PATTERSON BELKNAP WEBB & TYLER LLP
Philip R. Forlenza (*prforlenza@pbwt.com*)
Erik Haas (*ehaas@pbwt.com*)
Peter W. Tomlinson (*pwtomlinson@pbwt.com*)
Nicolas Commandeur (*ncommandeur@pbwt.com*)
Ella Campi (*ecampi@pbwt.com*)
Benjamin S. Litman (*blitman@pbwt.com*)
1133 Avenue of the Americas
New York, New York 10036
Telephone: (212) 336-2000
Fax: (212) 336-2222

*Attorneys for Ambac Assurance Corporation and*
*The Segregated Account of Ambac Assurance Corporation*

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

| | | |
|---|---|---|
| AMBAC ASSURANCE CORPORATION and THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION, | : | Index No. 651013/2012<br>Hon. Charles E. Ramos |
| Plaintiffs, | : | |
| - against - | : | **FIRST AMENDED COMPLAINT** |
| EMC MORTGAGE LLC (formerly known as EMC MORTGAGE CORPORATION), J.P. MORGAN SECURITIES LLC (formerly known as BEAR, STEARNS & CO. INC.), and JPMORGAN CHASE BANK, N.A., | : | |
| Defendants. | | |

## TABLE OF CONTENTS

NATURE OF THE ACTION ....................1

I. THE PARTIES ....................11

A. PLAINTIFFS ....................11

B. THE "BEAR STEARNS" DEFENDANTS ....................12

II. JURISDICTION AND VENUE ....................14

III. THE BEAR STEARNS MORTGAGE LOAN SECURITIZATION "MACHINE" ....................14

A. BEAR STEARNS CONTROLLED EVERY ASPECT OF THE SECURITIZATION PROCESS ....................14

B. BEAR STEARNS CHURNED OUT SECURITIZATIONS BY SACRIFICING LOAN QUALITY ....................19

C. TOP BEAR STEARNS EXECUTIVES DROVE BEAR STEARNS'S SECURITIZATION MACHINE TO ASSUME INORDINATE RISK FOR PERSONAL GAIN ....................25

IV. THE ORIGINATORS OF LOANS IN THE TRANSACTIONS FUELED THE BEAR STEARNS SECURITIZATION MACHINE ....................31

A. GREENPOINT MORTGAGE FUNDING, INC. ....................32

B. COUNTRYWIDE HOME LOANS, INC. ....................38

C. BSRM AND SOUTHSTAR ....................43

V. THE TRANSACTIONS ....................46

A. THE TRANSACTIONS (OTHER THAN BALTA 2006-R1) ....................46

B. THE BALTA 2006-R1 TRANSACTION ....................48

C. THE INSURED CERTIFICATES ....................49

VI. BEAR STEARNS'S FRAUDULENT INDUCEMENT BASED ON MATERIALLY FALSE AND MISLEADING PRE-CONTRACTUAL REPRESENTATIONS TO AMBAC ....................50

A. BEAR STEARNS SOLICITED AMBAC TO PARTICIPATE IN THE TRANSACTIONS ....................50

**1.** Bear Stearns Knowingly Made Materially False and Misleading Statements in Its Marketing Presentations and Deal Correspondence ....................51

**2.** Bear Stearns Knowingly Disseminated Materially False and Misleading Mortgage-Loan Tapes ....................55

**3.** Bear Stearns Knowingly Disseminated Materially False and Misleading Data Concerning the Historical Performance of Its Earlier Securitizations ................................57

**4.** Bear Stearns Knowingly Supplied Materially False and Misleading Information to Secure Rating-Agency Ratings ................................59

**5.** Bear Stearns Knowingly Made Materially False and Misleading Representations and Disclosures in the Offering Documents Used to Market and Sell the Certificates ................................60

B. BEAR STEARNS FAILED TO DISCLOSE AND AFFIRMATIVELY CONCEALED MATERIAL FACTS TO INDUCE PARTICIPATION IN ITS SECURITIZATIONS ................................67

**1.** Bear Stearns's Representations Concerning Its Due Diligence Were Knowingly False and Misleading ................................67

**2.** Bear Stearns Knowingly Conducted and Concealed Its Substandard Due-Diligence Practices ................................71

**3.** Bear Stearns Covertly Implemented Policies to Securitize Defective Loans ................................75

**4.** Bear Stearns's Quality-Control and Repurchase Practices Furthered Its Scheme to the Detriment of the Securitizations ................................80

**5.** The Sheer Magnitude of Defective Loans that Bear Stearns Securitized Overwhelmed Its Quality-Control and Repurchase Protocols ................................84

**6.** Bear Stearns Failed to Disclose that Its Counsel and Outside Auditors Found that Its Claims Practices Contravened Its Contractual Obligations, Investors' Expectations, and Industry Standards ................................85

**7.** Bear Stearns Made Accommodations to Sellers to Conceal the Volume of Defective Loans and Maintain the Flow of Loans from Those Sellers ................................88

C. BEAR STEARNS MADE MATERIAL MISREPRESENTATIONS AND OMITTED MATERIAL FACTS CONCERNING THE QUALITY AND ATTRIBUTES OF THE LOANS IT PACKAGED INTO THE TRANSACTIONS ................................91

**1.** Contrary to Bear Stearns's Representations, There Are Numerous Indications that Borrowers Did Not Actually Occupy the Mortgaged Properties ................................94

**2.** The LTV Ratios on the Data Tapes Were Based on Incorrect Appraisals and Therefore Were Severely Understated ....95

**3.** Many of Bear Stearns's Representations Regarding Other Aspects of the Loans Were Also False and Misleading....99

D. BEAR STEARNS'S INDIVIDUAL AND CORPORATE HEDGING STRATEGY DEMONSTRATES ITS KNOWLEDGE OF THE DEFICIENCIES IN THE COLLATERAL BACKING ITS SECURITIZATIONS....101

VII. AMBAC'S RELIANCE ON BEAR STEARNS'S REPRESENTATIONS WAS JUSTIFIABLE AND ITS DUE DILIGENCE WAS REASONABLE AND CONSISTENT WITH THE RISK ALLOCATION IN THE TRANSACTIONS ....103

VIII. BEAR STEARNS'S EXPRESS REPRESENTATIONS AND WARRANTIES, AND RELATED COVENANTS, WERE A MATERIAL INDUCEMENT TO AMBAC TO PARTICIPATE IN THE TRANSACTIONS AND ISSUE ITS POLICIES ....110

A. EMC'S EXPRESS CONTRACTUAL REPRESENTATIONS AND WARRANTIES THAT EFFECTUATED THE PARTIES' BARGAINED-FOR RISK ALLOCATION ....110

B. EMC'S CONTRACTUAL COVENANTS REINFORCING THE PARTIES' BARGAINED-FOR RISK ALLOCATION ....113

**1.** EMC's Promise to Give Prompt Notice of Breaches....113

**2.** EMC's Promise to Repurchase or Cure Breaching Loans Within 90 Days ....114

IX. EMC'S PERVASIVE BREACHES OF ITS REPRESENTATIONS AND WARRANTIES....115

A. AMBAC'S LOAN-LEVEL REVIEW UNCOVERED PERVASIVE BREACHES....115

X. HARM SUFFERED BY AMBAC AND CERTIFICATEHOLDERS....116

XI. EMC WAS A MERE ALTER EGO AND INSTRUMENTALITY OF BEAR, STEARNS & CO....119

XII. JPMORGAN CHASE & CO. HAS STRIPPED EMC OF ITS ASSETS, SEEKING TO RENDER EMC A JUDGMENT-PROOF SHELL, BUT SUBJECTING JPMC BANK TO SUCCESSOR LIABILITY ....120

A. EMC'S PAST SERVICING OPERATIONS....121
B. AMBAC'S CONTRACTUAL RIGHTS TO SUE ANY SUCCESSOR OF EMC....121
C. JPMORGAN CHASE & CO. EFFECTUATED A *DE FACTO* MERGER OF EMC AND JPMC BANK....122
FIRST CAUSE OF ACTION....123
SECOND CAUSE OF ACTION....124
THIRD CAUSE OF ACTION....125
FOURTH CAUSE OF ACTION....126
PRAYER FOR RELIEF....128

Plaintiffs Ambac Assurance Corporation ("Ambac") and The Segregated Account of Ambac Assurance Corporation (the "Segregated Account," collectively with Ambac, "Plaintiff"), by and through their attorneys Patterson Belknap Webb & Tyler LLP, for their complaint against defendants EMC Mortgage LLC, formerly known as EMC Mortgage Corporation ("EMC"), Bear, Stearns & Co. Inc. ("Bear, Stearns & Co.," together with EMC, "Bear Stearns" and now doing business as J.P. Morgan Securities LLC ("JP Morgan")), and JPMorgan Chase Bank, N.A. ("JPMC Bank"), hereby allege upon personal knowledge as to themselves and as to their own conduct and upon information and belief as to all other matters, as follows:

## NATURE OF THE ACTION

1. This is the second action brought by Ambac in this Court against Bear Stearns after inquiry and investigation revealed Bear Stearns's remarkable misconduct – and that of its affiliate EMC and successor JP Morgan – pertaining to its mortgage-backed securitization business.[1] The securitization transactions and loans at issue in this action are different, but the story is the same: Driven by management's "Bear don't care" mentality, Bear Stearns perpetrated a massive fraud that deceived investors and financial guarantors, such as Ambac, into believing that the mortgage loans backing its securitizations were originated pursuant to established underwriting guidelines and were therefore of good quality. Bear Stearns compounded that harm by flagrantly ignoring its contractual obligations to Ambac and others. The loans involved in the transactions at issue in this case are plagued by the same pervasive defects found in the transactions at issue in Ambac's original action against Bear Stearns. And

[1] The first action is captioned *Ambac Assurance Corp. v. EMC Mortgage LLC et al.*, No. 650421/2011 (N.Y. Sup. Ct.). The amended complaint in that action ("Ambac Amended Complaint") was filed on July 18, 2011.

further evidence adduced from the public domain since the filing of Ambac's existing action corroborates the overwhelming proof of Bear Stearns's misconduct, including in the form of confidential witnesses who have come forward to blow the whistle on Bear Stearns's fraud.

2. The transactions at issue in this action were among the hundreds of residential mortgage-backed securitizations ("RMBS") that Bear Stearns effectuated from 2003 through early 2007. The transactions involved the sale by EMC of thousands of loans to trusts, which in turn issued to investors securities that were to be paid down by the promised cashflows from the loans. (One of the transactions, known as a "re-REMIC," involved the issuance of securities that were backed by other mortgage-backed securities, rather than mortgage loans themselves.) Bear, Stearns & Co., as the "Deal Manager" and "Underwriter" for the transactions, solicited and induced (i) financial guarantors (in this case Ambac) to insure payments due on certain securities issued in the transactions, (ii) rating agencies such as Standard & Poor's and Moody's to rate the securities, and (iii) investors to purchase the securities issued. At every point in the securitization process, and specifically with respect to the transactions at issue in this litigation, Bear, Stearns & Co. exercised exclusive and complete domination and control of EMC – under the common control of their parent The Bear Stearns Companies, Inc. (Thus, Bear, Stearns & Co. and EMC are referred to together herein as "Bear Stearns" unless clarification is required.)

3. Specifically, this action arises from Bear Stearns's breaches of contract and fraudulent inducement of Ambac to participate in seven securitization transactions executed between March 2006 and November 2006: GreenPoint Mortgage Funding Trust 2006-AR2 ("GPMF 2006-AR2"), GreenPoint Mortgage Funding Trust 2006-AR3 ("GPMF 2006-AR3"), Structured Asset Mortgage Investments II Trust 2006-AR7 ("SAMI 2006-AR7"), Bear Stearns Mortgage Funding Trust 2006-AR2 ("BSMF 2006-AR2"), Bear Stearns Alt-A Trust 2006-R1

("BALTA 2006-R1"), Structured Asset Mortgage Investments II Trust 2006-AR8 ("SAMI 2006-AR8"), and Bear Stearns Mortgage Funding Trust 2006-AR4 ("BSMF 2006-AR4") (each a "Transaction" and, collectively, the "Transactions").

4. These Transactions were plagued by the same fundamental problems that were endemic to Bear Stearns's RMBS operations. The Transactions have failed miserably and large percentages (from nearly 60% to more than 80%) of the securitized loans in the loan groups that back the securities insured by Ambac have defaulted or are severely delinquent, causing massive shortfalls in the cashflows required to pay down the securities and, thereby, requiring Ambac to make significant payments with respect to its insurance policies. With respect to the loan groups backing the Ambac-insured securities, the Transactions have experienced cumulative losses of more than $1.8 billion, resulting in nearly $300 million in claims that Ambac has paid or is obligated to pay under its policies.

5. In order to induce Ambac's participation in the Transactions, Bear Stearns made various representations to Ambac in advance of the closing of each Transaction. Bear Stearns represented that the securitized loans had certain key attributes critical to their credit quality, that the originators from which it acquired the securitized loans originated the loans in compliance with their underwriting guidelines, and that those guidelines were designed to, among other things, confirm the borrowers' ability to repay the loans. Bear Stearns also touted that it closely monitored the originators from which it purchased loans to ensure that they adhered to high quality standards. Along those lines, Bear Stearns represented that it conducted re-underwriting "due diligence" before acquiring the loans to ensure that defective loans were not securitized. Bear Stearns also represented that it had in place, and adhered to, "quality control" and "repurchase" protocols to identify and remove defective loans from the securitizations. And

Bear Stearns provided numerous contractual warranties to Ambac regarding the quality of the loans to give Ambac comfort that it could rely on Bear Stearns's various representations.

6. Bear Stearns knew full well that these representations, going to the very premise of the securitizations, were false and misleading when made. Recently obtained disclosures from Bear Stearns's files, as reflected in prior filed actions, have revealed that it secretly adopted certain practices and policies, and abandoned others, to (i) increase its transaction volume by quickly securitizing defective loans before they defaulted, (ii) conceal from Ambac and others the defective loans so it could keep churning out its securitizations, and (iii) profit on Ambac's harm. It has also become apparent that Bear Stearns knew full well of problems with the loan originators from which it acquired loans (including those that supplied loans for the Transactions). Bear Stearns also knew that the due-diligence reviews of the loans prior to acquisition that it commissioned from third-party firms – Clayton Holdings, LLC ("Clayton") and Watterson Prime Consulting LLC ("Watterson Prime") – were a sham, designed to provide a veneer of "control" rather than to ferret out defective loans.

7. The truth is now coming directly from Bear Stearns's own former employees. As revealed in a recent complaint by another financial guarantor[2] and as summarized below, numerous confidential witnesses who were responsible for underwriting at EMC each have affirmed that they faced intense pressure to approve the purchase of high volumes of loans for Bear Stearns's securitizations without adequate review and at the expense of loan quality. For example, Bear Stearns imposed strict requirements on EMC's underwriters to review a minimum number of loan files each day that far exceeded what was reasonable in order to adequately underwrite a loan file. The pressure to maintain loan volume resulted in the increasing approval

[2] Complaint, *Assured Guaranty Corp. v. EMC Mortgage LLC et al.*, No. 650805/2012 (Sup. Ct. N.Y. County) (filed Mar. 15, 2012) ("Assured Complaint").

and purchase (and ultimately securitization by Bear Stearns) of defective loans without regard to quality or compliance with underwriting guidelines. Despite repeated complaints to senior managers and executives, the EMC underwriters were consistently told to "keep it moving" and that it was a "waste of time" to undertake proper and prudent underwriting because Bear Stearns intended to pass the loans – and the risks associated with them – on to other investors and, ultimately, Ambac and the other financial guarantors that stood behind the investors. Those underwriters that did not succumb to these directives were given adverse reviews or summarily terminated.

8. The truth is also being revealed by former employees of some of the major originators of loans for the Transactions, including GreenPoint Mortgage Funding, Inc. ("GreenPoint"), the originator of all of the loans in two of the Transactions, and Countrywide Home Loans, Inc. ("Countrywide"), the originator of the majority of the loans in two of the other Transactions. These confidential witnesses confirm that – contrary to Bear Stearns's representations to Ambac regarding the conservative and rigorous nature of these originators' underwriting practices applied to the loans in the Transactions – the originators' management pressured their underwriters to approve loans regardless of quality, and, among other things, to assume that income listed by the borrower on the loan application was reasonable, all evidence to the contrary notwithstanding. The witnesses also confirm that the originators consistently funded and closed loans in violation of their own underwriting guidelines to maintain relationships with favored brokers. Bear Stearns was aware of or recklessly disregarded these practices, but condoned them in order to perpetuate a good relationship with the originators, whose defective loans were the lifeblood of the Bear Stearns securitization enterprise.

9. The truth also is being told by employees of the third-party firms hired to perform the re-underwriting "due diligence" that Bear Stearns represented to Ambac and other investors was designed to prevent defective loans from being securitized. This includes statements made by dozens of confidential witnesses from the third-party firms – Clayton and Watterson Prime – who consistently affirm that Bear Stearns disregarded loan ***quality*** for loan ***quantity***. As the "client," Bear Stearns routinely instructed the Watterson Prime and Clayton underwriters "not to focus on finding certain defects," and directed Watterson Prime's and Clayton's project leads and management to override loans initially deemed to be defective by changing the loan grade and then to delete any evidence of the audit trail. The mantra among the reviewers was "Bear don't care."

10. The story told by these whistleblowers is consistent with recently revealed internal documents from Bear Stearns, which show that Bear Stearns ***knew*** its representations concerning the re-underwriting due diligence it commissioned were false and misleading. While touting to Ambac the high quality of its due diligence, Bear Stearns withheld that it had decided ***not*** to implement policies that the head of its due-diligence department – Vice President John Mongelluzzo – advised senior executives were required to screen out bad loans. For example, as early as April 2005, well before the closing of the Transactions, Mongelluzzo advised Bear Stearns directors that its due-diligence protocols were deficient and should be revised to apply additional resources to the review of riskier loans. Nothing changed. Thus, almost exactly two years later in March 2007 – well after the closing of the Transactions – Mongelluzzo renewed the same proposal to apply greater scrutiny to riskier loans, stating "we need to completely revamp how we do due diligence." But Bear Stearns ***never*** "revamped" its protocols to implement that significant requirement. Instead, Bear Stearns went so far as to affirmatively manipulate the

results it received from the due-diligence firms by waiving or overriding even those defects that were identified during the firms' substandard review. The due-diligence process was a charade: touted as rigorous to give comfort to securitization participants like Ambac, but in reality purposefully deficient to ensure an unimpeded flow of loans to the securitizations, regardless of quality.

11. Bear Stearns likewise ***knew*** that its representations regarding the "quality control" and "repurchase" processes that it purportedly implemented for the benefit of the securitizations were false and misleading. In addition to the pre-acquisition due-diligence review it claimed to perform, Bear Stearns also represented that it conducted a thorough review of loans after it securitized them to ensure compliance with EMC's contractual representations and warranties. Bear Stearns further represented that it repurchased breaching loans from its securitizations, and that it tracked the results over time to "monitor" the quality of the loan sellers. But, in fact, these quality-control processes were virtually non-existent.

12. As a Bear Stearns quality-control manager has testified, even as of late 2007 Bear Stearns had "no protocols in place" for reviewing and repurchasing breaching loans out of securitizations, including the Transactions. Recent disclosures have also confirmed that to the extent Bear Stearns did perform a quality-control review of loans, it identified serious issues. For example, leading up to the GPMF 2006-AR2 Transaction, which consisted entirely of loans originated by GreenPoint, Bear Stearns uncovered through the sparse quality control it did perform of GreenPoint loans between 2002 and September 2005 that ***43 percent*** of the loans reviewed contained underwriting defects.[3] None of this was disclosed to Ambac.

[3] *See* Assured Complaint ¶¶ 14, 121, 209.

13. Worse still, the minimal quality control that Bear Stearns actually did perform was not done for the benefit of the Transaction participants, as it had represented, but rather to line Bear Stearns's own pockets. As we now know, the quality-control results were used to demand that Bear Stearns's originators repurchase defective loans. Those demands resulted in settlements with originators to resolve repurchase claims at a discount (one of many ways in which Bear Stearns appeased its originators and ensured their continued allegiance to Bear Stearns), and, in turn, Bear Stearns pocketing the recoveries from the settlements – ***all without ever informing the participants in Bear Stearns's securitizations, such as Ambac, of the loan defects and without ever passing these recoveries to the securitization trusts***. This practice, which further padded Bear Stearns's coffers at the expense of those to whom the money rightfully belonged, was widespread: A 2009 JP Morgan report, for example, lists $575 million worth of loans that Bear Stearns put back to originators, but did not repurchase – in violation of its explicit contractual obligations – from its securitizations.

14. In sum, the recently obtained statements from confidential witnesses and Bear Stearns's admissions are directly contrary to the representations Bear Stearns made to Ambac in advance of closing of the Transactions regarding Bear Stearns's securitization operations and the quality and attributes of the mortgage loans that Bear Stearns securitized in the Transactions.

15. Having erected this house of cards that was destined to fail – and having profited handsomely from it – Bear Stearns secretly set in motion a scheme to profit on the back end from the inevitable collapse. Specifically, Bear Stearns executives adopted trading strategies for the company, and their personal holdings, that leveraged their inside knowledge of such defective collateral and the harm it would inflict on the financial guarantors that insured Bear Stearns's securitizations (including Ambac). Starting in October 2007 and continuing through March

2008, Bear Stearns began aggressively shorting both the financial-guaranty insurers and the banks with large exposure to the securities they insured. And at around the same time, in November 2007, Thomas Marano, the Bear Stearns Senior Managing Director who was responsible for its mortgage-securitization business, liquidated his personal holdings in various financial-guaranty insurers. These trading patterns confirm what Bear Stearns always knew but failed to disclose – that these toxic securities were doomed to fail.

16. Ambac's recent analyses of the loans in the Transactions have revealed defects that are systemic and consistent with these various revelations of Bear Stearns's fraud. Ambac recently analyzed more than 5,000 loans included in the Transactions, with an aggregate principal balance of nearly $2 billion, to determine whether certain key information about the loans provided to Ambac by Bear Stearns in advance of each Transaction was true. Ambac's analysis focused primarily on just two principal attributes of mortgage loans: (1) the occupancy status of the mortgaged properties and (2) the appraisal value of the mortgaged properties, which is an input to a key loan metric, the loan-to-value ("LTV") ratio. The LTV is the ratio of the amount of the mortgage loan to the value of the mortgaged property when the loan was made. These are critical metrics to assessing a borrower's likelihood to repay the loan. A borrower is more likely to pay back a loan secured by the borrower's residence (as opposed to an investment property) because non-payment will result in eviction from the borrower's home. Similarly, the higher the LTV ratio, the less equity the borrower has to lose if he walks away from the loan. In deciding to issue the policies, Ambac relied upon the truth of Bear Stearns's representations about these metrics for the loans in the Transactions.

17. The results of Ambac's review have been revealing: On average, almost 15%[4] of the loans that were represented by Bear Stearns as being "owner occupied" have strong indications that they were actually investor properties or second homes, and over 23% of the loans had LTV ratios at least 10% higher than Bear Stearns represented. Most strikingly, contrary to Bear Stearns's representations that none of the loans in any of the Transactions had an LTV ratio higher than 100%, more than 8% of the loans had LTV ratios greater than 100%, meaning that the size of the loan was greater than the value of the property at origination.

18. Ambac's initial loan review has focused on these two metrics because JP Morgan has continually refused Ambac's requests to review the origination files for the loans at issue. Those files are necessary to confirm the loans' compliance with these and other critical, represented attributes, such as adherence to other requirements of the applicable underwriting guidelines, and to determine the presence of other types of misrepresentations in the loan applications. Notwithstanding that Ambac initially requested the loan files more than two years ago, JP Morgan has only in recent months – and after repeated demands – produced loan files for loans that are seriously delinquent, are in foreclosure, or have already been liquidated.

19. Ambac, through its counsel, hired an independent consultant to conduct loan-by-loan forensic reunderwriting on 100 of these recently obtained loan files. As discussed more fully in Section IX, to date Ambac's consultant has reviewed 50 loans from GPMF 2006-AR3 and 50 loans from BSMF 2006-AR2. The consultant found breaches of representations and warranties in 45 of the loans from GPMF 2006-AR3 and 40 of the loans from BSMF 2006-AR2—breach rates of 90% and 80%, respectively. The aggregate original principal balance on

[4] This conclusion is arrived at by dividing (a) the number of properties in the samples that were reported as owner-occupied but show strong indications that their owners lived elsewhere (here, 555) by (b) the number of properties in the samples that were reported as being owner-occupied on the mortgage-loan data "tapes" provided to Ambac by Bear Stearns for the relevant Transactions (here, 3,763).

just these 85 loans is more than $43.6 million. On April 9, 2012, Ambac provided notice and detailed descriptions of the breaches attributable to each loan to all parties with respect to the 85 breaching loans. Pursuant to the agreements governing the Transactions and at Ambac's request, the trustee in turn demanded repurchase of the breaching loans. To date, EMC has not repurchased a single loan.

20. Ambac brings this action to seek redress for the pervasive misconduct by Bear Stearns relating to the Transactions. Bear Stearns's material misrepresentations, omissions, and breaches of the parties' agreements fundamentally altered the risk profile of the Transactions that Ambac insured and thereby gutted the parties' bargain. Bear Stearns has thus inflicted and is continuing to inflict tremendous harm on Ambac and the investors Ambac insures. Among other relief, Ambac is entitled to be put in the position it would be in had it not been fraudulently induced to enter into the Transactions and issue its insurance policies; the recovery of claims paid and due for payment in the future under those policies; the recovery of fees and costs expended to uncover and prosecute Bear Stearns's egregious fraud; punitive damages; and all other appropriate damages.

## I. THE PARTIES

### A. PLAINTIFFS

21. The Segregated Account of Ambac Assurance Corporation is a segregated account that was established on March 24, 2010 pursuant to Wis. Stat. § 611.24, with the approval of the Office of the Commissioner of Insurance of the State of Wisconsin (the "Commissioner").

22. Upon the Verified Petition of the Commissioner, the Circuit Court for Dane County, Wisconsin, placed the Segregated Account into statutory rehabilitation under Wis. Stat. §§ 645.31 and 645.32 on March 24, 2010. Pursuant to Wis. Stat. § 611.24(3)(e), the Segregated

Account is a separate Wisconsin insurer with the legal capacity and authority to sue in its own name and right. Ambac allocated the policies and claims at issue in this action to the Segregated Account pursuant to the Plan of Operation for the Segregated Account attached to the Commissioner's Verified Petition (the "Plan of Operation").

23. The Commissioner is the court-appointed Rehabilitator of the Segregated Account. As Rehabilitator, the Commissioner has the authority to prosecute the claims in this action on behalf of the Segregated Account. Pursuant to Wisconsin Statute § 645.33(1), the Commissioner has appointed a full-time Special Deputy Commissioner to rehabilitate the Segregated Account.

24. Ambac is a Wisconsin corporation that maintains its principal place of business in New York, New York. Under the Plan of Operation, Ambac performs specified management services for the Segregated Account and retains the right to receive any cash recoveries relating to the policies and claims that were allocated to the Segregated Account, including the policies and claims at issue in this action.

**B. THE "BEAR STEARNS" DEFENDANTS**

25. EMC is organized under the laws of the State of Delaware and its principal place of business is at 2780 Lake Vista Drive, Lewisville, Texas 75067. At all relevant times leading up to, and including, the closing dates of the Transactions, EMC was a wholly owned subsidiary of The Bear Stearns Companies Inc. ("The Bear Stearns Companies") and an affiliate of Bear, Stearns & Co. (the underwriter for the Transactions). Pursuant to a merger agreement effective May 30, 2008, JPMorgan Chase & Co. acquired The Bear Stearns Companies Inc., including Bear, Stearns & Co. and EMC, for nominal consideration in a transaction that was financed in part by a $29 billion non-recourse loan made by taxpayers (the "Merger"). After the Merger, EMC is wholly owned by The Bear Stearns Companies, LLC, which in turn is wholly owned by

JPMorgan Chase & Co.[5] On or about March 31, 2011, EMC underwent a change in form from a corporation to a limited-liability company, and is now organized in Delaware as EMC Mortgage LLC.

26. Bear, Stearns & Co. was an SEC-registered broker-dealer and a wholly owned subsidiary of The Bear Stearns Companies, principally located at 383 Madison Avenue, New York, New York 10179. Bear, Stearns & Co. served as the underwriter for the Transactions. Following the Merger, on or about October 1, 2008, Bear, Stearns & Co. merged with an existing subsidiary of JPMorgan Chase & Co. known as J.P. Morgan Securities Inc., and the resulting entity was renamed as J.P. Morgan Securities Inc. Effective September 1, 2010, J.P. Morgan Securities Inc. converted from a corporation to a limited-liability company, and changed its name to J.P. Morgan Securities LLC (defined above as “JP Morgan”). All allegations against Bear Stearns are made against JP Morgan. JP Morgan is an indirect wholly owned subsidiary of JPMorgan Chase & Co., which is a bank holding company incorporated in Delaware and principally located at 270 Park Avenue, New York, New York 10016.

27. JPMC Bank is a national banking association whose articles of association designate Columbus, Ohio as the location of its main office, and whose principal place of business is in New York, New York. JPMC Bank acquired all or substantially all of EMC’s assets and succeeded to EMC’s business on or about April 1, 2011. JPMC Bank and EMC are both wholly owned by JPMorgan Chase & Co. JPMC Bank and EMC are affiliated entities that shared common ownership before JPMC Bank acquired all or substantially all of EMC’s assets, and continue to share common ownership after the acquisition. As explained more fully below, JPMC Bank is a successor to EMC and is therefore liable for the conduct of EMC alleged herein.

[5] *See* EMC’s Rule 7.1 Disclosure Statement, *Ambac Assurance Corp. v. EMC Mortgage Corp.*, No. 08-CV-9464 (RMB) (FM) (S.D.N.Y. Jan. 20, 2009).

## II. JURISDICTION AND VENUE

28. This Court has personal jurisdiction over the defendants pursuant to C.P.L.R. §§ 301, 302, 311, and 311-a.

29. Venue is proper in New York County pursuant to C.P.L.R. §§ 503(a), 503(c), and 503(d).

30. Defendant JP Morgan, formerly known as Bear, Stearns & Co., is subject to personal jurisdiction in this Court because it is authorized to do business within New York and regularly transacts business within the State.

31. Defendant JPMC Bank is subject to personal jurisdiction in this Court because it is authorized to do business within New York, has offices within the State, and regularly transacts business within the State.

32. Defendants EMC and Bear, Stearns & Co. participated in negotiations and other activities within the State that led to the Transactions that give rise to the claims in this complaint, and the Transactions occurred within the State.

## III. THE BEAR STEARNS MORTGAGE LOAN SECURITIZATION "MACHINE"

33. This action arises from the materially false and misleading disclosures and representations and warranties made by Bear Stearns in connection with the securitization of mortgage loans in seven RMBS transactions between March and November 2006. Each Transaction involved the pooling and sale of mortgage loans to a trust. The trusts issued debt securities of varying seniority, whose payments to investors were dependent on, or "backed" by, the cash flow received from the mortgage payments on the pooled loans. The Transactions were among hundreds that the Bear Stearns securitization machine churned out from 2003 to 2007.

