, and local lending compliance standards. The BOA Representative told CCW1 that "we [Bank of America] can sell them [the loans] to whoever" regardless of the other underwriting criteria. "[Bank of America] can sell it [the loans] down the line" as long as the loans were not "predatory."

345. Another client similarly told CCW1 to "get this [expletive] done and get out of here, and don't make a big deal" about any issues, even though CCW1 had found problems such as inflated appraisals and missing documents.

346. CCW1 told of instances where many loans failed because the truth-in-lending disclosures did not actually match the loans' terms. These represented, according to CCW1, "pretty serious" legal violations. After CCW1 failed many such loans, he was told that he would not obtain a bonus for completing the project because the client had been unhappy with the number of failures. Project leads had been told to "make everyone happy."

347. While at Clayton, CCW1 typically reviewed 8 to 10 loans a day. Later, CCW1 was pressured to increase that to 21 loans per day. CCW1 protested that this afforded an

insufficient amount of time to review each loan. CCW1 was further instructed to simply "get the deal done." This made CCW1 feel that the due diligence reviews were "just going through the motions," performing only a cursory review of loans. CCW1 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. CCW1 also admitted that many of the appraisals suffered from "bad comps."

348. CCW1 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.

349. ***Clayton Confidential Witness 2*** ("CCW2"), who worked at Clayton reviewing loans from 2003 to 2006 (*i.e.*, the same period Clayton was provided many of the services at issue here for BOA), has stated that 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 CCW2's review (and thus making the high rejection rates all the more astounding) was the fact that CCW2 was not authorized to conduct any independent outside confirmation, but only to mechanically check to see that the appraisals contained, for example, a list of three other properties. According to CCW2, 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 had to have four deviations from the applicable guidelines before it was even considered for rejection. Even then, the loan was not immediately rejected, but rather simply elevated for further review.

350. In other words, CCW2, like CCW1, confirms that the staggering "reject" rates seen in the third-party diligence reports provided to Defendants likely vastly understate the problems that would have been caught by Defendants' processes.

351. ***Clayton Confidential Witness 3*** ("CCW3") was a Contract Underwriter at Clayton from 2003 to 2004, and a Transaction Specialist there from 2005 to 2007. CCW3's team would underwrite loans, including by visiting a client's offices to conduct the review. CCW3 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 CCW3, 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.

352. ***Clayton Confidential Witness 4*** ("CCW4") worked for Clayton as a Contract Underwriter. Like CCW2, CCW4 stated that reviewers were given only 45 minutes to an hour to approve or reject a loan file. Also like CCW2, CCW4 recalled a lot of pressure to approve loans. According to CCW4, Clayton's team leaders had the ability to "fix" CCW4's findings, and CCW4 was told to keep CCW4's mouth shut rather than raise questions.

353. ***Clayton Confidential Witness 5*** ("CCW5") further confirmed that the review process at Clayton, Defendants' chosen primary third-party due-diligence provider, included the regular approval—at the clients' direction—of loans containing defects. Based on the high "waiver" rates discussed above, among other things, such improper approval occurred with respect to Defendants' due diligence here, too.

354. CCW5 worked as a Senior Underwriter directly responsible for reviewing loans for Clayton, as well as a QC Auditor. The QC Auditor's function included reviewing loans that had been "kicked" by the underwriter assigned to that loan. Like the other witnesses, CCW5 confirmed that the primary objective of Clayton's review was to ensure the loans adhered to the lender's guidelines. This included reviewing the loan files to determine that they were complete. Also like the other witnesses, CCW5 explained that clients often "waived" in defects.

355. CCW5 complained that the loans were even worse than the guideline failures suggested. For instance, employees of the fast-food restaurant McDonald's would claim to earn $10,000 a month, far more than employees would actually be paid. Such loans would be "kicked" by CCW5, but CCW5 believed they were nonetheless taken by the clients as part of the "stip clearing" process. Other lending violations were also discovered, such as truth-in-lending violations and missing documents.

356. ***Clayton Confidential Witness 6*** ("CCW6") was a Senior Project Lead at Clayton from 2004 to 2009. In this role, CCW6 oversaw teams of underwriters assigned to review samples of loan pools being considered for purchase. CCW6's teams ranged from a dozen or so employees to over a hundred, depending on the number of loans to be reviewed. Confirming Defendants' process was well-equipped to catch errors like those at issue here, according to CCW6, his team included quality-control personnel whose job it was to double-check and review the work done by the underwriters. According to CCW6, these reviews were sometimes even conducted on the premises of the lender itself. Wherever the review was conducted, according to CCW6, Clayton was given access to the loan files, and a set of the lender's underwriting guidelines.

357. CCW6 again confirmed that Defendants received daily reports on the progress of reviews, as well as a final report summarizing the total results at the end of a project. CCW6 even stated that clients could access the reports in real-time using Clayton's software application. The reports reflected the results of CCW6's teams' review of the loans as against the underwriting guidelines they were given to apply. These reports also provided Defendants with supporting documentation for each and every grade given to the loans.

358. CCW6 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."

359. According to CCW6, 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." In this process, waivers were given and loans re-graded. According to CCW6, 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.

360. Sometimes Clayton received pre-instructions to give loans "2s" rather than "3s," despite the underwriting guidelines, based on decisions as to what criteria would be "let go." These situations were not uncommon or infrequent, and the instructions would come both in emails and in phone calls to Clayton personnel.

361. CCW6 harbored doubts about whether the borrowers could and would repay the loans. CCW6 stated that loans were approved by way of accepting clearly unreasonable income claims.

362. CCW6 indicated that the amount of defects flagged for Defendants was also likely understated because the underwriters were bound to accept loans' representations for certain products, such as stated-income loans, even if facially unreasonable. "It was not for [CCW6] to

question" whether claims, such as someone making $6,000 a month working at Wal-Mart, meant the loan should be rejected.

363. ***Clayton Confidential Witness 7*** ("CCW7") 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, CCW7 oversaw due diligence on both conduit and bulk loan pools that Clayton reviewed, including at the time Clayton provided work for Defendants on the Loans at issue here. CCW7 specifically recalls doing work for BOA, and characterized BOA as being more aggressive than other banks.

364. A typical Clayton engagement may involve 20 underwriters working at the premises of the lender. The reviewers were "checking the boxes," in the sense that if a borrower was claiming a certain income, they would check the loan file to ensure that the appropriate paystubs and bank statements were included. If so, they would "check a box" to indicate the borrower did in fact meet the guideline requirements for income.

365. CCW7 confirmed that daily reports from Team Leads were created for Defendants, including an indication of what grades were given to what loans that day, and how many loans had already undergone a second quality-control review. These reports were either forwarded by CCW7 to Defendants, or given directly to their representatives by the Team Lead if the project involved a Defendant representative on-site.

366. According to CCW7, in addition to the "waivers" discussed elsewhere, Clayton was also told what it was *not* to evaluate—*i.e.*, Clayton was told to "disregard certain items." Even more loans were given a passing grade outside of formal instructions, according to CCW7, because underwriters would give loans a "2" grade even if it was technically a "3" loan, only because the underwriter thought that was what the client wanted.

