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

ROYAL PARK INVESTMENTS SA/NV, Plaintiff,	Index No.
vs.	SUMMONS
MORGAN STANLEY, MORGAN STANLEY & CO. LLC, MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC, MORGAN STANLEY ABS CAPITAL I, INC. and MORGAN STANLEY CAPITAL I INC., Defendants.	

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TO: THE ABOVE NAMED DEFENDANTS

YOU ARE HEREBY SUMMONED to answer the complaint in this action and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance, on plaintiff's attorneys within 20 days after the service of this summons, exclusive of the day of service (or within 30 days after the service is complete if this summons is not personally delivered to you within the State of New York); and in case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Plaintiff designates New York County as the place of trial. Venue is proper because the defendants do business in or derive substantial revenue from activities carried out in this County, and many of the wrongful acts alleged herein occurred in this County.

DATED: October 24, 2013

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<table>
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COMPLAINT

DEMAND FOR JURY TRIAL</td></tr>
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I. SUMMARY OF THE ACTION

1. This action arises out of plaintiff's purchases of nearly $600 million worth of residential mortgage-backed securities ("RMBS").[1] The specific RMBS at issue are generally referred to as "certificates." The certificates are essentially bonds backed by a large number of residential real estate loans, which entitle their holders to receive monthly distributions derived from the payments made on those loans. The claims at issue herein arise from 37 separate certificate purchases made in 27 different offerings (the "Morgan Stanley Offerings"), all of which were structured, marketed, and sold by defendants during the period from 2005 through 2007. *See* Appendix A hereto.

2. Defendants used U.S. Securities and Exchange Commission ("SEC") forms, such as registration statements, prospectuses and prospectus supplements, as well as other documents – such as pitch books, term sheets, loan tapes, offering memoranda, draft prospectus supplements, "red," "pink" and "free writing" prospectuses and electronic summaries of such materials – to market and sell the certificates to plaintiff. In addition, defendants also disseminated the key information in these documents to third parties – such as the rating agencies (the "Credit Rating Agencies"), broker-dealers and analytics firms, like Intex Solutions, Inc. ("Intex") – for the express purpose of marketing the certificates to plaintiff and other investors. Collectively, all of the documents and information disseminated by defendants for the purpose of marketing and/or selling the certificates

[1] As explained more fully *infra*, at §II.A., plaintiff obtained its claims through assignment. The certificates were initially purchased by subsidiaries of Fortis Bank SA/NV, but all rights, title, interest and causes of action to the certificates were assigned to plaintiff. Accordingly, all references herein to plaintiff's purchases of certificates refer to plaintiff's claims arising by assignment.

to plaintiff are referred to herein as the "Offering Documents." Each purchase at issue herein was made in direct reliance on the information contained in the Offering Documents.[2]

3. As further detailed herein, the Offering Documents were materially false and misleading at the time they were issued by defendants and relied on by plaintiff and/or its assignors. Specifically, the Offering Documents both failed to disclose and affirmatively misrepresented material information regarding the very nature and credit quality of the certificates and their underlying loans. The Offering Documents further failed to disclose that, at the same time defendants were offering the certificates for sale to plaintiff, they were privately betting that similar certificates would soon default at significant rates. Defendants used these Offering Documents to defraud plaintiff and its assignors into purchasing supposedly "investment grade" certificates at falsely inflated prices. Plaintiff's certificates are now all rated at junk status or below, and are essentially worthless investments, while defendants, on the other hand, have profited handsomely – both from their roles in structuring, marketing and selling the certificates, and from their massive "short" bets against the certificates they, themselves, sold to plaintiff.

II. PARTIES

A. Plaintiff

4. Plaintiff Royal Park Investments SA/NV ("RPI") is a limited liability company incorporated under the laws of Belgium, with its principal place of business at Van Orley 15, 1000 Brussels, Belgium. RPI was created by the Belgian State, Ageas (formerly known as Fortis Holding SA/NV), and BNP Paribas for the purpose of acquiring and managing a portion of Fortis Bank

[2] As further detailed *infra*, at §V.B, some of the purchase decisions at issue herein were made prior to the date of the final prospectus supplements for the offerings from which such certificates were purchased. On information and belief, however, all such purchases were made in direct reliance upon draft prospectus supplements that were distributed by defendants and were identical in all material respects to the final prospectus supplements for such offerings.

SA/NV's ("Fortis Bank") structured credit portfolio. The special purpose and mission statement of RPI is to minimize the downside risk and maximize recoveries on the legacy portfolio.

5. RPI brings its claims against defendants as an assignee of causes of action regarding securities that were initially purchased by Fortis Bank and two of its subsidiaries. The three original purchasers of the securities at issue herein are identified below:

(a) Fortis Bank is a Belgian limited liability company with its registered office at Montagne du Parc 3, 1000 Brussels, Belgium, and its principal place of business in Brussels, Belgium. Fortis Bank was the banking arm of Fortis Holding SA/NV ("Fortis Holding"), a Belgian insurance, banking, and investment management company. In 2008, Fortis Holding sold Fortis Bank to the Belgian State, which then sold 75% of Fortis Bank to BNP Paribas. Fortis Bank is now a subsidiary of BNP Paribas. The certificates initially purchased by Fortis Bank were assigned to RPI, along with all associated rights, title, interest, causes of action and claims in and related to such certificates, including all claims at issue herein.

(b) Fortis Bank SA/NV, Cayman Islands Branch ("Fortis Cayman"), is a branch of, and wholly owned by, Fortis Bank. The certificates initially purchased by Fortis Cayman were assigned to RPI, along with all associated rights, title, interest, causes of action and claims in and related to such certificates, including all claims at issue herein.

(c) Scaldis Capital Limited ("Scaldis") is a conduit special purpose vehicle, created, along with co-issuer Scaldis Capital LLC, for placement of commercial paper in both the United States and European markets. Scaldis was created, fully controlled, and sponsored by Fortis Bank. All of Scaldis's assets, including the securities at issue herein, were consolidated into the balance sheet of Fortis Bank, and all losses on the securities were incurred by Fortis Bank. As the sponsor of Scaldis, Fortis Bank provided both credit and liquidity support for Scaldis and managed all its operations. During the relevant period, the individuals conducting the administrative duties of

Scaldis's business (including the purchasing of the securities at issue herein) were Fortis Bank employees located in Amsterdam, the Netherlands. All decisions to purchase the securities at issue herein were made on behalf of Scaldis in Belgium by employees of Fortis Bank. The certificates initially purchased by Scaldis were assigned to RPI, along with all associated rights, title, interest, causes of action and claims in and related to such certificates, including all claims at issue herein.

6. Fortis Bank, Fortis Cayman, and Scaldis are referred to collectively herein as the "assigning entities."

7. RPI acquired the legal claims at issue in this case in exchange for good and valuable consideration. The certificates at issue in this case were severely damaged on or before the day they were transferred to RPI, and continued to be damaged, in an amount to be proven at trial. RPI has standing to sue defendants to recover those damages as an assignee of claims regarding securities initially purchased by the three assigning entities identified above. As a result, use of the terms "plaintiff" and "RPI" herein shall also refer to each of the above-identified assigning entities.

B. The "Morgan Stanley Defendants"

8. As further set forth below, each of the following defendants was actively involved with and/or liable for some or all of the Morgan Stanley Offerings at issue herein. *See* §V, *infra*. Additional detailed information concerning each Morgan Stanley Offering is also set forth in Appendix A, attached hereto.

9. Defendant Morgan Stanley is a global financial services firm and financial holding company. Morgan Stanley is a Delaware corporation with its principal place of business in New York, New York. Morgan Stanley's business units include its Institutional Securities division which, among other things, acts as an underwriter of RMBS; provides warehouse lending to subprime and other mortgage originators; trades, makes markets and takes proprietary positions in RMBS; and structures debt securities and derivatives involving mortgage-related securities. Morgan

Stanley is the ultimate owner and parent company of the other "Morgan Stanley Defendants" alleged herein, and controlled the activities and conduct of such defendants in connection with the "Morgan Stanley Offerings" alleged herein.

10. Defendant Morgan Stanley & Co. LLC (formerly known as Morgan Stanley & Co., Inc.) is a wholly-owned subsidiary of co-defendant Morgan Stanley, and is a Delaware limited liability company with its principal place of business in New York, New York. Unless otherwise noted, use of the term "Morgan Stanley & Co." herein refers collectively to both Morgan Stanley & Co. LLC and Morgan Stanley & Co., Inc. Morgan Stanley & Co. is an SEC-registered broker-dealer and was the lead or co-lead underwriter and broker-dealer for all of the Morgan Stanley Offerings alleged herein. Plaintiff purchased all of the certificates it purchased in the Morgan Stanley Offerings directly from Morgan Stanley & Co. in its capacity as an underwriter for such offerings. As an underwriter, Morgan Stanley & Co. was intimately involved in the Morgan Stanley Offerings, including investigating the loans at issue herein, and participating in the drafting and disseminating of the Offering Documents.

11. Defendant Morgan Stanley Mortgage Capital Holdings LLC (formerly known as Morgan Stanley Mortgage Capital, Inc.) is a New York limited liability company, and is a wholly-owned subsidiary of co-defendant Morgan Stanley. Unless otherwise noted, use of the term "Morgan Stanley Mortgage Capital" or "MSMC" herein refers collectively to both Morgan Stanley Mortgage Capital Holdings LLC and Morgan Stanley Mortgage Capital, Inc. Morgan Stanley Mortgage Capital has its principal place of business in New York, New York. Morgan Stanley Mortgage Capital was the sponsor for 25 of the certificates plaintiff purchased in the Morgan Stanley Offerings alleged herein. In its capacity as the sponsor for such offerings, Morgan Stanley Mortgage Capital organized and initiated the deals by acquiring the mortgage loans to be securitized,

negotiating the principal securitization transaction documents and working with the securities underwriters to structure the offerings.

12. Defendant Morgan Stanley ABS Capital I, Inc. ("MSABS") is a wholly-owned subsidiary of Morgan Stanley that is incorporated in the state of Delaware and has its principal place of business in New York, New York. MSABS was the depositor for 20 of the Morgan Stanley Offerings alleged herein. As the depositor, MSABS was also the "issuer" of the certificates sold to plaintiff in such offerings under the U.S. securities laws.

13. Defendant Morgan Stanley Capital I Inc. ("MS Capital") is a wholly-owned subsidiary of co-defendant Morgan Stanley that is incorporated in the state of Delaware and has its principal offices in New York, New York. MS Capital was the depositor for four of the certificates plaintiff purchased in the Morgan Stanley Offerings alleged herein. As the depositor, MS Capital was also the "issuer" of the certificates sold to plaintiff in such offerings under the U.S. securities laws.

14. Defendants Morgan Stanley, Morgan Stanley & Co., Morgan Stanley Mortgage Capital, MSABS and MS Capital are collectively referred to herein as "defendants," the "Morgan Stanley Defendants" and/or "Morgan Stanley."

III. JURISDICTION AND VENUE

15. This Court has subject matter jurisdiction over this action pursuant to Article VI, §7 of the New York State Constitution, which authorizes it to serve as a court of "general [and] original jurisdiction in law and equity." The amount in controversy exceeds the minimum threshold of $150,000 pursuant to §202.70(a) of the Uniform Civil Rules of the New York Supreme Court.

16. The Court's personal jurisdiction over defendants is founded upon C.P.L.R. §§301 and 302, as each defendant transacts business within the State of New York within the meaning of

C.P.L.R. §302(a)(1), and each of them committed a tortious act inside the State of New York within the meaning of C.P.L.R. §302(a)(2).

17. Defendants regularly and systematically transact business within the State of New York and derive substantial revenue from activities carried out in New York. A majority of defendants' acts pertaining to the securitization of the RMBS giving rise to the causes of action alleged herein occurred in New York. Each defendant was actively involved in the creation, solicitation and/or sale of the subject certificates to plaintiff in the State of New York. Specifically, defendants originated and/or purchased the loans at issue, prepared, underwrote, negotiated, securitized and marketed the offerings, and sold and/or marketed the certificates to plaintiff, in substantial part, in New York County, New York.

18. Since numerous witnesses with information relevant to the case and key documents are located within the State of New York, any burdens placed on defendants by being brought under the State's jurisdiction will not violate fairness or substantial justice.

19. This Court also has personal jurisdiction over many of the defendants based on consent under C.P.L.R. §301 due to their unrevoked authorization to do business in the State of New York and their designations of registered agents for service of process in New York.

20. This Court has personal jurisdiction over any foreign defendants because they transact business within the State of New York either directly or through their wholly-owned subsidiaries, by selling securities in the State, and/or maintaining offices in the State. Any subsidiaries, affiliates and/or agents of such foreign defendants conducting business in this State are organized and operated as instrumentalities and/or alter egos of such foreign defendants. Such foreign defendants are the direct or indirect holding companies that operate through their subsidiaries, affiliates and/or agents in this State.

21. Venue is proper in this Court pursuant to C.P.L.R. §503(c) because most of the defendants maintain their principal place of business in New York County, and pursuant to C.P.L.R. §503(a) as designated by plaintiff. Many of the alleged acts and transactions, including the preparation and dissemination of the Offering Documents, also occurred in substantial part in New York County, New York.

IV. BACKGROUND ON RMBS OFFERINGS IN GENERAL AND DEFENDANTS' INVOLVEMENT IN THE PROCESS

A. The Mortgage-Backed Securities Market

22. This case involves securities that are supported by residential mortgages. Residential mortgages are loans made to homeowners that are secured by a piece of collateral – a residence. The loans generate specific, periodic payments, and the related collateral interest gives the lender the right to "foreclose" on the loan by seizing and selling the property to recover the amount of money that was loaned.

23. The mortgage-backed securities market has existed for decades. In 1980, the market's size was about $100 billion. By 2004, the size of that market had reached over $4.2 trillion. To place this figure in context, in 2004 the total size of the U.S. corporate debt market was $4.6 trillion. Investors from all over the world purchased mortgage-backed securities, and that demand drove down mortgage borrowing costs in the United States.

24. Creating RMBS involves a process called "securitization."

B. Organizations and Defendant Entities Involved in the Securitization Process

25. The securitization process requires a number of parties, including: (1) mortgage originators; (2) borrowers; (3) RMBS sponsors (or "sellers"); (4) mortgage depositors; (5) securities underwriters; (6) trusts that issue certificates backed by mortgages; (7) Nationally Recognized

Statistical Rating Organizations ("NRSROs"), three of which are the Credit Rating Agencies; and (8) investors. Following is a description of their roles in order.

26. ***Mortgage originators*** accept mortgage applications and other information from prospective borrowers. They set borrowing standards, purport to evaluate a borrower's ability to repay, and appraise the value of the collateral supporting the borrower's obligations. This process is called "underwriting" a mortgage. The key mortgage originators at issue herein are set forth in §VI.A, *infra*.

27. ***Borrowers*** who purport to satisfy the originators' underwriting criteria sign documentation memorializing the terms and conditions of the mortgages. Those documents typically include a promissory note and lien securing repayment – which together form what is known as the mortgage. Originators are then able to sell such mortgages to securitization sponsors in a large secondary market.

28. ***Sponsors*** (or "sellers") typically organize and initiate the securitization aspect of the process by acquiring large numbers of mortgages, aggregating them, and then selling them through an affiliated intermediary into an issuing trust. In this case, the sponsor for most of the RMBS offerings at issue herein was defendant MSMC. MSMC was generally responsible for pooling the mortgage loans to be securitized by the depositors, negotiating the principal securitization transaction documents and participating with the underwriters to structure the RMBS offerings.

29. ***Depositors*** typically buy the pools of mortgages from the sponsors (or "sellers"), settle the trusts, and deposit the mortgages into those trusts in exchange for the certificates to be offered to investors, which the depositors in turn sell to the underwriters, for ultimate sale to investors. Under the U.S. securities laws, depositors are technically considered "issuers" of the securities, and are strictly liable for material misrepresentations and omissions in any registration statement under the Securities Act of 1933. Defendants MSABS and MS Capital acted as the

depositors for most of the RMBS offerings at issue herein. A more detailed summary of the roles that MSABS and MS Capital performed in connection with plaintiff's certificates follows:

(a) First, MSABS and MS Capital acquired discrete pools of mortgages from the offering's "sponsor," in most cases, MSMC. The sponsor typically transferred those mortgages to the depositor via written mortgage purchase agreements that typically contained written representations and warranties about the mortgages ("Mortgage Purchase Agreements").

(b) Second, the depositor settled the issuing trusts, and "deposited" the discrete pools of mortgages acquired from the offering sponsor, along with their rights under the Mortgage Purchase Agreements, into the issuing trusts, in exchange for the certificates, which were then transferred to the underwriter for ultimate sale to investors such as plaintiff. The sponsor was responsible for making sure title to the mortgage loans was properly and timely transferred to the trusts and/or trustees of the trusts. The mortgages and their rights, among other things, constitute the trusts' res. The trusts – their res, trustee and beneficiaries – are defined by a written pooling and servicing agreement ("Pooling Agreement").

(c) Third, the depositor, who is technically the "issuer" under the U.S. securities laws, filed a "shelf" registration statement with the SEC, which enabled the depositor to issue securities rapidly in "shelf take-downs." In order to be offered through this method, it was necessary for the certificates to be deemed "investment grade" quality by the NRSRO processes described herein.

30. ***Securities underwriters*** purchase the certificates from the depositors and resell them to investors, such as plaintiff. The terms of a particular underwriter's liabilities and obligations in connection with the purchase, sale and distribution of RMBS certificates are typically set forth in a written agreement between the depositor and the underwriter ("Underwriting Agreement"). Moreover, the underwriters also have obligations and responsibilities placed upon them by U.S.

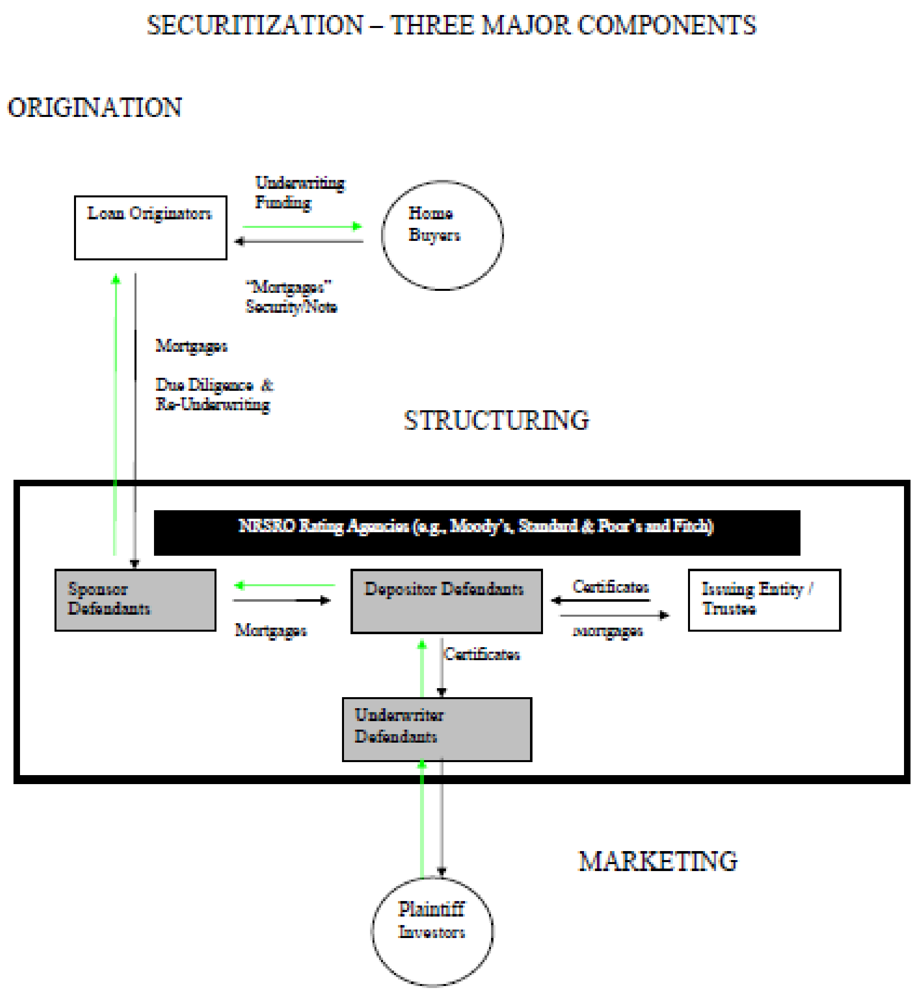
securities laws, including, without limitation, that they investigate the loans and ensure representations about the loans in the offering documents are true and correct. The "underwriter defendant" at issue herein is Morgan Stanley & Co., which served as underwriter in all of the RMBS offerings at issue herein.

31. ***Issuing trusts*** hold the mortgages and all accompanying rights under the Mortgage Purchase Agreements. Pursuant to the terms of the Pooling Agreements, the issuing trusts issue the certificates to the depositors, for ultimate sale to investors by the securities underwriters. The certificates entitle the investors to principal and interest payments from the mortgages held by the trusts. Trustees voluntarily agree to administer the trusts and voluntarily agree to satisfy contractual and common law duties to trust beneficiaries – the plaintiff certificate investor in this case.

32. ***NRSROs***, which include the Credit Rating Agencies herein, analyze performance data on mortgage loans of every type and use that information to build software programs and models that are ultimately used to assign credit ratings to RMBS. These computer models generate various "levels" of subordination and payment priorities that are necessary to assign "investment grade" credit ratings to the certificates that the RMBS trusts issue. The rules generated by the NRSRO models are then written into the Pooling Agreements drafted by the sponsor and the securities underwriter(s). As alleged above, in order to be issued pursuant to a "shelf take-down," the certificates must receive "investment grade" credit ratings from the NRSROs.

33. ***Investors***, like plaintiff, purchase the RMBS certificates, and thus, provide the funding that compensates all of the securitization participants identified above.

34. The illustration below further summarizes the roles of the various parties in an RMBS securitization. In this illustration, the green arrows – moving from investors to home buyers or borrowers – illustrate funds flow, and the grey cells identify certain defendant entities in the context of their roles in the securitization process:



C. To Market the Certificates, Defendants Registered Them with the SEC on "Investment Grade" Shelves

35. Receiving strong credit ratings assigned to a particular RMBS is what enables securities dealers, like defendants, to register those securities on a "shelf" with the SEC. Issuing securities in this way involves two steps. First, an issuer must file a "shelf" registration statement with the SEC, governing potentially dozens of individual issuances of securities, or "shelf take-downs," that the issuer plans to conduct in the future. Second, to market a particular issuance, the issuer must file a prospectus "supplement" to the registration statement. The registration statement describes the shelf program in general, while the prospectus supplement and other offering documents describe in detail the particular securities offered to investors at that time.

36. Many of the securities at issue in this case were "taken down" from shelves that defendants created, in most cases, a process that never would have been possible without investment grade ratings from the Credit Rating Agencies.

V. C.P.L.R. §3016 PARTICULARITY ALLEGATIONS

37. As detailed immediately below, all of the Offering Documents distributed by defendants and relied on by plaintiff's assignors were materially false and misleading, as they omitted and affirmatively misrepresented material information regarding the certificates and their underlying loans. Moreover, as set forth *infra*, defendants were well aware of each of the following material misrepresentations and omissions. *See* §VII, *infra.*

A. Each of the Offering Documents Omitted Material Information

38. The Offering Documents for each of the 27 offerings at issue failed to disclose critical information within defendants' possession regarding the certificates and their underlying loans. Specifically, prior to selling the certificates to plaintiff, defendants hired Clayton Holdings, Inc. ("Clayton") and/or other due diligence providers to re-underwrite samples of the loans underlying each of the specific certificates purchased by plaintiff.[3] For each of the 27 offerings, Clayton and/or other due diligence providers determined that a significant percentage of the loans had been defectively underwritten and/or was secured by inadequate collateral, and was thus likely to default. In aggregate, during 2006 and 2007 – the time period during which the vast majority of offerings at issue herein occurred – Clayton determined that ***36.8% of all loans it reviewed for Morgan Stanley's offerings were defective***. This information was directly provided to the defendants prior to

[3] During the relevant time frame, Clayton reviewed loan samples for approximately 50% to 70% of all RMBS offerings brought to market by third-party investment banks, including Morgan Stanley. Based upon Clayton's re-underwriting of sampled loans, the due diligence firm was able to establish, at a 95% confidence level, the overall defect rate for the specific pools of loans underlying the offerings at issue.

the offerings, but defendants affirmatively chose ***not*** to include it in the Offering Documents, even though Clayton expressly recommended that it be so included.

39. The Offering Documents also failed to disclose what defendants did with the material, undisclosed information they received from Clayton. Specifically, with regard to the test samples of loans that were reviewed by Clayton, Morgan Stanley knowingly "waived" back into the purchase pools for its offerings approximately ***56.3% of the specific loans that had been affirmatively identified as defective***. With regard to the unsampled portion of the purchase pools – *i.e.*, the vast majority of the loans – defendants simply purchased the loans in their entirety, ***sight unseen***, notwithstanding the significant defect rates Clayton had uncovered. Moreover, on information and belief, defendants even used these significant, undisclosed material defect rates as leverage to force their loan suppliers to accept lower purchase prices for the loans, without passing the benefits of such discounts on to plaintiff and other investors. ***None*** of the foregoing information was disclosed in the Offering Documents relied on by plaintiff and its assignors, making such documents materially misleading.

40. The Offering Documents also failed to disclose that, at the same time Morgan Stanley sold the certificates to plaintiff, the bank was also purchasing large credit default swaps ("CDSs") on various collateralized debt obligations ("CDOs"), which effectively served as massive bets that the ***same*** certificates sold to plaintiff – as well as other similar certificates issued from the same shelf registrations as the certificates sold to plaintiff – would ***fail***.[4]

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[4] A CDS is a financial swap agreement in which the seller of the CDS agrees it will compensate the buyer in the event that the underlying asset defaults or experiences another specified credit event. Much like an insurance contract, the buyer of the CDS makes a series of payments to the seller and, in exchange, receives a payoff if/when the default or other specified credit event occurs. Accordingly, the purchase of a CDS effectively amounts to a bet that the underlying asset will fail.

41. For example, as set forth in more detail in §VII.B *infra*, Morgan Stanley was allowed to hand-pick the RMBS that backed a group of CDOs known as the "Dead President CDOs," against which Morgan Stanley purchased large CDSs. Because the bank's CDSs were designed to only pay Morgan Stanley in the event that the RMBS backing the CDOs failed, Morgan Stanley had every incentive to select RMBS that the bank knew were backed by low-quality, defectively underwritten loans. Tellingly, Morgan Stanley selected several RMBS that the bank itself had structured, marketed and/or sold, including ***two of the very same offerings at issue herein***, the MSHEL 2006-2 and MSHEL 2006-3 offerings. In addition, Morgan Stanley selected several other RMBS issued pursuant to the ***same*** MSAC, MSHEL, MSIX and IXIS shelf registration offerings at issue herein. Not surprisingly, the RMBS selected by Morgan Stanley for inclusion in the "Dead President CDOs" suffered strikingly high default rates – just as Morgan Stanley had expected – in turn, generating significant profits for the bank. Morgan Stanley also placed other CDSs against similar CDOs containing the same and/or similar RMBS as those the bank sold to plaintiff, which similarly allowed Morgan Stanley to profit at the expense of plaintiff and other RMBS investors. *See* §VII.B, *infra.*

42. Unfortunately for plaintiff, ***none*** of defendants' Offering Documents made any mention of Morgan Stanley's scheme to profit from the poor quality of its own RMBS offerings, rendering such documents materially misleading.

B. Each of the Offering Documents Contained Material Misrepresentations

1. The MSAC 2007-NC1 Certificates

43. The Morgan Stanley ABS Capital I Inc. Trust 2007-NC1, Mortgage Pass-Through Certificates, Series 2007-NC1 ("MSAC 2007-NC1 Certificates") were issued pursuant to a Prospectus Supplement dated January 19, 2007. The following defendants played critical roles in

the fraudulent structuring, offering and sale of the MSAC 2007-NC1 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

44. Plaintiff purchased the following MSAC 2007-NC1 Certificate:

Original Purchaser	**Tranche Purchased**	**CUSIP**	**Purchase Date**	**Original Face Amount**	**Purchased From**
Fortis Bank	A2D	61750AE2	1/22/2007	$10,000,000	Morgan Stanley & Co.

45. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSAC 2007-NC1 Offering Documents, including draft and/or final MSAC 2007-NC1 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2007-NC1 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

46. The MSAC 2007-NC1 Offering Documents disclosed that 100% of the loans underlying plaintiff's MSAC 2007-NC1 Certificate were acquired by the sponsor, MSMC, from NC Capital Corporation ("NC Capital"), which in turn acquired them from its affiliate, loan originator New Century Mortgage Corporation ("New Century"). *See* MSAC 2007-NC1 Prospectus Supplement ("Pros. Supp.") at S-10, S-27.

47. The MSAC 2007-NC1 Offering Documents represented that "[t]he New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the related mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-30. The MSAC 2007-NC1 Offering Documents also represented that, "[w]hile New Century's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, New Century also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as

the type and use of the mortgaged property." *Id.* The MSAC 2007-NC1 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans generally are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2007-NC1 Offering Documents represented that "New Century reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id*. Moreover, the MSAC 2007-NC1 Offering Documents represented that the maximum allowable debt service-to-income ratio is usually 50% to 55%. *Id.* at S-32-S-34. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

b. Loan-to-Value Ratios

48. The MSAC 2007-NC1 Offering Documents also made certain misrepresentations regarding the loan-to-value ("LTV") ratios associated with the loans supporting the MSAC 2007-NC1 Certificate purchased by plaintiff.[5] Specifically, the MSAC 2007-NC1 Offering Documents represented that just over 40% of the loans supporting plaintiff's MSAC 2007-NC1 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2007-NC1 Certificate had LTV ratios over 100%.

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5 For the reasons set forth *infra*, LTV ratios are very important to RMBS investors. *See* §§VI.B and IX.A, *infra*.

49. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2007-NC1 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2007-NC1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2007-NC1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:[6]

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Stated Percentage of Loans Having LTV Ratios Over 80%**	**Actual Percentage of Loans Having LTV Ratios Over 80%**	**Stated Percentage of Loans Having LTV Ratios Over 100%**	**Actual Percentage of Loans Having LTV Ratios Over 100%**
A2D	61750AE2	All	42.28%	66.91%	0.00%	20.15%

c. Owner Occupancy Rates

50. The MSAC 2007-NC1 Offering Documents also made certain misrepresentations regarding the owner occupancy rates ("OOR" or "Primary Residence Percentages") associated with the loans supporting the MSAC 2007-NC1 Certificate purchased by plaintiff.[7] Specifically, the MSAC 2007-NC1 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2007-NC1 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

51. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2007-NC1 Certificate, which reveals that the OOR

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6 Consistent with defendants' representations in the Offering Documents, all LTV ratio percentages herein are stated as a percentage of the aggregate outstanding loan balance of the supporting loan group or groups at issue.

7 For the reasons set forth *infra*, OOR percentages are very important to RMBS investors. *See* §§VI.C and IX.A, *infra*.

percentages stated in the MSAC 2007-NC1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2007-NC1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:[8]

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
A2D	61750AE2	All	90.68%	82.44%	10.00%

d. Credit Ratings

52. The MSAC 2007-NC1 Offering Documents also represented that the MSAC 2007-NC1 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's"), indicating that the security was a very strong, safe investment with an extremely low probability of default.[9] Specifically, the MSAC 2007-NC1 Offering Documents represented that plaintiff's MSAC 2007-NC1 Certificate had been assigned AAA/Aaa ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.[10]

53. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2007-NC1 Certificate should not have received AAA/Aaa credit ratings, because it

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8 Consistent with defendants' representations in the Offering Documents, all Primary Residence Percentages herein are stated as a percentage of the aggregate outstanding loan balance of the supporting loan group or groups at issue.

9 For the reasons set forth *infra*, credit ratings are very important to RMBS investors. *See* §§VI.D and IX.B, *infra*.

10 As explained *infra*, "[t]raditionally, investments holding AAA ratings have had ***a less than 1% probability of incurring defaults***." *See* §VI.D, *infra* (citing Carl Levin & Tom Coburn, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse*, Majority and Minority Staff Report, Permanent Subcommittee on Investigations, United States Senate, 112th Congress (Apr. 13, 2011) ("Levin-Coburn Report") at 6).

was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSAC 2007-NC1 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSAC 2007-NC1 Certificate was because defendants had fed them falsified information regarding the MSAC 2007-NC1 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower debt-to-income ("DTI") ratios, and false OOR percentages.

54. The falsity of the credit ratings set forth in the MSAC 2007-NC1 Offering Documents is confirmed by subsequent events. Specifically, ***approximately 43%***[11] ***of the loans supporting plaintiff's MSAC 2007-NC1 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them.[12] Moreover, plaintiff's "investment grade" MSAC 2007-NC1 Certificate is now rated at "junk" status. Clearly, plaintiff's MSAC 2007-NC1 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2007-NC1 Certificate's credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

[11] The default rates for all offerings at issue were obtained from trustee reports which were generally issued in or about May 2013.

[12] When used herein to describe the status of a loan or group of loans, the terms "in default," "into default" or "defaulted" are defined to include any loan or group of loans that is delinquent, in bankruptcy, foreclosed or bank owned.

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Current Percentage of Outstanding Loan Balance in Default	Moody's Ratings		S&P's Ratings	
				Initial	**Current**	**Initial**	**Current**
A2D	61750AE2	All	42.72%	Aaa	Ca	AAA	CCC

e. Transfer of Title

55. The MSAC 2007-NC1 Offering Documents also represented that the loans underlying the MSAC 2007-NC1 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering.[13] Specifically, the MSAC 2007-NC1 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2007-NC1 Pros. Supp. at S-53. The MSAC 2007-NC1 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to the trustee, on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* at S-53-S-54. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

2. The MSAC 2007-HE1 Certificates

56. The Morgan Stanley ABS Capital I Inc. Trust 2007-HE1, Mortgage Pass-Through Certificates, Series 2007-HE1 ("MSAC 2007-HE1 Certificates") were issued pursuant to a Prospectus Supplement dated January 24, 2007. The following defendants played critical roles in

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13 For the reasons set forth *infra*, transfer of title of the underlying loans was very important to RMBS investors. *See* §VI.E, *infra*.

the fraudulent structuring, offering and sale of the MSAC 2007-HE1 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

57. Plaintiff purchased the following MSAC 2007-HE1 Certificates:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	A2D	617526AF5	1/11/2007	$15,000,000	Morgan Stanley & Co.
Fortis Bank	M1	617526AG3	1/11/2007	$10,000,000	Morgan Stanley & Co.

58. The decision to purchase the above securities was made by Fortis Bank in direct reliance upon the MSAC 2007-HE1 Offering Documents, including draft and/or final MSAC 2007-HE1 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2007-HE1 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

59. The MSAC 2007-HE1 Offering Documents disclosed that approximately 70.80% of the MSAC 2007-HE1 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century; and approximately 29.20% of the MSAC 2007-HE1 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Decision One Mortgage Company, LLC ("Decision One"). *See* MSAC 2007-HE1 Pros. Supp. at S-29.

60. With regard to the New Century loans, the MSAC 2007-HE1 Offering Documents represented that "[t]he New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-30. The MSAC 2007-HE1 Offering Documents also represented that, "[w]hile New Century's primary consideration

in underwriting a mortgage loan is the value of the mortgaged property, New Century also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2007-HE1 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2007-HE1 Offering Documents represented that "New Century reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* at S-30-S-31. Moreover, the MSAC 2007-HE1 Offering Documents represented that the maximum allowable debt service-to-income ratio is usually 50% to 55%. *Id.* at S-31-S-33. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

61. With regard to the Decision One loans, the MSAC 2007-HE1 Offering Documents represented that "[t]he Decision One Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2007-HE1 Pros. Supp. at S-34. The MSAC 2007-HE1 Offering Documents also represented that, "[w]hile Decision One's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, Decision One also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id.*

The MSAC 2007-HE1 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2007-HE1 Offering Documents represented that "Decision One reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* at S-35. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

b. Loan-to-Value Ratios

62. The MSAC 2007-HE1 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2007-HE1 Certificates purchased by plaintiff. Specifically, the MSAC 2007-HE1 Offering Documents represented that a little over 40% of the loans supporting plaintiff's MSAC 2007-HE1 Certificates had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2007-HE1 Certificate had LTV ratios over 100%.

63. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2007-HE1 Certificates, which reveals that the LTV ratio percentages stated in the MSAC 2007-HE1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the

MSAC 2007-HE1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Stated Percentage of Loans Having LTV Ratios Over 80%**	**Actual Percentage of Loans Having LTV Ratios Over 80%**	**Stated Percentage of Loans Having LTV Ratios Over 100%**	**Actual Percentage of Loans Having LTV Ratios Over 100%**
A2D	617526AF5	All	43.17%	70.36%	0.00%	22.04%
M1	617526AG3	All	43.17%	70.36%	0.00%	22.04%

c. Owner Occupancy Rates

64. The MSAC 2007-HE1 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2007-HE1 Certificates purchased by plaintiff. Specifically, the MSAC 2007-HE1 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2007-HE1 Certificates were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

65. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2007-HE1 Certificates, which reveals that the OOR percentages stated in the MSAC 2007-HE1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2007-HE1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A2D	617526AF5	All	92.48%	86.16%	7.33%
M1	617526AG3	All	92.48%	86.16%	7.33%

d. Credit Ratings

66. The MSAC 2007-HE1 Offering Documents also represented that the MSAC 2007-HE1 Certificates purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the securities were very strong, safe investments with an extremely low probability of default. Specifically, the MSAC 2007-HE1 Offering Documents represented that plaintiff's MSAC 2007-HE1 Certificates had been assigned AAA/Aaa and AA+/Aa1 ratings – signifying that they were extremely safe "investment grade" securities.

67. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2007-HE1 Certificates should not have received AAA/Aaa and AA+/Aa1 credit ratings, because they were ***not*** safe, "investment grade" securities. Rather, as defendants were well aware, plaintiff's MSAC 2007-HE1 Certificates were extremely risky, speculative grade "junk" bonds or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSAC 2007-HE1 Certificates was because defendants had fed them falsified information regarding the MSAC 2007-HE1 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

68. The falsity of the credit ratings set forth in the MSAC 2007-HE1 Offering Documents is confirmed by subsequent events. Specifically, ***more than 38% of the loans supporting plaintiff's MSAC 2007-HE1 Certificates are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2007-HE1 Certificates are now rated at "junk" status or below. Clearly, plaintiff's MSAC 2007-HE1 Certificates were not the highly rated, "investment grade" securities defendants represented them to be. The evidence supporting the falsity of the MSAC 2007-HE1 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Current Percentage of Outstanding Loan Balance in Default	Moody's Ratings		S&P's Ratings	
				Initial	Current	Initial	Current
A2D	617526AF5	All	38.50%	Aaa	Ca	AAA	CCC
M1	617526AG3	All	38.50%	Aa1	C	AA+	D

e. Transfer of Title

69. The MSAC 2007-HE1 Offering Documents also represented that the loans underlying the MSAC 2007-HE1 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2007-HE1 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2007-HE1 Pros. Supp. at S-55. The MSAC 2007-HE1 Offering Documents also stated that:

> In connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to (i) LaSalle Bank National Association, as custodian on behalf of the trustee with respect to the Decision One mortgage loans, and (ii) the trustee with respect to the NC Capital mortgage loans, on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file:
>
> (a) the original mortgage note . . . ;
>
> (c) the related original mortgage . . . ; [and]
>
> (d) the mortgage assignment . . . .

Id. at S-56. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

3. The MSAC 2007-HE2 Certificates

70. The Morgan Stanley ABS Capital I Inc. Trust 2007-HE2, Mortgage Pass-Through Certificates, Series 2007-HE2 ("MSAC 2007-HE2 Certificates") were issued pursuant to a Prospectus Supplement dated February 27, 2007. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2007-HE2 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

71. Plaintiff purchased the following MSAC 2007-HE2 Certificate:

Original Purchaser	**Tranche Purchased**	**CUSIP**	**Purchase Date**	**Original Face Amount**	**Purchased From**
Fortis Bank	M1	61753EAE0	2/8/2007	$10,000,000	Morgan Stanley & Co.

72. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSAC 2007-HE2 Offering Documents, including draft and/or final MSAC 2007-HE2 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2007-HE2 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

73. The MSAC 2007-HE2 Offering Documents disclosed that approximately 45.69% of the MSAC 2007-HE2 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century; approximately 38.27% of the MSAC 2007-HE2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator WMC Mortgage Corp. ("WMC"); and approximately 16.05% of the MSAC 2007-HE2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Decision One. *See* MSAC 2007-HE2 Pros. Supp. at S-29.

74. With regard to the New Century loans, the MSAC 2007-HE2 Offering Documents represented that "[t]he New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the related mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-30. The MSAC 2007-HE2 Offering Documents also represented that, "[w]hile New Century's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, New Century also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2007-HE2 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans generally are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2007-HE2 Offering Documents represented that "New Century reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id*. at S-31. Moreover, the MSAC 2007-HE2 Offering Documents represented that the maximum allowable debt service-to-income ratio is usually 50% to 55%. *Id.* at S-32-S-34. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

75. With regard to the WMC loans, the MSAC 2007-HE2 Offering Documents represented that "[t]he WMC Underwriting Guidelines are primarily intended to (a) determine that

the borrower has the ability to repay the mortgage loan in accordance with its terms and (b) determine that the related mortgaged property will provide sufficient value to recover the investment if the borrower defaults." *See* MSAC 2007-HE2 Pros. Supp. at S-35. The MSAC 2007-HE2 Offering Documents also represented that "WMC verifies the loan applicant's eligible sources of income for all products, calculates the amount of income from eligible sources indicated on the loan application, reviews the credit and mortgage payment history of the applicant and calculates the Debt Ratio to determine the applicant's ability to repay the loan, and reviews the mortgaged property for compliance with the WMC Underwriting Guidelines." *Id.* at S-36. The MSAC 2007-HE2 Offering Documents further represented that:

> The WMC Underwriting Guidelines . . . require, among other things, (1) an appraisal of the mortgaged property which conforms to Uniform Standards of Professional Appraisal Practice and (2) an audit of such appraisal by a WMC-approved appraiser or by WMC's in-house collateral auditors (who may be licensed appraisers) and such audit may in certain circumstances consist of a second appraisal, a field review, a desk review or an automated valuation model.

Id. Moreover, the MSAC 2007-HE2 Offering Documents represented that the maximum allowable debt-to-income ratio was 50% to 55%. *Id.* at S-38-S-44. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that WMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.3, *infra*.

76. With regard to all of the loans underlying the MSAC 2007-HE2 Certificates, the MSAC 2007-HE2 Offering Documents represented that "[t]he mortgage loans were originated or acquired generally in accordance with the underwriting guidelines of the responsible parties" (citing the underwriting guidelines for the New Century and Decision One loans). *See* MSAC 2007-HE2

Pros. Supp. at S-27. The MSAC 2007-HE2 Offering Documents also represented that "[u]nderwriting standards are applied by or on behalf of a lender to evaluate the borrower's credit standing and repayment ability, and the value and adequacy of the related mortgaged property, home improvements or manufactured home, as applicable, as collateral." *See* MSAC 2007-HE2 Prospectus ("Pros.") at 34. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that WMC, Decision One and New Century had completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §§VI.A.1-VI.A.3, *infra*.

b. Loan-to-Value Ratios

77. The MSAC 2007-HE2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2007-HE2 Certificate purchased by plaintiff. Specifically, the MSAC 2007-HE2 Offering Documents represented that about 40% of the loans supporting plaintiff's MSAC 2007-HE2 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2007-HE2 Certificate had LTV ratios over 100%.

78. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2007-HE2 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2007-HE2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2007-HE2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
M1	61753EAE0	All	40.60%	73.19%	0.00%	21.92%

c. Owner Occupancy Rates

79. The MSAC 2007-HE2 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2007-HE2 Certificate purchased by plaintiff. Specifically, the MSAC 2007-HE2 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2007-HE2 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

80. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2007-HE2 Certificate, which reveals that the OOR percentages stated in the MSAC 2007-HE2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2007-HE2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
M1	61753EAE0	All	93.16%	83.10%	12.10%

d. Credit Ratings

81. The MSAC 2007-HE2 Offering Documents also represented that the MSAC 2007-HE2 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an

extremely low probability of default. Specifically, the MSAC 2007-HE2 Offering Documents represented that plaintiff's MSAC 2007-HE2 Certificate had been assigned AA+/Aa1 ratings – signifying it was an extremely safe and stable security.

82. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2007-HE2 Certificate should not have received AA+/Aa1 credit ratings, because it was ***not*** a safe, "investment grade" security. Rather, as defendants were well aware, plaintiff's MSAC 2007-HE2 Certificate was an extremely risky, speculative grade "junk" bond or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSAC 2007-HE2 Certificate was because defendants had fed them falsified information regarding the MSAC 2007-HE2 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

83. The falsity of the credit ratings set forth in the MSAC 2007-HE2 Offering Documents is confirmed by subsequent events. Specifically, ***more than 45% of the loans supporting plaintiff's MSAC 2007-HE2 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2007-HE2 Certificate is now rated at below "junk" status. Clearly, plaintiff's MSAC 2007-HE2 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2007-HE2 Certificate's credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**	
				Initial	**Current**	**Initial**	**Current**
M1	61753EAE0	All	45.36%	Aa1	C	AA+	D

e. Transfer of Title

84. The MSAC 2007-HE2 Offering Documents also represented that the loans underlying the MSAC 2007-HE2 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2007-HE2 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2007-HE2 Pros. Supp. at S-67. The MSAC 2007-HE2 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to [custodians on behalf of the trustee with respect to the WMC and Decision One loans and the trustee with respect to the New Century loans], on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* at S-67-S-68. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

4. The MSAC 2007-HE3 Certificates

85. The Morgan Stanley ABS Capital I Inc. Trust 2007-HE3, Mortgage Pass-Through Certificates, Series 2007-HE3 ("MSAC 2007-HE3 Certificates") were issued pursuant to a Prospectus Supplement dated February 27, 2007. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2007-HE3 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

86. Plaintiff purchased the following MSAC 2007-HE3 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	A2D	617538AD5	2/26/2007	$25,000,000	Morgan Stanley & Co.

87. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSAC 2007-HE3 Offering Documents, including draft and/or final MSAC 2007-HE3 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2007-HE3 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

88. The MSAC 2007-HE3 Offering Documents disclosed that approximately 77.16% of the MSAC 2007-HE3 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Fremont Investment & Loan ("Fremont"); and approximately 22.84% of the MSAC 2007-HE3 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century. *See* MSAC 2007-HE3 Pros. Supp. at S-28.

89. With regard to the Fremont loans, the MSAC 2007-HE3 Offering Documents represented that "Fremont's underwriting guidelines are primarily intended to assess the ability and willingness of the borrower to repay the debt and evaluate the adequacy of the mortgaged property as collateral for the mortgage loan." *Id.* at S-29. The MSAC 2007-HE3 Offering Documents also represented that "Fremont's underwriting guidelines under the Scored Programs with respect to each rating category generally require: debt to income ratios of 55% or less on mortgage loans with loan-to-value ratios of 95% or less, however, debt to income ratios of 50% or less are required on loan-to-value ratios greater than 95%." *Id.* at S-31. The MSAC 2007-HE3 Offering Documents further represented that "Fremont's underwriting guidelines . . . require an appraisal of the mortgaged

property, and if appropriate, a review appraisal." *Id.* at S-30. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Fremont had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.5, *infra*.

90. With regard to the New Century loans, the MSAC 2007-HE3 Offering Documents represented that "[t]he New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the related mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2007-HE3 Pros. Supp. at S-33. The MSAC 2007-HE3 Offering Documents also represented that, "[w]hile New Century's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, New Century also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2007-HE3 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans generally are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2007-HE3 Offering Documents represented that "New Century reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* at S-34. Moreover, the MSAC 2007-HE3 Offering Documents represented that the maximum allowable debt service-to-income ratio is usually 50% to 55%. *Id.* at S-32-S-34. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative

representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

b. Loan-to-Value Ratios

91. The MSAC 2007-HE3 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2007-HE3 Certificate purchased by plaintiff. Specifically, the MSAC 2007-HE3 Offering Documents represented that a little over 40% of the loans supporting plaintiff's MSAC 2007-HE3 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2007-HE3 Certificate had LTV ratios over 100%.

92. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2007-HE3 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2007-HE3 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2007-HE3 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	617538AD5	All	40.40%	68.68%	0.00%	23.23%

c. Owner Occupancy Rates

93. The MSAC 2007-HE3 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2007-HE3

Certificate purchased by plaintiff. Specifically, the MSAC 2007-HE3 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2007-HE3 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

94. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2007-HE3 Certificate, which reveals that the OOR percentages stated in the MSAC 2007-HE3 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2007-HE3 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A2D	617538AD5	All	92.25%	81.06%	13.81%

d. Credit Ratings

95. The MSAC 2007-HE3 Offering Documents also represented that the MSAC 2007-HE3 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSAC 2007-HE3 Offering Documents represented that plaintiff's MSAC 2007-HE3 Certificate had been assigned AAA/Aaa ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

96. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2007-HE3 Certificate should not have received AAA/Aaa credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults."

Rather, as defendants were well aware, plaintiff's MSAC 2007-HE3 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSAC 2007-HE3 Certificate was because defendants had fed them falsified information regarding the MSAC 2007-HE3 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

97. The falsity of the credit ratings set forth in the MSAC 2007-HE3 Offering Documents is confirmed by subsequent events. Specifically, ***more than 38% of the loans supporting plaintiff's MSAC 2007-HE3 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2007-HE3 Certificate is now rated at "junk" status. Clearly, plaintiff's MSAC 2007-HE3 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2007-HE3 Certificate's credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**	
				Initial	**Current**	**Initial**	**Current**
A2D	617538AD5	All	38.34%	Aaa	Ca	AAA	CCC

e. Transfer of Title

98. The MSAC 2007-HE3 Offering Documents also represented that the loans underlying the MSAC 2007-HE3 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2007-HE3 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to

each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2007-HE3 Pros. Supp. at S-54. The MSAC 2007-HE3 Offering Documents also stated that:

> In connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to (i) Wells Fargo Bank, National Association, as custodian on behalf of the trustee with respect to the Fremont mortgage loans and (ii) the trustee with respect to the NC Capital mortgage loans, on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file:
>
> (a) the original mortgage note . . . ;
>
> (c) the related original mortgage . . . ; [and]
>
> (d) the mortgage assignment . . . .

Id. at S-55. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

5. The MSAC 2007-HE5 Certificates

99. The Morgan Stanley ABS Capital I Inc. Trust 2007-HE5, Mortgage Pass-Through Certificates, Series 2007-HE5 ("MSAC 2007-HE5 Certificates") were issued pursuant to a Prospectus Supplement dated April 24, 2007. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2007-HE5 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

100. Plaintiff purchased the following MSAC 2007-HE5 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	A2D	61753KAE6	4/11/2007	$30,000,000	Morgan Stanley & Co.

101. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSAC 2007-HE5 Offering Documents, including draft and/or final MSAC 2007-HE5 Prospectus Supplements, all of which were distributed by the defendants associated with the

MSAC 2007-HE5 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

102. The MSAC 2007-HE5 Offering Documents disclosed that approximately 50.56% of the MSAC 2007-HE5 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator WMC; and approximately 49.44% of the MSAC 2007-HE5 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Decision One. *See* MSAC 2007-HE5 Pros. Supp. at S-30.

103. With regard to the WMC loans, the MSAC 2007-HE5 Offering Documents represented that "[t]he WMC Underwriting Guidelines are primarily intended to (a) determine that the borrower has the ability to repay the mortgage loan in accordance with its terms and (b) determine that the related mortgaged property will provide sufficient value to recover the investment if the borrower defaults." *Id.* at S-31–S-32. The MSAC 2007-HE5 Offering Documents also represented that "WMC verifies the loan applicant's eligible sources of income for all products, calculates the amount of income from eligible sources indicated on the loan application, reviews the credit and mortgage payment history of the applicant and calculates the Debt Ratio to determine the applicant's ability to repay the loan, and reviews the mortgaged property for compliance with the WMC Underwriting Guidelines." *Id.* at S-32. The MSAC 2007-HE5 Offering Documents further represented that "[t]he WMC Underwriting Guidelines . . . require, among other things, (1) an appraisal of the mortgaged property which conforms to Uniform Standards of Professional Appraisal Practice and (2) an audit of such appraisal by a WMC-approved appraiser or by WMC's in-house collateral auditors (who may be licensed appraisers) and such audit may in certain circumstances consist of a second appraisal, a field review, a desk review or an automated valuation model." *Id.* Moreover, the MSAC 2007-HE5 Offering Documents represented that the maximum allowable DTI

ratio is 50% to 55%. *Id.* at S-34-S-42. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that WMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.3, *infra*.

104. With regard to the Decision One loans, the MSAC 2007-HE5 Offering Documents represented that "[t]he Decision One Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2007-HE5 Pros. Supp. at S-43. The MSAC 2007-HE5 Offering Documents also represented that, "[w]hile Decision One's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, Decision One also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2007-HE5 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2007-HE5 Offering Documents represented that "Decision One reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any

regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

b. Loan-to-Value Ratios

105. The MSAC 2007-HE5 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2007-HE5 Certificate purchased by plaintiff. Specifically, the MSAC 2007-HE5 Offering Documents represented that less than 40% of the loans supporting plaintiff's MSAC 2007-HE5 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2007-HE5 Certificate had LTV ratios over 100%.

106. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2007-HE5 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2007-HE5 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2007-HE5 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	61753KAE6	All	39.07%	79.86%	0.00%	29.32%

c. Owner Occupancy Rates

107. The MSAC 2007-HE5 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2007-HE5 Certificate purchased by plaintiff. Specifically, the MSAC 2007-HE5 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2007-HE5 Certificate

were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

108. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2007-HE5 Certificate, which reveals that the OOR percentages stated in the MSAC 2007-HE5 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2007-HE5 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A2D	61753KAE6	All	97.05%	89.01%	9.03%

d. Credit Ratings

109. The MSAC 2007-HE5 Offering Documents also represented that the MSAC 2007-HE5 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSAC 2007-HE5 Offering Documents represented that plaintiff's MSAC 2007-HE5 Certificate had been assigned AAA/Aaa ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

110. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2007-HE5 Certificate should not have received AAA/Aaa credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSAC 2007-HE5 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed,

one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSAC 2007-HE5 Certificate was because defendants had fed them falsified information regarding the MSAC 2007-HE5 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

111. The falsity of the credit ratings set forth in the MSAC 2007-HE5 Offering Documents is confirmed by subsequent events. Specifically, ***more than 43% of the loans supporting plaintiff's MSAC 2007-HE5 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2007-HE5 Certificate is now rated at "junk" status. Clearly, plaintiff's MSAC 2007-HE5 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2007-HE5 Certificate's credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**	
				Initial	**Current**	**Initial**	**Current**
A2D	61753KAE6	All	43.51%	Aaa	Ca	AAA	CCC

e. Transfer of Title

112. The MSAC 2007-HE5 Offering Documents also represented that the loans underlying the MSAC 2007-HE5 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2007-HE5 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2007-HE5 Pros. Supp. at S-62. The MSAC 2007-HE5

Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to [custodians on behalf of the trustees], on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* at S-62-S-63. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

6. The MSAC 2006-HE2 Certificates

113. The Morgan Stanley Capital I Inc. Trust 2006-HE2, Mortgage Pass-Through Certificates, Series 2006-HE2 ("MSAC 2006-HE2 Certificates") were issued pursuant to a Prospectus Supplement dated April 24, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2006-HE2 Certificates: MS Capital (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

114. Plaintiff purchased the following MSAC 2006-HE2 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	M1	617451EW5	3/14/2006	$10,000,000	Morgan Stanley & Co.

115. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSAC 2006-HE2 Offering Documents, including draft and/or final MSAC 2006-HE2 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2006-HE2 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

116. The MSAC 2006-HE2 Offering Documents disclosed that approximately 72.84% of the MSAC 2006-HE2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator WMC; and approximately 27.16% of the MSAC 2006-HE2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Decision One. *See* MSAC 2006-HE2 Pros. Supp. at S-27, S-38.

117. With regard to the WMC loans, the MSAC 2006-HE2 Offering Documents represented that the loans were originated or re-underwritten in accordance with the WMC underwriting guidelines, which were "primarily intended to (a) determine that the borrower has the ability to repay the mortgage loan in accordance with its terms and (b) determine that the related mortgaged property will provide sufficient value to recover the investment if the borrower defaults." *Id.* at S-28. The MSAC 2006-HE2 Offering Documents also represented that "WMC verifies the loan applicant's eligible sources of income for all products, calculates the amount of income from eligible sources indicated on the loan application, reviews the credit and mortgage payment history of the applicant and calculates the Debt Ratio to determine the applicant's ability to repay the loan, and reviews the mortgaged property for compliance with the WMC Underwriting Guidelines." *Id.* The MSAC 2006-HE2 Offering Documents further represented that "[t]he WMC Underwriting Guidelines . . . require[], among other things, (1) an appraisal of the mortgaged property which conforms to Uniform Standards of Professional Appraisal Practice and (2) an audit of such appraisal by a WMC-approved appraiser or by WMC's in-house collateral auditors (who may be licensed appraisers) and such audit may in certain circumstances consist of a second appraisal, a field review, a desk review or an automated valuation model." *Id.* Moreover, the MSAC 2006-HE2 Offering Documents represented that the maximum allowable DTI ratio is 50% to 55%. *Id.* at S-30-S-38. As further detailed *infra*, these representations were false and misleading at the time they were made.

Contrary to defendants' affirmative representations, the truth was that WMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.3, *infra*.

118. With regard to the Decision One loans, the MSAC 2006-HE2 Offering Documents represented that "[t]he Decision One Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2006-HE2 Pros. Supp. at S-38. The MSAC 2006-HE2 Offering Documents also represented that, "[w]hile Decision One['s] . . . primary consideration in underwriting a mortgage loan is the value of the mortgaged property, Decision One . . . also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2006-HE2 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers," and that "[t]he Decision One Underwriting Guidelines . . . require[] Decision One['s] . . . underwriters to be satisfied that the value of the property being financed, as indicated by an appraisal and a review of the appraisal, currently supports the outstanding loan balance." *Id.* at S-39. In addition, the MSAC 2006-HE2 Offering Documents represented that in each of its origination programs, "Decision One . . . reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id*. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision

One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

b. Loan-to-Value Ratios

119. The MSAC 2006-HE2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-HE2 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE2 Offering Documents represented that less than a third of the loans supporting plaintiff's MSAC 2006-HE2 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-HE2 Certificate had LTV ratios over 100%.

120. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-HE2 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2006-HE2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2006-HE2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Stated Percentage of Loans Having LTV Ratios Over 80%**	**Actual Percentage of Loans Having LTV Ratios Over 80%**	**Stated Percentage of Loans Having LTV Ratios Over 100%**	**Actual Percentage of Loans Having LTV Ratios Over 100%**
M1	617451EW5	All	32.29%	76.12%	0.00%	31.97%

c. Owner Occupancy Rates

121. The MSAC 2006-HE2 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-HE2 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE2 Offering Documents

represented that a large percentage of the loans supporting plaintiff's MSAC 2006-HE2 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

122. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-HE2 Certificate, which reveals that the OOR percentages stated in the MSAC 2006-HE2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-HE2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
M1	617451EW5	All	96.60%	86.55%	11.61%

d. Credit Ratings

123. The MSAC 2006-HE2 Offering Documents also represented that the MSAC 2006-HE2 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch Ratings ("Fitch"), indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSAC 2006-HE2 Offering Documents represented that plaintiff's MSAC 2006-HE2 Certificate had been assigned AA+/Aa1/AA+ ratings – signifying an extremely safe and stable security.

124. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-HE2 Certificate should not have received AA+/Aa1/AA+ credit ratings, because it was ***not*** a safe, "investment grade" security. Rather, as defendants were well aware, plaintiff's MSAC 2006-HE2 Certificate was an extremely risky, speculative grade "junk" bond or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that

S&P, Moody's and Fitch had assigned such high ratings to plaintiff's MSAC 2006-HE2 Certificate was because defendants had fed them falsified information regarding the MSAC 2006-HE2 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

125. The falsity of the credit ratings set forth in the MSAC 2006-HE2 Offering Documents is confirmed by subsequent events. Specifically, ***more than 45% of the loans supporting plaintiff's MSAC 2006-HE2 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-HE2 Certificate is now rated at below "junk" status. Clearly, plaintiff's MSAC 2006-HE2 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2006-HE2 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**		**Fitch's Ratings**	
				Initial	**Current**	**Initial**	**Current**	**Initial**	**Current**
M1	617451EW5	All	45.21%	Aa1	C	AA+	D	AA+	D

e. Transfer of Title

126. The MSAC 2006-HE2 Offering Documents also represented that the loans underlying the MSAC 2006-HE2 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2006-HE2 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-HE2 Pros. Supp. at S-55. The MSAC 2006-HE2

Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered … [to] custodian[s] on behalf of the trustee . . . on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment(s)." *Id.* at S-56. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

7. The MSAC 2006-HE3 Certificates

127. The Morgan Stanley ABS Capital I Inc. Trust 2006-HE3, Mortgage Pass-Through Certificates, Series 2006-HE3 ("MSAC 2006-HE3 Certificates") were issued pursuant to a Prospectus Supplement dated May 22, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2006-HE3 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

128. Plaintiff purchased the following MSAC 2006-HE3 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	A2D	61749HAE0	5/5/2006	$25,000,000	Morgan Stanley & Co.

129. The decision to purchase the above security was made by Fortis Bank, in direct reliance upon the MSAC 2006-HE3 Offering Documents, including draft and/or final MSAC 2006-HE3 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2006-HE3 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

130. The MSAC 2006-HE3 Offering Documents disclosed that approximately 41.00% of the MSAC 2006-HE3 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century; approximately 40.01% of the MSAC 2006-HE3 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator WMC; and approximately 18.99% of the MSAC 2006-HE3 Certificates' underlying loans were originated or acquired by the sponsor, MSMC, from loan originator Decision One. *See* MSAC 2006-HE3 Pros. Supp. at S-27.

131. With regard to the New Century loans, the MSAC 2006-HE3 Offering Documents represented that the "New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-28. The Offering Documents also represented that, "[w]hile New Century['s] . . . primary consideration in underwriting a mortgage loan is the value of the mortgaged property, New Century . . . also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2006-HE3 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers," and that "[t]he New Century Underwriting Guidelines require a review of the appraisal by a qualified employee of New Century . . . or by an appraiser retained by New Century." *Id.* In addition, the MSAC 2006-HE3 Offering Documents represented that "[t]he New Century Underwriting Guidelines require . . . New Century['s] . . . underwriters to be satisfied that the value of the property being financed, as indicated by an appraisal and a review of the appraisal, currently supports the outstanding loan balance." *Id.* at S-29. Moreover, the MSAC 2006-HE3 Offering Documents represented that "New Century . . . reviews

the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* at S-28. Furthermore, the MSAC 2006-HE3 Offering Documents represented that the maximum allowable debt service-to-income ratio was 50% to 55%. *Id.* at S-29-S-31. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

132. With regard to the WMC loans, the MSAC 2006-HE3 Offering Documents represented that "[t]he WMC Underwriting Guidelines are primarily intended to (a) determine that the borrower has the ability to repay the mortgage loan in accordance with its terms and (b) determine that the related mortgaged property will provide sufficient value to recover the investment if the borrower defaults." *See* MSAC 2006-HE3 Pros. Supp. at S-32. The MSAC 2006-HE3 Offering Documents also represented that "WMC verifies the loan applicant's eligible sources of income for all products, calculates the amount of income from eligible sources indicated on the loan application, reviews the credit and mortgage payment history of the applicant and calculates the Debt Ratio to determine the applicant's ability to repay the loan, and reviews the mortgaged property for compliance with the WMC Underwriting Guidelines." *Id.* at S-33. The MSAC 2006-HE3 Offering Documents further represented that "[t]he WMC Underwriting Guidelines . . . require[], among other things, (1) an appraisal of the mortgaged property which conforms to Uniform Standards of Professional Appraisal Practice and (2) an audit of such appraisal by a WMC-approved appraiser or

by WMC's in-house collateral auditors (who may be licensed appraisers) and such audit may in certain circumstances consist of a second appraisal, a field review, a desk review or an automated valuation model." *Id.* Moreover, the MSAC 2006-HE3 Offering Documents represented that the maximum allowable DTI ratio is 50% to 55%. *Id.* at S-34-S-42. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that WMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.3, *infra*.

133. With regard to all of the mortgage loans underlying the MSAC 2006-HE3 Offering Documents, the MSAC 2006-HE3 Offering Documents represented that they "were originated or acquired generally in accordance with the underwriting guidelines described in this prospectus supplement" (citing the underwriting guidelines for the New Century and WMC loans). *See* MSAC 2006-HE3 Pros. Supp. at S-25. The MSAC 2006-HE3 Offering Documents also represented that "[u]nderwriting standards are applied by or on behalf of a lender to evaluate the borrower's credit standing and repayment ability, and the value and adequacy of the related mortgaged property, home improvements or manufactured home, as applicable, as collateral." *See* MSAC 2006-HE3 Pros. at 36. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century, WMC and Decision One had completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §§VI.A.1-VI.A.3, *infra.*

b. Loan-to-Value Ratios

134. The MSAC 2006-HE3 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-HE3 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE3 Offering Documents represented that a little over a third of the loans supporting plaintiff's MSAC 2006-HE3 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-HE3 Certificate had LTV ratios over 100%.

135. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-HE3 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2006-HE3 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2006-HE3 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	61749HAE0	All	36.56%	67.32%	0.00%	19.07%

c. Owner Occupancy Rates

136. The MSAC 2006-HE3 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-HE3 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE3 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2006-HE3 Certificates were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

137. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-HE3 Certificate, which reveals that the OOR percentages stated in the MSAC 2006-HE3 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-HE3 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A2D	61749HAE0	All	93.86%	83.76%	12.06%

d. Credit Ratings

138. The MSAC 2006-HE3 Offering Documents also represented that the MSAC 2006-HE3 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSAC 2006-HE3 Offering Documents represented that plaintiff's MSAC 2006-HE3 Certificate had been assigned AAA/Aaa/AAA ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

139. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-HE3 Certificate should not have received AAA/Aaa/AAA credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSAC 2006-HE3 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P, Moody's and Fitch had assigned such high ratings to plaintiff's MSAC 2006-HE3 Certificate was because defendants had fed them falsified information

regarding the MSAC 2006-HE3 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

140. The falsity of the credit ratings set forth in the MSAC 2006-HE3 Offering Documents is confirmed by subsequent events. Specifically, ***more than 47% of the loans supporting plaintiff's MSAC 2006-HE3 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-HE3 Certificate is now rated at "junk" status. Clearly, plaintiff's MSAC 2006-HE3 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2006-HE3 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**		**Fitch's Ratings**	
				Initial	**Current**	**Initial**	**Current**	**Initial**	**Current**
A2D	61749HAE0	All	47.16%	Aaa	Ca	AAA	CCC	AAA	C

e. Transfer of Title

141. The MSAC 2006-HE3 Offering Documents also represented that the loans underlying the MSAC 2006-HE3 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2006-HE3 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-HE3 Pros. Supp. at S-58. The MSAC 2006-HE3 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each

mortgage loan to the trust, the depositor will cause to be delivered . . . [to] custodian[s] on behalf of the trustee . . . , on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment(s)." *Id.* These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

8. The MSAC 2006-HE4 Certificates

142. The Morgan Stanley ABS Capital I Inc. Trust 2006-HE4, Mortgage Pass-Through Certificates, Series 2006-HE4 ("MSAC 2006-HE4 Certificates") were issued pursuant to a Prospectus Supplement dated June 20, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2006-HE4 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

143. Plaintiff purchased the following MSAC 2006-HE4 Certificates:

Original Purchaser	**Tranche Purchased**	**CUSIP**	**Purchase Date**	**Original Face Amount**	**Purchased From**
Scaldis	A4	61748BAD6	5/15/2006	$20,000,000	Morgan Stanley & Co.
Fortis Bank	M1	61748BAE4	5/15/2006	$9,000,000	Morgan Stanley & Co.

144. The decisions to purchase the above securities were made by Fortis Bank, on behalf of itself and Scaldis, in direct reliance upon the MSAC 2006-HE4 Offering Documents, including draft and/or final MSAC 2006-HE4 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2006-HE4 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

145. The MSAC 2006-HE4 Offering Documents disclosed that approximately 44.83% of the MSAC 2006-HE4 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator WMC; approximately 36.53% of the MSAC 2006-HE4 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Decision One; and approximately 18.52% of the MSAC 2006-HE4 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century. *See* MSAC 2006-HE4 Pros. Supp. at S-5, S-27.

146. With regard to the WMC loans, the MSAC 2006-HE4 Offering Documents represented that the "Underwriting Guidelines are primarily intended to (a) determine that the borrower has the ability to repay the mortgage loan in accordance with its terms and (b) determine that the related mortgaged property will provide sufficient value to recover the investment if the borrower defaults." *Id.* at S-28. The MSAC 2006-HE4 Offering Documents also represented that WMC "verifies the loan applicant's eligible sources of income for all products, calculates the amount of income from eligible sources indicated on the loan application, reviews the credit and mortgage payment history of the applicant and calculates the Debt Ratio to determine the applicant's ability to repay the loan, and reviews the mortgaged property for compliance with the Underwriting Guidelines." *Id*. The MSAC 2006-HE4 Offering Documents further represented that "[t]he Underwriting Guidelines . . . require[], among other things, (1) an appraisal of the mortgaged property which conforms to Uniform Standards of Professional Appraisal Practice and (2) an audit of such appraisal [which] may in certain circumstances consist of a second appraisal, a field review, a desk review or an automated valuation model." *Id.* Moreover, the MSAC 2006-HE4 Offering Documents represented that the maximum allowable DTI ratio was limited to 50%-55%. *Id.* at S-32-S-38. As further detailed *infra*, these representations were false and misleading at the time they were

made. Contrary to defendants' affirmative representations, the truth was that WMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.3, *infra*.

147. With regard to the Decision One loans, the MSAC 2006-HE4 Offering Documents represented that "[t]he Decision One Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2006-HE4 Pros. Supp. at S-39. The MSAC 2006-HE4 Offering Documents also represented that, "[w]hile Decision One's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, Decision One also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id*. The MSAC 2006-HE4 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2006-HE4 Offering Documents represented that "Decision One reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id*. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

148. With regard to all of the loans underlying the MSAC 2006-HE4 Certificates, the MSAC 2006-HE4 Offering Documents represented that they were "originated or acquired generally in accordance with the underwriting guidelines of the responsible parties" (citing the underwriting guidelines for the WMC and Decision One loans). *See* MSAC 2006-HE4 Pros. Supp. at S-25. The MSAC 2006-HE4 Offering Documents also represented that "[u]nderwriting standards are applied by or on behalf of a lender to evaluate the borrower's credit standing and repayment ability, and the value and adequacy of the related mortgaged property, home improvements or manufactured home, as applicable, as collateral." *See* MSAC 2006-HE4 Pros. at 35. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision One, WMC and New Century had completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §§VI.A.1-VI.A.3, *infra*.

b. Loan-to-Value Ratios

149. The MSAC 2006-HE4 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-HE4 Certificates purchased by plaintiff. Specifically, the MSAC 2006-HE4 Offering Documents represented that a little over a third of the loans supporting plaintiff's MSAC 2006-HE4 Certificates had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-HE4 Certificates had LTV ratios over 100%.

150. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-HE4 Certificates, which reveals that the LTV ratio percentages stated in the MSAC 2006-HE4 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the

MSAC 2006-HE4 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Stated Percentage of Loans Having LTV Ratios Over 80%**	**Actual Percentage of Loans Having LTV Ratios Over 80%**	**Stated Percentage of Loans Having LTV Ratios Over 100%**	**Actual Percentage of Loans Having LTV Ratios Over 100%**
A4	61748BAD6	All	34.75%	70.72%	0.00%	21.21%
M1	61748BAE4	All	34.75%	70.72%	0.00%	21.21%

c. Owner Occupancy Rates

151. The MSAC 2006-HE4 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-HE4 Certificates purchased by plaintiff. Specifically, the MSAC 2006-HE4 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2006-HE4 Certificates were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

152. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-HE4 Certificates, which reveals that the OOR percentages stated in the MSAC 2006-HE4 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-HE4 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A4	61748BAD6	All	95.13%	85.51%	11.25%
M1	61748BAE4	All	95.13%	85.51%	11.25%

d. Credit Ratings

153. The MSAC 2006-HE4 Offering Documents also represented that the MSAC 2006-HE4 Certificates purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch, indicating that the securities were very strong, safe investments with an extremely low probability of default. Specifically, the MSAC 2006-HE4 Offering Documents represented that plaintiff's MSAC 2006-HE4 Certificates had been assigned AAA/Aaa/AAA and AA+/Aa1/AA+ ratings – signifying extremely safe and stable securities.

154. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-HE4 Certificates should not have received AAA/Aaa/AAA and AA+/Aa1/AA+ credit ratings, because they were ***not*** safe, "investment grade" securities with an extremely low probability of default. Rather, as defendants were well aware, plaintiff's MSAC 2006-HE4 Certificates were extremely risky, speculative grade "junk" bonds or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P, Moody's and Fitch had assigned such high ratings to plaintiff's MSAC 2006-HE4 Certificates was because defendants had fed them falsified information regarding the MSAC 2006-HE4 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

155. The falsity of the credit ratings set forth in the MSAC 2006-HE4 Offering Documents is confirmed by subsequent events. Specifically, ***more than 48% of the loans supporting plaintiff's MSAC 2006-HE4 Certificates are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-HE4 Certificates are now rated at "junk" status or below. Clearly, plaintiff's MSAC 2006-HE4 Certificates were not the highly rated, "investment grade" securities defendants

represented them to be. The evidence supporting the falsity of the MSAC 2006-HE4 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**		**Fitch Ratings**	
				Initial	**Current**	**Initial**	**Current**	**Initial**	**Current**
A4	61748BAD6	All	48.30%	Aaa	Ca	AAA	CCC	AAA	C
M1	61748BAE4	All	48.30%	Aa1	C	AA+	D	AA+	D

e. Transfer of Title

156. The MSAC 2006-HE4 Offering Documents also represented that the loans underlying the MSAC 2006-HE4 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2006-HE4 Offering Documents stated that "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-HE4 Pros. Supp. at S-54. The MSAC 2006-HE4 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to [the custodians on behalf of the trustee with respect to the WMC and Decision One loans and the trustee with respect to the New Century loans], on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

9. The MSAC 2006-HE5 Certificates

157. The Morgan Stanley ABS Capital I Inc. Trust 2006-HE5, Mortgage Pass-Through Certificates, Series 2006-HE5 ("MSAC 2006-HE5 Certificates") were issued pursuant to a Prospectus Supplement dated June 28, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2006-HE5 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

158. Plaintiff purchased the following MSAC 2006-HE5 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Scaldis	A2D	61749NAE7	6/26/2006	$20,000,000	Morgan Stanley & Co.

159. The decision to purchase the above security was made by Fortis Bank, on behalf of Scaldis, in direct reliance upon the MSAC 2006-HE5 Offering Documents, including draft and/or final MSAC 2006-HE5 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2006-HE5 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

160. The MSAC 2006-HE5 Offering Documents disclosed that approximately 62.58% of the MSAC 2006-HE5 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century; approximately 31.84% of the MSAC 2006-HE5 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Decision One; and approximately 5.58% of the MSAC 2006-HE5 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator WMC. *See* MSAC 2006-HE5 Pros. Supp. at S-5, S-30-S-31.

161. With regard to the New Century loans, the MSAC 2006-HE5 Offering Documents represented that "[t]he New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-31. The MSAC 2006-HE5 Offering Documents also represented that "[w]hile New Century['s] . . . primary consideration in underwriting a mortgage loan is the value of the mortgaged property, New Century . . . also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2006-HE5 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* at S-32. In addition, the MSAC 2006-HE5 Offering Documents represented that "New Century . . . reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id*. Moreover, the MSAC 2006-HE5 Offering Documents represented that the maximum allowable debt service-to-income ratio is usually 50% to 55%. *Id.* at S-33-S-35. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

162. With regard to the Decision One loans, the MSAC 2006-HE5 Offering Documents represented that "[t]he Decision One Underwriting Guidelines are primarily intended to assess the

borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2006-HE5 Pros. Supp. at S-36. The MSAC 2006-HE5 Offering Documents also represented that, "[w]hile Decision One's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, Decision One also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2006-HE5 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2006-HE5 Offering Documents represented that "Decision One reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id*. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

163. With regard to all of the loans underlying the MSAC 2006-HE5 Offering Documents, the MSAC 2006-HE5 Offering Documents represented that they were "originated or acquired generally in accordance with the underwriting guidelines of the responsible parties." *See* MSAC 2006-HE5 Pros. Supp. at S-28 (citing the underwriting guidelines for the New Century and Decision One loans). The MSAC 2006-HE5 Offering Documents also represented that "[u]nderwriting standards are applied by or on behalf of a lender to evaluate the borrower's credit standing and

repayment ability, and the value and adequacy of the related mortgaged property, home improvements or manufactured home, as applicable, as collateral." *See* MSAC 2006-HE5 Pros. at 34. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century, Decision One and WMC had completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §§VI.A.1-VI.A.3, *infra*.

b. Loan-to-Value Ratios

164. The MSAC 2006-HE5 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-HE5 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE5 Offering Documents represented that less than 45% of the loans supporting plaintiff's MSAC 2006-HE5 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-HE5 Certificate had LTV ratios over 100%.

165. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-HE5 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2006-HE5 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2006-HE5 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	61749NAE7	All	44.35%	67.81%	0.00%	20.88%

c. Owner Occupancy Rates

166. The MSAC 2006-HE5 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-HE5 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE5 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2006-HE5 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

167. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-HE5 Certificate, which reveals that the OOR percentages stated in the MSAC 2006-HE5 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-HE5 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
A2D	61749NAE7	All	92.87%	83.87%	10.74%

d. Credit Ratings

168. The MSAC 2006-HE5 Offering Documents also represented that the MSAC 2006-HE5 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by Moody's and Fitch, indicating that the security was a very strong, safe investment with an

extremely low probability of default. Specifically, the MSAC 2006-HE5 Offering Documents represented that plaintiff's MSAC 2006-HE5 Certificate had been assigned Aaa/AAA ratings by Moody's and Fitch – signifying an extremely safe and stable security.

169. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-HE5 Certificate should not have received Aaa/AAA credit ratings, because it was ***not*** a safe, "investment grade" security. Rather, as defendants were well aware, plaintiff's MSAC 2006-HE5 Certificate was an extremely risky, speculative grade "junk" bond or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that Moody's and Fitch had assigned such high ratings to plaintiff's MSAC 2006-HE5 Certificate was because defendants had fed Moody's and Fitch falsified information regarding the MSAC 2006-HE5 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

170. The falsity of the credit ratings set forth in the MSAC 2006-HE5 Offering Documents is confirmed by subsequent events. Specifically, ***approximately 54% of the loans supporting plaintiff's MSAC 2006-HE5 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-HE5 Certificate is now rated at "junk" status. Clearly, plaintiff's MSAC 2006-HE5 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2006-HE5 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Current Percentage of Outstanding Loan Balance in Default	Moody's Ratings		Fitch Ratings	
				Initial	Current	Initial	Current
A2D	61749NAE7	All	53.71%	Aaa	Ca	AAA	C

e. Transfer of Title

171. The MSAC 2006-HE5 Offering Documents also represented that the loans underlying the MSAC 2006-HE5 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2006-HE5 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each Initial Mortgage Loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-HE5 Pros. Supp. at S-62. The MSAC 2006-HE5 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to [custodians on behalf of the trustee with respect to the WMC and Decision One loans and the trustee with respect to the New Century loans], on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* at S-63-S-64. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

10. The MSAC 2006-HE6 Certificates

172. The Morgan Stanley ABS Capital I Inc. Trust 2006-HE6, Mortgage Pass-Through Certificates, Series 2006-HE6 ("MSAC 2006-HE6 Certificates") were issued pursuant to a Prospectus Supplement dated September 21, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2006-HE6 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

173. Plaintiff purchased the following MSAC 2006-HE6 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Scaldis	A2D	61750FAF7	9/8/2006	$15,000,000	Morgan Stanley & Co.

174. The decision to purchase the above security was made by Fortis Bank, on behalf of Scaldis, in direct reliance upon the MSAC 2006-HE6 Offering Documents, including draft and/or final MSAC 2006-HE6 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2006-HE6 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

175. The MSAC 2006-HE6 Offering Documents disclosed that approximately 44.17% of the MSAC 2006-HE6 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, New Century; approximately 33.97% of the MSAC 2006-HE6 Certificates' underlying were acquired by the sponsor, MSMC, from loan originator WMC; and approximately 21.86% of the MSAC 2006-HE6 Certificates' underlying were acquired by the sponsor, MSMC, from loan originator Decision One. *See* MSAC 2006-HE6 Pros. Supp. at S-5, S-28.

176. With regard to the New Century loans, the MSAC 2006-HE6 Offering Documents represented that "New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-29. The MSAC 2006-HE6 Offering Documents also represented that, "[w]hile New Century['s] . . . primary consideration in underwriting a mortgage loan is the value of the mortgaged property, New Century . . . also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC

2006-HE6 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2006-HE6 Offering Documents represented that "New Century . . . reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* at S-30. Moreover, the MSAC 2006-HE6 Offering Documents represented that the maximum allowable debt service-to-income ratio is usually 50% to 55%. *Id.* at S-31-S-33. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for its borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

177. With regard to the WMC loans, the MSAC 2006-HE6 Offering Documents represented that "[t]he WMC Underwriting Guidelines are primarily intended to (a) determine that the borrower has the ability to repay the mortgage loan in accordance with its terms and (b) determine that the related mortgaged property will provide sufficient value to recover the investment if the borrower defaults." *See* MSAC 2006-HE6 Pros. Supp. at S-33. The MSAC 2006-HE6 Offering Documents also represented that "WMC verifies the loan applicant's eligible sources of income for all products, calculates the amount of income from eligible sources indicated on the loan application, reviews the credit and mortgage payment history of the applicant and calculates the Debt Ratio to determine the applicant's ability to repay the loan, and reviews the mortgaged property for compliance with the WMC Underwriting Guidelines." *Id.* at S-34. The MSAC 2006-HE6 Offering

Documents further represented that "[t]he WMC Underwriting Guidelines require[], among other things, (1) an appraisal of the mortgaged property which conforms to Uniform Standards of Professional Appraisal Practice and (2) an audit of such appraisal [which] may in certain circumstances consist of a second appraisal, a field review, a desk review or an automated valuation model." *Id.* Moreover, the MSAC 2006-HE6 Offering Documents represented that the maximum allowable DTI ratio is limited to 50%-55%. *Id.* at S-37-S-44. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that WMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.3, *infra*.

178. With regard to the Decision One loans, the MSAC 2006-HE6 Offering Documents represented that the Decision One underwriting guidelines "are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgage property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2006-HE6 Pros. Supp. at S-44. The Offering Documents also represented that, "[w]hile Decision One's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, Decision One also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2006-HE6 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers," and that "[t]he Decision One Underwriting Guidelines require . . . Decision One's underwriters to be satisfied that the value of the property being financed, as indicated by an appraisal and a review of the appraisal, currently supports the outstanding loan balance." *Id.* at S-45. Moreover, the MSAC 2006-HE6 Offering

Documents represented that "Decision One reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

b. Loan-to-Value Ratios

179. The MSAC 2006-HE6 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-HE6 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE6 Offering Documents represented that a little over a third of the loans supporting plaintiff's MSAC 2006-HE6 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-HE6 Certificate had LTV ratios over 100%.

180. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-HE6 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2006-HE6 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2006-HE6 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	61750FAF7	All	36.96%	70.09%	0.00%	19.93%

c. Owner Occupancy Rates

181. The MSAC 2006-HE6 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-HE6 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE6 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2006-HE6 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

182. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-HE6 Certificate, which reveals that the OOR percentages stated in the MSAC 2006-HE6 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-HE6 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
A2D	61750FAF7	All	93.45%	83.57%	11.83%

d. Credit Ratings

183. The MSAC 2006-HE6 Offering Documents also represented that the MSAC 2006-HE6 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch, indicating that the security was a very strong, safe investment

with an extremely low probability of default. Specifically, the MSAC 2006-HE6 Offering Documents represented that plaintiff's MSAC 2006-HE6 Certificate had been assigned AAA/Aaa/AAA ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

184. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-HE6 Certificate should not have received AAA/Aaa/AAA credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSAC 2006-HE6 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P, Moody's and Fitch had assigned such high ratings to plaintiff's MSAC 2006-HE6 Certificate was because defendants had fed them falsified information regarding the MSAC 2006-HE6 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

185. The falsity of the credit ratings set forth in the MSAC 2006-HE6 Offering Documents is confirmed by subsequent events. Specifically, ***more than 63% of the loans supporting plaintiff's MSAC 2006-HE6 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-HE6 Certificate is now rated at "junk" status. Clearly, plaintiff's MSAC 2006-HE6 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2006-HE6 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Current Percentage of Outstanding Loan Balance in Default	Moody's Ratings		S&P's Ratings		Fitch's Ratings	
				Initial	Current	Initial	Current	Initial	Current
A2D	61750FAF7	All	63.10%	Aaa	Ca	AAA	CCC	AAA	C

e. Transfer of Title

186. The MSAC 2006-HE6 Offering Documents also represented that the loans underlying the MSAC 2006-HE6 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2006-HE6 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-HE6 Pros. Supp. at S-65. The MSAC 2006-HE6 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to [custodians on behalf of the trustee with respect to the WMC and Decision One loans and the trustee with respect to the New Century loans], on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

11. The MSAC 2006-HE7 Certificates

187. The Morgan Stanley ABS Capital I Inc. Trust 2006-HE7, Mortgage Pass-Through Certificates, Series 2006-HE7 ("MSAC 2006-HE7 Certificates") were issued pursuant to a Prospectus Supplement dated October 12, 2006. The following defendants played critical roles in

the fraudulent structuring, offering and sale of the MSAC 2006-HE7 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

188. Plaintiff purchased the following MSAC 2006-HE7 Certificate:

Original Purchaser	**Tranche Purchased**	**CUSIP**	**Purchase Date**	**Original Face Amount**	**Purchased From**
Scaldis	A2D	61750MAF2	10/12/2006	$28,080,000	Morgan Stanley & Co.

189. The decision to purchase the above security was made by Fortis Bank, on behalf of Scaldis, in direct reliance upon the MSAC 2006-HE7 Offering Documents, including draft and/or final MSAC 2006-HE7 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2006-HE7 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

190. The MSAC 2006-HE7 Offering Documents disclosed that approximately 46.75% of the MSAC 2006-HE7 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century; approximately 25.62% of the MSAC 2006-HE7 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator WMC; and approximately 27.63% of the MSAC 2006-HE7 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Decision One. *See* MSAC 2006-HE7 Pros. Supp. at *The Mortgage Loan Pool –Underwriting Guidelines*.

191. With regard to the New Century loans, the MSAC 2006-HE7 Offering Documents represented that "New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* The MSAC 2006-HE7 Offering Documents also represented that, "[w]hile New Century['s] . . . primary consideration

in underwriting a mortgage loan is the value of the mortgaged property, New Century . . . also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2006-HE7 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2006-HE7 Offering Documents represented that "New Century . . . reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* Moreover, the MSAC 2006-HE7 Offering Documents represented that the maximum allowable debt service-to-income ratio is usually 50% to 55%. *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

192. With regard to the WMC loans, the MSAC 2006-HE7 Offering Documents represented that "[t]he WMC Underwriting Guidelines are primarily intended to (a) determine that the borrower has the ability to repay the mortgage loan in accordance with its terms and (b) determine that the related mortgaged property will provide sufficient value to recover the investment if the borrower defaults." *See* MSAC 2006-HE7 Pros. Supp. at *The Mortgage Loan Pool – Underwriting Guidelines*. The MSAC 2006-HE7 Offering Documents also represented that WMC "verifies the loan applicant's eligible sources of income for all products, calculates the amount of income from eligible sources indicated on the loan application, reviews the credit and mortgage

payment history of the applicant and calculates the Debt Ratio to determine the applicant's ability to repay the loan, and reviews the mortgaged property for compliance with the Underwriting Guidelines." *Id.* The MSAC 2006-HE7 Offering Documents further represented that WMC's underwriting guidelines "require[], among other things, (1) an appraisal of the mortgaged property which conforms to Uniform Standards of Professional Appraisal Practice and (2) an audit of such appraisal [which] may in certain circumstances consist of a second appraisal, a field review, a desk review or an automated valuation model." *Id.* Moreover, the MSAC 2006-HE7 Offering Documents represented that the maximum allowable DTI ratio is limited to 50%-55%. *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that WMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.3, *infra*.

193. With regard to the Decision One loans, the MSAC 2006-HE7 Offering Documents represented that the Decision One underwriting guidelines "are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgage property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2006-HE7 Pros. Supp. at *The Mortgage Loan Pool – Underwriting Guidelines*. The MSAC 2006-HE7 Offering Documents also represented that, "[w]hile Decision One's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, Decision One also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2006-HE7 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2006-HE7 Offering Documents represented

that "Decision One reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

b. Loan-to-Value Ratios

194. The MSAC 2006-HE7 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-HE7 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE7 Offering Documents represented that 40% of the loans supporting plaintiff's MSAC 2006-HE7 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-HE7 Certificate had LTV ratios over 100%.

195. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-HE7 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2006-HE7 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2006-HE7 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	61750MAF2	All	40.02%	71.09%	0.00%	20.74%

c. Owner Occupancy Rates

196. The MSAC 2006-HE7 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-HE7 Certificate purchased by plaintiff. Specifically, the MSAC 2006-HE7 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2006-HE7 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

197. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-HE7 Certificate, which reveals that the OOR percentages stated in the MSAC 2006-HE7 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-HE7 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
A2D	61750MAF2	All	94.34%	86.64%	8.89%

d. Credit Ratings

198. The MSAC 2006-HE7 Offering Documents also represented that the MSAC 2006-HE7 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an

extremely low probability of default. Specifically, the MSAC 2006-HE7 Offering Documents represented that plaintiff's MSAC 2006-HE7 Certificate had been assigned AAA/Aaa ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

199. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-HE7 Certificate should not have received AAA/Aaa credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSAC 2006-HE7 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSAC 2006-HE7 Certificate was because defendants had fed them falsified information regarding the MSAC 2006-HE7 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

200. The falsity of the credit ratings set forth in the MSAC 2006-HE7 Offering Documents is confirmed by subsequent events. Specifically, ***more than 60% of the loans supporting plaintiff's MSAC 2006-HE7 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-HE7 Certificate is now rated at "junk" status. Clearly, plaintiff's MSAC 2006-HE7 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2006-HE7 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Current Percentage of Outstanding Loan Balance in Default	Moody's Ratings		S&P's Ratings	
				Initial	Current	Initial	Current
A2D	61750MAF2	All	60.11%	Aaa	Ca	AAA	CCC

e. Transfer of Title

201. The MSAC 2006-HE7 Offering Documents also represented that the loans underlying the MSAC 2006-HE7 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2006-HE7 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-HE7 Pros. Supp. at *Description of the Certificates – Assignment of the Mortgage Loans*. The MSAC 2006-HE7 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to [custodians on behalf of the trustee with respect to the WMC and Decision One loans and the trustee with respect to the New Century loans], on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* at *Description of the Certificates – Delivery of Mortgage Loan Documents*. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra.*

12. The MSAC 2006-HE8 Certificates

202. The Morgan Stanley ABS Capital I Inc. Trust 2006-HE8, Mortgage Pass-Through Certificates, Series 2006-HE8 ("MSAC 2006-HE8 Certificates") were issued pursuant to a

Prospectus Supplement dated November 21, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2006-HE8 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

203. Plaintiff purchased the following MSAC 2006-HE8 Certificates:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Scaldis	A2D	61750SAF9	11/22/2006	$30,000,000	Morgan Stanley & Co.
Fortis Bank	M1	61750SAG7	11/22/2006	$11,000,000	Morgan Stanley & Co.

204. The decisions to purchase the above securities were made by Fortis Bank, on behalf of itself and Scaldis, in direct reliance upon the MSAC 2006-HE8 Offering Documents, including draft and/or final MSAC 2006-HE8 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2006-HE8 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

205. The MSAC 2006-HE8 Offering Documents disclosed that 63.16% of the MSAC 2006-HE8 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century; approximately 10.01% of the MSAC 2006-HE8 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator WMC; and approximately 26.83% of the MSAC 2006-HE8 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Decision One. *See* MSAC 2006-HE8 Pros. Supp. at S-6, S-30.

206. With regard to the New Century loans, the MSAC 2006-HE8 Offering Documents represented that "[t]he New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to

evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-31. The MSAC 2006-HE8 Offering Documents also represented that "[w]hile New Century's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, New Century also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2006-HE8 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2006-HE8 Offering Documents represented that "New Century reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id*. at S-32. Moreover, the MSAC 2006-HE8 Offering Documents represented that the maximum allowable debt service-to-income ratio is 50% to 55%. *Id.* at S-32-S-34. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

207. With regard to the Decision One loans, the MSAC 2006-HE8 Offering Documents represented that "[t]he Decision One Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2006-HE8 Pros. Supp. at S-35. The MSAC 2006-HE8 Offering Documents also represented that that "[w]hile Decision One's primary consideration in underwriting a mortgage loan is the value of the mortgaged

property, Decision One also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id*. The MSAC 2006-HE8 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2006-HE8 Offering Documents represented that "Decision One reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id*. at S-36. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

208. With regard to all of the loans underlying the MSAC 2006-HE8 Certificates, the MSAC 2006-HE8 Offering Documents represented that they were "originated or acquired generally in accordance with the underwriting guidelines of the responsible parties" (citing the underwriting guidelines for the WMC and Decision One loans). *See* MSAC 2006-HE8 Pros. Supp. at S-28. The MSAC 2006-HE8 also represented that with regard to all of the loans underlying the MSAC 2006-HE8 Certificates, "[u]nderwriting standards are applied by or on behalf of a lender to evaluate the borrower's credit standing and repayment ability, and the value and adequacy of the related mortgaged property, home improvements or manufactured home, as applicable, as collateral." *See* MSAC 2006-HE8 Pros. at 34. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the

truth was that WMC, New Century and Decision One had completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §§VI.A.1-VI.A.3, *infra*.

b. Loan-to-Value Ratios

209. The MSAC 2006-HE8 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-HE8 Certificates purchased by plaintiff. Specifically, the MSAC 2006-HE8 Offering Documents represented that a little over 40% of the loans supporting plaintiff's MSAC 2006-HE8 Certificates had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-HE8 Certificates had LTV ratios over 100%.

210. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-HE8 Certificates, which reveals that the LTV ratio percentages stated in the MSAC 2006-HE8 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2006-HE8 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	61750SAF9	All	42.76%	73.23%	0.00%	25.57%
M1	61750SAG7	All	42.76%	73.23%	0.00%	25.57%

c. Owner Occupancy Rates

211. The MSAC 2006-HE8 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-HE8

Certificates purchased by plaintiff. Specifically, the MSAC 2006-HE8 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2006-HE8 Certificates were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

212. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-HE8 Certificates, which reveals that the OOR percentages stated in the MSAC 2006-HE8 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-HE8 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
A2D	61750SAF9	All	93.50%	84.73%	10.35%
M1	61750SAG7	All	93.50%	84.73%	10.35%

d. Credit Ratings

213. The MSAC 2006-HE8 Offering Documents also represented that the MSAC 2006-HE8 Certificates purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the securities were very strong, safe investments with an extremely low probability of default. Specifically, the MSAC 2006-HE8 Offering Documents represented that plaintiff's MSAC 2006-HE8 Certificates had been assigned AAA/Aaa and AA+/Aa1 ratings – signifying that they were extremely safe and stable securities.

214. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-HE8 Certificates should not have received AAA/Aaa and AA+/Aa1 credit ratings, because they were ***not*** safe, "investment grade" securities. Rather, as defendants were well

aware, plaintiff's MSAC 2006-HE8 Certificates were extremely risky, speculative grade "junk" bonds or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSAC 2006-HE8 Certificates was because defendants had fed them falsified information regarding the MSAC 2006-HE8 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

215. The falsity of the credit ratings set forth in the MSAC 2006-HE8 Offering Documents is confirmed by subsequent events. Specifically, ***approximately 47% of the loans supporting each of plaintiff's MSAC 2006-HE8 Certificates are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-HE8 Certificates are now rated at "junk" status or below. Clearly, plaintiff's MSAC 2006-HE8 Certificates were not the highly rated, "investment grade" securities defendants represented them to be. The evidence supporting the falsity of the MSAC 2006-HE8 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**	
				Initial	**Current**	**Initial**	**Current**
A2D	61750SAF9	All	46.91%	Aaa	Ca	AAA	CCC
M1	61750SAG7	All	46.91%	Aa1	C	AA+	D

e. Transfer of Title

216. The MSAC 2006-HE8 Offering Documents also represented that the loans underlying the MSAC 2006-HE8 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2006-HE8 Offering Documents stated that, "[p]ursuant to the pooling and servicing

agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-HE8 Pros. Supp. at S-60. The MSAC 2006-HE8 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to [custodians on behalf of the trustee with respect to the WMC and Decision One loans and the trustee with respect to the New Century loans], on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* at S-60-S-61. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

13. The MSAC 2006-NC2 Certificates

217. The Morgan Stanley Capital I Inc. Trust 2006-NC2, Mortgage Pass-Through Certificates, Series 2006-NC2 ("MSAC 2006-NC2 Certificates") were issued pursuant to a Prospectus Supplement dated March 27, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2006-NC2 Certificates: MS Capital (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

218. Plaintiff purchased the following MSAC 2006-NC2 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	A2D	617451EF2	2/28/2006	$9,000,000	Morgan Stanley & Co.

219. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSAC 2006-NC2 Offering Documents, including draft and/or final MSAC 2006-NC2 Prospectus Supplements, all of which were distributed by the defendants associated with the

MSAC 2006-NC2 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

220. The MSAC 2006-NC2 Offering Documents disclosed that 100% of the loans underlying plaintiff's MSAC 2006-NC2 Certificate were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century. *See* MSAC 2006-NC2 Pros. Supp. at S-25.

221. The MSAC 2006-NC2 Offering Documents represented that "[t]he New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-27-S-28. The MSAC 2006-NC2 Offering Documents also represented that "[w]hile New Century['s] . . . primary consideration in underwriting a mortgage loan is the value of the mortgaged property, New Century . . . also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* at S-28. The MSAC 2006-NC2 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2006-NC2 Offering Documents represented that "New Century . . . reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the allowable debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* Moreover, the MSAC 2006-NC2 Offering Documents represented that the maximum debt service-to-income ratio is usually 50% to 55%. *Id.* at S-29-S-31. As further detailed *infra*, these representations were false and misleading at the time

they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

b. Loan-to-Value Ratios

222. The MSAC 2006-NC2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-NC2 Certificate purchased by plaintiff. Specifically, the MSAC 2006-NC2 Offering Documents represented that less than 40% of the loans supporting plaintiff's MSAC 2006-NC2 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-NC2 Certificate had LTV ratios over 100%.

223. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-NC2 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2006-NC2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2006-NC2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	617451EF2	All	37.93%	66.68%	0.00%	18.99%

c. Owner Occupancy Rates

224. The MSAC 2006-NC2 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-NC2

Certificate purchased by plaintiff. Specifically, the MSAC 2006-NC2 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2006-NC2 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

225. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-NC2 Certificate, which reveals that the OOR percentages stated in the MSAC 2006-NC2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-NC2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A2D	617451EF2	All	90.53%	81.75%	10.75%

d. Credit Ratings

226. The MSAC 2006-NC2 Offering Documents also represented that the MSAC 2006-NC2 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSAC 2006-NC2 Offering Documents represented that plaintiff's MSAC 2006-NC2 Certificate had been assigned AAA/Aaa/AAA ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

227. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-NC2 Certificate should not have received AAA/Aaa/AAA credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring

defaults." Rather, as defendants were well aware, plaintiff's MSAC 2006-NC2 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P, Moody's and Fitch had assigned such high ratings to plaintiff's MSAC 2006-NC2 Certificate was because defendants had fed them falsified information regarding the MSAC 2006-NC2 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

228. The falsity of the credit ratings set forth in the MSAC 2006-NC2 Offering Documents is confirmed by subsequent events. Specifically, ***more than 42% of the loans supporting plaintiff's MSAC 2006-NC2 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-NC2 Certificate is now rated at "junk" status. Clearly, plaintiff's MSAC 2006-NC2 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2006-NC2 Certificate's credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**		**Fitch's Ratings**	
				Initial	**Current**	**Initial**	**Current**	**Initial**	**Current**
A2D	617451EF2	All	42.56%	Aaa	Ca	AAA	B-	AAA	CC

e. Transfer of Title

229. The MSAC 2006-NC2 Offering Documents also represented that the loans underlying the MSAC 2006-NC2 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2006-NC2 Offering Documents stated that, "[p]ursuant to the pooling and servicing

agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-NC2 Pros. Supp. at S-46. The MSAC 2006-NC2 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to the trustee, on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* at S-47. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

14. The MSAC 2006-NC4 Certificates

230. The Morgan Stanley ABS Capital I Inc. Trust 2006-NC4, Mortgage Pass-Through Certificates, Series 2006-NC4 ("MSAC 2006-NC4 Certificates") were issued pursuant to a Prospectus Supplement dated May 19, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2006-NC4 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

231. Plaintiff purchased the following MSAC 2006-NC4 Certificates:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Scaldis	A2D	61748LAE2	5/22/2006	$24,570,000	Morgan Stanley & Co.
Fortis Bank	M1	61748LAF9	5/22/2006	$10,000,000	Morgan Stanley & Co.

232. The decisions to purchase the above securities were made by Fortis Bank, on behalf of itself and Scaldis, in direct reliance upon the MSAC 2006-NC4 Offering Documents, including draft and/or final MSAC 2006-NC4 Prospectus Supplements, all of which were distributed by the

defendants associated with the MSAC 2006-NC4 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

233. The MSAC 2006-NC4 Offering Documents disclosed that 100% of the MSAC 2006-NC4 Certificates' underlying loans were acquired by the sponsor, MSMC, from NC Capital, which in turn acquired them from its affiliate, loan originator New Century. *See* MSAC 2006-NC4 Pros. Supp. at S-9, S-25.

234. The MSAC 2006-NC4 Offering Documents represented that "[t]he New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-28. The MSAC 2006-NC4 Offering Documents also represented that "[w]hile New Century's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, New Century also considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2006-NC4 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans generally are appraised by qualified independent appraisers." *Id.* In addition, the MSAC 2006-NC4 Offering Documents represented that "New Century reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id*. Moreover, the MSAC 2006-NC4 Offering Documents represented that the maximum allowable debt service-to-income ratio is usually 50% to 55%. *Id.* at S-30-S-31. As further detailed *infra*, these representations were false and misleading at the time they were made.

Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

b. Loan-to-Value Ratios

235. The MSAC 2006-NC4 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-NC4 Certificates purchased by plaintiff. Specifically, the MSAC 2006-NC4 Offering Documents represented that just over 40% of the loans supporting plaintiff's MSAC 2006-NC4 Certificates had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-NC4 Certificates had LTV ratios over 100%.

236. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-NC4 Certificates, which reveals that the LTV ratio percentages stated in the MSAC 2006-NC4 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2006-NC4 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	61748LAE2	All	40.98%	64.80%	0.00%	18.71%
M1	61748LAF9	All	40.98%	64.80%	0.00%	18.71%

c. Owner Occupancy Rates

237. The MSAC 2006-NC4 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-NC4

Certificates purchased by plaintiff. Specifically, the MSAC 2006-NC4 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2006-NC4 Certificates were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

238. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-NC4 Certificates, which reveals that the OOR percentages stated in the MSAC 2006-NC4 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-NC4 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A2D	61748LAE2	All	90.21%	81.67%	10.46%
M1	61748LAF9	All	90.21%	81.67%	10.46%

d. Credit Ratings

239. The MSAC 2006-NC4 Offering Documents also represented that the MSAC 2006-NC4 Certificates purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch, indicating that the securities were very strong, safe investments with an extremely low probability of default. Specifically, the MSAC 2006-NC4 Offering Documents represented that plaintiff's MSAC 2006-NC4 Certificates had been assigned AAA/Aaa/AAA and AA+/Aa1/AA+ ratings – signifying that they were extremely safe and stable securities.

240. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-NC4 Certificates should not have received AAA/Aaa/AAA and

AA+/Aa1/AA+ credit ratings, because they were ***not*** safe, "investment grade" securities. Rather, as defendants were well aware, plaintiff's MSAC 2006-NC4 Certificates were extremely risky, speculative grade "junk" bonds or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P, Moody's and Fitch had assigned such high ratings to plaintiff's MSAC 2006-NC4 Certificates was because defendants had fed them falsified information regarding the MSAC 2006-NC4 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

241. The falsity of the credit ratings set forth in the MSAC 2006-NC4 Offering Documents is confirmed by subsequent events. Specifically, ***more than 48% of the loans supporting plaintiff's MSAC 2006-NC4 Certificates are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-NC4 Certificates are now rated at "junk" status or below. Clearly, plaintiff's MSAC 2006-NC4 Certificates were not the highly rated, "investment grade" securities defendants represented them to be. The evidence supporting the falsity of the MSAC 2006-NC4 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**		**Fitch's Ratings**	
				Initial	**Current**	**Initial**	**Current**	**Initial**	**Current**
A2D	61748LAE2	All	48.27%	Aaa	Ca	AAA	CCC	AAA	C
M1	61748LAF9	All	48.27%	Aa1	C	AA+	D	AA+	C

e. Transfer of Title

242. The MSAC 2006-NC4 Offering Documents also represented that the loans underlying the MSAC 2006-NC4 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the

MSAC 2006-NC4 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-NC4 Pros. Supp. at S-47. The MSAC 2006-NC4 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to the trustee, on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment." *Id.* at S-48. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

15. The MSAC 2006-WMC2 Certificates

243. The Morgan Stanley ABS Capital I Inc. Trust 2006-WMC2, Mortgage Pass-Through Certificates, Series 2006-WMC2 ("MSAC 2006-WMC2 Certificates") were issued pursuant to a Prospectus Supplement dated May 25, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2006-WMC2 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

244. Plaintiff purchased the following MSAC 2006-WMC2 Certificates:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Scaldis	A2D	61749KAF0	5/26/2006	$17,000,000	Morgan Stanley & Co.
Fortis Bank	M1	61749KAG8	5/26/2006	$10,000,000	Morgan Stanley & Co.

245. The decisions to purchase the above securities were made by Fortis Bank, on behalf of itself and Scaldis, in direct reliance upon the MSAC 2006-WMC2 Offering Documents, including

draft and/or final MSAC 2006-WMC2 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2006-WMC2 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

246. The MSAC 2006-WMC2 Offering Documents disclosed that 100% of the loans underlying the plaintiff's MSAC 2006-WMC2 Certificates were acquired by the sponsor, MSMC, from loan originator WMC. *See* MSAC 2006-WMC2 Pros. Supp. at S-26.

247. The MSAC 2006-WMC2 Offering Documents represented that "[t]he [WMC] Underwriting Guidelines are primarily intended to (a) determine that the borrower has the ability to repay the mortgage loan in accordance with its terms and (b) determine that the related mortgaged property will provide sufficient value to recover the investment if the borrower defaults." *Id.* at S-28. The MSAC 2006-WMC2 Offering Documents also represented that "WMC verifies the loan applicant's eligible sources of income for all products, calculates the amount of income from eligible sources indicated on the loan application, reviews the credit and mortgage payment history of the applicant and calculates the Debt Ratio to determine the applicant's ability to repay the loan, and reviews the mortgaged property for compliance with the [WMC] Underwriting Guidelines." *Id.* The MSAC 2006-WMC2 Offering Documents further represented that "[t]he WMC Underwriting Guidelines . . . require[], among other things, (1) an appraisal of the mortgaged property which conforms to Uniform Standards of Professional Appraisal Practice and (2) an audit of such appraisal by a WMC-approved appraiser or by WMC's in-house collateral auditors (who may be licensed appraisers) and such audit may in certain circumstances consist of a second appraisal, a field review, a desk review or an automated valuation model." *Id.* Moreover, the MSAC 2006-WMC2 Offering Documents represented that the maximum allowable DTI ratio was 50% to 55%. *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary

to defendants' affirmative representations, the truth was that WMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.3, *infra*.

b. Loan-to-Value Ratios

248. The MSAC 2006-WMC2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2006-WMC2 Certificates purchased by plaintiff. Specifically, the MSAC 2006-WMC2 Offering Documents represented that less than 30% of the loans supporting plaintiff's MSAC 2006-WMC2 Certificates had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2006-WMC2 Certificates had LTV ratios over 100%.

249. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2006-WMC2 Certificates, which reveals that the LTV ratio percentages stated in the MSAC 2006-WMC2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2006-WMC2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2D	61749KAF0	All	28.90%	79.46%	0.00%	28.93%
M1	61749KAG8	All	28.90%	79.46%	0.00%	28.93%

c. Owner Occupancy Rates

250. The MSAC 2006-WMC2 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2006-WMC2

Certificates purchased by plaintiff. Specifically, the MSAC 2006-WMC2 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2006-WMC2 Certificates were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

251. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2006-WMC2 Certificates, which reveals that the OOR percentages stated in the MSAC 2006-WMC2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2006-WMC2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
A2D	61749KAF0	All	95.74%	86.47%	10.73%
M1	61749KAG8	All	95.74%	86.47%	10.73%

d. Credit Ratings

252. The MSAC 2006-WMC2 Offering Documents also represented that the MSAC 2006-WMC2 Certificates purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch, indicating that the securities were very strong, safe investments with an extremely low probability of default. Specifically, the MSAC 2006-WMC2 Offering Documents represented that plaintiff's MSAC 2006-WMC2 Certificates had been assigned AAA/Aaa/AAA and AA+/Aa1/AA+ ratings – signifying that they were extremely safe and stable securities.

253. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2006-WMC2 Certificates should not have received AAA/Aaa/AAA and

AA+/Aa1/AA+ credit ratings, because they were ***not*** safe, "investment grade" securities. Rather, as defendants were well aware, plaintiff's MSAC 2006-WMC2 Certificates were extremely risky, speculative grade "junk" bonds or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P, Moody's and Fitch had assigned such high ratings to plaintiff's MSAC 2006-WMC2 Certificates was because defendants had fed them falsified information regarding the MSAC 2006-WMC2 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

254. The falsity of the credit ratings set forth in the MSAC 2006-WMC2 Offering Documents is confirmed by subsequent events. Specifically, ***more than 51% of the loans supporting plaintiff's MSAC 2006-WMC2 Certificates are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2006-WMC2 Certificates are now rated at "junk" status or below. Clearly, plaintiff's MSAC 2006-WMC2 Certificates were not the highly rated, "investment grade" securities defendants represented them to be. The evidence supporting the falsity of the MSAC 2006-WMC2 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**		**Fitch's Ratings**	
				Initial	**Current**	**Initial**	**Current**	**Initial**	**Current**
A2D	61749KAF0	All	51.25%	Aaa	Ca	AAA	CCC	AAA	C
M1	61749KAG8	All	51.25%	Aa1	C	AA+	D	AA+	D

e. Transfer of Title

255. The MSAC 2006-WMC2 Offering Documents also represented that the loans underlying the MSAC 2006-WMC2 Certificates would be timely transferred to the issuing trust, so

that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2006-WMC2 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-WMC2 Pros. Supp. at S-54. The MSAC 2006-WMC2 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to Wells Fargo Bank, N.A., as custodian on behalf of the trustee, on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment(s)." *Id.* These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

16. The MSAC 2005-HE2 Certificates

256. The Morgan Stanley ABS Capital I Inc. Trust 2005-HE2, Mortgage Pass-Through Certificates, Series 2005-HE2 ("MSAC 2005-HE2 Certificates") were issued pursuant to a Prospectus Supplement dated March 24, 2005. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSAC 2005-HE2 Certificates: MSABS (depositor); and Morgan Stanley & Co. (underwriter).

257. Plaintiff purchased the following MSAC 2005-HE2 Certificate:

Original Purchaser	**Tranche Purchased**	**CUSIP**	**Purchase Date**	**Original Face Amount**	**Purchased From**
Fortis Bank	M1	61744CNB8	3/8/2005	$2,000,000	Morgan Stanley & Co.

258. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSAC 2005-HE2 Offering Documents, including draft and/or final MSAC 2005-

HE2 Prospectus Supplements, all of which were distributed by the defendants associated with the MSAC 2005-HE2 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra.*

a. Underwriting Guidelines

259. The MSAC 2005-HE2 Offering Documents disclosed that approximately 41.98% of the MSAC 2005-HE2 Certificates' underlying loans were originated by Option One Mortgage Corporation ("Option One"); approximately 22.39% of the MSAC 2005-HE2 Certificates' underlying loans were originated by Decision One; approximately 17.52% of the MSAC 2005-HE2 Certificates' underlying loans were originated by New Century; approximately 17.49% of the MSAC 2005-HE2 Certificates' underlying loans were originated by Accredited Home Lenders, Inc. ("Accredited"); and approximately 0.63% of the MSAC 2005-HE2 Certificates' underlying loans were originated by Aames Capital Corporation ("Aames"). *See* MSAC 2005-HE2 Pros. Supp. at 25, 30, 33, 38, 41.

260. With regard to the Option One loans, the MSAC 2005-HE2 Offering Documents represented that "[t]he Option One Underwriting Guidelines are primarily intended to assess (i) the value of the mortgaged property and to evaluate the adequacy of such property as collateral for the mortgage loan and (ii) the creditworthiness of the related mortgagor." *Id.* at 25. The MSAC 2005-HE2 Offering Documents also represented that "[m]ortgaged properties that are to secure mortgage loans generally are appraised by qualified independent appraisers," and that "[t]he Option One Underwriting Guidelines require a review of the appraisal by a loan underwriter, who may request a written review by an independent appraiser retained by Option One." *Id.* at 25-26. The MSAC 2005-HE2 Offering Documents further represented that "Option One reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio

to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* at 26. In addition, the MSAC 2005-HE2 Offering Documents represented that "[t]he Option One Underwriting Guidelines . . . require[] Option One's underwriters to be satisfied that the value of the property being financed, as indicated by an appraisal and a review of the appraisal, currently supports the outstanding loan balance." *Id*. Moreover, the MSAC 2005-HE2 Offering Documents represented that the maximum allowable debt service-to-income ratio was generally less than 55%-60%. *Id.* at 27-29. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Option One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.9, *infra*.

261. With regard to the Decision One loans, the MSAC 2005-HE2 Offering Documents represented that "[t]he Decision One Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgage property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2005-HE2 Pros. Supp. at 31. The MSAC 2005-HE2 Offering Documents also represented that, "[w]hile Decision One['s] . . . primary consideration in underwriting a mortgage loan is the value of the mortgaged property, Decision One . . . also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2005-HE2 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers," and that "[t]he Decision One Underwriting Guidelines . . . require[] Decision One['s] . . . underwriters to be satisfied that the value of the property being financed, as indicated by an

appraisal and a review of the appraisal, currently supports the outstanding loan balance." *Id.* In addition, the MSAC 2005-HE2 Offering Documents represented that "Decision One . . . reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Decision One had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

262. With regard to the New Century loans, the MSAC 2005-HE2 Offering Documents represented that "[t]he New Century Underwriting Guidelines are primarily intended to assess the borrower's ability to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *See* MSAC 2005-HE2 Pros. Supp. at 34. The MSAC 2005-HE2 Offering Documents also represented that, "[w]hile the originator's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, the originator also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id.* The MSAC 2005-HE2 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans generally are appraised by qualified independent appraisers," and that "[t]he New Century Underwriting Guidelines require a review of the appraisal by a qualified employee of the originator or by an appraiser retained by the originator." *Id.* at 35. In addition, the MSAC 2005-HE2 Offering Documents represented that "the originator reviews the applicant's

source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service-to-income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* Moreover, the MSAC 2005-HE2 Offering Documents represented that "[t]he New Century Underwriting Guidelines . . . require[] the originator's underwriters to be satisfied that the value of the property being financed, as indicated by an appraisal and a review of the appraisal, currently supports the outstanding loan balance." *Id.* Furthermore, the MSAC 2005-HE2 Offering Documents represented that the maximum allowable debt service-to-income ratio was usually 45% to 55%. *Id.* at 36-38. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that New Century had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.2, *infra*.

263. With regard to the Accredited loans, the MSAC 2005-HE2 Offering Documents represented that "Accredited's underwriting process is intended to assess a loan applicant's credit standing and repayment ability and the value and adequacy of the real property security as collateral for the proposed loan." *See* MSAC 2005-HE2 Pros. Supp. at 38-39. The MSAC 2005-HE2 Offering Documents also represented that "[a] full appraisal of the property proposed to be pledged as collateral is required in connection with the origination of each first priority loan and each second priority loan greater than $50,000," and that "[a] second full appraisal or a field review, in addition to the full appraisal, may be required for combined loan amounts and/or property values greater than $750,000." *Id.* at 39. The MSAC 2005-HE2 Offering Documents further represented that "Accredited reviews the loan applicant's source of income, calculates the amount of income from

sources indicated on the loan application or similar documentation, and calculates debt service-to-income ratios to determine the applicant's ability to repay the loan." *Id.* Moreover, the MSAC 2005-HE2 Offering Documents represented that "[o]ur maximum debt-to-income ratios range from 50% to 55% for Full Documentation programs, and a maximum of 45% for Lite Documentation and Stated Income Programs." *Id.* at 40. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Accredited had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.4, *infra*.

264. With regard to the Aames loans, the MSAC 2005-HE2 Offering Documents represented that "Aames's underwriting policy is to analyze the overall situation of the borrower and to take into account compensating factors that may be used to offset certain areas of weakness." *See* MSAC 2005-HE2 Pros. Supp. at 41. The MSAC 2005-HE2 Offering Documents also represented that the "Aames underwriting process and guidelines require a rigorous application review and documentation designed to determine the borrower's ability to repay the loan and maximize the value of our mortgage loans." *Id.* The MSAC 2005-HE2 Offering Documents further represented that "[a]n assessment of the adequacy of the real property as collateral for the loan is primarily based upon an appraisal of the property and a calculation of the loan-to-value ratios of the loan applied for and of all mortgages existing on the property, including the loan applied for the combined loan-to-value ratio, to the appraised value of the property at the time of origination," and that "[t]he underwriting of a mortgage loan to be originated or purchased by Aames generally includes . . . a current appraisal." *Id.* at 42. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the

truth was that Aames had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.4, *infra*.

b. Loan-to-Value Ratios

265. The MSAC 2005-HE2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSAC 2005-HE2 Certificate purchased by plaintiff. Specifically, the MSAC 2005-HE2 Offering Documents represented that a little over 40% of the loans supporting plaintiff's MSAC 2005-HE2 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSAC 2005-HE2 Certificate had LTV ratios over 100%.

266. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSAC 2005-HE2 Certificate, which reveals that the LTV ratio percentages stated in the MSAC 2005-HE2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSAC 2005-HE2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
M1	61744CNB8	All	41.08%	64.79%	0.00%	21.31%

c. Owner Occupancy Rates

267. The MSAC 2005-HE2 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSAC 2005-HE2

Certificate purchased by plaintiff. Specifically, the MSAC 2005-HE2 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSAC 2005-HE2 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

268. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSAC 2005-HE2 Certificate, which reveals that the OOR percentages stated in the MSAC 2005-HE2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSAC 2005-HE2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
M1	61744CNB8	All	94.33%	85.67%	10.12%

d. Credit Ratings

269. The MSAC 2005-HE2 Offering Documents also represented that the MSAC 2005-HE2 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by Fitch and Moody's, indicating that the security was a very strong, safe investments with an extremely low probability of default. Specifically, the MSAC 2005-HE2 Offering Documents represented that plaintiff's MSAC 2005-HE2 Certificate had been assigned AA+/Aa1 ratings – signifying an extremely safe and stable security.

270. These representations, however, were false and misleading when made. In truth, plaintiff's MSAC 2005-HE2 Certificate should not have received AA+/Aa1 credit ratings, because it was ***not*** a safe, "investment grade" security. Rather, as defendants were well aware, plaintiff's MSAC 2005-HE2 Certificate was an extremely risky, speculative grade "junk" bond, backed by low

credit quality, extremely risky loans. Indeed, one of the primary reasons that Fitch and Moody's had assigned such high ratings to plaintiff's MSAC 2005-HE2 Certificate was because defendants had fed them falsified information regarding the MSAC 2005-HE2 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

271. The falsity of the credit ratings set forth in the MSAC 2005-HE2 Offering Documents is confirmed by subsequent events. Specifically, ***approximately 40% of the loans supporting plaintiff's MSAC 2005-HE2 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSAC 2005-HE2 Certificate is now rated at "junk" status by Fitch. Clearly, plaintiff's MSAC 2005-HE2 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSAC 2005-HE2 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**Fitch Ratings**	
				Initial	**Current**	**Initial**	**Current**
M1	61744CNB8	All	39.99%	Aa1	Baa3	AA+	BB

e. Transfer of Title

272. The MSAC 2005-HE2 Offering Documents also represented that the loans underlying the MSAC 2005-HE2 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSAC 2005-HE2 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close

of business on the cut-off date." *See* MSAC 2005-HE2 Pros. Supp. at 119. The MSAC 2005-HE2 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to the custodian on behalf of the trustee with respect to the mortgage loans transferred to the trust by Option One . . . and to the trustee with respect to the other mortgage loans, on or before the closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment(s)." *Id.* These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

17. The ACCR 2006-1 Certificates

273. The Accredited Mortgage Loan Trust 2006-1, Asset-Backed Notes, Series 2006-1 ("ACCR 2006-1 Certificates") were issued pursuant to a Prospectus Supplement dated March 20, 2006. Morgan Stanley & Co., as the primary underwriter, played a critical role in the fraudulent structuring, offering and sale of the ACCR 2006-1 Certificates.

274. Plaintiff purchased the following ACCR 2006-1 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	A4	004375FG1	3/20/2006	$4,000,000	Morgan Stanley & Co.

275. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the ACCR 2006-1 Offering Documents, including draft and/or final ACCR 2006-1 Prospectus Supplements, all of which were distributed by the defendants associated with the ACCR 2006-1 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

276. The ACCR 2006-1 Offering Documents disclosed that 100% of the loans underlying plaintiff's ACCR 2006-1 Certificate were originated or acquired by the sponsor, Accredited. *See* ACCR 2006-1 Pros. Supp. at S-48.

277. The ACCR 2006-1 Offering Documents represented that "Accredited's underwriting process is intended to assess a loan applicant's credit standing and repayment ability and the value and adequacy of the real property security as collateral for the proposed loan." *Id.* at S-50. The ACCR 2006-1 Offering Documents also represented that "[a] full appraisal of the property proposed to be pledged as collateral is required in connection with the origination of each first priority loan and each second priority loan greater than $50,000." *Id.* The ACCR 2006-1 Offering Documents further represented that "Accredited reviews the loan applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, and calculates debt service-to-income ratios to determine the applicant's ability to repay the loan." *Id.* at S-50-S-51. In addition, the ACCR 2006-1 Offering Documents represented that "each program relies upon Accredited's analysis of each borrower's ability to repay, the risk that the borrower will not repay the loan . . . , [and] the value of the collateral." *Id.* at S-52. Moreover, the ACCR 2006-1 Offering Documents represented that Accredited's "maximum debt-to-income ratios range from 50% to 55% for Full Documentation programs, and maximum 45% for Lite Documentation and Stated Income Programs" *Id.* at S-52. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Accredited had completely abandoned its underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.4, *infra.*

b. Loan-to-Value Ratios

278. The ACCR 2006-1 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the ACCR 2006-1 Certificate purchased by plaintiff. Specifically, the ACCR 2006-1 Offering Documents represented that less than 30% of the loans supporting plaintiff's ACCR 2006-1 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's ACCR 2006-1 Certificate had LTV ratios over 100%.

279. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's ACCR 2006-1 Certificate, which reveals that the LTV ratio percentages stated in the ACCR 2006-1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the ACCR 2006-1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Stated Percentage of Loans Having LTV Ratios Over 80%**	**Actual Percentage of Loans Having LTV Ratios Over 80%**	**Stated Percentage of Loans Having LTV Ratios Over 100%**	**Actual Percentage of Loans Having LTV Ratios Over 100%**
A4	004375FG1	All	29.82%	53.24%	0.00%	17.59%

c. Owner Occupancy Rates

280. The ACCR 2006-1 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the ACCR 2006-1 Certificate purchased by plaintiff. Specifically, the ACCR 2006-1 Offering Documents represented that a large percentage of the loans supporting plaintiff's ACCR 2006-1 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

281. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's ACCR 2006-1 Certificate, which reveals that the OOR percentages stated in the ACCR 2006-1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the ACCR 2006-1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
A4	004375FG1	All	91.95%	82.72%	11.17%

d. Credit Ratings

282. The ACCR 2006-1 Offering Documents also represented that the ACCR 2006-1 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the ACCR 2006-1 Offering Documents represented that plaintiff's ACCR 2006-1 Certificate had been assigned AAA/Aaa ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

283. These representations, however, were false and misleading when made. In truth, plaintiff's ACCR 2006-1 Certificate should not have received AAA/Aaa credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's ACCR 2006-1 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's ACCR 2006-1 Certificate was because defendants had fed them falsified information regarding the ACCR

2006-1 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

284. The falsity of the credit ratings set forth in the ACCR 2006-1 Offering Documents is confirmed by subsequent events. Specifically, ***31% of the loans supporting plaintiff's ACCR 2006-1 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" ACCR 2006-1 Certificate is now rated at "junk" status. Clearly, plaintiff's ACCR 2006-1 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the ACCR 2006-1 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**	
				Initial	**Current**	**Initial**	**Current**
A4	004375FG1	All	31.00%	Aaa	Ca	AAA	CCC

e. Transfer of Title

285. The ACCR 2006-1 Offering Documents also represented that the loans underlying the ACCR 2006-1 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the ACCR 2006-1 Offering Documents stated "the sponsor will direct the depositor to sell, transfer, assign, set over and otherwise convey without recourse to the issuing entity, all right, title and interest in and to each mortgage loan, including all scheduled payments of principal and interest due after the close of business on the Cut-off Date." *See* ACCR 2006-1 Pros. Supp. at S-68. This statement was false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

18. The IXIS 2006-HE2 Certificates

286. The IXIS Real Estate Capital Trust 2006-HE2, Mortgage Pass-Through Certificates, Series 2006-HE2 ("IXIS 2006-HE2 Certificates") were issued pursuant to a Prospectus Supplement dated May 22, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the IXIS 2006-HE2 Certificates: MSABS (depositor); and Morgan Stanley & Co. (underwriter).

287. Plaintiff purchased the following IXIS 2006-HE2 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	A4	46602WAD6	4/24/2006	$25,000,000	Morgan Stanley & Co.

288. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the IXIS 2006-HE2 Offering Documents, including draft and/or final IXIS 2006-HE2 Prospectus Supplements, all of which were distributed by the defendants associated with the IXIS 2006-HE2 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra.*

a. Underwriting Guidelines

289. The IXIS 2006-HE2 Offering Documents disclosed that approximately 18.17% of the IXIS 2006-HE2 Certificates' initial underlying loans were originated or acquired by Accredited; approximately 15.34% of the IXIS 2006-HE2 Certificates' initial underlying loans were originated or acquired by First NLC Financial Services ("First NLC"); approximately 13.65% of the IXIS 2006-HE2 Certificates' initial underlying loans were originated or acquired by NC Capital; approximately 11.94% of the IXIS 2006-HE2 Certificates' initial underlying loans were originated or acquired by Master Financial, Inc. ("Master Financial"); and the remaining loans underlying the

IXIS 2006-HE2 Certificates were originated by various originators, none of which originated more than 10% of the mortgage loans. *See* IXIS 2006-HE2 Pros. Supp. at S-2, S-40-S-41.

290. With regard to all of the IXIS 2006-HE2 Certificates' underlying loans, the IXIS 2006-HE2 Offering Documents represented that they were originated according to underwriting guidelines under which:

> Based on the data provided in the application and certain verification (if required), a determination will have been made by the original lender that the mortgagor's monthly income (if required to be stated) should be sufficient to enable the mortgagor to meet its monthly obligations on the mortgage loan and other expenses related to the mortgaged property (such as property taxes, standard hazard insurance and other fixed obligations other than housing expenses). Generally, scheduled payments on a mortgage loan during the first year of its term plus taxes and insurance and other fixed obligations equal no more than a specified percentage of the prospective mortgagor's gross income. The percentage applied varies on a case by case basis depending on a number of underwriting criteria, including the loan-to-value ratio of the mortgage loan.

Id. at S-41. The IXIS 2006-HE Offering Documents also represented that "the Originator generally reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt-to-income ratio to determine the applicant's ability to repay the loan, and reviews the type and use of the property being financed." *Id.* at S-42. The IXIS 2006-HE2 Offering Documents further represented that "[t]he underwriting guidelines . . . require underwriters to be satisfied that the value of the property being financed, as indicated by an appraisal, supports the outstanding loan balance." *Id.* In addition, the IXIS 2006-HE2 Offering Documents represented that "[t]he adequacy of the mortgaged property as security for repayment of the related mortgage loan will generally have been determined by an appraisal." *Id.* Moreover, the IXIS 2006-HE2 Offering Documents represented that "[u]nderwriting standards are applied by or on behalf of a lender to evaluate the borrower's credit standing and repayment ability, and the value and adequacy of the related mortgage property . . . as collateral." *See* IXIS 2006-HE2 Pros. at 36. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Accredited, First NLC, NC Capital, Master Financial and the various originators had completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §§VI.A.1, VI.A.2, VI.A.4 and VI.A.6, *infra*.

b. Loan-to-Value Ratios

291. The IXIS 2006-HE2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the IXIS 2006-HE2 Certificate purchased by plaintiff. Specifically, the IXIS 2006-HE2 Offering Documents represented that less than 30% of the loans supporting plaintiff's IXIS 2006-HE2 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's IXIS 2006-HE2 Certificate had LTV ratios over 100%.

292. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's IXIS 2006-HE2 Certificate, which reveals that the LTV ratio percentages stated in the IXIS 2006-HE2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the IXIS 2006-HE2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A4	46602WAD6	All	27.19%	70.48%	0.00%	27.25%

c. Owner Occupancy Rates

293. The IXIS 2006-HE2 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the IXIS 2006-HE2 Certificate purchased by plaintiff. Specifically, the IXIS 2006-HE2 Offering Documents represented that a large percentage of the loans supporting plaintiff's IXIS 2006-HE2 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

294. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's IXIS 2006-HE2 Certificate, which reveals that the OOR percentages stated in the IXIS 2006-HE2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the IXIS 2006-HE2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
A4	46602WAD6	All	94.13%	83.23%	13.09%

d. Credit Ratings

295. The IXIS 2006-HE2 Offering Documents also represented that the IXIS 2006-HE2 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the IXIS 2006-HE2 Offering Documents represented that plaintiff's IXIS 2006-HE2 Certificate had been assigned AAA/Aaa/AAA ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

296. These representations, however, were false and misleading when made. In truth, plaintiff's IXIS 2006-HE2 Certificate should not have received AAA/Aaa/AAA credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's IXIS 2006-HE2 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P, Moody's and Fitch had assigned such high ratings to plaintiff's IXIS 2006-HE2 Certificate was because defendants had fed them falsified information regarding the IXIS 2006-HE2 Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

297. The falsity of the credit ratings set forth in the IXIS 2006-HE2 Offering Documents is confirmed by subsequent events. Specifically, ***more than 33% of the loans supporting plaintiff's IXIS 2006-HE2 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" IXIS 2006-HE2 Certificate is now rated at "junk" status. Clearly, plaintiff's IXIS 2006-HE2 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the IXIS 2006-HE2 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**		**Fitch's Ratings**	
				Initial	**Current**	**Initial**	**Current**	**Initial**	**Current**
A4	46602WAD6	All	33.18%	Aaa	Ca	AAA	CCC	AAA	C

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e. Transfer of Title

298. The IXIS 2006-HE2 Offering Documents also represented that the loans underlying the IXIS 2006-HE2 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the IXIS 2006-HE2 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, transfer, assign, set over and otherwise convey without recourse to the issuing entity, all right, title and interest in and to each Initial Mortgage Loan, including all principal outstanding as of, and interest due after the close of business on the cut-off date." *See* IXIS 2006-HE2 Pros. Supp. at S-60. The IXIS 2006-HE2 Offering Documents also stated that, "[i]n connection with the sale, transfer, assignment or pledge of the mortgage loans to the issuing entity, the depositor will cause to be delivered to the custodian on behalf of the trustee, on or before the closing date or the subsequent transfer date, as applicable, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (b) the related original mortgage . . . ; [and] (d) . . . a mortgage assignment." *Id.* at S-61. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

19. The MSHEL 2005-1 Certificates

299. The Morgan Stanley Home Equity Loan Trust 2005-1, Mortgage Pass-Through Certificates, Series 2005-1 ("MSHEL 2005-1 Certificates") were issued pursuant to a Prospectus Supplement dated January 24, 2005. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSHEL 2005-1 Certificates: MSABS (depositor); MSMC (seller); and Morgan Stanley & Co. (underwriter).

300. Plaintiff purchased the following MSHEL 2005-1 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	M1	61744CLE4	1/12/2005	$3,500,000	Morgan Stanley & Co.

301. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSHEL 2005-1 Offering Documents, including draft and/or final MSHEL 2005-1 Prospectus Supplements, all of which were distributed by the defendants associated with the MSHEL 2005-1 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

302. The MSHEL 2005-1 Offering Documents disclosed that approximately 30.69% of the MSHEL 2005-1 Certificates' underlying loans were acquired by sponsor MSMC from loan originator MILA, Inc. ("MILA"); approximately 29.04% of the MSHEL 2005-1 Certificates' underlying loans were acquired by sponsor MSMC from loan originator First NLC; approximately 28.55% of the MSHEL 2005-1 Certificates' underlying loans were acquired by sponsor MSMC from loan originator AIG Federal Savings Bank ("AIG Federal Savings"), acting through its Wilmington Finance division ("Wilmington"); and approximately 11.71% of the MSHEL 2005-1 Certificates' underlying loans were acquired by sponsor MSMC from loan originator Meritage Mortgage Corporation ("Meritage"). *See* MSHEL 2005-1 Pros. Supp. at S-25, S-27, S-35 and S-37.

303. With regard to the MILA loans, the MSHEL 2005-1 Offering Documents represented that "[t]he MILA Underwriting Guidelines are primarily intended to assess the borrower's job stability, credit history, and capacity to repay the mortgage loan, to assess the value of the mortgaged property and to evaluate the adequacy of the property as collateral for the mortgage loan." *Id.* at S-25. The MSHEL 2005-1 Offering Documents also represented that, "[w]hile the originator's primary consideration in underwriting a mortgage loan is the value of the mortgaged property, the

originator also considers, among other things, a mortgagor's credit history, repayment ability and debt service to income ratio, as well as the type and use of the mortgaged property." *Id.* The MSHEL 2005-1 Offering Documents further represented that "[m]ortgaged properties that are to secure mortgage loans are appraised by qualified independent appraisers," and that "[t]he MILA Underwriting Guidelines require a review of the appraisal by a qualified employee of the originator or by an appraiser retained by the originator." *Id.* at S-26. In addition, the MSHEL 2005-1 Offering Documents represented that, "[u]nder each of the programs, the originator reviews the applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, reviews the credit history of the applicant, calculates the debt service to income ratio to determine the applicant's ability to repay the loan, reviews the type and use of the property being financed, and reviews the property." *Id.* Moreover, the MSHEL 2005-1 Offering Documents represented that "[t]he MILA Underwriting Guidelines require . . . the originator's underwriters to be satisfied that the value of the property being financed, as indicated by an appraisal and a review of the appraisal, currently supports the outstanding loan balance." *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that MILA had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.8, *infra*.

304. With regard to the First NLC loans, the MSHEL 2005-1 Offering Documents represented that "First NLC's underwriting guidelines are designed to evaluate a borrower's credit history, his or her capacity, willingness and ability to repay the loan and the value and adequacy of the collateral." *See* MSHEL 2005-1 Pros. Supp. at S-28. The MSHEL 2005-1 Offering Documents also represented that "First NLC also requires an appraisal." *Id*. The MSHEL 2005-1 Offering

Documents further represented that "First NLC reviews the loan applicant's source of income, calculate [sic] the amount of income from sources indicated on the loan application or similar documentation and calculate [sic] debt-to-income ratios to determine the applicant's ability to repay the loan." *Id.* at S-29. Moreover, the MSHEL 2005-1 Offering Documents represented that the maximum allowable DTI ratio is 50%-55%. *Id.* at S-30-S-33. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that First NLC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.6, *infra*.

305. With regard to the Wilmington loans, the MSHEL 2005-1 Offering Documents represented that these mortgage loans were originated in general accordance with Wilmington underwriting guidelines, which were intended to "assess a loan applicant's credit standing and repayment ability and the value and adequacy of the real property security as collateral for the proposed loan." *See* MSHEL 2005-1 Pros. Supp. at S-35. The MSHEL 2005-1 Offering Documents also represented that "[a] full appraisal of the property proposed to be pledged as collateral is required in connection with the origination of each loan," and that "[e]very appraisal is reviewed by a qualified underwriter before the mortgage loan is closed, and the underwriter may choose to obtain additional property valuation information, including but not limited to obtaining a review appraisal or automated valuation report." *Id.* at S-35-S-36. The MSHEL 2005-1 Offering Documents further represented that "Wilmington . . . reviews the loan applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, and calculates debt service-to-income ratios to determine the applicant's ability to repay the loan." *Id.* at S-36. Moreover, the MSHEL 2005-1 Offering Documents represented that "Wilmington['s] . . .

maximum debt-to-income ratios range from 50% to 55% for Full Documentation programs, and up to a maximum of 50% for Stated Income Programs." *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Wilmington . . . had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.10, *infra*.

306. With regard to the Meritage loans, the MSHEL 2005-1 Offering Documents represented that "Meritage's underwriting standards are primarily intended to assess the ability and willingness of the borrower to repay the debt and to evaluate the adequacy of the mortgaged property as collateral for the mortgage loan." *See* MSHEL 2005-1 Pros. Supp. at S-37. The MSHEL 2005-1 Offering Documents also represented that "Meritage considers, among other things, a mortgagor's credit history, repayment ability and debt service-to-income ratio ('Debt Ratio'), as well as the value, type and use of the mortgaged property." *Id.* The MSHEL 2005-1 Offering Documents further represented that "Meritage's underwriting staff fully reviews each Meriscore loan to determine whether Meritage's guidelines for income, assets, employment and collateral are met." *Id.* at S-38. Moreover, the MSHEL 2005-1 Offering Documents represented that "Meritage's guidelines . . . generally require an appraisal of the mortgaged property which conforms to Freddie Mac and/or Fannie Mae standards; and if appropriate, a review appraisal." *Id.* at S-39. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Meritage had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

b. **Loan-to-Value Ratios**

307. The MSHEL 2005-1 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSHEL 2005-1 Certificate purchased by plaintiff. Specifically, the MSHEL 2005-1 Offering Documents represented that a third of the loans supporting plaintiff's MSHEL 2005-1 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSHEL 2005-1 Certificate had LTV ratios over 100%.

308. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSHEL 2005-1 Certificate, which reveals that the LTV ratio percentages stated in the MSHEL 2005-1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSHEL 2005-1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
M1	61744CLE4	All	33.14%	71.82%	0.00%	22.30%

c. **Owner Occupancy Rates**

309. The MSHEL 2005-1 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSHEL 2005-1 Certificate purchased by plaintiff. Specifically, the MSHEL 2005-1 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSHEL 2005-1 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

310. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSHEL 2005-1 Certificate, which reveals that the OOR percentages stated in the MSHEL 2005-1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSHEL 2005-1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
M1	61744CLE4	All	96.80%	85.57%	13.12%

d. Credit Ratings

311. The MSHEL 2005-1 Offering Documents also represented that the MSHEL 2005-1 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSHEL 2005-1 Offering Documents represented that plaintiff's MSHEL 2005-1 Certificate had been assigned AA+/Aa1 ratings – signifying an extremely safe and stable security.

312. These representations, however, were false and misleading when made. In truth, plaintiff's MSHEL 2005-1 Certificate should not have received AA+/Aa1 credit ratings, because it was ***not*** a safe, "investment grade" security. Rather, as defendants were well aware, plaintiff's MSHEL 2005-1 Certificate was an extremely risky, speculative grade "junk" bond or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSHEL 2005-1 Certificate was because defendants had fed them falsified information regarding the MSHEL 2005-1 Certificates' underlying

loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

313. The falsity of the credit ratings set forth in the MSHEL 2005-1 Offering Documents is confirmed by subsequent events. Specifically, ***more than 25% of the loans supporting plaintiff's MSHEL 2005-1 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, after initially being rated "investment grade," plaintiff's MSHEL 2005-1 Certificate is no longer rated at all. Clearly, plaintiff's MSHEL 2005-1 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSHEL 2005-1 Certificate's credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**	
				Initial	**Current**	**Initial**	**Current**
M1	61744CLE4	All	25.41%	Aa1	WR	AA+	NR

e. Transfer of Title

314. The MSHEL 2005-1 Offering Documents also represented that the loans underlying the MSHEL 2005-1 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSHEL 2005-1 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSHEL 2005-1 Pros. Supp. at S-92. The MSHEL 2005-1 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to the trustee, on or before the

closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; (d) the mortgage assignment(s)." *Id.* These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

20. The MSHEL 2006-2 Certificates

315. The Morgan Stanley Home Equity Loan Trust 2006-2, Mortgage Pass-Through Certificates, Series 2006-2 ("MSHEL 2006-2 Certificates") were issued pursuant to a Prospectus Supplement dated March 27, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSHEL 2006-2 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

316. Plaintiff purchased the following MSHEL 2006-2 Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	A4	61744CYP5	3/10/2006	$10,000,000	Morgan Stanley & Co.

317. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSHEL 2006-2 Offering Documents, including draft and/or final MSHEL 2006-2 Prospectus Supplements, all of which were distributed by the defendants associated with the MSHEL 2006-2 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

318. The MSHEL 2006-2 Offering Documents disclosed that approximately 45.20% of the MSHEL 2006-2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator AIG Federal Savings; approximately 26.14% of the MSHEL 2006-2 Certificates'

underlying loans were acquired by the sponsor, MSMC, from loan originator Accredited; approximately 19.33% of the MSHEL 2006-2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Meritage; approximately 9.05% of the MSHEL 2006-2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator First NLC; and approximately 0.28% of the MSHEL 2006-2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Countrywide Home Loans, Inc. ("Countrywide"). *See* MSHEL 2006-2 Pros. Supp. at S-25, S-27, S-29, Annex III.

319. With regard to the AIG Federal Savings loans, the MSHEL 2006-2 Offering Documents represented that the AIG Federal Savings underwriting guidelines were "intended to assess a mortgage loan applicant's credit standing and repayment ability and the value and adequacy of the real property security as collateral for the proposed mortgage loan." *Id.* at S-28. The Offering Documents also represented that "[a] full appraisal of the property proposed to be pledged as collateral is required in connection with the origination of each mortgage loan," and that "[e]very appraisal is reviewed by a qualified underwriter before the mortgage loan is closed, and the underwriter may choose to obtain additional property valuation information, including but not limited to obtaining a review appraisal or automated valuation report." *Id.* The MSHEL 2006-2 Offering Documents further stated that "AIG [Federal Savings] reviews the mortgage loan applicant's source of income, calculates the amount of income from sources indicated on the mortgage loan application or similar documentation, and calculates debt service-to-income ratios to determine the applicant's ability to repay the mortgage loan." *Id.* Moreover, the MSHEL 2006-2 Offering Documents represented that "AIG [Federal Savings'] maximum debt-to-income ratios range from 50% to 55% for Full Documentation programs, and up to a maximum of 50% for Stated Income Programs." *Id.* at S-29. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the

truth was that AIG Federal Savings had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.10, *infra*.

320. With regard to the Accredited loans, the MSHEL 2006-2 Offering Documents represented that Accredited's underwriting guidelines are "intended to assess a mortgage loan applicant's credit standing and repayment ability and the value and adequacy of the real property security as collateral for the proposed mortgage loan." *See* MSHEL 2006-2 Pros. Supp. at S-30. The MSHEL 2006-2 Offering Documents also represented that "[a] full appraisal of the property proposed to be pledged as collateral is required in connection with the origination of each first priority mortgage loan and each second priority mortgage loan greater than $50,000," and that "[e]very appraisal is reviewed by a non-affiliated appraisal review firm or by Accredited's Appraisal Review Department or a qualified underwriter before the mortgage loan is closed." *Id.* The MSHEL 2006-2 Offering Documents further represented that "Accredited reviews the mortgage loan applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, and calculates debt service-to-income ratios to determine the applicant's ability to repay the mortgage loan." *Id.* at S-30-S-31. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Accredited had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.4, *infra*.

321. With regard to the Meritage, First NLC and Countrywide loans, the MSHEL 2006-2 Offering Documents represented that "[t]he mortgage loans were originated or acquired generally in

accordance with the underwriting guidelines described in [the] prospectus supplement" (citing the underwriting guidelines for the AIG Federal Savings and Accredited loans). *See* MSHEL 2006-2 Pros. Supp. at S-25. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Meritage, First NLC and Countrywide had completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §§VI.A.1 and VI.A.6, *infra*.

b. Loan-to-Value Ratios

322. The MSHEL 2006-2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSHEL 2006-2 Certificate purchased by plaintiff. Specifically, the MSHEL 2006-2 Offering Documents represented that less than 40% of the loans supporting plaintiff's MSHEL 2006-2 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSHEL 2006-2 Certificate had LTV ratios over 100%.

323. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSHEL 2006-2 Certificate, which reveals that the LTV ratio percentages stated in the MSHEL 2006-2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSHEL 2006-2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A4	61744CYP5	All	38.48%	69.86%	0.00%	18.64%

c. Owner Occupancy Rates

324. The MSHEL 2006-2 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSHEL 2006-2 Certificate purchased by plaintiff. Specifically, the MSHEL 2006-2 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSHEL 2006-2 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

325. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSHEL 2006-2 Certificate, which reveals that the OOR percentages stated in the MSHEL 2006-2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSHEL 2006-2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Primary Residence Percentage Stated in the Offering Documents	Actual Primary Residence Percentage	Percent Overstatement of Actual Primary Residence Percentage
A4	61744CYP5	All	96.17%	85.72%	12.19%

d. Credit Ratings

326. The MSHEL 2006-2 Offering Documents also represented that the MSHEL 2006-2 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch, indicating that the security was a very strong, safe investments with an

extremely low probability of default. Specifically, the MSHEL 2006-2 Offering Documents represented that plaintiff's MSHEL 2006-2 Certificate had been assigned AAA/Aaa/AAA ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

327. These representations, however, were false and misleading when made. In truth, plaintiff's MSHEL 2006-2 Certificate should not have received AAA/Aaa/AAA credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSHEL 2006-2 Certificate was an extremely risky, speculative grade "junk" bond backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P, Moody's and Fitch had assigned such high ratings to plaintiff's MSHEL 2006-2 Certificate was because defendants had fed them falsified information regarding the MSHEL 2006-2 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

328. The falsity of the credit ratings set forth in the MSHEL 2006-2 Offering Documents is confirmed by subsequent events. Specifically, ***more than 34% of the loans supporting plaintiff's MSHEL 2006-2 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSHEL 2006-2 Certificate is now rated at "junk" status. Clearly, plaintiff's MSHEL 2006-2 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSHEL 2006-2 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Current Percentage of Outstanding Loan Balance in Default	Moody's Ratings		S&P's Ratings		Fitch's Ratings	
				Initial	Current	Initial	Current	Initial	Current
A4	61744CYP5	All	34.69%	Aaa	Caa1	AAA	BB	AAA	CCC

e. Transfer of Title

329. The MSHEL 2006-2 Offering Documents also represented that the loans underlying the MSHEL 2006-2 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSHEL 2006-2 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSHEL 2006-2 Pros. Supp. at S-50. The MSHEL 2006-2 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to the trustee on or before the closing date, the following documents with respect to each mortgage loan, which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment(s)." *Id.* at S-51. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

21. The MSHEL 2006-3 Certificates

330. The Morgan Stanley Home Equity Loan Trust 2006-3, Mortgage Pass-Through Certificates, Series 2006-3 ("MSHEL 2006-3 Certificates") were issued pursuant to a Prospectus Supplement dated May 22, 2006. The following defendants played critical roles in the fraudulent

structuring, offering and sale of the MSHEL 2006-3 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

331. Plaintiff purchased the following MSHEL 2006-3 Certificate:

Original Purchaser	**Tranche Purchased**	**CUSIP**	**Purchase Date**	**Original Face Amount**	**Purchased From**
Fortis Bank	A4	61749GAD4	5/8/2006	$20,000,000	Morgan Stanley & Co.

332. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSHEL 2006-3 Offering Documents, including draft and/or final MSHEL 2006-3 Prospectus Supplements, all of which were distributed by the defendants associated with the MSHEL 2006-3 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

333. The MSHEL 2006-3 Offering Documents disclosed that approximately 30.59% of the MSHEL 2006-3 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator AIG Federal Savings; approximately 19.88% of the MSHEL 2006-3 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Aegis Mortgage Corporation ("Aegis"); approximately 19.82% of the MSHEL 2006-3 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Meritage; approximately 11.18% of the MSHEL 2006-3 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator ResMAE Mortgage Corporation ("ResMAE"); approximately 9.22% of the MSHEL 2006-3 Certificates' underlying loans were acquired by the sponsor, MSMC, through loan originator Accredited; approximately 5.06% of the MSHEL 2006-3 Certificates' underlying loans were acquired by the sponsor, MSMC, through loan originator Lime Financial Services, Ltd. ("Lime"); and approximately 4.24% of the MSHEL 2006-3 Certificates' underlying loans were acquired by the

sponsor, MSMC, through loan originator First NLC. *See* MSHEL 2006-3 Pros. Supp. at S-27, Annex III.

334. With regard to the AIG Federal Savings loans, the MSHEL 2006-3 Offering Documents represented that the AIG Federal Savings underwriting guidelines were "intended to assess a mortgage loan applicant's credit standing and repayment ability and the value and adequacy of the real property security as collateral for the proposed mortgage loan." *Id.* at S-28. The Offering Documents also represented that "[a] full appraisal of the property proposed to be pledged as collateral is required in connection with the origination of each mortgage loan," and that "[e]very appraisal is reviewed by a qualified underwriter before the mortgage loan is closed, and the underwriter may choose to obtain additional property valuation information, including but not limited to obtaining a review appraisal or automated valuation report." *Id.* The MSHEL 2006-3 Offering Documents further represented that "AIG [Federal Savings] reviews the mortgage loan applicant's source of income, calculates the amount of income from sources indicated on the mortgage loan application or similar documentation, and calculates debt service-to-income ratios to determine the applicant's ability to repay the mortgage loan." *Id.* at S-28-S-29. Moreover, the MSHEL 2006-3 Offering Documents represented that AIG Federal Savings' "maximum debt-to-income ratios range from 50% to 55% for Full Documentation programs, and up to a maximum of 50% for Stated Income Programs." *Id.* at S-29. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that AIG Federal Savings had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.10, *infra*.

335. With regard to all of the loans underlying the MSHEL 2006-3 Certificates, the Offering Documents represented that "[t]he mortgage loans were originated or acquired generally in accordance with the underwriting guidelines described in [the] prospectus supplement" (citing the underwriting guidelines for the AIG Federal Savings loans). *See* MSHEL 2006-3 Pros. Supp. at S-25. The MSHEL 2006-3 Offering Documents also represented that, with regard to all of the loans underlying the MSHEL 2006-3 Certificate, "[u]nderwriting standards are applied by or on behalf of a lender to evaluate the borrower's credit standing and repayment ability, and the value and adequacy of the related mortgaged property, home improvements or manufactured home, as applicable, as collateral." *See* MSHEL 2006-3 Pros. at 36. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that AIG Federal Savings, Aegis, Meritage, ResMAE, Accredited, Lime, and First NLC had all completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §§VI.A.1, VI.A.4, VI.A.6 and VI.A.10, *infra*.

b. Loan-to-Value Ratios

336. The MSHEL 2006-3 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSHEL 2006-3 Certificate purchased by plaintiff. Specifically, the MSHEL 2006-3 Offering Documents represented that less than 40% of the loans supporting plaintiff's MSHEL 2006-3 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSHEL 2006-3 Certificate had LTV ratios over 100%.

337. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSHEL 2006-3 Certificate, which reveals that the LTV

ratio percentages stated in the MSHEL 2006-3 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSHEL 2006-3 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Stated Percentage of Loans Having LTV Ratios Over 80%**	**Actual Percentage of Loans Having LTV Ratios Over 80%**	**Stated Percentage of Loans Having LTV Ratios Over 100%**	**Actual Percentage of Loans Having LTV Ratios Over 100%**
A4	61749GAD4	All	37.97%	67.88%	0.00%	18.19%

c. Owner Occupancy Rates

338. The MSHEL 2006-3 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSHEL 2006-3 Certificate purchased by plaintiff. Specifically, the MSHEL 2006-3 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSHEL 2006-3 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

339. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSHEL 2006-3 Certificate, which reveals that the OOR percentages stated in the MSHEL 2006-3 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSHEL 2006-3 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A4	61749GAD4	All	95.72%	84.66%	13.06%

d. Credit Ratings

340. The MSHEL 2006-3 Offering Documents also represented that the MSHEL 2006-3 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P, Moody's and Fitch, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSHEL 2006-3 Offering Documents represented that plaintiff's MSHEL 2006-3 Certificate had been assigned AAA/Aaa/AAA ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

341. These representations, however, were false and misleading when made. In truth, plaintiff's MSHEL 2006-3 Certificate should not have received AAA/Aaa/AAA credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSHEL 2006-3 Certificate was an extremely risky, speculative grade "junk" bond backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P, Moody's and Fitch had assigned such high ratings to plaintiff's MSHEL 2006-3 Certificate was because defendants had fed them falsified information regarding the MSHEL 2006-3 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

342. The falsity of the credit ratings set forth in the MSHEL 2006-3 Offering Documents is confirmed by subsequent events. Specifically, ***more than 39% of the loans supporting plaintiff's MSHEL 2006-3 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSHEL 2006-3 Certificate is now rated at "junk" status. Clearly, plaintiff's MSHEL 2006-3 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The

evidence supporting the falsity of the MSHEL 2006-3 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Current Percentage of Outstanding Loan Balance in Default	Moody's Ratings		S&P's Ratings		Fitch's Ratings	
				Initial	Current	Initial	Current	Initial	Current
A4	61749GAD4	All	39.56%	Aaa	Ca	AAA	CCC	AAA	C

e. Transfer of Title

343. The MSHEL 2006-3 Offering Documents also represented that the loans underlying the MSHEL 2006-3 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSHEL 2006-3 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSHEL 2006-3 Pros. Supp. at S-45. The MSHEL 2006-3 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to the trustee on or before the closing date, the following documents with respect to each mortgage loan, which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment(s)." *Id.* at S-46. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

22. The MSHEL 2007-2 Certificates

344. The Morgan Stanley Home Equity Loan Trust 2007-2, Mortgage Pass-Through Certificates, Series 2007-2 ("MSHEL 2007-2 Certificates") were issued pursuant to a Prospectus

Supplement dated April 2, 2007. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSHEL 2007-2 Certificates: MSABS (depositor); MSMC (sponsor); and Morgan Stanley & Co. (underwriter).

345. Plaintiff purchased the following MSHEL 2007-2 Certificate:

Original Purchaser	**Tranche Purchased**	**CUSIP**	**Purchase Date**	**Original Face Amount**	**Purchased From**
Fortis Bank	A4	61752UAD7	3/26/2007	$32,000,000	Morgan Stanley & Co.

346. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSHEL 2007-2 Offering Documents, including draft and/or final MSHEL 2007-2 Prospectus Supplements, all of which were distributed by the defendants associated with the MSHEL 2007-2 offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

347. The MSHEL 2007-2 Offering Documents disclosed that approximately 35.13% of the MSHEL 2007-2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator First NLC; approximately 34.86% of the MSHEL 2007-2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Wilmington; and approximately 30.01% of the MSHEL 2007-2 Certificates' underlying loans were acquired by the sponsor, MSMC, from loan originator Accredited. *See* MSHEL 2007-2 Pros. Supp. at S-28.

348. With regard to the First NLC loans, the MSHEL 2007-2 Offering Documents represented that First NLC's underwriting guidelines were "designed to evaluate a borrower's credit history, his or her capacity, willingness and ability to repay the loan and the value and adequacy of the collateral." *Id.* The MSHEL 2007-2 Offering Documents also represented that "First NLC also requires an appraisal." *Id.* at S-29. The MSHEL 2007-2 Offering Documents further represented

that "First NLC reviews the loan applicant's source of income, calculate [sic] the amount of income from sources indicated on the loan application or similar documentation and calculate [sic] debt-to-income ratios to determine the applicant's ability to repay the loan." *Id.* at S-30. Moreover, the MSHEL 2007-2 Offering Documents represented that the maximum allowable DTI ratio was 50% to 55%. *Id.* at S-31-S-34. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that First NLC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.6, *infra*.

349. With regard to the Wilmington loans, the MSHEL 2007-2 Offering Documents represented that "[t]he Wilmington underwriting process is intended to assess a mortgage loan applicant's credit standing and repayment ability and the value and adequacy of the real property security as collateral for the proposed mortgage loan." *See* MSHEL 2007-2 Pros. Supp. at S-35. The Offering Documents also represented that "[a] full appraisal of the property proposed to be pledged as collateral is required in connection with the origination of each mortgage loan," and that "[e]very appraisal is reviewed by a qualified underwriter before the mortgage loan is closed, and the underwriter may choose to obtain additional property valuation information, including but not limited to obtaining a review appraisal or automated valuation report." *Id.* The MSHEL 2007-2 Offering Documents further represented that "Wilmington reviews the mortgage loan applicant's source of income, calculates the amount of income from sources indicated on the mortgage loan application or similar documentation, and calculates debt service-to-income ratios to determine the applicant's ability to repay the mortgage loan." *Id.* Moreover, the MSHEL 2007-2 Offering Documents stated that Wilmington's "maximum debt-to-income ratios range from 50% to 55% for Full Documentation programs, and up to a maximum of 50% for Stated Income programs." *Id.* at S-

36. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Wilmington had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.10, *infra*.

350. With regard to the Accredited loans, the MSHEL 2007-2 Offering Documents represented that "Accredited's underwriting process is intended to assess a mortgage loan applicant's credit standing and repayment ability and the value and adequacy of the real property security as collateral for the proposed mortgage loan." *See* MSHEL 2007-2 Pros. Supp. at S-37. The MSHEL 2007-2 Offering Documents also represented that "[a] full appraisal of the property proposed to be pledged as collateral is required in connection with the origination of each mortgage loan," and that "[e]very appraisal is reviewed by a non-affiliated appraisal review firm or by Accredited's Appraisal Review Department or a qualified underwriter before the mortgage loan is closed." *Id.* The MSHEL 2007-2 Offering Documents further represented that "Accredited reviews the mortgage loan applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, and calculates debt service-to-income ratios to determine the applicant's ability to repay the mortgage loan." *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Accredited had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.4, *infra*.

b. Loan-to-Value Ratios

351. The MSHEL 2007-2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSHEL 2007-2 Certificate purchased by plaintiff. Specifically, the MSHEL 2007-2 Offering Documents represented that just over 40% of the loans supporting plaintiff's MSHEL 2007-2 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSHEL 2007-2 Certificate had LTV ratios over 100%.

352. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSHEL 2007-2 Certificate, which reveals that the LTV ratio percentages stated in the MSHEL 2007-2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSHEL 2007-2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A4	61752UAD7	All	42.87%	73.91%	0.00%	25.77%

c. Owner Occupancy Rates

353. The MSHEL 2007-2 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSHEL 2007-2 Certificate purchased by plaintiff. Specifically, the MSHEL 2007-2 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSHEL 2007-2 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

354. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSHEL 2007-2 Certificate, which reveals that the OOR percentages stated in the MSHEL 2007-2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSHEL 2007-2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A4	61752UAD7	All	94.09%	85.47%	10.08%

d. Credit Ratings

355. The MSHEL 2007-2 Offering Documents also represented that the MSHEL 2007-2 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSHEL 2007-2 Offering Documents represented that plaintiff's MSHEL 2007-2 Certificate had been assigned AAA/Aaa ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

356. These representations, however, were false and misleading when made. In truth, plaintiff's MSHEL 2007-2 Certificate should not have received AAA/Aaa credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSHEL 2007-2 Certificate was an extremely risky, speculative grade "junk" bond backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSHEL 2007-2 Certificate was because defendants had fed them falsified information regarding the

MSHEL 2007-2 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

357. The falsity of the credit ratings set forth in the MSHEL 2007-2 Offering Documents is confirmed by subsequent events. Specifically, ***more than 44% of the loans supporting plaintiff's MSHEL 2007-2 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSHEL 2007-2 Certificate is now rated at "junk" status. Clearly, plaintiff's MSHEL 2007-2 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSHEL 2007-2 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Current Percentage of Outstanding Loan Balance in Default	Moody's Ratings		S&P's Ratings	
				Initial	Current	Initial	Current
A4	61752UAD7	All	44.14%	Aaa	Ca	AAA	CCC

e. Transfer of Title

358. The MSHEL 2007-2 Offering Documents also represented that the loans underlying the MSHEL 2007-2 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSHEL 2007-2 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSHEL 2007-2 Pros. Supp. at S-57-S-58. The MSHEL 2007-2 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to the trustee on or before the

closing date, the following documents with respect to each mortgage loan which constitute the mortgage file: (a) the original mortgage note . . . ; (c) the related original mortgage . . . ; [and] (d) the mortgage assignment(s)." *Id.* at S-58. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

23. The MSIX 2006-2 Certificates

359. The Morgan Stanley IXIS Real Estate Capital Trust 2006-2, Mortgage Pass-Through Certificates, Series 2006-2 ("MSIX 2006-2 Certificates") were issued pursuant to a Prospectus Supplement dated November 21, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSIX 2006-2 Certificates: MSABS (depositor); MSMC (co-sponsor); and Morgan Stanley & Co. (underwriter).

360. Plaintiff and/or its assignors purchased the following MSIX 2006-2 Certificate:

Plaintiff	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Scaldis	A4	617463AD6	11/6/2006	$24,000,000	Morgan Stanley & Co.

361. The decision to purchase the above security was made by Fortis Bank, on behalf of Scaldis, in direct reliance upon the MSIX 2006-2 Offering Documents, including draft and/or final MSIX 2006-2 Prospectus Supplements. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

362. The MSIX 2006-2 Offering Documents disclosed that approximately 27.77% of the MSIX 2006-2 Certificates' underlying loans were acquired by the sponsors, including MSMC, from loan originator First NLC; approximately 23.00% of the MSIX 2006-2 Certificates' underlying loans were acquired by the sponsors, including MSMC, from loan originator Accredited; approximately

21.74% of the MSIX 2006-2 Certificates' underlying loans were acquired by the sponsors, including MSMC, from loan originator Master Financial; approximately 18.42% of the MSIX 2006-2 Certificates' underlying loans were acquired by the sponsors, including MSMC, from loan originator Wilmington; and the remainder of the loans underlying the MSIX 2006-2 Certificate were originated by various lenders, none of which originated more than 5% of the mortgage loans. *See* MSIX 2006-2 Pros. Supp. at S-25, S-27, S-34, S-38, Annex IV-1.

363. With regard to the First NLC loans, the MSIX 2006-2 Offering Documents represented that "First NLC's underwriting guidelines are designed to evaluate a borrower's credit history, his or her capacity, willingness and ability to repay the loan and the value and adequacy of the collateral." *Id.* at S-27. The MSIX 2006-2 Offering Documents also represented that "First NLC also requires an appraisal." *Id.* at S-28. The MSIX 2006-2 Offering Documents further represented that "First NLC reviews the loan applicant's source of income, calculate [sic] the amount of income from sources indicated on the loan application or similar documentation and calculate [sic] debt-to-income ratios to determine the applicant's ability to repay the loan." *Id.* at S-29. Moreover, the MSIX 2006-2 Offering Documents represented that the maximum allowable DTI ratio was 50% to 55%. *Id.* at S-30-S-33. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that First NLC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.6, *infra*.

364. With regard to the Accredited loans, the MSIX 2006-2 Offering Documents represented that "Accredited's underwriting process is intended to assess a mortgage loan applicant's credit standing and repayment ability and the value and adequacy of the real property security as collateral for the proposed mortgage loan." *Id.* at S-34. The MSIX 2006-2 Offering Documents also

represented that "[a] full appraisal of the property proposed to be pledged as collateral is required in connection with the origination of each first priority mortgage loan and each second priority mortgage loan greater than $50,000," and that "[e]very appraisal is reviewed by a non-affiliated appraisal review firm or by Accredited's Appraisal Review Department or a qualified underwriter before the mortgage loan is closed." *Id.* at S-35. The MSIX 2006-2 Offering Documents further represented that "Accredited reviews the mortgage loan applicant's source of income, calculates the amount of income from sources indicated on the loan application or similar documentation, and calculates debt service-to-income ratios to determine the applicant's ability to repay the mortgage loan." *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Accredited had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.4, *infra*.

365. With regard to the Master Financial loans, the MSIX 2006-2 Offering Documents represented that "Master Financial's underwriting guidelines assess a borrower's credit history as well as their willingness, ability and capacity to repay the loan in a timely manner," and that "[a]dditional emphasis is placed on determining the value and adequacy of the collateral." *See* MSIX 2006-2 Pros. Supp. at S-39. The MSIX 2006-2 Offering Documents also represented that "[t]he underwriting of a mortgage loan to be originated by Master Financial includes a review of the completed loan package, which includes the loan application, a current appraisal, a preliminary title report and a credit report." *Id.* The MSIX 2006-2 Offering Documents further represented that each of Master Financial's documentation programs includes "a review of the borrower's source of income, calculate [sic] the amount of income from the sources indicated on the loan application or similar documentation and calculate [sic] DTI ratios to determine the borrower's ability to repay the

loan." *Id.* at S-40. The MSIX 2006-2 Offering Documents further represented that "[t]he underwriting of a mortgage loan to be originated by Master Financial includes a review of the completed loan package, which includes the loan application, a current appraisal, a preliminary title report and a credit report." *Id.* at S-39. Moreover, the MSIX 2006-2 Offering Documents represented that the maximum allowable DTI ratio was 50%. *Id.* at S-42. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Master Financial had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

366. With regard to all of the loans underlying the MSIX 2006-2 Certificates, the Offering Documents represented that they "were originated or acquired generally in accordance with the underwriting guidelines of the original loan sellers" (citing the underwriting guidelines for the First NLC, Accredited and Master Financial loans). *See* MSIX 2006-2 Pros. Supp. at S-25. The MSIX 2006-2 Offering Documents also represented that "[u]nderwriting standards are applied by or on behalf of a lender to evaluate the borrower's credit standing and repayment ability, and the value and adequacy of the related mortgaged property, home improvements or manufactured home, as applicable, as collateral." *See* MSIX 2006-2 Pros. at 34. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that First NLC, Accredited, Master Financial, Wilmington and the various other originators had completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §§VI.A.1, VI.A.4, VI.A.6 and VI.A.10, *infra*.

b. Loan-to-Value Ratios

367. The MSIX 2006-2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSIX 2006-2 Certificate purchased by plaintiff. Specifically, the MSIX 2006-2 Offering Documents represented that approximately 40% of the loans supporting plaintiff's MSIX 2006-2 Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSIX 2006-2 Certificate had LTV ratios over 100%.

368. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSIX 2006-2 Certificate, which reveals that the LTV ratio percentages stated in the MSIX 2006-2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSIX 2006-2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A4	617463AD6	All	40.80%	71.79%	0.00%	18.98%

c. Owner Occupancy Rates

369. The MSIX 2006-2 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSIX 2006-2 Certificate purchased by plaintiff. Specifically, the MSIX 2006-2 Offering Documents represented that a large percentage of the loans supporting plaintiff's MSIX 2006-2 Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that those borrowers would default on their loans.

370. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSIX 2006-2 Certificate, which reveals that the OOR percentages stated in the MSIX 2006-2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the Primary Residence Percentages stated in the MSIX 2006-2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A4	617463AD6	All	94.73%	85.75%	10.47%

d. Credit Ratings

371. The MSIX 2006-2 Offering Documents also represented that the MSIX 2006-2 Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSIX 2006-2 Offering Documents represented that plaintiff's MSIX 2006-2 Certificate had been assigned AAA/Aaa ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

372. These representations, however, were false and misleading when made. In truth, plaintiff's MSIX 2006-2 Certificate should not have received AAA/Aaa credit ratings, because it was ***not*** a safe, "investment grade" security. Rather, as defendants were well aware, plaintiff's MSIX 2006-2 Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSIX 2006-2 Certificate was because defendants had fed them falsified information regarding the MSIX 2006-2 Certificate's underlying loans, including,

without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

373. The falsity of the credit ratings set forth in the MSIX 2006-2 Offering Documents is confirmed by subsequent events. Specifically, ***approximately 36% of the loans supporting plaintiff's MSIX 2006-2 Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSIX 2006-2 Certificate is now rated at "junk" status. Clearly, plaintiff's MSIX 2006-2 Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSIX 2006-2 Certificate's credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Rating**		**S&P's Rating**	
				Initial	**Current**	**Initial**	**Current**
A4	617463AD6	All	35.72%	Aaa	Ca	AAA	CCC

e. Transfer of Title

374. The MSIX 2006-2 Offering Documents also represented that the loans underlying the MSIX 2006-2 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSIX 2006-2 Offering Documents stated that, "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSIX 2006-2 Pros. Supp. at S-60. The MSIX 2006-2 Offering Documents also stated that, "[i]n connection with the transfer and assignment of each mortgage loan to the trust, the depositor will cause to be delivered to the trustee on or before the closing date, the following documents with respect to each mortgage loan, which constitute the mortgage file: (a) the original

mortgage note . . . ; (c) the related original mortgage . . . ; (d) the mortgage assignment(s)." *Id.* at S-61. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

24. The MSM 2005-11AR Certificates

375. The Morgan Stanley Mortgage Loan Trust 2005-11AR, Mortgage Pass-Through Certificates, Series 2005-11AR ("MSM 2005-11AR Certificates") were issued pursuant to a Prospectus Supplement dated December 22, 2005. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSM 2005-11AR Certificates: MS Capital (depositor); MSMC (seller); and Morgan Stanley & Co. (underwriter).

376. Plaintiff purchased the following MSM 2005-11AR Certificate:

Original Purchaser	**Tranche Purchased**	**CUSIP**	**Purchase Date**	**Original Face Amount**	**Purchased From**
Fortis Bank	A1	61748HTG6	1/13/2006	$56,659,000	Morgan Stanley & Co.

377. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSM 2005-11AR Offering Documents, including draft and/or final MSM 2005-11AR Prospectus Supplements, all of which were distributed by the defendants associated with the MSM 2005-11AR offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

378. The MSM 2005-11AR Offering Documents disclosed that approximately 66.24% of the MSM 2005-11AR Certificates' underlying loans were originated by the seller, MSMC; approximately 10.21% of the MSM 2005-11AR Certificates' underlying loans were acquired by the seller, MSMC, from loan originator First National Bank of Nevada ("FNBN"); approximately 10.19% of the MSM 2005-11AR Certificates' underlying loans were acquired by the seller, MSMC,

from loan originator Wachovia Mortgage Corporation ("Wachovia"); and approximately 13.36% of the MSM 2005-11AR Certificates' underlying loans were acquired by the seller, MSMC, from "other" undisclosed loan originators. *See* MSM 2005-11AR Pros. Supp. at S-19.

379. With regard to all of the loans underlying the MSM 2005-11AR Certificates, the MSM 2005-11AR Offering Documents represented that they were originated in accordance with the seller MSMC's underwriting guidelines. *Id.* at S-31. The MSM 2005-11AR Offering Documents represented that under MSMC's underwriting guidelines:

> Based on the data provided in the application and certain verification (if required), a determination is made by the original lender that the mortgagor's monthly income (if required to be stated) will be sufficient to enable the mortgagor to meet its monthly obligations on the mortgage loan and other expenses related to the property such as property taxes, utility costs, standard hazard insurance and other fixed obligations other than housing expenses. Generally, scheduled payments on a mortgage loan during the first year of its term plus taxes and insurance and all scheduled payments on obligations that extend beyond ten months equal no more than a specified percentage of the prospective mortgagor's gross income. The percentage applied varies on a case by case basis depending on a number of loan purchasing criteria, including the Loan-to-Value Ratio of the mortgage loan.

Id. at S-32. The MSM 2005-11AR Offering Documents also represented that "[t]he adequacy of the mortgaged property as security for repayment of the related mortgage loan will generally have been determined by an appraisal in accordance with pre-established appraisal procedure guidelines for appraisals established by or acceptable to the originator." *Id.* As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that MSMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

b. Loan-to-Value Ratios

380. The MSM 2005-11AR Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSM 2005-11AR Certificate purchased by plaintiff. Specifically, the MSM 2005-11AR Offering Documents represented that only a very small percentage of the loans supporting plaintiff's MSM 2005-11AR Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSM 2005-11AR Certificate had LTV ratios over 100%.

381. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSM 2005-11AR Certificate, which reveals that the LTV ratio percentages stated in the MSM 2005-11AR Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSM 2005-11AR Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Stated Percentage of Loans Having LTV Ratios Over 80%**	**Actual Percentage of Loans Having LTV Ratios Over 80%**	**Stated Percentage of Loans Having LTV Ratios Over 100%**	**Actual Percentage of Loans Having LTV Ratios Over 100%**
A1	61748HTG6	All	3.53%	39.14%	0.00%	11.55%

c. Owner Occupancy Rates

382. The MSM 2005-11AR Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSM 2005-11AR Certificate purchased by plaintiff. Specifically, the MSM 2005-11AR Offering Documents represented that a large percentage of the loans supporting plaintiff's MSM 2005-11AR Certificate were issued to borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

383. Plaintiff, however, has performed an in-depth investigation of actual borrowers, loans and properties underlying plaintiff's MSM 2005-11AR Certificate, which reveals that the OOR percentages stated in the MSM 2005-11AR Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSM 2005-11AR Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
A1	61748HTG6	All	70.61%	64.55%	9.39%

d. Credit Ratings

384. The MSM 2005-11AR Offering Documents also represented that the MSM 2005-11AR Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSM 2005-11AR Offering Documents represented that plaintiff's MSM 2005-11AR Certificate had been assigned AAA/Aaa ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

385. These representations, however, were false and misleading when made. In truth, plaintiff's MSM 2005-11AR Certificate should not have received AAA/Aaa credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSM 2005-11AR Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSM 2005-11AR Certificate was because defendants had fed them falsified information regarding the

MSM 2005-11AR Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

386. The falsity of the credit ratings set forth in the MSM 2005-11AR Offering Documents is confirmed by subsequent events. Specifically, ***approximately 28% of the loans supporting plaintiff's MSM 2005-11AR Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSM 2005-11AR Certificate is now rated at "junk" status. Clearly, plaintiff's MSM 2005-11AR Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSM 2005-11AR Certificate's credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**	
				Initial	**Current**	**Initial**	**Current**
A1	61748HTG6	All	27.89%	Aaa	Caa3	AAA	NR

e. Transfer of Title

387. The MSM 2005-11AR Offering Documents also represented that the loans underlying the MSM 2005-11AR Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSM 2005-11AR Offering Documents stated that, "[p]ursuant to a pooling and servicing agreement . . . , on the Closing Date the Depositor will sell, transfer, assign, set over and otherwise convey without recourse to the Trustee, in its capacity as trustee, all of its rights to the Mortgage Loans." *See* MSM 2005-11AR Pros. Supp. at S-30. The MSM 2005-11AR Offering Documents also stated that:

> In connection with such transfer and assignment of the Mortgage Loans, the Depositor will deliver or cause to be delivered to the Trustee or its custodian, among other things, the original promissory note . . . (the "Mortgage Note") . . . , the original instrument creating a first lien on the related Mortgaged Property (the "Mortgage") . . . , an assignment in recordable form of the Mortgage, all recorded intervening assignments of the Mortgage and any modifications to such Mortgage Note and Mortgage . . . (collectively, the "Mortgage File").

Id. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

25. The MSM 2006-3AR Certificates

388. The Morgan Stanley Mortgage Loan Trust 2006-3AR, Mortgage Pass-Through Certificates, Series 2006-3AR ("MSM 2006-3AR Certificates") were issued pursuant to a Prospectus Supplement dated February 24, 2006. The following defendants played critical roles in the fraudulent structuring, offering and sale of the MSM 2006-3AR Certificates: MS Capital (depositor); MSMC (sponsor/seller); and Morgan Stanley & Co. (underwriter).

389. Plaintiff purchased the following MSM 2006-3AR Certificate:

Original Purchaser	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	1A3	61748HWP2	2/17/2006	$25,000,000	Morgan Stanley & Co.

390. The decision to purchase the above security was made by Fortis Bank in direct reliance upon the MSM 2006-3AR Offering Documents, including draft and/or final MSM 2006-3AR Prospectus Supplements, all of which were distributed by the defendants associated with the MSM 2006-3AR offering. Fortis Bank's diligent investment processes are described in great detail in §VIII.A, *infra*.

a. Underwriting Guidelines

391. The MSM 2006-3AR Offering Documents disclosed that approximately 56.34% of the loans underlying plaintiff's MSM 2006-3AR Certificate were originated by the sponsor, MSMC; approximately 14.77% of the loans underlying plaintiff's MSM 2006-3AR Certificate were acquired

by the sponsor, MSMC, from loan originator Wachovia; approximately 13.28% of the loans underlying plaintiff's MSM 2006-3AR Certificate were acquired by the sponsor, MSMC, from other undisclosed loan originators; approximately 10.29% of the loans underlying plaintiff's MSM 2006-3AR Certificate were acquired by the sponsor, MSMC, from loan originator Wells Fargo; and approximately 5.31% of the loans underlying plaintiff's MSM 2006-3AR Certificate were acquired by the sponsor, MSMC, from loan originator Morgan Stanley Credit Corporation ("MSCC"). *See* MSM 2006-3AR Pros. Supp. at S-30.

392. With regard to all of the loans underlying the MSM 2006-3AR Certificates, the MSM 2006-3AR Offering Documents represented that they were originated in accordance with MSMC's underwriting guidelines. *See* MSM 2006-3AR Pros. Supp. at S-56. The MSM 2006-3AR Offering Documents represented that under MSMC's underwriting guidelines:

> Based on the data provided in the application and certain verification (if required), a determination is made by the original lender that the mortgagor's monthly income (if required to be stated) will be sufficient to enable the mortgagor to meet its monthly obligations on the mortgage loan and other expenses related to the property such as property taxes, utility costs, standard hazard insurance and other fixed obligations other than housing expenses. Generally, scheduled payments on a mortgage loan during the first year of its term plus taxes and insurance and all scheduled payments on obligations that extend beyond ten months equal no more than a specified percentage of the prospective mortgagor's gross income. The percentage applied varies on a case by case basis depending on a number of loan purchasing criteria, including the LTV ratio of the mortgage loan.

Id. The MSM 2006-3AR Offering Documents also represented that "[t]he adequacy of the mortgaged property as security for repayment of the related mortgage loan will generally have been determined by an appraisal in accordance with pre-established appraisal procedure guidelines for appraisals established by or acceptable to the originator." *Id.* at S-57. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that MSMC had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.1, *infra*.

b. Loan-to-Value Ratios

393. The MSM 2006-3AR Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the MSM 2006-3AR Certificate purchased by plaintiff. Specifically, the MSM 2006-3AR Offering Documents represented that only a very small percentage of the loans supporting plaintiff's MSM 2006-3AR Certificate had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's MSM 2006-3AR Certificate had LTV ratios over 100%.

394. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's MSM 2006-3AR Certificate, which reveals that the LTV ratio percentages stated in the MSM 2006-3AR Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the MSM 2006-3AR Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
1A3	61748HWP2	Group 1	2.02%	41.93%	0.00%	13.25%

c. Owner Occupancy Rates

395. The MSM 2006-3AR Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the MSM 2006-3AR Certificate purchased by plaintiff. Specifically, the MSM 2006-3AR Offering Documents represented that a large percentage of the loans supporting plaintiff's MSM 2006-3AR Certificate were issued to

borrowers that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that such borrowers would default on their loans.

396. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's MSM 2006-3AR Certificate, which reveals that the OOR percentages stated in the MSM 2006-3AR Offering Documents were materially false ***at the time they were made***. The following chart summarizes the OOR percentages stated in the MSM 2006-3AR Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
1A3	61748HWP2	Group 1	82.86%	74.59%	11.09%

d. Credit Ratings

397. The MSM 2006-3AR Offering Documents also represented that the MSM 2006-3AR Certificate purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the security was a very strong, safe investment with an extremely low probability of default. Specifically, the MSM 2006-3AR Offering Documents represented that plaintiff's MSM 2006-3AR Certificate had been assigned AAA/Aaa ratings – the highest, safest credit ratings available, which are in fact the same as, or even higher than, the current credit rating of U.S. Treasury debt.

398. These representations, however, were false and misleading when made. In truth, plaintiff's MSM 2006-3AR Certificate should not have received AAA/Aaa credit ratings, because it was ***not*** a safe, "investment grade" security with "a less than 1% probability of incurring defaults." Rather, as defendants were well aware, plaintiff's MSM 2006-3AR Certificate was an extremely risky, speculative grade "junk" bond, backed by low credit quality, risky loans. Indeed, one of the

primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's MSM 2006-3AR Certificate was because defendants had fed them falsified information regarding the MSM 2006-3AR Certificate's underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

399. The falsity of the credit ratings set forth in the MSM 2006-3AR Offering Documents is confirmed by subsequent events. Specifically, ***more than 23% of the loans supporting plaintiff's MSM 2006-3AR Certificate are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" MSM 2006-3AR Certificate is now rated at "junk" status. Clearly, plaintiff's MSM 2006-3AR Certificate was not the highly rated, "investment grade" security defendants represented it to be. The evidence supporting the falsity of the MSM 2006-3AR Certificate's credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Ratings**		**S&P's Ratings**	
				Initial	**Current**	**Initial**	**Current**
1A3	61748HWP2	Group 1	23.13%	Aaa	Caa3	AAA	NR

e. Transfer of Title

400. The MSM 2006-3AR Offering Documents also represented that the loans underlying the MSM 2006-3AR Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the MSM 2006-3AR Offering Documents stated that, "[p]ursuant to a pooling and servicing agreement . . . , on the Closing Date the Depositor will sell, transfer, assign, set over and otherwise convey without recourse to the Trustee, in its capacity as Trustee, all of its rights to the Mortgage Loans."

See MSM 2006-3AR Pros. Supp. at S-54. The MSM 2006-3AR Offering Documents also stated that:

> In connection with such transfer and assignment of the Mortgage Loans, the Depositor will deliver or cause to be delivered to the Trustee or its custodian, among other things, the original promissory note . . . (the "Mortgage Note") . . . , the original instrument creating a first lien on the related Mortgaged Property (the "Mortgage") . . . , an assignment in recordable form of the Mortgage, all recorded intervening assignments of the Mortgage and any modifications to such Mortgage Note and Mortgage . . . (collectively, the "Mortgage File").

Id. These statements were false and misleading. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

26. The SAST 2007-1 Certificates

401. The Saxon Asset Securities Trust 2007-1, Mortgage Loan Asset Backed Certificates, Series 2007-1 ("SAST 2007-1 Certificates") were issued pursuant to a Prospectus Supplement dated March 1, 2007. Morgan Stanley & Co., as the primary underwriter, played a critical role in the fraudulent structuring, offering and sale of the SAST 2007-1 Certificates.

402. Plaintiff purchased the following SAST 2007-1 Certificates:

Plaintiff	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Cayman	M2	80556BAG0	3/7/2007	$9,000,000	Morgan Stanley & Co.
Fortis Cayman	M1	80556BAF2	3/7/2007	$4,820,000	Morgan Stanley & Co.

403. The decision to purchase the above security was made by Fortis Cayman in direct reliance upon the SAST 2007-1 Offering Documents, including draft and/or final SAST 2007-1 Prospectus Supplements, all of which were distributed by the defendants associated with the SAST 2007-1 offering. Fortis Cayman's diligent investment processes are described in great detail in §VIII.B, *infra*.

a. Underwriting Guidelines

404. The SAST 2007-1 Offering Documents disclosed that 100% of the loans underlying plaintiff's SAST 2007-1 Certificates were originated or acquired by the sponsor and seller, Saxon Funding Management LLC, in accordance with Saxon Mortgage Inc.'s ("Saxon Mortgage") mortgage loan program. *See* SAST 2007-1 Pros. Supp. at S-34, S-46, Appendix A at S-A-2.

405. The SAST 2007-1 Offering Documents represented that all of the SAST 2007-1 Certificates' underlying loans "were originated in accordance with Saxon Mortgage['s] . . . mortgage loan program for non-confirming credits" and "were originated or acquired in accordance with the underwriting guidelines of the Seller." *See* SAST 2007-1 Pros. Supp. at S-34, S-48. The SAST 2007-1 Offering Documents also represented that the SAST 2007-1 Certificates' underlying loans were originated according to Saxon Mortgage's underwriting guidelines, which "aid in assessing: the borrower's ability and willingness to repay a loan according to its terms; and whether the value of the property securing the loan will allow the lender to recover its investment if a loan default occurs." *Id.* at S-49. The SAST 2007-1 Offering Documents further represented that the maximum allowable DTI ratio was 50% to 55%. *Id.* at S-51-S-52. Moreover, the SAST 2007-1 Offering Documents represented that "Saxon Mortgage's underwriting standards are applied in accordance with applicable federal and state laws and regulations and may permit the use of an insured automated valuation model ('AVM'), a qualified appraisal of the mortgaged property which conforms to Fannie Mae and Freddie Mac standards, or both," and that "[i]n most instances, either a second full appraisal or a desk or field review of the original appraisal will be required for loan amounts over $500,000." *Id.* at S-49. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Saxon Mortgage had completely abandoned its stated underwriting guidelines and was simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual

repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.7, *infra*.

b. Loan-to-Value Ratios

406. The SAST 2007-1 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the SAST 2007-1 Certificates purchased by plaintiff. Specifically, the SAST 2007-1 Offering Documents represented that less than 45% of the loans supporting plaintiff's SAST 2007-1 Certificates had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's SAST 2007-1 Certificates had LTV ratios over 100%.

407. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's SAST 2007-1 Certificates, which reveals that the LTV ratio percentages stated in the SAST 2007-1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the SAST 2007-1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
M2	80556BAG0	All	44.95%	64.45%	0.00%	22.44%
M1	80556BAF2	All	44.95%	64.45%	0.00%	22.44%

c. Owner Occupancy Rates

408. The SAST 2007-1 Offering Documents also made certain misrepresentations regarding the OOR percentages associated with the loans supporting the SAST 2007-1 Certificates purchased by plaintiff. Specifically, the SAST 2007-1 Offering Documents represented that a large percentage of the loans supporting plaintiff's SAST 2007-1 Certificates were issued to borrowers

that actually lived in the properties serving as collateral for their loans, significantly decreasing the likelihood that those borrowers would default on their loans.

409. Plaintiff, however, has performed an in-depth investigation of the actual borrowers, loans and properties underlying plaintiff's SAST 2007-1 Certificates, which reveals that the OOR percentages stated in the SAST 2007-1 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the Primary Residence Percentages stated in the SAST 2007-1 Offering Documents, and the actual percentages that should have been stated according to plaintiff's investigation:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Primary Residence Percentage Stated in the Offering Documents**	**Actual Primary Residence Percentage**	**Percent Overstatement of Actual Primary Residence Percentage**
M2	80556BAG0	All	93.78%	87.94%	6.65%
M1	80556BAF2	All	93.78%	87.94%	6.65%

d. Credit Ratings

410. The SAST 2007-1 Offering Documents also represented that the SAST 2007-1 Certificates purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the securities were very strong, safe investments with an extremely low probability of default. Specifically, the SAST 2007-1 Offering Documents represented that plaintiff's SAST 2007-1 Certificates had been assigned AA/Aa2 and AA+/Aa1 ratings – signifying they were extremely safe and stable securities.

411. These representations, however, were false and misleading when made. In truth, plaintiff's SAST 2007-1 Certificates should not have received AA/Aa2 and AA+/Aa1 credit ratings, because they were ***not*** safe, "investment grade" securities. Rather, as defendants were well aware, plaintiff's SAST 2007-1 Certificates were extremely risky, speculative grade "junk" bonds or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P

and Moody's had assigned such high ratings to plaintiff's SAST 2007-1 Certificates was because defendants had fed them falsified information regarding the SAST 2007-1 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false OOR percentages.

412. The falsity of the credit ratings set forth in the SAST 2007-1 Offering Documents is confirmed by subsequent events. Specifically, ***approximately 29% of the loans supporting plaintiff's SAST 2007-1 Certificates are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" SAST 2007-1 Certificates are now rated at "junk" status or below. Clearly, plaintiff's SAST 2007-1 Certificates were not the highly rated, "investment grade" securities defendants represented them to be. The evidence supporting the falsity of the SAST 2007-1 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	**CUSIP**	**Applicable Supporting Loan Group**	**Current Percentage of Outstanding Loan Balance in Default**	**Moody's Rating**		**S&P's Rating**	
				Initial	**Current**	**Initial**	**Current**
M2	80556BAG0	All	28.72%	Aa2	C	AA	D
M1	80556BAF2	All	28.72%	Aa1	C	AA+	CC

e. Transfer of Title

413. The SAST 2007-1 Offering Documents also represented that the loans underlying the SAST 2007-1 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the SAST 2007-1 Offering Documents stated that the depositor "will sell the mortgage loans to the issuing entity." *See* SAST 2007-1 Pros. Supp. at S-7. The SAST 2007-1 Offering Documents also stated that "the Depositor will be required to deliver a file with respect to each mortgage loan," including, among other things, "the original mortgage note endorsed in blank or to the order of the Trustee or a

custodian acting on behalf of the Trustee," "the original recorded security instrument," "each original recorded intervening assignment of the security instrument," and other related documents. *Id.* at S-104-S-105. The SAST 2007-1 Offering Documents further represented that, "[p]ursuant to the sale and servicing agreement, among the issuing entity, the related master servicer and servicer, the depositor, and the trustee, the depositor will, in turn, sell the mortgage loans to the trust, and the issuing entity will pledge to the trustee all the issuing entity's right, title and interest in the mortgage assets." *See* SAST 2007-1 Pros. at 47-48. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

27. The SAST 2007-2 Certificates

414. The Saxon Asset Securities Trust 2007-2, Mortgage Loan Asset Backed Certificates, Series 2007-2 ("SAST 2007-2 Certificates") were issued pursuant to a Prospectus Supplement dated April 25, 2007. Morgan Stanley & Co., as the primary underwriter, played a critical role in the fraudulent structuring, offering and sale of the SAST 2007-2 Certificates.

415. Plaintiff purchased the following SAST 2007-2 Certificates:

Plaintiff	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Purchased From
Fortis Bank	A2C	80556YAD7	4/18/2007	$35,000,000	Morgan Stanley & Co.
Fortis Cayman	M2	80556YAG0	4/19/2007	$2,500,000	Morgan Stanley & Co.
Fortis Cayman	M1	80556YAF2	4/19/2007	$2,000,000	Morgan Stanley & Co.
Fortis Cayman	M4	80556YAJ4	5/7/2007	$2,000,000	Morgan Stanley & Co.
Fortis Cayman	M3	80556YAH8	4/19/2007	$1,250,000	Morgan Stanley & Co.

416. The decisions to purchase the above securities were made by Fortis Bank and Fortis Cayman in direct reliance upon the SAST 2007-2 Offering Documents, including draft and/or final SAST 2007-2 Prospectus Supplements, all of which were distributed by the defendants associated

with the SAST 2007-2 offering. Fortis Bank's and Fortis Cayman's diligent investment processes are described in great detail in §§VIII.A and VIII.B, *infra*.

a. Underwriting Guidelines

417. The SAST 2007-2 Offering Documents disclosed that 100% of the SAST 2007-2 Certificates' underlying loans were originated or acquired by the sponsor and seller, Saxon Funding Management LLC, in accordance with Saxon Mortgage's mortgage loan program. *See* SAST 2007-2 Pros. Supp. at S-34, S-46, Appendix A at S-A-1.

418. The SAST 2007-2 Offering Documents represented that all of the SAST 2007-2 Certificates' underlying loans "were generally originated or acquired in accordance with the underwriting guidelines of the Seller." *Id.* at S-48. The SAST 2007-2 Offering Documents also represented that the SAST 2007-2 Certificates' underlying loans were originated or acquired according to Saxon Mortgage's underwriting guidelines, which "aid in assessing: the borrower's ability and willingness to repay a loan according to its terms; and whether the value of the property securing the loan will allow the lender to recover its investment if a loan default occurs." *Id.* at S-49. The SAST 2007-2 Offering Documents further represented that the maximum allowable DTI ratio was 50% to 55%. *Id.* at S-51-S-52. Moreover, the SAST 2007-2 Offering Documents represented that "Saxon Mortgage's underwriting standards are applied in accordance with applicable federal and state laws and regulations and may permit the use of an insured automated valuation model ('AVM'), a qualified appraisal of the mortgaged property which conforms to Fannie Mae and Freddie Mac standards, or both," and that "[i]n most instances, either a second full appraisal or a desk or field review of the original appraisal will be required for loan amounts over $500,000." *Id.* at S-49. As further detailed *infra*, these representations were false and misleading at the time they were made. Contrary to defendants' affirmative representations, the truth was that Saxon Mortgage had completely abandoned its stated underwriting guidelines and was simply seeking to originate as

many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. *See* §VI.A.7, *infra*.

b. Loan-to-Value Ratios

419. The SAST 2007-2 Offering Documents also made certain misrepresentations regarding the LTV ratios associated with the loans supporting the SAST 2007-2 Certificates purchased by plaintiff. Specifically, the SAST 2007-2 Offering Documents represented that less than half of the loans supporting plaintiff's SAST 2007-2 Certificates had LTV ratios over 80%, and that ***none*** of the loans supporting plaintiff's SAST 2007-2 Certificates had LTV ratios over 100%.