### A. BEAR STEARNS CONTROLLED EVERY ASPECT OF THE SECURITIZATION PROCESS

34. Through its well-engineered network of affiliates, Bear Stearns controlled every link in the mortgage-loan-securitization chain, including (i) the origination, and financing of the origination, of loans that provided the cashflow for the mortgage-backed securities, (ii) the "warehousing" or temporary financing of large pools of loans pending their pooling and securitization into mortgage-backed securities, (iii) the underwriting, offering, and sale of the mortgage-backed securities, including to funds managed by its affiliates, and (iv) the servicing of loan pools to ensure the continued payment of principal and interest needed to make payments under the mortgage-backed securities. As Bear Stearns's parent, The Bear Stearns Companies, reported in its 2006 Annual Report, this "vertically integrated franchise allows us access to every step of the mortgage process, including origination, securitization, distribution and servicing."[6] Bear Stearns and the affiliates that implemented each of these components of the mortgage-securitization process were directed and controlled by the senior executives and traders sitting in New York, and shared common board members, executives, systems, and resources.[7]

35. Bear Stearns used the offices of EMC in Texas to house its mortgage-loan "conduit," which generated the flow of loans into the securitization pipeline from which the mortgage-backed securities issued.[8] Mary Haggerty, who was the Senior Managing Director responsible for the conduit's creation in 2001, has explained that the EMC conduit acquired mortgage loans for securitization and not to hold in inventory: "[I]f you think of a pipe, water

---

[6] The Bear Stearns Companies Inc., 2006 Annual Report, at 11 (2007).

[7] *See* Ambac Amended Complaint ¶ 45 (citing 4/26/2010 Golden Deposition Tr. at 12-13, 52-53 (stating that the "reporting relationship was to New York" and noting that approximately 50 to 60 individuals had dual titles at Bear Stearns and an EMC entity); 12/11/2009 Durden Rule 30(b)(6) Deposition Tr. at 45; 1/22/2010 Megha Rule 30(b)(6) Deposition Tr. at 71-73; 4/15/2010 Gray Deposition Tr. at 48; 5/28/2010 Sears Deposition Tr. at 247-48).

[8] *See* Ambac Amended Complaint ¶ 46 (citing 4/19/2010 Glory Deposition Tr. at 93-95 (Bear Stearns Managing Director testified that references to the "Bear Stearns Subprime Mortgage Conduit" meant the conduit housed at EMC); EMC Investor Presentation dated July 26, 2006, EMC-AMB 010838314-413 at 315 (EMC's conduit operations were headquartered in Dallas, Texas)).

comes in and water goes out as opposed to a pipe leading to a reservoir that's going to be held."[9] EMC thus supplied the Bear Stearns securitization machine with mortgage loans that Bear Stearns had no intention of ever holding, and indeed was loathe to hold, in its own inventory.

36. EMC guided the flow of loans through the pipeline by (i) acquiring and aggregating the mortgage loans to be securitized, (ii) sponsoring the securitizations by selling loan pools to the trusts that issued the securities, and (iii) acting as "servicer" for a large number of the securitized loans, with, among other things, the obligation to collect amounts from the borrowers for the benefit of the trusts. Moreover, as discussed in detail below, EMC also purported to undertake pre- and post-acquisition reviews and implement other controls to ensure the quality of the loans acquired.

37. Bear Stearns, acting through EMC and its affiliate EMC Residential Mortgage Corporation ("EMCRM"), also provided financing for the origination of a large volume of loans it acquired for securitization through the residential mortgage-loan conduit. EMCRM provided warehouse lines of credit to finance lenders that originated defective loans, on the condition that the lenders would sell the loans originated to larger entities referred to as "takeout investors," including GreenPoint and Countrywide, the originators of the loans in or underlying five of the Transactions. The takeout investors in turn sold many of the loans to EMC for securitization.

38. Bear, Stearns & Co., for its part, acted as lead underwriter and designated its employees as the deal managers to broker the EMC-sponsored securities offerings. It solicited the rating agencies to rate, financial guarantors such as Ambac to insure, and investors to purchase these mortgage-backed securities. Thus, Bear, Stearns & Co. (i) worked with EMC to structure the Transactions, (ii) took the lead in coordinating the flow of documents and

[9] Ambac Amended Complaint ¶ 46 (citing 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 21).

information among the rating agencies and parties to the Transactions, (iii) purchased the mortgage-backed securities issued in the Transactions (the "Certificates") on a firm commitment basis pursuant to written agreements with the depositor (a special-purpose vehicle created by Bear Stearns for the sole purpose of transferring the loans to the trusts), and (iv) offered and sold the Certificates to investors. The Bear, Stearns & Co. trading organization – reporting to Tom Marano – also made the decisions on the volume of securitizations to effectuate, and, likewise, the volume of loans being acquired by the conduit was "highly controlled by the trading desk."[10] And, as discussed further below, Bear, Stearns & Co. executives made decisions regarding the due-diligence, quality-control, and repurchase protocols to be followed (or not followed) by EMC in relation to the securitized loans.

39. Bear Stearns's affiliates also frequently purchased or retained a financial interest in a portion of the securities issued in its transactions, which it often repackaged into securities known as "collateralized debt obligations" ("CDOs"). Ralph Cioffi, then a Senior Managing Director of Bear, Stearns & Co., helped create both the supply and demand for Bear Stearns's securitizations, soliciting insurers and investors to participate in its transactions, and then purchasing the securities issued for the investment funds he managed through Bear Stearns's affiliates, including Bear Stearns Asset Management. Bear Stearns also provided financial research for residential mortgage-backed securities and related structured products that it created and sold. Finally, as discussed below, Bear Stearns took short positions betting against securitization counterparties, including Ambac and other financial guarantors that insured the mortgage-backed securities. Bear Stearns knew its short positions were fixed bets because it had

[10] Ambac Amended Complaint ¶ 50 (citing 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 86-87).

loaded up the securitizations with defective loans and refused to repurchase those loans when those defects were identified.

40. Through Bear Stearns, The Bear Stearns Companies recorded gains and earned fees at every step in this chain: (i) loan-origination fees on loans originated by Bear Stearns affiliates, including EMC and Bear Stearns Residential Mortgage Corporation ("BSRM"), which originated a majority of the loans in two of the Transactions; (ii) the proceeds of the sale of notes and certificates to investors as consideration for conveying securitized mortgage pools to the securitization trusts; (iii) fees from underwriting mortgage-backed securities; (iv) fees from servicing of the securitized loans serviced by EMC; (v) fees from CDOs into which these securities were repackaged; (vi) gains and fees from trading in these securities and interests in the CDOs into which they were placed; (vii) gains from taking "short" positions in entities that were adversely affected by Bear Stearns's securitization activities; and (viii) management fees and carried interests from hedge funds and other investment vehicles that invested in the vast array of securities and financial products structured by Bear Stearns and its affiliates that ultimately were backed by residential mortgage loans.[11] As the Financial Crisis Inquiry Commission ("FCIC") concluded in January 2011 after its investigation of Bear Stearns's role in the economic crisis: "In mortgage securitization, Bear followed a vertically integrated ***model that made money at every step, from loan origination through securitization and sale***."[12]

41. As discussed below, the greatest benefit from these fees flowed to the senior executives and traders, who obtained obscene compensation by putting Bear Stearns's counterparties – and, indeed, ultimately its own ongoing wherewithal – at risk.

---

[11] Assured Complaint ¶ 56 (citing 10/3/01 Marano Deposition Tr. 96:24-99:24).

[12] FCIC, The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States 280 (Jan. 2011) [hereinafter "FCIC Report"], *available at* http://fcic.law.stanford.edu/report.

### B. BEAR STEARNS CHURNED OUT SECURITIZATIONS BY SACRIFICING LOAN QUALITY

42. At the time the Transactions at issue in this lawsuit were consummated, The Bear Stearns Companies had long been a leader in all facets of mortgage-loan securitization, at or near the top of the charts for issuance and underwriting of mortgage-backed securities for 17 years running.[13] The Bear Stearns Companies built this once-stellar reputation on the securitization of large, high-quality loans referred to as "jumbo prime," which was the business it maintained until 2001.[14]

43. But The Bear Stearns Companies then formed the mortgage-loan conduit at EMC that effectuated the Transactions at issue. The new conduit initially focused on the securitization of "Alt-A" loans, which were made to borrowers that were generally considered more risky than prime borrowers. The profits from the securitizations grew year after year, but took off in 2003, when Bear Stearns began to securitize "subprime" mortgage loans, which it never squarely defined, but that generally constitute loans issued to borrowers with limited incomes or relatively low FICO credit scores due to poor credit history.[15]

---

[13] *See, e.g.*, Asset-Backed Alert, Dec. 31, 2006, *available at:* http://www.abalert.com/Public/MarketPlace/Ranking/index.cfm?files=disp&article_id=1044674725 (ranking Bear Stearns as the fifth-largest issuer of mortgage-backed securities); Q4 2006 The Bear Stearns Companies Earnings Conference Call, Dec. 14, 2006 (stating that, for 2006, "Bear Stearns ranked as the number one underwriter of MBS Securities [mortgage-backed securities] as the Company's securitization volume rose to $113 billion from $95 billion in fiscal 2005, capturing 11% of the overall U.S. mortgage securities market").

[14] Ambac Amended Complaint ¶ 54 (citing 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 28, 30).

[15] Ambac Amended Complaint ¶ 55 (citing 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 32-33 (EMC began purchasing subprime loans for securitization); *see also* 12/11/2009 Durden Rule 30(b)(6) Deposition Tr. at 29-30 (unable to provide a definition distinguishing Alt-A loans from subprime); 4/15/2010 Glory Deposition Tr. at 178-79 (testifying she had no knowledge of whether the definition of subprime changed over time); 5/28/2010 Sears Deposition Tr. at 36-37 (defining a subprime loan as one given to a borrower with "less than pristine" credit history); 6/2/2010 Smith Deposition Tr. at 93 ("I don't believe there was a definition [of subprime]")).

44. From 2003 to 2006, The Bear Stearns Companies' revenue and profit increased by 123.8% and 77.6%, respectively, driven in large part by mortgage finance and its securitization machine.[16] For 2006, The Bear Stearns Companies' overall securitization volume rose to $113 billion from $95 billion in fiscal year 2005, amounting to 11% of the overall U.S. mortgage-securities market.[17] Consistently, the volume of EMC's securitizations grew markedly over the same period. In 2003, EMC securitized 86,000 loans valued at approximately $20 billion. That number nearly tripled in 2004 to 230,000 loans valued at $48 billion.[18] In 2005, the number jumped to 389,000 loans valued at nearly $75 billion.[19] And in 2006, EMC securitized over 345,000 loans valued at $69 billion.[20] All told, from 2003 to 2007, EMC purchased and securitized more than one million mortgage loans originally valued in excess of $212 billion.[21] Bear Stearns achieved the dramatic growth in its securitization volume by obtaining an ever-increasing supply of mortgage loans for its securitizations, while maintaining the demand for the securities backed by those loans.

45. Having already moved from the prime into the Alt-A and subprime markets, Bear Stearns further extended the reach of its mortgage portfolio by expanding its use of "reduced documentation" or "no documentation" loan programs, through which the overwhelming majority of the loans in the Transactions were originated. While these programs bear various names (*e.g.*, "Stated Income," "No Ratio," "Stated Income Stated Asset," or "SISA"), they share

---

[16] The Bear Stearns Companies Inc., Annual Report (Form 10-K), at 79 (Nov. 30, 2006); The Bear Stearns Companies Inc., Annual Report (Form 10-K), at 77 (Nov. 30, 2005).

[17] Q4 2006 Bear Stearns Earnings Conference Call, Dec. 14, 2006.

[18] *See* Prospectus Supplement ("ProSupp") for the BSMF 2006-AR2 Transaction at S-30.

[19] *See* BSMF 2006-AR2 ProSupp at S-30.

[20] ProSupp for the Bear Stearns Second Lien Trust 2007-1 (Group I) transaction ("BSSLT 2007-1 (Group I)") at S-35.

[21] BSSLT 2007-1 (Group I) ProSupp at S-35.

the common characteristic of requiring less documentation from the borrower than traditional full-documentation loan programs. Accordingly, the reduced- or no-documentation programs were designed to be offered only to certain types of pre-qualified borrowers (*e.g.*, self-employed individuals with very strong credit and substantial equity in the mortgaged property), and the originators supplying the loans were required to use alternative means of assessing the borrowers' ability to repay the loans. Over time, however, Bear Stearns and its stable of third-party originators like GreenPoint and Countrywide, and affiliated originators like EMC and BSRM, disregarded their own protocols and guidelines to expand these programs to riskier categories of borrowers in order to increase loan volume.

46. The reduced-documentation programs that Bear Stearns exploited had been in use in residential mortgage lending for some time, and were not at the time considered problematic in and of themselves. Rather, the programs were appropriate sources of loans ***as long as*** commensurate controls were implemented and followed to ensure the quality of the securitized loans and, in particular, borrowers' ability to repay them.

47. Equally important to the Bear Stearns securitization machine was investor demand. As discussed in detail below, Bear Stearns made extensive representations in advance of and at the closing of its securitizations to convince investors and financial guarantors, including Ambac, that it had implemented and was applying the controls required to ensure the quality of these securitized loans. The Bear Stearns Companies underscored the commitment to loan quality to assuage any potential concerns regarding the pace of its growth:

> [O]ur [origination and] conduit business . . . saw a significant increase in origination volume over the course of the year and that's important not only because it secures a direct pipeline of product for securitization and thereby allows us to maintain and increase share, but also it has a lot to do with the quality of the product that we're able to put out in the nonagency space.[22]

48. The Bear Stearns Companies' pitch was persuasive and worked. Bear Stearns's representations induced financial guarantors such as Ambac to insure payments due on securities issued from its securitization pipeline, and induced investors to purchase those securities.

49. But Bear Stearns did not take steps, much less "controls," to ensure the "quality of the product" and actively concealed material facts regarding its actual securitization practices and internal protocols.[23] What has come to light only painstakingly and long after Bear Stearns induced Ambac to participate in the Transactions is that Bear Stearns's expanded securitization of reduced-documentation products, including the loans securitized in the Transactions, was ***not*** accompanied by the implementation – but rather by the abandonment – of controls required to ensure the quality of the securitized loans. Bear Stearns's abandonment of underwriting policies and controls required to ensure the quality of securitized loans has been (i) revealed by evidence gathered in litigation by financial guarantors, including Ambac, who insured and investors who purchased Bear Stearns's mortgage-backed securities[24] and (ii) affirmed by the admissions of

---

[22] The Bear Stearns Companies Investor Conference Call regarding Q4 2005 Earnings, Dec. 15, 2005.

[23] *See Bear Naked Lenders*, Wall St. J., March 18, 2008, at A22 ("Bear took particular pride in its risk management, but let its standards slide in the hunt for higher returns during the mortgage mania earlier this decade.").

[24] *See, e.g.,* Ambac Amended Complaint; Assured Complaint; *Syncora Guarantee, Inc. v. EMC Mortgage Corp.*, No. 09-CV-3106 (PAC) (S.D.N.Y. filed Mar. 31, 2009) ("Syncora Federal Complaint"); *Syncora Guarantee Inc. v. J.P. Morgan Sec. LLC et al.*, No. 651566 (N.Y. Sup. Ct. filed June 6, 2011) ("Syncora State Complaint"); *Federal Home Loan Bank of Seattle v. Bear, Stearns & Co., Inc.*, No. 10-CV-151 (RSM) (W.D. Wa. June 10, 2010); *Federal Home Loan Bank of San Francisco v. Credit Suisse Securities (USA) LLC, et al.*, No. CGC 10-497839 (Cal. Super. Ct. June 10, 2010); *Federal Home Loan Bank of San Francisco v. Credit Suisse Securities (USA) LLC, et al.*, No. CGC 10-497840 (Cal. Super. Ct. June 10, 2010); *Federal Home Loan Bank of Boston v. Ally Fin., Inc.*, No. 11-1533 (Mass. Super. Ct.).; *In re Bear Stearns Mortgage Pass-Through Certificates Litig.*, No. 08-CV-8093 (S.D.N.Y.); *Massachusetts Mutual*

former employees of Bear Stearns, as well as former employees of several of Bear Stearns's largest third-party suppliers of loans (including GreenPoint and Countrywide, which together supplied loans for five of the seven Transactions at issue), and former employees of the two third-party firms that Bear Stearns used to conduct its so-called "due diligence" reviews in advance of acquiring loans from these suppliers (Watterson Prime and Clayton).

50. For example, Bear Stearns's internal documents show that its senior traders put inordinate pressures on EMC staff to meet loan-purchase volume objectives at the expense of prudent underwriting standards. As an EMC underwriting manager wrote to her staff:

> I refuse to receive any more emails from JV [Bear Stearns Senior Managing Director, Jeff Verschleiser] (or anyone else) questioning why we're not funding more loans each day. . . . [I]f we have 500+ loans in this office ***we MUST find a way to underwrite them and buy them***. . . . I was not happy when I saw the funding numbers and I knew that NY would NOT BE HAPPY. . . . I expect to see 500+ each day. . . . ***I'll do whatever is necessary*** to make sure you're successful in meeting this objective. [25]

51. As set forth in a recent complaint filed against Bear Stearns by another financial guarantor, Bear Stearns's "whatever is necessary" approach to increasing loan volume is corroborated by multiple confidential witnesses – former underwriters, underwriting assistants, or underwriting supervisors at EMC – who confirm that, among other things:

- EMC employees, who often lacked any prior underwriting experience upon arriving at EMC and didn't receive any formal training once at EMC, faced intense pressure to approve the purchase of defective loans regardless of loan quality, often being asked to review several multiples of the number of loans that an underwriter could adequately underwrite in a day. Underwriters who failed to meet these impossible quotas were often reprimanded or fired.

---

*Life Ins. Co. v. JPMorgan Chase Bank, N.A.*, No. 11-CV-30094 (D. Mass.); *Plascencia v. Lending 1st Mortgage*, No. 07-CV-4485 (N. D. Cal.); *In re Bear Stearns Co. ERISA Litig.*, No. 08-MDL 1963 (RWS) (S.D.N.Y.).

[25] Ambac Amended Complaint ¶ 136 (citing email from Jo-Karen Whitlock (EMC Mortgage Corporation Senior Vice President, Conduit Operations), to loan acquisition staff, dated April 4, 2006, EMC-SYN 00596927-928 (emphasis added, capitalization in original)).

- EMC increasingly approved risky, low- or no-documentation loans without adequate review, as underwriters were regularly directed by management ***not to question the reasonableness of incomes stated on the borrowers' loan applications and to ignore fraud found in the loan files*** because doing so was a "waste of time." Management explained that the reason underwriters should ***not*** focus their efforts on finding fraud or defects in loans being purchased by EMC was that EMC was going to pass the loans – and the risks associated with them – on to other investors and insurers, like Ambac, that guaranteed their investments.

- EMC purchased loans it knew were defective and did not comply with underwriting guidelines, as management instructed underwriters to "[q]uit conditioning [these loans] and get these loans into funding." With respect to GreenPoint loans, one EMC underwriter recalled management instructing him as follows: "We have to approve these loans. GreenPoint is a good customer. Without our customers, we don't have jobs."

- EMC routinely approved loans that contained exceptions to underwriting guidelines for which there were no reasonable compensating factors.[26]

52. Another complaint recently filed by an RMBS investor against Bear Stearns sheds light specifically on Bear Stearns's knowledge of one of the principal defects uncovered by Ambac during its review of loans in the Transactions at issue here: overstated and fraudulent appraisals. The investor's complaint, which cites statements from yet another former EMC employee, reveals that

> Bear Stearns knew that numerous loans that it included in securitizations failed to meet the stated loan origination and underwriting standards, and were based on inflated property values. For example, CW[confidential witness]4, an auditor at

[26] Assured Complaint ¶¶ 68-81. The statements of other former EMC employees cited in the complaints brought by the Federal Home Loan Bank of Boston and investors who purchased Bear Stearns stock further confirm the fraudulent practices at Bear Stearns. One former employee, who was responsible for auditing 30 to 50 loan files each week for fraud, regularly found fraud relating to inflated appraisals, altered credit reports, investors using straw buyers for multiple properties and transactions, and titles that had been doctored. According to this former employee, loans in which she identified fraud remained in the mortgage pools that were sold to investors. *See* Complaint ¶¶ 336-337, *Federal Home Loan Bank of Boston v. Ally Fin., Inc.*, No. 11-1533 (Mass. Super. Ct. filed Apr. 20, 2011). Several other former employees confirm that Bear Stearns's management knew that the loans Bear Stearns was purchasing and securitizing were unusually risky, but management was "buying everything" because "of the potential for profits from securitizing these loans." *See* Consolidated Class Action Complaint for Violations of the Federal Securities Laws ¶¶ 54-60, *In re The Bear Stearns Companies Inc. Sec, Deriv., and ERISA Litig.*, No. 08-MDL-1963 (RWS) (S.D.N.Y. Feb. 27, 2009).

> EMC Mortgage from August 2005 through October 2007, reviewed many loan files in which the stated income was "way overstated" and the property values were "way overinflated"—causing both the borrowers' ability to pay and the value of the collateral to be overstated. EMC Mortgage would nevertheless approve and purchase those loans. As CW4 stated, "as long as it was not totally ridiculous, we took it."[27]

53. As one former Bear Stearns employee wrote to another fellow former employee in late 2007:

> I have been toying with the idea of writing a book about our experiences. . . . Think of all of the crap that went on and how nobody outside of the company would believe us. . . . [T]he fact that data was constantly changing ***and we sold loans without the data being correct – wouldn't investors who bought the [R]MBS's want to know that***? And how shitty and incompetent things were behind the scenes? No wonder it is down the crapper . . . .[28]

54. The testimony and candid email exchanges of these former employees confirm that, by abandoning appropriate underwriting and due diligence to increase loan volume, Bear Stearns secretly conveyed to its securitizations loans that did not comply with the requisite underwriting guidelines and were made to borrowers who did not have the ability to repay them. As a result, Bear Stearns knowingly, or with reckless disregard, marketed and sold in connection with its securitizations billions of dollars worth of securities backed by mortgage loans that did not conform to its representations and disclosures.

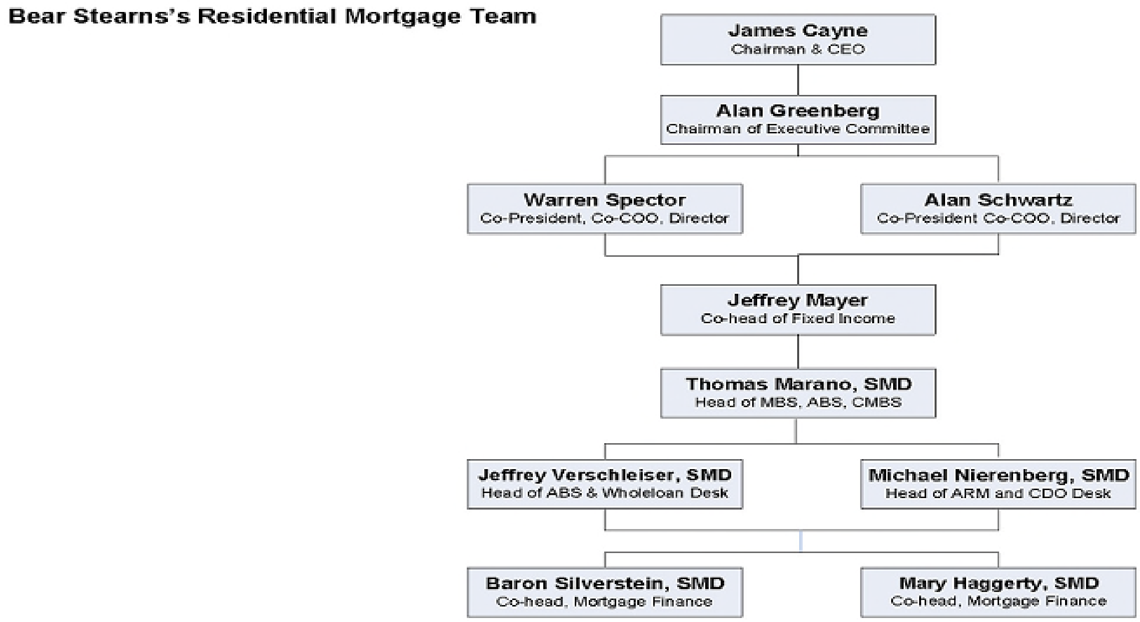
### C. TOP BEAR STEARNS EXECUTIVES DROVE BEAR STEARNS'S SECURITIZATION MACHINE TO ASSUME INORDINATE RISK FOR PERSONAL GAIN

55. Bear Stearns's top executives drove the Bear Stearns securitization machine and were responsible for Bear Stearns's fraudulent scheme and failure to implement the requisite

[27] Complaint ¶ 72, *Landesbank Baden-Württemberdg v. Bear, Stearns & Co. et al.*, No. 652680/2011 (N.Y. Sup. Ct. filed Jan. 27, 2012).

[28] Assured Complaint ¶ 79 (citing 6/14/2011 James Deposition Ex. 21; 6/14/2011 James Deposition Tr. at 247-252).

controls relating to its securitizations. In the marketing materials disseminated to Ambac and investors to induce their participation in the Transactions, Bear Stearns identified, in their official capacities, the senior executives within Bear Stearns's RMBS Team as follows:[29]




56. From their respective positions in the highest echelons of Bear, Stearns & Co.'s executive management, Cayne, Greenberg, Spector, and Schwartz directed or encouraged the very policies and procedures undertaken to expand securitization volume for the sake of maximizing short-term profitability, with intentional or reckless disregard to the fraudulent disclosures used to market and sell the securities issued in connection with Bear Stearns's RMBS transactions. For example, Cayne, Marano, Mayer, Spector and Schwartz received internal audit reports specifying the need to establish and enhance controls relating to Bear Stearns's quality-control and claims operations.[30] But those controls were not implemented, and specifically, the

[29] *See* Ambac Amended Complaint ¶ 66 (citing June 2005 Bear Stearns RMBS Platform, www.emcmortgagecorp.com (ABK-EMC01515471-561 at p.5)).

[30] Ambac Amended Complaint ¶ 67 (citing email from Stephanie Paduano (Bear, Stearns & Co. Internal Audit Department) dated March 7, 2006, forwarding EMC Reps & Warrants Internal Audit Report dated Feb. 28, 2006, EMC-AMB 001496304-311).

senior executives did not establish protocols necessary to ensure that Bear Stearns was not securitizing pools replete with loans made to borrowers with no ability to repay. The upper management of Bear, Stearns & Co. thus enabled and encouraged all of its executives and managers to implement and perpetuate Bear Stearns's fraudulent scheme.

57. Co-Head of Fixed Income Jeffrey Mayer met with Ambac's then-CEO, and Managing Director of its Consumer Asset-Backed Securities Department, in advance of the Transactions and represented Bear Stearns in soliciting Ambac's executives to induce Ambac's participation in Bear Stearns's securitizations. Mayer also supervised various aspects of the mortgage-finance business, oversaw Bear Stearns's purported loan-underwriting guidelines, and received, among other things, internal audit reports and memoranda regarding reserves.[31]

58. In the words of a former Bear Stearns executive, Senior Managing Directors Marano, Nierenberg, and Verschleiser acted as the "decision-makers" during the relevant time frame and "were actively involved in running the mortgage business, which included servicing conduit, trading, etc."[32] Tom Marano was the Senior Managing Director and Global Head of Mortgage-Backed Securities and Asset-Backed Securities. Marano reported directly to Mayer.

59. As the Co-Heads of Mortgage Trading, Senior Managing Directors Nierenberg and Verschleiser directly supervised the Co-Heads of Mortgage Finance, Mary Haggerty and Baron Silverstein, and had oversight over all aspects of Bear Stearns's mortgage-finance operations. For example, the traders responsible for determining which loans to package and

[31] *See* Ambac Amended Complaint ¶ 68 (citing, *e.g.*, email from Stephanie Paduano (Bear, Stearns & Co. Internal Audit Department); email from Marano to, among others, Mayer, dated January 25, 2008, EMC-AMB 005486312-327 (attaching MBS reserve memo)).

[32] Ambac Amended Complaint ¶ 69 (citing 4/26/2010 Golden Deposition Tr. at 252). *See also* Teri Buhl, *E-mails Show Bear Stearns Cheated Clients Out of Billions*, The Atlantic, Jan. 25, 2011 ("According to former Bear Stearns and EMC traders and analysts who spoke with *The Atlantic*, Nierenberg and Verschleiser were the decision-makers for the double dipping scheme . . . .").

securitize in the Transactions would report to Verschleiser. In turn, Nierenberg and Verschleiser each reported to Marano.

60. As the Co-Heads of Bear, Stearns & Co.'s Mortgage Finance Department, Haggerty and Silverstein each had oversight responsibilities that allowed for, and encouraged, the acquisition of defective mortgage loans to be pooled into the Transactions, and the management of the purported review of the loans before they were securitized. Starting in 2001, Haggerty's responsibilities were to "build," and then manage, "all aspects" of "creating a business where we could buy [loans] and securitize them."[33] Between 2000 and 2007, Silverstein was also in charge of "taking a pool of mortgage loans and completing and executing the securitization process," including presentations to the rating agencies; coordinating with the trading desk for the securities to be issued; preparing the Registration Statements, Free Writing Prospectuses ("FWPs"), Prospectuses, and Prospectus Supplements ("ProSupps") (collectively, "Offering Documents") that were publicly filed with the U.S. Securities and Exchange Commission ("SEC") and used to market the securities; reviewing the due diligence performed for the securitized loan pool; and then coordinating the settlement and closing of the securitization transaction.[34] During his deposition in connection with Ambac's first action against Bear Stearns in this Court, Silverstein was resolute when asked what his specific role was in the process: "I would not manage – I would be responsible for each of these processes in relation to a securitization."[35]

[33] Ambac Amended Complaint ¶ 71 (citing 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 35-36).

[34] Ambac Amended Complaint ¶ 71 (citing 6/4/2010 Silverstein Deposition Tr. at 36-37; 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 37-38 (stating that Silverstein was responsible for "the process by which pools of mortgages are sent to a rating agency for analysis and the . . . preparation of the offering documents in connection with a securitization and then the closing and settlement of that securitization")).

[35] Ambac Amended Complaint ¶ 71 (citing 6/4/2010 Silverstein Deposition Tr. at 38 (emphasis added)).

61. After securitizations closed, Haggerty and Silverstein continued to oversee and manage the quality-control process. In connection with Bear Stearns's acquisition by JPMorgan Chase & Co., JP Morgan hired Haggerty and Silverstein to serve as two of the three Co-Heads of the transaction management group responsible for activities "in connection with sale, purchase, securitization, [and] servicing" of mortgage loans.[36] As of December 2011, Haggerty worked, and, on information and belief, continues to work at JP Morgan as a Managing Director in the Securitized Products Group. Silverstein was a Managing Director in Mortgage Finance at JP Morgan until December 2008.