367. In addition, CCW7 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 CCW7, if the originator could not persuade the Clayton Team Lead to re-grade a defective loan, the originator would contact CCW7. If CCW7 resisted, the originator would contact the bank's asset manager, who would apply pressure on CCW7 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, CCW7 was directly contacted by asset managers and traders from banks who would "pound" on him until he re-graded a loan.

368. While noting that pressure from the originator or bank representative often caused Clayton to re-grade a rejected loan, CCW7 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 CCW7, the banks were "buying [expletive] loans because the guidelines allowed [expletive] loans."

369. ***Clayton Confidential Witness 8*** ("CCW8") worked as a Due Diligence Underwriter at Clayton from August 2004 to July 2005, evaluating loans for credit and compliance issues. CCW8 specifically recalls doing work for BOA.

370. CCW8 confirmed that Clayton's role in Defendants' due diligence processes was to audit loans for compliance with underwriting guidelines and legal requirements. This included, for example, reviewing the file to ensure the appropriate truth-in-lending and HUD forms were included. CCW8 also confirmed that, at the outset, the due diligence process would

include instructions to ignore problems if they fell within a given range, such as LTV ratios being within 5% of the underwriting guidelines.

371. The last screen on the underwriter's computer program asked for a grade to be given. Loans graded "2" or "3" required a "Credit Narrative" to be provided, explaining for the client's benefit why the loan received that grade. Once the underwriter hit "enter," the data was transferred to a version of the loan tape held by Clayton, known as the Clayton Loan Analysis System. That tape reflected the review results, and was delivered to the client.

372. Even though CCW8 gave "3" grades only to "really, really" bad loans, 99% of the time the grades were eventually changed to a "2." Rather than rejecting the loans, CCW8 understood that Clayton's clients would negotiate a lower purchase price from the originators.

373. ***Clayton Confidential Witness 9*** ("CCW9") was a Due Diligence Underwriter at Clayton from 2003 to 2007. CCW9 noted that it was easy to get a job at Clayton; the company was even hiring truck drivers to do loan re-underwriting because investors put the company under so much pressure to churn through so many loans. About half the people on larger jobs had "no clue what they were doing," and thus would take short-cuts like copying and pasting information to make it appear as though the loan met the guidelines. This, despite the fact that the point of the review was to double-check that information to begin with, such as verifying the loan file had the correct supporting documentation for the income claims reported on the loan tape.

374. CCW9 also confirmed that Clayton's review for Defendants would under-report the number of loans that failed the guidelines because the real guidelines had a series of "if/then" relationships (such as that a loan with a high LTV ratio was permissible *if* it had a concomitantly

lower borrower DTI). But the Clayton matrix would only report the maximum values, regardless of their inter-relationships.

375. According to CCW9, the changing of loans from "3s" to "2s" was going on "across the board."

376. ***Clayton Confidential Witness 10*** ("CCW10") worked as a Supervisory Lead/Quality Control Underwriter for Clayton from August 2004 through February 2008, *i.e.*, during the entire period Defendants were using Clayton as part of their due diligence process. CCW10 confirmed that Clayton was using a lot of inexperienced people that "had no idea what they were doing."

377. According to CCW10, part of Clayton's job was to review the files to make sure the data provided accurately described the backup documentation. It also involved reviewing the file overall to see if the borrower had the ability to repay the loan.

378. CCW10 agreed with the "textbook" explanation of the 3-grade system described above (with a "2" meaning the loan fell outside the guidelines, but was apparently subject to an exception). But "in practice," according to CCW10, a "2" was used merely to hold loans that Defendants thought were of acceptable risk, even if Clayton did not agree with the designation, and even if there was no evidence in the file of any "compensating factors." In other words, "[q]uite often, the investor had you make it a 2 without any compensating factors in the file." This included Clayton receiving instructions from clients not to grade loans "3," even if they did not comply with the stated guidelines, merely because the clients grew tired of ordering re-grades at the back end, and to disregard facially unreasonable income claims. CCW10 asked for his sarcasm to be excused after he jadedly asked "What? Investors asking us to change the loan scores?"

379. ***Clayton Confidential Witness 11*** ("CCW11") was a Team Lead at Clayton, who started work there in 1999 and continued with the firm until 2008. CCW11 specifically recalled working on projects for BOA. As with the other Clayton employees, CCW11 confirmed that Defendants received daily reports that not only informed them of how many loans had failed, but also provided narrative descriptions for why the loans failed. CCW11 also confirmed that clients often had representatives on-site. CCW11 recalled that when he met a particular BOA representative, the first words out of the representative's mouth were, ***"I don't want any [expletive] 3s.*** " CCW11 also recalled that on-site managers would sometimes receive the actual loan files for the "3" loans, for their personal review. CCW11 described the relevant time period as a "feeding frenzy."

380. ***Bohan Confidential Witness 1*** ("BCW1") worked as a Contract Underwriter at another third-party due diligence firm, the Bohan Group ("Bohan"), from 2004 until 2006. BCW1 specifically recalls doing work for BOA. ***BCW1 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 they "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." BCW1 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.

381. BCW1 said reviewers "were told to overlook things . . . that should not have been overlooked." During the review, the income claims would "jump out at you" as being clearly unreasonable and unrealistic, but many clients did not care. If the client did not care, the loan would be given a passing grade.

382. According to BCW1, Bohan Team Leads and Quality Control Underwriters could change loan scores without the underwriter's knowledge. When BCW1 would bring discrepancies to a Team Lead's attention, BCW1 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 BCW1 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 BCW1.

383. While at Bohan, BCW1 reviewed loans that had been originated by WaMu, among other originators. BCW1 described the WaMu loans as "a joke." WaMu contributed loans to certain of the Original RMBS.

384. ***Bohan Confidential Witness 2*** ("BCW2") worked as a Deal Manager at Bohan during the 1990s and into 2006. BCW2 explained that a typical review might include 10 to 20 underwriters, plus one or two quality-control supervisors. BCW2 communicated with clients to help determine how to configure the Bohan Risk Analysis Information Network ("BRAIN") (which was fed the "loan tape" descriptions of the loans in the pool) to reflect the underwriting parameters the client wanted tested, and would communicate with the underwriters on how to run those tests.

385. According to BCW2, the due diligence process did not give loans a "3" grade unless the error was outside a margin of error, which would have been set by Defendants. (For instance, the client might have given pre-instructions to accept variations in LTV ratios or DTI ratios up to 5 percent, such that a loan with a DTI of 57 percent would be given a passing grade even if the guidelines only allowed for 52 percent DTI).

386. BCW2 would email the day's results to the client nightly. The BRAIN system even allowed Defendants to request customized reports as to the grades that had been given, for instance highlighting only certain types of loans or grades. Most clients would respond to the nightly reports the next morning. This often involved challenging the failing grades. According to BCW2, clients would change grade "3" loans to grade "2" loans "constantly." An example that BCW2 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 BCW2. The reasons why a loan was given a "3" grade were to be noted in the reports, so that the client could see why a given loan failed. Indeed, Bohan stressed that everyone involved in the review should make it very clear in the file notes why a loan was given a particular rank.