420. Plaintiff, however, has performed an industry-accepted historical valuation analysis on the actual loans underlying plaintiff's SAST 2007-2 Certificates, which reveals that the LTV ratio percentages stated in the SAST 2007-2 Offering Documents were materially false ***at the time they were made***. The following chart summarizes the LTV ratio percentages stated in the SAST 2007-2 Offering Documents, and the actual percentages that should have been stated according to plaintiff's industry-accepted analysis:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Stated Percentage of Loans Having LTV Ratios Over 80%	Actual Percentage of Loans Having LTV Ratios Over 80%	Stated Percentage of Loans Having LTV Ratios Over 100%	Actual Percentage of Loans Having LTV Ratios Over 100%
A2C	80556YAD7	All	46.02%	67.14%	0.00%	25.89%
M2	80556YAG0	All	46.02%	67.14%	0.00%	25.89%
M1	80556YAF2	All	46.02%	67.14%	0.00%	25.89%
M4	80556YAJ4	All	46.02%	67.14%	0.00%	25.89%
M3	80556YAH8	All	46.02%	67.14%	0.00%	25.89%

c. Credit Ratings

421. The SAST 2007-2 Offering Documents also represented that the SAST 2007-2 Certificates purchased by plaintiff had been assigned certain high "investment grade" credit ratings by S&P and Moody's, indicating that the securities were very strong, safe investments with an

extremely low probability of default. Specifically, the SAST 2007-2 Offering Documents represented that plaintiff's SAST 2007-2 A2C, M2, M1, M4, and M3 Certificates had been assigned AAA/Aaa, AA/Aa2, AA+/Aa1, A+/A1, and AA-/Aa3 ratings, respectively – all signifying extremely safe and stable securities.

422. These representations, however, were false and misleading when made. In truth, plaintiff's SAST 2007-2 Certificates should not have received AAA/Aaa, AA/Aa2, AA+/Aa1, A+/A1, and AA-/Aa3 credit ratings, because they were ***not*** safe, "investment grade" securities. Rather, as defendants were well aware, plaintiff's SAST 2007-2 Certificates were extremely risky, speculative grade "junk" bonds or worse, backed by low credit quality, extremely risky loans. Indeed, one of the primary reasons that S&P and Moody's had assigned such high ratings to plaintiff's SAST 2007-2 Certificates was because defendants had fed them falsified information regarding the SAST 2007-2 Certificates' underlying loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, and false borrower DTI ratios.

423. The falsity of the credit ratings set forth in the SAST 2007-2 Offering Documents is confirmed by subsequent events. Specifically, ***more than 25% of the loans supporting plaintiff's SAST 2007-2 Certificates are currently in default*** because they were made to borrowers who either could not afford them or never intended to repay them. Moreover, plaintiff's "investment grade" SAST 2007-2 Certificates are now rated at "junk" status or below. Clearly, plaintiff's SAST 2007-2 Certificates were not the highly rated, "investment grade" securities defendants represented them to be. The evidence supporting the falsity of the SAST 2007-2 Certificates' credit ratings is set forth in further detail in §VI.D, *infra*, and summarized by the following chart:

Tranche Purchased	CUSIP	Applicable Supporting Loan Group	Current Percentage of Outstanding Loan Balance in Default	Moody's Rating		S&P's Rating	
				Initial	Current	Initial	Current
A2C	80556YAD7	All	25.49%	Aaa	Ca	AAA	CCC
M2	80556YAG0	All	25.49%	Aa2	C	AA	D
M1	80556YAF2	All	25.49%	Aa1	C	AA+	D
M4	80556YAJ4	All	25.49%	A1	WR	A+	D
M3	80556YAH8	All	25.49%	Aa3	WR	AA-	D

d. Transfer of Title

424. The SAST 2007-2 Offering Documents also represented that the loans underlying the SAST 2007-2 Certificates would be timely transferred to the issuing trust, so that the trust would obtain good title to the mortgage loans comprising the pool for the offering. Specifically, the SAST 2007-2 Offering Documents stated that the depositor "will sell the mortgage loans to the issuing entity." *See* SAST 2007-2 Pros. Supp. at S-7. The SAST 2007-2 Offering Documents also stated that "the Depositor will be required to deliver a file with respect to each mortgage loan," including, among other things, "the original mortgage note endorsed in blank or to the order of the Trustee or a custodian acting on behalf of the Trustee," "the original recorded security instrument," "each original recorded intervening assignment of the security instrument," and other related documents. *Id.* at S-103-S-104. The SAST 2007-2 Offering Documents further represented that, "[p]ursuant to the sale and servicing agreement, among the issuing entity, the related master servicer and servicer, the depositor, and the trustee, the depositor will, in turn, sell the mortgage loans to the trust, and the issuing entity will pledge to the trustee all the issuing entity's right, title and interest in the mortgage assets." *See* SAST 2007-2 Pros. at 47-48. Defendants failed to legally and properly transfer the promissory notes and security instruments to the trusts. *See* §VI.E, *infra*.

VI. DEFENDANTS' STATEMENTS AND OMISSIONS WERE MATERIALLY FALSE AND MISLEADING

A. Defendants' Statements that the Loan Underwriting Guidelines Were Designed to Assess a Borrower's Ability to Repay the Loan and to Evaluate the Adequacy of the Property as Collateral for the Loan Were Materially False and Misleading

425. As set forth above in §V, the Offering Documents for each Morgan Stanley Offering represented that the underlying loans were originated pursuant to specific, prudent, underwriting guidelines, which the Offering Documents represented were generally intended to: (1) assess the borrowers' creditworthiness and/or ability to repay the loans; and/or (2) evaluate the adequacy of the underlying properties to serve as security for the loans.

426. These representations were highly material to plaintiff because they confirmed that, regardless of the technical guidelines being applied, the certificates' underlying loans were generally being originated on the basis of a valid determination that the borrower would be able to repay his or her loans and that the property serving as collateral would provide adequate security in the event of a default. In other words, these representations assured plaintiff that the loans supporting their investments were unlikely to default, and further, were unlikely to incur a loss in the unlikely event of default. As such, they were material to plaintiff's investment decision.

427. Unfortunately for plaintiff, however, defendants' material representations regarding the underwriting guidelines used to originate the certificates' underlying loans were false and misleading at the time defendants made them. As set forth immediately below, the originators of the certificates' underlying loans had, in fact, completely abandoned their stated underwriting guidelines and were simply seeking to originate as many loans as possible, ***without*** any regard for the borrowers' actual repayment ability or the true value and adequacy of the mortgaged properties to serve as collateral. Moreover, in acquiring the certificates' underlying loans, Morgan Stanley also abandoned its own loan acquisition guidelines.

1. The Loan Originators Had Systematically Abandoned the Underwriting Guidelines Set Forth in the Morgan Stanley Offering Documents

428. The representations in the Offering Documents for the Morgan Stanley Offerings concerning the loan originators' underwriting guidelines were false and misleading when made. In reality, the loan originators at issue herein were ***not*** originating loans in accordance with their stated underwriting guidelines and were ***not*** evaluating the borrowers' true repayment ability or assessing the actual value of the properties serving as collateral. Instead, during the relevant time period, 2004-2007 – when the loans underlying the offerings at issue herein were originated – the loan originators identified herein had abandoned their stated underwriting guidelines and were simply making loans to nearly anyone they could, without regard for the borrowers' repayment ability or the adequacy of the mortgaged properties as collateral. These lenders made loans as fast as they possibly could and ignored borrowers' true repayment ability because they knew defendants would purchase the loans ***regardless*** of whether the lenders had given any consideration to the borrowers' ability to repay, and ***regardless*** of whether the loans otherwise complied with the lenders' stated underwriting guidelines. This was the case because the demand for RMBS was skyrocketing during the relevant time period and defendants were making billions of dollars by satisfying that demand. Thus, defendants were scrambling to buy as many loans as they could, as fast as they could, so that they could quickly bundle the loans into RMBS offerings like those at issue herein, and sell them to unsuspecting investors like plaintiff.

429. Defendants knew that, contrary to their affirmative representations in the Offering Documents, the certificates' underlying loans had not been originated pursuant to underwriting guidelines that were designed to evaluate the borrowers' ability to repay or assess the adequacy of the mortgaged properties to serve as collateral. Defendants also knew, as a result, that the loans were not likely to be repaid. Defendants, however, failed to disclose any of this information.

Instead, they simply packaged the defective loans as quickly as they could, concealed them within the offerings, and passed the risk of their repayment on to plaintiff.

430. Contrary to their affirmative representations in the Offering Documents, defendants knew that the loan originators had, in fact, implemented loan underwriting policies and practices that were simply designed to extend mortgages to as many borrowers as possible, regardless of whether those borrowers could actually repay them. These policies and practices included, among other things:

- Falsifying borrowers' incomes and/or coaching borrowers to misstate their income on loan applications to qualify them for loans they could not afford to repay, while making it appear that the loans complied with the stated underwriting guidelines;

- Coaching borrowers to omit or understate debts and expenses on loan applications to qualify them for loans they could not afford to repay, while making it appear the loans complied with the stated underwriting guidelines;

- Steering borrowers to loans that exceeded their borrowing capacity;

- Approving borrowers based on "teaser rates" for loans, despite knowing that the borrowers would not be able to afford the fully indexed rates when the loan rates adjusted; and

- Approving non-qualifying borrowers for loans under "exceptions" to the originators' underwriting standards based on purported "compensating factors," when no such compensating factors ever existed.

431. Further, the loan originators and their agents had become so aggressive at improperly approving and funding mortgage loans that many of the loans at issue herein were made to borrowers who had either not submitted required documents or had falsely altered the required documentation. In many instances, required income/employment verifications were improperly performed because the lenders' clerical staff either did not have adequate verification skills or did not care to exercise such skills, and oftentimes verifications were provided by inappropriate contacts at a borrower's place of employment (*e.g.*, a friend of the borrower would complete the verification

instead of the human resources department at the borrower's employer). In this way, many suspect and false income verifications and loan applications were accepted by the originators at issue herein.

432. In addition, borrowers who submitted "stated income" loan applications were routinely approved on the basis of stated income levels that were inflated to extreme levels relative to their stated job titles, in order to give the appearance of compliance with stated underwriting guidelines. In many cases, the loan originators herein actually coached the borrowers to falsely inflate their stated incomes in order to qualify under the originators' underwriting guidelines. Inflation of stated income was so rampant that a study cited by Mortgage Asset Research Institute later found that almost ***all*** stated income loans exaggerated the borrower's actual income by 5% or more, ***and more than half overstated income by at least 50%***.

433. This type of income inflation was a direct result of the loan originators' abandonment of their stated underwriting guidelines and their complete disregard for borrowers' true repayment ability. For instance, many "stated income" borrowers were actually wage earners who could have supplied Internal Revenue Service ("IRS") Forms W-2 or other income-verifying documentation, but were not required to do so. Instead, they were steered to stated income loans by the lenders at issue herein, who then helped the borrowers "state" falsely inflated incomes. Originators also routinely issued loans without requiring the borrowers to execute IRS Forms 4506, which would have allowed the lenders to access such borrowers' tax returns from the IRS, because the originators simply did not want to know that the borrowers' true income levels were less than the income levels reported on the loan applications. In other cases, lenders removed documentation of borrowers' incomes from loan files, because such documentation revealed that the borrowers' stated incomes were falsely inflated. The falsification of income levels by the borrowers and the loan originators at issue herein was rampant.

434. The originators at issue herein also routinely violated their stated underwriting guidelines by using falsely inflated appraisals and other valuations – which, in turn, resulted in falsely understated LTV ratios – in order to approve loans that otherwise would have never been made. The U.S. Government's Financial Crisis Inquiry Commission ("FCIC") investigation confirmed that, during the time the loans underlying plaintiff's certificates were originated, the lenders at issue herein regularly pressured appraisers to falsely inflate their appraisals in order to meet or exceed the amount needed for the subject loans to be approved. This was especially true for loans, such as those at issue here, which were originated by lenders with the intention of being pooled and sold to defendants for eventual re-sale to investors like plaintiff, who would ultimately bear the risk of default.

435. The constant pressure appraisers routinely faced from originators such as those at issue herein was described by Jim Amorin, President of the Appraisal Institute, who stated in his April 23, 2009 FCIC testimony that, "***[i]n many cases, appraisers are ordered or severely pressured to doctor their reports and 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***.'" This complete lack of independence by appraisers was also noted by Alan Hummel, Chair of the Appraisal Institute, in his testimony before the U.S. Senate, where Hummel noted that the dynamic between lenders and appraisers created a "terrible conflict of interest" by which ***appraisers "experience[d] systemic problems with coercion" and were "ordered to doctor their reports" or else they would never "see work from those parties again" and were placed on "'exclusionary appraiser lists***.'" Testimony on "Legislative Proposals on Reforming Mortgage Practices" presented by Alan E. Hummel before the House Committee on Financial Services, at 5 (Oct. 24, 2007).

436. As a result of such pressures, appraisers routinely provided the originators at issue herein with falsely inflated appraisals that had no reasonable basis in fact, in direct contravention of the Offering Documents' false and misleading representations that the certificates' underlying loans had been originated pursuant to underwriting guidelines that required the lenders to evaluate the adequacy of the mortgaged properties to serve as collateral for the loans. Moreover, the falsely inflated property values also resulted in artificially understated LTV ratios, which caused the loans and certificates to appear to plaintiff to be of much higher credit quality and to be much less risky than they actually were.

437. Following below are detailed allegations demonstrating that the loan originators for the offerings at issue herein did not comply with the loan underwriting guidelines stated in the Offering Documents, thereby rendering the Offering Documents false and misleading. While the allegations concerning these originators cover most of the offerings, plaintiff has not provided such allegations for every originator at issue herein, in an attempt to streamline the allegations. Nonetheless, on information and belief, plaintiff alleges that ***all*** of the loan originators at issue herein engaged in similar conduct, and that such allegations are factually supported by both the investigations of the FCIC and the U.S. Senate, each of which concluded, after extensive investigations, that the breakdown in residential loan underwriting standards alleged herein was systemic in the lending industry during the relevant time period (2004-2007). *See* The Financial Crisis Inquiry Report ("FCIC Report") at 125 ("***Lending standards collapsed, and there was a significant failure of accountability and responsibility throughout each level of the lending system***."); Levin-Coburn Report at 12 (One of four major causes of worldwide financial collapse was that "***[l]enders introduced new levels of risk into the U.S. financial system by selling . . . home loans with . . . poor underwriting***."); *id.* at 50 ("***The Subcommittee investigation indicates that***"

there were "a host of financial institutions that knowingly originated, sold, and securitized billions of dollars in high risk, poor quality home loans.").

438. In fact, in 2005, federal examiners and agencies conducted a "confidential . . . study of mortgage practices at six companies that together had originated . . . almost half the national total" of mortgages in that year. ***The study "'showed a very rapid increase in the volume of these irresponsible, very risky loans***,'" according to Sabeth Siddique, then head of credit risk at the Federal Reserve Board's Division of Banking Supervision and Regulation. ***For "[a] large percentage of the[] loans" reviewed, "the underwriting standards . . . had deteriorated***." FCIC Report at 172.

439. In addition, on December 30, 2007, *The Kansas City Star* published an article titled "American Dreams Built on a Shaky Foundation of Subprime Loans," analyzing the Nation's mortgage meltdown and the reasons behind it. The news article painted a picture of systematic abandonment of underwriting guidelines by lenders during the relevant time period (2004-2007). Kurt Eggert, a law professor and member of the Federal Reserve's Consumer Advisory Panel was quoted: "'***Originators were making loans based on quantity rather than quality. . . . They made loans even when they didn't make sense from an underwriting standpoint***.'" The news article further stated: "Mark Duda, a research affiliate at Harvard University's Joint Center for Housing Studies, said that because ***brokers were so intent to quickly sell off loans to investors, they had little incentive to make sure the loans were suitable for borrowers. 'They were setting people up to fail***,' Duda said." A news article in the *San Diego Union-Tribune* on November 16, 2008 echoed these sentiments, stating: "Bankruptcy specialists say part of what led to the housing market collapse ***was systemic. Lenders set themselves up for problems by not requiring buyers to prove they could afford the loans*** . . . ."

440. At a March 11, 2009 hearing of the U.S. House of Representatives Subcommittee investigating the Nation's mortgage meltdown, Representative Jeb Hensarling from the State of Texas was even more blunt about the pervasive abandonment of underwriting guidelines: "***Mortgage fraud ran rampant for a decade, on the lenders' side and on the borrower side . . . . We know that mortgage fraud ran rampant*** . . . ."

441. The systemic abandonment of stated underwriting guidelines by all of the originators identified herein during the period 2004-2007, which included the originators' complete failure to evaluate borrowers' repayment ability, is further corroborated by the following allegations, which demonstrate that the abandonment of loan underwriting guidelines was rampant, pervasive and commonplace in the residential lending industry during 2004-2007.

2. The Offering Documents Misrepresented New Century's Underwriting Guidelines

442. New Century and NC Capital are two affiliated companies that originated loans for the offerings at issue herein. Both companies were subsidiaries of New Century Financial Corporation. New Century originated and/or acquired loans directly and sold them to the sponsors for the offerings at issue herein. For the offerings at issue herein identifying NC Capital as an originator, NC Capital acquired the loans from New Century and then transferred the loans to the sponsors for such offerings. Because New Century and NC Capital operated under the dominion and control of New Century Financial Corporation, and because the loans they contributed to the trusts at issue herein were all products of the same dubious loan origination practices, these originators are collectively referred to herein as "New Century."

443. As detailed *supra*, defendants' Offering Documents purported to describe the underwriting guidelines that were supposedly used by New Century in originating loans underlying plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these representations

were false and misleading at the time defendants made them. In truth, New Century had completely abandoned its stated underwriting guidelines and was routinely originating loans without any regard for the borrowers' true repayment ability or the actual adequacy of the mortgaged properties to serve as collateral.

444. The U.S. Senate investigation found that New Century "w[as] known for issuing poor quality subprime loans," but "[d]espite [its] reputation[] for poor quality loans, leading investment banks [such as the Morgan Stanley Defendants] continued to do business with [New Century] and helped [it and other lenders] sell or securitize hundreds of billions of dollars in home mortgages." Levin-Coburn Report at 21.

445. In 2007, New Century went into bankruptcy. An examiner was appointed by the bankruptcy court to investigate New Century and its collapse. After reviewing "a large volume of documents" from numerous sources, including New Century, and interviewing over 100 fact witnesses, the bankruptcy examiner filed a detailed report concerning New Century. *See* Final Report of Michael J. Missal, *In re: New Century TRS Holdings, Inc.*, No. 07-10416 (D. Del. Feb. 29, 2008) ("Examiner's Report") at 14, 16. The examiner confirmed that New Century routinely failed to follow its stated underwriting guidelines when originating loans during the relevant time period. The examiner, after his comprehensive fact-gathering process, "conclude[d] that New Century engaged in a number of significant improper and imprudent practices related to its loan originations." *Id.* at 2. Among other things, the examiner found that:

- "***New Century had a brazen obsession with increasing loan originations, without due regard to the risks associated with that business strategy . . . and trained mortgage brokers to originate New Century loans in the aptly named 'CloseMore University***.'" *Id.* at 3.

- "***The increasingly risky nature of New Century's loan originations created a ticking time bomb that detonated in 2007***." *Id.*

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

- ***A New Century employee had informed the company's senior management in 2005 that, under New Century's underwriting guidelines, "'we are unable to actually determine the borrowers' ability to afford a loan***.'" *Id.*

- "***New Century also made frequent [unmerited] exceptions to its underwriting guidelines for borrowers who might not otherwise qualify for a particular loan," so much so that a senior officer of New Century warned internally that the "'number one issue is exceptions to guidelines***.'" *Id.* at 3-4.

- ***New Century's Chief Credit Officer had noted as early as 2004 that New Century had "'no standard for loan quality***.'" *Id.* at 4. "'***[L]oan quality'" referred to "New Century's loan origination processes, which were supposed to ensure that New Century loans met its own internal underwriting guidelines . . . .***" *Id.* at 109.

- "***Instead of focusing on whether borrowers could meet their obligations under the terms of the mortgages, a number of members of [New Century's] Board of Directors and Senior Management told the Examiner that their predominant standard for loan quality was whether the loans New Century originated could be sold or securitized . . . .***" *Id.* at 4.

- ***A large number of New Century's loans did not meet its underwriting guidelines, suffering from defects such as "defective appraisals, incorrect credit reports and missing documentation***." *Id.* at 109.

- ***From 2003 forward, New Century's Quality Assurance and Internal Audit departments identified "significant flaws in New Century's loan origination processes***." *Id.* at 110.

- ***Notwithstanding all the foregoing facts, New Century's Board of Directors and Senior Management did little to nothing to remedy the company's abandonment of its stated underwriting guidelines***. *Id.*

446. The FCIC found that New Century "ignored early warnings that its own loan quality was deteriorating and stripped power from two risk-control departments that had noted the evidence." FCIC Report at 157. The FCIC reported that New Century's Quality Assurance staff "had found severe underwriting errors," while New Century's Internal Audit department had "identified numerous deficiencies in loan files," with seven out of nine reviews of the company's loan production department resulting in "'unsatisfactory'" ratings. *Id.* New Century's senior

management's reaction to the revelation of this information – establishing that New Century was not complying with its underwriting guidelines – was not what one would expect. Instead of making efforts designed to bring the company into compliance with its underwriting guidelines, New Century's management directed that the negative results be removed from the company's loan tracking performance, that the Quality Assurance department be dissolved, and that the Internal Audit department's budget be cut. *Id.*

447. New Century thereafter continued making numerous loans in violation of the company's stated underwriting guidelines, and then sold them to defendants. Indeed, New Century had a practice during the relevant time period whereby if a loan it attempted to sell to one securitizer was rejected because it was found not to comply with New Century's underwriting guidelines, New Century would put that defective loan into a subsequent pool of loans and sell it to another RMBS securitizer.

448. Patricia Lindsay ("Lindsay"), a former fraud specialist for New Century, told the FCIC that New Century's definition of a "good" loan changed during the relevant time period: "'The definition of a good loan changed from "one that pays" to "one that could be sold."'" FCIC Report at 105. The import of this statement was that New Century no longer cared if the loan met its stated underwriting guideline of determining whether the borrower could afford to repay the loan. Rather, the guideline was ignored, as it only mattered if defendants would purchase the loan. As will become more evident, defendants did buy huge quantities of such loans – even when the borrowers could not afford to repay them – and defendants did so knowingly. In fact, Lindsay pointed out that defendants, *i.e.*, "'Wall Street[,] was very hungry for our product. We had loans sold three months in advance, ***before they were even made at one point***.'" FCIC Report at 117. Given that defendants bought New Century's defective loans ***before*** they were even made, and thus could not possibly have determined whether the loans met the stated underwriting guidelines, it is evident that

defendants did not bother to determine whether the statements in the Offering Documents were true. In any event, as alleged more fully below, ***defendants did in fact know that the Offering Documents were false***.

449. Lindsay also confirmed to the FCIC that New Century subjected its appraisers to the pressures described above. Specifically, Lindsay stated that New Century's appraisers "fear[ed]" for their "livelihoods," and therefore cherry-picked data "that would help support the needed value rather than finding the best comparables to come up with the most accurate value." Written Testimony of Patricia Lindsay to the FCIC, April 7, 2010, at 5.

450. The Attorney General for the Commonwealth of Massachusetts ("Attorney General") similarly found that New Century originated numerous loans to borrowers who could not afford them, and which were illegal and not in compliance with New Century's purported underwriting guidelines. On June 24, 2010, the Attorney General announced a settlement with Morgan Stanley related to its purchase, financing and securitization of New Century loans. Morgan Stanley agreed to pay $102 million to settle charges that it assisted New Century in making and securitizing awful loans to borrowers who could not afford to repay them. In announcing the settlement, the Attorney General also released the findings of its investigation. The Attorney General found the following with respect to New Century's loans:

- The Attorney General found that ***New Century was making unfair and illegal loans to borrowers in Massachusetts who could not afford to repay them***. The Attorney General found that New Century unlawfully qualified borrowers for adjustable rate mortgages by using "teaser" rates, instead of using the "fully indexed rates," as required by law. By using teaser rates, New Century was able to calculate artificially low DTI ratios to qualify borrowers for loans they could not afford. The Attorney General found that if the borrowers' DTI ratios had been properly calculated, 41% of the loans Morgan Stanley purchased from New Century were to borrowers who could not afford them. Assurance of Discontinuance at 13, *In re: Morgan Stanley & Co. Incorporated*, No. 10-2538 (Mass. Super. Ct., Suffolk Cty. June 24, 2010).

- The Attorney General found that, by late 2005, New Century engaged in "***sloppy underwriting for many loans and stretching of underwriting guidelines to***

encompass or approve loans not written in accordance with the guidelines." *Id*. at 9.

- The Attorney General found that ***New Century successfully pressured Morgan Stanley into buying loans which both parties knew did not comply with the underwriting guidelines***. In March 2006, New Century complained to Morgan Stanley that it was rejecting too many loans and further pressured Morgan Stanley to buy more loans, by suggesting that it would begin shifting its business to other buyers if Morgan Stanley did not buy more loans. ***The very next month, in April 2006, Morgan Stanley's senior bankers purchased hundreds of New Century loans that Morgan Stanley's due diligence team had rejected***. In addition, "Morgan Stanley's due diligence teams began to be more responsive to New Century's desire to include additional [defective] loans in the purchase pools." *Id*. at 10.

- The Attorney General found ***that the majority of loans Morgan Stanley purchased from New Century and securitized in 2006 and 2007 did not comply with the underwriting guidelines***. According to the Attorney General, Clayton was hired to determine whether samples of New Century's loans "complied with the originator's underwriting guidelines and whether the loans were in compliance with applicable laws. When Clayton's examination uncovered loans that were in violation of guidelines or law in any respect, it graded the loans as 'exceptions.'" The Attorney General's investigation found that "[i]n Morgan Stanley's 2006-2007 New Century [loan] pools, the large majority of the loans reviewed by Clayton were identified by Clayton as having some type of exception. Most loans had multiple exceptions." ***The Attorney General further found that "[d]uring 2006 and 2007, Morgan Stanley waived exceptions on and purchased a large number of the loans found by Clayton to violate guidelines without sufficient compensating factors. In the last three quarters of 2006, Morgan Stanley waived more than half of all material exceptions found by Clayton . . . and purchased a substantial number of New Century loans found by Clayton to violate guidelines without sufficient compensating factors***." *Id*.

- The Attorney General also found that New Century "***loans with certain exceptions such as high DTI ratios or high LTV or CLTV ratios that were in excess of underwriting guidelines but within a tolerance found acceptable to Morgan Stanley were purchased without a review by Clayton for compensating factors***." *Id*.

- ***The Attorney General found that large numbers of New Century's loans had LTV ratios exceeding 100%, contrary to representations in the Offering Documents. In the Offering Documents***, defendants represented that pursuant to the underwriting guidelines, almost none of the loans had LTV ratios over 100%. However, the Attorney General found that "***31% of the New Century loans on properties checked via BPOs . . . and securitized by Morgan Stanley in 2006 and 2007 had []LTV ratios . . . that were greater than 100%***." *Id*. at 13.

- The Attorney General found that ***New Century's "stated income" loans contained falsely inflated borrower incomes***. The Attorney General found that "***[a]s early as***

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

- ***The Attorney General found that New Century's deficient and illegal lending practices went on unabated throughout the relevant time period***. The Attorney General found that “***[n]otwithstanding the problems identified above, Morgan Stanley continued to . . . purchase and securitize New Century's subprime mortgages through 2006 and the first half of 2007***.” *Id*. at 14.

451. New Century also made the U.S. Government's Office of the Comptroller of the Currency's (“OCC”) “Worst Ten in the Worst Ten” list of lenders, which identified the lenders with the highest number of foreclosures in the ten metropolitan areas with the highest foreclosure rates. ***Indeed, New Century was the worst of all the lenders – New Century's loans had more foreclosures than any other lenders' loans originated during the 2005-2007 time period***. This corroborates the fact that New Century did not determine whether borrowers could afford to repay the loans, thereby rendering the Offering Documents false and misleading.

3. The Offering Documents Misrepresented WMC's Underwriting Guidelines

452. As detailed *supra*, defendants' Offering Documents purported to describe the underwriting guidelines that were supposedly used by WMC in originating loans underlying plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these representations were false and misleading at the time defendants made them. In truth, WMC had completely abandoned its stated underwriting guidelines and was routinely originating loans without any regard for the borrowers' true repayment ability or the actual adequacy of the mortgaged properties to serve as collateral.

453. Like many other lenders during the relevant time period (2004-2007), WMC had a culture of deception and fraud as the basis of its lending operations. According to a news article

published by *iWatch News* in January 2012, which was based on interviews of eight former WMC employees, ***WMC's mantra was "Fraud pays***." The article described a company, during the period from 2004-2007 (the timeframe when the loans at issue herein were originated), that routinely disregarded its purported underwriting guidelines and instead "***embraced fraud as a tool for pushing through loans that borrowers couldn't afford***." Sales managers were making upwards of $1-$2 million a year and were incentivized to make as many loans as possible. ***Therefore, they ignored WMC's underwriting guidelines and "used falsified paperwork, bogus income documentation and other tricks to get loans approved and sold off to Wall Street investors."***

454. The *iWatch News* article quoted former WMC Compliance Manager Dave Riedel ("Riedel"), who worked at WMC from 2004 until it was closed by its parent company, General Electric, Inc. ("GE"), in 2007. Riedel was a quality control manager for WMC and was responsible for detecting fraud in the company's loan applications. Riedel started working for WMC immediately after it was acquired by GE in 2004. Riedel had previously worked as a real estate appraiser, loan underwriter, and most recently, as a mortgage fraud investigator manager for Washington Mutual Bank ("WaMu"), which similarly was engaged in fraudulent lending practices that ignored company lending guidelines.

455. Riedel supervised a team of people at WMC who watched over WMC's lending activities in Southern California. *iWatch News* reported that Riedel's team "found ***many examples of fraud committed by in-house staffers or the independent mortgage brokers who helped bring in customers to the lender. These included faking proofs of loan applicants' employment and faking verifications that would-be home buyers had been faithfully paying rent for years rather than, say, living with their parents." It also included "creating bogus W-2 tax forms," with some employees doing it the "old-school" way, by "cutting and pasting numbers from one photocopy to another," while the more modern fraudsters "had software on their computers that allowed them to create***

W-2s from scratch." Such widespread practices obviously did not comply with WMC's stated underwriting guidelines.

456. Riedel told *iWatch News* that in 2005 he investigated a WMC sales manager who oversaw hundreds of loan originations per month. Riedel's audit of these loans "found that many of the deals showed evidence of fraud or other defects such as missing documents." Riedel reported the discrepancies to a GE compliance officer. Rather than reprimanding the sales manager or disciplining him, according to Riedel, "'nothing changed.'" However, GE's/WMC's response to Riedel was swift and sure – Riedel was stripped of his title and staff and given nothing more to do. According to a former WMC executive, Riedel was thereafter "'branded as a whistleblower and not a team player. . . . They just marginalized him and he really didn't have anything to do'" subsequently.

457. Notwithstanding the above, in 2006 Riedel was trying to rebuild his career within WMC. He was involved in meetings with GE officials, trying to give GE a sense of how serious WMC's fraud problems were. Riedel recalled an audit of a group of loans during that time period that indicated 78% of the loans were fraudulent, containing either falsified incomes or employment. Moreover, Riedel was also working on a computer program designed to detect fraud in WMC's loans. Riedel told *iWatch News* that the program detected fraudulent loans but that WMC never regularly used the program. It was at a meeting about this computer program that Riedel attended where a WMC executive declared "Fraud pays."

458. Riedel's experience was not an isolated incident. The *iWatch News* article also quoted Gail Roman, a former WMC loan auditor in New York. ***iWatch News reported that Roman revealed that she and her colleagues "dug up persuasive evidence of inflated borrower incomes and other deceptions on loan applications," but that WMC's "[m]anagement ignored their reports and approved the loans anyway." Roman stated: "'They didn't want to hear what you found . . .***

[e]ven if you had enough documentation to show that there was fraud or questionable activity.'" Roman further reported that such fraudulent activity occurred the entire time she was at WMC during the period from 2004-2006.

459. Former WMC risk analyst Victor Argueta confirmed to *iWatch News* the complete abandonment of WMC's underwriting guidelines taking place at the company during the relevant time period. Argueta reported that ***one of WMC's top salespersons was never reprimanded or disciplined for using his computer to create fake documents to get borrowers' loans approved, even though this salesperson's fraudulent activities were well known within the company. Argueta stated the following concerning this salesperson's fabrication of documents: "'Bank Statements, W-2s, you name it, pretty much anything that goes into a file, . . . [a]nything to make the loan look better than what was the real story'" was created by this salesperson***.

460. Glen Pizzolorusso was interviewed for a National Public Radio broadcast. Pizzolorusso, a former WMC Area Sales Manager, discussed the horrible loans WMC made to borrowers: "'We looked at loans, these people didn't have a pot to piss in. . . . [T]hey could barely make the car payment, and now we're giving them a $300,000 to $400,000 house.'"

461. WMC's conduct led to having a Statement of Charges filed against it by the Washington State Department of Financial Institutions, Division of Consumer Services in 2008, *see* Statement of Charges, No. C-07-557-08-SC01, June 4, 2008, for deceptive and unfair lending practices. The Statement of Charges alleged that the Washington State regulator reviewed 86 loans extended by WMC and found that 76 of them were defective or otherwise violated Washington State law. WMC subsequently entered into a consent order with the State of Washington. In addition, according to the *Los Angeles Times*, the Federal Bureau of Investigation and the Department of Justice were investigating potentially criminal business practices at WMC. The government was investigating the very conduct at issue in this case: whether WMC used falsified paperwork,

overstated income and other tactics to push through questionable loans, according to sources cited by the *Los Angeles Times*. The probe appeared to be focused on whether senior managers condoned improper practices that enabled fraudulent loans to be sold to investors, according to the *Los Angeles Times*.

462. Further proof that WMC did not comply with the underwriting guidelines stated in the Offering Documents is found in a lawsuit against WMC and another originator, EquiFirst Corporation ("EquiFirst"). *See* Complaint, *MASTR Asset Backed Securities Trust 2006-HE3 v. WMC Mortgage Corp., et al.*, No. 11-CV-02542-PAM-TNV (D. Minn. Sept. 2, 2011). In that action, the trustee of an RMBS trust alleged that loans within that trust acquired from WMC and EquiFirst were fraudulent, did not comply with the stated underwriting guidelines, and did not determine properly whether the borrowers could afford to repay their loans. A sample of 200 loans within the trust were reviewed and it was found that 150 of those loans were either fraudulent, not originated pursuant to the underwriting guidelines, and/or did not have a proper determination made of whether the borrower could afford to repay the loan. ***In other words, a stunning 75% of the loans did not comply with the underwriting guidelines***. Given WMC's culture, as described above, such a statistic is understandable. The complaint in the action gave examples of loans that were made even though they did not comply with the underwriting guidelines. For example, WMC extended a loan to a borrower that claimed in his loan application that he earned $14,782 per month performing "account analysis," when in fact his tax returns showed he actually earned $1,548 per month driving a taxi. The borrower also did not disclose in his loan application thousands of dollars per month in debt payments that he had, thus concealing his true DTI ratio, which was in violation of the lending guidelines. He further misrepresented that he would occupy the property as his primary residence when in fact he did not. *Id.*, ¶24.

463. Another loan was extended by WMC to a borrower that claimed in her loan application that she made $9,200 per month as a billing manager when in fact she made only $2,405 per month as an optometric technician. This borrower also did not disclose all of her debts, thus concealing that she had an unacceptable DTI ratio. Her co-borrower also misrepresented his income and occupation to be $8,800 per month earned as a "grade check" rather than the actual $2,843 per month he earned as a laborer. *Id.*, ¶25. These examples are stunningly similar to the examples of borrowers alleged herein at §V.

464. In addition, the U.S. Government's Federal Housing Finance Agency ("FHFA") sued GE and others in 2011 concerning the ***exact*** type of conduct at issue herein. *See FHFA v. General Electric Company, et al.*, No. 652439/2011 (N.Y. Sup. Ct., N.Y. Cty.). In the *FHFA* action, FHFA sued GE and others for misrepresentations in offering documents for other RMBS offerings, and alleged, as here, that there were misrepresentations in the offering documents that WMC originated loans pursuant to underwriting guidelines designed to assess the borrowers' repayment ability and the adequacy of the properties as collateral for the loan. In the *FHFA* action, as here, it is alleged that WMC did not originate loans pursuant to such guidelines but instead abandoned its guidelines.

465. Further corroborating that WMC did not comply with its purported guidelines is the fact that WMC made the OCC's "Worst Ten in the Worst Ten" list of lenders with the most foreclosures on loans originated between 2005 and 2007. WMC was not the worst lender, but it was close – WMC was fourth "worst" of all lenders. Such high foreclosure rates further demonstrate that, contrary to defendants' representations, WMC was not actually attempting to determine whether borrowers could afford to repay their loans.

4. The Offering Documents Misrepresented Accredited's and Aames's Underwriting Guidelines

466. Aames was a California-based lender that originated loans for one of the offerings at issue herein. In May 2006, Aames was acquired by Accredited, another California-based lender that originated loans for several of the offerings at issue herein. As a result of these lenders' consolidation during the period at issue herein, plaintiff's allegations regarding both Accredited's and Aames's conduct are set forth in the same section.

467. As detailed *supra*, defendants' Offering Documents purported to describe the underwriting guidelines that were supposedly used by Accredited and Aames in originating loans underlying plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these representations were false and misleading at the time defendants made them. In truth, Accredited and Aames had completely abandoned their stated underwriting guidelines and were routinely originating loans without any regard for the borrowers' true repayment ability or the actual adequacy of the mortgaged properties to serve as collateral.

468. Accredited faced stiff competition from other lenders in a market that was rapidly expanding. As a result, in order to gain market share, the company deviated from its stated underwriting guidelines and disregarded both the borrowers' true repayment ability and the adequacy of the mortgaged properties to serve as collateral. According to a former Accredited Regional Manager, who worked for the company from 2003 through 2005, the constant refrain that he heard from Accredited's account executives was "if we don't do [the loan] somebody else will." He stated that the mortgage market "was screaming for new loans," and that Accredited's competitors, such as Argent and New Century, "were ready to fund the deal" no matter the quality of the loan. This created great pressures on Accredited's account executives to find ways to have their loans approved.

469. As a result, Accredited engaged in lending fraud. According to a former Senior Underwriter, who worked at Accredited's Austin, Texas branch from July 2006 through March 2007, the company originated numerous stated income loans with falsified incomes. According to the former Senior Underwriter, ***Accredited had a pattern and practice, on stated income loan applications, of falsely adjusting borrowers' incomes upward so that the borrowers would appear to qualify for the loans under the company's underwriting guidelines.*** This Senior Underwriter's manager routinely asked the Senior Underwriter to falsely increase borrowers' incomes. In fact, the Senior Underwriter's manager hosted a tour for visiting outside mortgage brokers at Accredited's Austin branch. The purpose of the tour was to attempt to have these independent mortgage brokers do business with Accredited, that is, to bring borrowers to Accredited. According to the former Senior Underwriter, during this tour, ***the Senior Underwriter's manager told the brokers that "unlike other originators [Accredited] will adjust stated incomes if necessary***." In addition, on another occasion, at a branch meeting for the operations team, the former Senior Underwriter recalled that a new employee had questioned the practice of allowing Accredited employees to adjust stated incomes. ***Accredited Operations Manager Will Shipp publicly responded: "It is common practice to change the stated income, but we will talk about that later***." The former Senior Underwriter found Accredited's practices involving stated income to be so objectionable that she resigned from the company.

470. The underwriting system at Accredited allowed loan processors, account executives and underwriters to adjust loan applications. Thus, according to the former Senior Underwriter, the underwriting system lacked any security feature, and therefore any employee was allowed to view and adjust loan applications. This left Accredited's loan applications open to manipulation, which frequently occurred. The Senior Underwriter recalled situations where she had rejected a loan only to later learn her rejection had been overridden and the loan approved.

471. According to a former Accredited Regional Manager, account executives would often bypass him and go over his head to seek approval for rejected loans and loans with unmet conditions from Lance Burt, Accredited's Divisional Manager for Southern California. The former Regional Manager stated that Burt had the final authority to approve loans and in fact "made the final approval of all loans." He described Burt's authority as "carte blanche" to approve any loans that he (Burt) wanted. The former Regional Manager joked that Burt had "the magic pen" and could make loans happen. He stated that Burt "routinely signed off" on rejected loans, approving them. The former Regional Manager also stated that he believed that Burt also approved non-compliant loans from high-producing independent mortgage brokers in order to maintain the business relationship between the company and the brokers. In other words, the decision to approve defective loans in these circumstances became a "business decision," according to the former Regional Manager.

472. The former Regional Manager recalled a situation where an Accredited account executive was terminated because the account executive had committed fraud with at least 10-15 funded loans. However, Accredited never reported the incident to law enforcement or anyone else, in order to avoid negative publicity and a potential decline in the company's stock price. He noted that the fired account executive began working at Countrywide within a few days.

473. According to a former Corporate Underwriter in Accredited's Orange, California, office, who worked for the company from 1995 until 2007, there were many problems in Accredited's loans. For example, the former Corporate Underwriter saw issues such as stated "income[s] [that were] out of whack" with the stated profession, and paystubs that appeared to be fraudulent. In other cases, she questioned whether or not the applicant actually "lived in the house" listed on the application as the current residence. ***This former Corporate Underwriter reported that Divisional Manager Burt also routinely overrode her rejections of loans, as he had done with the***

former Regional Manager. This former Corporate Underwriter stated that "[a] lot of loans" were approved by Burt which she believed lacked any credible basis for approval.

474. According to the former Corporate Underwriter, there were instances of account executives manipulating closing documents after loan approval with the assistance of document "drawers." She recalled an account executive "paying off" a document drawer "to turn the other way" while the account executive manipulated and falsified the loan documents on the document drawer's computer.

475. Further corroboration that Accredited routinely ignored its stated underwriting guidelines comes from a former Accredited Underwriter who worked in one of Accredited's Florida offices, from 2005 until 2006. The former Underwriter stated that, rather than following its stated underwriting guidelines, ***if the borrower came close to meeting the guidelines, Accredited approved the loan application***. Moreover, the former Underwriter reported that his Operations Manager regularly issued overrides for loans that did not comply with the underwriting guidelines, and approved them anyway.

476. A lawsuit filed against Accredited in late August 2007 confirms the accounts of the foregoing former Accredited employees that Accredited ignored its underwriting guidelines. In late August 2007, shareholders of Accredited's parent company, Accredited Home Lenders Holding Co., filed a complaint against the company and its officers and directors, alleging that they committed securities fraud by lying about the company's financial condition. *See* Corrected Consolidated Class Action Complaint, *Atlas v. Accredited Home Lenders Holding Co., et al.*, No. 07-cv-488-H (RBB) (S.D. Cal. Aug. 24, 2007) (the "*Atlas* Complaint"). In the *Atlas* Complaint, the plaintiffs cited to reports from at least 12 former Accredited and Aames employees. Those former employees reported a pervasive and systematic disregard by Accredited of its underwriting guidelines, including the following:

- ***According to a former Corporate Underwriter who worked at Accredited between June 2004 and March 2005, "the Company approved risky loans that did not comply with its underwriting guidelines"; his rejections of loans "were frequently overridden by managers on the sales side of the business"; and his overridden loan rejections involved loans containing improper "'straw borrower[s],'" employment that could not be verified, inflated incomes, and violations of Accredited's DTI, credit score, LTV and employment history requirements***. *Id*., ¶¶48-49.

- ***According to a former Accredited employee from 1998 until December 2006, pressure to approve loans, regardless of quality, was especially bad from mid-2005 until the time she left the company at the end of 2006, and Accredited's growing issues with problem loans was due to management's overrides of the underwriting and appraisal processes***. *Id*., ¶¶50-51.

- ***According to a former Corporate Underwriter at Accredited from August 2003 until February 2006, her decisions to reject loans were constantly overridden by management, and such overrides "were rampant***." *Id*., ¶¶56-57.

- ***According to a former Accredited Regional Manager who worked at the company throughout 2005, "the Company's underwriting guidelines were frequently overridden by senior management***." *Id*., ¶¶58-60.

- ***According to other former Accredited employees who worked at the company during the relevant time period (2004-2007), management frequently overrode underwriters' decisions to reject loans that did not comply with the underwriting guidelines. According to one underwriter, when underwriters challenged the overrides they were told by management: ""You have to go forward with it.'" If you made a big stink about it, they would raise their eyebrows and say "'Do you want a job?'"" Other former employees recounted loan applications that were approved with inflated incomes, inflated appraisals, and suspicious verifications of employment***. *Id*., ¶67.

- ***Several former Accredited employees who worked with appraisals reported that the company management overrode licensed appraisers' decisions and approved many loans based on inflated appraisals***. *Id*., ¶77.

- ***A former Aames and Accredited employee reported that both Aames and Accredited frequently made exceptions to their underwriting guidelines. According to this former employee, while Aames's violations of the underwriting guidelines were limited to one exception per loan, at Accredited it was common to see multiple exceptions per loan***. *Id*., ¶83.

477. Accredited ultimately paid $22 million to settle the shareholders' lawsuit in 2010.

5. The Offering Documents Misrepresented Fremont's Underwriting Guidelines

478. As detailed *supra*, defendants' Offering Documents purported to describe the underwriting guidelines that were supposedly used by Fremont in originating loans underlying plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these representations were false and misleading at the time defendants made them. In truth, Fremont had completely abandoned its stated underwriting guidelines and was routinely originating loans without any regard for the borrowers' true repayment ability or the actual adequacy of the mortgaged properties to serve as collateral.

479. The U.S. Senate investigation found that Fremont "became known inside the industry for issuing high risk, poor quality loans yet during the years leading up to the financial crisis [Fremont was] able to securitize and sell [its] home loans with few problems." Levin-Coburn Report at 21. Moreover, "[d]espite [Fremont's] reputation[] for poor quality loans, leading investment banks [such as the Morgan Stanley Defendants] continued to do business with [Fremont] and helped [it] sell or securitize hundreds of billions of dollars in home mortgages." *Id.*

480. In March 2007, the Federal Deposit Insurance Corporation ("FDIC") issued a "cease and desist" order against Fremont (the "FDIC March 7 Order"), requiring the lender to end its subprime loan business, due to "'unsafe and unsound banking practices and violations of law,'" including operating with "'a large volume of poor quality loans'"; "'unsatisfactory lending practices'"; "'excessive risk'"; and "inadequate capital." Levin-Coburn Report at 238; FDIC March 7 Order at 2-3. The FDIC determined that Fremont lacked effective risk management practices, lacked adequate mortgage underwriting criteria, and was "'approving loans with loan to-value ratios approaching or exceeding 100 percent of the value of the collateral.'" Levin-Coburn Report at 238; FDIC March 7 Order at 4. In addition, the FDIC concluded that Fremont had been engaging in

unsatisfactory lending practices by "***marketing and extending [ARM] products to subprime borrowers in an unsafe and unsound manner" that "greatly increase[d] the risk that borrowers will default***." FDIC March 7 Order at 3. The FDIC further found that Fremont was "***approving borrowers without considering appropriate documentation and/or verification of their income . . . [and] making mortgage loans without adequately considering the borrower's ability to repay the mortgage according to its terms***." *Id.* at 3-4.

481. In addition, on October 4, 2007, the Massachusetts Attorney General brought an enforcement action against Fremont. The action was for "unfair and deceptive business conduct" "on a broad scale" against Fremont. Complaint, *Commonwealth of Mass. v. Fremont Investment & Loan, et al.*, No. SUCV2007-4373 (Mass. Super. Ct., Suffolk Cty. Oct. 4, 2007) (the "*Fremont* Complaint"). According to the *Fremont* Complaint, ***Fremont (a) "approve[ed] borrowers without considering or verifying the relevant documentation related to the borrower's credit qualifications, including the borrower's income"; (b) "approv[ed] borrowers for loans with inadequate debt-to-income analyses that do not properly consider the borrowers' ability to meet their overall level of indebtedness and common housing expenses"; (c) "failed to meaningfully account for [ARM] payment adjustments in approving and selling loans"; (d) "approved borrowers for these ARM loans based only on the initial fixed 'teaser' rate, without regard for borrowers' ability to pay after the initial two year period"; (e) "consistently failed to monitor or supervise brokers' practices or to independently verify the information provided to Fremont by brokers"; and (f) "ma[de] loans based on information that Fremont knew or should have known was inaccurate or false, including, but not limited to, borrowers' income, property appraisals, and credit scores***." *Fremont* Complaint, ¶¶24-25, 35, 139.