62. Bear Stearns's top executives adopted and succumbed to a compensation structure that created perverse incentives for Bear Stearns to purchase and securitize loans regardless of their quality in order to secure obscene payouts. Indeed, based on publicly available information, CEO James Cayne, Executive Committee Chairman Greenberg, and Co-Presidents Alan Schwartz and Warren Spector earned an aggregate total of over ***$1 billion*** in total salary, bonus, and stock benefits during the years preceding Bear Stearns's collapse in 2008. Even after reducing this total to account for the post-2008 plummeting of Bear Stearns's stock value, these individuals made an aggregate ***net payoff exceeding $650 million***. Meanwhile, the firm disintegrated, its shareholders' investments evaporated, and the loans it funded and securitized – and the mortgage-backed securities and other financial products linked to them – have wreaked unprecedented harm on borrowers, investors, and the economy as a whole.

63. Bear Stearns also awarded the lower tiers of executives within Bear Stearns's "Residential Mortgage Team" with extraordinarily high compensation that was ***directly correlated*** to the performance and expansion of Bear Stearns's securitization machine.

[36] Ambac Amended Complaint ¶ 72 (citing 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 43 and 46 (admitting that she is also responsible for assisting Bear Stearns in defending litigations such as this one)).

Consequently, during the height of Bear Stearns's securitization machine, Marano, Nierenberg, and Verschleiser received stratospheric compensation, with the majority paid out as cash bonuses. Others on Bear Stearns's trading desks were also handsomely compensated for increasing the volume and pace at which loans were fed into the securitization pipeline. Between 2005 and 2007, remarkable bonuses were awarded to the trading-desk executives that Bear Stearns identified as directly responsible for effectuating each of the Transactions at issue. The means and the motivation were the same – money, and lots of it – to churn out securitizations from the Bear Stearns machine regardless of the consequences.

64. The complete apathy and callous disregard that the architects of these securitizations had for those they were defrauding and harming is illustrated in correspondence involving Jeff Wise, EMC's former senior vice president responsible for seller approval and current Senior Vice President of Seller Approval at JP Morgan. As revealed in Ambac's first action, an August 2008 email sent to Wise by a Countrywide executive mockingly revised a *New York Times* article, which had addressed the alarming market meltdown from the RMBS crisis, to state:

> "Virtually everybody was frankly slow in recognizing that we were on the cusp of a really draconian crisis because ***we were having too much fun waiving shit in and getting loaded on Miller Lite***. Hell! I had a guy that rolled in [sic] Corvette for chrissakes! said Jeff Wise, a former EVP of Credit Risk at Countrywide Securities Corp."[37]

65. This exchange also reveals the close relationship between Bear Stearns and Countrywide, the originator of a majority of the loans in two of the Transactions at issue in this action and the industry's former highest-volume originator of mortgage loans. Simply, Bear

[37] Ambac Amended Complaint ¶ 77 (citing email from James Baker (and John Relihan) at Countrywide to Jeffrey Wise (EMC Mortgage Corp. Senior Vice President, Seller Approval), and associates at Countrywide, dated August 6, 2008, EMC-AMB 010730188-91 (emphasis added)).

Stearns and Countrywide, as well as GreenPoint and the other originators that fueled Bear Stearns's success, were in cahoots in perpetrating the fraud that has wreaked havoc on the world's economy.

## IV. THE ORIGINATORS OF LOANS IN THE TRANSACTIONS FUELED THE BEAR STEARNS SECURITIZATION MACHINE

66. Within its vast originator network, Bear Stearns thrived off a handful of large mainstay third-party originators that supplied thousands of toxic loans critical to the success of its securitization machine. GreenPoint, Countrywide, and SouthStar were three of Bear Stearns's largest-volume third-party originators of such loans. Because of its close relationship with these originators, Bear Stearns had unique access to the true nature of the originators' improper practices – practices that were never disclosed to Ambac. Indeed, Bear Stearns represented to Ambac just the opposite: that Bear Stearns took steps to ensure that the originators adhered to the highest-quality standards. As has come to light, these representations were false.

67. Bear Stearns and its affiliates extended financing within its originator network to make available to originators an advance line of funds necessary to maintain the constant stream of loans acquired by EMC for securitization. Bear Stearns also promised originators that it would pay premium pricing on any loans originated and sold to EMC.[38] Because the originators were not lending their own funds, Bear Stearns encouraged and enabled them to originate a continuous flow of defective loans. Bear Stearns thus provided the means by which these originators approved and generated thousands of mortgages in total disregard of borrowers' ability to repay their debts. From due diligence, conducted by third-party firms such as Clayton

[38] Ambac Amended Complaint ¶ 48 (citing email from Norman Scott (Bear, Stearns & Co. Inc. Vice President and Product Manager) to the originator CPMC, dated April 4, 2005, EMC-AMB 001254436-437 at 437 ("Bear Stearns have [sic] substantially expanded our Alt-A and Sub Prime product offering and are offering premium pricing for product that is sent to the warehouse facility and purchased by EMC.")).

and Watterson Prime, and its own quality control, Bear Stearns knew that these origination practices violated state laws, including deceptive-trade-practices and anti-predatory-lending laws, such as those requiring that the loan or refinancing be in the borrowers' best interests. Bear Stearns nevertheless facilitated these improper practices so it could continue to reap short-term profits.

68. EMC also obtained an enormous volume of loans for securitization from its originator affiliates BSRM and EMC Residential Corporation ("EMCRC"). Bear Stearns financed and purchased those loans "with the ultimate strategy of securitization into an array of Bear Stearns' securitizations."[39] Bear Stearns leveraged its multiple roles and affiliates to dictate loan-origination standards for the loans it securitized, either by requiring that loans be originated to its published guidelines or by approving the guidelines used by its larger originators, with whatever changes Bear Stearns believed were necessary.[40] Bear Stearns touted these facts to securitization participants like Ambac to provide comfort regarding the rigor of Bear Stearns's loan-origination and loan-acquisition practices. What Bear Stearns did not disclose is that it abandoned the protocols necessary to ensure adherence to those guidelines, which were in turn systematically abandoned by the originators.

### A. GREENPOINT MORTGAGE FUNDING, INC.

69. GreenPoint was the sole supplier of the loans for two of the Transactions – GPMF 2006-AR2 and GPMF 2006-AR3 – and one of Bear Stearns's largest suppliers of loans during the 2005-2007 time period when Bear Stearns's securitization machine was at its height.

[39] *See* BSMF 2006-AR2 ProSupp at S-29.

[40] Ambac Amended Complaint ¶ 49 (citing Bear Stearns Subprime Mortgage Conduit and EMC Servicing Investor Presentation, EMC-AMB 001421565-597 at 572, 576 (noting process to "approve seller underwriting guidelines."). *See also* 4/26/2010 Golden Deposition Tr. at 54-55 ("[O]n the origination side, I guess we set the – the limits and the type of product that sellers could sell to EMC.")).

Contrary to Bear Stearns's representations to Ambac that GreenPoint adhered to conservative underwriting guidelines, GreenPoint in fact abandoned whatever guidelines it had and was among the worst originators in the industry.

70. A raft of litigation involving GreenPoint loans packaged into Bear Stearns's RMBS transactions has brought the truth to light, revealing what another financial guarantor (Assured Guaranty Corp.) described as "a mortgage mill that disregarded prudent underwriting standards to recklessly originate defective loans irrespective of borrowers' ability to repay"[41] – precisely the opposite of what Bear Stearns represented to Ambac in the Offering Documents for the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions. One whistleblower, Rachel Steinmetz, sued GreenPoint in June 2008 and, as revealed in Assured's lawsuit, which relates to another Bear Stearns RMBS transaction filled with GreenPoint-originated loans, other former employees have come forward to blow the whistle on GreenPoint's fraud.[42]

71. All of these former GreenPoint employees tell a similar story: that GreenPoint abandoned its underwriting guidelines to increase volume; failed to assess the reasonableness of the borrowers' incomes on stated-income loan applications (a significant percentage of the loans in the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions are stated-income loans)[43]; and approved loans it knew were fraudulent to maintain a good relationship with its brokers.[44]

72. For instance, Assured's complaint reveals that, according to confidential witness 8 ("CW-8"), who was an underwriter at GreenPoint between 2003 and 2005, underwriters at

---

[41] Assured Complaint ¶ 105.

[42] *See generally* Assured Complaint.

[43] Amended Complaint ¶¶ 105, 111-191, *Steinmetz v. GreenPoint Mortgage Funding, Inc.*, No. 08-CV-5367 (S.D.N.Y. filed Dec. 24, 2008).

[44] Amended Complaint ¶ 118, *Steinmetz v. GreenPoint Mortgage Funding, Inc.*, No. 08-CV-5367 (S.D.N.Y. filed Dec. 24, 2008); Assured Complaint ¶ 109.

GreenPoint were under considerable pressure from management to approve nearly every single loan that they came across regardless of the loan's quality. With respect to stated-income loans, CW-8 stated that she and other underwriters at GreenPoint were directed by management to deem reasonable the stated income listed on every loan application. According to CW-8, she was directed to approve loans where the borrowers' stated incomes diverged significantly from the range set forth by external sources such as Salary.com. CW-8 recalled approving stated-income loans where landscapers claimed to be earning over $6,000 per month in Ohio. CW-8 considered this income to be unreasonable for a landscaper in the region, especially in light of the fact that the borrower was likely unemployed for a significant portion of the year because landscaping work in that region is predominately seasonal. Nevertheless, CW-8 was pressured to approve, and did approve, such loans.[45]

73. GreenPoint's internal documents, also revealed in Assured's complaint, corroborate these whistleblowers' admissions. For example, the documents reveal that, in response to an investor's 2007 request to conduct 100% due diligence on GreenPoint-originated loans, GreenPoint began to "re-train" its underwriters to test incomes stated on stated-loan applications for reasonableness. The goal was to avoid having the investor realize that, in the several years before – including the years in which the GreenPoint loans in the Transactions were originated – GreenPoint had not complied with the requirement in its guidelines that all stated incomes be tested for reasonableness.[46]

74. It is evident that these improper practices affected loan quality, as numerous reviews of GreenPoint loans acquired and securitized by Bear Stearns have identified extraordinarily high percentages of loans plagued by underwriting deficiencies and fraud. As

[45] Assured Complaint ¶ 108.

[46] Assured Complaint ¶¶ 7, 109.

explained in its lawsuit against EMC, Syncora Guarantee Inc., another financial guarantor, reviewed a random sample of 400 GreenPoint loans in connection with the GreenPoint 2007-HE1 transaction and discovered that a remarkable 85.5% of the loans breached one or more of EMC's representations and warranties about the quality of the loans and GreenPoint's practices in underwriting them.[47] Likewise, Assured reviewed 906 loans in another EMC-sponsored transaction filled with GreenPoint loans and identified at least 820 – or a staggering 88.5% – as in breach of one or more of EMC's representations and warranties.[48] As explained in more detail below, Ambac's loan-level reviews in this case reflect similar findings of an exceptionally high breach rate of GreenPoint loans. Among the more common breaches identified in these reviews are inflated or fraudulent appraisals, as well as various kinds of misrepresentations and fraud.

75. This mountain of evidence demonstrates that Bear Stearns's representations to Ambac about its "controls" to screen out deficient sellers and defective loans, to say nothing of its representations about GreenPoint's underwriting practices, were false and misleading.

76. Bear Stearns was well aware of the falsity of its representations because Bear Stearns had intimate and unique familiarity with GreenPoint. By 2005, and continuing ***past*** the demise of GreenPoint's origination business in mid-2007, GreenPoint was the source of a significant percentage of loans acquired and securitized by Bear Stearns. During those years, GreenPoint was either the largest or one of the largest originators of non-subprime loans that Bear Stearns acquired for its securitizations. From June 2005 to February 2007, GreenPoint sold almost $15 billion worth of loans to Bear Stearns. Even after GreenPoint's parent company Capital One Financial Corporation shut down GreenPoint's mortgage-origination operations in

[47] Syncora Federal Complaint ¶ 6.

[48] Assured Complaint ¶ 270.

August 2007 – on account of tightened underwriting standards in the lending industry[49] – Bear Stearns continued to buy loans from GreenPoint.

77. Throughout that time, Bear Stearns had direct knowledge that GreenPoint's loans were defective. Bear Stearns tracked the number of loans in its securitizations that defaulted shortly after purchase – so-called "early payment default" or "EPD" loans. Because mortgage loans typically are the most significant personal debt incurred by an individual, the failure to make payments from the outset is viewed – and was viewed in the industry, including by Bear Stearns,[50] at the time – as a red flag of fraud or of the borrower's inability to repay the loan. Bear Stearns often had rights against originators, including GreenPoint, to demand that they repurchase EPD loans.

78. In 2006, the year that all of the Transactions took place, Bear Stearns submitted ***more repurchase claims against GreenPoint than against any other seller*** with which Bear Stearns did business.[51] As a result, Bear Stearns knew that GreenPoint was not a quality originator but toward the "worst end of scale," based on the high percentages of loans suffering from both unacceptable defects and delinquencies relative to the loans of other originators.[52]

---

[49] *See* Jed Moss, *Alt-A Mortgage Lender Closes Up Shops*, Mortgage Found., June 9, 2007 (citing GreenPoint spokesperson Julie Rakes); Bauerlein, *Capital One Shuts Down GreenPoint Mortgage Unit* (citing a memo circulated by Capital One Chairman and Chief Executive Richard D. Fairbanks).

[50] Ambac Amended Complaint ¶ 7 (citing 6/4/2010 Silverstein Deposition Tr. at 178).

[51] Assured Complaint ¶ 124 (citing Seller Monitoring Report, 1/1/06 to 12/31/06, EMC-AMB 007653616 (total count of Bear Stearns's claims against GreenPoint is highest of any active seller); email from Steve Corn (Bear, Stearns & Co. Associate Director of Mortgage Origination) to Mieko Willoughby (Bear, Stearns & Co. Senior Managing Director, Account Executive) and Pat Moore (EMC Mortgage Corporation Manager, Representations and Warranties Department), among others, dated March 10, 2006, EMC-AMB 006803400-402).

[52] Assured Complaint ¶ 124 (citing Seller Monitoring Report, 1/1/06 to 12/31/06, EMC-AMB 007653616 (Bear Stearns graded sellers in its originator network using a scale of 1 to 10, where a grade of 10 signified the "worst end of the scale"; Bear Stearns assigned GreenPoint a rating of 7 in category for unacceptable loan defects, and a rating of 6 in the category for the number of loans suffering from delinquencies of sixty days or more).

Bear Stearns disclosed none of this to Ambac when inducing Ambac to insure the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions, which consisted exclusively of GreenPoint loans.

79. Despite its extensive knowledge of GreenPoint's deficient and fraudulent underwriting practices, Bear Stearns not only failed to notify Ambac and other securitization participants of the truth, but also failed to give GreenPoint anything more than a token slap on the wrist. To the contrary, Bear Stearns made repeated concessions to GreenPoint to ensure the continued flow of loans – albeit knowingly defective ones – that Bear Stearns relied on to fuel its securitization machine. These concessions took various forms:

- ***Approving GreenPoint's ever-loosening underwriting guidelines:*** According to Mary Haggerty, Bear Stearns's Co-Head of Mortgage Finance, EMC adjusted or matched its guidelines with those of its competitors and would grant "variances" for specific sellers from which it purchased loans. GreenPoint was among these sellers, and, in 2006, Bear Stearns maintained a steady flow of GreenPoint loans by accepting without limitation GreenPoint's increasingly loosened guidelines.

- ***Reducing and postponing due diligence on GreenPoint loans:*** Despite having already determined – through, among other things, its EPD findings – that GreenPoint's loan pools were replete with defective and fraudulent loans, Bear Stearns both postponed (in 2006) conducting due diligence on GreenPoint loans until after Bear Stearns had acquired them and reduced (in 2007) the number of GreenPoint loans it reviewed as part of its touted due-diligence protocols.

- ***Conducting virtually no quality control on already-securitized GreenPoint loans:*** As Bear Stearns's appetite for GreenPoint loans nearly doubled from 2004 to 2005, the proportion of GreenPoint loans that Bear Stearns selected and reviewed for quality control actually declined to a mere ***17*** loans out of 10,081 loans (or less than 0.2%) purchased from GreenPoint between August 2004 to July 2005.

- ***Refusing to enforce claims against GreenPoint upon discovery of defective loans:*** As noted, Bear Stearns had millions of dollars in EPD claims against GreenPoint. But Bear Stearns delayed enforcing these claims, and even when an internal audit pressured Bear Stearns to pursue the claims, Bear Stearns caved to GreenPoint's demands to settle the claims on the cheap through so-called "downbids." And Bear Stearns pocketed these amounts for itself, rather than, as required under its various agreements with securitization participants, including Ambac with respect to the

> Transactions at issue in this litigation, passing those amounts along to the securitization trusts.[53]

80. In short, throughout its relationship with GreenPoint – including before, during, and after the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions – Bear Stearns condoned and reinforced lax underwriting and was careful not to step on the toes of "one of [its] oldest Conduit Sellers" because "the relationship is an important one."[54] Meanwhile, the workings and consequences of this relationship were hidden from – and deliberately misrepresented to – Ambac.

### B. COUNTRYWIDE HOME LOANS, INC.

81. The Countrywide story is equally ugly. Countrywide originated a majority of the loans in the SAMI 2006-AR7 (100%) and SAMI 2006-AR8 (52%) Transactions, as well as many of the underlying loans for the re-REMIC transaction, BALTA 2006-R1. As with GreenPoint, Bear Stearns assured Ambac that Bear Stearns went to great pains to ensure that the loans originated by Countrywide (and securitized by Bear Stearns) adhered to the highest underwriting standards. Bear Stearns's represented protocols included its purportedly careful monitoring of Countrywide and its loans. These representations about the quality of Countrywide's loans and underwriting practices have proven false. Like GreenPoint, but to an even greater degree, Countrywide and its management are currently subject to myriad investigations and actions, some of which have already settled for billions of dollars, for having engaged in systematic fraud in connection with the origination of residential mortgage loans.

---

[53] Assured Complaint ¶¶ 113-20.

[54] Assured Complaint ¶ 120 (citing email from Pat Moore (EMC Mortgage Corporation Manager, Representations and Warranties Department) to Thomas Durkin among others, dated May 24, 2007, EMC-SYN 00316139).

82. Among these actions is a lawsuit by Ambac, for fraud and breach of contract, in this Court. Ambac's complaint sets forth in detail the facts establishing what one federal judge has referred to as "a Company-wide culture that, at every level, emphasized increased loan origination volume in derogation of underwriting standards," which were "rampant[ly] disregard[ed]."[55]

83. Specifically, as documented in Ambac's complaint, Countrywide employees and internal documents have revealed Countrywide's pervasive, imprudent, and unlawful origination practices, all done with the knowledge of senior management, including the following:

- a high-level corporate strategy to find a way to make every loan regardless of the borrowers' ability to repay, and thereby pursue origination volume at the expense of underwriting standards;
- the processing of exceptions to underwriting guidelines without a reasonable basis and in such volumes as to make exceptions the rule;
- actively and systematically funneling into its reduced-documentation loan programs – through which the majority of the loans in the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions were originated – unqualified borrowers who Countrywide knew were not likely to be able to repay indebtedness in a timely fashion;
- pressuring appraisers to inflate values of appraised properties or risk being blacklisted;
- engaging in abusive and predatory lending in violation of state consumer-protection statutes; and
- failing to implement controls to guard against, or even actively condoning and facilitating, borrower, broker, and employee fraud on a massive scale.[56]

84. Ambac's complaint further reveals Countrywide's "unlawful practice of systematically overstating another key metric used to asses the risk of mortgage loans: the

[55] *In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1058-59 (C.D. Cal. 2008).

[56] Amended Complaint ¶ 155, *Ambac Assurance Corp. et al. v. Countrywide Home Loans, Inc. et al.*, No. 651612/2010 (N.Y. Sup. Ct. filed Aug. 24, 2011) ("Ambac-Countrywide Complaint").

appraised value of the mortgaged property,"[57] a practice that Ambac's findings in connection with the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions at issue in this case confirm. Countrywide's practice was not only unlawful, but in direct contravention of Countrywide's own written policies, which stated that Countrywide was responsible "to its investors for the quality of appraisals used to support the value of a security property" and for assuring that the appraisers Countrywide used "d[id] not engage in unacceptable practices."[58] Worse yet, Countrywide's systematic appraisal fraud was perpetrated with the full knowledge and acquiescence of Countrywide executives.[59]

85. Ambac's review of 8,804 loans in the transactions at issue in its lawsuit against Countrywide complete the picture of a company operating, at the direction of management, with a flagrant disregard for its own stated underwriting guidelines. Of those loans, Ambac discovered that an incredible 7,989 – or almost 91% – breached one of more of Countrywide's various representations and warranties about the quality of the loans and Countrywide's practices in underwriting them.[60]

86. The public record is littered with similar revelations. A civil fraud action brought by the SEC against Countrywide confirms Countrywide's duplicity vis-à-vis the public, alleging that from "2005 through 2007" – *i.e.*, when the Transactions at issue in this complaint were effectuated – Countrywide's "senior executives misled the market by falsely assuring investors that Countrywide was primarily a prime quality mortgage lender which had avoided the excesses

---

[57] Ambac-Countrywide Complaint ¶ 87.

[58] Ambac-Countrywide Complaint ¶ 87.

[59] Ambac-Countrywide Complaint ¶ 89.

[60] Ambac-Countrywide Complaint ¶ 157.

of its competitors."[61] The duplicity was internal to Countrywide as well. Countrywide's underwriting manual – *i.e.*, the internal policies it set for its underwriters – was cautious in tone and emphasized various controls to ensure that only "investment quality loans" were made. But Countrywide's own executives encouraged its underwriters to disregard the stated guidelines and instead use what a California federal court found to be the most aggressive guidelines in the industry.[62] In particular, as the SEC's complaint against former Countrywide CEO Angelo Mozilo reveals, Countrywide – much like GreenPoint – abused the exceptions process, which was, as its name suggests, intended to be the exception, but became the rule.[63]

87. The allegations in these complaints regarding Countrywide's systematic abandonment of its underwriting guidelines are confirmed by the statements of confidential witnesses. For example, Countrywide confidential witness 1 ("CW-1"), who worked at Countrywide as an underwriter from March 2006 to December 2007 (*i.e.*, around the time the loans in the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions were originated), has confirmed the allegations that Countrywide systematically abandoned its underwriting guidelines. CW-1 revealed that Countrywide's automated underwriting system (known as "CLUES") violated Countrywide's underwriting guidelines by (a) not assessing whether the income stated on stated-loan applications was reasonable and (b) not allowing red flags of fraud to be evaluated. In addition, CW-1 revealed that loan officers at Countrywide would regularly input incorrect data metrics into CLUES, such as by inflating borrowers' income beyond what the documents in the loan file supported. When underwriters refused to engage in similarly improper practices, managers would intervene and pressure the underwriters to approve even

---

[61] Complaint ¶ 6, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. filed June 4, 2009).

[62] *SEC v. Mozilo*, No. 09-CV-3994, slip op. at 20-21 (C.D. Cal. Sept. 16, 2010) (citation omitted).

[63] Complaint ¶ 54, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. filed June 4, 2009).

clearly defective loans, including by discouraging the underwriters from using Countrywide's own fraud-detection tools. In short, CW-1 confirmed that Countrywide's actual practices differed significantly from its stated protocols and policies, all in furtherance of Countrywide's goal to fund as many loans as possible, by any means necessary.

88. As noted above, Bear Stearns represented to Ambac – in the Offering Documents for the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions, as well as in email correspondence, discussed below – that Countrywide did none of these things and instead complied with its seemingly rigorous and conservative underwriting guidelines, including with respect to proper appraisal practices. These revelations, together with the awful performance of the Transactions and Ambac's loan-level findings regarding the Countrywide loans in the Transactions, prove the falsity of Bear Stearns's representations to Ambac.

89. Bear Stearns knew, or at least had to have known, all of this as well: After all, Bear Stearns was the largest securitizer of loans in the industry, and Countrywide was the largest originator of securitized loans. Sure enough, as Matt van Leeuwen, a former EMC analyst who supported the Bear Stearns trading desk, explained, Bear Stearns did "tons of deals" with Countrywide, which was "the biggest provider[] . . . by far" of so-called "Alt-A" loans securitized by Bear Stearns.[64] All of the loans in the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions are Alt-A. A recent complaint filed in this Court by another insurance company against Bear Stearns reveals that, between 2005 and 2007, Bear Stearns securitized nearly $15 billion of loans originated by Countrywide and, as a result, "obtained unique access to material, non-public information about Countrywide's operations, including its loan origination and loan

[64] Transcription of Videotaped Interview of Matthew Van Leeuwen, attached as Exhibit 1 to the Declaration of Muhammad U. Faridi in Support of Syncora's Opposition to Van Leeuwen's Motion to Quash, *Syncora Guarantee Inc. v. EMC Mortgage Corp.*, No. 10-MC-825 (SS) (W.D. Tex. Nov. 15, 2010).

underwriting practices, loan quality and performance, and reserve methodologies for nonperforming loans."[65]

90. Indeed, Bear Stearns represented to Ambac in connection with the Transactions at issue that it in fact was monitoring Countrywide's practices and procedures to insure compliance with represented standards. Based on that monitoring and Bear Stearns's unique access to Countrywide, Bear Stearns assured Ambac that Countrywide was one of the "stronger originators" that Bear Stearns relied on to fuel its securitization machine. Bear Stearns further represented to Ambac that it had so much confidence in Countrywide's underwriting practices and the quality of Countrywide's loans that it was considering reducing the amount of due diligence it did on loans it acquired from Countrywide.[66] On the basis of these representations, as well as those in the Offering Documents that similarly represented the sound practices purportedly employed by Countrywide to originate the loans that Bear Stearns acquired for securitization, Ambac agreed to participate in the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions.

### C. BSRM AND SOUTHSTAR

91. In addition to GreenPoint and Countrywide, multiple other originators furnished Bear Stearns with the loans it securitized in the Transactions. Most notable were Bear Stearns's own BSRM, which originated 91% of the loans in the BSMF 2006-AR2 Transaction and approximately 52% of the loans in the BSMF 2006-AR4 Transaction, and SouthStar, which originated approximately 24% of the loans in the SAMI 2006-AR8 Transaction. As with GreenPoint and Countrywide, Bear Stearns touted to Ambac that it had used its unique access to

[65] *John Hancock Life Ins. Co. et al. v. JPMorgan Chase & Co. et al.*, No. 650195/2012 (N.Y. Sup. Ct. filed Mar. 3, 2012).

[66] Feb. 17, 2005 email from Bear Stearns's Sara Bonesteel to Ambac's Christine Lachnicht.

BSRM and SouthStar to ensure that they adhered to rigorous and conservative underwriting practices to originate loans in the Transactions. But also as with GreenPoint and Countrywide, these representations were false.

92. BSRM was part and parcel of Bear Stearns's securitization machine, and Bear Stearns used BSRM, like EMC, as an instrumentality to help Bear Stearns perpetrate its fraud. A recent lawsuit by a borrower against Bear Stearns and its affiliates sheds light on the role that BSRM played. The lawsuit alleges, among other things, that "[d]uring the time period 2005-2007" – when the Transactions at issue in this action were negotiated – Bear Stearns "promoted and encouraged BSRM . . . to expand loan volume by ignoring or disregarding stated underwriting guidelines." In response,

> BSRM increased the level-one risk of nontraditional mortgages [defined as the risk inherent in nontraditional mortgages originated in compliance with stated underwriting guidelines and standards] to level-two risk [defined as the risk of nontraditional mortgages not originated in compliance with stated underwriting guidelines and standards] during the time period 2005-2007, (i) by systematically disregarding stated underwriting standards regarding income and employment; (ii) by regularly making exceptions to their underwriting guidelines in the absence of sufficient compensating factors; (iii) by falsifying loan-to-value ratios with inflated appraisals; and (iv) by underwriting a dangerously high percentage of mortgages for borrowers who did not intend to occupy the property they were purchasing.[67]

93. The specific act complained of in the lawsuit involved BSRM's improper inflation of appraisal value. The borrower's lawsuit alleges that "BSRM abandoned its conventional role as a money lender of preparing and reviewing the appraisal on the underlying property . . . by overvaluing and over-financing the underlying property in order to induce

[67] Complaint ¶ 26, *Spizzirri v. JP Morgan Chase Bank, N.A. et al.*, SACV12-00311 JVS (RNBx) (C.D. Cal. Feb. 28, 2012).

Plaintiff . . . into borrowing money from BSRM . . . to purchase the underlying property."[68] As discussed further below, these allegations are consistent with Ambac's findings detailed in this lawsuit reflecting that appraisal values for BSRM loans in the Transactions were inflated. So, too, is the borrower's broader allegation that "BSRM and the other Bear Stearns Entities were actively participating in a fraudulent business scheme designed to conceal from prospective homebuyers including Plaintiff the high risk quality of the nontraditional mortgages they were originating and acquiring for securitization."[69]

94. Like GreenPoint and Countrywide, SouthStar was among the worst originators in the business – another fact that Bear Stearns knew but failed to mention to Ambac or investors. In early 2007, only several months after the SAMI 2006-AR8 Transaction closed, Bear Stearns publicly purported to "tighten" standards (to adopt policies that should have been in place all along) to buy time while it attempted to clear out its inventory of defective loans. For example, Bear Stearns downgraded certain suppliers of its loans to "suspended" or "terminated" status pursuant to its touted "seller monitoring" protocols. Among the originators that Bear Stearns suspended mere months after the SAMI 2006-AR8 Transaction closed was SouthStar. However, Bear Stearns then directed its quality-control personnel ***to stop conducting reviews of these originators' loans*** so that it could move the loans out of its inventory and into its securitizations.[70] Indeed, simultaneous with Bear Stearns's hard-sell to Ambac regarding its purported efforts to improve underwriting standards of the loans in a separate transaction that

---

[68] Complaint ¶ 40, *Spizzirri v. JP Morgan Chase Bank, N.A. et al.*, SACV12-00311 JVS (RNBx) (C.D. Cal. Feb. 28, 2012).

[69] Complaint ¶ 52, *Spizzirri v. JP Morgan Chase Bank, N.A. et al.*, SACV12-00311 JVS (RNBx) (C.D. Cal. Feb. 28, 2012).

[70] Ambac Amended Complaint ¶ 18 (citing 5/20/2010 Serrano Deposition Tr. at 180-184 (testifying that, over his objections, the President of EMC Residential Corporation, and others, directed the quality-control department to stop the review of suspended and terminated sellers)).

closed in April 2007 (and that Ambac also insured), the Bear Stearns analyst working on the deal more accurately described the deal in internal correspondence as a "going out of business sale."[71] Another called it a "DOG."[72] Both were accurate – yet undisclosed, internal perspectives. And both reflected what Bear Stearns had known about SouthStar, which was the largest source of loans in that transaction, for years.