387. ***Bohan Confidential Witness 3*** ("BCW3") worked as an underwriter at Bohan from 2003 to 2007. BCW3 confirmed that the Defendants' reviews did include credit, compliance, and collateral analyses. However, the due diligence began with instructions from Defendants, including criteria they "did not care" about. After a review, a "clean-up meeting" was held with the Team Lead, which involved "re-underwriting" the loans. Team Leads could overturn failing grades, but it was not possible to delete the narrative entry from the file, meaning that data would always be visible to Defendants even after a grade had been changed. BCW3 stated that investors would use such information to negotiate a lower price with the originators.

388. ***Bohan Confidential Witness 4*** ("BCW4") worked as a Contract Underwriter at Bohan from roughly 2004 to 2007. The work involved reviewing mortgage pools offered for

sale over the course of one to two weeks for each project, either at the lender's offices or at a rented space.

389. Bohan's review teams consisted of between 10 and 15 underwriters, supervised by a Team Lead, and at least one Quality Control Underwriter (often more, for larger jobs). Each underwriter would review 10 to 12 loans per day, checking the loan's characteristics against the given guidelines for such parameters as FICO scores, LTV ratios, DTI ratios, property values, and documentation. Because of time constraints, the reviews did not often "get into the meat of the loan," such that the reviews were largely "data entry."

390. BCW4 stated that Team Leads and Quality Control Underwriters could change the final scores without the underwriter's knowledge. Team Leads were "nonchalant" about quality because their goal was to "hit numbers, make money, more than anything." The constant message was to "get the job done quickly." Further, the entire process was "completely client-driven," so if a client wanted a "2" grade, it got a "2" grade.

391. According to BCW4, the most common discrepancies included FICO scores actually being far below the guidelines; DTI and LTV ratios being higher than guidelines; suspect income calculations (including claims about income from rental properties, cash tips, and part-time side jobs); and truth-in-lending violations. In addition, discrepancies in the value of the collateral were common, such as square footage failing to comply with specifications for the type of property purportedly being purchased (such as guidelines limiting loans to only large properties). Though instructed not to look carefully at borrower income claims, much of the claims looked like "garbage" to BCW4.

392. ***In sum***, despite the many limitations and pressures on the due diligence process, and the opportunities to cure or otherwise change the grades from fail to pass, the third-party

reports still showed high numbers of loans that were identified by the due diligence firms as failing the given underwriting guidelines. These numbers show that Defendants regularly securitized large numbers of defective loans, including in all of the Original RMBS, contrary to Defendants' representations.

393. The proper response to Clayton's conclusions would have been to refuse to buy a loan pool, or to use the findings of the due diligence firm to probe the loans' quality more deeply. Instead, Defendants used the deficiencies in the loan pools to increase their own profit margins on the Original RMBS and the Certificates. Clayton's former president, D. Keith Johnson, testified to the FCIC that the investment banks, like Defendants, would use the exception reports to force a lower price. In other words, rather than reject defective loans from collateral pools, or cease doing business with consistently failing originators, Defendants would instead use the Clayton data simply to insist on a lower price from the loan originators, increasing their own profits when the problem loans were hidden in securitization pools. This is confirmed by many of above witnesses .

394. Defendants' hidden "waiver" of rejected loans into the Original RMBS was a fraudulent omission and rendered Defendants' disclosures even more misleading. 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 loans were waived in.
>
> . . .
>
> [O]ne could reasonably expect [the untested loans] to have many of the same deficiencies, 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.***

(FCIC Report at 167, 170 (emphasis added).)

C. Facts Showing Defendants' Knowledge of Appraisal Misrepresentations

395. Defendants' extensive due diligence processes, described above, also revealed the systemic appraisal problems found by CIFG's loan-level analysis here. Evidence of appraisal problems is supported by the consistency of the wide disparities between reported and actual LTV ratios for the Certificates, discovered through the use of loan-level, contemporaneous information. As summarized above, the number of loans with LTV ratios above 100% was misrepresented across every Original RMBS, by as much as ***19.67%.*** Defendants' knowledge of appraisal misrepresentations 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.

396. Former BOA employees have revealed that Defendants abused the appraisal process by pressuring appraisers to inflate appraisals, which skewed the LTV ratios reported to investors and insurers like CIFG. According to BOACW2, a former Loan Processor/Junior Underwriter, it was common knowledge and widely understood that during the period of 2004 to 2007, BOA Loan Officers had close relationships with appraisers that allowed them to directly influence the appraisal decisions. For example, Loan Officers "called the appraiser and said they [the Loan officer] needed this amount" for the valuation of the property at issue. Not only did Loan Officers tell appraisers "I need you to come in at this amount," but the Loan Officers would often also tell BOACW2 before the appraisal was actually received that they knew the appraiser would be submitting the necessary valuation. BOACW2 had concerns that the ability of the Loan Officers to influence the appraisers was inappropriate, but as with her other concerns, she felt she had little opportunity to express them.

397. As a result, Defendants did not genuinely believe the appraisal values used to calculate the LTV ratios, because they knew that the property values were being purposefully and baselessly inflated in order to increase the amount of money that could be given to borrowers.

398. Former employees also confirm that Defendants knew that the loans they purchased from third party originators contained appraisal misrepresentations. According, to BOA Confidential Witness 5 ("BOACW5"), a former Junior Underwriter and Senior Loan Specialist from 2001 to 2008, among the loans that BOA purchased from third party originators "we saw a lot of fraud," including "appraisal issues." Defendants went on to securitize and resell these loans and falsely claim that they had no knowledge that there were appraisal-related problems with them.

399. During their diligence review, Defendants could see the appraisal report itself, which often showed, for example, that the appraisals were subject to too many "adjustments." They also reviewed photographs of the subject property that belied the valuation given.

400. In addition, as described above, Defendants' due-diligence process included the use of third-party firms, such as Clayton. Clayton gave Defendants real-time updates about what loans had been flagged as defective, including narrative reports for each loan as to why that loan was given a failing grade. The Clayton reviewers inputted into the "notes" section of their systems details on why the loans were given failing grades, including descriptions of problems seen in the appraisal reports. This system, as above, was used to generate daily reports for Defendants. Defendants could also typically see the data in real time, both using remote software access given to clients or through Defendants' on-site representatives. In other words, Defendants were often receiving, on a daily basis, information about problems with appraisals.

401. For instance, CCW1, who did extensive work for Bank of America, confirmed that the underwriters at Clayton who reviewed loans for Defendants looked at the hard-copy loan files to determine whether the data included in the file supported the LTV and similar data in the loan tape. This common-sense check involved tasks such as reviewing the appraisal report to see whether the "comparable" properties were actually close in value to the mortgaged property, and whether the comparable properties actually had the same or similar features (such as the number of bedrooms and bathrooms). CCW1 also confirmed that the reports that were generated for Defendants from the Clayton Loan Analysis System included the narrative descriptions of why loans with unreliable appraisals were being given a "3" grade. On top of such information, the report given to Defendants also included summary appraisal-related statistics, such as the range of appraised values, average appraised values, and other appraisal-related metrics.