482. On December 9, 2008, a Massachusetts appeals court affirmed the lower court's order enjoining Fremont from foreclosing on thousands of its loans issued to Massachusetts residents. The

court found that the ***factual record*** supported the lower court's conclusions that "***Fremont made no effort to determine whether borrowers could 'make the scheduled payments under the terms of the loan***,'" and that "***Fremont knew or should have known that [its lending practices and loan terms] would operate in concert essentially to guarantee that the borrower would be unable to pay and default would follow***." *Commonwealth v. Fremont Inv. & Loan*, 897 N.E.2d 548, 556, 558 (Mass. 2008). The terms of the preliminary injunction were made permanent by a settlement reached on June 9, 2009.

483. In addition, the FCIC found that Fremont had a company policy whereby any loan that was rejected by a securitizer because it did not comply with Fremont's underwriting guidelines was nonetheless put into a subsequent pool of Fremont loans and offered for sale to another securitizer. These defective loans remained in the pools offered for sale until they were either sold or were rejected by securitizers at least three times. D. Keith Johnson, the former president of Clayton, the firm that sampled such loan pools for defendants, called this practice the "'three strikes, you're out rule.'" FCIC Report at 168.

484. In another instance, the FCIC reported on the case of a real estate appraiser in Bakersfield, California, who had discovered multiple instances of lending fraud. When he contacted a quality assurance officer at Fremont to inform them of the fraudulent activity he was told: "'Don't put your nose where it doesn't belong.'" *Id.* at 14-15.

485. The findings of the Levin-Coburn Report, the FDIC, the FCIC, and the Commonwealth of Massachusetts are confirmed by statements from former Fremont employees in several complaints alleging that Fremont disregarded its established underwriting guidelines in order to increase the volume of its loan originations. For example, in *Teachers Insurance & Annuity Ass'n v. Deutsche Bank AG, et al.*, No. 11-cv-6141 (S.D.N.Y. Aug. 1, 2011) (the "*TIAA* Complaint"), the plaintiffs cited statements from a senior underwriter for Fremont from September 2002 to August

2007. This former underwriter reported that Fremont engaged in unsatisfactory lending practices, and that its primary concern was increasing the volume of mortgage loans that it issued and sold to Wall Street, ***regardless of the borrower's ability to repay***. The senior underwriter further revealed that exceptions to Fremont's stated underwriting guidelines were a "'standing joke'" and that "'the exception was the rule.'" *TIAA* Complaint, ¶98 n.8. Another former underwriter at Fremont's Anaheim, California office from May 2005 until March 2007, stated exceptions to the underwriting guidelines "'were done on a daily basis'" and estimated that 30% of Fremont's loans contained some sort of exception. *Id.* Many of the loans in the offerings at issue herein were originated by Fremont in California. The *TIAA* Complaint also cites to another Fremont employee who stated that outright fraud occurred at Fremont from at least 2002-2007, including instances where Fremont brokers would cut and paste bank statements and forge letters of reference for prospective borrowers. According to this witness, ***the fraud was so blatant that "'you ha[d] to be brain dead if you didn't see it***,'" and that ***Fremont was "'just giv[ing] anyone a loan who wants one***.'" *Id.*, ¶¶5, 99. In addition, in another case, *Dexia SA/NV, et al. v. Deutsche Bank AG, et al.*, No. 11-05672 (S.D.N.Y.), these same former Fremont employees are cited to support other claims that Fremont did not comply with its stated underwriting guidelines.

486. Fremont also made the OCC's "Worst Ten in the Worst Ten" list of originators with the most foreclosures. Fremont had the fifth-highest number of foreclosures on loans originated between 2005 and 2007. This corroborates that Fremont had abandoned its purported underwriting guidelines, which were supposedly designed to evaluate borrowers' repayment ability.

487. Indeed, the U.S. Senate confirmed as much in its report: "[L]enders [such as Fremont] issued billions of dollars in high risk, poor quality home loans." Levin-Coburn Report at 239.

6. The Offering Documents Misrepresented First NLC's Underwriting Guidelines

488. As detailed *supra*, defendants' Offering Documents purported to describe the underwriting guidelines that were supposedly used by First NLC in originating loans underlying plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these representations were false and misleading at the time defendants made them. In truth, First NLC had completely abandoned its stated underwriting guidelines and was routinely originating loans without any regard for the borrowers' true repayment ability or the actual adequacy of the mortgaged properties to serve as collateral.

489. The fact that First NLC did ***not*** comply with its stated underwriting guidelines was confirmed by a former Quality Control Supervisor with First NLC from November 2004 through April 2007, who worked in First NLC's Florida headquarters and ran the company's quality control department, which was responsible for auditing samples of loans that had already been closed and funded by First NLC throughout the United States. In this role, this former First NLC employee saw many "underwriting errors" in the originated loans, including routinely finding "a lot of fraud in the loan files." Specifically, the fraud included numerous instances of appraisers who had been "paid off to bring in the value" of a property higher than it actually merited, problems verifying a borrower's employment, numerous stated income claims that were clearly unverified and insupportable by the background information available about the borrower, and discrepancies related to borrowers' credit and assets. This former employee routinely found falsified IRS Forms W-2, pay stubs and bank statements. Despite these numerous instances of fraud, the witness stated that First NLC operations managers would grant exceptions to these loan applications. ***This former employee stated that by the time she found problems with the loans, it was too late, and nothing was done to prevent the loans being sold to investors***. First NLC's Loan Processors handling the pre-funding

audit were under intense pressure from the company's Sales Managers at the wholesale branches to get the loans funded.

490. First NLC's improper and fraudulent lending practices were also documented in the complaint filed in the action titled *Allstate Ins. Co., et al. v. Morgan Stanley, et al.*, No. 651840/2011 (N.Y. Sup. Ct., N.Y. Cty. July 5, 2011) (the "*Allstate* Complaint"). The complaint in that case quotes former First NLC employees as stating:

- According to a former underwriter for First NLC in Deerfield Beach, Florida, from April 2004 until November 2006, "'every loan had a problem with it. Every loan seemed to have an exception on it.'" Between half and three-quarters of the mortgage loans that were initially denied by the former underwriter and other First NLC underwriters were subsequently overruled and approved by First NLC management because the loans could be sold to purchasers such as defendants. This former underwriter also stated that if a prospective borrower's tax return appeared to be fraudulent and the underwriter sought to request further documentation to verify the submitted information, First NLC account representatives would "'scream bloody murder.'" A loan application with this type of questionable documentation would still be approved by First NLC's underwriting manager or Vice President of Operations/Underwriting, who decided no further due diligence was necessary. In regards to verifying the borrower's ability to repay the mortgage loan, this underwriter stated they were told by First NLC management that "'[w]e don't need this, so just don't dig,'" and that verifying borrowers' income was discouraged, as it was considered "'digging for problems.'"

- According to another former senior underwriter for First NLC in Deerfield Beach, Florida, from August 2004 until September 2005, First NLC made numerous unwarranted exceptions to its stated underwriting guidelines, including appraisal exceptions and income exceptions. Instead of denying the loan in accordance with First NLC's stated underwriting guidelines, according to the former senior underwriter, employees at First NLC would institute "'premium pricing'" and charge the prospective borrower a higher price to compensate for "'overlook[ing] things.'" This senior underwriter believed that 80% of First NLC's stated income loans contained inflated borrower incomes.

- According to another First NLC senior underwriter in Anaheim, California, from September 2005 to December 2007, and whose unit was overseen by Charles Bryson, the former Chief Financial Officer of First NLC, the underwriter once alerted Bryson that a stated loan file lacked a signed income statement. Bryson directed the underwriter to "make one up."

Allstate Complaint, ¶¶108-111.

7. The Offering Documents Misrepresented Saxon Mortgage's Underwriting Guidelines

491. Saxon Mortgage is an affiliate of Saxon Funding Management LLC and a wholly-owned subsidiary of Saxon Capital, LLC, which is in turn a wholly-owned subsidiary of defendant MSMC and an indirect, wholly-owned subsidiary of defendant Morgan Stanley. Given that the Morgan Stanley Defendants owned Saxon Mortgage during the relevant time period herein, they were responsible for establishing and controlling the underwriting guidelines (or lack thereof) at Saxon Mortgage during the relevant time period herein.

492. As detailed *supra*, defendants' Offering Documents purported to describe the underwriting guidelines that were supposedly used by Saxon Mortgage in originating loans underlying plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these representations were false and misleading at the time defendants made them. In truth, Saxon Mortgage had completely abandoned its stated underwriting guidelines and was routinely originating loans without any regard for the borrowers' true repayment ability or the actual adequacy of the mortgaged properties to serve as collateral.

493. According to a former Saxon Mortgage employee, who worked as both an Underwriter and an Assistant Vice President from 1996 until October 2007, Saxon Mortgage's main objective was simply to originate whatever kind of loans Wall Street had an appetite for. According to this witness, that objective led Saxon Mortgage to originate more and more stated income loans during his tenure with the lender.

494. According to the former Underwriter and Assistant Vice President, underwriters at Saxon Mortgage routinely expressed concern that their borrowers would not be able to repay their loans, but were prevented from "go[ing] deeper" due to the limited documentation available to them and the excessive pressures they faced from Saxon Mortgage's sales department. ***As a result, this***

former employee stated that the underwriters at Saxon Mortgage were nothing more than mere "rubber stampers."

495. Moreover, according to this same former Saxon Mortgage employee, even when an underwriter did decline a loan, a member of the sales department would typically get involved and request an exception to the guidelines. According to the former Underwriter and Assistant Vice President, this was a problem because the sales personnel lacked knowledge and familiarity with Saxon Mortgage's underwriting guidelines. Yet, such exceptions were routinely granted. In addition, according to this same former employee, members of the sales department regularly made efforts to keep income documentation out of the files they submitted to underwriting, in order to avoid having applications declined, even where such income information was already in their possession and clearly indicative of the borrower's ability – or inability – to repay the loan.

496. Defendants' representations that Saxon Mortgage's underwriting guidelines prohibited the making of any loan with an LTV ratio in excess of 100% were also false. Indeed, as set forth *supra*, for each of the two offerings in which Saxon Mortgage served as an originator – the SAST 2007-1 and SAST 2007-2 offerings – ***more than 20% of the loans underlying plaintiff's certificates had LTV ratios in excess of 100%***. *See* §§V.B.26-V.B.27, *supra*. In other words, over 20% of the loans supporting plaintiff's certificates in those offerings were "under water" on the day they were originated, guaranteeing a loss when the loans defaulted – which they did in large numbers shortly after origination. ***This high number of very risky loans with LTV ratios over 100% demonstrates that Saxon Mortgage ignored its stated underwriting guideline of not lending to any borrowers where the loan amount exceed the value of the property***. It also demonstrates that Saxon Mortgage was systematically using falsely inflated appraisals, also in violation of its supposed underwriting guideline of assessing whether the property was adequate collateral for the loan, in order to falsely qualify loans that otherwise would not have met the LTV ratio guidelines.

497. Defendants' representations that Saxon Mortgage's underwriting guidelines prohibited the making of any loan with a DTI ratio in excess of 55% were also false and misleading when made, for the following reasons. Indeed, as set forth *infra*, Saxon Mortgage routinely made loans to borrowers with DTI ratios far in excess of that limit. *See, e.g.*, §§VI.A.12.n and VI.A.12.o, *infra* (borrowers in SAST 2007-1 and SAST 2007-2 offerings with DTI ratios over 183% and 684%, respectively – far in excess of 55%). ***The borrower examples cited below unequivocally show that Saxon Mortgage made loans to persons who clearly and obviously could not afford to repay the loans, a violation of the most basic underwriting guideline***. *See id.* (loans made to borrowers whose debts far exceeded their incomes, making them clearly unable to repay the loans, and resulting in the borrowers' bankruptcies). Indeed, Saxon Mortgage made many loans to borrowers who could not afford to repay them, as evidenced by the ***high default rates*** for the loans underlying the offerings in which Saxon Mortgage served as an originator. *See* §§V.B.26.d and V.B.27.c, *supra* (SAST 2007-1 and SAST 2007-2 offerings both have loan default rates of at least 25%).

498. Given the Morgan Stanley Defendants' penchant for purchasing and securitizing obviously defective loans (*see* §VI.A.2, *supra*, describing Morgan Stanley's practice of intentionally purchasing and securitizing defective loans from New Century), it is no surprise that Morgan Stanley's captive originator, Saxon Mortgage, originated numerous loans that did not comply with its stated underwriting guidelines.

8. The Offering Documents Misrepresented MILA's Underwriting Guidelines

499. As detailed *supra*, defendants' Offering Documents purported to describe the underwriting guidelines that were supposedly used by MILA in originating loans underlying plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these representations were false and misleading at the time defendants made them. In truth, MILA had completely

abandoned its stated underwriting guidelines and was routinely originating loans without any regard for the borrowers' true repayment ability or the actual adequacy of the mortgaged properties to serve as collateral.

500. MILA was a wholesale mortgage lender that focused its business on subprime lending. MILA originated loans for sale to the secondary market, to investment banks like the defendants who used the loans for their RMBS securitizations. According to a former MILA Senior Business Development Manager, who worked at the company from 2001 until it closed in April 2007, the Morgan Stanley Defendants purchased loans from MILA.

501. Contrary to MILA's stated underwriting guidelines, MILA's focus was not on determining whether borrowers could afford to repay their loans, or whether the property had sufficient value to serve as collateral for the loan. Instead, MILA's main criterion was "whether [the loan] could be sold" to investment banks such as defendants, according to the former Senior Business Development Manager. As a result, loans were being made to persons who could not afford to repay them. According to this former MILA employee, "you could tell by the law of averages that some of these borrowers did not have a pot to piss in."

502. This former MILA Senior Business Development Manager also reported that, with respect to MILA's stated income loan programs, the loans MILA made were "foreclosures waiting to happen." This former employee revealed that stated income loans presented the opportunity for borrowers and brokers to manipulate, or "work[] the ratios," such as the borrower's DTI ratio, by "lying about the [borrower's] income."

503. In addition, notwithstanding the fact that the Offering Documents represented that no MILA loans would have an LTV ratio in excess of 100%, MILA offered loans with 125% LTV ratios according to the former Senior Business Development Manager. Predictably, when the loans "went bad," the holders of the loans "lost big," according to this former employee.

504. MILA also granted "exceptions" to its purported underwriting guidelines, approving loans when there in fact were no real or legitimate exceptions. The former MILA Senior Business Development Manager revealed that at times senior MILA underwriters overruled junior underwriters' rejections of loan applications, granting exceptions and approving the loans, for no better reason than MILA needed to meet loan origination levels/commitments to buyers of its loans.

9. The Offering Documents Misrepresented Option One's Underwriting Guidelines

505. As detailed *supra*, defendants' Offering Documents purported to describe the underwriting guidelines that were supposedly used by Option One in originating loans underlying plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these representations were false and misleading at the time defendants made them. In truth, Option One had completely abandoned its stated underwriting guidelines and was routinely originating loans without any regard for the borrowers' true repayment ability or the actual adequacy of the mortgaged properties to serve as collateral.

506. In June 2008, the Massachusetts Attorney General sued Option One and others, alleging that, beginning in 2004, Option One "increasingly disregarded underwriting standards, created incentives for loan officers and brokers to disregard the interests of the borrowers and steer them into high-cost loans, and originated thousands of loans that [Option One] knew or should have known the borrowers would be unable to pay, all in an effort to increase loan origination volume so as to profit from the practice of packaging and selling the vast majority of [Option One's] residential subprime loans to the secondary market." *See* Complaint, ¶4, *Commonwealth of Massachusetts v. H&R Block, Inc., et al.*, No. SUCV2008-2474 (Mass. Super. Ct., Suffolk Cty. June 3, 2008). The Massachusetts Attorney General alleged that Option One's agents and brokers "frequently overstated an applicant's income and/or ability to pay, and inflated the appraised value of the applicant's

home," and that Option One "avoided implementing reasonable measures that would have prevented or limited these fraudulent practices." *Id.*, ¶8. As a result, Option One's "origination policies . . . employed from 2004 through 2007 have resulted in an explosion of foreclosures." *Id.*, ¶10.

507. In November 2008, the Suffolk County Superior court granted a preliminary injunction in favor of the Massachusetts Attorney General, finding that "certain mortgage loans [issued by Option One] were 'presumptively unfair,' because they posed an unreasonable risk of default and foreclosure." On October 29, 2009, the Appeals Court of Massachusetts affirmed the preliminary injunction. *See Commonwealth v. Option One Mortg. Co.*, No. 09-P-134, 2009 Mass. App. LEXIS 1330 (Mass. App. Ct. Oct. 29, 2009).

508. On August 9, 2011, the Massachusetts Attorney General announced that H&R Block, Inc., Option One's parent company, had agreed to settle the suit for $125 million. *See* Press Release, Massachusetts Attorney General, "H&R BLOCK Mortgage Company Will Provide $125 Million in Loan Modifications and Restitutions" (Aug. 9, 2011). Media reports noted that the suit was being settled amidst ongoing discussions among multiple states' attorneys general, federal authorities, and five major mortgage servicers, aimed at resolving investigations of the lenders' foreclosure and mortgage-servicing practices. The Massachusetts Attorney General released a statement saying that no settlement should include a release for conduct relating to the lenders' packaging of mortgages into securitizations. *See, e.g.*, David McLaughlin, *H&R Block, Massachusetts Reach $125 Million Accord in State Mortgage Suit*, Bloomberg, Aug. 9, 2011.

509. Similarly, in a lawsuit pending in the New York Supreme Court, former employees of Option One have provided information establishing that Option One did not comply with its stated underwriting guidelines. *See* Complaint, *Stichting Pensioenfonds ABP v. ACE Securities Corp, et al.*, No. 652460/2011 (N.Y. Sup. Ct., N.Y. Cty. Sept. 7, 2011). In that action, alleging

misrepresentations in offering documents for RMBS like the instant action does, former Option One employees are the sources for the following allegations:

- ***A former Option One underwriter in Atlanta, Georgia, stated that for loans that were rejected by underwriters, the loans were escalated to the branch manager, who would overlook "red flags" and approve the loans at least 50% of the time. The same underwriter stated that loan applicants could lie about their incomes and that this false information was overlooked and the loans approved***. *Id*., ¶152.

- ***An Option One underwriter in Marietta, Georgia, reported that stated income loans were approved even when the stated income was manifestly implausible***. *Id*., ¶153.

- ***An Option One underwriter employed in Hawaii from November 2004 to January 2006 reported that the majority of stated income loans there had falsely stated incomes but he felt pressured to approve them anyway***. *Id*.

- ***An Option One staff review appraiser stated that during 2004-2007 he viewed Option One's appraisals as "bordering on fraudulent," and that whenever he objected his complaint would eventually be escalated to Option One's Appraisal Department at headquarters, whereupon the loan was approved***. *Id*., ¶154.

510. News and media reports further confirm that Option One was originating loans that did not comply with its stated underwriting guidelines. For example, on October 26, 2007, *The Boston Globe* reported that a mortgage broker with which Option One did business had been shut down by the Massachusetts Division of Banks. The news article reported that the mortgage broker was shut down by the Commonwealth because it had ***inflated the incomes of borrowers. The news article cited several examples of borrowers whose incomes had been falsely inflated, in some cases, nearly tripled***. In another instance, on January 22, 2010, the *Dow Jones Newswire* reported on the story of Option One borrower Sarah Schrock, who "has a low credit score[,] . . . has had trouble holding on to jobs[, and] is deaf." In 2006, Schrock obtained a loan from Option One through a mortgage broker named Soldi Financial LLC. The news article reported that Schrock claimed a ***"Soldi loan broker falsified her income to get her into a loan [from Option One] whose monthly payment exceeded her income***." The article further reported that one of Soldi's regional

managers was sentenced to prison for mortgage fraud unrelated to Schrock's loan. These news reports further confirm that Option One's loans did not comply with its underwriting guidelines.

511. Many consumer lawsuits have also been filed against Option One as a result of its questionable lending practices. In April 2009, a consumer lawsuit was filed in the United States District Court for the District of Massachusetts claiming Option One violated the Truth in Lending Act and the Real Estate Settlement Procedures Act by failing to disclose the true cost and interest rates associated with the borrower's mortgage. Another complaint filed in November 2009 alleged that Option One had intentionally inflated a borrower's income on the loan documentation to get the loan approved.

512. That Option One was not following its underwriting guidelines is corroborated by the OCC's "Worst Ten in the Worst Ten" list of lenders with the highest numbers of foreclosures on loans originated between 2005 and 2007. Option One had the sixth-highest number of foreclosures of any of the lenders on the OCC's list. Had Option One actually followed its underwriting guidelines and determined whether its borrowers could afford to repay their loans, Option One would not have had so many foreclosures.

513. Further support for the fact the Option One was not following its underwriting guidelines is found in the U.S. Senate Report. There, the Senate Subcommittee found that Option One had agreed to pay Goldman Sachs millions of dollars for defective loans that did not comply with Option One's underwriting guidelines, which Option One had originated and sold to Goldman Sachs. *See* Levin-Coburn Report at 487 n.2053. In addition, on December 30, 2007, *The Kansas City Star* reported that "Option One has shuttered its business and plans to write off $125 million in bad loans," another indicator that the company was not following its underwriting guidelines.

514. Finally, on April 24, 2012, the SEC sued Option One, alleging that it had misled investors concerning RMBS that Option One had sold. *See* Complaint for Violations of the Federal

Securities Laws, *United States Securities and Exchange Commission v. Option One Mortgage Corp., et al.*, No. 12-cv-00633-JST-MLG (C.D. Cal. Apr. 24, 2012). In the complaint in that action, the SEC alleged that in 2007 Option One had concealed from investors that it was suffering financial difficulties as a result of, *inter alia*, the fact that Option One "***could not meet its loan repurchase obligations***." *Id.*, ¶10. ***Option One "was borrowing hundreds of millions of dollars to fund, among other things, loan repurchases***," according to the SEC's complaint. *Id.*, ¶60. The reason that Option One was required to repurchase so many loans was because they had not been originated pursuant to Option One's purported underwriting guidelines, thereby entitling the buyers of the loans to demand that Option One repurchase them. ***Option One's abandonment of its underwriting guidelines was so pervasive that it faced hundreds of millions in repurchase claims by 2007***. Option One settled the SEC's action for over $28 million.

10. The Offering Documents Misrepresented AIG Federal Savings' and Wilmington's Underwriting Guidelines

515. One of the loan originators at issue herein is AIG Federal Savings. AIG Federal Savings is a subsidiary of American International Group ("AIG"). Another loan originator at issue herein, Wilmington, is also a subsidiary of AIG. Because AIG controlled both AIG Federal Savings and Wilmington – including their lending activities – during the relevant time period, AIG Federal Savings and Wilmington are discussed together herein. In fact, beginning in 2003, AIG Federal Savings outsourced its lending activities to Wilmington, with Wilmington providing all loan underwriting for the two lenders, while AIG Federal Savings funded the loans.

516. As detailed *supra*, defendants' Offering Documents purported to describe the underwriting guidelines that were supposedly used by AIG Federal Savings and Wilmington in originating loans underlying plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these representations were false and misleading at the time defendants made them. In truth,

AIG Federal Savings and Wilmington had completely abandoned their stated underwriting guidelines and were routinely originating loans without any regard for the borrowers' true repayment ability or the actual adequacy of the mortgaged properties to serve as collateral.

517. Wilmington and AIG Federal Savings were the subject of a government investigation into their lending practices. The Office of Thrift Supervision ("OTS"), based on the exercise of its regulatory responsibilities, determined that AIG Federal Savings "failed to manage and control the mortgage lending activities outsourced to [Wilmington] in a safe and sound manner." Supervisory Agreement at 1. The stated purpose of the Supervisory Agreement was, among other things, to "correct and remediate the negative financial impact to certain borrowers from the insufficiently supervised lending activities of [AIG Federal Savings] outsourced to [Wilmington]." *Id.* at 2. Thus, pursuant to that agreement, AIG Federal Savings and Wilmington and their affiliates established a $128 million reserve to cover, among other things, costs associated with providing affordable loans to ***borrowers whose creditworthiness was not adequately evaluated at the time the loan were originated***. *Id.* Moreover, AIG Federal Savings agreed to improve its mortgage loan origination policies "to enhance its compliance with applicable laws and regulations." *Id.*

518. Proof that AIG Federal Savings and Wilmington did not actually evaluate the borrowers' repayment ability is found in the astronomical default rates experienced by the relevant loan groups in the offerings for which these lenders originated loans. For these four specific offerings, the loan default rates were an astounding 25.41%, 34.69%, 39.56%, and 44.14%. In other words, from over one-quarter to nearly one-half of the relevant loans are currently in default.

11. Clayton Holdings Confirmed that the Offering Documents Were False and Misleading

519. As previously alleged, from at least January 1, 2006 through June 30, 2007, defendants hired Clayton to test samples of loans defendants were placing into their offerings to

determine whether the loans complied with their stated underwriting guidelines, or were subject to compensating factors that would merit an exception to such guidelines; were supported by valid appraisals/valuations; and had other valid characteristics. Clayton generally provided its findings to defendants in the form of written reports and updates, which were delivered to defendants on a daily basis throughout the duration of a typical due diligence project. This was first made public in late September 2010, when the FCIC released testimony and documents from Clayton.

520. In September 2010, Clayton provided to the FCIC trending reports it created that summarized its work for various Wall Street banks, including the Morgan Stanley Defendants at issue herein. Among other things, these reports established that, during the period from January 1, 2006 through June 30, 2007 – when the vast majority of the loans at issue herein were originated, and when most of the certificates were being sold to plaintiff – Clayton determined that ***36.8% of the mortgage loans it tested for the Morgan Stanley Defendants did not comply with their stated underwriting guidelines, and did not possess adequate compensating factors to warrant an exception to such guidelines.*** The same reports also established that, during the same time period, ***defendants "waived" back into their offerings 56.3% of the specific loans that Clayton had affirmatively identified as defective***. *See* Clayton Trending Reports, *available at* http://fcic.law.stanford.edu/hearings/testimony/the-impact-of-the-financial-crisis-sacramento#documents (last visited June 24, 2013).

521. Moreover, documents recently disclosed in an action pending in the United States District Court for the Southern District of New York, entitled *Abu Dhabi Commercial Bank, et al. v. Morgan Stanley & Co. Inc., et al.*, No. 08-cv-7508 (S.D.N.Y.) ("*Abu Dhabi*"), reveal that Clayton's reports to Morgan Stanley disclosed astonishing facts about the systematic abandonment of stated underwriting guidelines by many of the very originators at issue herein. Specifically, one Clayton report disclosed in the *Abu Dhabi* action showed that, during the second to fourth quarters of 2006,

Clayton informed Morgan Stanley that the due diligence provider had found material exceptions to underwriting guidelines on 51.8% of all WMC loans, 49.7% of all New Century loans, 49.4% of all Accredited loans, 23.6% of all First NLC loans, and 17.3% of all Decision One loans – each of which originated a significant number of the loans underlying plaintiff's certificates. Typical problems identified in this report regarding Morgan Stanley's top loan sellers included unsupported or missing lenders' appraisal values, lack of compliance with stated guidelines or programs, insufficient borrower credit history, inadequate income/employment documentation, and DTI ratios in excess of 55%. Nevertheless, from the group of specific loans that Clayton identified as containing material underwriting exceptions, ***Morgan Stanley affirmatively decided to accept 60.7% of the materially defective WMC loans, 48.4% of the materially defective New Century loans, 78.0% of the materially defective Accredited loans, 61.0% of the materially defective First NLC loans and 69.6% of the Decision One loans***.

522. The forgoing information from Clayton undisputedly establishes that defendants' representations in the Offering Documents – namely that the certificates' underlying loans complied with the stated underwriting guidelines – were false and misleading at the time defendants made them.

523. Moreover, defendants not only knowingly included in the offerings loans that had been affirmatively identified as defective, they also ***did no further testing on the vast majority of unsampled loans***, even in the face of Clayton's reports indicating – at a 95% confidence level – that such loans were subject to the same ***36.8% defect rate*** uncovered by Clayton's samples. In fact, defendants, fully aware of the situation, turned a blind eye to the information, did no further testing, and then ***included these defective loans into the offerings***, thereby rendering the Offering Documents materially false and misleading. As the FCIC later pointed out, "***one could reasonably expect [the untested loans] to have many of the same deficiencies, and at the same rate, as the***

sampled loans," and that defendants' failure to do any further testing or disclose Clayton's findings "***rais[ed] the question of whether" the Offering Documents "were materially misleading, in violation of the securities laws***." FCIC Report at 170.

524. Moreover, recently discovered evidence establishes that the above Clayton defect rates and numbers of defective loans that were "waived" into defendants' offerings were actually ***understated***. In a lawsuit entitled *Ambac Assurance Corp. v. EMC Mortgage LLC, et al.*, No. 650421/2011 (N.Y. Sup. Ct., N.Y. Cty.), excerpts of a deposition transcript of a former Clayton employee were recently filed. The former Clayton employee (whose identity was redacted) testified that ***all*** of Clayton's Wall Street clients (including Morgan Stanley, a client of Clayton's) ***instructed Clayton to ignore defective loans, to code defective loans as non-defective, and to change loans that had been graded as defective to non-defective***. The essence of the former Clayton employee's testimony was that defendants had instructed Clayton to fraudulently change defective, non-complying loans into compliant loans. The effect of such efforts was that Clayton's reports ***understated*** the number of loans that were defective and which were included in defendants' offerings.

12. Actual Loan and Borrower Information Confirms that the Offering Documents Were False and Misleading

525. Plaintiff has obtained information concerning loans within the offerings at issue herein and the attendant borrowers from public bankruptcy filings and other sources. This information confirms that there was a systemic abandonment of the stated loan underwriting guidelines in this case by the loan originators at issue in this action. The following examples conclusively demonstrate that the loan originators used by the Morgan Stanley Defendants did not originate loans in conformance with the underwriting guidelines set forth in the Offering Documents, and did not evaluate either the creditworthiness of the borrowers or their ability to repay the loans.

Because of the large number of offerings at issue in this action, plaintiff has not provided examples from every offering. However, the examples provided are not aberrations or outliers. Rather, they are an accurate representative sample of the underwriting defects that permeated all of the loans and offerings at issue herein and loan originators in general during the relevant time period. Indeed, as previously alleged, former Clayton executive D. Keith Johnson confirmed in his testimony to the FCIC that the breakdown in lending standards was "systemic."

526. The systemic breakdown in loan underwriting guidelines with respect to the loans at issue in this action is further confirmed by, among many other things, the huge numbers of loans at issue herein that have subsequently defaulted. Indeed, as alleged more fully at §V, *supra*, ***all*** of the loan groups supporting plaintiff's certificates have double-digit default rates, ***with the vast majority of the loan groups having stunning defaults rates between 35%-54%, and with several having default rates in excess of 60%.*** The fact that so many loans have defaulted is strong evidence that the lenders at issue herein did not follow their loan origination guidelines and did not determine, or care, whether borrowers could afford to repay their loans.

527. The following information concerns loans and borrowers from the Morgan Stanley Offerings at issue herein:

a. ACCR 2006-1 Offering

528. A husband and wife obtained a loan for $468,000 in 2005 which was contained within the ACCR 2006-1 offering. The loan was originated through Accredited, one of the loan originators identified in the Offering Documents. These borrowers had income in 2005 of $2,645 per month, according to the borrowers' sworn bankruptcy filings. ***However, the borrowers' monthly debt payments were at least $4,163, far in excess of the borrowers' monthly income***. The borrowers' monthly debt payments were in addition to the borrowers' monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, these borrowers could not

afford to repay the loan. This is confirmed by the fact that the borrowers declared bankruptcy shortly after obtaining the loan, in 2006 and 2007.

b. IXIS 2006-HE2 Offering

529. A borrower obtained a loan for $431,200 in 2005 which was contained within the IXIS 2006-HE2 offering. ***This borrower had income in 2005 of only $285 per month***, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $4,663, far in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy after obtaining the loan at issue, in 2007.

c. MSAC 2006-HE2 Offering

530. A borrower obtained a loan for $367,200 in 2005 which was contained within the MSAC 2006-HE2 offering. ***This borrower had no income in 2005***, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $4,296, far in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy shortly after obtaining the loan, in 2006.

d. MSAC 2006-HE6 Offering

531. A borrower obtained two loans in 2006, a first-lien loan for $440,000, and a second-lien loan for $110,000, both of which were contained within the MSAC 2006-HE6 offering. The loans were originated through WMC, one of the loan originators identified in the Offering Documents. This borrower had income in 2006 of $3,355 per month, according to the borrower's

sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $4,397, far in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loans. This is confirmed by the fact that the borrower declared bankruptcy shortly after obtaining the loans at issue, in 2006.

e. MSAC 2006-HE8 Offering

532. A borrower obtained two loans in 2006, a first-lien loan for $544,000, and a second-lien loan for $136,000, both of which were contained within the MSAC 2006-HE8 offering. The loans were originated through WMC, one of the loan originators identified in the Offering Documents. ***This borrower had no income in 2006***, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $14,930, far in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loans. This is confirmed by the fact that the borrower declared bankruptcy shortly after obtaining the loans at issue, in 2006.

f. MSAC 2006-NC2 Offering

533. A borrower obtained a loan for $582,400 in 2005 which was contained within the MSAC 2006-NC2 offering. The loan was originated through New Century, one of the loan originators identified in the Offering Documents. This borrower had income in 2005 of $6,585 per month, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $7,474, in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not

afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy shortly after obtaining the loan at issue, in 2006.

g. MSAC 2006-WMC2 Offering

534. A borrower obtained a loan for $682,893 in 2006 which was contained within the MSAC 2006-WMC2 offering. The loan was originated through WMC, one of the loan originators identified in the Offering Documents. This borrower had joint (with his wife) income of $5,511 per month and rental income of $2,058 per month in 2006, according to the borrower's sworn bankruptcy filings. Accordingly, the borrower had a total of $7,569 per month to pay his debts and expenses. ***However, the borrower's monthly debt payments were at least $13,476, far in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy shortly after obtaining the loan at issue, in 2007.

h. MSAC 2007-HE1 Offering

535. A borrower obtained a loan for $399,200 in 2006 which was contained within the MSAC 2007-HE1 offering. The loan was originated through New Century, one of the loan originators identified in the Offering Documents. This borrower had income in 2006 of $2,006 per month, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $4,090, far in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy shortly after obtaining the loan at issue, in 2007.

i. MSAC 2007-HE2 Offering

536. A husband and wife obtained a loan for $553,500 in 2006 which was contained within the MSAC 2007-HE2 offering. The loan was originated through New Century, one of the loan originators identified in the Offering Documents. These borrowers had income in 2006 of $1,666 per month, according to the borrowers' sworn bankruptcy filings. ***However, the borrowers' monthly debt payments were at least $5,170, far in excess of the borrowers' monthly income***. The borrowers' monthly debt payments were in addition to the borrowers' monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, these borrowers could not afford to repay the loan. This is confirmed by the fact that the borrowers declared bankruptcy shortly after obtaining the loan at issue, in 2007.

j. MSAC 2007-HE5 Offering

537. A borrower obtained a loan for $556,000 in 2006 which was contained within the MSAC 2007-HE5 offering. The loan was originated through Decision One, one of the loan originators identified in the Offering Documents. This borrower had income in 2006 of $3,895 per month, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $9,750, far in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy shortly after obtaining the loan at issue, in 2007.

k. MSAC 2007-NC1 Offering

538. A husband and wife obtained a loan for $568,000 in 2006 which was contained within the MSAC 2007-NC1 offering. The loan was originated through New Century, one of the loan originators identified in the Offering Documents. These borrowers had income in 2006 of $9,374

per month, according to the borrowers' sworn bankruptcy filings. ***However, the borrowers' monthly debt payments were at least $13,228, far in excess of the borrowers' monthly income***. The borrowers' monthly debt payments were in addition to the borrowers' monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, these borrowers could not afford to repay the loan. This is confirmed by the fact that the borrowers declared bankruptcy shortly after obtaining the loan at issue, in 2007.

l. MSHEL 2006-3 Offering

539. A borrower obtained a loan for $438,500 in 2005 or 2006 which was contained within the MSHEL 2006-3 offering. This borrower had monthly income of $2,667 for 2005, and monthly income of $4,800 for 2006, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $5,152, in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy shortly after obtaining the loan at issue, in 2006

m. MSIX 2006-2 Offering

540. A borrower obtained a loan for $585,000 in 2006 which was contained within the MSIX 2006-2 offering. The loan was originated through Master Financial, one of the loan originators identified in the Offering Documents. This borrower had income in 2006 of $1,304 per month, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $4,717, far in excess of the borrower's monthly income***. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower

could not afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy shortly after obtaining the loan at issue, in 2006.

n. SAST 2007-1 Offering

541. A borrower obtained a loan for $154,000 in 2006 that was contained within the SAST 2007-1 offering. The loan was originated by Saxon Mortgage, the originator identified in the Offering Documents. ***This borrower had income in 2006 of only $875 per month***, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $1,605, far in excess of the borrower's monthly income***. Therefore, this borrower had a DTI ratio of over 183%. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy after obtaining the loan at issue, in 2008.

o. SAST 2007-2 Offering

542. A borrower obtained a loan for $520,000 in 2007 which was contained within the SAST 2007-2 offering. The loan was originated through Saxon Mortgage, the loan originator identified in the Offering Documents. ***This borrower had income in 2007 of only $583 per month***, according to the borrower's sworn bankruptcy filings. ***However, the borrower's monthly debt payments were at least $3,993, far in excess of the borrower's monthly income***. Therefore, this borrower had a DTI ratio of over 684%. The borrower's monthly debt payments were in addition to the borrower's monthly expenses for things such as taxes, utilities, groceries, health care, transportation, and the like. Clearly, this borrower could not afford to repay the loan. This is confirmed by the fact that the borrower declared bankruptcy after obtaining the loan at issue, in 2009.

B. Defendants Made Material Misrepresentations Regarding the Underlying Loans' LTV Ratios

543. As set forth *supra*, defendants' Offering Documents affirmatively misrepresented the LTV ratios associated with the certificates' underlying loans. *See* §V. For the reasons set forth immediately below, these misrepresentations were material to plaintiff's investments in the certificates.

544. An LTV ratio is calculated by dividing the loan amount into the value of the mortgaged property. LTV ratios are extremely important to both investors and the Credit Rating Agencies, because they are indicative of the credit quality and safety of a particular loan or group of loans. Generally speaking, a lower LTV ratio indicates a higher credit quality, safer loan. Conversely, a higher LTV ratio indicates a lower quality, riskier loan.

545. To explain, the mortgaged property serves as collateral and security for the repayment of the loan. If the borrower defaults on the loan, foreclosure occurs and the property is sold, with the proceeds of the sale going toward paying the outstanding loan balance, but only after all other expenses are paid. If there is insufficient collateral, *i.e.*, the sale proceeds (minus all expenses) are less than the outstanding loan balance, the investor suffers a loss. A low LTV ratio indicates that there is more collateral, or security, for the loan in the event of a foreclosure. In other words, the investor is less likely to face a situation where the sale proceeds net of expenses are less than the outstanding loan amount, and therefore the investor is less likely to suffer a loss. In addition, a lower LTV ratio indicates that the borrower has more "equity" committed to the property, and is thus less likely to default on the loan compared to a borrower with little or less equity, who consequently has less financial incentive to avoid defaulting on the loan. As a result, the lower the LTV ratio, the more likely it is the borrower will repay the loan, and the more likely it is that there will be sufficient

security to make the investor whole, and avoid a loss, in the event of a default and/or a decline in real estate values.

546. In any case, an investor ***never*** wants a group of loans with a large number of loans with LTV ratios over 100%, as that implies a ***certain loss*** in the event of foreclosure. Moreover, a group of loans with a high number of loans with LTV ratios over 100% is highly susceptible to default, because the borrowers have little financial incentive to continue making payments if their financial circumstances change or the value of the properties decline. An understanding of the true LTV ratios associated with the loans underlying a given RMBS is thus essential to an investor, as it allows the investor to properly gauge the risk associated with the investment.

547. Because LTV ratios are critically important to the risk analysis for a given RMBS, they also constitute one of the critical pieces of information used by the Credit Rating Agencies' computerized rating models to determine what credit ratings should be assigned to RMBS certificates. Generally, the lower the LTV ratios, the higher the ratings the Credit Rating Agencies assign to the certificates. Moreover, the lower the LTV ratios, the less credit enhancement the Credit Rating Agencies generally require to obtain "investment grade" credit ratings. And the less credit enhancement that is required, the less costly, and more profitable, the RMBS offering is to the entities structuring, marketing and selling the RMBS (*i.e.*, defendants here).[14]

548. Defendants were very aware of the foregoing. Accordingly, defendants affirmatively misrepresented the actual percentages of the certificates' underlying loans that had LTV ratios in excess of 80% and 100%. These representations were intended to convey that there was sufficient

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[14] "Credit enhancements" can take numerous forms, but one common form is to require the sellers (defendants in this case) to include additional collateral, *i.e.*, additional loans or better credit quality loans, in the offering to help ensure the expected cash flow. Either way, the practical effect is that additional credit enhancements represent additional costs and/or decreased profit margins to the entities responsible for the offering.

protection against losses in the event of defaults, and that the loans (and therefore the certificates) were of high credit quality, and were safe, solid investments. Unfortunately for plaintiff, defendants' representations concerning the LTV ratios associated with the certificates' underlying loans were false and misleading when made. *See* §V, *supra*.

549. Defendants accomplished their deception by using false and inflated appraisals and valuations for the relevant properties, as alleged above. Because false and inflated appraisals were used, defendants were able to generate artificially understated LTV ratios, which were then included in the Offering Documents.

550. The appraisers knew that their appraisals were false and inaccurate, and did not believe them to be true. The appraisers, and others providing valuations, were being strong-armed into providing inflated valuations by the lenders, who threatened the appraisers with being black-balled in the industry and excluded from future work unless the inflated valuations were provided. In other instances, appraisers were being bribed into providing inflated valuations by lenders who paid the appraisers above-market fees for inflated valuations and/or rewarded appraisers with substantial additional work for inflated appraisals. In yet other instances, lenders intentionally provided appraisers with false sales information designed to generate inflated appraisals and valuations. Lenders also required appraisers to rely on information outside the relevant market to support inflated valuations. Lenders and some appraisers further retaliated against any appraisers that questioned or criticized their corrupt practices.

551. Defendants were well aware that the appraisal valuation process was being actively manipulated by loan originators and appraisers, and therefore also knew that the reported property valuations and LTV ratios for the loans did not reflect accurate information. Defendants learned such facts when they performed due diligence on the loans, as well as through Clayton, and by virtue of their participation in originating the loans, and through their ownership and control of lenders and

their close relationships with them. Defendants had little incentive to correct the inflated appraisals – and did not – because inflated appraisals led to larger loan amounts, thereby increasing the size of defendants' RMBS offerings, and decreased credit enhancement requirements, all of which, in turn, increased defendants' compensation and profits. Accordingly, defendants knew that the LTV ratios reported in the Offering Documents were not accurate or reliable indicators of the credit quality of the loans, and that such LTV ratios had no reasonable basis in fact.

C. Defendants Made Material Misrepresentations Regarding the Underlying Loans' Owner Occupancy Rates

552. As set forth *supra*, the Offering Documents misrepresented the OOR percentages, or Primary Residence Percentages, associated with the loan groups supporting plaintiff's certificates. *See* §V. For the reasons set forth immediately below, these misrepresentations were material to plaintiff's investments in the certificates.

553. The purpose behind disclosing the OOR percentages associated with a particular group of loans supporting RMBS is to identify the percentage of such loans that are owner occupied or primary residences – that is, the percentage of loans issued to borrowers who purportedly lived in the mortgaged properties. Primary Residence Percentages are extremely important to investors like plaintiff, because borrowers are much less likely to default on loans secured by their primary homes, as opposed to loans secured by investment properties or second homes. Accordingly, higher Primary Residence Percentages indicate safer loans, and thus safer RMBS certificates, while lower Primary Residence Percentages indicate riskier loans, and thus lower credit quality certificates.

554. Because Primary Residence Percentages are critically important to the risk analysis for a given RMBS, they also constitute one of the critical pieces of information used by the Credit Rating Agencies' computerized rating models to determine what credit ratings should be assigned to RMBS certificates. Generally, the higher the Primary Residence Percentages, the higher the ratings

the Credit Rating Agencies assign to the certificates. Moreover, the higher the Primary Residence Percentages, the less credit enhancement the Credit Rating Agencies generally require to obtain "investment grade" credit ratings. And the less credit enhancement that is required, the less costly, and more profitable, the RMBS offering is to the entities responsible for structuring, marketing and selling the RMBS (*i.e.*, defendants here).

555. Well aware of this dynamic, defendants systematically overstated the Primary Residence Percentages associated with plaintiff's certificates, as set forth *supra*. As a result, defendants created the false impression that the loans and certificates were of higher credit quality than they in fact were. Indeed, in most instances, defendants materially overstated the actual Primary Residence Percentages by double-digit percentages. *See* §V, *supra*.

556. Defendants knew, based on their due diligence of the loans, Clayton's reports and their own active role in the loan origination process, that the Primary Residence Percentages for the certificates' underlying loans were being actively manipulated by loan originators and borrowers. Specifically, defendants were well aware that borrowers were misrepresenting their residency status in order to obtain lower interest rates and/or eligibility for higher LTV or DTI ratio loans. Defendants were further aware that the originators were also actively manipulating the Primary Residence Percentages in order to receive higher prices when selling their loans. Even though defendants were aware that the Primary Residence Percentages were falsely inflated, they did not challenge them or change them to reflect the true OORs because defendants knew that higher Primary Residence Percentages for the loans would result in higher credit ratings from the Credit Rating Agencies and less additional credit enhancement requirements for their offerings, thereby increasing defendants' profits in selling the certificates. As a result of the foregoing, defendants knew that the Primary Residence Percentages stated in the Offering Documents were false and had no reasonable basis in fact.

D. Defendants Made Material Misrepresentations Regarding the Credit Ratings for the Certificates

557. As set forth *supra*, in each of the Offering Documents at issue herein, defendants represented that the certificates plaintiff was purchasing had or would have certain high, safe, "investment grade" credit ratings from at least two of the three major Credit Rating Agencies (S&P, Moody's and/or Fitch). *See* §V. For the reasons set forth *supra* and immediately below, these representations were both material and false.

558. Credit ratings are extremely important to investors in assessing the quality and safety of RMBS certificates. Credit ratings on such securities indicate how reliable and safe the investments are, and are used to predict the likelihood that they will perform, *i.e.*, pay, as expected and return the investors' principal at the end of the lending term. The credit ratings of the certificates were very important to plaintiff, as plaintiff was required to purchase only certificates that were rated "investment grade" by the Credit Rating Agencies. Indeed, many of the certificates purchased by plaintiff received the highest, safest credit ratings available – "Aaa" by Moody's or "AAA" by S&P and Fitch. These credit ratings indicated that the certificates were the "safest of the safe," as such ratings were ***the same as, or even higher than, the current credit rating of U.S. Treasury debt***. Indeed, "[t]raditionally, investments holding AAA ratings have had a ***less than 1% probability of incurring defaults***." Levin-Coburn Report at 6. Below is a chart setting forth the Credit Rating Agencies' credit grading systems, denoting the various investment grade and speculative grade ratings they provided:

Moody's Grades	**S&P's Grades**	**Fitch's Grades**
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-

Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
↑Investment Grade		
Speculative Grade↓		
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-
B1	B+	B+
B2	B	B
B3	B-	B-
Caa1	CCC+	CCC+
Caa2	CCC	CCC
Caa3	CCC-	CCC-
Ca	CC	CC
C	C	C
	D	D

559. As previously discussed, the certificates never should have received the safe, "investment grade" ratings touted by defendants in the Offering Documents. In truth, the certificates were anything but safe, "investment grade" securities, as defendants well knew. In fact, the certificates were exactly the opposite – extremely risky, speculative grade "junk" bonds or worse, backed by low credit quality, extremely risky loans. As defendants were well aware, each of the certificates was backed by numerous loans that had not been originated pursuant to the stated underwriting guidelines, with many loans being made without any regard for the borrowers' true repayment ability, and/or on the basis of falsely inflated incomes and property values, as alleged above. Moreover, as also alleged above, the LTV ratios and Primary Residence Percentages for the loans had been falsified so as to make the loans (and thus, the certificates) appear to be of much higher credit quality than they actually were.

560. In order to obtain "investment grade" credit ratings for the certificates, defendants were required to work with the Credit Rating Agencies. Specifically, defendants were required to provide the Credit Rating Agencies with information concerning the underlying loans, which the Credit Rating Agencies then put into their computerized ratings models to generate the credit ratings.