## V. THE TRANSACTIONS

### A. THE TRANSACTIONS (OTHER THAN BALTA 2006-R1)

95. Except for the BALTA 2006-R1 Transaction, which is a "re-REMIC" transaction and which is described separately below, each of the Transactions proceeded in similar fashion. As the Sponsor/Seller, EMC, acting at all times at the direction and under the control of Bear, Stearns & Co., pooled and securitized thousands of residential mortgage loans, with aggregate principal balances in the millions and billions of dollars, that EMC had purchased from various originators. These loans served as collateral for the issuance of publicly offered mortgage-backed securities.

96. The Transactions were effectuated through the following series of agreements executed by EMC and its affiliates that governed, among other things, the rights and obligations of the various parties with respect to the mortgage loans and the securities that resulted from their securitization.

97. EMC, acting as Seller, sold and assigned its entire interest in the mortgage loans to its affiliate Structured Asset Mortgage Investments II Inc. ("SAMI II") pursuant to an MLPA

[71] Ambac Amended Complaint ¶ 18 (citing email from Charles Mehl (Bear, Stearns & Co. Analyst, Mortgage Finance) to Keith Lind (Bear, Stearns & Co. Managing Director, Trading), dated April 5, 2007, EMC-AMB 002075468).

[72] Ambac Amended Complaint ¶ 18 (citing email from John Tokarczyk (Bear, Stearns & Co. Associate Director) to Jeffrey Maggard (Bear, Stearns & Co. Managing Director and Deal Manager on the BSSLT 2007-1 Transaction), dated April 30, 2007, EMC-AMB 001469603-604 ("LETS CLOSE THIS DOG")).

for each Transaction. Under the MLPAs, EMC made numerous detailed representations and warranties concerning the quality of the mortgage loans.

98. SAMI II, in turn, acting as Depositor, sold its interest in the mortgage loans to a securitization trust pursuant to a Pooling and Servicing Agreement ("PSA") for each Transaction. The trusts then issued various classes of mortgage-backed securities, which were registered with the SEC and underwritten and marketed to investors by Bear, Stearns & Co. by means of the related Prospectus and ProSupp. In order to enhance the marketability of certain classes of securities and, thereby, increase its return on the Transactions, Bear Stearns sought a financial-guaranty insurance policy from Ambac for each Transaction. Ambac's insurance made the securities more marketable because investors could look to Ambac for minimum principal and interest payments in the event that income from the loans in the trusts could not support these payments. As an inducement to issue its policies, Ambac was made a third-party beneficiary of both the MLPAs and the PSAs.

99. Relying on Bear Stearns's pre-contractual representations detailed below and EMC's representations and warranties contained in the MLPAs and PSAs, Ambac issued financial-guaranty insurance policies for each Transaction (the "Policies"). Under its Policies, Ambac agreed to insure certain payments of interest and principal with respect to certain classes of the securities issued in the Transactions (the "Insured Certificates"). The Insured Certificates were underwritten and marketed, and sold to investors, by Bear, Stearns & Co.

100. The following chart contains each of these relevant details for each Transaction, with the exception of the BALTA 2006-R1 Transaction, which is described below the chart:

| Transaction | Closing | # of Securitized Loans | Principal Originators of Securitized Loans | Original Aggregate Principal Balance of Securitized Loans (approx.) | Original Value of Issued Securities (approx.) | MLPA Date | PSA Date | Ambac's Policy Number |
|---|---|---|---|---|---|---|---|---|
| GPMF 2006-AR2 | Mar. 31, 2006 | 3,111 | GreenPoint (100%) | $1.37 billion | $1.36 billion | Mar. 31, 2006 | Mar. 1, 2006 | AB0982BE |
| GPMF 2006-AR3 | April 28, 2006 | 6,321 | GreenPoint (100%) | $1.92 billion | $1.89 billion | April 28, 2006 | April 1, 2006 | AB0990BE |
| SAMI 2006-AR7 | Sept. 5, 2006 | 7,219 | Countrywide (100%) | $2.94 billion | $2.87 billion | Sept. 5, 2006 | Aug. 1, 2006 | AB1019BE |
| BSMF 2006-AR2 | Sept. 29, 2006 | 2,951 | BSRM (91%), EMC (9%) | $1.12 billion | $1.10 billion | Sept. 29, 2006 | Sept. 1, 2006 | AB1034BE |
| SAMI 2006-AR8 | Oct. 31, 2006 | 5,034 | Countrywide (52%), SouthStar (24%) | $1.74 billion | $1.72 billion | Oct. 31, 2006 | Oct. 1, 2006 | AB1043BE |
| BSMF 2006-AR4 | Nov. 30, 2006 | 1,351 | BSRM (64%), EMC (36%) | $511 million | $497 million | Nov. 30, 2006 | Nov. 1, 2006 | AB1047BE |

## B. THE BALTA 2006-R1 TRANSACTION

101. The BALTA 2006-R1 Transaction, which closed on September 29, 2006, is a "re-securitization" or "re-REMIC." For re-REMIC transactions, a trust issues certificates backed by certificates from an underlying securitization, which underlying securitization is in turn backed by pools of mortgage loans.

102. In consummating the BALTA 2006-R1 Transaction, Bear, Stearns & Co. pooled 10 classes of certificates issued from two prior EMC-sponsored transactions: Bear Stearns ALT-A Trust, Mortgage Pass-Through Certificates, Series 2006-4, Class II-2A-2, Class II-3A-3, Class II-3A-4, Class II-3A-5, Class III-1A-2, Class III-2A-2, Class III-3A-2, Class III-3A-3, and Class III-3A-4 Certificates, and the Bear Stearns ALT-A Trust, Mortgage Pass-Through Certificates,

Series 2006-5, Class II-B-1 Certificates (the "Underlying Certificates"). The aggregate principal balance for the Underlying Certificates was approximately $637 million.

103. The BALTA 2006-R1 Transaction was effectuated through the following series of agreements. Bear, Stearns & Co., acting as Seller, sold and transferred its entire interest in the Underlying Certificates to SAMI II pursuant to a Sales Agreement dated as of September 29, 2006. SAMI II, in turn, sold its interest in the Underlying Certificates to the Bear Stearns ALT-A Trust 2006-R1 pursuant to a Pooling Agreement dated as of September 29, 2006 (the "BALTA 2006-R1 PA").

104. Relying on Bear Stearns's pre-contractual representations detailed below and certain rights granted to Ambac in the BALTA 2006-R1 PA, Ambac issued Certificate Guaranty Insurance Policy No. AB1035BE (the "BALTA 2006-R1 Policy"). Under the BALTA 2006-R1 Policy, Ambac agreed to insure certain interest and principal payments with respect to a mezzanine class of AAA-rated securities issued in the BALTA 2006-R1 Transaction for the benefit of the holders of those securities (the "BALTA 2006-R1 Insured Certificates"). The BALTA 2006-R1 Insured Certificates were backed by the Class II-2A-2, II-3A-5, III-1A-2, III-2A-2, and III-3A-4 Certificates from the Bear Stearns ALT-A Trust, Mortgage Pass-Through Certificates, Series 2006-4 transaction, and were underwritten and marketed, and sold to investors, by Bear, Stearns & Co.

### C. THE INSURED CERTIFICATES

105. Across all seven Transactions, Ambac's Policies insure Certificates that, at closing, had an aggregate value of more than $1.1 billion, as set forth in the chart below:

| Transaction | Certificates Insured by Ambac | Value of Certificates Insured by Ambac at Closing |
|---|---|---|
| GPMF 2006-AR2 | Class I-A-2<br>Class II-A-2 | $169.8 million |
| GPMF 2006-AR3 | Class II-A-2 | $256.7 million |
| SAMI 2006-AR7 | Class A-13B | $150 million |
| SAMI 2006-AR8 | Class A-6B | $100 million |
| BALTA 2006-R1 | Class V-A-1<br>Class VI-A-1<br>Class VII-A-1<br>Class VIII-A-1<br>Class IX-A-1 | $141.9 million |
| BSMF 2006-AR2 | Class II-A-2 | $114.2 million |
| BSMF 2006-AR4 | Class A-2 | $183.6 million |

## VI. BEAR STEARNS'S FRAUDULENT INDUCEMENT BASED ON MATERIALLY FALSE AND MISLEADING PRE-CONTRACTUAL REPRESENTATIONS TO AMBAC

### A. BEAR STEARNS SOLICITED AMBAC TO PARTICIPATE IN THE TRANSACTIONS

106. In advance of closing a contemplated securitization transaction, Bear Stearns made myriad false and misleading representations directly to investors, insurers, and rating agencies to induce their participation and complete the intended transaction. From Ambac's perspective, given that its claims-payment obligations under its Policies would be triggered only in the event that income from loans could not support the requisite payments to investors, the quality of those loans was paramount. Thus, Ambac sought from Bear Stearns information about the loans, the practices used in underwriting and originating them, and Bear Stearns's due-diligence and quality-control processes. Bear Stearns gave information on these subjects – but it was all false.

107. Bear Stearns followed virtually the same routine in communicating its false and misleading representations to effectuate its securitizations, including the Transactions at issue here. First, Bear Stearns made presentations and disclosures to investors and financial

guarantors concerning its securitization operations. Second, Bear Stearns provided to the financial guarantors and rating agencies mortgage loan "tapes" (data files with key information for each loan proposed for securitization) that were supposed to contain the true and accurate loan attributes critical to assess the risks associated with the loans to be securitized. Third, Bear Stearns sent financial guarantors information pertaining to the historical performance of loans that Bear Stearns had previously securitized. Fourth, Bear Stearns secured ratings from the rating agencies on various classes of securities to be issued in the contemplated transaction. Fifth, Bear Stearns disseminated draft and final Offering Documents to financial guarantors and investors purporting to describe the contemplated transaction and its associated risks.

#### *1. Bear Stearns Knowingly Made Materially False and Misleading Statements in Its Marketing Presentations and Deal Correspondence*

108. Throughout the relevant period, beginning in 2005, Bear Stearns routinely made presentations to investors and financial guarantors to induce their participation in Bear Stearns's securitizations. The presentations were made at Bear Stearns's "Investor Days" by, among others, Bear, Stearns & Co. directors Thomas Marano, Michael Nierenberg, Jeffrey Verschleiser, and Ralph Cioffi. The Investor Day presentations were supplemented by direct communications with securitization participants in advance of particular transactions, including during on-site due-diligence visits that those participants, including Ambac, made to Bear Stearns's facilities. Bear Stearns's investor-relations department and the deal managers responsible for particular transactions disseminated these presentations, which were based on information assembled by, and in conjunction with, employees from its mortgage-loan conduit.[73] As part of the presentations, Bear Stearns provided investors and financial guarantors with information (*e.g.*,

[73] Ambac Amended Complaint ¶ 82 (citing 4/19/2010 Glory Deposition Tr. at 69-71).

PowerPoint presentations known as "marketing decks") concerning the Bear Stearns mortgage-loan conduit and its purported securitization practices.

109. At Bear Stearns's invitation, Ambac attended a number of Investor Day presentations in advance of the Transactions. Bear Stearns provided Ambac with the marketing decks and other documentation regarding the Bear Stearns mortgage-loan conduit. And, in advance of the Transactions, Bear Stearns reinforced the disclosures made at the Investor Day and in the marketing decks.

110. By way of example, Bear Stearns gave Ambac a marketing deck dated June 2005, another sent on December 23, 2005, and another dated May 11, 2006. The presentations followed a standardized format, and the June 2005 deck is illustrative as to the representations made:

- <u>Integrated Entities</u>: Bear Stearns first emphasized the integrated nature of its securitizations operations. Indeed, the front cover of the presentation is titled "Bear Stearns RMBS Platform," lists an EMC website, and includes Bear, Stearns & Co. Inc.'s name and address. The presentation then provides an organization chart of "Bear Stearns' Residential Mortgage Team" that shows a seamless reporting line from EMC up to Bear, Stearns & Co.'s Chairman and CEO. Then, to make explicit the interrelation of the affiliates in the mortgage-loan conduit, the next slide asks "Why purchase RMBS from Bear Stearns?" and answers by referring to the "Integral role played by Bears affiliate, EMC Mortgage Corporation (EMC)." That slide specifically assures investors that "EMC acts as principal and makes mortgage reps and warranties, rather than passing on reps and warranties from smaller underlying sellers."

- <u>Seller Approval and Monitoring</u>: Bear Stearns next lauded its purported processes for screening and monitoring the originators from which it purchased loans for its securitizations. Bear Stearns contended, among other things, that it tracked metrics regarding the sellers' loans that were predictors of loan quality, including the level of early payment defaults ("EPDs"), delinquencies, quality-control findings, and repurchases.

- Due Diligence: Bear Stearns then described the "due diligence" protocols it purported to have implemented to prevent defective mortgage loans from entering the securitizations. For instance, the deck asserted that Bear Stearns conducted due diligence with respect to "Data Compare, Fraud, and Appraisal" for "100%," and with respect to "Credit and Compliance" for "20-100%," of the Alt-A loans it securitized through its so-called "flow" channel for acquiring loans, and with respect to "Credit, Compliance, and Data Compare" for "20 to 100%" of the Alt-A loans it securitized through its so-called "bulk" channels. To add a false veneer of integrity to the process, Bear Stearns emphasized that it retained the third-party due-diligence firms Clayton and Watterson Prime to conduct its pre-acquisition review of the loans.

- Quality Control: Bear Stearns next touted the "quality control" processes that it purportedly conducted after the securitizations closed to identify any defective loans that might have circumvented its due-diligence protocols. As with the due-diligence representations, Bear Stearns emphasized the broad scope of its quality control (including random (or "statistical") as well as targeted sampling "for all loan purchase channels," referrals from the servicing department and other departments of EMC, and "100%" review of new sellers' loans), the extensive re-verification of loan information purportedly undertaken, and the third-party consultants it retained to conduct the analysis.

- Repurchase Processes: Bear Stearns then conveyed that it had an entire "conduit team" devoted to asserting breach-of-representation-and-warranty claims, on behalf of the securitization participants, for the repurchase of loans identified as defective by the quality-control process.

- Historical Performance: Finally, Bear Stearns provided appendices with extensive data purporting to reflect the performance of its prior securitizations and the loans therein.[74]

111. Cheryl Glory – the Bear, Stearns & Co. Managing Director for U.S. RMBS Investor Relations – has acknowledged that these representations were intended to convey to investors and financial guarantors that (i) Bear Stearns implemented stringent protocols, (ii) to ensure that the securitizations contained quality loans, and (iii) for the benefit of the investors and financial guarantors.[75] Haggerty has also confirmed that Bear Stearns made these

[74] Ambac Amended Complaint ¶ 84 (citing Investor Presentation, dated June 2005, ABK-EMC01515471-561).

[75] Ambac Amended Complaint ¶ 85 (citing 4/19/2010 Glory Deposition Tr. at 109-10 (Bear Stearns intended investors and financial guarantors to believe that they benefited from the quality-control

presentations with the understanding that the information "would contribute to the investor's decision to invest in the securitizations," and in order to "solicit their participation in transactions."[76]

112. In advance of each deal, Bear Stearns reinforced through email and oral communications the disclosures made at the Investor Days and in the marketing decks. For example, several months before the GPMF 2006-AR2 Transaction closed, Cheryl Glory sent an email to Ambac with respect to another EMC-sponsored deal repeating that

> [a]s provided in the presentation materials for Investor Day, flow diligence includes credit, appraisal and compliance for the sample size. Bulk diligence is 100% for subprime and Alt B with a minimum 20% for prime Alt A. Bulk diligence would also include credit, appraisal and compliance for the sample.[77]

113. These communications, which Bear Stearns intended to provide additional assurances to investors and Ambac regarding the quality of the loans and the integrity of Bear Stearns's protocols, were materially false and misleading in several ways. Contrary to its affirmative representations, Bear Stearns knew full well that (i) its due-diligence protocols were inadequate to screen out defective loans or deliberately abandoned through overrides, (ii) its seller-monitoring controls were a farce, (iii) its quality-control and repurchase processes were designed to secure recoveries for Bear Stearns to the exclusion of, and without notice to, the securitization participants, and, as a result, (iv) the historical performance data did not reflect the

---

processes), 110-119 (Bear Stearns intended investors and financial guarantors to rely on the benefits from the seller-approval and seller-monitoring processes)).

[76] Ambac Amended Complaint ¶ 85 (citing 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 113, 121).

[77] Ambac Amended Complaint ¶ 86 (citing email from Cheryl Glory (Bear, Stearns & Co. Managing Director, Mortgage Finance) to Ervin Pilku (Ambac Associate, MBS Department of Structured Finance), dated December 13, 2005, ABK-EMC01534777).

true level of defective loans in the securitized pools. Ambac would not have entered into the Transactions had it known that Bear Stearns's disclosures were false and misleading.

***2. Bear Stearns Knowingly Disseminated Materially False and Misleading Mortgage-Loan Tapes***

114. As part of its initial solicitation to participants in a contemplated securitization, Bear Stearns sent by email certain information concerning the contemplated transaction structure and the loans proposed for securitization. Bear Stearns included in all these initial distributions to the financial guarantors and rating agencies the mortgage-loan "tape" (or electronic spreadsheet) that it asserted contained true, accurate, and complete information pertaining to critical attributes of the loans to be securitized. More specifically, the tapes listed for each loan the data metrics that insurers and rating agencies used as inputs for their cashflow and risk modeling.

115. Consistent with this general practice, Bear Stearns sent (often multiple versions of) loan tapes directly to Ambac in the days leading up to the closing date of each Transaction, as follows:

| Transaction | Closing Date | Date(s) Loan Tape Sent from Bear Stearns to Ambac |
|---|---|---|
| GPMF 2006-AR2 | March 31, 2006 | January 18, 2006 |
| GPMF 2006-AR3 | April 28, 2006 | February 14, 2006<br>February 16, 2006 |
| SAMI 2006-AR7 | September 5, 2006 | August 15, 2006<br>August 28, 2006 |
| BSMF 2006-AR2 | September 29, 2006 | September 7, 2006<br>September 11, 2006<br>September 12, 2006<br>September 13, 2006 |
| BALTA 2006-R1 | September 29, 2006 | September 18, 2006<br>September 25, 2006 |
| SAMI 2006-AR8 | October 31, 2006 | September 11, 2006<br>October 12, 2006 |
| BSMF 2006-AR4 | November 30, 2006 | October 24, 2006 |

116. Ambac required and relied on these tapes as a critical component in deciding whether to provide insurance for the Transactions, and rating agencies relied on the tapes as a critical component in determining the ratings to be assigned to each class of securities being issued. Ambac used the data on the tapes as inputs to its risk models, and analyzed the loan metrics, which were central to assessing the risk associated with the loan pools and predicting the expected rates and severity of defaults by the borrowers. The following were some of the key metrics included on the tapes:

- the loan-to-value ratio ("LTV") for each loan, which measured the amount of mortgage debt that encumbers a property against the value of the property;
- the FICO (or credit) score for each borrower;
- the debt-to-income ratio ("DTI") for each borrower, which compared payments due on a borrower's monthly debts to a borrower's income;
- the occupancy status of the property, which listed whether the property was the borrower's primary or secondary residence, or an investment property; and
- the "doc-type" of each loan, which described the program pursuant to which the loan was originated, and which specified the information that borrowers were required to disclose concerning their income, employment, and assets, and how such information would be verified.

117. Bear Stearns knew that Ambac and the rating agencies would rely, and intended that they rely, on the veracity of the tape data to evaluate the Transactions and assess the "market risks" pertaining to the loans.[78]

118. Owner-occupancy statistics were material to Ambac and other investors because homeowners who reside in mortgaged properties are less likely to default (which would result in eviction from their homes) than owners who purchase homes as investments or second homes and live elsewhere. Indeed, internal Ambac memoranda for the Transactions list the percentage

[78] Ambac Amended Complaint ¶ 92 (citing 6/2/2010 Smith Deposition Tr. at 67-72, 83; 12/11/2009 Durden Rule 30(b)(6) Deposition Tr. at 213-15; 4/19/2010 Glory Deposition Tr. at 65).

of “non-owner occupied” properties or “investor properties” in a given loan pool as among the related Transaction’s “Weaknesses” or “Risks.”

119. Likewise, LTV ratios were material to Ambac and other investors because higher LTV ratios are correlated with a higher risk of default. A borrower with a small equity position in a property has less to lose if he or she defaults on the loan. Additionally, the higher the LTV ratio, the greater the likelihood that a foreclosure will result in a loss for the lender. LTV ratio is a common metric for analysts and investors to evaluate the price and risk of mortgage-backed securities.

120. DTI ratios were material to Ambac because the higher the borrower’s DTI ratio, the greater the risk that the borrower will have difficulty repaying the loan.

121. In light of the recent revelations about Bear Stearns’s due-diligence and quality-control practices, it is clear that Bear Stearns fully understood the failings of those controls and, therefore, knew that the loan tapes contained false and misleading data – or recklessly disregarded the veracity of the disclosures. Indeed, Ambac’s recent loan-level reviews of loans in the Transactions have confirmed that the loan tapes contained materially false and misleading data.

#### ***3. Bear Stearns Knowingly Disseminated Materially False and Misleading Data Concerning the Historical Performance of Its Earlier Securitizations***

122. As part of its representations to induce participation in a contemplated securitization, Bear Stearns disseminated historical data showing the performance of previously securitized loans bearing similar attributes to the loans proposed for securitization. Consistent with its general practices, in advance of the Transactions, Bear Stearns included historical performance data in its investor presentations and marketing decks disseminated to Ambac to induce its participation.

123. Bear Stearns knew that these disclosures were critical to Ambac's assessments of the risks and, ultimately, Ambac's decision to issue its Policies in connection with the Transactions. Specifically, it knew that Ambac considered and evaluated Bear Stearns's disclosures concerning the performance of comparable loans in previous Bear Stearns securitizations in order to assess the risks and expected future performance (and, thus, structural protections needed for its financial-guaranty insurance) of the loans intended for the contemplated Transaction.[79]

124. The historical-performance data was materially misleading in that Bear Stearns failed to disclose that it intentionally adopted practices and policies (*e.g.*, its due-diligence, quality-control, and EPD-repurchase policies) that it knew had resulted in the securitization of defective loans in those earlier transactions – loans that were prevented from defaulting solely by virtue of the ability of the borrowers to refinance or sell their homes due to easy credit fueled by an artificially inflated real-estate market. Bear Stearns thus knew that prior performance of the loans, including those in earlier Transactions, was not in any way indicative of their quality or the likely performance of the similarly defective loans in future Transactions. To the contrary, Bear Stearns knew and actively concealed that it was building a house of cards, waiting to collapse as soon as borrowers lost the ability to refinance or "flip" their way out of loans they could not afford to pay. By concealing the true quality of its collateral, Bear Stearns deliberately misled Ambac and investors into participating in Bear Stearns's securitizations, including the Transactions.

[79] Ambac Amended Complaint ¶ 95 (citing email from Darryl Smith (Bear, Stearns & Co., Fixed Income Structured Credit Sales, Securitization Side) to Patrick McCormick (Ambac First Vice President, MBS Department of Structured Finance), dated March 30, 2007, ABK-EMC01536369-370).

#### *4. Bear Stearns Knowingly Supplied Materially False and Misleading Information to Secure Rating-Agency Ratings*

125. Bear Stearns provided false and misleading information to the rating agencies, Standard & Poor's and Moody's, to secure "shadow ratings" and "final ratings" required to induce financial guarantors to insure and investors to purchase the securities issued in connection with its securitizations, including the Transactions at issue. A shadow rating is an assessment of the value or risk of a mortgage-backed security without consideration of the protection afforded by a financial-guaranty insurance policy. A final rating is an assessment of the value or risk of the security taking the financial-guaranty policy into consideration. Bear Stearns knew full well that Ambac used the shadow ratings in deciding whether and on what terms to participate in the Transactions. The commitment letters for each Transaction specified the shadow ratings that were a condition precedent to Ambac's issuance of its Policies.

126. Bear Stearns similarly knew that investors relied, and intended that they rely, on the rating-agency ratings in deciding whether to purchase the securities issued in the Transactions. It was for that reason that the Offering Documents used to market the Certificates expressly stated that a final rating was a condition precedent to Bear Stearns's offering of the securities.

127. For each of the Transactions, Ambac received both shadow and final ratings that were derived from information supplied to the rating agencies by Bear Stearns. To secure the shadow ratings and, thus, the final ratings, Bear Stearns disseminated the same false and misleading data to the rating agencies that it provided Ambac, including marketing presentations, loan tapes, and Offering Documents.

128. Because they were based on the same false and misleading information provided to Ambac and investors, the shadow ratings were false and misleading. The final

ratings, in turn, were false and misleading because they were given in reliance on Ambac's Policies, which were obtained by virtue of the fraudulently obtained shadow ratings. These ratings therefore added another critical layer of false assurances to investors and Ambac as to the quality of the securitized loan pools.

#### *5. Bear Stearns Knowingly Made Materially False and Misleading Representations and Disclosures in the Offering Documents Used to Market and Sell the Certificates*

129. Bear Stearns marketed the securities issued in its securitizations, including the Transactions, pursuant to Offering Documents[80] that were publicly filed with the SEC pursuant to the Securities Act of 1933. As a matter of law, the Offering Documents were required to disclose all material facts concerning the securities offered; not contain any untrue statement of material fact concerning the securities; not omit to disclose any material fact concerning the securities; and not omit to state a material fact necessary to make the statements made therein, in light of the circumstances in which they were made, not misleading.

130. The Registration Statements and FWPs were filed with the SEC several days in advance of the contemplated closing date for a securitization; the ProSupps were then filed with the SEC at or around the closing date. In advance of the closing date for each Transaction, Bear Stearns also prepared and sent to Ambac drafts of the FWPs and the ProSupps to induce its participation in the Transactions. The drafts contained false and misleading statements and omissions similar to those made in the Offering Documents eventually filed with the SEC.

131. Bear Stearns knew and intended that Ambac and investors would rely on these draft and final Offering Documents in assessing whether to participate in the Transactions. That was the very purpose for which the documents were created and disseminated. Through these

[80] The Offering Documents are defined above to include the Registration Statements, FWPs, Prospectuses, and ProSupps.

disclosures, Bear Stearns deliberately misled investors and induced Ambac to provide financial-guaranty insurance for securitizations plagued by defective loans that did not comport with the characteristics and were not underwritten in accordance with the underwriting standards represented in the Offering Documents.

132. The disclosures in the Offering Documents of the risks associated with the Transactions were false and misleading in that they (i) mischaracterized the origination and underwriting practices, (ii) presented false and misleading data metrics pertaining to the securitized loan pools, (iii) provided false and misleading ratings, and (iv) failed to disclose Bear Stearns's complete abdication of its due-diligence and quality-control processes, which it knew resulted in the securitization of pools replete with defective loans.

133. ***Origination and underwriting practices:*** The Offering Documents sent by Bear Stearns to Ambac and filed with the SEC in connection with each Transaction contained numerous statements purporting to describe the underwriting standards that were applied to assess borrowers' creditworthiness and to ensure the quality of all of the loans in the Transactions. For example, the ProSupp for the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions disclosed that Countrywide originated its loans, which constituted 100% of the loans in the SAMI 2006-AR7 Transaction and approximately 52% of the loans in the SAMI 2006-AR8 Transaction, pursuant to underwriting standards designed to "evaluate the prospective borrower's credit standing and repayment ability, and the value and adequacy of the mortgaged property as collateral."[81] The ProSupps for the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions contain identical language with respect to GreenPoint, which originated 100% of

[81] SAMI 2007-AR7 ProSupp at S-45; SAMI 2006-AR8 ProSupp at S-49.

the loans in each of those deals.[82] And the ProSupps for the BSMF 2006-AR2 and BSMF 2006-AR4 Transactions contain similar language with respect to BSRM, which originated the majority of the loans in those deals.[83]

134. The Offering Documents also explain that the underwriting guidelines allow for exceptions to be made on a case-by-case basis for borrowers that meet specific criteria described as "compensating factors." For example, the ProSupps for the BSMF 2006-AR2 and BSMF 2006-AR4 Transactions assured Ambac and investors that a reasonableness standard guided BSRM's review of "exception loans," which were "managed through a formal exception process" as follows:

> Exceptions to the BSRM Underwriting Guidelines are considered ***with reasonable compensating factors on a case-by-case basis and at the sole discretion of senior management***. When exception loans are reviewed, all loan elements are examined as a whole to determine the level of risk associated with approving the loan including appraisal, credit report, employment, compensating factors ***and borrower's willingness and ability to repay the loan***.[84]

135. The Offering Documents also describe the originators' various loan products, including so-called "low doc" or "no doc" loans, or those that require less documentation from the borrower regarding his or her income and assets than "full doc" loans require. Bear Stearns assured Ambac and investors that these types of loans – which constitute the overwhelming majority of the loans in the Transactions – were limited to prime borrowers, or those "with excellent credit histories," as the description of Countrywide's underwriting guidelines in the SAMI 2006-AR7 and SAMI 2006-AR8 ProSupps explains.[85] The description of GreenPoint's

---

[82] GPMF 2006-AR2 ProSupp at S-33; GPMF 2006-AR3 ProSupp at S-29.

[83] BSMF 2006-AR2 ProSupp at S-35; BSMF 2006-AR4 ProSupp at S-27.

[84] BSMF 2006-AR2 ProSupp at S-36; BSMF 2006-AR4 ProSupp at S-27 (emphasis added).

[85] SAMI 2006-AR7 ProSupp at S-49; SAMI 2006-AR8 ProSupp at S-53.

underwriting guidelines in the GPMF 2006-AR2 and GPMF 2006-AR3 ProSupps likewise explains that "[m]ortgage loans underwritten under this type of [limited-documentation] program are generally limited to borrowers with credit histories that demonstrate an established ability to repay indebtedness in a timely fashion."[86] The guidelines descriptions in the ProSupps also include assurances that for "stated income" loans – in which the borrower states his income and the lender does not independently verify it – ***underwriters are required to confirm the reasonableness of the stated incomes***.[87]

136. The Offering Documents also discuss the originators' policies with respect to appraisals, which, as noted, directly inform the LTV ratios on which Ambac and other investors relied in deciding to participate in the Transactions. In particular, Bear Stearns represented in the Offering Documents that one or more ***independent*** appraisals were obtained for nearly every loan in the Transactions. For example, in the ProSupps for the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions, Bear Stearns represented as follows with respect to Countrywide's appraisal practices:

> Except with respect to mortgage loans originated pursuant to its Streamlined Documentation Program, whose values were confirmed with a Fannie Mae proprietary automated valuation model, Countrywide Home Loans obtains appraisals from independent appraisers or appraisal services for properties that are to secure mortgage loans. The appraisers inspect and appraise the proposed mortgaged property and verify that the property is in acceptable condition. Following each appraisal, the appraiser prepares a report which includes a market data analysis based on recent sales of comparable homes in the area and, when deemed appropriate, a replacement cost analysis based on the current cost of constructing a similar home. All appraisals are required to

[86] GPMF 2006-AR2 ProSupp at S-33; GPMF 2006-AR3 ProSupp at S-30.