402. Similarly, according to BCW1, who also specifically recalls doing work for BOA, the review Bohan provided for Defendants involved such simple steps as reviewing the photographs in the appraisal file, which would show obvious problems like a house missing stairs. The appraisal review also involved asking for clarification on the "comps" used to calculate the value. Or a loan might be flagged as having an appraisal too high in relation to the same property's prior sales (such as an appraisal for $350,000 on a house that sold for $200,000 two years earlier).

403. CCW8 also confirmed many of the loans graded "3" were due to bad appraisals. The problems with the appraisals were apparent in the files. For instance, often too many line-adjustments were used to increase the value above and beyond what the "comps" supported. An adjustment could be made, for example, if the comparable had one bedroom less than the mortgaged property. But the guidelines limited how large any one adjustment could be, and

limited the total number of adjustments that could be made. Too many "adjustments," of course, suggests the property was not really "comparable" to begin with.

404. According to CCW8, Defendants' due diligence reviewers also checked whether the comps were actually comparable—such as where the loan was for a two-story property but the "comp" was a single-story dwelling. CCW8 also confirmed that the photos included in the appraisal were reviewed by Clayton, as was the appraiser's explanation for why the "comps" were chosen.

405. According to CCW10, Clayton reviewed the reasonability of the appraisals based on factors such as whether it just "made sense," including by looking at whether the "comparables" were close enough geographically, whether they had similar features to the mortgaged property, and whether they had not been subject to too many "adjustments." Notes about why the underwriter did not believe the appraisal supported the reported value (and thus, did not support the reported LTV guideline requirements) were inputted into the narrative section of the Clayton Loan Analysis System, which, as discussed above, typically generated reports for Defendants on a daily basis.

406. According to CCW10, Clayton's review for Defendants would have also caught even more fundamental problems with the appraisal-related representations, such as the wrong formulas being used (*i.e.*, LTVs being calculated based on the purchase price rather than the appraised value, in violation of the stated guidelines). This review was on top of the more substantive review of the documents in the loan file that Clayton performed for Defendants, such as looking not just at the difference in value between the mortgaged property and the "comps," but also whether there was any geographic divider (such as a freeway, or railroad tracks) that may also have rendered the two properties too different to be compared. In addition, according

to CCW10, some Clayton clients did "drive-bys" of the mortgaged properties to further assure themselves of the accuracy of the appraisal reports.

407. The failure rates identified by Defendants' due diligence processes likely vastly understated the number of appraisal problems in the Loans, because of all the pressure Defendants' due diligence providers were under to "pass" as many loans as possible. Confidential witness testimony confirms this pressure extended to appraisal issues. For instance, according to CCW1, Bank of America expressly told Clayton to "get this [expletive] done and get out of here, and don't make a big deal" about any issues, even though CCW1 had found problems such as inflated appraisals and missing documents.

408. CCW5, who had previously worked as an appraiser earlier in his career, also stated that he encountered many loans that he believed were based on inflated appraisals. 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.

409. CCW10 also discussed how the due diligence process included reviewing the reasonableness of the appraisals—even though certain clients began instructing Clayton to grade loans with unreasonable appraisals "2s," rather than "3s," because they tired of having to re-grade the loans at the back end anyway.

410. Congressional testimony and other statements, which have recently come to light, confirm there was widespread corruption in the appraisal processes during the period relevant to this Complaint. For instance, Richard Bitner, a former executive of a subprime lender for 15 years, testified in April 2010 that "the appraisal process [was] highly susceptible to manipulation," and 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 in April 2010 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" for 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."

411. 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.'"

412. The FCIC's January 2011 report recounts the similar testimony of Dennis J. Black, an appraiser with 24 years of experience who held continuing education services across the country. "He heard complaints from the 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.)

413. Defendants knew appraisal fraud was occurring both in BOA and the Originators. The Defendants, the Originators, and their appraisers did not genuinely believe in the appraised values underlying the Mortgage Loans.

D. <u>Defendants' Knowledge as to Owner-Occupancy Representations</u>

414. Defendants' extensive due diligence processes, described above, also caught the systemic owner-occupancy problems found by CIFG's loan-level analysis here. As summarized

above, occupancy rates were misrepresented across every Original RMBS by as much as ***17.10%***.

415. As described above, Defendants engaged in an extensive due diligence process. That process typically gave Defendants real time updates as to what loans had been flagged as defective, including narrative reports for each loan as to why that loan was given a failing grade. The Clayton reviewers inputted into the "notes" section of their systems details on why the loans were given failing grades, including by describing occupancy-related "red flags." This system was used to generate daily reports for Defendants, on top of the fact that Defendants could usually see the data in real-time both by way of the remote software access given to clients, or by way of Defendants' on-site representatives.

416. In other words, Defendants frequently received information on a daily basis about problems seen in the loan files in terms of false occupancy claims. CCW10 confirmed that owner-occupancy representations were reviewed as part of Defendants' due-diligence process. Indeed, "the three things any due diligence underwriter worth his salt always verifies is owner occupancy, LTV, and debt ratio," according to CCW10. CCW1 also confirmed that Clayton's underwriters could and did spot problems in the loan file that indicated the occupancy representations were false.

417. Defendants' due diligence reviewers were instructed to spot occupancy problems in a variety of ways. CCW10 gave a litany of examples, such as: (a) the place of employment being unreasonably far from the mortgaged property; (b) inconsistencies in the addresses listed in the supporting documents in the file (such as W-2s and bank statements); (c) the mortgaged property also being relied on as a source of rental income; (d) borrowers with long histories of rental income; (e) mortgaged properties worth more than the "second" properties (as most people

live in the more-valuable property, as compared to their investment or vacation properties); (f) addresses and rental information contained in the credit reports indicating that mail was being sent elsewhere, while rental income was being claimed; (g) landlord hazard policies being included in the loan files; and (h) differing data between the loan tape and the loan file.

418. According to CCW10, notes made on unreasonable occupancy claims were entered into the Clayton Loan Analysis System, which, as discussed above, generated reports for clients on a regular basis. In addition, CCW10 knows that banks *on their own* would sometimes hire investigators to visit the properties, to do a visual check as to whether the property appeared owner-occupied.

419. CCW1 personally flagged problems with regard to owner-occupancy claims, because he understood that vacation or investment properties have "significantly higher risk" than primary residences. This meant loans that were flagged for having misrepresented occupancy characteristics were given a "3," with a note in the Clayton Loan Analysis System (which, as discussed above, typically generated daily reports for Defendants) explaining exactly what information in the file called into serious question the occupancy claim.

420. As with CCW10, both CCW1 and CCW11 gave examples of how the due diligence processes gave Defendants actual knowledge of owner-occupancy defects, such as discrepancies in the claimed address and those that appear on the credit report. This and other evidence confirms that Defendants had knowledge of the owner-occupancy defects in the Mortgage Loans but included them in the Original RMBS and the Certificates anyway.