In order to procure the falsely inflated ratings defendants desired for the certificates, defendants fed the Credit Rating Agencies falsified information on the loans, including, without limitation, false loan underwriting guidelines, false LTV ratios, false borrower FICO scores, false borrower DTI ratios, and false Primary Residence Percentages. Among other things, defendants falsely represented to the Credit Rating Agencies that virtually none of the loans in any of the offerings had LTV ratios in excess of 100%. Defendants also misrepresented and underreported the numbers of loans that had LTV ratios in excess of 80% in many cases. Defendants further misrepresented that the loans had much higher Primary Residence Percentages than they actually did. Defendants also concealed from the Credit Rating Agencies that most of the loans were not originated pursuant to the underwriting guidelines stated in the Offering Documents and/or were supported by falsely inflated incomes, appraisals and valuations. Defendants also never informed the Credit Rating Agencies that Clayton had detected defect rates of 36.8% in the samples of loans it tested for defendants, or that defendants had put 56.3% of those identifiably defective loans into the offerings. Defendants also never told the Credit Rating Agencies that defendants did no further testing on the vast majority of loans, despite their awareness that there were significant numbers of defective loans detected by the test samples.

561. That the credit ratings stated in the Offering Documents were false and misleading is confirmed by subsequent events, as set forth *supra*. Specifically, after the sale of the certificates to plaintiff was completed, staggering percentages of the loans underlying the certificates began to go into default, because they had been made to borrowers who either could not afford them or never intended to pay them. Indeed, ***in a majority of the loan groups at issue herein, at least 35% of the loans currently in the trusts are in default***.

562. ***The average default rate for all the offerings at issue herein currently hovers at around 42%***. It is also important to understand that these reported default rates are for loans that are ***currently*** still in the trusts. Any ***prior*** loans that were in default and which had been previously

liquidated or sold, and thus written off and taken out of the trusts, have not been included in the calculations. Therefore, the foregoing default rates do not include earlier defaults, and thus ***understate*** the cumulative default rates for all of the loans that were originally part of the trusts.

563. Further proving that the credit ratings stated in the Offering Documents were false and misleading is the fact that ***all*** of the certificates have since been downgraded to reflect their true credit ratings, now that the true credit quality (or more accurately, lack of quality) and riskiness of their underlying loans is known. Indeed, ***all of the 37 certificates plaintiff bought have now been downgraded to speculative "junk" status or below by Moody's and/or S&P***. Moreover, ***16 of the 37 certificates plaintiff bought now have a credit rating of "D" by S&P and/or "C" by Moody's, which means they are in "default***," and reflects that they have suffered losses and/or writedowns, and/or have completely stopped paying. In other words, approximately ***43% of plaintiff's certificates are in default***. This is strong evidence that defendants lied about the credit ratings. This is so because the high, "investment grade" credit ratings assigned to plaintiff's certificates had a probability of default of between "less than 1%" (Levin-Coburn Report at 6) for the highest rated certificates and 2.6% (according to Moody's) for certificates rated even lower than plaintiff's. The huge discrepancy in the actual default rates and the historically expected default rates (less than 2.6%) demonstrates the falsity of defendants' statements regarding the credit ratings.

564. These massive downgrades – in many cases, from "safest of the safe" "AAA" ratings to "junk" (anything below Baa3 or BBB-) – show that, due to defendants' knowing use of bogus loan data, the initial ratings for the certificates, as stated in the Offering Documents, were false. Indeed, the fact that ***all*** of the certificates are now rated at "junk" status or below, and ***more than 43% of the certificates are now in default***, is compelling evidence that the initial high ratings touted by defendants in the Offering Documents were grossly overstated and false.

E. Defendants Materially Misrepresented that Title to the Underlying Loans Was Properly and Timely Transferred

565. An essential aspect of the mortgage securitization process is that the issuing trust for each RMBS offering must obtain good title to the mortgage loans comprising the pool for that offering. This is necessary in order for the plaintiff and other certificate holders to be legally entitled to enforce the mortgage and foreclose in case of default. 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).

566. The rules for these transfers are governed by the law of the state where the property is located, by the terms of the pooling and servicing agreement ("PSA") for each securitization, and by the law governing the issuing trust (with respect to matters of trust law). Generally, state laws and the PSAs 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.

567. In addition, in order to preserve the bankruptcy-remote status of the issuing trusts in RMBS transactions, the notes and security instruments are generally not transferred directly from the mortgage loan originators to the trusts. Rather, the notes and security instruments are generally initially transferred from the originators to the sponsors of the RMBS offerings. After this initial transfer to the sponsor, the sponsor in turn transfers the notes and security instruments to the depositor. The depositor then transfers the notes and security instruments to the issuing trust for the particular securitization. This is done to protect investors from claims that might be asserted against a bankrupt originator. Each of these transfers must be valid under applicable state law in order for the trust to have good title to the mortgage loans.

568. Moreover, the PSAs generally require the transfer of the mortgage loans to the trusts to be completed within a strict time limit – three months – after formation of the trusts in order to

ensure that the trusts qualify as tax-free real estate mortgage investment conduits ("REMICs"). In order for the trust to maintain its tax free status, the loans must have been transferred to the trust no later than three months after the "startup day," *i.e.*, the day interests in the trust are issued. *See* Internal Revenue Code §860D(a)(4). That is, the loans must generally have been transferred to the trusts within at least three months of the "closing" dates of the offerings. In this action, all of the closing dates occurred in 2005, 2006 or 2007, as the offerings were sold to the public. If loans are transferred into the trust after the three-month period has elapsed, investors are injured, as the trusts lose their tax-free REMIC status and investors like plaintiff face several adverse draconian tax consequences: (1) the trust's income is subject to corporate "double taxation"; (2) the income from the late-transferred mortgages is subject to a 100% tax; and (3) if late-transferred mortgages are received through contribution, the value of the mortgages is subject to a 100% tax. *See* Internal Revenue Code §§860D, 860F(a), 860G(d).

569. In addition, applicable state trust law generally requires strict compliance with the trust documents, including the PSAs, so that failure to strictly comply with the timeliness, endorsement, physical delivery, and other requirements of the PSAs with respect to the transfers of the notes and security instruments means the transfers would be void and the trust would ***not*** have good title to the mortgage loans.

570. To this end, all of the Offering Documents relied upon by plaintiff stated that the loans would be timely transferred to the trusts. For example, in the MSAC 2006-HE2 Offering Documents, the Morgan Stanley Defendants represented that "[p]ursuant to the pooling and servicing agreement, the depositor will sell, without recourse, to the trust, all right, title and interest in and to each mortgage loan, including all principal outstanding as of, and interest due on or after, the close of business on the cut-off date." *See* MSAC 2006-HE2 Pros. Supp. at S-55. The Offering Documents for each of the offerings at issue herein contained either the same or very similar

language, uniformly representing that defendants would ensure that the proper transfer of title to the mortgage loans to the trusts occurred in a timely fashion.

571. However, defendants' statements were materially false and misleading when made. Rather than ensuring that they legally and properly transferred the promissory notes and security instruments to the trusts, as they represented they would do in the Offering Documents, defendants instead did not do so. This failure was driven by defendants' desire to complete securitizations as fast as possible and maximize the fees they would earn on the deals they closed. Because ensuring the proper transfer of the promissory notes and mortgages hindered and slowed defendants' securitizations, defendants deliberately chose to disregard their promises to do so to plaintiff.

572. Defendants' failure to ensure proper transfer of the notes and the mortgages to the trusts at closing has already resulted in damages to investors in securitizations underwritten by defendants. Trusts are unable to foreclose on loans because they cannot prove they own the mortgages, due to the fact that defendants never properly transferred title to the mortgages at the closing of the offerings. Moreover, investors are only now becoming aware that, while they thought they were purchasing "***mortgage-backed***" securities, in fact they were purchasing ***<u>non</u>***-mortgage-backed securities.

573. Meanwhile, Attorneys General from 49 states have investigated foreclosure practices after the discovery that mortgage servicers used faulty or falsified paperwork to improperly seize homes from borrowers. The investigation culminated in a huge settlement of $25 billion with five large banks.

574. Facts disclosed in recent news reports and uncovered through government investigations and home owner foreclosure litigation over securitizations confirm widespread problems with the failure to ensure proper transfer of the required mortgage documents, and highlight the damage that failure has caused to plaintiff's investments. In an interview on *60*

Minutes, Lynn Szymoniak, a lawyer and fraud investigator who has uncovered instances in which banks appear to have manufactured mortgage documentation, explained the issue as follows:

> "When you could make a whole lotta money through securitization. And every other aspect of it could be done electronically, you know, key strokes. This was the only piece where somebody was supposed to actually go get documents, transfer the documents from one entity to the other. And it looks very much like they just eliminated that stuff all together."

575. As part of its exposé, *60 Minutes* interviewed Chris Pendley, a temporary employee of a company called Docx. Pendley was paid $10 per hour to sign the name "Linda Green," who, on paper, purportedly served as vice president of at least 20 different banks at one time, to thousands of mortgage documents that were later used in foreclosure actions. Pendley said he and other employees of Docx were expected to sign at least 350 documents per hour using the names of other individuals on documents used to establish valid title. Asked if he understood what these documents were, Pendley said, "[n]ot really." He then explained that he signed documents as a "vice president" of five to six different banks per day. Purported transfers bearing the signature of "Linda Green" were used to transfer mortgages from major originators to the depositors.

576. Further illustrating the falsity of defendants' representations in the Offering Documents regarding proper transfer of the mortgage documents to the issuing trusts is attorney Szymoniak's letter to the SEC (the "SEC Letter"). In the SEC Letter, Szymoniak detailed the fraudulent alteration and manufacture of mortgage documents by employees of Lender Processing Services, Inc. ("LPS"). LPS is a mortgage default company located in Jacksonville, Florida that, according to Szymoniak, "produced several missing Mortgage Assignments, using its own employees to sign as if they were officers of the original lenders." Szymoniak observed instances of mortgage transfers prepared by LPS employees that contained forged signatures, signatures of individuals as corporate officers on behalf of a corporation that never employed the individuals in

any such capacity, and signatures of individuals as corporate officers on behalf of mortgage companies that had been dissolved by bankruptcy years prior to the transfers, among other things.

577. The fabrication of the mortgage transfers appears to have been intended to conceal the actual date that interests in the properties were acquired by the RMBS trusts. The fraudulent transfers uncovered in foreclosure litigation often show that the transfers were prepared and filed in 2008 and 2009, when, in reality, the mortgages and notes were intended and should have been transferred prior to the closing date of the trusts, in 2005, 2006 and 2007, as stated in the Offering Documents relied on by plaintiff. Moreover, Szymoniak published an article on *Phil's Stock World* on July 20, 2011, setting forth the huge numbers of "trusts that closed in 2005, 2006 and 2007 [that have] repeatedly filed mortgage assignments signed and notarized in 2011," years after the closing dates. Nearly all of the securitizers at issue in this case are identified in Szymoniak's article. These late transfers of mortgages are an obvious improper attempt by defendants to untimely transfer the mortgage loans to the trusts after-the-fact. As discussed above, even if such transfers are valid, plaintiff has been severely damaged because of defendants' failure to timely transfer the loans, as the trusts have potentially lost their tax-free status and the payments to investors might now be subject to various forms of draconian taxation.

578. Other public reports corroborate the fact that the loans were not properly transferred. For example, Cheryl Samons, an office manager for the Law Office of David J. Stern, a "foreclosure mill" under investigation by the Florida Attorney General for mortgage foreclosure fraud that was forced to shut down in March 2011, signed tens of thousands of documents purporting to establish mortgage transfers for trusts that closed in 2005 and 2006 in 2008, 2009 and 2010 from Mortgage Electronic Registration Services, an electronic registry that was intended to eliminate the need to file transfers in the county land records. In depositions in foreclosure actions, Samons has admitted that she had no personal knowledge of the facts recited on the mortgage transfers that were used in

foreclosure actions to recover the properties underlying the mortgages backing RMBS. *See, e.g.*, Deposition of Cheryl Samons, *Deutsche Bank Nat'l Trust Co., as Trustee for Morgan Stanley ABS Capital 1 Inc. Trust 2006-HE4 v. Pierre*, No. 50-2008-CA-028558-XXX-MB (Fla. Cir. Ct., 15th Jud. Cir., Palm Beach City, May 20, 2009).

579. The need to fabricate or fraudulently alter mortgage assignment documentation provides compelling evidence that, in many cases, title to the mortgages backing the certificates plaintiff purchased was never properly or timely transferred. In fact, plaintiff has conducted investigations on the loans underlying several of the offerings at issue herein to determine whether the loans were properly transferred to the trusts. In each case investigated, the vast majority of loans underlying the offerings was not properly or timely transferred to the trusts.

580. Specifically, plaintiff performed an investigation concerning the mortgage loans purportedly transferred to the trust for the Morgan Stanley Defendants' MSAC 2006-HE6 offering. The closing date for this offering was on or about September 27, 2006. Plaintiff reviewed the transfer history for 334 loans that were supposed to be timely transferred to this trust. Forty-six (46) of the loans were not and have never been transferred to the trust. In addition, several other loans that were supposed to be transferred to the trust were transferred to entities other than the trust, but not to the trust. The remainder of the loans (approximately 267) were eventually transferred to the trust, but almost all such transfers occurred between 2007 and the present, well beyond the three-month time period required by the trust documents and far after the three-month period for the trust to maintain its tax-free REMIC status. Only one (1) of the reviewed loans was transferred to the trust within the three-month time period. ***In other words, 333 of the 334 reviewed mortgage loans were not timely transferred to the trust, a 99.7% failure rate. Moreover, there were three transfers that were obvious frauds, as they are back-dated to a time in 2006 which predated the existence of the trust***.

581. The foregoing example, coupled with the public news, lawsuits and settlements discussed above, establish that defendants failed to properly and timely transfer title to the mortgage loans to the trusts. Moreover, they show that defendants' failure to do so was widespread and pervasive. In fact, the specific examples discussed above show that defendants utterly and completely failed to properly and timely transfer title. Defendants' failure has caused plaintiff (and other RMBS investors) massive damages. As noted by law professor Adam Levitin of Georgetown University Law Center on November 18, 2010, in testimony he provided to the a U.S. House Subcommittee investigating the mortgage crisis, "[i]f the notes and mortgages were not properly transferred to the trusts, then the mortgage-backed securities that the investors[] purchased were in fact ***non-mortgage-backed securities***" (emphasis in original), and defendants' failure "ha[d] profound implications for [R]MBS investors" like plaintiff. Indeed, Professor Levitin noted in his testimony that widespread failures to properly transfer title would appear to provide investors with claims for rescission that could amount to trillions of dollars in claims.

VII. THE MORGAN STANLEY DEFENDANTS KNEW THAT THE REPRESENTATIONS IN THE OFFERING DOCUMENTS WERE FALSE AND MISLEADING

582. Defendants' representations in the Offering Documents were not only false and misleading, but defendants also ***knew***, or were at least reckless in disregarding, that the misrepresentations identified herein were false and misleading at the time defendants made them.

583. Indeed, as set forth above and further detailed immediately below, defendants were explicitly informed by their own independent due diligence providers, such as Clayton, that substantial percentages of the loans underlying plaintiff's certificates either did not comply with their stated guidelines, had been issued without regard for the borrowers' true repayment ability or were secured by inadequate collateral.

584. Moreover, defendants were not only provided such information, they in fact used it – in many different ways – for their own personal gain, at the expense of plaintiff and other investors. First, defendants used the material, undisclosed information Clayton had provided them to force the loan suppliers into accepting lower purchase prices for the certificates' underlying loans, ***without*** passing the benefits of such discounts onto plaintiff and other investors. Second, defendants relied on the insight gained from Clayton's due diligence efforts to purchase large CDSs on CDOs, which effectively served as massive bets that the ***same*** certificates sold to plaintiff – as well as other similar certificates issued from the same shelf registrations as the certificates sold to plaintiff – would ***fail***.

585. In addition, as further detailed below, defendants' undeniable awareness of the Offering Documents' misrepresentations is further established by several other publicly available sources of information, including settlement agreements between Morgan Stanley and various states' Attorneys General, other governmental investigations and documents disclosed in other civil litigations.

A. Morgan Stanley's Due Diligence Confirmed that the Certificates' Underlying Loans Did Not Conform to the Offering Documents' Representations

586. As alleged above, Morgan Stanley, through defendant Morgan Stanley & Co., served as an underwriter for each of the Morgan Stanley Offerings at issue herein. In this capacity, Morgan Stanley was required under U.S. securities laws to "perform a review of the pool assets underlying the [certificates]," *i.e.,* the loans, and ensure that the Offering Documents were "accurate in all material respects." 17 C.F.R. §230.193. As such, Morgan Stanley's legal duty was two-fold: first, to investigate the underlying loans, and second, to ensure that the statements in the Offering Documents about such loans were true and accurate.

587. Morgan Stanley repeatedly stated that it performed such due diligence on the loans it securitized. For example, the Offering Documents represented that defendant MSMC – which, in its

role as the sponsor/seller for most of the Morgan Stanley Offerings, was responsible for purchasing the mortgage loans to be securitized for most of the Morgan Stanley Offerings – conducted a thorough review of the loan originators, the loans, and the loan origination processes used, to ensure that the loans in the offerings were originated pursuant to the stated underwriting guidelines. For example, the MSAC 2006-NC2 prospectus supplement provided:

> Prior to acquiring any residential mortgage loans, [MSMC] conducts a review of the related mortgage loan seller . . . . [MSMC]'s review process may include reviewing select financial information for credit and risk assessment and conducting an underwriting guideline review, senior level management discussion and/or background checks. The scope of the mortgage loan due diligence varies based on the credit quality of the mortgage loans.
>
> The underwriting guideline review entails a review of the mortgage loan origination processes and systems. In addition, such review may involve a consideration of corporate policy and procedures relating to state and federal predatory lending, origination practices by jurisdiction, historical loan level loss experience, quality control practices, significant litigation and/or material investors.

MSAC 2006-NC2 Pros. Supp. at S-36. Similar representations were made in the Offering Documents for the Morgan Stanley Offerings where MSMC acted as sponsor and seller (*e.g.*, MSAC 2006-HE2, MSAC 2006-HE6, MSAC 2006-HE8, MSAC 2006-WMC2, MSAC 2007-HE1, MSAC 2007-HE2, MSAC 2007-HE5, MSAC 2007-NC1, MSHEL 2006-3, and MSIX 2006-2).

588. Furthermore, Terry L. Smith, a Morgan Stanley Executive Director, claimed that Morgan Stanley performed due diligence on the loans in its offerings to "provide assurance that the loans it buys and sells don't contain hidden underwriting flaws, ensuring that potential sellers [are aware of any issues with the loans in order to] correct problems or withdraw loans before sale and that buyers obtain quality product." *See, e.g.*, Amended Complaint, ¶64, *Dexia SA/NV v. Morgan Stanley, et al.*, No. 650231/2012 (N.Y. Sup. Ct., N.Y. Cty. May 24, 2012) (the "*Dexia* Amended Complaint").

589. Given Morgan Stanley's legally mandated duty to conduct due diligence on the loans, and its express affirmations that it did so, combined with the sheer number and magnitude of defective loans underlying the Morgan Stanley Offerings – as demonstrated above by the astonishing loan defect rates, LTV understatements and OOR overstatements associated with the offerings herein, as well as the first-hand accounts of numerous witnesses with knowledge of the loan originators' conduct – it is clear that Morgan Stanley was aware of the Offering Documents' misrepresentations regarding the nature and quality of the certificates' underlying loans. Moreover, given how the errors were always deceptively slanted to make the loans look safer than they actually were, thereby increasing Morgan Stanley's profits at the time of securitization, it is also clear that defendants' misrepresentations in the Offering Documents were deliberate and intentional. Indeed, documents and testimony recently provided by Morgan Stanley's own hired due diligence provider, Clayton, as well as recently disclosed documents and testimony from Morgan Stanley's internal due diligence team, unequivocally confirm as much.

590. As alleged above, the Morgan Stanley defendants, in addition to performing their own due diligence, retained Clayton to review samples of loan pools that Morgan Stanley sought to purchase and securitize. The purpose of Clayton's work was to review the loans and determine whether they met the stated underwriting guidelines or had valid compensating factors otherwise meriting approval. As part of the foregoing review, Clayton also checked the loans to determine whether the loans were supported by accurate appraisals that conformed to the underwriting guidelines and indicated that the loans were secured by adequate collateral.

591. Specifically, according to deposition testimony in the *Abu Dhabi* action by Tony Peterson, a Vice President at Morgan Stanley responsible for managing due diligence of subprime loans since the second half of 2005, Clayton's review involved "compar[ing] the [mortgage] loans against the guidelines, mak[ing] a determination, if they find variance to the guidelines or a potential

risk issue, on the severity of that variance or risk issue and apply[ing] their grading system of a 2 or a 3 to any loan with a variance."[15] Clayton also reviewed the loans for missing documentation and graded such loans accordingly. Examples of non-conformity to guidelines included DTI ratios that exceeded five percent of the guidelines or above 60%, or LTVs that exceeded five percent of the guideline requirements. In such cases, Clayton had to grade the loans as Event "3s" and brought them to Morgan Stanley's attention. Loans with "Unreasonable Stated income" or "Questionable Benefit to Borrower" were elevated by Clayton to Morgan Stanley for review regardless of guideline conformity.[16]

592. Furthermore, "[l]oans with value concerns or property issues [were] identified for review in the Clayton System and an automated report [wa]s produced daily by Clayton and electronically distributed to the MS Value Team for further action." Moreover, as was recently disclosed in the *King County* case, Clayton provided ten additional daily and weekly reports, containing credit and compliance re-underwriting results and flagging Event 3 loans, to be "utilized by Morgan Stanley Due Diligence managers to ensure clear communication, constant feedback with the lender and Morgan Stanley Management, quality control as it relates to loan decisions, and to ensure the most accurate data as it relates to loan quality." In addition, Clayton provided final "snapshots" of loans with greater than 60% DTI ratios and FICO scores of less than 500.

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15 According to Tony Peterson's November 22, 2011 deposition testimony in the *Abu Dhabi* action, which was recently disclosed in an action pending in the United States District Court for the Southern District of New York, entitled *King County, Washington, et al. v. IKB Deutsche Industriebank AG, et al.*, No. 09-cv-08387 (S.D.N.Y.) ("*King County*"), loans graded with an Event "2" were non-conforming loans that purportedly contained compensating factors that made them acceptable to Morgan Stanley. Event "3" loans contained material exceptions to the underwriting guidelines.

16 In a write-up entitled "Sub prime Bulk Acquisition Elevation/Appeals," recently disclosed in the *King County* case, Morgan Stanley outlined the process flows, metrics and reporting requirements of the subprime due diligence process.

593. According to Tony Peterson's deposition testimony, once Clayton flagged the non-conforming and materially defective loans, Morgan Stanley's own team of due diligence managers then reviewed the loan files, commented on the exceptions, made the decision on whether to accept the non-conforming loans, and changed the grading directly in Clayton's system. For valuation related issues, Morgan Stanley's loan valuation team "review[ed] the appraisals from the mortgage loan files . . . , obtain[ed] additional valuation products and [did] research and ma[de] determination regarding values of properties and recommendations on which ones to keep in the pool and which ones to decline for purchase." When Morgan Stanley deemed the defective loans to be acceptable for purchase, it went into Clayton's system and changed the grading from Event "3" to Event "2" or "2W."

594. During the period from January 1, 2006 through June 30, 2007 – when the vast majority of the Morgan Stanley Offerings were being sold to plaintiff – Clayton reported to Morgan Stanley through these various reports that ***36.8% of the loans Clayton had reviewed did not meet the applicable underwriting guidelines, did not have compensating factors otherwise meriting approval, and/or were not supported by adequate appraisals***. In other words, ***more than one in every three loans reviewed by Clayton was defective***. Shockingly, Morgan Stanley nonetheless proceeded to purchase and securitize the vast majority of these defective loans. In fact, ***Morgan Stanley actually "waived" back into its securitization pools 56.3% of the specific loans that Clayton had explicitly identified as defective***. In other words, ***from 2006-2007, Morgan Stanley affirmatively chose to purchase and securitize into its offerings more than one half of the specific loans its own due diligence provider identified as defective***.[17]

[17] In fact, according to a Clayton "Trending Reports Executive Summary," recently disclosed in the *Abu Dhabi* case, from the second to the fourth quarters of 2006, "***64% of the exceptions Clayton identified as 'material' were overturned by Morgan [Stanley]***." Thus, for the majority of 2006 –

595. Indeed, according to documents recently disclosed in the *Abu Dhabi* case, during the second to fourth quarters of 2006, Morgan Stanley affirmatively waived in 78.0% of Accredited's defective loans, 69.6% of Decision One's defective loans, 61.0% of First NLC's defective loans, 60.7% of WMC's defective loans, 48.4% of New Century's defective loans and 52.8% of the defective loans by all other originators reviewed by Clayton. The top material exceptions relating to the waived in loans included problems such as appraisal "[v]alue used by lender not supported," "[l]oan characteristics do not match any available program," "[c]redit history insufficient for program/grade," "[m]issing review appraisal," "[i]ncome docs do not meet guidelines for grade/doc type," and "[d]ebt [r]atio > 55%." These statistics and problems are based solely on the Event "3" materially defective loans, without even accounting for the numerous non-conforming loans that Clayton graded as Event "2s" and deemed acceptable based upon so-called "compensating factors" dictated by Morgan Stanley.[18]

596. Morgan Stanley's practice of waiving in defective mortgage loans and accepting non-conforming loans is not surprising, given the profitability of the securitization transactions and the need to appease defendants' originators in order to keep the securitization factory going. For example, according to internal emails disclosed in the *King County* action, for the MSAC 2006-HE2 transaction alone, Morgan Stanley made a profit of $28.125 million. Thus, when one of the "top 5" loan sellers, such as Accredited, complained about Morgan Stanley kicking out all of 20 loans in April 2006, ***Peterson urged the team "to work with this client to improve their perception of us as***

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when most of the offerings at issue herein took place – Morgan Stanley ***affirmatively waived into its offerings nearly two out of every three loans its own due diligence provider identified as defective***.

[18] According to a report disclosed by the United States Senate Permanent Subcommittee on Investigations, "compensating factors are often used to override or offset loan characteristics that do not meet stated program guidelines. However, typically a single compensating factor would not offset multiple layers of risk."

a trading partner," despite "the decline in credit quality that we have seen across the subprime business in the last 6 months" and the recognition of "very poor appraisal quality" with "the average LTV of the loans kicked for value was 125% based on MS LTV." Evidently, Peterson's urging was heeded, because, according to Clayton's Morgan Stanley Trending Reports Executive Summary, Accredited loans had the ***highest*** waiver rate during the second to fourth quarters of 2006. Overall, during the period, ***Morgan Stanley waived in 91% of the loans that were rejected by Clayton due to the material exception of "[v]alue used by lender not supported.***"

597. Moreover, as the FCIC pointed out, even though "one could reasonably expect [the loans which Clayton did not sample] to have many of the same deficiencies, and at the same rate, as the sampled loans," FCIC Report at 170, ***Morgan Stanley did absolutely no further testing*** on the much larger pool of non-sampled loans, and instead simply purchased and securitized those loans ***sight unseen***, before quickly and knowingly passing their substantial risk of failure onto plaintiff and other investors. In so doing, the Morgan Stanley Defendants guaranteed that the Morgan Stanley Offerings at issue herein would be infested with defective loans that did not comply with the affirmative representations contained in the Offering Documents.

598. The above facts regarding Clayton's due diligence, and Morgan Stanley's subsequent handling of the information uncovered by Clayton, unequivocally demonstrates that Morgan Stanley ***knew*** it was putting loans into its offerings that did not comply with the stated underwriting guidelines, in direct contradiction to the Offering Documents' representations. Morgan Stanley's deception, however, did not stop there. Indeed, defendants went even one step further, actually using their knowledge of the substantial defects in the certificates' underlying loans as leverage to lower purchase prices for the loans, ***without*** passing the benefits of such discounts on to plaintiff and other investors.

599. Morgan Stanley never disclosed that Clayton found numerous defective loans in the pools that Morgan Stanley bought and securitized. Nor did the Morgan Stanley Defendants ever disclose that they deliberately included well over half of those defective loans into their Morgan Stanley Offerings, or that they simply purchased and securitized the vast majority of those defective loans sight unseen, or that they had used the loans' defects to fatten their own profits without passing the benefits on to plaintiff and other investors. Instead, the Morgan Stanley Defendants simply misrepresented that the loans within the Morgan Stanley Offerings generally complied with the stated underwriting guidelines when selling the certificates to plaintiff, even though they knew the truth was the exact opposite.

600. Recently uncovered evidence from the action titled *Ambac Assurance Corp. v. EMC Mortgage LLC, et al.*, No. 650421/2011 (N.Y. Sup. Ct., N.Y. Cty.), further supports the fact that the Morgan Stanley Defendants acted fraudulently. In that case, a former employee of Clayton was deposed and excerpts of his deposition were recently filed with the court.[19] The deposition transcript revealed that the former Clayton employee testified under oath that Clayton was instructed by ***all*** of its Wall Street bank clients (of which Morgan Stanley was indisputably one) to "approve loans ***that often did not satisfy the underwriting guidelines,***" to ignore defects in loan applications, to code defective loans as non-defective and to change many of the grades on loans that were coded as defective to reflect that they were non-defective. According to the former Clayton employee, these instructions included ignoring appraisals that did not support the stated value of the properties and applications for which a borrower's stated income was "unreasonable" and not supported by documentation. The former Clayton employee testified that the practice of failing to follow

[19] The former Clayton employee's identity was redacted from the version of his deposition transcript that was filed with the court, apparently because his testimony was so damning to the defendants therein.

underwriting guidelines when re-underwriting loans at Clayton was pervasive, and that "[d]ue diligence underwriters like myself were forced to find compensating factors for defective loans where none existed."

601. This former Clayton employee's testimony clearly establishes that the shocking defect rates set forth in the Clayton reports discussed actually ***understated*** the true number of defective loans in the Morgan Stanley Offerings, because the Morgan Stanley Defendants were instructing Clayton to re-designate defective loans as non-defective and telling Clayton to ignore such defective loans. More importantly, it clearly shows the Morgan Stanley Defendants' fraudulent intent, as the Morgan Stanley Defendants instructed Clayton to essentially conceal the defective loans by either ignoring them or changing loans designated as defective to non-defective.

602. Internal Morgan Stanley documents recently made public in the *Abu Dhabi* and *King County* actions further confirm that Morgan Stanley learned through its due diligence that there were massive failures in the loan underwriting processes and defective loans in its offerings.[20] For example, one such document revealed an internal e-mail discussion, wherein a Morgan Stanley employee discussed loans the bank had bought and securitized, and acknowledged that "***we saw numerous occasions where the stated income (12 to 15k per month) was not reasonable for the job description/tenure, and was not supported by the borrower's credit profile***."

603. Furthermore, Morgan Stanley actually knew that the loans it was purchasing and securitizing were extremely defective, whether originated within or outside of the stated guidelines. For example, in one October 2005 internal Morgan Stanley document, a Morgan Stanley employee

[20] While the *Abu Dhabi* and *King County* cases involved "SIVs," or "structured investment vehicles," the portfolios of these investment vehicles included some of the exact same RMBS offerings at issue herein, thus establishing the relevance of the evidence made public in the two cases. Indeed, the investment portfolios included at least five of the Morgan Stanley Offerings at issue herein, namely MSAC 2006-WMC2, IXIS 2006-HE2, MSAC 2007-NC1, MSAC 2006-NC2, and ACCR 2006-1.

stated "***[t]he 100%, Stated Doc loans are our most risky and most prevalent in default***."[21] In another October 2005 e-mail, a Morgan Stanley Due Diligence Manager stated that he was "concern[ed]" about the "quality of the [loan] files and the product that the borrowers [we]re being placed" in, admitting that the "loans are riskier than [we] have seen the past." He further commented that ***"[b]ottom line, there is not a lot of 'common sense' being used when approving these types of loans."*** To the question, ***"[d]o these loans meet guidelines or are they outside guidelines,"*** the Morgan Stanley Due Diligence Manager responded: ***"A little of both . . . The real issue is that the loan requests do not make sense. $900K in combined loans to a renter with no prior mtg history stated making $16k a month as a manager of a knock off gold club distributor via the internet and mailings, a borrower that makes $12k a month as an operations manger [sic] of an unknown company – after research on my part I reveal that it is a tarot reading house. Compound these issues with the fact that we are seeing what I would call a lot of this type of profile***."

604. As Pamela Barrow, a Vice President at Morgan Stanley overseeing due diligence, aptly summed up to her team in an email about Fremont: "We should discuss in detail with you programs that we should stip in the future due to the ***risk embedded within the guidelines themselves*** concerning thin credit and minimal seasoning requirements. ***The programs are too lenient*** and requirements are much more minimal in guideline (in the name of 'benefit to the borrower') than our other subprime clients."

605. Moreover, in a March 17, 2006 internal e-mail by a Morgan Stanley Valuations President, it was made absolutely clear that Morgan Stanley had actual knowledge of the rampantly inflated appraisals:

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21 Many of the Morgan Stanley Offerings herein were supported by "stated doc loans" – that is, loans for which income and other information were "stated."

> ***Across the board, [they] have informed me . . . [of] the deteriorating appraisal quality they are finding with all of the sellers . . . . This feedback has directly surrounded this months Accredite d [sic], Decision One, WMC, and New Century trades, but we are seeing the same issues across the board with the majority of all sellers***.
>
> ***The deteriorating appraisal quality that is very flagrant are the use of superior quality comparable sales, all comps taken from a higher market outside the subject neighborhood, use of all dated sales in declining markets, etc. In the past year, these issues have been there, but not to the magnitude we are starting to see***.

606. This same awareness of appraisal manipulation was further illustrated by another e-mail from Barrow, in which Barrow stated that Fremont had "a process by which the front-line originating underwriter has the option to adjust the value that determines LTV, ***which in most cases we are seeing, result in a lower LTV with no justification***."

607. These e-mails conclusively demonstrate that Morgan Stanley was aware that there were inflated appraisals infecting the loans it was buying and securitizing as early as mid-2005 ("In the past year, these issues have been there . . . ."). Moreover, the ***e-mails demonstrate that Morgan Stanley saw these issues with loan originators generating many of the loans underlying the very offerings at issue in this case***, as Accredited, Decision One, WMC, Fremont and New Century – the specific lenders mentioned in the above e-mails – all originated numerous loans in numerous offerings at issue herein.

608. Notwithstanding the abundance of facts within defendants' possession conclusively confirming the defective and noncompliant nature of the certificates' underlying loans, the Morgan Stanley Defendants purchased the defective loans, put them into the Morgan Stanley Offerings, and sold them to plaintiff. And, notwithstanding defendants' knowledge of the pervasive defects in the certificates' underlying loans, and the underwriting processes used to originate such loans, the Morgan Stanley Defendants deliberately and contradictorily represented to plaintiff in the Offering Documents that the loans were originated pursuant to the stated underwriting guidelines, had certain

purported LTV and OOR statistics that made the loans appear safer than they actually were, and that the certificates, themselves, were safe, investment grade securities. All of this, however, was false, as defendants were undeniably aware.

B. Morgan Stanley's Awareness that the Offering Documents Were False Is Confirmed by Its Shorting of Many of the Same, and Similar, Securities Sold to Plaintiff

609. Defendants' awareness of the fact that the certificates were not the safe, investment grade securities the Offering Documents represented them to be is further demonstrated by Morgan Stanley's decision to short many of the ***same*** certificates defendants sold to plaintiff, as well as other similar certificates issued from the ***same shelf registrations*** as the certificates sold to plaintiff.

610. On May 12, 2010, *The Wall Street Journal* reported that Morgan Stanley was being investigated by federal prosecutors for its role in structuring – and then betting against – a series of CDOs in mid-2006. Specifically, the report revealed that Morgan Stanley purchased CDSs betting against a series of CDOs, known as the "Dead Presidents" CDOs, which were backed by RMBS that had been hand-picked by Morgan Stanley.[22] Tellingly, Morgan Stanley selected several RMBS that the bank, itself, had structured, marketed and/or sold, including ***two of the very same offerings at issue herein***, MSHEL 2006-2 and MSHEL 2006-3. In addition, Morgan Stanley selected several other RMBS issued pursuant to the ***same*** MSAC, MSHEL, MSIX and IXIS shelf registration offerings at issue herein. Not surprisingly, the RMBS selected by Morgan Stanley for inclusion in the Dead Presidents CDOs suffered strikingly high default rates – just as Morgan Stanley had expected – in turn, generating significant profits for the bank.

611. In addition to the Dead Presidents CDOs, Morgan Stanley used its knowledge of the defective nature of the loans underlying its own RMBS offerings to purchase additional CDSs on

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[22] The Dead Presidents CDOs were actually named after former U.S. presidents Andrew Jackson (the "Jackson CDO") and James Buchanan (the "Buchanan CDO").

other CDOs, such as the ABSpoke, Libertas and Baldwin CDOs. Like the Dead Presidents CDOs, these other CDOs referenced the same and/or similar RMBS as the certificates at issue herein. And like the Dead Presidents CDOs, defendants only stood to profit from the CDSs they acquired on these other CDOs in the event that the CDOs' underlying RMBS – which were the same as and/or similar to the "investment grade" certificates defendants sold to plaintiff – failed.

612. For example, in June 2006, Morgan Stanley underwrote the ABSpoke 2006-IIIC CDO, which referenced RMBS issued pursuant to the same MSAC shelf from which the plaintiff at issue herein purchased more than $390 million worth of certificates. Like the Dead Presidents CDOs, Morgan Stanley entered into a CDS with the issuer of the ABSpoke 2006-IIIC CDO so that Morgan Stanley could profit when borrowers began to default on the loans underlying the referenced RMBS.

613. Defendants' decision to reference plaintiff's certificates in CDOs that Morgan Stanley had placed substantial short bets against is incredibly telling of Morgan Stanley's knowledge regarding the true credit quality of the certificates and their underlying loans. Indeed, just months before Morgan Stanley placed these massive bets, which could only pay off in the event of a failure by the CDOs' underlying RMBS, defendants sold the ***same*** certificates to plaintiff via the Offering Documents, which touted the certificates as ***safe, investment grade securities*** – securities that historically had only a ***2.6% probability of default***. Given this purportedly remote chance of default, there is ***no way*** defendants would have purchased CDSs that hinged on the ***failure*** of plaintiff's certificates, unless they ***knew*** that, in reality, the certificates were ***not*** the safe, investment securities the Offering Documents represented them to be.

C. Numerous Other Sources Confirm Morgan Stanley's Awareness of the Offering Documents' Misrepresentations Concerning the Certificates' Underlying Loans

614. Further evidence that Morgan Stanley knew its statements in the Offering Documents were false comes from former Morgan Stanley employee Mike Francis, who worked as an Executive Director on Morgan Stanley's residential mortgage trading desk, and essentially ***admitted that Morgan Stanley knowingly bought and sold risky, defective loans that contradicted Morgan Stanley's statements in its Offering Documents***. Specifically, Francis stated the following on a National Public Radio broadcast: "No income no asset loans, ***that's a liar's loan. We are telling you to lie to us, effectively***. . . . ***We're setting you up to lie. Something about that transaction feels very wrong. It felt wrong way back when. And I wish we had never done it. Unfortunately, what happened, we did it because everybody else was doing it***."

615. Francis further told the National Public Radio interviewer that Morgan Stanley "bought loans, lots of loans, from [WMC, an originator that originated loans in many of the Morgan Stanley Offerings, that Francis] knew in [his] gut . . . were bad loans."

616. Additional evidence of Morgan Stanley's fraudulent intent in connection with the certificates it sold to plaintiff comes from settlements reached between Morgan Stanley and two separate states' Attorneys General. For example, on June 24, 2010, the Attorney General of the Commonwealth of Massachusetts ("Attorney General") held a press conference to announce a settlement with Morgan Stanley, concerning Morgan Stanley's misconduct in financing, purchasing and securitizing high-risk mortgage loans during the period from 2005 through 2007 from lender New Century.[23] After an extensive investigation by the Attorney General, ***Morgan Stanley agreed to pay $102 million to settle the charges leveled against it by the Attorney General***.

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[23] As set forth *supra*, New Century served as one of the primary loan originators for the Morgan Stanley Offerings at issue herein. *See* §V. As also alleged above, New Century was one of the

617. Massachusetts and Morgan Stanley signed a settlement agreement, titled an "Assurance of Discontinuance" ("AOD"), which was filed with the Superior Court of the Commonwealth of Massachusetts, in Suffolk County, on June 24, 2010. The AOD set forth the results of the Attorney General's investigation of Morgan Stanley and New Century, which was based on the review of internal Morgan Stanley and/or New Century documents by the Attorney General. ***The Attorney General's investigation revealed that Morgan Stanley unquestionably knew that the statements it was making in the Offering Documents were false and misleading, because Morgan Stanley deliberately bought and securitized numerous defective loans made to borrowers who could not afford to repay them and which violated the stated underwriting guidelines***. Some of the Attorney General's investigation findings are summarized below:

- ***Morgan Stanley securitized loans that it knew were illegal and that Morgan Stanley also knew were made to borrowers who were "unable to afford the[m]***." AOD at 8. In particular, Morgan Stanley was aware that New Century unlawfully qualified borrowers for adjustable rate mortgages by using "teaser" rates, instead of using the "fully indexed rates," as required by law. Id. at 6-8. By using teaser rates, New Century was able to calculate artificially low DTI ratios to qualify borrowers for the loans. Morgan Stanley was aware of this but nonetheless bought and securitized New Century's illegal loans. Moreover, while "***Morgan Stanley considered borrowers with DTI ratios in excess of 55% to be unable to afford their loans***," Morgan Stanley was aware that the loans it bought from New Century would have DTI ratios far in excess of 55% if the borrowers' DTI ratios were properly calculated using the fully indexed rates. Id. at 8. In fact, the Attorney General found that if the borrowers' DTI ratios had been properly calculated, 41% of the loans Morgan Stanley purchased from New Century would have had DTI ratios in excess of 55%, and 29% would have DTI ratios in excess of 60%. *Id.*

- "***As a result of the due diligence process, Morgan Stanley was aware of quality problems with New Century subprime loans pools by late 2005. These problems included sloppy underwriting for many loans and stretching of underwriting guidelines to encompass or approve loans not written in accordance with the guidelines***." *Id.* at 9.

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worst, if not the worst, loan originators in the nation during the relevant time period, engaging in some of the most dubious lending practices and experiencing the highest foreclosure rate of any lender investigated by the OCC. *See* §VI.A.2, *supra*.

- ***New Century successfully pressured Morgan Stanley into knowingly buying defective loans that did not comply with the underwriting guidelines***. In March 2006, New Century complained to Morgan Stanley that it was rejecting too many loans and further pressured Morgan Stanley to buy more loans by suggesting that it would begin shifting its business to other buyers if Morgan Stanley did not buy more loans. ***The very next month, in April 2006, Morgan Stanley's senior bankers purchased hundreds of New Century loans that Morgan Stanley's due diligence team had rejected***. In addition, "Morgan Stanley's [due] diligence teams began to be more responsive to New Century's desire to include additional [defective] loans in the purchase pools." *Id*. at 9-10.

- ***Morgan Stanley knew that the majority of loans it purchased from New Century and securitized in 2006 and 2007 did not comply with the underwriting guidelines***. As alleged elsewhere, Clayton was hired to determine whether samples of New Century's loans "complied with the originator's underwriting guidelines and whether the loans were in compliance with applicable laws. When Clayton's examination uncovered loans that were in violation of guidelines or law in any respect, it graded the loans as 'exceptions.'" *Id*. at 9. "***In Morgan Stanley's 2006-2007 New Century [loan] pools, the large majority of the loans reviewed by Clayton were identified by Clayton as having some type of exception. Most loans had multiple exceptions." Id. at 10. "During 2006 and 2007, Morgan Stanley waived exceptions on and purchased a large number of the loans found by Clayton to violate guidelines without sufficient compensating factors. In the last three quarters of 2006, Morgan Stanley waived more than half of all material exceptions found by Clayton . . . and purchased a substantial number of New Century loans found by Clayton to violate guidelines without sufficient compensating factors***." *Id*.

- "***In addition, loans with certain exceptions such as high DTI ratios or high LTV or CLTV ratios that were in excess of underwriting guidelines but within a tolerance found acceptable to Morgan Stanley were purchased without a review by Clayton for compensating factors***." *Id*.

- ***Morgan Stanley knew of pervasive inflated appraisals that generated falsely understated LTV ratios but nonetheless purchased and securitized the loans***. "Starting in or around October 2005, . . . Morgan Stanley became aware of problems in the quality of appraisals at New Century. The quality problems persisted through 2006 and 2007." *Id*. at 11. Morgan Stanley hired "independent providers" to check the appraisal values on the New Century loans it purchased and securitized. These independent providers provided Morgan Stanley with "broker price opinions," or "BPOs," to check the value of the properties. Based on the BPOs, Morgan Stanley found large percentages of the loans had appraisals that were inflated, thus resulting in false LTV ratios. *Id*. at 11-12.

- ***Morgan Stanley knowingly misrepresented in its offering documents that no loan had an LTV ratio in excess of 100%.*** In the Offering Documents, Morgan Stanley represented that ***none*** of the loans in any of its Morgan Stanley Offerings – including those offerings where New Century was identified as an originator – had an LTV ratio in excess of 100%. *See* §V, *supra*. However, ***Morgan Stanley knew that "31% of the New Century loans on properties checked via BPOs . . . and securitized by Morgan Stanley in 2006 and 2007 had []LTV ratios . . . that were greater than 100%. In Morgan Stanley's securitizations during 2006 and 2007, 60% of the New Century loans with []LTVs based on the BPO-checked values over 100% had ratios greater than 105% on that basis, and about 19% of such loans had ratios greater than 120% on that basis."*** AOD at 11-12. This clearly demonstrates that Morgan Stanley intentionally misrepresented the LTV ratios of the loans underlying its offerings.

- ***Morgan Stanley knew that the "stated" incomes of borrowers were falsely inflated***. "In 2005, Morgan Stanley employees were aware that stated income loans were among the riskiest newly originated subprime loans Morgan Stanley purchased and that such loans were among the most likely subprime loans to become delinquent or default. . . . [O]ne of Morgan Stanley's employees described the stated income method as overused to the point of abuse. . . . ***As early as October 2005, Morgan Stanley's [due] diligence team determined . . . that the stated income on a number of New Century loans was unreasonable. In early 2006, a Morgan Stanley employee commented that stated income credit was not adequately evaluated by New Century. . . . On average, the stated income of these borrowers was approximately 42% higher than the income of fully documented borrowers***." *Id.* at 13-14.

- ***Morgan Stanley, despite all of the above knowledge indicating that New Century's loans did not comply with its underwriting guidelines, and had inflated appraisals, false incomes, false LTV ratios, and false DTI ratios, deliberately continued purchasing defective loans and securitizing them, passing them on to unsuspecting investors like plaintiff***. "Notwithstanding the problems identified above, Morgan Stanley continued to . . . purchase and securitize New Century's subprime mortgages through 2006 and the first half of 2007." *Id.* at 14.

618. ***In summary, the Attorney General's investigation found that "[f]rom [the] fourth quarter [of] 2005 through [the] first quarter [of] 2007, Morgan Stanley . . . knew that many borrowers could not repay the loans***." *Id.* at 15. Accordingly, there can be absolutely no doubt regarding Morgan Stanley's scienter here.

619. Similarly, on September 27, 2011, Nevada Attorney General Catherine Cortez Masto announced that the State of Nevada had entered into a settlement with MSMC, whereby Morgan Stanley agreed to pay between $21 million and $40 million because of its role in financing, purchasing and securitizing defective New Century loans in that state. In announcing the settlement,

Masto stated: "'***Morgan Stanley's deceptive practices hurt Nevada homeowners and played a role in our economy's decline.'. . . 'This is the first step in the right direction to protect consumers and put an end to this financial firm's egregious behavior***.'"

620. Like the Massachusetts' Attorney General's settlement with Morgan Stanley, the Nevada Attorney General's settlement with MSMC grew out of an investigation into MSMC's role in assisting New Century in making predatory loans to borrowers who could not afford them. The Nevada Attorney General investigated loans that New Century made and MSMC financed, purchased and securitized. According to the settlement agreement, the Nevada Attorney General's investigation focused on "inflated appraisals [that were used] to support [the] loans" that MSMC purchased, and the Nevada Attorney General's concern that New Century and MSMC induced "many borrowers [to take] out loans . . . that they would not be able to repay." The fact that Morgan Stanley would pay such a substantial sum in settlement is evidence that it knew it knowingly assisted such predatory loans by New Century and knowingly bought and securitized loans that did not comply with the stated underwriting guidelines.