[87] *See, e.g.*, BSRM 2006-AR4 ProSupp at S-29 ("The applicant's income as stated must be reasonable for the related occupation, borrowers' credit profile and stated asset, in the loan underwriter's discretion.").

> conform to Fannie Mae or Freddie Mac appraisal standards then in effect.[88]

The ProSupps for the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions include similar language with respect to GreenPoint's appraisal practices, including that "[i]n determining the adequacy of the property as collateral, an independent appraisal is generally made of each property considered for financing."[89] These representations regarding appraiser independence were material to Ambac and other investors because, among other things, they are important indicators of the reliability of the LTV ratios discussed above.

137. Contrary to its representations, Bear Stearns did not exercise any appropriate or meaningful oversight to ensure compliance with the basic risk criteria for prudent and responsible lending. As has now been revealed, based on its own due-diligence and quality-control results – including results provided to it by Clayton in so-called "Ttrending Reports" – Bear Stearns knew prior to consummating the respective Transactions that the originators' underwriting standards were abandoned and that borrowers' ability to repay the loans was ignored in order to produce as many loans as possible. This was accomplished, in large part, by turning a blind eye to the systematic inflation of both appraisal values and borrowers' patently unreasonable stated incomes, by failing to require adherence to the applicable underwriting guidelines, or by placing clearly ineligible borrowers into loan products like so called "no ratio" or "no doc" loans that did not even require them to state their income to obtain a loan.

138. Specifically with respect to appraisal practices, Bear Stearns failed to disclose in the Offering Documents that – contrary to its representations – during the time period of the Transactions, it regularly found evidence of inflated and fraudulent appraisals in the loans it

[88] SAMI 2006-AR7 ProSupp at S-46; SAMI 2006-AR8 ProSupp at S-50.

[89] GPMF 2006-AR2 ProSupp at S-34; GPMF 2006-AR3 ProSupp at S-30.

securitized.  When asked what the most common loan defects were from 2003 to 2007, Haggerty began by telling the FCIC, "I think what one would typically see would be things like the appraised value of the property was misstated."[90]

139. What the Offering Documents also did not disclose is that exceptions to underwriting standards became the rule and that the originators Bear Stearns bought loans from, under pressure from securitization sponsors like Bear Stearns, routinely deviated from the stated guidelines without establishing any of the compensating factors, which were intended specifically to limit exceptions to qualified borrowers.

140. ***Loan data:*** The Offering Documents also contained detailed appendices purporting to represent critical statistical data for stratified segments of the loan pools, including LTV ratios, credit scores, occupancy characteristics, and documentation types.[91] These characteristics were used by Ambac and potential investors to evaluate the risks and expected performance of the underlying loan pools for the securities issued in each Transaction.  As discussed below, based on its due diligence and quality control, Bear Stearns knew that these loan characteristics, as disclosed in the Offering Documents, were materially false and misleading in that they significantly understated the credit risk of the securitized loans.

141. ***Ratings:*** The Offering Documents provided that "[i]t is a condition to the issuance" of the Certificates that they receive the ratings from Standard & Poor's and Moody's set forth in the ProSupps.  For each of the Transactions, the rating agencies assigned ratings of "AAA" (Standard & Poor's) and "Aaa" (Moody's) to the Certificates that had the benefit of Ambac's policy.  These ratings were given in reliance on Ambac's policies, which, as noted,

---

[90] February 24, 2011 FCIC Interview with former Bear Stearns Senior Managing Director Mary Haggerty, Tr. at 32.

[91] *See* ProSupps Schedule A, except in the context of the BALTA 2006-R1 Transaction, whose ProSupp Schedule A contains statistical data on the underlying certificates (as opposed to the loans).

were obtained by virtue of the fraudulently obtained "shadow ratings" for the Transactions. As discussed above, the represented credit ratings were materially misleading in that they were fraudulently obtained from the rating agencies on the basis of Bear Stearns's false and misleading representations concerning the characteristics of the securitized loans and Bear Stearns's omissions of material facts regarding its securitization operations and practices. Had Bear Stearns made truthful and complete disclosures to the rating agencies, the shadow ratings, and thus the final ratings, would not have been obtained and Ambac would not have issued its Policies.

142. ***Controls:*** Bear Stearns's statements in the Offering Documents were also false and misleading because they failed to adequately disclose key risks – that the due-diligence, quality-control, and repurchase protocols touted in its investor presentations and communications with Ambac and investors were severely flawed and that the Transactions were thus replete with defective loans. In the ProSupp for each Transaction, Bear Stearns represented that "[p]ortfolios may be reviewed for credit, data integrity, appraisal valuation, documentation, as well as compliance with certain laws" and that "[p]erforming loans purchased will have been originated pursuant to the sponsor's underwriting guidelines or the originator's underwriting guidelines that are acceptable to the sponsor."[92] Bear Stearns concealed that, in fact, guidelines for the loans in its securitizations were completely abandoned during the underwriting process and that, to compound the problem, Bear Stearns's purportedly robust due-diligence operations did not identify and remove defective loans from the securitizations.

---

[92] *See* GPMF 2006-AR2 ProSupp at S-29; GPMF 2006-AR3 ProSupp at S-26; BSMF 2006-AR2 ProSupp at S-30; BSMF 2006-AR4 ProSupp at S-22; SAMI 2006-AR7 ProSupp at S-37; SAMI 2006-AR8 ProSupp at S-39; BALTA 2006-AR1 ProSupp at S-30.

## B. BEAR STEARNS FAILED TO DISCLOSE AND AFFIRMATIVELY CONCEALED MATERIAL FACTS TO INDUCE PARTICIPATION IN ITS SECURITIZATIONS

### *1. Bear Stearns's Representations Concerning Its Due Diligence Were Knowingly False and Misleading*

143. In advance of the Transactions, and to induce Ambac to issue its Policies, Bear Stearns knowingly made materially false and misleading statements – at investor conferences, in investor presentations, and in private meetings between Bear Stearns and Ambac, as noted – about the scope and integrity of the due-diligence protocols purportedly in place for Bear Stearns to review loans prior to acquiring them from originators or including them in Bear Stearns's securitizations, and in the Transactions in particular. Contrary to Bear Stearns's representations to Ambac that the due-diligence process entailed a robust loan-file audit to assess whether the loans complied with the applicable underwriting guidelines and federal and state law – including in particular, as noted, reviews for "credit, data integrity, appraisal valuation, and documentation" – Bear Stearns had designed the due-diligence process to permit the acquisition and securitization of defective loans.[93] As has been revealed by numerous confidential witnesses, the pre-acquisition due-diligence process was highly flawed and fraudulently manipulated by Bear Stearns.

144. Bear Stearns knew – and indeed contemporaneously acknowledged – that financial-guaranty insurers, including Ambac, relied on Bear Stearns's due-diligence disclosures because they did not have a reasonable opportunity to review individual loan files given, among

[93] A former Watterson Prime due-diligence consultant who reviewed loans for Bear Stearns, Tracy Warren, confirmed during deposition testimony in connection with Assured's lawsuit against Bear Stearns that Watterson Prime's due-diligence review was nothing more than a rubber stamp of originators' findings to satisfy the "client's" – Bear Stearns's – objective of purchasing a large volume of loans for securitization. *See* Assured Complaint ¶ 166 (citing 8/25/2010 Warren Deposition Tr. at 41-43 (Q. "So, [your supervisors] were aware that there were issues with respect to the borrowers' ability to pay, but they told you to focus on technical compliance with the guidelines as stated?" (over objection) A. "Yes.")).

other things, the rapid pace of Bear Stearns's securitizations.[94] Moreover, Bear Stearns knew that insurers like Ambac relied on Bear Stearns's due diligence because there was a fundamental asymmetry of information between the parties. That is, Bear Stearns – not the insurer – was in privity with the loan seller and had access to the loan files needed to perform due diligence, which took place at the time Bear Stearns acquired mortgage loans from sellers, not at the time of securitization. But Bear Stearns made the above representations and disclosures regarding its due-diligence protocols with knowledge that they were false and materially misleading when made or with reckless disregard as to their truth.

145. More specifically, Bear Stearns knew that its due-diligence practices did not screen out defective loans with respect to loans from originators included in the Transactions, including, for example, GreenPoint. As revealed in Assured's lawsuit, on August 29, 2005 – two months before the transaction on which the GPMF 2006-AR2 was based – Bear Stearns personnel suggested that Bear Stearns use "more due diligence up front" in order to avoid "what has happened on the past Greenpoint deals."[95] Bear Stearns failed to disclose to Ambac its contemporaneous knowledge about the failings of its due diligence on GreenPoint deals.

146. Before the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions closed, Bear Stearns also knew that due diligence was of increased importance because its own monitoring of

[94] Assured Complaint ¶ 172 (citing email from Ernest Calabrese, Jr. (Managing Director, Mortgage Finance, Bear, Stearns & Co.) to John Mongelluzzo (Bear, Stearns & Co. Vice President, Due Diligence) among others, dated Sept. 14, 2005, EMC-AMB 001699864-865 ("These parties have been either performing there [sic] own due diligence (usually not enough time) or piggybacking off of the Clayton/Price results."); and noting that Haggerty also confirmed that securitization participants relied on Bear Stearns's disclosures as to the scope of due diligence that was performed. 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 155; email from John Mongelluzzo (Bear, Stearns & Co. Vice President, Due Diligence) to Pattie Sears (Due Diligence Manager, EMC Mortgage Corporation) and Jose Carrion (EMC Mortgage Corporation Subprime Underwriting Manager), dated March 23, 2005, EMC-AMB 001699111).

[95] *See* Assured Complaint ¶ 173 (citing email from Patty Lester (EMC Mortgage Corporation, Vice President, Special Loans) to Janet Gonzales (EMC Mortgage Corporation, Vice President, Trading), dated Aug. 26, 2005, EMC-AMB 008918775).

GreenPoint revealed a high percentage of underwriting failures and other defects.[96] GreenPoint even told Bear Stearns's head of due diligence that it was "selling everything under the sun."[97] In July 2005, Bear Stearns traders and executives internally commented on the unusually high risk and poor quality of the loans in a GreenPoint transaction, showing their surprise that GreenPoint approved up to "40% of first time home buyer with no down payment wow!"[98] Nonetheless, Bear Stearns purchased and securitized these high-risk loans in the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions knowing that the need for effective due diligence was even more critical, but that such due diligence was non-existent.

147. The falsity of Bear Stearns's fraudulent scheme is corroborated by statements by dozens of former employees of Watterson Prime and Clayton. As noted, Watterson Prime and Clayton were the two vendors that, according to Bear Stearns's representations to Ambac, conducted pre-closing due diligence on loans for securitization. The confidential witnesses confirm that the farce that was Watterson Prime's and Clayton's re-underwriting due-diligence process was in many ways the result of Bear Stearns's express directives. These witnesses include (i) Clayton and Watterson Prime "team leads," who were assigned to manage individual due-diligence-review projects and reported directly to and received instructions from Bear Stearns's due-diligence managers, (ii) underwriters, who were hired on a contract basis to review the loan files and received their instructions from the team leads, (iii) "quality control" underwriters, who purportedly conducted quality-control review of the underwriters and received

---

[96] *See* Assured Complaint ¶¶ 14, 121, 209.

[97] *See* Assured Complaint ¶ 174 (citing email from Dianne Hill (GreenPoint) to John Mongelluzzo (Bear, Stearns & Co. Vice President, Due Diligence), dated July 13, 2005, EMC-ASSURED 000482090).

[98] Assured Complaint ¶ 174 (citing email exchange between Scott Eichel (Bear, Stearns & Co. Senior Managing Director, ABS/MBS Credit Trading) and Jeff Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk), dated July 6, 2005, EMC-ASSURED 000480417).

their instructions from the team leads, and (iv) underwriters employed by the "trailing docs" department, which purportedly ensured that documents missing from loan files subject to due-diligence review were obtained from the sellers.

148. These confidential witnesses corroborate that Clayton and Watterson Prime followed Bear Stearns's directives to, among other things, re-underwrite the loans in a substandard manner and code defective loans as non-defective:

- ***Clayton and Watterson Prime overlooked defects at the direction of Bear Stearns:*** The confidential witnesses state that they were directed to overlook defects and to grade defective loans as non-defective. Several team leads, who communicated directly with Mongelluzzo and Patti Sears (Co-Head of Due Diligence), confirmed that they were directed by Mongelluzzo and Sears to overlook defects in loans. For instance, according to the team leads, when Clayton and Watterson Prime discovered defects related to compliance issues, they were instructed by Mongelluzzo and Sears that Bear Stearns had already priced the defects into the amount it paid to the originator. As such, the team leads directed the underwriters to grade these defective loans as non-defective. The underwriters complied with these instructions.

- ***At the direction of Bear Stearns, Clayton and Watterson Prime rubber-stamped unreasonable stated incomes:*** The confidential witnesses state that although they often found the incomes listed on stated-income loan applications to be unreasonable, they were directed by their supervisors and Bear Stearns to grade such loans as non-defective. According to the team leads, when they discussed unreasonable stated incomes with Mongelluzzo and Sears, the Bear Stearns managers replied, "we are not worried about it" and "it's priced in the pool."

- ***Bear Stearns directed Clayton and Watterson Prime to overlook fraudulent loans:*** The confidential witnesses state that they were directed not to look for fraud in the loan files and to overlook any fraudulent documents found in the loan files. The team leads state that when they notified Mongelluzzo and Sears that Clayton and Watterson Prime had discovered fraud in loans, they were directed to grade such loans as non-defective if fraud was the only defect.

- ***At the direction of Bear Stearns, Clayton and Watterson Prime used contrived compensating factors:*** The confidential witnesses state that they were directed by their supervisors and Bear Stearns to cite compensating factors, even ones that they believed were insufficient to overcome the defects. The team leads state that they were likewise directed by Mongelluzzo and Sears to cite compensating factors that they believed were insufficient to overcome defects, and they conveyed these instructions to Clayton and Watterson Prime underwriters. The underwriters complied with these instructions.

- ***Bear Stearns directed Clayton and Watterson Prime to utilize a "5 percent tolerance":*** According to the confidential witnesses, they were directed to utilize a "tolerance" of 5 percent with respect to certain ratios, such as DTI, LTV, and CLTV. That is, Clayton and Watterson Prime were directed by Bear Stearns to grade a loan as non-defective so long as the DTI, LTV, and CLTV ratios for that loan did not exceed the maximum ratios permitted by underwriting guidelines by more than 5 percent. In other words, they were effectively directed to apply different guidelines. The team leads state that they received these instructions from Mongelluzzo and Sears and conveyed them to the underwriters. The underwriters complied.

- ***Bear Stearns directed Clayton and Watterson Prime to change grades on defective loans to reflect that they were not defective:*** The team leads state they were directed by Mongelluzzo and Sears to improperly re-grade defective loans as non-defective. The team leads passed these instructions on to quality-control underwriters, who implemented the grade-changing scheme.

- ***Clayton and Watterson Prime underwriters coined the phrase "Bear Don't Care":*** The confidential witnesses state that underwriters used the phrase "Bear don't care" to describe Bear Stearns's attitude towards the due-diligence-review process.

149. As these witnesses' accounts about the practices at Watterson Prime and Clayton confirm, Bear Stearns furthered its fraudulent scheme by secretly pooling a large volume of loans into the Transactions without their having been subject to anything remotely close to the due-diligence protocols that Bear Stearns touted to Ambac to induce its participation in the Transactions.

### *2. Bear Stearns Knowingly Conducted and Concealed Its Substandard Due-Diligence Practices*

150. Bear Stearns's disclosures and representations regarding its due diligence were materially false and misleading because Bear Stearns knew, but deliberately concealed, that the due-diligence firms it retained were directed not to screen out defective loans to prevent their securitization. Tellingly, Bear Stearns senior management rejected repeated recommendations from more junior-level due-diligence personnel to address observed problems and, as discussed above, intentionally implemented protocols designed to falsify the due-diligence results and

conceal from securitization counterparties even those defects that its due-diligence firms had identified.

151. For example, according to an internal Clayton "Trending Report" made public in September 2010, in the period from the first quarter of 2006 to the second quarter of 2007 – *i.e.*, when all of the Transactions were effectuated – 16% of the loans in RMBS loan pools that Bear Stearns submitted to Clayton for review were rejected by Clayton as falling outside the applicable underwriting guidelines. Of the loans that Clayton found to be defective, however, 42% were subsequently "waived in" by Bear Stearns without proper consideration and analysis of compensating factors and included in securitizations such as the Transactions at issue here.[99]

152. Thus, Bear Stearns ensured that the due-diligence protocols facilitated, and did not impede, the free flow of loans for securitization. This directive was set early and enforced firmly. In February 2005 – at the same time Bear Stearns was touting its due-diligence practices to Ambac – Bear Stearns's Co-Head of Mortgage Finance, Mary Haggerty, gave explicit directions to reduce the amount of due diligence "in order to make us more competitive on bids with larger sub-prime sellers."[100] Haggerty has since admitted that limiting the due diligence was an accommodation to suppliers that Bear Stearns relied on to ensure the flow of mortgage loans available and necessary for its securitizations.[101]

---

[99] *See* "All Clayton: Trending Reports, 1st Quarter 2006 – 2nd Quarter 2007," *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0923-Clayton-All-Trending-Report.pdf.

[100] Ambac Amended Complaint ¶ 133 (citing email from John Mongelluzzo (Bear, Stearns & Co. Vice President, Due Diligence) conveying instructions from Mary Haggerty (Bear, Stearns & Co. Senior Managing Director, Co-Head Mortgage Finance) to reduce due diligence, dated Feb. 11, 2005, EMC-AMB 001718713-714).

[101] Assured Complaint ¶ 190 (citing 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 194; 12/11/2009 Durden Rule 30(b)(6) Deposition Tr. at 251-52 ("Q. Was it your understanding that in February 2005 that EMC reduced the amount of due diligence it was undertaking in order to make it more competitive on bids with large subprime sellers? . . . A. It does appear as though they did.")).

153. Recognizing that the existing protocols allowed the purchase and securitization of defective loans, in April 2005, Mongelluzzo repeatedly advised the Co-Heads of Bear Stearns's mortgage-finance department (Senior Managing Directors Haggerty and Silverstein) to revise due-diligence protocols. Mongelluzzo proposed to rank loans slotted for due diligence by risk criteria and apply additional resources to the review of each successive gradation of loan.[102] Silverstein conceded that this proposed change was "significant" and not mere "incremental Darwinian creep" in the evolution of a due-diligence process.[103] As Mongelluzzo and other Bear Stearns executives have testified, however, Bear Stearns did not implement this change – or any significant change – to its due-diligence protocols prior to the closing of the Transactions.[104] In fact, although Mongelluzzo renewed his proposal to allocate greater resources to riskier loans almost two years later, when Bear Stearns recognized that its scheme was beginning to unravel, the proposal was ***never*** implemented.[105]

---

[102] *See* Ambac Amended Complaint ¶ 123 (citing email from John Mongelluzzo (Bear, Stearns & Co. Vice President, Due Diligence) to Mary Haggerty (Bear, Stearns & Co. Senior Managing Director, Co-Head, Mortgage Finance) and Baron Silverstein (Bear, Stearns & Co. Senior Managing Director, Co-Head, Mortgage Finance), dated April 26, 2005, EMC-AMB 001597507-508 (proposing "New Due Diligence Processes," including "[i]dentify higher risk loans within sample to DD firms so that more seasoned UW's are reviewing the loans."); email from John Mongelluzzo (Bear, Stearns & Co. Vice President, Due Diligence) to Mary Haggerty and Baron Silverstein (Bear, Stearns & Co. Senior Managing Directors, Co-Heads Mortgage Finance), dated May 11, 2005, EMC-AMB 001597504 ("We should also identify the top 25% of loans with the sample that we feel pose the largest risk potential. Both Clayton and PWC upon having those loans tagged/identified can place their most seasoned underwriters to review the loans and also perform additional QC on the loans. Both of these processes are ones that we can use to market our process to investors and the rating agencies going forward.")).

[103] Ambac Amended Complaint ¶ 123 (citing 6/4/2010 Silverstein Deposition Tr. at 178; 4/21/2010 Mongelluzzo Deposition Tr. at 172).

[104] Assured Complaint ¶ 191 (citing 9/8/2011 Mongelluzzo Deposition Tr. at 160-64; 4/21/2010 Mongelluzzo Deposition Tr. at 175).

[105] Assured Complaint ¶ 191 (citing email from John Mongelluzzo (Bear, Stearns & Co. Vice President, Due Diligence) to Mary Haggerty (Bear, Stearns & Co. Senior Managing Director, Co-Head, Mortgage Finance) and Baron Silverstein (Bear, Stearns & Co. Senior Managing Director, Co-Head Mortgage Finance), among others, dated March 6, 2007, EMC-AMB 001431086; 9/8/2011 Mongelluzzo Deposition Tr. at 167-69; 4/21/2010 Mongelluzzo Deposition Tr. at 174-75).

154. Reflecting its actual motivation – *i.e.*, to allow the free flow of loans into its securitizations regardless of quality – Bear Stearns also rejected Mongelluzzo's proposal made as early as May 2005 "to track loans that are overridden by our due diligence managers and track the performance of those loans."[106] Haggerty previously had been advised by the due-diligence department that maintaining the documentation of the due-diligence firms' analysis would allow Bear Stearns to track "trends in the reasons for rejection" and, for "trades that actually turn into deals[, to] determine how different credit performance is for loans that had been flagged as 'exceptions' vs. those that were not."[107] But that is what Haggerty and others at Bear Stearns desperately wanted to avoid. Bear Stearns did not want to track or document the particular reasons for its overrides and the "exceptions" it made to underwriting guidelines to allow defective loans to be purchased.

155. Bear Stearns thus did not implement Mongelluzzo's proposal; instead, it did the opposite by maintaining a policy of directing its due-diligence firms to "purg[e] all of the older reports on the trade leaving only the final reports."[108] A Bear Stearns due-diligence manager has confirmed that, pursuant to this policy, she did not retain the "daily reports" submitted by the

---

[106] Ambac Amended Complaint ¶ 129 (citing email from John Mongelluzzo (Bear, Stearns & Co. Vice President, Due Diligence) to Mary Haggerty (Bear, Stearns & Co. Senior Managing Director, Co-Head, Mortgage Finance) and Baron Silverstein (Bear, Stearns & Co. Senior Managing Director, Co-Head Mortgage Finance), dated May 11, 2005, EMC-AMB 001597504).

[107] Ambac Amended Complaint ¶ 129 (citing email from Mary Haggerty (Bear, Stearns & Co. Senior Managing Director, Co-Head, Mortgage Finance), dated April 25, 2005, EMC-AMB 001699079-080).

[108] *See* Assured Complaint ¶ 193 (citing email from Jose Carrion (EMC Mortgage Corporation Subprime Underwriting Manager) to Jo-Karen Whitlock (EMC Mortgage Corporation Senior Vice President, Conduit Operations), dated May 17, 2006, EMC-AMB 004416519-525, at EMC-AMB 004416524 (attaching the EMC Conduit Manual, Bulk Underwriting Chapter, dated April 30, 2005 and March 1, 2006). *See also* EMC Conduit Manual, Bulk Underwriting Chapter, dated Sept. 30, 2003, EMC-ASSURED 000818571-590, at EMC-ASSURED 000818581-82 (providing that only the final Due Diligence Summary is shared with distribution list)).

due-diligence firms.[109] By company policy, therefore, Bear Stearns destroyed evidence of the audit trails concerning the high incidence of Bear Stearns's overrides and waivers leading up to its final purchase decisions.[110] As a former Watterson Prime consultant that conducted due diligence on Bear Stearns loans has confirmed, "the vast majority of the time the loans that were rejected were still put in the pool and sold."[111]

### *3. Bear Stearns Covertly Implemented Policies to Securitize Defective Loans*

156. Armed with the knowledge that its due-diligence protocols were patently inadequate or simply ignored, Bear Stearns's trading desk devised policies to rid its inventory of the toxic loans that EMC had acquired by packaging them into securitizations as quickly as possible – *i.e.*, before a default or delinquency occurred that would render the loans "unsecuritizable." Motivated by huge short-term gains, Bear Stearns increased its securitization volume and pace by covertly revising its internal policies to securitize those loans before they defaulted, as Bear Stearns fully expected they would. In 2005, Bear Stearns quietly revised its protocols to allow for the securitization of loans before the expiration of the "Early Payment Default," or EPD, period, which it defined as the first 30 to 90 days after the loan was acquired from the originator.

---

[109] *See* Assured Complaint ¶ 193 (citing 5/28/2010 Sears Deposition Tr. at 101-03).

[110] Assured Complaint ¶ 193 (citing Email from Jose Carrion (EMC Mortgage Corporation Subprime Underwriting Manager) to Jo-Karen Whitlock (EMC Mortgage Corporation Senior Vice President, Conduit Operations), dated May 17, 2006, EMC-AMB 004416519-525 at EMC-AMB 004416524 (attaching the EMC Conduit Manual, Bulk Underwriting Chapter, dated April 30, 2005 and March 1, 2006)).

[111] Assured Complaint ¶ 193 (citing 8/25/2010 Warren Deposition Tr. at 51; Chris Arnold, *Auditor: Supervisors Covered Up Risky Loans*, National Public Radio, dated May 27, 2008, http://www.npr.org/templates/story/story.php? storyId=90840958; email from Anthony Neske (Watterson Prime LLC) to John Mongelluzzo (Bear, Stearns & Co. Vice President, Due Diligence), dated May 29, 2008, EMC-AMB 005964024-025 (discussing the Watterson Prime employee's public admissions)).

157. Bear Stearns's prior policy was to keep loans in its inventory and "not securitize those loans until the early payment default period ran."[112] Because, as discussed above, Bear Stearns had recourse against the suppliers of loans that experienced a missed or delinquent payment shortly after origination, seasoning the loans through the EPD period allowed Bear Stearns to cull out and prevent the securitization of loans likely to "contain some form of misrepresentations and [that] should not have been made."[113] As revealed in Assured's lawsuit against Bear Stearns, Silverstein explained that EPDs (and first payment defaults, or "FPDs") are indicators of fraud or an inability to pay with respect to a loan, suggesting that the loan never should have been granted in the first instance.[114] The former head of Bear Stearns's Fraud Prevention Group concurred, testifying that an "EPD or FPD is an indicator that there could be a possibility of red flags that could eventually be an indicator of misrep[resentation]."[115]

158. Bear Stearns covertly began securitizing loans before the EPD period ran during 2005,[116] and by the end of 2005 – months before the first of the Transactions closed – the Bear Stearns trading desk made that practice the rule. On or about December 2005, Verschleiser

[112] Ambac Amended Complaint ¶ 140 (citing 12/11/09 Durden Rule 30(b)(6) Deposition Tr. at 178-79 ( "Q: And for sub prime loan originations and subprime mortgage loans, was it a practice at EMC to not securitize those loans until the early payment default period ran? A: . . . yes . . . ");*id.* at 271 ("I believe that a certain point in time the ordinary target date for securitization for certain assets could have been at the expiration of the EPD protection period as well as additional items that could go into that decision making process.")).

[113] Ambac Amended Complaint ¶ 140 (citing Bear Stearns Whole Loan Repurchase Project: Repurchases, Current Processes, dated June 21, 2006, EMC-AMB 004919710-740 at p. 30 ("Loans which become delinquent more than 90+ days in their first year. Although a fraud flag can be raised, many such loans contain some form of misrepresentation and should not have been made.")).

[114] Ambac Amended Complaint ¶ 140 (citing 6/4/2007 Silverstein Deposition Tr. at 192; and noting that the Collateral Analyst for Mortgage Finance at Bear, Stearns & Co. also confirmed that the existence of an EPD "is an indicator of a borrower's ***unwillingness*** to pay their mortgage." 12/11/2009 Durden Rule 30(b)(6) Deposition Tr. at 275-76 (emphasis added)).

[115] Ambac Amended Complaint ¶ 140 (citing 4/15/2007 Gray Deposition Tr. at 113-14).

[116] Ambac Amended Complaint ¶ 141 (citing 12/11/2009 Durden Rule 30(b)(6) Deposition Tr. at 272-73 ("[I]n the period of time that EMC has held mortgage loans, I am sure that there are instances of mortgage loans being securitized prior to the expiration of the EPD protection period.")).

ordered Bear Stearns's deal managers and traders to start securitizing all "the subprime loans closed in December for the conduit" by January 2006. Because this directive contravened then-existing policy to "typically hold the conduit loans through EPD protection period," when asked if Verschleiser intended to keep this policy in place, a senior Managing Director from the trading desk immediately confirmed: "No, want to see everything regardless of EPDs."[117]

159. Bear Stearns strongly enforced the revised policy. On June 13, 2006, Verschleiser said in no uncertain terms that we need "***to be certain we can securitize the loans with 1 month epd before the epd period expires***."[118] When this directive was not applied, Verschleiser angrily demanded explanations as to why loans "were dropped from deals and not securitized before their epd period expired."[119]

160. While recognizing fully that its revised policy materially increased the risk profile of the loans it securitized, Bear Stearns never informed Ambac or any other participant in the securitizations that Bear Stearns "had changed the policy from not securitizing loans before the EPD period had run to securitizing loans while the EPD period had not run."[120]

---

[117] Ambac Amended Complaint ¶ 141 (citing email from Chris Scott (Bear, Stearns & Co. Senior Managing Director, Trading) to, among others, Robert Durden (Bear, Stearns & Co. Deal Manager) and Keith Lind (Bear, Stearns & Co. Managing Director, Trading), dated January 3, 2006, EMC-AMB 001385832-833).

[118] Ambac Amended Complaint ¶ 142 (citing email from Jeffrey Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk) to Mary Haggerty (Bear, Stearns & Co. Senior Managing Director, Co-Head of Mortgage Finance), among others, dated June 13, 2006, EMC-AMB 003993365-367).

[119] Ambac Amended Complaint ¶ 142 (citing email from Jeffrey Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk) to Baron Silverstein and Mary Haggerty (Bear, Stearns & Co. Senior Managing Director, Co-Heads of Mortgage Finance), among others, dated March 1, 2007, EMC-AMB 006087607-616).

[120] *See* Ambac Amended Complaint ¶ 143 (citing, *e.g.*, 12/11/09 Durden Rule 30(b)(6) Deposition Tr. at 273-74 ("In what I've reviewed, I'm not aware of EMC ever disclosing either of those positions to [a] party external to the firm.")).