E. <u>Defendants' Knowledge as to the Title-Transfer Representations</u>

421. As discussed above, Defendants' misrepresentations concerning title to the Mortgage Loans were consistent, and reflect huge discrepancies between the Offering Materials' representations and reality. For all the reasons above that securitizers could not have

consistently misrepresented underwriting guidelines without knowing they were false, so, too, Defendants could not have operated such huge securitization operations without gaining knowledge that the Original RMBS were not in fact backed by many of the Mortgage Loans at all.

F. Defendants' Knowledge as to the Credit Rating Representations

422. As discussed above, the credit ratings were a garbage-in, garbage-out process. In addition, even before loans were purchased for securitization, securitizers knew what types of loan features the loan pools had to have in order to receive the desired credit ratings from the rating agencies. For instance, prior to bidding in an auction, Defendants would often submit the purported loan features (contained on a loan tape) to the credit rating agencies. The agencies would then run the loan-level information (*e.g.*, LTV ratio, occupancy status) through their quantitative models in order to estimate the number of loans that were likely to default. By combining predictions of the number of underlying loan defaults with the proposed "waterfall" structure of the various RMBS tranches, a rating could be assigned in accordance with the predicted likelihood that holders of that tranche would receive full payment on their securities.

423. Securitizers knew what loan features would result in which credit ratings in other ways. For example, the agencies often made key features of their ratings model available to their customers, making it possible to see what a rating would likely be based on a given set of loan features, even without directly involving the agencies themselves. As such, Defendants had intimate knowledge of the process by which ratings were produced.

424. The loan information was also often given to the agencies in advance of the finalization of the transaction to procure "shadow" ratings, the ratings that the securities would receive if no insurance coverage were provided. Through these and other methods, by the time a

final, for-publication rating was issued it had already been a *fait accompli* as the securitizers knew what (false) data was going to be given in exchange for what resulting credit rating.

425. Rating are always based on output from the agencies' quantitative models. Those models use loan tape data—the same type of loan tapes used to create the Offering Materials—to mathematically predict how many loans in the pools would likely default under certain assumed scenarios. But the models' prediction of loan defaults, and thus the resulting rating, were substantively meaningless because, as detailed above, the underlying loan data fed to the rating agencies was materially and substantially false.

426. The fact that the ratings were only as good as the data given to the agencies via the same loan tapes used to create the Offering Materials has been confirmed by testimony given in connection with the government's investigation into the mortgage meltdown. As the SPSI reported:

> 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.)

427. Government reports also recognize that other data analyzed by the rating agencies included, without limitation, the amount of equity that borrowers had in their homes, occupancy status, and the amount of documentation provided by borrowers to verify their assets and income levels. SEC, Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies at 8 (2008).

428. Susan Barnes, the North American Practice Leader for RMBS at S&P from 2005 to 2008, confirmed that the rating agencies relied upon the investment banks 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, Apr. 23, 2010 (emphasis added).)

429. These governmental reports and testimony confirm that the credit ratings were a garbage-in, garbage-out process controlled by the securitizers. As discussed above, key risk features such as the LTV ratios, and occupancy status were all being falsely reported. Given Defendants' vertically integrated structure, in which it controlled all aspects of securitization, as well as its knowledge of the ratings process, Defendants knew not only that the LTV and owner-occupancy data was being misrepresented, but that the same data, when fed to the rating agencies, would produce credit ratings that were substantively meaningless. Accordingly, Defendants knew the credit ratings did not reasonably address the "likelihood of the receipt by a certificateholder of distributions on the mortgage loans" and did not genuinely believe in the credit ratings themselves.

V. CIFG'S REASONABLE RELIANCE ON DEFENDANTS' REPRESENTATIONS

430. CIFG's Initial Diligence and credit underwriting process were robust—but were entirely dependent on the provision of data from Defendants that actually reflected the characteristics of the borrowers and the Mortgage Loans. "Stress tests" and risk modeling provide useful results only if the data fed into them is actually descriptive of the mortgage loans

being pooled and the security being insured. In this case, Defendants knew that CIFG's Initial Diligence and assessment of the risk profile of the Certificates were reliant on the information Defendants were providing, including such data points as the guidelines used to originate the Loans, the occupancy rates of the Mortgage Loans, and the LTV ratios of the Mortgage Loans. Indeed, Defendants represented the data was accurate, and that all relevant data was provided to CIFG.

431. However, Defendants actually knew and intended that CIFG's Initial Diligence and assessment of the risk profile of the Certificates would be skewed by the false data they were providing. Unfortunately, as expounded upon below, it was only years later that databases were large and sophisticated enough to allow third parties (such as CIFG) to independently test the accuracy and integrity of Defendants' representations, and to explain why the actual performance of the Certificates was significantly worse than CIFG's initial risk profile suggested.

432. In deciding to enter into the I&I Agreements and issue the Policies, CIFG reasonably relied on Defendants' representations regarding the Mortgage Loans, the Original RMBS, and the Certificates. The veracity and completeness of Defendants' statements and promises was critical to CIFG's assessment of the risks associated with the Certificates and its decision to enter into the I&I Agreements and issue the Policies.

433. Before deciding to enter into the I&I Agreements and issue the Policies, CIFG reviewed the Offering Materials provided to it by Defendants, including the prospectuses and prospectus supplements for the Original RMBS, loan tapes for the Mortgage Loans, credit ratings for the Original RMBS and the Certificates, and draft documents describing the Certificates. Such materials were made available prior to CIFG's decision to provide insurance for the Certificates, and were sent directly by Defendants to CIFG, with Defendants' assurance

that after receiving these materials CIFG would "have all the data [CIFG] need[s] for [its] modeling."

434. Specifically, before deciding to insure the Certificates, CIFG reviewed and considered the underwriting guidelines described in the prospectuses and prospectus supplements provided by Defendants. CIFG also reviewed statistical information about the Mortgage Loans provided in the underlying Offering Materials, such as whether the Loans were backed by owner-occupied properties, and the Loans' LTV ratios. CIFG used these and other statistics about the Mortgage Loans to conduct rigorous quantitative analyses and modeling of the Mortgage Loans, the Original RMBS, and the structures and anticipated performance of the Certificates themselves in order to assess the creditworthiness of the Certificates.

435. CIFG's Initial Diligence followed (and in many ways exceeded) industry standards. CIFG began with the Mortgage Loans' supposed characteristics, as represented on the loan tapes provided to CIFG by Defendants. It ran hundreds of simulations of the projected performance of the Mortgage Loans under different market conditions in order to model probable cash flows, losses, and loss severity. It then used this modeling to analyze the potential effects on the performance of the Original RMBS and the Certificates and the creditworthiness thereof.

436. In addition to its quantitative analysis, CIFG also, as part of its Initial Diligence: (a) analyzed the Mortgage Loans' historical delinquency, foreclosure and pre-payment rates; (b) compared the performance history of the Original RMBS to bonds with similar characteristics and vintages; (c) analyzed the historical performance of other RMBS issued pursuant to the same "shelf" programs; (d) compared the results of CIFG's cash flow and loss models to those of the rating agencies and Defendants; (e) analyzed the ratings assigned to the Original RMBS and the

shadow ratings assigned to the Certificates; (f) carefully vetted the respective structures of the Original RMBS and the Certificates (including the sufficiency of credit enhancement and subordination built into each level of the deals); and (g) conducted diligence into the Mortgage Loans' originators and servicers. When all of this was completed, the results were submitted to CIFG's Credit Committee, which subjected the modeling and the transaction to multiple rounds of further scrutiny.