621. The U.S. Government is also investigating Morgan Stanley concerning the very conduct at issue herein. In its annual report filed on Form 10-K with the SEC on February 26, 2010, Morgan Stanley confirmed that it was under direct investigation and was "responding to subpoenas and requests for information from certain regulatory and governmental entities concerning the origination, purchase, securitization and servicing of subprime and non-subprime residential mortgages and related issues including collateralized debt obligations and credit default swaps backed by or referencing mortgage pass through certificates."

622. Morgan Stanley confirmed that the government investigations were continuing in its annual report, filed on Form 10-K with the SEC on February 26, 2013. Morgan Stanley confirmed again that it was still under direct investigation and was

> responding to subpoenas and requests for information from certain regulatory and governmental entities concerning the origination, financing, purchase, securitization and servicing of subprime and non-subprime residential mortgages and related matters such as residential mortgage backed securities ("RMBS"), collateralized debt obligations ("CDOs"), structured investment vehicles ("SIVs") and credit default swaps backed by or referencing mortgage pass through certificates. These matters include, but are not limited to, investigations related to the Company's due diligence on the loans that it purchased for securitization, the Company's communications with ratings agencies, the Company's disclosures to investors, and the Company's handling of servicing and foreclosure related issues.

623. The foregoing facts further confirm the Morgan Stanley Defendants' indisputable awareness that the certificates' underlying loans were systematically defective and had routinely failed to be originated in accordance with their stated underwriting guidelines. Accordingly, defendants' scheme to nonetheless purchase and securitize such loans, and pass their risk of default onto investors like plaintiff in the form of investment grade RMBS that was materially misrepresented by defendants' Offering Documents, can be viewed as nothing other than fraud.

D. Morgan Stanley Knowingly Misled the Credit Rating Agencies

624. As the foregoing demonstrates, Morgan Stanley knowingly bought and securitized loans with misrepresented underwriting guidelines, appraisals, LTV ratios, OORs, and DTI ratios. The Morgan Stanley Defendants successfully concealed such information from plaintiff and other investors until late 2010, when the FCIC released its findings. The Morgan Stanley Defendants were equally successful in concealing the true statistics and facts about the loans from the Credit Rating Agencies, to whom Morgan Stanley fed the same falsified loan information as they did to plaintiff, in order to trick the Credit Rating Agencies' ratings models into generating "investment grade" credit ratings for the certificates.

625. The Morgan Stanley Defendants have not been so successful in hiding their credit rating agency scam from government regulators, however. On May 13, 2010, *Bloomberg* reported that Morgan Stanley, along with seven other banks, had been subpoenaed by New York Attorney

General Andrew Cuomo "to see whether they misled credit-rating services about mortgage-backed securities . . . [including] whether the banks manipulated the companies' ratings models." Other investigative bodies involved in this probe include the SEC and the U.S. Attorney's Office in Manhattan.

626. Nonetheless, the Morgan Stanley Defendants' efforts to deceive the Credit Rating Agencies and investors did not stop with feeding them falsified data. In addition to feeding the Credit Rating Agencies falsified data, the Morgan Stanley Defendants further tried to prevent the Credit Rating Agencies from using newer, more accurate ratings models on the Morgan Stanley Offerings, which would have potentially unraveled Morgan Stanley's fraudulent scheme to sell plaintiff worthless junk bonds masquerading as safe, "investment grade" securities. As revealed by internal documents released by the U.S. Senate Permanent Subcommittee on Investigations on April 23, 2010, Morgan Stanley routinely tried to persuade the Credit Rating Agencies to use their older and less accurate ratings models on Morgan Stanley's RMBS offerings, because such models were more favorable to Morgan Stanley. Morgan Stanley was frequently successful.

627. For example, on November 23, 2005, a Morgan Stanley executive sent an e-mail to S&P expressing concern that Morgan Stanley's current mortgage-backed deal would be re-tested using S&P's new and improved ratings model. *See* Levin-Coburn Report at 301 & n.1169. The Morgan Stanley executive urgently pressured S&P to apply an older and more favorable – but less accurate – ratings model instead, or to at least create a disclaimer for investors about the application of the new model. *Id.*

628. In another instance, a Morgan Stanley employee sent an e-mail to an S&P employee on August 1, 2006 insisting that S&P's older, less accurate ratings methods be used for some mortgage-backed transactions. *Id.* at 281 & n.1086. The Morgan Stanley employee's e-mail noted that Morgan Stanley had been successful in persuading S&P to do so in the past:

> "When you went from [model] 2.4 to 3.0, there was a period of time where you would rate on either model. I am asking for a similar 'dual option' window for a short period. I do not think this is unreasonable."

Id. at 281. In this instance, the frustrated S&P manager resisted Morgan Stanley's request for the exception. *Id.* However, in so doing, he reminded the banker of the frequency at which exceptions were made for Morgan Stanley, stating in part, "'[h]ow many times have I accommodated you on tight deals?'" *Id.*

629. Morgan Stanley applied the same pressure on Moody's to alter the ratings process to its benefit. In an October 2006 e-mail, a Morgan Stanley investment banker expressed concerns with Moody's use of key new methodology changes. *Id.* at 296 & n.1148.

630. In another instance, Morgan Stanley sent an e-mail in May 2007 to a Moody's Managing Director thanking him for complying with Morgan Stanley's request to delay the use of newer, revised ratings models and grandfather in Morgan Stanley's transactions. *Id.* at 303 & n.1175. The e-mail stated, in relevant part, as follows:

> "Thanks again for your help (and Mark's) in getting Morgan Stanley up-to-speed with your new methodology. As we discussed last Friday, please find below a list of transactions with which Morgan Stanley is significantly engaged already (assets in warehouses, some liabilities placed). We appreciate your willingness to grandfather these transactions [under] Moody's old methodology."

Id. at 303.

631. Thus, in addition to simply feeding the Credit Rating Agencies false loan data, Morgan Stanley also aggressively attempted to channel the Credit Rating Agencies away from using their newer, better, more accurate ratings models – which were more likely to reveal the true creditworthiness (or lack thereof) of the certificates – in order to try and keep its fraud concealed. Such conduct only further illustrates Morgan Stanley's fraudulent intent.

E. Morgan Stanley Knowingly Misrepresented that Title to the Certificates' Underlying Loans Was Properly and Timely Transferred

632. As previously alleged, defendants represented in the Offering Documents that they would properly and timely transfer title to the mortgage loans to the trusts that issued plaintiff's certificates. The Offering Documents represented that the depositor defendants would ensure that all right, title and interest in the mortgage loans would be transferred to the trusts at or about the "closing" or "cut-off" dates of the offerings, to ensure that plaintiff's certificates would be "mortgage-backed," as opposed to "***non***-mortgage-backed" securities, as well as to ensure the trust maintained its tax-free status as a REMIC mortgage pass-through conduit.

633. However, as is now evident, defendants, notwithstanding their promises, did not timely and/or effectively transfer title to the mortgage loans. This is evidenced by the news reports and lawsuits concerning the problems trustees are having with foreclosing on defaulting loans, the news reports of large scale forgeries and bogus assignments of loans after-the-fact, the mega-settlement with the Attorneys General of 49 states for $25 billion over such practices, and plaintiff's representative investigation concerning the loans in at least one of the trusts at issue herein, which revealed that nearly all of the loans were never properly or timely transferred to the trusts. *See* §VI.E, *supra*.

634. The foregoing shows that defendants did not timely or effectively transfer title to the mortgage loans to plaintiff's trusts. Of course, defendants were aware of this failure, as it was they, themselves, who were responsible for carrying out such conduct. Defendants obviously know what they did or did not do – here, it is obvious they did nothing, and equally obvious that they are aware of that fact. This is evidenced by the fact that years after the offerings closed, defendants attempted to scramble and create assignments after-the-fact, once they realized the implications of their earlier

failures to act. The mass of late assignments, forged assignments, and bogus assignment documents is just further evidence of defendants' attempts to cover up their fraudulent scheme.

VIII. DEFENDANTS' MISREPRESENTATIONS AND OMISSIONS WERE MADE FOR THE PURPOSE OF INDUCING RPI TO RELY ON THEM AND RPI ACTUALLY AND JUSTIFIABLY RELIED ON DEFENDANTS' MISREPRESENTATIONS AND OMISSIONS

635. RPI, through its assigning entities,[24] actually and justifiably relied upon the false information that defendants knowingly wrote into the Offering Documents and that was used to market the certificates.

636. The Offering Documents contained detailed descriptions of the mortgage pools underlying the certificates. The Offering Documents provided the specific terms of the particular offerings. They included data concerning the loans underlying the offerings, including, without limitation: the types of loans; the number of loans; the mortgage rate; the aggregate scheduled principal balance of the loans; the LTV ratios; the OOR percentages, including the Primary Residence Percentages; the credit enhancements; and the geographic concentration of the mortgaged properties. The Offering Documents also contained a description of the loan originators' underwriting and appraisal/valuation standards, guidelines and practices. The Offering Documents further contained the investment grade credit ratings assigned to the certificates by the Credit Rating Agencies, and a promise that the relevant mortgage loans would be properly and timely transferred to the trusts.

637. In deciding to purchase the certificates, the assigning entities actually relied on each of defendants' false representations and omissions of material fact in the prospectuses, pitch books, term sheets, loan tapes, "free writing" prospectuses, "red" and "pink" prospectuses, prospectus

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[24] In this section of the complaint alleging justifiable reliance, all references to RPI include the entities that assigned their claims to RPI alleged herein and include those entities' justifiable reliance.

supplements and other offering documents alleged herein that defendants provided to the assigning entities, including the representations regarding the loan underwriting guidelines, the characteristics of the underlying mortgage loans (such as the LTV ratios and OOR percentages, including the Primary Residence Percentages), the credit ratings assigned by the Credit Rating Agencies, and the transfer of title to the mortgage loans. But for defendants' misrepresentations and omissions in the Offering Documents, plaintiff's assignors would not have purchased the certificates.

638. RPI, through the assigning entities, reasonably and justifiably relied upon the information that defendants wrote into the Offering Documents and could not have discovered that defendants – some of the most sophisticated and then-respected commercial actors in the world – were omitting and misrepresenting material information exclusively within their possession, custody and control. RPI, through the assigning entities, performed a diligent investigation concerning the offerings, certificates and the underlying loans before purchasing the certificates and could not have learned that defendants were making material misrepresentations and omissions about the offerings, certificates and loans.

A. Fortis Bank Actually and Justifiably Relied on the False Information that Defendants Used to Sell the Subject Certificates

639. Assigning entity Fortis Bank made the decisions to purchase certain of the certificates at issue for itself, and for its affiliate Scaldis. All of the certificates purchased by Fortis Bank and Scaldis were purchased for those entities' own accounts, with the intention to hold the certificates on their balance sheets.

640. Fortis Bank employed highly qualified, conscientious, and experienced investment professionals to make investments on its behalf. The process involved screening and testing the quality of potential investments, which included portfolio and RMBS-level analyses. This process

was diligently followed by Fortis Bank in purchasing the securities at issue and was eminently reasonable.

641. Fortis Bank was only permitted to purchase securities for its asset-backed security ("ABS") portfolio that conformed to numerous investment parameters. For example, the security had to be a debt security, which, unlike equity, requires the obligor to return 100% of the invested principal amount by a date certain. Further, each debt security must have passed the major Credit Rating Agencies' own tests, qualifying as "investment grade" securities under those tests and analyses. Only if the particular security satisfied such portfolio-level criteria could it be considered for further review. Any security affected by defendants' misrepresentations and omissions would have been rejected at this first screening ***if*** defendants' misrepresentations and omissions ***could have*** been detected.

642. After putting in place reasonable portfolio-level screens to weed out risky investments, Fortis Bank conducted a detailed, three-tiered analysis of each RMBS. This analysis consisted of analyzing: (1) the capital structure of the particular security; (2) the quality of the underlying collateral, including the loans' LTV ratios, OOR percentages, DTI ratios, underwriting standards, and types of loans; and (3) the parties participating in the creation of the RMBS, including the originator of the loans, the servicer, the manager, and the underwriter. Investment professionals at Fortis Bank reviewed term sheets or similar summary materials that defendants wrote and provided (including pitch books, offering circulars, draft and final prospectuses, and investor presentations) regarding a particular RMBS, analyzed the RMBS's yield and price relative to similar securities in the market, and made an initial recommendation about whether to purchase the RMBS.

643. Fortis Bank also took into consideration which companies were originating the loans underlying the RMBS, based upon the originators' underwriting guidelines and historical performance. Fortis Bank regularly met with loan originators to discuss underwriting guidelines, at

conferences and on-site. Fortis Bank continued to meet with both defendants and originators after purchasing the securities at issue, and both defendants and those originators continued to provide assurances that the loans underlying the securities were originated pursuant to underwriting guidelines. Fortis Bank relied upon the statements regarding the originators' underwriting guidelines in the Offering Documents in making its investment decisions.

644. The next step in Fortis Bank's investment process involved conducting further credit analyses on the proposed RMBS. In that process, a credit analyst read marketing materials that defendants wrote, including the prospectus supplements and other Offering Documents. The process also involved using an expensive database and software system to detect any anomalies in a particular offering and to model the particular offering under various economic assumptions. This credit analysis further considered the level of structural subordination (or credit enhancement) supporting the proposed RMBS, and how sensitive the particular RMBS security was to various cashflow assumptions. The credit analysis focused on underwriting criteria, LTV ratios, FICO scores, OOR percentages, geographic dispersion, and the quality of the loan servicer supporting the transaction, among other pertinent credit characteristics.

645. Following its credit analysis, Fortis Bank subjected a proposed RMBS purchase to even more screening. Fortis Bank gathered the foregoing portfolio-level data, pricing information and credit analysis data, including LTVs, OORs, credit ratings, and originator information, and subjected all of that data to review by Fortis Bank's investment committee. The investment committee was comprised of experienced senior investment professionals and a risk management officer, who were required to approve the particular RMBS prior to purchase.

646. In fact, there were at least four different screens that Fortis Bank employed that would have rejected defendants' "junk" securities that were falsely masquerading as investment grade bonds. ***First***, the certificates at issue in this case never should have been rated "investment grade,"

because, as defendants knew, those ratings were based on "garbage in" the Credit Rating Agencies' rating models, resulting naturally in "garbage out" of those models. Thus, the certificates would have failed Fortis Bank's portfolio-level screening had the truth about defendants' misrepresentations been known. ***Second***, the subject certificates would have failed the initial RMBS-level screening, because the true qualitative and quantitative data would have exposed the certificates as being massively mispriced had it been accurately set forth in the certificates' Offering Documents. ***Third***, the subject certificates would have been thoroughly rejected by Fortis Bank's robust credit analysis, which, as noted, served to double check prior analyses and dive even deeper into the credit characteristics of the particular bond. ***Fourth***, if Fortis Bank's personnel had detected defendants' use of phony data, they would have rejected the certificates at every stage noted above and would have rejected the certificates at the investment committee phase of the investment process.

647. In the end, none of Fortis Bank's expertise, databases, software, investment personnel, quality control checks or substantial investment in all of these processes really mattered. Indeed, where highly sophisticated commercial actors like defendants have material non-public information about a security and a premeditated plan to commit fraud, such as was the case here, even the most sophisticated systems in the world are insufficient to detect those misrepresentations and omissions. That is one of the many reasons why it has taken the full force of the U.S. Government and its agencies, exercising their subpoena power, through the U.S. Senate and the FCIC, to alert investors to the fact that defendants received reports from Clayton showing that the loans they were selling to investors – including plaintiff and its assigning entities – via the certificates were ***defective on the day they were made***.

B. Fortis Cayman Actually and Justifiably Relied on the False Information that Defendants Used to Sell the Subject Certificates

648. Assigning entity Fortis Cayman hired professional asset investment managers, such as Fortis Investment Management ("FIM") and FSI Capital LLC ("FSI"), to conduct its investment activities. On information and belief, these investment managers, in turn, employed highly qualified, conscientious, and experienced investment professionals to make investments on behalf of their clients, reviewed the term sheets and/or similar summary materials that defendants wrote and provided (including pitch books, offering circulars, draft and final prospectuses, and investor presentations) regarding a particular RMBS, analyzed the RMBS's yield and price relative to similar securities in the market, and made a decision to purchase the RMBS based on that information.

649. Fortis Cayman's investment managers, such as FIM and FSI, were only permitted to purchase securities for Fortis Cayman's portfolio that conformed to numerous investment parameters and criteria contained in the engagement letters between Fortis Cayman and its investment managers. Further, each debt security must have passed the major Credit Rating Agencies' own tests, qualifying as an "investment grade" security under those tests and analyses. Any security affected by defendants' misrepresentations and omissions would have been rejected at this first screening if defendants' misrepresentations and omissions could have been detected.

650. In the end, none of Fortis Cayman's or its professional investment managers' expertise, investment personnel, quality control checks or substantial investment in all of these processes really mattered. Indeed, where highly sophisticated commercial actors like defendants have material non-public information about a security and a premeditated plan to commit fraud, such as was the case here, even the most sophisticated systems in the world are insufficient to detect those misrepresentations and omissions. That is one of the many reasons why it has taken the full force of the U.S. Government and its agencies, exercising their subpoena power, through the U.S. Senate and

the FCIC, to alert investors to the fact that defendants received reports from Clayton showing that the loans they were selling to investors – including plaintiff through the assigning entities – via the certificates were ***defective on the day they were made***.

C. All of the Assignors and Plaintiff Were Reasonable and Could Not Have Discovered the Fraud Alleged Herein

651. Plaintiff and the assigning entities did not learn that the defendants were making the misrepresentations and omissions alleged herein prior to purchasing the certificates because such information about the certificates and loans was peculiarly within defendants' knowledge and control, and defendants did not allow plaintiff and the assigning entities access to such information. The only way for plaintiff or the assigning entities to learn that defendants were making misrepresentations and omissions about the certificates and the underlying loans was to have access to the actual loan files or due diligence reports analyzing those loan files. Defendants had such access, but did not share it with plaintiff, the assigning entities, or other investors.

652. At the time they purchased the certificates, plaintiff and the assigning entities could not determine from available information that defendants had made misrepresentations and omissions in the Offering Documents. The information that would have revealed defendants' misrepresentations and omissions – the loan files – was private information in the complete control and possession of defendants. Moreover, information such as "loan tapes," and the like, and other information defendants supplied to plaintiff or its assignors before they purchased the certificates, would not have revealed borrowers' names or property addresses so that plaintiff could conduct an investigation. Such information also would not have revealed defendants' misrepresentations and omissions because the "loan tapes" and the other information defendants provided to plaintiff ***contained*** the falsified appraisal values, LTV ratios, OOR percentages, FICO scores and DTI ratios

upon which defendants' scheme was premised, and thus, revealed nothing concerning the loans' true nature, characteristics and risks.

653. In addition, at the time plaintiff bought the certificates – 2005 through 2007 – there were no loan databases available that contained sufficient data to conduct analyses concerning the LTV ratios and OOR percentages like the ones plaintiff was able to conduct before filing this complaint. In short, there was no information available to plaintiff or the assigning entities at the time they bought the certificates – other than the loan files, which defendants did not share – that would have allowed plaintiff or the assigning entities to conduct an investigation that would have revealed that defendants were making misrepresentations and omitting material information in the Offering Documents.

654. Indeed, plaintiff could not have learned, and did not learn, that defendants were defrauding it until late September 2010, when the FCIC investigation revealed for the first time that defendants: (1) were told by Clayton in 2006 and 2007 that significant portions of the loans within the offerings did not comply with the underwriting guidelines stated in the Offering Documents; and (2) ***defendants then knowingly included large numbers of those defective loans into the offerings***. It was only at that time that plaintiff and the public first learned that defendants were intentionally defrauding investors in connection with RMBS offerings. Specifically, the information disclosed by the FCIC in September 2010 revealed, for the first time, that defendants were expressly aware that their RMBS offerings were filled with defective loans, and that defendants knew so:

(a) ***before*** marketing the RMBS;

(b) ***before*** describing the collateral underlying the RMBS;

(c) ***before*** writing the prospectuses, prospectus supplements and other Offering Documents they used to market the certificates;

(d) ***before*** "structuring" the RMBS with the Credit Rating Agencies' data-sensitive models;

(e) ***before*** "pricing" the subject RMBS; and

(f) ***before conveying*** the false information to plaintiff or its agents.

655. This information only came to light in late September 2010, and only after the U.S. Government compelled defendants, Clayton, and others to produce documents and testimony that finally revealed defendants' fraud. Only the unique power of the government to compel people, documents and testimony without bringing a legal action revealed defendants' fraud. Obviously, plaintiff does not and did not have such power or unique abilities. This further serves to demonstrate that plaintiff and the assigning entities could not have uncovered defendants' misconduct by any means available to them.

IX. DEFENDANTS' MATERIAL MISREPRESENTATIONS AND OMISSIONS CAUSED INJURY TO PLAINTIFF

656. Defendants' material misrepresentations and omissions relate directly to plaintiff's economic losses. Sophisticated securities dealers like defendants have long known about the relationship between LTV ratios, OORs, credit ratings, title and ownership, and underwriting criteria on the one hand, and the price and performance of an RMBS certificate on the other hand. Defendants' misrepresentations were the actual and proximate causes of plaintiff's injuries.

A. The Relationship Between Original LTV Ratios, Owner Occupancy Data and RMBS Performance

657. Original LTV or "OLTV" metrics are among the most important variables indicating whether a loan will default. Studies conducted by one industry participant, Smith Barney, demonstrate that there is a strong correlation between the likelihood of default of a mortgage loan and the loan's OLTV ratio. When home prices decrease, borrowers with lower OLTV ratios are more likely to retain more equity in their homes ***even if*** housing prices generally decline. Retaining

such equity provides borrowers a powerful incentive to make loan payments, which reduces the propensity of a loan to default. Retaining such equity also enables the borrower to sell the property, repay the loan and recover value in the event of default.

658. Conversely, if a borrower has a higher OLTV ratio, like those that were concealed in this case, there is much less incentive for the borrower to repay the loan if home prices decline or a borrower's financial condition changes, because such borrower would have little equity at risk of loss and therefore far less economic incentive to pay the loan. As a consequence, from an investor's perspective, a loan with a higher OLTV ratio is a much riskier investment, as there is a much higher chance of default and a much higher risk of incurring a loss because of insufficient collateral for the loan.

659. When defendants misrepresented the OLTV ratios associated with the RMBS at issue in this case, they knew that they were also misrepresenting both the propensity of the loans to default ***and*** their propensity to recover any value and avoid a loss in the event of default.

660. Defendants had actual knowledge of the relationship between the OLTV ratios and the value of the RMBS certificates at issue in this case. *See*, *e.g.*, MSAC 2007-HE2 Pros. Supp. at S-22. Thus, the very documents that defendants wrote to market the RMBS at issue in this case demonstrate that defendants understood the relationship between the misrepresentations that defendants made concerning LTV ratios and plaintiff's economic harm: an increase in LTV ratios creates a greater risk of loss on the RMBS certificates.

661. The foregoing demonstrates that defendants clearly knew that the false OLTV ratios, and the related inflated appraisals they used to sell the certificates, would cause plaintiff's damages. The relationship between those inaccurate numbers and plaintiff's harm is immediate and clear. Just as industry literature shows a direct relationship between OLTV ratios, defaults and loss severity, that literature shows the same relationship between OOR percentages and default probabilities.

Under every market condition, the OLTV ratios and OOR percentages drive the probability of a loan defaulting. Under every market condition, OLTV ratios and OOR percentages also drive the degree of loss that will be suffered in the event of a loan default. As illustrated above, defendants say as much in their own Offering Documents.

662. But that is not the full extent of defendants' fraud as it relates to OLTV ratios and OOR percentages in this case. Defendants further inflated the prices of the RMBS in this case by entering inaccurate OLTV and OOR numbers into the Credit Rating Agencies' computerized ratings models to secure artificially inflated ratings. This misconduct also relates to plaintiff's losses.

B. The Relationship Between Credit Ratings and RMBS Performance

663. It is already clear that defendants used "garbage" data to get overrated, inflated credit ratings assigned to the certificates at issue in this case. These false credit ratings, based on false facts, also contributed directly to plaintiff's damages.

664. When the Credit Rating Agencies began downgrading the certificates at issue in this case to speculative or "junk" grade levels and below because of escalating default rates, it became apparent that the certificates did not have the creditworthiness defendants had portrayed. As a result, the market value of the certificates plummeted. Because of defendants' misrepresentations and omissions, plaintiff suffered damages in the form of overpaying for the certificates in the first instance. Plaintiff also suffered damages as a result of defendants' misrepresentations and omissions when the risky loans defaulted, causing plaintiff to lose principal and interest payments and incur write-downs to the loan pools underlying the certificates. Sixteen of the 37 certificates are now in default.

665. Industry executives have explained how false credit ratings relate to losses on RMBS products like those defendants sold in this case. According to Charles Prince, the former CEO of

Citigroup, the largest bank in the world, the Credit Rating Agencies' downgrades were "the precipitating event in the financial crisis."

666. Downgrades to junk revealed the truth that the original ratings – like the OLTV and OOR data – were based on false and inaccurate information on the day they were issued. It is not possible to ascribe this inaccurate information to mistakes in the origination or structuring processes outside of defendants' control. Rather, as revealed by the government's disclosure of the Clayton data in September 2010, defendants were well aware of reports detailing the inaccurate OLTV, OOR and ratings data used to structure the RMBS at issue in this case ***before*** making, structuring and selling their RMBS to plaintiff, and defendants nonetheless deliberately decided to misrepresent that data to plaintiff, the Credit Rating Agencies, and other investors, so that they could profit.

C. The Relationship Between Underwriting and RMBS Performance

667. Defendants also concealed rampant, systematic violations of stated loan underwriting standards to maximize their profits at plaintiff's expense. Underwriting, by definition, refers to the process of determining a borrower's ability and willingness to repay a loan. As with LTV ratios, OORs and credit ratings, defendants' decision to misrepresent underwriting standards relates directly to plaintiff's economic damages.

668. Government investigations demonstrate the direct link between defendants' misrepresentations about underwriting standards and plaintiff's economic harm. On or about March 13, 2008, for example, after a seven-month investigation requested by the President of the United States, a working group led by the Secretary of Treasury and including the chairmen of the Federal Reserve, the SEC, and the Commodities Futures Trading Commission, issued a report finding that: (i) "a significant erosion of market discipline by those involved in the securitization process, including originators, underwriters, credit rating agencies and global investors, related in part to

failures to provide adequate risk disclosures"; and (ii) "[t]he turmoil in financial markets clearly was triggered by a dramatic weakening of underwriting standards for U.S. subprime mortgages."

669. Indeed, contrary to defendants' expected efforts to claim that plaintiff's certificates declined in value because of this Nation's economic collapse, in fact the opposite is true – defendants' systemic misrepresentations in the Offering Documents caused plaintiff's and many other investors' certificates to plummet in value, which in turn caused this Nation's financial collapse. Defendants' systemic misrepresentations and omissions concerning the loans at issue caused plaintiff's damages, and thereafter "***the high risk loans [defendants] issued became the fuel that ignited the financial crisis***." Levin-Coburn Report at 50; *see also id.* at 475 ("***The widespread losses caused by . . . RMBS securities originated by investment banks [which contained "poor quality assets"] are a key cause of the financial crisis that affected the global financial system in 2007 and 2008***.").

670. When it became known that the loans in the offerings were much riskier than represented, through skyrocketing default rates that led to major credit downgrades to the certificates, it also became apparent that the loans had not been originated pursuant to the underwriting standards represented in the Offering Documents. It became apparent then that the loans had been originated in a slipshod fashion, with little regard to the most basic underwriting guideline of all – determining whether the borrower could repay the loan. This fact too was a cause of the plummeting value of plaintiff's certificates, and a contributing cause of plaintiff's damages. Therefore, defendants' misrepresentations about underwriting standards directly and proximately caused plaintiff's injuries.

D. The Relationship Between Proper and Timely Transfer of Title and Plaintiff's Damages

671. Defendants' misrepresentations that the loans would be properly and timely transferred to the trusts were also a proximate cause of plaintiff's economic damages. Plaintiff believed it was purchasing mortgage-***backed*** securities. Given that the certificates are lacking much of the backing or collateral that was supposed to be providing security, and guaranteeing a source of funds if the loans defaulted, the certificates have lost value as it has become known that the RMBS might actually be ***non***-mortgage-backed securities. In other words, the lack of collateral underlying the certificates has caused an understandable and logical diminution in the value of the certificates. As Professor Levitin noted in his testimony to Congress in November 2010, the failure to properly or timely transfer title would have "profound implications for [R]MBS investors," and would cause trillions of dollars in damages. Defendants' misrepresentations concerning the transfer of title proximately caused plaintiff's damages.

FIRST CAUSE OF ACTION

(Common Law Fraud Against All Defendants)

672. Plaintiff repeats and realleges the allegations set forth in the preceding paragraphs, as if fully set forth herein.

673. As alleged above, in the Offering Documents, defendants made false and misleading statements of material fact, and omitted material facts necessary in order to make their statements, in light of the circumstances under which the statements were made, not misleading.

674. As the corporate parent of its wholly-owned subsidiaries, defendant Morgan Stanley directed and controlled the activities of its co-defendants, and used them as conduits to conduct the RMBS offerings alleged herein.

675. Defendants knew at the time they sold and marketed each of the certificates that the foregoing statements were false and misleading or, at the very least, were made recklessly.

676. Defendants made these materially false and misleading statements and omissions for the purpose of inducing plaintiff (and the assigning entities) to purchase the certificates. Furthermore, these statements related to these defendants' own acts and omissions.

677. Defendants knew or recklessly disregarded that investors like plaintiff (and the assigning entities) were relying on defendants' expertise, and defendants encouraged such reliance through the Offering Documents, as described herein. Defendants knew or recklessly disregarded that investors like plaintiff (and the assigning entities) would rely upon defendants' representations in connection with their decisions to purchase the certificates. As alleged herein, defendants were in a position of unique and superior knowledge regarding the true facts concerning the foregoing material misrepresentations and omissions.

678. It was only by making such misrepresentations and omissions that defendants were able to induce plaintiff (and the assigning entities) to buy the certificates. Plaintiff (and the assigning entities) would not have purchased or otherwise acquired the certificates but for defendants' fraudulent representations and omissions about the quality of the certificates and the underlying loans.

679. Plaintiff (and the assigning entities) actually, justifiably, reasonably, and foreseeably relied upon defendants' false and misleading representations and omissions regarding the certificates and the underlying loans.

680. As a result of defendants' false and misleading statements and omissions, as alleged herein, plaintiff (and the assigning entities) has suffered substantial damages.

681. The Morgan Stanley Defendants also defrauded plaintiff (and the assigning entities) by concealing from plaintiff (and the assigning entities) that they were "shorting" RMBS like the

certificates sold to plaintiff (and the assigning entities) at the same time defendants sold the certificates at issue to plaintiff (and the assigning entities).

682. Because defendants committed these acts and omissions maliciously, wantonly and oppressively, and because the consequences of these acts knowingly affected the general public, including, but not limited to, all persons with interests in the RMBS, plaintiff (through itself and the assigning entities) is entitled to recover punitive damages.

SECOND CAUSE OF ACTION

(Fraudulent Inducement Against All Defendants)

683. Plaintiff repeats and realleges the allegations set forth in the preceding paragraphs, as if fully set forth herein.

684. As alleged above, in the Offering Documents defendants made fraudulent, false and misleading statements of material fact, and omitted material facts necessary in order to make their statements, in light of the circumstances under which the statements were made, not misleading. The Morgan Stanley Defendants also omitted that they were "shorting" RMBS, including plaintiff's (and the assigning entities'), at the same time those defendants sold the certificates at issue herein to plaintiff (and the assigning entities).

685. This is a claim for fraudulent inducement against all of the defendants. As the corporate parent, defendant Morgan Stanley directed the activities of its co-defendant subsidiaries and used them as conduits to conduct the RMBS offerings alleged herein.

686. Defendants knew at the time they sold and marketed each of the certificates that the foregoing statements were false and misleading or, at the very least, were made recklessly.

687. Defendants made these materially false and misleading statements and omissions for the purpose of inducing plaintiff (and the assigning entities) to purchase the certificates. Furthermore, these statements related to defendants' own acts and omissions.

688. Defendants knew or recklessly disregarded that investors like plaintiff (and the assigning entities) were relying on defendants' expertise, and defendants encouraged such reliance through the Offering Documents, as described herein. Defendants knew or recklessly disregarded that investors like plaintiff (and the assigning entities) would rely upon defendants' representations in connection with their decisions to purchase the certificates. As alleged herein, defendants were in a position of unique and superior knowledge regarding the true facts concerning the foregoing material misrepresentations and omissions.

689. It was only by making such misrepresentations and omissions that defendants were able to induce plaintiff (and the assigning entities) to buy the certificates. Plaintiff (and the assigning entities) would not have purchased or otherwise acquired the certificates but for defendants' fraudulent representations and omissions about the certificates and the underlying loans.

690. Plaintiff (and the assigning entities) actually, justifiably, reasonably, and foreseeably relied upon defendants' false and misleading representations and omissions regarding the certificates and underlying loans.

691. By virtue of defendants' false and misleading statements and omissions, as alleged herein, plaintiff (and the assigning entities) has suffered substantial damages.

692. In addition, because defendants acted maliciously, wantonly and oppressively, and defendants' acts affected the general public, plaintiff is entitled to recover punitive damages.

THIRD CAUSE OF ACTION

(Aiding and Abetting Fraud Against All Defendants)

693. Plaintiff repeats and realleges the allegations set forth in the preceding paragraphs, as if fully set forth herein.

694. This is a claim against each of the defendants for aiding and abetting the fraud by their co-defendants. Specifically, each of the Morgan Stanley Defendants aided and abetted each of the other Morgan Stanley Defendants.

695. Each of the defendants knew of the fraud perpetrated by each of their co-defendants on plaintiff (and the assigning entities). As alleged in detail above, each of the defendants knew that the certificates were not backed by loans of the quality represented by defendants, and were not underwritten according to the originators' stated underwriting standards. In fact, defendants owned originators and/or conducted due diligence on the loan pools securitized into the offerings purchased by plaintiff (and the assigning entities) and identified the originators' deviations from the loan underwriting and appraisal standards set forth in the Offering Documents and knew that the LTV ratios, OOR percentages (including the Primary Residence Percentages) and credit ratings in the Offering Documents were false. Each of the defendants also knew that their representations that they had timely and properly transferred title to the mortgage loans were false. Each of the defendants concealed from plaintiff (and the assigning entities) that some of their co-defendants were simultaneously "shorting" the same types of investments that they were selling to plaintiff (and the assigning entities). Each of the defendants participated in those violations by their co-defendants, and had actual knowledge of their own acts and participated in and had actual knowledge of their co-defendants' fraudulent acts alleged herein.

696. Furthermore, each of the defendants provided their co-defendants with substantial assistance in advancing the commission of their frauds. As alleged in detail above, each of the defendants participated in the following acts constituting the fraud with their co-defendants: making false and misleading statements and omissions in the Offering Documents about the originators' loan underwriting and appraisal standards, the loans' LTV ratios, the loans' OOR percentages (including the Primary Residence Percentages), the certificates' credit ratings, and the transfer of title of the

mortgage loans; providing false information about the loans underlying the certificates to the Credit Rating Agencies; providing false information for use in the Offering Documents; concealing from plaintiff (and the assigning entities) the originators' deviations from their stated mortgage loan underwriting and appraisal standards; and concealing from plaintiff (and the assigning entities) that some of their co-defendants were shorting investments like the certificates.

697. It was foreseeable to each of the defendants at the time they actively assisted in the commission of their co-defendants' frauds that plaintiff (and the assigning entities) would be harmed as a result of each of the defendants' assistance of their co-defendants.

698. As a direct and natural result of the frauds committed by each defendant and each defendant's knowing and active participation in each fraud committed by such defendant's co-defendants, plaintiff (and the assigning entities) has suffered substantial damages.

699. In addition, because defendants acted maliciously, wantonly and oppressively, and defendants' acts affected the general public, plaintiff is entitled to recover punitive damages.

FOURTH CAUSE OF ACTION

(Negligent Misrepresentation Against All Defendants)

700. Plaintiff repeats and realleges the allegations set forth in the preceding paragraphs, as if fully set forth herein, except any allegations that defendants made any untrue statements and omissions intentionally or recklessly. For the purposes of this cause of action, plaintiff expressly disclaims any claim of fraud or intentional or reckless misconduct.

701. This is a claim for negligent misrepresentation against all defendants.

702. Plaintiff (and the assigning entities) made 37 separate investments in 27 offerings of RMBS that the defendants securitized and sold.

703. It is a required industry practice for underwriters of RMBS offerings to perform an investigation of the loans backing the certificates to ensure that the quality of the loans is as

represented in the offering documents provided to investors. In fact, U.S. securities laws require defendants to "***perform a review of the pool assets underlying the asset-backed security***" and ensure that such information shall be disclosed in the offering documents and "***is accurate in all material respects***." 17 C.F.R. §230.193. In addition, "[p]rospective investors look to the underwriter – a fact well known to all concerned and ***especially to the underwriter*** – to pass on the soundness of the security and the correctness of the [offering documents]." *Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d, 341, 370 (2d Cir. 1973).

704. Because of the foregoing, defendants conducted due diligence and investigated the loans that backed their RMBS offerings. The purpose and effect of defendants' legal obligations as underwriters to conduct due diligence and ensure the correctness of the statements in the Offering Documents, as well as the investing public's understanding that the RMBS underwriters perform such due diligence to ensure the accuracy of statements made in the Offering Documents, was to assure plaintiff (and the assigning entities) that it could reasonably rely upon the Offering Documents. Moreover, by virtue of the due diligence defendants performed, and their extensive role in originating, purchasing, securitizing and selling the certificates that plaintiff (and the assigning entities) purchased, defendants had extremely unique and special knowledge and expertise regarding the loans backing those certificates, including the loans' quality, the nature of their underwriting, their value and adequacy as collateral, their LTV ratios, their OOR percentages, and the title to such loans.

705. In particular, because plaintiff (and the assigning entities) did not have access to the loan files for the mortgage loans, or defendants' due diligence and valuation reports, while only defendants did, and because plaintiff (and the assigning entities) could not examine the underwriting quality of the mortgage loans underlying the offerings on a loan-by-loan basis, plaintiff (and the assigning entities) was heavily dependent on defendants' unique and special knowledge and

expertise regarding the loans that backed the certificates at issue herein when determining whether to invest in each certificate. Plaintiff (and the assigning entities) was entirely dependent on defendants to provide accurate and truthful information regarding the loans because plaintiff (and the assigning entities) had no access to the loan files, which were completely within defendants' control. Moreover, as alleged above, at the time plaintiff (and the assigning entities) purchased the certificates, plaintiff (and the assigning entities) had no ability to test the veracity of defendants' representations in the Offering Documents concerning the loans because there were no loan databases available in the 2005 to 2007 time period which would allow plaintiff (or the assigning entities) to conduct sufficient analyses, like the analyses plaintiff performed prior to filing this complaint. Accordingly, defendants were uniquely situated to evaluate the safety and economics of each certificate sold to plaintiff (and the assigning entities) and the loans underlying them.

706. Because plaintiff (and the assigning entities) was without access to critical information regarding the loans backing the certificates, and defendants had a legal obligation to perform due diligence on the loans and ensure any statements made about the loans in the Offering Documents were truthful and accurate, and plaintiff (and the assigning entities) had the understanding that RMBS underwriters performed due diligence to ensure the accuracy of the Offering Documents, defendants had a duty to plaintiff (and the assigning entities) to verify the accuracy and truthfulness of the Offering Documents.

707. Over the course of at least five years, plaintiff (and the assigning entities) relied on defendants' unique and special knowledge regarding the quality of the underlying mortgage loans and defendants' underwriting when determining whether to invest in the certificates. These longstanding relationships, coupled with defendants' unique and special position of knowledge about the underlying loans, created a special relationship of trust, confidence, and dependence between defendants and plaintiff (and the assigning entities).

708. Defendants were aware that plaintiff (and the assigning entities) relied on defendants' unique and special position, expertise and experience, and depended upon defendants for accurate and truthful information. Defendants also knew that the actual true statistics regarding the loans and the loans' compliance with the stated underwriting standards were exclusively within defendants' knowledge.

709. Based on defendants' expertise, superior knowledge, legal duties, and relationship with plaintiff (and the assigning entities), defendants owed a duty to plaintiff (and the assigning entities) to provide complete, accurate, truthful and timely information regarding the mortgage loans and the certificates. Defendants breached their duty to provide such information to plaintiff (and the assigning entities).

710. Defendants likewise made misrepresentations which they knew, or were negligent in not knowing at the time, to be false and misleading in order to induce plaintiff's (and the assigning entities') investment in the certificates. Defendants provided the Offering Documents to plaintiff (and the assigning entities) in connection with the sale of the certificates for the purpose of informing plaintiff (and the assigning entities) of material facts necessary to make an informed judgment about whether to purchase the certificates in the offerings. In providing these documents, defendants knew that the information contained and incorporated therein would be used for a serious purpose, and that plaintiff (and the assigning entities), like other reasonably prudent investors, intended to rely on the information contained in the Offering Documents.

711. As alleged above, the Offering Documents contained materially false and misleading information and omissions, including, without limitation, misrepresentations concerning the underwriting guidelines, appraisals, LTV ratios, Primary Residence Percentages, credit ratings, and the transfer of title to the loans, and the omissions that the Morgan Stanley Defendants were selling

RMBS like the ones sold to plaintiff (and the assigning entities) "short" at the same time those defendants sold plaintiff (and the assigning entities) the certificates.

712. Defendants acted negligently in making the materially false and misleading statements and omissions to plaintiff (and the assigning entities).

713. Unaware that the Offering Documents contained materially false and misleading statements and omissions, plaintiff (and the assigning entities) reasonably relied on those false and misleading statements and omissions when deciding to purchase the certificates.

714. Plaintiff (and the assigning entities) purchased certificates from defendant Morgan Stanley & Co. in the offerings, and is therefore in privity with them.

715. Based on defendants' expertise and specialized knowledge, and in light of the false and misleading representations and omissions in the Offering Documents, defendants owed plaintiff (and the assigning entities) a duty to provide it with complete, accurate, truthful and timely information regarding the quality of the certificates and underlying loans, and their title, and defendants breached their duty to provide such information to plaintiff (and the assigning entities).

716. Plaintiff (and the assigning entities) reasonably relied on the information provided by defendants and has suffered substantial damages as a result of defendants' misrepresentations.

PRAYER FOR RELIEF

WHEREFORE, plaintiff prays for relief and judgment, as follows:

(a) Awarding compensatory damages in favor of plaintiff against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

(b) Awarding punitive damages for plaintiff's common-law fraud claims;

(c) Awarding plaintiff its reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

(d) Such other relief, including equitable relief, as the Court may deem just and proper.

JURY DEMAND

Plaintiff demands a trial by jury on all claims so triable.

DATED: October 24, 2013

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Appendix A

Offering	Issue Date	Depositor	Sponsor	Defendant Underwriter	Tranche Purchased	CUSIP	Purchase Date	Original Face Amount	Assigning Entity	Seller
ACCR 2006-1	3/28/2006	Accredited	Accredited	Morgan Stanley & Co.	A4	004375FG1	3/20/2006	$4,000,000	Fortis Bank	Morgan Stanley & Co.
IXIS 2006-HE2	5/25/2006	MSABS	IXIS Real Estate Cap.	Morgan Stanley & Co.	A4	46602WAD6	4/24/2006	$25,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2005-HE2	3/30/2005	MSABS	Option One	Morgan Stanley & Co.	M1	61744CNB8	3/8/2005	$2,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2006-HE2	4/28/2006	MS Capital	MSMC	Morgan Stanley & Co.	M1	617451EW5	3/14/2006	$10,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2006-HE3	5/25/2006	MSABS	MSMC	Morgan Stanley & Co.	A2D	61749HAE0	5/5/2006	$25,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2006-HE4	6/23/2006	MSABS	MSMC	Morgan Stanley & Co.	A4	61748BAD6	5/15/2006	$20,000,000	Scaldis	Morgan Stanley & Co.
					M1	61748BAE4	5/15/2006	$9,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2006-HE5	6/30/2006	MSABS	MSMC	Morgan Stanley & Co.	A2D	61749NAE7	6/26/2006	$20,000,000	Scaldis	Morgan Stanley & Co.
MSAC 2006-HE6	9/27/2006	MSABS	MSMC	Morgan Stanley & Co.	A2D	61750FAF7	9/8/2006	$15,000,000	Scaldis	Morgan Stanley & Co.
MSAC 2006-HE7	10/31/2006	MSABS	MSMC	Morgan Stanley & Co.	A2D	61750MAF2	10/12/2006	$28,080,000	Scaldis	Morgan Stanley & Co.
MSAC 2006-HE8	11/29/2006	MSABS	MSMC	Morgan Stanley & Co.	A2D	61750SAF9	11/22/2006	$30,000,000	Scaldis	Morgan Stanley & Co.
					M1	61750SAG7	11/22/2006	$11,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2006-NC2	3/30/2006	MS Capital	MSMC	Morgan Stanley & Co.	A2D	617451EF2	2/28/2006	$9,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2006-NC4	6/23/2006	MSABS	MSMC	Morgan Stanley & Co.	A2D	61748LAE2	5/22/2006	$24,570,000	Scaldis	Morgan Stanley & Co.
					M1	61748LAF9	5/22/2006	$10,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2006-WMC2	6/28/2006	MSABS	MSMC	Morgan Stanley & Co.	A2D	61749KAF0	5/26/2006	$17,000,000	Scaldis	Morgan Stanley & Co.
					M1	61749KAG8	5/26/2006	$10,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2007-HE1	1/26/2007	MSABS	MSMC	Morgan Stanley & Co.	A2D	617526AF5	1/11/2007	$15,000,000	Fortis Bank	Morgan Stanley & Co.
					M1	617526AG3	1/11/2007	$10,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2007-HE2	2/28/2007	MSABS	MSMC	Morgan Stanley & Co.	M1	61753EAE0	2/8/2007	$10,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2007-HE3	2/28/2007	MSABS	MSMC	Morgan Stanley & Co.	A2D	617538AD5	2/26/2007	$25,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2007-HE5	4/26/2007	MSABS	MSMC	Morgan Stanley & Co.	A2D	61753KAE6	4/11/2007	$30,000,000	Fortis Bank	Morgan Stanley & Co.
MSAC 2007-NC1	1/26/2007	MSABS	MSMC	Morgan Stanley & Co.	A2D	617505AE2	1/22/2007	$10,000,000	Fortis Bank	Morgan Stanley & Co.
MSHEL 2005-1	1/28/2005	MSABS	First NLC	Morgan Stanley & Co.	M1	61744CLE4	1/12/2005	$3,500,000	Fortis Bank	Morgan Stanley & Co.
MSHEL 2006-2	3/30/2006	MSABS	MSMC	Morgan Stanley & Co.	A4	61744CYP5	3/10/2006	$10,000,000	Fortis Bank	Morgan Stanley & Co.

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MSHEL 2006-3	5/25/2006	MSABS	MSMC	Morgan Stanley & Co.	A4	61749GAD4	5/8/2006	$20,000,000	Fortis Bank	Morgan Stanley & Co.
MSHEL 2007-2	4/3/2007	MSABS	MSMC	Morgan Stanley & Co.	A4	61752UAD7	3/26/2007	$32,000,000	Fortis Bank	Morgan Stanley & Co.
MSIX 2006-2	11/28/2006	MSABS	MSMC	Morgan Stanley & Co.	A4	617463AD6	11/6/2006	$24,000,000	Scaldis	Morgan Stanley & Co.
MSM 2005-11AR	12/25/2005	MS Capital	MSMC	Morgan Stanley & Co.	A1	61748HTG6	1/13/2006	$56,659,000	Fortis Bank	Morgan Stanley & Co.
MSM 2006-3AR	2/25/2006	MS Capital	MSMC	Morgan Stanley & Co.	1A3	61748HWP2	2/17/2006	$25,000,000	Fortis Bank	Morgan Stanley & Co.
SAST 2007-1	3/7/2007	Saxon Asset Secs.	Saxon	Morgan Stanley & Co.	M2	80556BAG0	3/7/2007	$9,000,000	Fortis Cayman	Morgan Stanley & Co.
					M1	80556BAF2	3/7/2007	$4,820,000	Fortis Cayman	Morgan Stanley & Co.
SAST 2007-2	4/30/2007	Saxon Asset Secs.	Saxon	Morgan Stanley & Co.	A2C	80556YAD7	4/18/2007	$35,000,000	Fortis Bank	Morgan Stanley & Co.
					M2	80556YAG0	4/19/2007	$2,500,000	Fortis Cayman	Morgan Stanley & Co.
					M1	80556YAF2	4/19/2007	$2,000,000	Fortis Cayman	Morgan Stanley & Co.
					M4	80556YAJ4	5/7/2007	$2,000,000	Fortis Cayman	Morgan Stanley & Co.
					M3	80556YAH8	4/19/2007	$1,250,000	Fortis Cayman	Morgan Stanley & Co.