161. Because large volumes of securitized loans were beginning to experience delinquencies within the EPD period, and because, as noted, Bear Stearns had contractual recourse against the originators of such loans, Bear Stearns issued repurchase claims against the originators despite having already securitized the loans. Notably, Bear Stearns did not advise those entities that it no longer owned the securitized loans and that Bear Stearns had yet to incur any loss resulting from the default – to the contrary, it had already generated hefty fees from securitizing the loans. Nor did Bear Stearns assert that it was seeking a recovery on behalf of the securitizations through EMC's role as the loan servicer. Rather, Bear Stearns was silent on the ownership status of the loans. Bear Stearns did not require these entities to repurchase a loan that it had already sold – that necessarily would have required Bear Stearns to itself repurchase the loan from the securitization trust. Bear Stearns instead would "provide alternatives to repurchase of a loan, such as a price adjustment."[121] As discussed below, Bear Stearns presented other alternatives permitting its recovery for EPD claims while accommodating its suppliers. These alternatives included cash settlements for a fraction of the repurchase price, "downbids," or other credits for future loan purchases.

162. For example, an internal presentation prepared for and at the request of Tom Marano for just the one-year period between April 2006 and April 2007, stated that Bear Stearns "resolved claims against sellers pertaining to EPDs in the amount of $1.9 billion," and that the "largest percentage of those resolutions were settlements."[122] The Managing Director that oversaw the preparation of the presentation also admitted that "EPDs were the majority . . . of the

---

[121] *See* Ambac Amended Complaint ¶ 144 (citing, *e.g.* EMC Claim Form, dated April 6, 2006, EMC-AMB 10534096-98 (claim against Plaza Home Mortgage Financial, Inc. for EPD violation stating "EMC may, at its option, provide alternatives to repurchase of a loan, such as a price adjustment. Please contact your Account Manager if interested.")).

[122] Ambac Amended Complaint ¶ 146 (citing "EPD Summary" Report, EMC-AMB 004099954; 4/26/2010 Golden Deposition Tr. at 255-56).

volumes of claims that EMC Mortgage Corporation submitted against sellers in 2005 and 2006," and pertained to loans that were in Bear Stearns's securitizations.[123] He further confirmed that, through October 31, 2005, Bear Stearns "resolved claims, the majority of which were EPDs, in the amount of $1.7 billion" and, that in 2006, "$2.5 billion in claims were filed, the majority of which were EPDs."[124]

163. Bear Stearns never "disclosed to Ambac or other investors that it was recovering on EPDs from originators with respect to securitized mortgage loans, pocketing the money and not putting it into the trust."[125] To the contrary, to perpetuate these recoveries and conceal loans that it knew raised "red flags" of fraud and other defects, the manager of Bear Stearns's repurchase operations admitted that when Bear Stearns recovered on an EPD claim it "would not evaluate the reps and warranties it gave on that very same loan to securitization participants, including Ambac, to assess whether there might be other breaches of reps and warranties other than an EPD breach."[126]

164. With this motivation and in view of the substantial recoveries it was able to generate, Bear Stearns then devoted its post-securitization efforts to identifying opportunities to generate recoveries and other benefits from the sellers and originators that supplied ever-growing numbers of defective loans backing its securitizations.

---

[123] Ambac Amended Complaint ¶ 146 (citing 4/26/2010 Golden Deposition Tr. at 120-21).

[124] Ambac Amended Complaint ¶ 146 (citing 4/26/2010 Golden Deposition Tr. at 141).

[125] Ambac Amended Complaint ¶ 148 (citing 12/11/2009 Durden Rule 30(b)(6) Deposition Tr. at 269 ("Q. Well, sitting here today, you can't identify any instance in which EMC or Bear Stearns disclosed to Ambac or other investors that it was recovering on EPDs from originators with respect to securitized mortgage loans, pocketing the money and not putting it into the trust, right? . . . A. Yeah, I'm not aware of a disclosure to Ambac.")).

[126] Ambac Amended Complaint ¶ 148 (citing 1/22/2010 Megha Rule 30(b)(6) Deposition Tr. at 94-95; 2/3/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 455 (noting that prior to 2007 when its counsel directed Bear Stearns to change its wrongful practices, "to the extent that EMC obtained a settlement on an EPD claim, it had not subject[ed] those loans to a separate rep and warranty review")).

### *4. Bear Stearns's Quality-Control and Repurchase Practices Furthered Its Scheme to the Detriment of the Securitizations*

165. As discussed above, Bear Stearns represented to Ambac, rating agencies and potential investors that the securitization participants would benefit from Bear Stearns's "quality control" operations, which re-underwrote loans "post settlement" or ***after*** Bear Stearns had purchased and securitized those loans.[127] Bear Stearns's quality-control operations comprised a "production" review undertaken on a randomly selected sample of all loans EMC acquired each month, as well as a comprehensive review of loans that Bear Stearns purchased from new sellers and loans that defaulted within the first year.[128] Bear Stearns reviewed "sample queries of production [to] determine if . . . the underwriter was doing their [sic] job and if it was underwritten correctly or there was any defect in the loan."[129] According to Bear Stearns, its quality-control department also was responsible for determining whether defective loans complied with the representations and warranties EMC made to Ambac and other securitization participants in the deal documents (referred to as a "securitization breach review").[130]

---

[127] *See* Ambac Amended Complaint ¶ 150 (citing Marketing Decks distributed to Ambac and other potential participants (stating that quality control is a "Post Settlement" review, which includes a "[c]onduit team dedicated to claims of breaches of reps and warrants discovered by the Quality Control group investigations."); 1/29/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 179 (confirming that due diligence "was done prior to the settlement of the purchase of the loans, whereas, the quality control reviews were done after EMC settled the purchase of the – of the loan."); 4/26/2010 Golden Deposition Tr. at 17 (confirming that quality control refers to the "post-purchase review of loans that EMC and Bear Stearns securitized")).

[128] Ambac Amended Complaint ¶ 150 (citing 4/26/2010 Golden Deposition Tr. at 208-209).

[129] Ambac Amended Complaint ¶ 150 (citing 1/22/2010 Megha Rule 30(b)(6) Deposition Tr. at 127; and noting that internal policy documents also establish that Bear Stearns viewed the randomly selected loan samples to provide "the basis for statistical inference (i.e. generalizing from sampled findings to the overall population)," and "[a]s such, they are the most important sample group." EMC's Quality Control Review Guidelines attached to the Contractor Services Agreement between EMC and Adfitech, dated January 26, 2005, EMC-AMB 000229896-918 at 910; 5/20/2010 Serrano Deposition Tr. at 25-27 (acknowledging that "the random sample would be representative of the pool that was purchased that month")).

[130] Ambac Amended Complaint ¶ 150 (citing 4/26/2010 Golden Deposition Tr. at 59-60 ("[T]he person who were [sic] QC'ing the loans then made a determination on whether or not it was a securitization

166. Bear Stearns's commitments to review, identify, and flush out defective loans found after securitization were material to Ambac's participation in the Transactions. Despite marketing its quality-control operations for the benefit of Ambac and investors, however, Bear Stearns never disclosed, and deliberately concealed, that its quality-control practices were dedicated exclusively to securing for Bear Stearns additional consideration from the entities that supplied Bear Stearns with the toxic loans – to the detriment of the securitizations, and ultimately financial guarantors such as Ambac, that were left with the massive risks and losses on the loans. That is, when a securitized loan defaulted during the EPD period or Bear Stearns identified a breach of a representation and warranty made ***to*** EMC, Bear Stearns would attempt to negotiate a settlement with the supplier of the loan, and would pocket the recovery. Bear Stearns deliberately decided not to review the defaulted or defective loans identified during quality control for breaches of representations made ***by*** EMC ("securitization breaches") unless the suppliers demanded to repurchase the loans (and tendered the repurchase funds to EMC) in lieu of settling, an approach the suppliers rarely took (and had little incentive to take) as it was the more costly alternative from their perspective.[131]

167. Reflecting its decision ***not*** to review defective loans for securitization breaches, Bear Stearns's quality-control manager confirmed that until late 2007 there were no "protocols in place to assess securitization breaches with respect to loans acquired through the bulk and flow

breach. . . it was actually the individual who reviewed the loan did the original QC."); 2/3/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 485 (as of December 2005, the department that "reviewed mortgage loans to assess whether or not the loans were in breach of a representation or warranty given by EMC to participants in a securitization," was "done by the quality control department")).

[131] As Mary Haggerty confirmed in her deposition in connection with Ambac's first lawsuit against Bear Stearns, when quality control uncovered defective loans, "the first process is the seller has an opportunity to rebut it, provide additional information, et cetera, to see if it could be cured," and if the defect could not be cured, "the claims department would typically issue a repurchase demand to the seller if there was a breach of the a rep and warranty." No securitization-breach review was commenced at that time. *See* Ambac Amended Complaint ¶ 151 (citing 2/3/2010 Haggerty Rule 30(b)(6) Deposition Tr. at 464, 476-77).

conduit" (which was the source of the vast majority of loans at issue in this action).[132] Before then, Bear Stearns limited the securitization-breach review to circumstances in which "the seller has already agreed to purchase these loans and then we need to find a reason on these loans to purchase it out of security."[133] In other words, Bear Stearns simply ignored EMC's express representations, warranties, and covenants, set forth below, requiring prompt disclosure of breaching loans irrespective of Bear Stearns's claims against the sellers of those loans.

168. Consequently, despite the substantial number of EPD claims Bear Stearns asserted against the suppliers of the securitized loans, its quality-control operations generally did not review those loans for securitization breaches. In a document brought to light in Ambac's first action against Bear Stearns in this Court, a Bear Stearns quality-control manager revealed Bear Stearns's reasoning for avoiding securitization-breach reviews: "I don't think we want to do anything with EPDs separate from the 90 Day DQs that are done in the 90 Day DQ shell because ***if we end up keeping the loan we don't want to find a PSA breach***, right?"[134] (The "PSA" is, along with the MLPA, one of the documents in which EMC ***made*** representations and warranties to the securitizations and agreed to repurchase loans that breached those representations and warranties.) So Bear Stearns deliberately avoided conducting securitization-breach reviews for defaulted or defective loans because it did not want to document the breaches it knew existed.

---

[132] Ambac Amended Complaint ¶ 152 (citing 5/20/2010 Serrano Deposition Tr. at 47; *id.* at 44 (noting that as of September 2006, Bear Stearns's securitization breach review "was not something that was executed correctly")).

[133] Ambac Amended Complaint ¶ 152 (citing EMC-AMB 010726678; and noting that the policies in place as of January 2007 for "reviewing loans for breaches," also provide that "[o]nce the lender has confirmed that the they are going to repurchase the loans, it is necessary to buy the loan out of a security if in a deal," EMC-AMB 009649870-076).

[134] Ambac Amended Complaint ¶ 153 (citing email from Tamara Jewell (EMC Residential Mortgage, Project Manager) to Robert Glenny (EMC Residential Mortgage, Analytics Group/Seller Approval) and Randy Deschenes (EMC Residential Mortgage, CEO), dated July 30, 2007, EMC-AMB 009526626-627).

169. The percentage of defective loans Bear Stearns identified through its quality-control sampling review was substantial. As revealed in Ambac's first action, Bear Stearns contracted with Adfitech, Inc. ("Adfitech") to perform the quality-control reviews on its behalf, and instructed Adfitech that the purpose of quality control is "to review loans to evaluate if they meet investor quality guidelines, if sound underwriting judgment was used, and if the loan is devoid of all misrepresentation or fraud characteristics."[135] With this as its directive, Adfitech conducted quality-control review of samples of loans Bear Stearns acquired. For the period through the end of 2006, Adfitech found that a significant number of loans were defective based on Bear Stearns's quality-control guidelines. Although these findings revealed material information about the risk profile of the loans – as well as breaches of EMC's representations and warranties (discussed below)[136] – at no time did Bear Stearns disclose these remarkably high defect rates to Ambac or other securitization counterparties.

170. Instead, to further its fraudulent scheme and benefit from the securitization of defective loans, Bear Stearns relied on its quality-control operations to assert repurchase claims against the entities from which it purchased the loans. Bear Stearns pursued and settled claims

[135] Ambac Amended Complaint ¶ 154 (citing Contractor Services Agreement between EMC and Adfitech, dated January 26, 2005, EMC-AMB 000229896-918 at 909; and noting that Bear Stearns reinforced these protocols with Adfitech in its "Loan Origination Quality Control Policy as of February 2007, which expressly stated that the purpose of quality control was to, among other things, "assure that all loans . . . comply with insurer and guarantor requirements," and also called for Bear Stearns to "report to the investor or government agency any violation of law or regulation, false statements, material defect or program abuses within 30 days of discovery." Email from Greg Anderson (Adfitech quality control supervisor) to Sherrie Dobbins (EMC Mortgage Corporation Assistant Manager, Quality Control Underwriting and Vendor Management) and Fernando Serrano (EMC Mortgage Corp., Quality Control Manager), dated February 2, 2007, EMC-AMB 006975253-267 at 255, 261).

[136] Ambac Amended Complaint ¶ 154 (citing 4/26/2010 Golden Deposition Tr. at 104-105; and noting that, in effectively conceding that the Adfitech quality-control findings evidenced securitization breaches, Bear Stearns's Senior Managing Director of the quality-control department confirmed that between 2005 through 2006 it applied the same criteria for both its quality-control and securitization-breach analyses).

against the loan suppliers on the basis that the loans were "not eligible for delivery to EMC" – without disclosing that it already had sold the loans into a securitization.[137]

171. By concealing the true nature of its quality-control operations, Bear Stearns deceived securitization participants, including Ambac

#### *5. The Sheer Magnitude of Defective Loans that Bear Stearns Securitized Overwhelmed Its Quality-Control and Repurchase Protocols*

172. By at least 2006, Bear Stearns had acquired and securitized so many defective and toxic loans that its quality-control and claims departments became overwhelmed to the point that Bear Stearns was unable to process its claims against the entities from which it purchased the loans. The Senior Managing Director at Bear, Stearns & Co. in charge of these departments confirmed being "overwhelmed" by the sheer magnitude of claims it had to file, which had escalated in parallel with Bear Stearns's "rapid increase in the amount of loans being purchased and securitized." [138]

173. A recently revealed internal audit report issued on February 28, 2006 and distributed to senior executives including Haggerty, Cayne, Marano, Mayer, Schwartz, and Spector[139] also confirms Bear Stearns's inability to process its claims, identifying "a significant backlog for collecting from and submitting claims to sellers" consisting of at least 9,000 outstanding claims worth over $720 million, and concluding that the procedures in place to process, collect, resolve, and monitor such claims were inadequate or simply non-existent.[140]

---

[137] *See* Ambac Amended Complaint ¶ 155.

[138] Ambac Amended Complaint ¶ 158 (citing 4/26/2010 Golden Deposition Tr. at 119-20).

[139] Ambac Amended Complaint ¶ 159 (citing email from Stephanie Paduano (Bear, Stearns & Co. Internal Audit Department) dated March 7, 2006, EMC-AMB 001496304).

[140] Ambac Amended Complaint ¶ 159 (citing EMC-AMB 001496305-EMC-AMB 001496311, "Bear Stearns Internal Audit Report – EMC Mortgage Corporation ('EMC') – Review of Representations and Warrants Department.")

174. Despite directing the Senior Managing Director to establish appropriate claims procedures and enhance existing protocols, less than two months later Verschleiser and Haggerty agreed that the "[c]laims situation continues to be a disaster – hitting crisis," because "our operation cannot support the claims collection methodology we have been trying to pursue," and that the Senior Managing Director "clearly continues to be overwhelmed and this is really hurting."[141] Indeed, also recently revealed internal audit reports issued on September 22, 2006 and February 26, 2007 continued to report that many of the issues previously identified in need of correction in early 2006 had yet to be addressed.[142]

175. No one at Bear Stearns disclosed to Ambac that it had acquired and securitized so many defective loans, requiring claims against originators so numerous that its internal departments could not handle the workload. The defective loans that Bear Stearns's understaffed departments were able to identify and file claims for represent just a small fraction of the total defective loans that were securitized to the detriment of investors and Ambac.

### *6. Bear Stearns Failed to Disclose that Its Counsel and Outside Auditors Found that Its Claims Practices Contravened Its Contractual Obligations, Investors' Expectations, and Industry Standards*

176. By mid-2006, the growing backlog of Bear Stearns's repurchase claims had risen to alarming levels, drawing the attention of its external auditors and counsel, which in no uncertain terms issued stern warnings instructing Bear Stearns to revise its claims practices.

---

[141] Ambac Amended Complaint ¶ 160 (citing emails from Mary Haggerty (Bear, Stearns & Co. Senior Managing Directors, Co-Head Mortgage Finance) to Jeffrey Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk), dated April 18 and April 12, 2006, EMC-AMB 001498898-899).

[142] Ambac Amended Complaint ¶ 160 (citing September 22, 2006 Internal Audit (EMC-AMB 010858575-576) and February 26, 2007 Internal Audit (EMC-AMB 010858610-613), each titled, "Status of Unresolved Audit Report Issues for EMC Mortgage Corporation ('EMC') – Review of Representations and Warrants Department").

177. In August 2006, Bear Stearns's external auditor, PriceWaterhouseCoopers ("PWC"), advised Bear Stearns that its failure to promptly review the loans identified as defaulting or defective was a breach of its obligations to the securitizations. PWC advised Bear Stearns to begin the "[i]mmediate processing of the buy-out if there is a clear breach in the PSA agreement to match common industry practices, the expectation of investors and to comply with the provisions in the PSA agreement." PWC explained that the effect of its proposal "in the Claims work processing flow, is to effectively reverse the current processing order by first considering whether there is a breach of representations and warranties in the PSA agreement and then pursue the claim against the original seller of the loan." The auditor further advised Bear Stearns to promptly remedy its "[l]ack of repurchase related policies and procedures in the Claims, G/L Control and Investor Accounting departments" to comply with SEC regulations.[143]

178. Shortly thereafter, Bear Stearns's legal counsel reinforced PWC's assessment and advised Bear Stearns that it had to revise its improper practices. Haggerty confirmed that, in early 2007, its counsel advised Bear Stearns that it could no longer keep for itself the substantial monetary recoveries obtained on its EPD and other claims relating to securitized loans, and moreover, that it was required to review the loans for which it obtained recoveries to assess whether the loans breached EMC's representations and warranties made in its securitizations.[144]

179. This legal advice was a recognition, and an admission, that Bear Stearns (i) was not complying with its obligation to review the defaulting or defective loans for which it made claims against suppliers to determine whether they breached representations and warranties EMC extended in the securitization, and (ii) was improperly retaining recoveries on those loans that

---

[143] *See* Ambac Amended Complaint ¶ 163 (citing EMC-AMB 006803201-277, "UPB Break Repurchase Project – August 31, 2006").

[144] Ambac Amended Complaint ¶ 164 (citing 2/3/2010 Haggerty Rule 30(b)(6) Deposition Tr. 455-63, 510).

should have been passed on to the securitizations.[145] Indeed, as of August 2006, there were no procedures in place for reviewing the loans subject to settlement agreements or tracking the funds recovered, causing one Bear Stearns employee to admit to "making it up as I go…scary!"[146] Bear, Stearns & Co.'s Executive Director and Assistant General Counsel also confirmed that, before its Legal Department intervened in 2007, no documentation existed setting forth the protocol for disclosing securitization breaches to investors or insurers, such as Ambac.[147] Bear Stearns concealed these operational deficiencies from Ambac and other securitization participants.

180. Contrary to its own counsel's advice, Bear Stearns did not implement a policy to promptly review defective or defaulted loans for securitization breaches until at least September 2007, long after the closing of the Transactions and only after the defaults on its securities began to rise sharply.[148] According to its employees who have testified in Ambac's first action, moreover, Bear Stearns still has not fully implemented its counsel's advice to contribute to the securitizations the recoveries it obtained on the securitized loans.[149]

---

[145] Ambac Amended Complaint ¶ 165 (citing 2/3/2010 Haggerty Rule 30(b)(6) Deposition Tr. 510; 4/19/2010 Glory Deposition Tr. 125).

[146] Ambac Amended Complaint ¶ 165 (citing email from Whitney Long (EMC Residential Mortgage, Vice President of Risk Management and Claims) to Stephen Golden (Bear, Stearns & Co. Managing Director, Warehouse and EMC Residential Mortgage President), dated August 12, 2006, EMC-AMB 010787527-31).

[147] Ambac Amended Complaint ¶ 165 (citing 1/7/2010 Mesuk Rule 30(b)(6) Deposition Tr. at 115-18).

[148] *See* Ambac Amended Complaint ¶ 166 (citing email from Whitney Long (EMC Residential Mortgage, Vice President of Risk Management and Claims) to, among others, Stephen Golden (Bear, Stearns & Co. Managing Director, Warehouse and EMC Residential Mortgage President) and Leslie Rodriguez (EMC Residential Mortgage Managing Director), dated September 13, 2007, EMC-AMB 007176791-800 at 793-94).

[149] Ambac Amended Complaint ¶ 166 (citing 4/19/2010 Glory Deposition Tr. 41 (process not complete as of her departure in Spring 2009); 4/26/2010 Golden Deposition Tr. 142-43 (the policy not fully implemented before he left in Spring 2008); email from Cheryl Glory (Bear, Stearns & Co. Managing Director, Mortgage Finance) to Mary Haggerty (Bear, Stearns & Co. Senior Managing Directors, Co-Head Mortgage Finanace) and John Horner (J.P. Morgan Managing Director, Co-Head of Agency and

181. Instead of promptly making the requisite disclosures and undertaking the appropriate cures, Bear Stearns disregarded the advice given to it and continued to conceal the true nature of its internal operations. Bear Stearns also developed ongoing measures to obscure the magnitude of defective loans in its securitizations, and continued to offer concessions designed to maintain its flow of loans from the suppliers of the defective loans.

### *7. Bear Stearns Made Accommodations to Sellers to Conceal the Volume of Defective Loans and Maintain the Flow of Loans from Those Sellers*

182. To perpetuate its fraudulent scheme, Bear Stearns quickly moved to reduce the outstanding claims against the entities from which it purchased the securitized loans by offering them substantial concessions and other accommodations as an alternative to repurchase. These concessions were designed to keep Bear Stearns's suppliers happy and ensure the continued flow of loans from these entities for Bear Stearns to package and bundle into future securitizations. At the same time, Bear Stearns still managed to secure for itself massive cash recoveries and other benefits on account of toxic loans that it long ago packaged into past securitizations.

183. Although these entities were contractually obligated to buy back defective loans at an agreed-upon repurchase price, by extending more favorable alternatives Bear Stearns could recover an economic benefit from these entities without having to first repurchase defective loans out of a securitization. Moreover, the Senior Managing Director responsible for the claims department has confirmed that before offering alternatives to the repurchase of loans that had been securitized, Bear Stearns did not seek the approval or consent of the securitization trusts.[150] Indeed, had it done so, Bear Stearns would have alerted the securitization participants to the

---

Non-Agency Trading), dated November 20, 2008, EMC-AMB 011045262-266 at 265 (discussing "***phase I*** of the settlement funds allocation methodology" as part of the Investor Relations Group's ongoing projects) (emphasis added)).

[150] Ambac Amended Complaint ¶ 169 (citing 4/26/2010 Golden Deposition Tr. at 148).

steadily growing number of loans plagued by material underwriting failures and other fraudulent activities.

184. Accordingly, through EMC, Bear Stearns entered into confidential settlement agreements with loan suppliers to resolve EPD and other claims in exchange for cash payments at a fraction of the repurchase price – all ***in lieu of repurchasing the defective loans***. In other instances, Bear Stearns accommodated originators by agreeing to (i) cancel or waive the claims entirely,[151] or (ii) create "reserve programs" that allowed it to use funds obtained from these entities for EPD violations and other defects by applying them toward future loan purchases.[152] Each of these alternatives provided additional consideration to Bear Stearns for toxic loans that it had already sold to and that remained in securitizations, while at the same time keeping its suppliers happy so as to maintain loan production for inclusion in subsequent securitizations.

185. The limited documentation secured to date by Ambac in Ambac's existing action against Bear Stearns in this Court reveals that Bear Stearns asserted claims against originators for large volumes of defective loans in its securitizations. For example, one report prepared by JP Morgan as late as 2009, lists $575 million worth of loans that Bear Stearns put back to

---

[151] *See* Ambac Amended Complaint ¶ 170 (citing emails from Mary Haggerty (Bear, Stearns & Co. Senior Managing Director, Co-Head Mortgage Finance), dated April 18 and April 12, 2006, EMC-AMB 001498898-899 (Haggerty recommends the "immediate cancel of EPD claims for loans that are in deals and are current" after "First Horizon traded a deal away that [EMC] had a 2 tic better bid because [EMC's] EPD claims with them is significantly more than market"); email from Brent Giese (Bear, Stearns & Co. Managing Director and Producing Manager of Bear/EMC Correspondent Sales Team), dated February 17, 2005, EMC-AMB 002551279-282 at 279 (noting that originators were complaining about the prevalence of EMC's EPD claims and stating that "at some point will penalize Bear/EMC in terms of not executing business with us if the issues continue")).

[152] *See* Ambac Amended Complaint ¶ 170 (citing email from Paul Nagai (EMC), dated August 7, 2006, EMC-AMB 003637057-058 (The email chain concerns a "new seller claims reserve program being instituted to support sellers with outstanding claims." It states that "This program will allow sellers that have outstanding claims to continue their production activities with Bear Stearns / EMC . . . ."); 12/11/2009 Durden Rule 30(b)(6) Deposition Tr. at 290 ("Q. Do you recall that this program was put in place as an accommodation to sellers with large claims so that EMC could continue to collect and obtain mortgage loans from those originators? A. From the language of the Email, it does appear so.")).

originators, ***but did not repurchase from the securitizations***. Rather, Bear Stearns entered into confidential settlement agreements with the originators to resolve its claims in exchange for monetary payments for just a small fraction of the total value of the repurchase claims.[153]

186. Bear Stearns did not contemporaneously disclose its practices, or the significant funds it recovered. Instead, breaching loans remained in the trusts and caused continued losses to Ambac and other participants in Bear Stearns's securitizations. Bear Stearns generated billions of dollars in recoveries through these activities. As brought to light in Ambac's first action, Bear Stearns's internal audit report issued on February 26, 2007 shows that in 2006, Bear Stearns (i) resolved "$1.7 billion of claims, an increase of over 227% from the previous year," and (ii) filed $2.5 billion in claims against the entities originating and selling it defective loans, "reflecting an increase of 78% from the prior year."[154]

187. By continuing to offer less expensive alternatives in lieu of an actual loan repurchase through 2007, Bear Stearns generated additional recoveries and benefits in violation of its obligations to review, disclose, or repurchase breaching loans from its securitizations.[155] And, by concealing the large volumes of defective loans and keeping for itself the recoveries generated from its undisclosed settlements with originators, Bear Stearns had no economic

---

[153] Ambac Amended Complaint ¶ 171.

[154] Ambac Amended Complaint ¶ 174 (citing Bear Stearns Internal Audit Department Escalation Memorandum entitled "Status of Unresolved Audit Report Issues for EMC Mortgage Corporation ("EMC") – Review of Representations and Warrants Department," dated February 26, 2007, EMC-AMB 010858610-613 at 611).

[155] *See* Ambac Amended Complaint ¶ 175 (citing email from Whitney Long (EMC Residential Mortgage, Vice President of Risk Management and Claims) to Stephen Golden (Bear, Stearns & Co. Managing Director, Warehouse and EMC Residential Mortgage President), dated July 27, 2007, EMC-AMB 006736165-172 (offering "amnesty program" to suspended or terminated sellers by "forgiving claims in exchange for loan production" at reduced pricing); email from Sharrell Atkins (EMC Mortgage Corp. Assistant Manager, Specialized Fraud Review ) to Stephen Golden (Bear, Stearns & Co. Managing Director, Warehouse and EMC Residential Mortgage President), dated August 27, 2007, EMC-AMB 006870833-834 (extending claim concerning fraud because "SunTrust is an active seller . . . we have issued a 12 month extension")).

incentive to honor its obligations to its securitizations because it then would have had to use its own funds to pay the difference between the repurchase price and the settlement without recourse against the originator. Taking full advantage of this scam, Bear Stearns was able to pocket hundreds of millions of dollars for itself. In 2007 and through the first quarter of 2008, Bear Stearns resolved claims representing $1.3 billion of unpaid principal balance through settlements or other consideration, which provided over $367 million of "economic value that was recovered from the sellers."[156] By making these enormous financial concessions, Bear Stearns continued to foster and financially reward the same type of abysmal origination practices by its sellers that had resulted in these defective loans in the first place. And, best of all, these practices allowed Bear Stearns to continue to keep securitization participants in the dark about the quality of the loans it was packaging into its transactions.

### C. BEAR STEARNS MADE MATERIAL MISREPRESENTATIONS AND OMITTED MATERIAL FACTS CONCERNING THE QUALITY AND ATTRIBUTES OF THE LOANS IT PACKAGED INTO THE TRANSACTIONS

188. In addition to making material misrepresentations and omissions regarding the protocols in place to ensure the quality of securitized loan pools, Bear Stearns knowingly made material misrepresentations and omissions regarding the particular loans it included in the Transactions.

189. The results of Ambac's recent loan-level forensic analyses – as well as the abysmal performance of the Transactions – confirm that Bear Stearns's fraudulent practices described above materially affected the credit quality of the loans included in the Transactions at issue in this litigation.

[156] Ambac Amended Complaint ¶ 175 (citing 4/26/2010 Golden Deposition Tr. at 63-65 (explaining Bear Stearns's Risk Management Division Report, EMC-AMB 010775342-407)).

190. Bear Stearns knowingly, and with intent to defraud, provided Ambac false and misleading loan-level data relating to the loans in advance of closing of the Transactions. As set forth earlier, Bear Stearns sent Ambac in advance of closing numerous preliminary and final loan tapes for each Transaction setting forth key metrics for assessing the borrowers' ability to repay their loans, their intentions to occupy the mortgaged properties, and the sufficiency of those properties as collateral. Bear Stearns knew that Ambac would rely, and intended that Ambac rely, on the veracity of the loan tapes to evaluate the Transactions and assess the "market risks" pertaining to the loans.[157]

191. As noted above, in the Offering Documents, Bear Stearns represented that the loans securitized in the Transactions were originated in accordance with the underwriting criteria described in the Offering Documents. In addition, the Offering Documents presented data metrics that Bear Stearns represented accurately reflected the attributes of the securitized loans, as well as credit ratings that Bear Stearns secured for the Transactions based on information it provided to the rating agencies.

192. A loan-level review recently undertaken by Ambac has revealed that the information provided by Bear Stearns to Ambac on the loan tapes prior to the closing of the Transactions, and that was reflected in the Offering Documents, was materially false and misleading. A forensic review of more than 5,000 loans included in the Transactions revealed that, on average, nearly 15%[158] of the loans sampled that the tapes showed as being "owner occupied" have strong indications that they were actually investor properties or second homes,

[157] Ambac Amended Complaint ¶ 92 (citing 6/2/2010 Smith Deposition Tr. at 67-72, 83; 12/11/2009 Durden Rule 30(b)(6) Deposition Tr. at 213-15; 4/19/2010 Glory Deposition Tr. at 65).