437. Throughout its Initial Diligence, CIFG exchanged hundreds of e-mails, and engaged in multiple conference calls with Defendants concerning the risk assessment of the Mortgage Loans and the Original RMBS. Not once did Defendants disclose to CIFG that the information provided to it during the parties' communications and on the loan tapes, prospectuses, and prospectus supplements, was false and/or materially misleading, or that Defendants had secured shadow ratings under false pretenses.

438. Ultimately, all of CIFG's extensive Initial Diligence was for naught. The accuracy and quality of CIFG's Initial Diligence were entirely dependent on the quality of the data provided by Defendants — data that is now known to be false in numerous respects.

439. CIFG had neither the right nor the ability to obtain the loan files for the Mortgage Loans. CIFG had no access to the loan files, because it was two levels removed from those files. The loan files were created during the origination of the Mortgage Loans, and were then reviewed by or on behalf of Defendants in the process of creating the Original RMBS. But CIFG was not in the picture until after the Original RMBS were issued. In that sense, CIFG was in the same position as an investor—it had no contractual rights under the various agreements pertaining to the Original RMBS, had no role in securitizing the Original RMBS, and thus had no

access to the loan files or the analysis of those files that Defendants would have performed while creating the Original RMBS.

440. CIFG entered the picture only *after* the Original RMBS were issued, and when they were being re-securitized into the Certificates. By that point, the underlying loan files would have been transferred to the servicers or the RMBS trustees, and CIFG had no contractual or other rights against these entities. CIFG thus had neither the contractual right nor practical ability to access the loan files. Instead, it had to rely on Defendants representations about those files, as contained in the loan tapes and other Offering Materials.

441. Thus, CIFG's Initial Diligence was entirely dependent on the data supplied to it by Defendants, along with their representations concerning the Loans. Moreover, CIFG's Initial Diligence was equally undermined by everything that CIFG was *not* told about the problems and deficiencies that Defendants knew infected the origination and servicing of the Mortgage Loans, the construction of the Original RMBS, and therefore the Certificates. Had Defendants told CIFG the truth, CIFG's models would have anticipated huge losses, CIFG's assessment of the risk profile of the Certificates would have increased significantly, and CIFG never would have agreed to insure the Certificates. Had CIFG been given the proper data, its assessment of the risk profile of the Certificates would have been significantly different.

442. CIFG's Initial Diligence did not and could not have uncovered that Defendants' representations regarding the credit quality and riskiness of the Certificates were false because the information necessary to make such an assessment was in the peculiar, unique, and special knowledge of Defendants. Among other things, Defendants knew about the nature and extent of the underwriting abandonment that had occurred with respect to the Loans, and had reviewed the underlying loan files that may have revealed that abandonment. But Defendants concealed that

information from CIFG. In order to assess the risk of the Certificates, CIFG was therefore reliant on Defendants to make accurate representations regarding the characteristics of the underlying Mortgage Loans that determined the credit quality and riskiness of the Certificates it was insuring.

443. The loan tapes given by Defendants to CIFG contained some detail regarding the Mortgage Loans. But the numerical data in those tapes was itself false. The loan tapes did not contain the addresses of properties or anything that could identify the borrowers, which would have potentially enabled CIFG to verify certain of the data. Without this and other data and information that was available to Defendants but never made available to CIFG—having the loan tapes full of (false) data did not reveal the fraud.

444. For instance, a loan tape might include data indicating 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 CIFG that the originators had wholly abandoned their guidelines, were making underwriting "exceptions" (such as those for high-LTV loans) without regard to whether there were "compensating factors," and were falsifying the descriptive data itself. Only starting in May 2009, as discussed below, was an information service available that allowed CIFG to obtain independent information about the Mortgage Loans, making it possible to test some of the representations Defendants made in the Offering Materials. Thus, it was only starting in May 2009 that a third party like CIFG could have even contemplated undertaking the 2012 Forensic Review.

445. In May 2009, an early form of informational service was first made public. This service required access to proprietary databases, developed by a data vendor over the course of many years and at a cost of millions of dollars. It was only through such databases that enough

data could be linked together, through the use of proprietary algorithms, such that specific loans underlying the Original RMBS could be identified. In 2006, without knowing a property's address, CIFG obviously could not know anything about the property's actual value other than what it was told in the Offering Materials. This new service allowed CIFG and others, for the first time (but even then, at a cost) to determine what specific properties were actually being included in RMBS collateral pools. For instance, the database takes the property zip code, loan amount, and date of origination (high-level information provided in the loan tapes) 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 is that it typically takes an enormous database to even identify what exact property is being included in the collateral pool.

446. Only with a specific address in hand—something that CIFG could not have obtained prior to May 2009—could CIFG have even begun to "test" the representations made in the Offering Materials. CIFG is not aware of any other similar service or process that could have reasonably provided this information prior to May 2009. Thus, there was simply no way, prior to this point, that CIFG could test such representations as what the LTV ratios of the Mortgage Loans were.

447. Similarly, without knowing what exact property was being mortgaged, there was no way to "test" whether the Offering Materials' representations regarding owner-occupancy were accurate. Though the identification of the property addresses was available in May 2009, the ability to test occupancy claims was not developed until 2010. Only then were databases and algorithms developed to compare the property addresses (again, themselves only derived through the use of these databases) against other sets of information so as to provide a "test" of the

occupancy claims made in the Offering Materials. CIFG is not aware of any other similar service or process that could have reasonably provided this information prior to 2010.

448. In insuring the Certificates, CIFG justifiably relied on Defendants' false representations of material fact detailed above, including the misstatements in the Offering Materials. CIFG also justifiably relied on Defendants' fraudulent omissions described above. It is a misrepresentation and a fraudulent omission to purport to provide data describing the Mortgage Loans without disclosing, for instance, that Defendants had systemically abandoned their underwriting guidelines, and that the descriptions of the Mortgage Loans' key features in fact bore no reasonable relationship to the true features of the Loans. But for the misrepresentations and omissions described above, CIFG would not have insured the Certificates, because those representations and omissions were material to its decision to insure the Certificates, as described above.

449. The material false and misleading statements of facts and omissions made to CIFG in the Offering Materials, and in written and verbal communications, directly and proximately caused CIFG's damage. Contrary to Defendants' representations concerning the quality of the loan collateral and their assurances regarding supposedly robust underwriting practices, the Loans underlying the Certificates were made to borrowers who did not have the represented ability or propensity to repay, and on properties that were overvalued and thus carried significantly more risk. As a result, CIFG insured securities whose true risks greatly exceeded the represented ones. As such, CIFG has been and will continue to be forced to make payments under the Policies to cover the lost principal and interest payments from the underlying Mortgage Loans that far exceed those it would have if the Loans, Original RMBS, and Certificates actually had the features Defendants described.