[158] This conclusion is arrived at by dividing (a) the number of properties in the samples that were reported as owner-occupied but show strong indications that their owners lived elsewhere (here, 555) by (b) the number of properties in the samples that were reported as being owner-occupied on the data tapes for the relevant Transactions (here, 3,763).

which have a higher risk of default, and more than 23% of the loans sampled had LTV ratios 10% or more higher than Bear Stearns represented on the tapes. Indeed, more than 8% of the loans sampled had LTV ratios greater than 100%, meaning that the size of the loan was already greater than the value of the property ***at origination***. Therefore, the loans were of much poorer credit quality and much more likely to default than Ambac reasonably expected based on Bear Stearns's representations and disclosures. These differences are significant as they fundamentally altered the represented characteristics of the collateral in the Transactions, which Ambac relied upon in deciding whether to issue its Policies.

193. From nine of the loan "groups" that serve as collateral for the Insured Certificates in the Transactions, Ambac's third-party forensic consultant selected loans to review to determine whether Bear Stearns's representations regarding (1) owner-occupancy rates and (2) LTV ratios were accurate. For those loan groups with more than 1,000 loans, Ambac reviewed 500 randomly selected loans. For those loan groups with fewer than 1,000 loans, Ambac reviewed every loan in the group for which information was available. In total, Ambac reviewed over 5,000 loans underlying the Insured Certificates. Ambac's sample sizes are more than sufficient to provide statistically significant data to demonstrate the degree to which Bear Stearns misrepresented certain of the material characteristics of the loans.

194. Ambac's findings – understated percentages of owner-occupied properties and inflated appraisals (leading to undervalued LTV ratios) – were well known to Bear Stearns at the time of the Transactions. As noted above, when asked what the most common loan defects were from 2003 to 2007, Haggerty told the FCIC, "I think what one would typically see would be things like the appraised value of the property was misstated. It could be that the borrower represented that they were going to be the primary residence, and it was in fact an investor

property, it was discovered."[159] What Bear Stearns knew then, Ambac – through its consultants' reviews – knows only now.

### *1. Contrary to Bear Stearns's Representations, There Are Numerous Indications that Borrowers Did Not Actually Occupy the Mortgaged Properties*

195. To determine whether a given borrower actually occupied the property as claimed, Ambac's consultants investigated tax information for the sampled loans. One would expect a borrower residing at a property to have tax bills sent to that address and to take all applicable tax exemptions available to residents of that property. If a borrower had his or her tax records sent to another address, that is good evidence that the borrower was not actually residing at the mortgaged property. If a borrower declined to make certain tax-exemption elections that depend on the borrower living at the property, that, too, is strong evidence that the borrower was living elsewhere.

196. Ambac's consultants also reviewed credit records. One would expect that people have bills sent to their primary address. If a borrower tells creditors to send bills to another address, even six months after buying the property, that is good evidence that the borrower was living elsewhere.

197. Ambac's consultants also reviewed property records. If a borrower owns multiple properties, his or her likelihood of living in any one property is diminished. If a concurrently owned separate property did not have its own tax bills sent to the property listed on the data tape for the Transaction, the borrower's likelihood of living in the mortgaged property is even slimmer.

[159] February 24, 2011 FCIC Interview with former Bear Stearns Senior Managing Director Mary Haggerty, Tr. at 32.

198. Ambac's consultants also reviewed other lien records. If the mortgaged property was subject to additional liens but the materials related to those liens were sent elsewhere, that is good evidence that the borrower was not living at the mortgaged property. If the other lien involved a conflicting declaration of residency, that, too, would be good evidence that the borrower did not live in the mortgaged property.

199. The below table sets forth the results of Ambac's loan-level analysis of true owner-occupancy rates of loans in its samples. Failing more than one of the above tests is strong evidence that the borrower did not in fact reside at the mortgaged property. These statistics therefore demonstrate that, contrary to the information Bear Stearns represented to Ambac in the loan tapes, a much higher percentage of borrowers did not occupy the mortgaged properties.

| Transaction | Supporting Loan Group | Percentage of Non-Owner Occupied Properties Reported on Tape[160] | Percentage of Properties Reported as Owner-Occupied with Strong Indication of Non-Owner Occupancy | Actual Percentage of Non-Owner-Occupied Properties | Percentage of Understatement of Non-Owner-Occupied Properties |
|---|---|---|---|---|---|
| GPMF 2006-AR2 | Group I | 57.2% | 19.8% | 65.7% | 8.5% |
| GPMF 2006-AR2 | Group II | 44.3% | 11.3% | 50.6% | 6.3% |
| GPMF 2006-AR3 | Group II | 49.8% | 21.5% | 60.6% | 10.8% |
| SAMI 2006-AR7 | Not Applicable | 22.0% | 16.4% | 34.8% | 12.8% |
| SAMI 2006-AR8 | Not Applicable | 18.4% | 16.9% | 32.2% | 13.8% |
| BSMF 2006-AR2 | Group II | 5.6% | 11.0% | 16.0% | 10.4% |
| BSMF 2006-AR4 | Not Applicable | 7.1% | 12.2% | 18.5% | 11.4% |
| BALTA 2006-R1 | Group II-2 | 14.6% | 15.0% | 27.4% | 12.8% |
| BALTA 2006-R1 | Group II-3 | 20.2% | 12.8% | 30.4% | 10.2% |

### *2. The LTV Ratios on the Data Tapes Were Based on Incorrect Appraisals and Therefore Were Severely Understated*

200. For each of the sampled loans, the underlying property was retroactively valued by an industry-standard automated valuation model ("AVM"). AVMs are routinely used in the

[160] This percentage covers properties that were reported as either investor properties or second homes.

industry as a way of valuing properties during prequalification, origination, portfolio review, and servicing. AVMs have become ubiquitous enough that their testing and use is specifically outlined in regulatory guidance and discussed in the Dodd-Frank Act. AVMs rely upon data that is similar to what appraisers rely on – primarily, county-assessor records, tax rolls, and data on comparable properties. AVMs produce independent, statistically derived valuation estimates by applying modeling techniques to this data. The AVM that Ambac's consultants used incorporates a database that covers 98% of all U.S. ZIP codes, representing 99% of the U.S. population, 97% of all properties, more than 50 million active mortgages, and 96% of loan-level, nonagency mortgage-backed securities. Independent testing services have determined that this AVM is the most accurate of all such models.

201. Applying the AVM to the available data for the loans sampled from the Transactions reveals that the appraised value of the mortgaged properties at origination was significantly higher than what the properties were actually worth at the time of the appraisal. Using this re-appraised value affected the LTV ratios by decreasing the actual value of the properties relative to the loan amount, thereby increasing the overall ratio. Overall, more than 23% of the loans had recalculated LTV ratios of at least 10% higher than what was represented on the data tapes, and more than 15% of the loans had recalculated LTV ratios of at least 15% higher than what was represented on the data tapes. This overvaluation affected numerous statistics set forth on the data tapes and/or in the Offering Documents.

202. For instance, Bear Stearns misrepresented the number of loans with LTV ratios greater than 90%. LTV ratios in excess of 90% provide the lender little equity cushion to protect against borrower default and loss upon foreclosure. However, the AVM results indicate that a

much higher percentage of loans had LTV ratios higher than 90%. The LTV ratios were understated by Bear Stearns, as shown in the chart below:

| Transaction | Supporting Loan Group | Percentage of Loans with an LTV Greater than 90% as Represented on the Tape | Actual Percentage of Loans with an LTV Greater than 90% | Percentage of Understatement |
|---|---|---|---|---|
| GPMF 2006-AR2 | Group I | 0.0% | 21.3% | 21.3% |
| GPMF 2006-AR2 | Group II | 0.2% | 22.2% | 20.0% |
| GPMF 2006-AR3 | Group II | 0.4% | 19.2% | 18.8% |
| SAMI 2006-AR7 | Not Applicable | 3.6% | 27.8% | 24.2% |
| SAMI 2006-AR8 | Not Applicable | 2.0% | 28% | 26.0% |
| BSMF 2006-AR2 | Group II | 0.0% | 21.0% | 21.0% |
| BSMF 2006-AR4 | Not Applicable | 0.0% | 24.9% | 24.9% |
| BALTA 2006-R1 | Group II-2 | 0.2% | 14.6% | 14.4% |
| BALTA 2006-R1 | Group II-3 | 0.2% | 21.8% | 21.6% |

203. Further, the data tapes uniformly show that none of the loans that collateralized an Insured Certificate had LTV ratios greater than 100%, meaning the size of the loan was represented as ***never*** being greater than the value of the property. (This is known as being "underwater" – *i.e.*, when a borrower owes more on the property than it is worth.) Loans with LTV ratios of more than 100% afford the lender no equity cushion and leave the lender with inadequate collateral from the outset of the loan. As a result, the borrower has less incentive to repay his or her loan. Ambac's analysis has found that, despite Bear Stearns's representations to the contrary, a substantial number of loans had true LTV ratios greater than 100%, as follows:

| Transaction | Supporting Loan Group | Percentage of Loans with an LTV Greater than 100% as Represented on the Tape | Actual Percentage of Loans with an LTV Greater than 100% | Percentage of Understatement |
|---|---|---|---|---|
| GPMF 2006-AR2 | Group I | 0 | 8.3% | 8.3% |
| GPMF 2006-AR2 | Group II | 0 | 9.4% | 9.4% |
| GPMF 2006-AR3 | Group II | 0 | 5.6% | 5.6% |
| SAMI 2006-AR7 | Not Applicable | 0 | 11.6% | 11.6% |
| SAMI 2006-AR8 | Not Applicable | 0 | 11.2% | 11.2% |
| BSMF 2006-AR2 | Group II | 0 | 5.4% | 5.4% |
| BSMF 2006-AR4 | Not Applicable | 0 | 10.4% | 10.4% |
| BALTA 2006-R1 | Group II-2 | 0 | 5.4% | 5.4% |
| BALTA 2006-R1 | Group II-3 | 0 | 6.4% | 6.4% |

204. In addition to understating the LTV ratios on the loan tapes, Bear Stearns also understated the LTV ratios in the Offering Documents. As shown in the chart below, the weighted-average LTV ratios that Bear Stearns provided on the loan tapes and in the ProSupps for the Transactions were significantly lower than the actual weighted-average LTV ratios for the loans in the Transactions.

| Transaction | Supporting Loan Group | Weighted Average LTVs as Stated in the ProSupp | Weighted Average LTVs for Samples Represented on the Tape | Actual Weighted Average LTVs for Samples |
|---|---|---|---|---|
| GPMF 2006-AR2 | Group I | 77.81 | 77.61 | 87.19 |
| GPMF 2006-AR2 | Group II | 77.86 | 77.7 | 88.29 |
| GPMF 2006-AR3 | Group II | 77.56 | 76.95 | 84.62 |
| SAMI 2006-AR7 | Not Applicable | 75.68 | 75.1 | 89.14 |
| SAMI 2006-AR8 | Not Applicable | 76.43 | 76.16 | 88.91 |
| BSMF 2006-AR2 | Group II | 78.23 | 77.91 | 85.3 |
| BSMF 2006-AR4 | Not Applicable | 77.44 | 77.33 | 87.51 |
| BALTA 2006-R1 | Group II-2 | 76.85 | 78.1 | 83.61 |
| BALTA 2006-R1 | Group II-3 | 75.02 | 76.69 | 86.83 |

205. These discrepancies with respect to represented LTV ratios indicate that the representations in the Offering Documents relating to the originators' appraisal practices were false, and that the appraisers often provided appraisals that they understood were inaccurate and

that they knew bore no reasonable relationship to the actual value of the mortgaged properties. Independent appraisers following proper practices – as noted, Bear Stearns made representations in the Offering Documents as to the independence of the originators' appraisal practices – would not systematically generate appraisals that deviate so significantly (and so consistently upward) from the true values of the mortgaged properties.

### *3. Many of Bear Stearns's Representations Regarding Other Aspects of the Loans Were Also False and Misleading*

206. In addition to the foregoing analysis, Ambac has sought to evaluate the compliance of individual loans with Bear Stearns's representations about other loan characteristics and underwriting guidelines generally. But Ambac's efforts to obtain the loan files necessary to conduct this more expansive review have been stymied by JP Morgan.

207. First Bear Stearns, and later JPMC Bank, as EMC's successor, have persistently thwarted Ambac's attempts to obtain the loan files necessary for Ambac to fully analyze the loans in the Transactions. As far back as 2009, Ambac demanded access to loan files and underwriting guidelines in the exclusive possession of Bear Stearns. Bear Stearns denied Ambac access by imposing inappropriate and unworkable restrictions on Ambac's use of the information as a precondition to providing such access. Thwarted by Bear Stearns, Ambac sought to obtain access via the trustees administering the trusts for the Transactions.

208. Specifically, in July and August of 2011, Ambac sent several letters to the trustees for the Transactions, requesting that the trustees exercise their powers to safeguard Ambac's and the investors' interests and to help Ambac determine whether the loans complied with Bear Stearns's representations. JPMC Bank, as successor servicer to EMC, has only recently provided the requested information.

209. To date, Ambac's consultant has reviewed 50 loans from each of the GPMF 2006-AR3 and BSMF 2006-AR2 Transactions and found breaches of representations and warranties in 45 of the loans from GPMF 2006-AR3 and 40 of the loans from BSMF 2006-AR2—breach rates of 90% and 80%, respectively. The aggregate original principal balance on just these 85 loans is more than $43.6 million. On April 9, 2012, Ambac provided notice of the breaches and detailed descriptions of the breaches attributable to each loan to all parties with respect to the 85 breaching loans.

210. Examples of defects identified by Ambac's consultants include:

- rampant fraud, primarily involving misrepresentation of the borrower's income, liabilities, employment, or intent to occupy the property as the borrower's primary residence;
- inadequately supported property values; and
- pervasive violations of the applicable underwriting guidelines and prudent mortgage-lending practices, including loans made to borrowers (i) who made unreasonable claims as to their income or otherwise clearly had no ability to repay their loans, (ii) with credit scores below the required minimum, (iii) with LTV ratios above the allowed maximum, or (iv) with relationships to the lender or originator or other non-arm's-length relationships.

These defects materially increased the risk profile of the breaching loans and of the pools of loans included in the Transactions as a whole.

211. All of these findings confirm that the abandonment of underwriting guidelines and the misrepresentation of key loan characteristics were systematic and affected a large percentage of the loans included in the Transactions. In sum, the loans included in the Transactions bore no resemblance to their represented characteristics.

## D. <u>BEAR STEARNS'S INDIVIDUAL AND CORPORATE HEDGING STRATEGY DEMONSTRATES ITS KNOWLEDGE OF THE DEFICIENCIES IN THE COLLATERAL BACKING ITS SECURITIZATIONS</u>

212. Bear Stearns's insatiable greed has provided arguably the most damning evidence of Bear Stearns's knowledge of its fraudulent scheme. Not content with the fact that it had made enormous profits by inducing parties like Ambac to participate in RMBS transactions, including the Transactions, that were destined to fail, Bear Stearns devised a scheme to make money on the inevitable demise of the deals it structured. It bet against them.

213. As revealed in Ambac's first action and Assured's recent complaint filed against Bear Stearns in this Court, in late 2007, Bear Stearns implemented a strategy of shorting financial-guaranty insurers, including Ambac, that had insured Bear Stearns securitizations. At the same time, Bear Stearns's Head of MBS, Tom Marano, liquidated his personal exposure to various financial guaranty insurers. These strategies amounted to a contemporaneous recognition and acknowledgement by Bear Stearns, based on inside knowledge, of the poor-quality collateral backing its securitizations, and constitute a bad-faith attempt to profit from its own misconduct.

214. Knowing that Bear Stearns's fraudulent conduct was resulting and would continue to result in grave harm to insurers, in October 2007 Bear, Stearns & Co. Senior Managing Director Jeffrey Verschleiser recommended to Bear Stearns's risk committee that "we should be short a multiple of 10 of the shorts I had put on," because "a few ***financial guarantors were vulnerable*** to potential write downs in the CDO and MBS market."[161] Bear Stearns in fact

[161] Ambac Amended Complaint ¶ 194 (citing email from Jeffrey Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk, Bear, Stearns & Co.), dated Nov. 20, 2007, EMC-AMB 009600760-763).

executed those trades and "in less than three weeks . . . made approximately $55 million on just these two trades."[162]

215. Contemporaneous with Bear Stearns's corporate short trades, Marano directed his personal financial advisor on November 6, 2007 to assess his exposure to various financial-guaranty insurers and exit those positions.[163] The advisor in fact executed those trades, informing Marano "we will have you ***all out*** by next Monday."[164]

216. Bolstered by the success of its shorting scheme, Bear Stearns continued its trading strategy into 2008, continuing to short both financial-guaranty insurers and the banks with large exposure to the securities they insured. On February 17, 2008, a Bear Stearns trader told colleagues and Verschleiser, "***I am positive fgic is done and ambac is not far behind***."[165] The next day, in the same email chain, the trader again wrote to Verschleiser and others to clarify which banks had large exposures to certain financial guarantors, asking "***who else has big fgic or abk [Ambac] exposures besides soc gen?***"[166] A colleague replied: "I believe the five with the biggest exposures are Barclays, CIBC, Merrill, Soc Gen and UBS. I think ABN, BNP, DB, HSBC and RBS have less."[167] Bear Stearns in fact entered into short positions with respect to

[162] *Id.*

[163] Assured Complaint ¶ 228 (citing email from Thomas Marano (Bear, Stearns & Co. Senior Managing Director, Head of MBS, ABS, and CMBS), dated Nov. 6, 2007, EMC-AMB 012124275).

[164] Assured Complaint ¶ 228 (citing email from Kenneth Ramos (Bear, Stearns & Co. Managing Director, Private Client Services) to Thomas Marano (Bear, Stearns & Co. Senior Managing Director, Head of MBS, ABS, and CMBS), dated Nov. 6, 2007, EMC-AMB 012124275 (emphasis in original)).

[165] Assured Complaint ¶ 229 (citing email from Adam Siegel (Bear, Stearns & Co. Senior Managing Director, ABS/MBS Credit Trading), dated Feb. 17, 2008, EMC-AMB 012117052-063).

[166] Assured Complaint ¶ 229 (citing email from Adam Siegel (Bear, Stearns & Co. Senior Managing Director, ABS/MBS Credit Trading) to Jeffrey Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk), among others, dated Feb. 18, 2008, EMC-AMB 012117048-051).

[167] Assured Complaint ¶ 229 (citing email from Warren Saft (Bear, Stearns & Co. trader), to Jeffrey Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk, Bear, Stearns & Co.), among others, dated Feb. 18, 2008, EMC-AMB 012117048-051).

those banks based on the knowledge of the banks' exposure to financial-guaranty-insured RMBS transactions.[168] At the same time, Bear Stearns entered into single-name corporate credit-default swaps shorting Ambac and other insurers to hedge Bear Stearns's retained positions in its insured securitizations.[169]

217. As it was shorting financial-guaranty insurers and the banks holding the Bear Stearns securities they insured, Bear Stearns continued to conceal the defects related to the collateral backing the securities issued in connection with the Transactions.

## VII. AMBAC'S RELIANCE ON BEAR STEARNS'S REPRESENTATIONS WAS JUSTIFIABLE AND ITS DUE DILIGENCE WAS REASONABLE AND CONSISTENT WITH THE RISK ALLOCATION IN THE TRANSACTIONS

218. Bear Stearns knowingly and with the intent to induce reliance thereon made the foregoing material misrepresentations to Ambac and investors and actively concealed material information pertaining to its securitization practices generally and the specific Transactions at issue in this litigation. These misrepresentations and omissions fraudulently induced Ambac to insure and investors to purchase the Certificates issued in the Transactions. In addition, Bear Stearns's false and misleading representations and omissions pertaining to each Transaction fraudulently induced Ambac to enter into each subsequent Transaction.

---

[168] Assured Complaint ¶ 229 (citing email from Beau Paulk (Bear, Stearns & Co. employee) to Thomas Marano (Bear, Stearns & Co. Senior Managing Director, Head of MBS, ABS and CMBS), Michael Nierenberg (Bear, Stearns & Co. Senior Managing Director, Head of ARM and CDO Desk), and Jeff Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk), among others, dated March 17, 2008, EMC-AMB 011189682-83 (attaching "Department Hedge Summary" as of March 14, 2008)).

[169] Assured Complaint ¶ 229 (citing email from Beau Paulk (Bear, Stearns & Co. employee) to Marano (Bear, Stearns & Co. Senior Managing Director, Head of MBS, ABS and CMBS), Michael Nierenberg (Bear, Stearns & Co. Senior Managing Director, Head of ARM and CDO Desk), and Verschleiser (Bear, Stearns & Co. Senior Managing Director, Head of ABS & Wholeloan Desk), among others, dated March 17, 2008, EMC 011189682-83 (attaching "Department Hedge Summary" as of March 14, 2008); email from Thomas Marano (Bear, Stearns & Co. Senior Managing Director, Head of MBS, ABS, and CMBS) to Scott Eichel (Bear, Stearns & Co. Senior Managing Director, ABS/MBS Credit Trading), and Adam Siegel (Bear, Stearns & Co. Senior Managing Director, ABS/MBS Credit Trading), dated Feb. 20, 2008, EMC-AMB 005486578-580).

219. Ambac reasonably relied to its detriment on Bear Stearns's false and misleading representations and material omissions – contained in, among other things, data tapes, Offering Documents, and investor presentations – concerning (i) its internal operations, including its seller-approval, due-diligence, quality-control, and loan-repurchase protocols, (ii) the mortgage-loan data that Bear Stearns disseminated in electronic "tapes" and the Offering Documents for each Transaction, (iii) the rating agencies' shadow ratings that Bear Stearns secured for each Transaction, (iv) the historical performance of Bear Stearns's securitizations and mortgage loans, (v) the underwriting practices that were followed during the origination of the loans, and (vi) Bear Stearns's wherewithal and intent to stand behind the representations and warranties that EMC made in the agreements governing the Transactions.

220. Ambac's reasonable reliance on Bear Stearns's representations and omissions was contemporaneously documented in both internal Ambac emails and formal memoranda that Ambac prepared to obtain internal approval from its Credit Committee for each of the Transactions (the "Underwriting Reports"). To start, the Underwriting Report for each Transaction underscored the perceived significance of Bear Stearns as a counterparty, listing "Bear Stearns" as the "Investment Banker," one of four key transaction-identifying facts (along with "Report Date," "Ambac Analysts," and "Closing Date") listed at the top of each report. Also among the first items set forth in the Underwriting Reports are the ratings that Bear Stearns secured from the ratings agencies. Reflecting the importance of the ratings to Ambac, the Underwriting Reports often list the ratings as one of several items that need to be "Satisfied" before Ambac decides to participate in the relevant Transaction. Similarly, the Underwriting Reports alternately refer to the ratings as among the "Mitigating Factors" for risks associated with the relevant Transaction and as part of the "Rationale" for approving the Transactions.

221. The Underwriting Reports also make plain how central Bear Stearns's representations regarding, in particular, the loan characteristics (as reflected in the loan tapes and Offering Documents) and the underwriting practices of the various originators (as reflected in the Offering Documents) were to Ambac's decision to insure the Transactions. The Underwriting Reports mention various loan characteristics, often in summary or aggregate form, on almost every page and typically include "Pool Characteristics" with additional loan-level detail as the first of several exhibits. The other exhibits, except for the last, are various models for which the loan characteristics serve as inputs. Almost every Underwriting Report lists several pool-wide loan characteristics – in particular, "WA LTV" (or weighted average loan-to-value ratio) – as among the "Strengths" or "Risk Mitigants" of the relevant Transaction. Conversely, other pool-wide characteristics – in particular, the number of non-owner-occupied properties – are listed as "Weaknesses" or "Risks." Without the loan characteristics provided to Ambac on the data tapes and in the Offering Documents, in short, Ambac would have been unable to model and assess the market risk of loss on the Transactions, precisely the risk that Ambac was agreeing to insure.

222. The final exhibit to each Underwriting Report is typically a detailed description – derived, in some cases verbatim, from the descriptions in the ProSupps that Bear Stearns had provided to Ambac – of the originators' underwriting practices. For example, Exhibit 5A to the Underwriting Report for the BSMF 2006-AR4 Transaction gives a "Servicer and Originator Overview" of EMC and BSRM, respectively. The overview of EMC includes notes from a due-diligence visit that two Ambac employees made to EMC in May 2006. During that visit – which involved "close discussions with EMC's senior management regarding its underwriting guidelines and servicing" – EMC represented to Ambac that "EMC continuously examines methodologies, and exercises financial prudence in every step of the servicing process" and gave

Ambac the impression that EMC had "strong financial condition and the support of its parent [Bear Stearns]."

223. The overview of BSRM, which originated approximately 36% of the loans in the BSMF 2006-AR4 Transaction and 91% of the loans in the BSMF 2006-AR2 Transaction, includes numerous lengthy excerpts from the ProSupp regarding the "BSRM Underwriting Guidelines." The first excerpt is Bear Stearns's statement that "[t]he BSRM Alt-A Underwriting Guidelines are intended to ensure that [i] the loan terms relate to the borrower's willingness and ability to repay and [ii] the value and marketability of the property are acceptable." Other excerpts include descriptions of BSRM's various loan products, including so-called SISA or "Stated Income/Stated Assets" loans. Even for those loans, the excerpt assures, "[t]he applicant's income as stated must be reasonable for the related occupation, borrowers' credit profile and stated asset, in the loan underwriter's discretion." The exhibit also includes an excerpt about BSRM's exceptions policy, whereby exceptions "are considered" but only "with reasonable compensating factors on a case-by-case basis and at the sole discretion of senior management."

224. The Underwriting Report for the GPMF 2005-AR5 Transaction, which predated by only five months and served as the basis for the GPMF 2006-AR2 Transaction, includes similarly detailed descriptions of GreenPoint's underwriting practices (GreenPoint originated all of the loans in not only the GPMF 2005-AR5 Transaction, but also the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions). Again copying Bear Stearns's representations in the ProSupp, the Underwriting Report notes that GreenPoint's limited-documentation loan products, which constituted the overwhelming majority of the loans in the three above-noted deals, "are generally limited to borrowers with credit histories that demonstrate an established ability to repay

indebtedness in a timely fashion."[170] The Underwriting Report also speaks to Ambac's ongoing comfort with Bear Stearns and reliance on its stature in the industry, listing as three of the five items under the heading "Rationale" for approval of the transaction that (1) "The loans . . . will be serviced by an established, experienced market participant [EMC]," (2) "The loans are serviced by a seasoned, financially sound entity – EMC Mortgage Corp," and (3) "The transaction will strengthen our relationship with Bear Stearns, an experienced and seasoned leader in the RMBS market."[171] Two similar reports that Ambac drafted in connection with other Bear Stearns-underwritten and EMC-sponsored transactions that closed during the same time period as the Transactions also reveal Ambac's reliance on Bear Stearns's representations regarding the due diligence it purported to perform in advance of closing: "There is no additional diligence done [by Ambac] at the time of the securitization ***as we rely on the EMC bulk and flow due diligence process***."[172]

225. Lacking an accurate depiction of Bear Stearns's and originators' practices, Ambac's reliance on Bear Stearns's representations was reasonable and consistent with the industry practice and the parties' bargain. As was the general practice and the parties' agreement, Bear Stearns and Ambac assumed risk and undertook due diligence consistent with their respective roles in the Transactions.

226. Bear Stearns, as the sponsor and seller (through EMC), and as the underwriter and deal manager (through Bear, Stearns & Co.), assumed the risk and the burden of assessing the validity of the attributes of the mortgage loans that it conveyed to the securitization trusts,

---

[170] GPMF 2005-AR5 Underwriting Report at p. 5.

[171] *Id.* at p. 6.

[172] *See* Ambac's credit memoranda for the SACO 2006-2 and SAC0 2005-10 transactions, both of which Bear, Stearns & Co. also underwrote and marketed and which EMC also sponsored (and Ambac also insured). Those two transactions are at issue in Ambac's first action against Bear Stearns in this Court.

including that the loans were originated pursuant to the appropriate underwriting guidelines and were not fraudulently procured. Ambac as the insurer bore the market risk and the burden of evaluating whether loans ***bearing the attributes represented by Bear, Stearns & Co. and warranted by EMC*** would perform after the closing of the Transactions.

227. That was a reasoned risk allocation. Bear Stearns was in privity with – and often financed – the originators that sold to Bear Stearns the loans that it in turn conveyed to the securitization trusts. Bear Stearns dictated the underwriting guidelines, owned the loans and held the loan files, all of which afforded it access and control over information required to evaluate the loans. To the extent Bear Stearns identified any defect in any loans, it had the right to exclude the loans from any transaction with the entity selling Bear Stearns the loans or to demand that the entity repurchase the loans if the defects were discovered after purchase. Bear Stearns thus had the means before the closing of the Transactions to assess the quality of the loans and recourse in the event a defect was discovered.

228. In contrast, Ambac was not in privity with and lacked recourse against the originators, never owned the loans or the loan files, and therefore didn't have the opportunity to review the loans before deciding whether to participate in the Transactions. What Ambac did have, however, were Bear Stearns's numerous representations about the loans. Recognizing the critical importance of these representations, Ambac also insisted, as sophisticated parties typically do, that Bear Stearns reduce many of these representations to enforceable warranties in the parties' written agreements. As explained below, Bear Stearns did so. It therefore made sense for the sophisticated parties to agree that Bear Stearns would bear the loan-origination risk, and that Ambac, relying on the truth of Bear Stearns's representations, would bear the market risk.

229. This risk-allocation arrangement enabled each party to conduct the appropriate due diligence consistent and commensurate with the risk each party bore. Bear Stearns purported to carefully vet the originators from which it bought the loans (as part of its seller-approval process), re-underwrite the loans before it purchased the loans (as part of its due-diligence process), and conduct further review of the loans after acquisition (as part of its quality-control process).

230. Ambac, in turn, (i) conducted on-site reviews of Bear Stearns's operations, (ii) secured and evaluated Bear Stearns's representations concerning the seller-approval, due-diligence, quality-control, and repurchase protocols Bear Stearns purportedly performed, (iii) conducted extensive modeling of its exposure to interest rate and other market variables using the loan data represented as true by Bear Stearns, (iv) assessed the adequacy of Bear Stearns's wherewithal to stand behind its representations and warranties, (v) analyzed the represented performance of Bear Stearns's prior securitizations, and, significantly, (vi) secured from Bear Stearns its commitment to provide, through EMC, extensive contractual representations and warranties concerning, among other things, the veracity of the mortgage-loan data that Bear Stearns provided and the underwriting practices followed in the origination of the loans.

231. These numerous representations and warranties that Bear Stearns provided through EMC, and on which Ambac relied, were the means by which the parties effectuated this reasoned risk allocation, and therefore, were an essential inducement for Ambac to participate in the Transactions. In particular, they gave Ambac comfort – both practically and as a matter of law – that even though it couldn't reasonably conduct its own loan-level due diligence of the loans and the underwriting practices followed in originating them, it didn't need to.