VI. BAS AND BAFC BREACHED THE TERMS OF THE I&I AGREEMENTS BY MAKING UNTRUE OR MISLEADING STATEMENTS OF MATERIAL FACT

450. Pursuant to the terms of the I&I Agreements, CIFG issued financial guaranty insurance policies for the BAFC-R1 and BAFC-R2 Certificates. The I&I Agreements were dated effective as of May 31, 2006, and October 31, 2006, respectively. The terms of each of the I&I Agreements are substantially similar.

451. One of the most crucial provisions in the I&I Agreements is the unequivocal representation as to the accuracy of all material written information BAS and BAFC provided to CIFG relating to the securities. Specifically, section 2.01(i) of both I&I Agreements states:

> Accuracy of Information. Neither the Operative Documents nor *other material written information relating to the Certificates*, the Seller or the Depositor (collectively, the "Documents"), as amended, supplemented or superseded, furnished to the Insurer in writing or in electronic form by the Seller or the Depositor in connection with the Transaction *contains any statement of a material fact which was untrue or misleading in any material respect when made* . . . .

(Emphasis added.)

452. Similarly, BAS and BAFC represented to CIFG that the Offering Documents issued in connection with both deals complied with the securities laws, and did not contain any material misrepresentations or omissions. Section 2.01(j) of both I&I Agreements provides:

> Compliance With Securities Laws. The offering of the Class A-1, Class A-2 and Class A-3 Certificates complies in all material respects with the requirements of the Securities Act and the regulations thereunder. Without limiting the foregoing, the Offering Document *does not contain any untrue statement of a material fact and does not omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which they were made, not misleading* . . . .

(Emphasis added.)

453. Section 5.02 of the I&I Agreements expressly provides that, upon the occurrence of any breach by BAS or BAFC of the representations, warranties, and affirmative covenants described therein, CIFG may:

> take whatever action at law or in equity as may appear necessary or desirable in its judgment to collect the amounts, if any, then due . . . or to enforce performance or observance of any obligation, agreement, or covenant . . . under this [I&I Agreement].

454. In addition, section 3.04 of the I&I Agreements specifically provides that BAS and BAFC will indemnify CIFG against any and all claims or losses "of any nature arising out of or relating to any breach by [BAS or BAFC] of any of the representations or warranties made by it contained in Section 2.01" of the I&I Agreements by reason of (a) "any omission or action . . . in connection with the offering, issuance, or delivery" of the Certificates or (b) "any untrue statement or alleged untrue statement of a material fact contained in the Offering Document[s] or any omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading."

455. Further, section 3.01(f) of the I&I Agreements requires, as a condition precedent to the issuance of the Policies, that CIFG be provided with shadow credit ratings for the Certificates.

456. BAS and BAFC have breached the terms of the I&I Agreements because, as detailed above, the Offering Materials contained untrue and misleading representations and omissions. In addition, they procured the shadow credit ratings by providing false and misleading information to the credit rating agencies. In effect, BAS and BAFC secured shadow credit ratings for different certificates than those for which CIFG issued its policies, thereby breaching the requirement to provide credit ratings for these Certificates.

457. CIFG has been damaged by such breaches because it has had to pay out over $123 million to date, and is obligated to pay out millions more in claims under the Policies.

* * * *

458. In summary, faced with the prospect of losing millions of dollars on unsellable bonds, Defendants took full advantage of their superior knowledge concerning every facet of the securitization process to work a fraud on and to breach their agreements with CIFG. To avoid taking those losses on the Original RMBS, Defendants developed and executed a fraudulent scheme (as detailed above) to move hundreds of millions of dollars' worth of Original RMBS off of their trading book at CIFG's expense.

459. In furtherance of this fraudulent scheme, Defendants made numerous misrepresentations to CIFG relating to the Certificates, the Original RMBS, and the Mortgage Loans, all the while representing to CIFG that the information they were providing was truthful, accurate and complete, for the purpose of inducing CIFG to insure the Certificates. Each of these misrepresentations related to critical facts concerning the credit and performance risks associated with the Mortgage Loans and the Original RMBS which back the Certificates, as detailed above.

460. BAS and BAFC made specific representations to CIFG in the I&I Agreements that all written information relating to the Certificates was true and correct and that it would obtain shadow credit ratings for these Certificates. As detailed above, the information contained in the written materials given by Defendants to CIFG in connection with the Certificates has proven false. Each of these contractual breaches related to critical facts concerning the credit and performance risks associated with the Mortgage Loans and the Original RMBS which back the Certificates, as detailed above. In addition, by providing false and misleading information to the ratings agencies, Defendants failed to acquire credit ratings for these Certificates.

461. Defendants also omitted and failed to disclose to CIFG material information concerning the Mortgage Loans, the Original RMBS and the Certificates. As part of their

fraudulent scheme, Defendants withheld this critical information, all the while intending to deceive CIFG and to induce CIFG to issue the Policies. Each of these fraudulent omissions of material fact related to critical facts concerning the credit and performance risk associated with the Mortgage Loans and the Original RMBS which back the Certificates, as detailed above. CIFG's assessment of the creditworthiness of the Certificates was based on the corrupt data and misrepresentations.

462. Had CIFG known the truth, it never would have issued the Policies. And, as a direct result of this fraudulent scheme, CIFG has paid or will have to pay in the future over $170 million in claims on Policies that it would never have issued had it known the truth concerning the underwriting, characteristics, and servicing of the Mortgage Loans and Original RMBS backing the Certificates.

463. CIFG now seeks damages relating to Defendants' fraud and breach of contract, and all other such relief as this Court may award.

FIRST CAUSE OF ACTION
(FRAUDULENT INDUCEMENT)
(Against All Defendants)

464. CIFG re-alleges and incorporates by reference each paragraph above.

465. This is a claim for fraudulent inducement against BOA, BAFC, and BAS.

466. Each Defendant made, authorized and/or caused the representations at issue, which are identified and summarized in Section II above and further identified in Exhibits C-X.

467. The representations set forth above were fraudulent, and Defendants' representations fraudulently omitted material statements of fact. These representations and omissions were material to CIFG's decision to enter into the I&I Agreements and issue the Policies.

468. Each of 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 CIFG.

469. Defendants had reason to expect that CIFG was among the class of persons who would receive and rely on such representations and omissions, and intended that their misleading statements and omissions would induce CIFG to enter into the I&I Agreements and issue the Policies.

470. CIFG justifiably relied on Defendants' false representations and misleading omissions.

471. Had CIFG known the true facts regarding the underwriting standards applied to the Loans (or lack thereof) and the features of the Loans themselves, or the true facts behind the procurement of credit ratings for the Original RMBS and the Certificates, it would not have entered into the I&I Agreements or issued the Policies.

472. As a result of the foregoing, CIFG has suffered damages according to proof. While rescission of the Policies is not practical and would be unfair to the purchasers of the Certificates who are beneficiaries of the Policies, CIFG should be awarded rescissionary damages under New York Insurance Law Section 3105.

473. In addition, because Defendants' fraud was willful and wanton, and because, by their acts, Defendants knowingly affected the general public, including but not limited to all persons with interests in the Certificates, CIFG is entitled to recover punitive damages.

SECOND CAUSE OF ACTION
(MISREPRESENTATION UNDER N.Y. INS. LAW § 3105)
(Against BAFC and BAS)

474. CIFG re-alleges and incorporates by reference each paragraph above.

475. This is a claim for misrepresentation under New York Insurance Law Section 3105 against BAFC and BAS.

476. BAFC and BAS made, authorized and/or caused the representations at issue, which are identified and summarized in Section II above and further identified in Exhibits C-X.

477. The representations set forth above were false, and omitted material statements of fact.

478. These misrepresentations were made by the applicants for insurance, BAFC and BAS, to CIFG at or before the making of the I&I Agreements and the issuance of the Policies, and were made as an inducement to CIFG to enter into the I&I Agreements and issue the Policies.

479. These misrepresentations were material to CIFG's decision to enter into the I&I Agreements and issue the Policies. Had CIFG known the true facts regarding the underwriting standards applied to the Loans (or lack thereof) and the features of the Loans themselves, or the true facts behind the procurement of credit ratings for the Original RMBS and the Certificates, it would not have entered into the I&I Agreements or issued the Policies.

480. As a result of the foregoing, CIFG has suffered damages according to proof. While rescission of the Policies is not practical and would be unfair to the purchasers of the Certificates who are beneficiaries of the Policies, CIFG should be awarded rescissionary damages under New York Insurance Law Section 3105.

THIRD CAUSE OF ACTION
(NEGLIGENT MISREPRESENTATION)
(Against All Defendants)

481. CIFG re-alleges and incorporates by reference each paragraph above.

482. This is a claim for negligent misrepresentation against BOA, BAS, and BAFC.

483. CIFG provided credit enhancement for two Re-REMICs for which BAS and BAFC served as the seller, depositor, and underwriter. BOA, BAS, and BAFC were also involved as originator, underwriter, or servicer for all but one of the Original RMBS.

484. Because of Defendants' extensive role in originating many of the Mortgage Loans and in putting together both the Certificates and the Original RMBS, Defendants had unique and special knowledge about the Mortgage Loans. In particular, Defendants had unique and special knowledge and expertise regarding the quality of the underwriting of the Loans securing the Original RMBS, as well as the servicing practices employed for such Loans, and the procurement of the credit ratings. CIFG could not evaluate the underwriting quality or the servicing practices of the Mortgage Loans in the Original RMBS on a loan-by-loan basis, so it relied on Defendants' unique and special knowledge when determining whether to provide credit enhancement for each of the Certificates. CIFG was entirely reliant on Defendants to provide accurate information regarding the Mortgage Loans to both itself and the rating agencies.

485. Defendants were aware that CIFG relied on their unique and special expertise and experience and depended on them for accurate and truthful information. Defendants also knew that CIFG did not have access to the facts regarding their compliance and the third-party originators' compliance with underwriting standards.

486. Defendants had a duty to provide CIFG complete, accurate, and timely information regarding the Mortgage Loans, Original RMBS, and Certificates. Defendants breached their duty to provide such information to CIFG.

487. CIFG reasonably relied on the information Defendants did provide and was damaged as a result of Defendants' misrepresentations and omissions.

FOURTH CAUSE OF ACTION
(BREACH OF CONTRACT)
(Against BAS and BAFC)

488. CIFG re-alleges and incorporates by reference each paragraph above.

489. The I&I Agreements are valid contracts entered between BAS, BAFC and CIFG.

490. CIFG has performed and continues to perform all of its obligations as specified by the I&I Agreements.

491. As detailed above, BAS and BAFC have materially failed to perform under the I&I Agreements by, without limitation, breaching the representations and warranties contained in Sections 2.01, 2.02, and 3.04 of the I&I Agreements.

492. In addition, BAS and BAFC have materially failed to perform under the I&I Agreements by, without limitation, breaching the condition precedent that CIFG be provided with shadow credit ratings for the Certificates, as required by Section 3.01 of the I&I Agreements.

493. These representations and warranties concern facts which tended to increase the risk of the occurrence of losses within the coverage of the Policies, as defined by New York Insurance Law Section 3106.

494. As a result, CIFG has suffered an economic loss and damages in an amount to be determined at trial. While rescission of the Policies is not practical and would be unfair to the purchasers of the Certificates who are beneficiaries of the Policies, CIFG should be awarded rescissionary damages under New York Insurance Law Section 3106.

FIFTH CAUSE OF ACTION
(BREACH OF IMPLIED DUTY OF GOOD FAITH AND FAIR DEALING)
(Against BAS and BAFC)

495. CIFG re-alleges and incorporates by reference each paragraph above.

496. This is a claim for breach of the implied covenant of good faith and fair dealing against BAS and BAFC.

497. The I&I Agreements were built on the premise that, as Defendants affirmatively represented, the Mortgage Loans had been evaluated consistently with the underwriting standards that led Bank of America to be an industry leader. Defendants encouraged trust and reliance on their representations precisely because of their expertise and experience.

498. The implied duty of good faith and fair dealing required application of underwriting standards consistent with CIFG's understanding, and with Defendants' awareness of what CIFG had understood.

499. Defendants' breach has caused substantial harm and damages to CIFG, in an amount to be proved at trial. At a minimum, Defendants' breach has caused:

(a) Damages representing the aggregate amount of actual and future claims on the Policies; and

(b) Damages representing losses sustained by CIFG because of its credit risk and exposure on the Policies, which are substantially greater than the parties bargained for, and has led to loss of business and other losses and expenses.

SIXTH CAUSE OF ACTION
(INDEMNIFICATION)
(Against BAS and BAFC)

500. CIFG re-alleges and incorporates by reference each paragraph above.

501. This is a claim for indemnification against BAS and BAFC.

502. Pursuant to the I&I Agreements, CIFG is entitled to indemnification for all of its claims, losses, liabilities, demands, damages, costs, and expenses of any nature whatsoever relating to the Certificates because of breaches by BAS and BAFC of the representations and warranties contained in the transaction documents.

503. BAS and BAFC have breached numerous representations, warranties, and covenants that have caused CIFG to incur costs and losses, in an amount to be determined at trial. These costs and losses include, without limitations, attorneys' fees and expert fees, incurred in order to enforce, defend, and preserve its rights under the relevant agreements.

PRAYER FOR RELIEF

WHEREFORE, CIFG prays for relief as follows:

a. CIFG's payments on past, current and future claims under the Policies;

b. In the alternative, CIFG's rescissionary damages under Insurance Law Section 3105;

c. CIFG's losses, including lost profits and business opportunities;

d. Punitive damages;

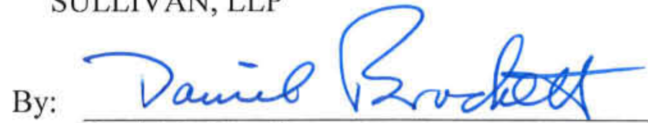
e. Attorneys' fees and costs;

f. Prejudgment interest at the maximum legal rate; and

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

DATED: New York, New York
November 20, 2012

QUINN EMANUEL URQUHART &
SULLIVAN, LLP

By: 

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