## VIII. BEAR STEARNS'S EXPRESS REPRESENTATIONS AND WARRANTIES, AND RELATED COVENANTS, WERE A MATERIAL INDUCEMENT TO AMBAC TO PARTICIPATE IN THE TRANSACTIONS AND ISSUE ITS POLICIES

### A. EMC'S EXPRESS CONTRACTUAL REPRESENTATIONS AND WARRANTIES THAT EFFECTUATED THE PARTIES' BARGAINED-FOR RISK ALLOCATION

232. Under the agreements that effectuated the Transactions, the principal and interest payments from the loans were to provide the cashflow necessary to make the monthly principal and interest payments due on the Certificates. Ambac's Policies required it to make payments to the purchasers of the Insured Certificates to the extent there was a shortfall of cashflow available from the loans (or, in the case of the BALTA 2006-R1 Transaction, the underlying securities), once the protection provided by subordinated classes of securities and other credit enhancement was eroded. Ambac agreed to assume this risk of payment shortfalls, which presumed the truth of the information that Bear Stearns provided to Ambac regarding the quality of the securitized loans and Bear Stearns's purportedly thorough due-diligence and quality-control practices in reviewing the loans both before and after the Transactions closed. Bear Stearns assumed the risk and the burden of assessing the validity and accuracy of the characteristics and attributes that it represented and warranted the loans possessed, including that the loans were originated pursuant to the relevant underwriting guidelines.

233. To effectuate this reasoned and bargained-for risk allocation, EMC made myriad representations and warranties in the MLPAs regarding, among other things, the attributes of the loans and the practices used to originate, underwrite, and service them ("Loan-Level Warranties"). As demonstrated by their number, scope, and particularity, these Loan-Level Warranties were designed to convey absolute confidence that EMC was standing behind the quality of the loans and, specifically, accepting the risk of loss should any of the loans be found to have been included in the Transactions in violation of any of the Loan-Level Warranties.

EMC represented and warranted as to each of the loans in each of the Transactions that, among other things:

- MLPA § 7(i): "[T]he information set forth in the Mortgage Loan Schedule is true and correct in all material respects and the information provided to the Rating Agencies, including the Mortgage Loan level detail, is true and correct according to the Rating Agency requirements."[173]

- MLPA § 7(iii): "Each Mortgage Loan at the time it was made complied in all material respects with all applicable local, state and federal laws, including, without limitation, . . . all applicable anti-predatory, abusive and fair lending laws."[174]

- MLPA § 7(iv): "[T]here is no monetary default existing under any Mortgage or the related Mortgage Note and there is no material event which, with the passage of time or with notice and the expiration of any grace or cure period, would constitute a default, breach or event of acceleration; and neither the Mortgage Loan Seller, any of its affiliates nor any servicer of any related Mortgage Loan has taken any action to waive any default, breach or event of acceleration."

- MLPA § 7(vi): "[N]o selection procedure reasonably believed by the Mortgage Loan Seller to be adverse to the interests of the Certificateholders was utilized in selecting the Mortgage Loans."

- MLPA § 7(x): "[T]here is no valid offset, defense or counterclaim to any Mortgage Note or Mortgage, including the obligation of the Mortgagor to pay the unpaid principal and interest on such Mortgage Note."

- MLPA § 7(xiv): "[A]t the time of origination, each Mortgaged Property was the subject of an appraisal which conformed to the underwriting requirements of the originator of the Mortgage Loan and the appraisal is in a form acceptable to Fannie Mae or Freddie Mac."

- MLPA § (xx): "[T]he information set forth in Schedule A of the Prospectus Supplement with respect to the Mortgage Loans is true and correct in all material respects."[175]

[173] Section 7(i) of the MLPAs for the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions omits the second part of this representation and warranty relating to the rating agencies, but is otherwise the same.

[174] Section 7(iii) of the MLPAs for the GPMF 2006-AR2 and GPMF 2006-AR3 Transactions omits the words "local, state and federal," but is otherwise the same.

[175] This representation and warranty appears in Section 7(xviii) of the MLPAs for the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions, but is otherwise the same. Schedule A of the ProSupps contains more detailed information about, among other things, both LTV ratios and occupancy status of the loans on a pool-wide basis.

- MLPA § 7(xxi): "[E]ach Mortgage Loan was originated in accordance with the underwriting guidelines of the related originator."[176]

- MLPA § 7(xxiv): "[T]he Mortgage Loans are currently being serviced in accordance with accepted servicing practices."[177]

234. EMC also made representations and warranties in the MLPAs regarding all of the loans in each Transaction in the aggregate ("Transaction-Level Warranties"). In particular, EMC represented and warranted in Section 8(vii) of the MLPAs as follows:

> The Mortgage Loan Seller's Information (identified in Exhibit 3 hereof) does not include any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

Exhibit 3 of each MLPA defines the "Mortgage Loan Seller's Information" to include three sections of the ProSupp: (1) "SUMMARY OF TERMS – The Mortgage Pool," (2) "DESCRIPTION OF THE MORTGAGE LOANS," and (3) "SCHEDULE A – Certain Characteristics of the Mortgage Loans." The "SUMMARY OF TERMS" section of the ProSupps contains, among other things, weighted-average LTV ratios for each pool of loans in the Transactions. "SCHEDULE A" of the ProSupps contains more detailed information about, among other things, both LTV ratios and occupancy status of the loans on a pool-wide basis.

235. Ambac is a third-party beneficiary of the MLPAs with the right to enforce breaches of both the Loan-Level Warranties and the Transaction-Level Warranties against EMC for all Transactions other than the BALTA 2006-R1 Transaction. The material misrepresentations and omissions by Bear Stearns detailed at length in this complaint constitute a

---

[176] This representation and warranty appears in Section 7(xx) of the MLPAs for the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions and Section 7(xxiv) of the MLPA for the GPMF 2006-AR2 Transaction, but is otherwise the same.

[177] This representation and warranty appears in Section 7(xxiii) of the MLPAs for the SAMI 2006-AR7 and SAMI 2006-AR8 Transactions and Section 7(xxvii) of the MLPA for the GPMF 2006-AR2 Transaction, but is otherwise the same.

breach of the Transaction-Level Warranties. In addition, the facts alleged as to the rampant misrepresentations of incomes, liabilities, and occupancy status permeating the loans in the Transactions, and the failure of the loans in the Transactions to otherwise comport with the represented attributes and the applicable underwriting guidelines, also constitute breaches of one or more of the Loan-Level Warranties with respect to a significant percentage of the loans in the Transactions.

## B. EMC'S CONTRACTUAL COVENANTS REINFORCING THE PARTIES' BARGAINED-FOR RISK ALLOCATION

### *1. EMC's Promise to Give Prompt Notice of Breaches*

236. To reinforce the parties' bargained-for risk allocation and to further assure the Transactions' participants that the loans complied with EMC's representations and warranties, the MLPAs provide ongoing obligations on all securitization participants to promptly disclose any loan found to have been included in the Transactions in violation of any of EMC's myriad Loan-Level Warranties.

237. Specifically, Section 7 of the MLPAs provide, in relevant part, as follows:

> Upon discovery or receipt of notice by the Mortgage Loan Seller [EMC], the Purchaser [a Bear Stearns affiliate], the Certificate Insurer [Ambac], the Trustee or the Custodian, as its agent, of a breach of any representation or warranty of [EMC] set forth in this Section 7 which materially and adversely affects the value of the interests of the Purchaser, the Certificateholders, [Ambac], or the Trustee in any of the Mortgage Loans . . . , the party discovering or receiving notice of such breach shall give prompt written notice to the others.[178]

238. The notification provisions are absolute; they are in no way conditioned on EMC's ability to pursue claims against the originators of breaching loans or ultimately cure the

[178] SAMI 2006-AR7 and SAMI 2006-AR8 MLPAs. Although the MLPAs for the other Transactions do not mention Ambac, as the "Certificate Insurer," in this notice provision, they do make Ambac an explicit third-party beneficiary of the entire agreements with rights to enforce the agreements' provisions, including this notice provision and the related repurchase protocol, discussed below.

defects affecting those loans. Instead, they are designed to give prompt notice to the Transactions' participants of any breaching loan to ensure that EMC – and not Ambac, the Transactions, or its investors – bear the risk of loss associated with defective loans that EMC should not have securitized.

239. EMC's promise to promptly notify other Transaction participants of breaching loans subsequently found to have been included in the Transactions was also a material inducement of Ambac's and investors' participation in the Transactions.

### *2. EMC's Promise to Repurchase or Cure Breaching Loans Within 90 Days*

240. Disclosing the existence of breaching loans identified in the Transactions was necessary and essential to enforcing EMC's express contractual obligation to repurchase those loans or cure the breach in a timely manner (*i.e.*, within 90 days) – and, thus, minimize the risk of loss to the Transactions' investors and Ambac in the event Bear Stearns securitized defective loans by allocating that risk squarely to EMC.

241. To carry out this bargained-for risk allocation, and to convey absolute confidence that EMC was standing behind the quality of the securitized loans, EMC agreed in the MLPAs that, should any of its Loan-Level Warranties prove untrue, it would cure the breach(es) or remove the breaching loan(s) from the securitization trusts (the "repurchase protocol"). To this end, immediately following the notification obligations described above, Section 7 of the MLPAs for the Transactions provides, in pertinent part, as follows:

> In the case of any such breach of a representation or warranty set forth in this Section 7, within 90 days from the date of discovery by [EMC], or the date [EMC] is notified by the party discovering or receiving notice of such breach (whichever occurs earlier), [EMC] will (i) cure such breach in all material respects [or] (ii)

purchase the affected Mortgage Loan at the applicable Purchase Price.[179]

# IX. EMC'S PERVASIVE BREACHES OF ITS REPRESENTATIONS AND WARRANTIES

## A. AMBAC'S LOAN-LEVEL REVIEW UNCOVERED PERVASIVE BREACHES

242. As noted above, Ambac recently obtained loan files for two of the Transactions: GPMF 2006-AR3 and BSMF 2006-AR2. To date, Ambac, through its independent consultant, has reviewed 50 loans from each of these two Transactions. The results of Ambac's loan-level reunderwriting revealed breaches of one or more of EMC's representations and warranties for 45 of the loans from GPMF 2006-AR3 and 40 of the loans from BSMF 2006-AR2—evidencing staggering breach rates of 90% and 80%, respectively. These loans contain one or, in most cases, more than one defect that constitute a breach of one or more of the numerous representations and warranties made by EMC in the applicable MLPA and materially altered the loans' risk profile. These defects include:

- rampant fraud, primarily involving misrepresentation of the borrower's income, liabilities, employment, or intent to occupy the property as the borrower's primary residence;
- inadequately supported property values;
- pervasive violations of the applicable underwriting guidelines and prudent mortgage-lending practices, including loans made to borrowers (i) who made unreasonable claims as to their income or otherwise clearly had no ability to repay their loans, (ii) with credit scores below the required minimum, (iii) with LTV ratios above the allowed maximum, or (iv) with relationships to the lender or originator or other non-arm's-length relationships.

---

[179] BSMF 2006-AR2 and BSMF 2006-AR4 MLPAs. The MLPAs for each of the other Transactions contains materially identical language. In addition to the "cure" and "repurchase" options, the MLPAs also provide for a "substitution" option (allowing EMC to substitute a non-breaching loan for a breaching loan), but that option exists only within two years of closing and is therefore no longer available to EMC with respect to any of the Transactions.

243. Each of these breaches adversely affected Ambac's interests, and materially and adversely affected the value of the interest of the Certificateholders in the identified loans. Loans that were subject to fraud, loans that were not originated pursuant to applicable guidelines, or loans for which the key attributes were otherwise misrepresented are markedly riskier and therefore less valuable than loans not suffering from such shortcomings.

244. On April 9, 2012, pursuant to Section 7 of the MLPAs, Ambac gave formal notice to EMC and the other deal participants identifying the breaching loans found to have been included in the GMPF 2006-AR3 and BSMF 2006-AR2 Transactions, and describing with specificity the breach, or breaches, affecting those loans. The trustee, in turn, provided these notices to EMC and the other deal participants on April 25, 2012. Upon receipt of such notices, EMC became obligated under the applicable MLPAs to repurchase or cure the affected loans within 90 days.

245. EMC refused to repurchase any of the loans or acknowledge the breaches in what amounts to a deliberate and bad-faith frustration of the repurchase protocol further compounding the massive harm inflicted by Bear Stearns on Ambac and the Transactions' investors.

246. By its wholesale rejection of Ambac's repurchase demands, EMC has thus made clear that it has no intention of honoring its contractual obligations.

## X. HARM SUFFERED BY AMBAC AND CERTIFICATEHOLDERS

247. The Transactions that Bear Stearns marketed and effectuated based on its materially false and misleading representations and disclosures have failed miserably. An overwhelming percentage of the loans that Bear Stearns securitized in each of the Transactions either have defaulted or are severely delinquent, causing massive shortfalls in the cashflows of principal and interest needed to pay down the Certificates. As a result, the Certificateholders have incurred severe losses that have been passed on to Ambac as the financial guarantor.

248. With respect to the loan groups backing the Insured Certificates, the Transactions have experienced cumulative losses of more than $1.8 billion as of February 29, 2012. A significant portion of the loans in those loan groups have defaulted or are severely delinquent, as reflected in the following table:

| **Transaction** | **Cumulative Losses** | **% of Loans Severely Delinquent, Liquidated, in Foreclosure, Bankruptcy, or REO (by Loan Balance)** |
|---|---|---|
| GPMF 2006-AR2 | $85.5 million | 42.31% |
| GPMF 2006-AR3 | $202.9 million | 46.29% |
| SAMI 2006-AR7 | $508.6 million | 61.68% |
| SAMI 2006-AR8 | $328.4 million | 55.36% |
| BALTA 2006-R1 | $441.1 million | 41.40% |
| BSMF 2006-AR2 | $118.6 million | 49.38% |
| BSMF 2006-AR4 | $141.4 million | 48.93% |

249. The severe losses realized by the Transactions have resulted in Ambac being obligated to make claim payments to insured Certificateholders. As of February 29, 2012, Ambac has paid, or is obligated to pay, claims of more than $200 million in the aggregate.

250. Due to the high rate of delinquency and expected defaults, future borrower re-payment shortfalls affecting the Transactions are inevitable. Therefore, in addition to the substantial claims that Ambac has paid and is obligated to pay under its Policies, Ambac expects hundreds of millions of dollars in additional claims in the future.

251. As discussed above, Bear Stearns's fraudulent statements and material omissions, and the pervasive breaches of EMC's representations and warranties, revealed by Ambac's loan-level reviews, Bear Stearns's internal documents, and confidential-witness statements and testimony, and corroborated by the dismal loan performance in all of the Transactions, pierce the very heart of the bargain struck by the parties. As has only recently become clear, Bear Stearns

did not sell to the trusts for the Transactions the contemplated portfolio of loans with the represented attributes. Rather, Bear Stearns transferred pools where the overwhelming majority of loans did not bear any resemblance to the loans Bear Stearns represented would comprise the pools. In doing so, Bear Stearns induced Ambac into insuring each successive Transaction based upon materially false and misleading information about that Transaction and the ones preceding it.

252. The Offering Documents that Bear Stearns prepared to market the Certificates that Ambac insured (and the same documents that it filed with the SEC) contained material misrepresentations and omissions because, like the loan tapes, they did not adequately or accurately disclose the true attributes of the loans (*e.g.*, LTV ratios and occupancy status), the level of fraud and underwriting failings permeating the EMC loan pools, the grossly deficient origination practices of the originators of these loans, Bear Stearns's dismal due-diligence practices, the duplicitous role of its quality-control department, or its scheme to recover from originators and pocket substantial sums of money that rightfully belonged to the securitization trusts (*i.e.*, Ambac and the investors). Ambac never would have issued its Policies or agreed to participate in the Transactions had it known the truth.

253. Bear Stearns's misconduct entitles Ambac to be, among other things, (i) returned to the position it would have been in had it not issued its Policies and (ii) compensated for the incremental harm incurred as a result of its participation in each of the Transactions. At the very least, this relief requires the payment to Ambac of all claims payments made and accrued to date and all future claims payments required to be made under its Policies.

## XI. EMC WAS A MERE ALTER EGO AND INSTRUMENTALITY OF BEAR, STEARNS & CO.

254. Throughout the time prior to JP Morgan's acquisition of Bear, Stearns & Co., Bear, Stearns & Co. exercised exclusive and complete domination and control over EMC both generally and specifically with respect to the Transactions.

255. As noted above, Bear, Stearns & Co.'s investor presentations answered the question "Why purchase RMBS from Bear Stearns?" by referring to the "Integral role played by Bear Stearns' affiliate, EMC Mortgage Corporation (EMC)," including the representations and warranties offered by EMC. But EMC did not operate separately from Bear, Stearns & Co. Instead, EMC was a sham entity with no legitimate business purpose other than to shield Bear, Stearns & Co. from liability for its fraudulent RMBS products.

256. Bear, Stearns & Co. directly pitched the Transactions to Ambac as Bear, Stearns & Co. products. Bear, Stearns & Co. conducted all negotiations with Ambac for the Transactions and provided all information regarding the Transactions to Ambac. Moreover, the commitment letters for the Transactions – which are the agreements obligating Ambac to issue its Policies on the Transactions – were entered into with Bear, Stearns & Co., not EMC. These commitment letters obligated EMC to enter into the agreements effectuating the Transactions (such as the MLPAs and PSAs).

257. Bear, Stearns & Co. held out EMC as an adequately capitalized corporation capable of backing the representations and warranties it made to Bear Stearns's securitization participants, including Ambac. But EMC was not adequately capitalized for its corporate undertaking, as it did not set sufficient reserves for its repurchase liabilities to securitization

trusts, including with respect to the Transactions.[180] Indeed, Bear, Stearns & Co. siphoned off EMC's corporate funds to offset losses on Bear, Stearns & Co.'s trading books, as if the funds belonged to Bear, Stearns & Co.[181] In sum, Bear, Stearns & Co. operated EMC as a mere instrumentality, which it used to defraud Ambac as well as investors in the Transactions while shielding itself from liability.

258. Accordingly, equity requires that JP Morgan, as successor to Bear, Stearns & Co., be held accountable and liable for the actions and wrongs of EMC.

## XII. JPMORGAN CHASE & CO. HAS STRIPPED EMC OF ITS ASSETS, SEEKING TO RENDER EMC A JUDGMENT-PROOF SHELL, BUT SUBJECTING JPMC BANK TO SUCCESSOR LIABILITY

259. JPMorgan Chase & Co. has recently taken steps to strip EMC (which was already undercapitalized) of its assets and render it unable to satisfy any judgment against it. On or about April 1, 2011, JPMorgan Chase & Co. effectuated an intercompany asset sale whereby EMC transferred to its affiliate, JPMC Bank, all of EMC's servicing-related assets (the "Asset Transfer"). The mortgage-servicing business entails processing payments from borrowers for securitized loans, such as those included in the Transactions, and distributing the proceeds to the securitization trusts, as well as pursuing delinquent borrowers and bringing foreclosure actions.

---

[180] *See* Assured Complaint ¶ 302 (citing EMC Mortgage Corporation and Subsidiaries, Independent Auditors' Report, Consolidated Financial Statements as of and for the Years Ended November 30, 2006 and 2005, EMC-AMB 012128918-947. With respect to claims by EMC against sellers, "[t]he Company evaluates seller obligations to the Company and reserves for any seller obligation that the Company deems uncollectible." *Id.* at 943. But, with respect to EMC's own liability for its representation-and-warranty breaches to securitization counterparties, "[t]he contingencies triggering the obligation to indemnify are not generally expected to occur," and "it is unlikely that the Company will have significant losses under these arrangements." *Id.* *See also* 10/3/2011 Marano Deposition Tr. at 123 ("I do not recall [EMC] establishing reserves for breaches of rep and warranty on securitization trusts.")).

[181] *See* Assured Complaint ¶ 302 (citing EMC Mortgage Corp. Claims Settlements Report for the month ending 11/30/2006, EMC-AMB 003673312 (allocating $6.7 million in cash obtained by EMC in claims settlements with sellers to offset markdown losses on Bear, Stearns & Co.'s FIXED and ARMS trading desks, led by Jeff Verschleiser and Michael Nierenberg, respectively); 10/6/2011 Verschleiser Deposition Tr. at 83-84 ("EMC was a subsidiary of Bear Stearns so if there was a fee earned, it was just an intercompany transfer. . . . ***[I]t's just one pocket to the other***.")).

The servicing assets transferred in the Asset Transfer include servicing rights on four of the Transactions at issue in this litigation, several other Ambac-insured securitizations, and dozens of other securitizations. The servicing operation that EMC sold to JPMC Bank constituted substantially all of EMC's assets and its last remaining operating asset. EMC has been shorn of its assets and has become, in essence, a shell. By taking these improper actions, JPMorgan Chase & Co. has subjected its subsidiary, JPMC Bank, to liability as EMC's successor.

### A. EMC'S PAST SERVICING OPERATIONS

260. EMC acted as a servicer in connection with four of the Transactions at issue in this litigation. At the time of the Transactions, servicing was one of EMC's several business operations, and one that Bear Stearns featured prominently in its discussions with Ambac. As explained above, EMC also specialized in the acquisition, securitization, and disposition of mortgage loans. But by the time of the Asset Transfer in early 2011, JPMorgan Chase & Co. had shut down EMC's mortgage-loan acquisition and securitization operations. Servicing was EMC's last remaining business operation, and its servicing business constituted EMC's last remaining substantial asset.

### B. AMBAC'S CONTRACTUAL RIGHTS TO SUE ANY SUCCESSOR OF EMC

261. The Asset Transfer has resulted in JPMC Bank becoming liable to Ambac for all obligations of EMC, including the repurchase of all breaching loans, as EMC's successor under the "Successor and Assigns" provisions of the MLPAs governing the Transactions. Pursuant to Section 23 of the MLPAs for all of the Transactions, "[a]ny person into which [EMC] may be merged or consolidated (or any person resulting from any merger or consolidation involving [EMC]), any person resulting from a change in form of [EMC] or any person succeeding to the

business of [EMC], shall be considered a 'successor' of [EMC] hereunder and shall be considered a party hereto."

262. Because the servicing business was EMC's sole remaining ongoing operating business, when JPMC Bank succeeded to that business through the Asset Transfer, it succeeded to EMC's obligations with respect to the Transactions pursuant to the plain terms of the MLPAs.

### C. JPMORGAN CHASE & CO. EFFECTUATED A *DE FACTO* MERGER OF EMC AND JPMC BANK

263. In addition to making JPMC Bank EMC's successor by operation of these contractual provisions, the Asset Transfer orchestrated by the two entities' mutual parent company, JPMorgan Chase & Co., also resulted in JPMC Bank becoming liable for all of the obligations and liabilities of EMC – including with respect to all of the Transactions – by operation of law. Ultimate ownership of the servicing operations that EMC transferred remains unchanged: Both before and after the Asset Transfer, EMC and JPMC Bank were affiliates of the same banking family and ultimately owned by the same parent holding company, JPMorgan Chase & Co.

264. In addition, EMC has ceased independent business operations. Before being recently removed from the Internet, EMC's website described EMC as "a brand of JPMorgan Chase Bank, N.A.,"[182] and stated that "JPMorgan Chase Bank, N.A. services loans under the EMC Mortgage name."[183] EMC no longer services mortgage loans, and no longer engages in any other business operations.

---

[182] EMC Mortgage® A Brand of JPMorgan Chase Bank, N.A., https://www.emcmortgagecorp.com/EMCMORTGAGE/ (last visited July 18, 2011).

[183] EMC Mortgage® A Brand of JPMorgan Chase Bank, N.A., About Us, https://www.emcmortgagecorp.com/EMCMORTGAGE/MainContent/about_us.jsp (last visited July 18, 2011).

265. JPMC Bank has assumed the obligations necessary for the uninterrupted continuation of the operations performed by EMC prior to the Asset Transfer. Specifically, JPMC Bank has assumed EMC's obligations to service mortgage loans under the contracts governing various RMBS deals, including four of the Transactions at issue in this litigation.

266. JPMC Bank has retained EMC's management and personnel, as well as EMC's physical locations and, as noted, EMC's assets and general business operations. After the Asset Transfer, EMC's former management and personnel continue to handle the transferred servicing operations from the same business locations. EMC's former servicing operations located in Dallas, Texas − now belonging to JPMC Bank − are continuing to handle payment processing, borrower inquires, and related functions.[184]

267. In short, the Asset Transfer constituted a *de facto* merger of EMC and JPMC Bank, making JPMC Bank liable as a successor for all of EMC's obligations and liabilities by operation of law.

## FIRST CAUSE OF ACTION

**(Against Defendants JP Morgan, as successor to Bear, Stearns & Co., and EMC for Fraudulent Inducement)**

268. Plaintiff realleges and incorporates by reference paragraphs 1 through 267 of this Complaint.

269. As set forth above, Defendants JP Morgan (formerly Bear, Stearns & Co.) and EMC made materially false public statements, and omitted material facts, with the intent to defraud the public and Ambac.

[184] EMC Mortgage® A Brand of JPMorgan Chase Bank, N.A., Contact Us, https://www.emcmortgagecorp.com/EMCMORTGAGE/MainContent/contact_us.jsp (last visited July 18, 2011).

270. Defendants made materially false statements and omitted material facts with the intent to defraud Ambac in pre-contractual communications between Ambac and Defendants' officers and other employees.

271. Defendants, knowingly and with the intent to defraud, delivered to Ambac materially false and misleading documentation, including investor presentations, loan tapes, and Offering Documents, and fraudulently induced ratings by the rating agencies.

272. Ambac reasonably relied on Defendants' statements and omissions when it issued its Policies.

273. As a result of Defendants' statements and omissions, Ambac insured securities backed by pools of loans that had a risk profile far greater than Defendants led Ambac to believe.

274. As a result of Defendants' false and misleading statements and omissions, Plaintiff has suffered, and will continue to suffer, damages in an amount to be determined at trial.

275. Because Defendants committed these acts and omissions maliciously, wantonly, oppressively, and with knowledge that they would affect the general public – which they have – Plaintiff is entitled to punitive damages.

## SECOND CAUSE OF ACTION

**(Against Defendants JP Morgan, as successor to Bear, Stearns & Co., and EMC for Breaches of Representations and Warranties)**

276. Plaintiff realleges and incorporates by reference paragraphs 1 through 275 of this Complaint.

277. EMC induced Ambac to issue its Policies by, among other things, making the Loan-Level Warranties and Transaction-Level Warranties in the MLPAs.

278. Each MLPA is a valid and binding agreement between EMC and the Depositor of the Transactions.

279. Ambac is a third-party beneficiary of each MLPA.

280. EMC has materially breached the Transaction-Level Warranties set forth in Section 8(vii) of the MLPAs.

281. As a result of EMC's breaches, Ambac has been damaged and will continue to be damaged in an amount to be determined at trial.

## **THIRD CAUSE OF ACTION**

**(Against Defendants JP Morgan, as successor to Bear, Stearns & Co., and EMC for Breaches of the Repurchase Obligation)**

282. Plaintiff realleges and incorporates by reference paragraphs 1 through 281 of this Complaint.

283. EMC induced Ambac to issue its Policies by, among other things, making the Loan-Level Warranties and Transaction-Level Warranties in the MLPAs.

284. Each MLPA is a valid and binding agreement between EMC and the Depositor of the Transactions.

285. Ambac is a third-party beneficiary of each MLPA.

286. EMC has materially breached the Loan-Level Warranties set forth in Section 7 of the MLPAs.

287. EMC has materially breached its obligations under Section 7 of the MLPAs by refusing to cure or repurchase the loans that breached EMC's Loan-Level Warranties and with respect to which (i) EMC had discovered the breach or (ii) notice of breach has been provided by Ambac to EMC.

288. As a result of EMC's breaches, Ambac has been damaged and will continue to be damaged in an amount to be determined at trial.

## FOURTH CAUSE OF ACTION
**(Against Defendant JPMC Bank for Successor Liability)**

289. Plaintiff re-alleges and incorporates by reference paragraphs 1 through 288 of this Complaint.

290. JPMC Bank is liable for any and all damages resulting from the wrongful actions of EMC, as alleged herein, because as a matter of law JPMC Bank is the successor to EMC both contractually under the Transaction Documents and as a result of the *de* facto merger of JPMC Bank and EMC resulting from EMC's Asset Transfer to JPMC Bank on or about April 1, 2011, wherein JPMC Bank acquired all or substantially all of EMC's assets.

291. JPMC Bank is a person that has succeeded to the business of EMC. As a result, JPMC Bank is the successor to EMC under the MLPAs governing the Transactions and automatically became a party to the MLPAs in accordance with their terms at the time of the Asset Transfer.

292. In addition, JPMC Bank is the successor to all of the obligations and liabilities of EMC by operation of law as a consequence of the *de facto* merger of JPMC Bank and EMC resulting from the Asset Transfer.

293. After the Asset Transfer, there remains continuity of ownership of EMC and JPMC Bank. Both before and after the Asset Transfer, EMC and JPMC Bank were ultimately owned and controlled by the same parent holding company, JPMorgan Chase & Co.

294. EMC has ceased its ordinary business operations. After the Asset Transfer, JPMC Bank services loans under the "EMC Mortgage" name.

295. JPMC Bank has assumed the liabilities necessary for the uninterrupted continuation of the operations performed by EMC prior to the Asset Transfer. Specifically,

JPMC Bank has assumed EMC's obligations to service mortgage loans under the contracts governing various RMBS deals, including four of the Transactions at issue in this litigation.

296. JPMC Bank has retained EMC's management and personnel, as well as EMC's physical locations, assets, and general business operations. After the Asset Transfer, JPMC Bank has continued the servicing operations once belonging to EMC using EMC's employees, management, and facilities.

## PRAYER FOR RELIEF

**WHEREFORE**, Plaintiff respectfully prays for the following relief:

- For an award of all legal, equitable, and punitive damages, including all of Plaintiff's claims paid or due for payment in the future under its Policies, and any other present and future damages to be proven at trial, against Defendants for their fraudulent inducement of Ambac's participation in the Transactions and issuance of its Policies;

- For an award of compensatory, consequential, and/or equitable damages, including all of Plaintiff's claims paid or due for payment in the future under its Policies, and any other present and future damages to be proven at trial, against Defendants for their pervasive and material breaches of representations and warranties and failure to comply with their obligations to cure or repurchase the loans that breach these representations and warranties, constituting a material breach of the MLPAs, and frustration of the parties' bargain;

- For an order compelling EMC to comply with its obligations under MLPA § 7 in each Transaction to cure or repurchase the loans that breach its representations and warranties;

- For an Order of prejudgment interest;

- For an Order holding JPMC Bank liable as EMC's successor to pay in full any award of damages in this case for which EMC may be liable to Ambac; and

- For an Order awarding Plaintiff such other and further relief as the Court deems just and proper.

Dated: New York, New York
August 14, 2012

Respectfully Submitted,

Nicolas Commandeur (*ncommandeur@pbwt.com*)
PATTERSON BELKNAP WEBB & TYLER LLP
1133 Avenue of the Americas
New York, NY 10036-6710
Telephone: (212) 336-2000
Fax: (212) 336-2222

*Attorneys for Ambac Assurance Corporation and the Segregated Account of Ambac Assurance Corporation*