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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

AMBAC ASSURANCE CORPORATION and THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION, Plaintiffs, v. COUNTRYWIDE HOME LOANS, INC., COUNTRYWIDE SECURITIES CORP., COUNTRYWIDE FINANCIAL CORP., and BANK OF AMERICA CORP., Defendants.	Index No. _______________ **<u>COMPLAINT</u>**

Plaintiffs Ambac Assurance Corporation ("Ambac") and The Segregated Account of Ambac Assurance Corporation (the "Segregated Account," and together with Ambac, "Plaintiffs"), by and through their attorneys Patterson Belknap Webb & Tyler LLP, for their complaint against the defendants, Countrywide Home Loans, Inc. ("Countrywide Home Loans"), Countrywide Securities Corporation ("Countrywide Securities"), Countrywide Financial Corporation ("Countrywide Financial Corp.," and collectively with Countrywide Home Loans and Countrywide Securities, "Countrywide"), and Bank of America Corporation ("Bank of America," and together with Countrywide, "Defendants"), allege as follows:

NATURE OF THE ACTION

1. This is a case about fraud. Ambac Assurance Corporation seeks to right the wrongs perpetrated against it by Countrywide, a mortgage bank. Countrywide fraudulently induced Ambac to issue insurance policies that have and will require Ambac to make more than $600 million in claims payments on eight transactions. Ambac issued insurance policies based on the representations made to it by Countrywide. But like so many other market participants, Ambac did not know that Countrywide was engaged in an outrageous campaign of fraud.

2. In 2003, Countrywide was determined to set records for mortgage origination – to dominate the marketplace and become the biggest and most profitable mortgage banking operation in the United States. Today, in 2014, it is plain that Countrywide succeeded in setting records, but not those envisioned by its management:

- Countrywide's fraudulent conduct formed the basis for a $16.65 billion settlement with the United States Department of Justice ("DOJ"), the largest civil fraud settlement reached by the DOJ with a single entity in American history.[1]
- Countrywide's mortgage fraud also formed the basis for a $1 billion settlement with the U.S. Attorney for the Eastern District of New York, at that time the largest False Claims Act settlement relating to mortgage fraud in American history.[2]
- Countrywide's former Chief Executive Officer, Angelo Mozilo, paid a record $22.5 million penalty to the Securities and Exchange

[1] *Bank of America to Pay $16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis*, U.S. Department of Justice, Office of Public Affairs, Press Release, Aug. 21, 2014, http://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading.

[2] *$1 Billion to be Paid by the Bank of America to the United States Largest False Claims Act Settlement Relating to Mortgage Fraud*, U.S. Attorney, Eastern District of New York, Press Release, http://www.justice.gov/usao/nye/pr/2012/2012feb09.html.

> Commission ("SEC"), the largest penalty ever paid by a public company's senior executive in an SEC settlement.[3] Mozilo was also ranked as the second worst chief executive in the history of the United States by a national business magazine.[4]

3. None of this was known or indeed knowable to Ambac in 2005, when it began to insure the transactions that are at issue in this lawsuit. Over several years, Ambac met with Countrywide management repeatedly to learn about Countrywide's mortgage origination practices. Ambac carefully studied the statements made by Countrywide for use in disclosure documents that were filed with the SEC. Ambac took the loan-level data provided by Countrywide – data that Countrywide promised was true – and used it to model residential mortgage-backed securitization transactions in order to assess the risk of loss inherent in issuing insurance policies for those transactions. Ambac looked to the representations and warranties that Countrywide made about its loans: that there was no fraud in the loans' origination and that the loans were scrupulously originated in accordance with the underwriting guidelines.

4. At every turn, Countrywide's statements to Ambac were reassuring – but largely false. Countrywide told Ambac that its loan underwriting guidelines were conservative and rigorously followed, unless good reasons existed to depart from them. In reality, Countrywide made rampant "exceptions" to the guidelines, extending loans to borrowers who were not creditworthy so long as those loans could be dumped on unsuspecting buyers.

5. To cite a few examples, Countrywide told Ambac that it used impartial appraisers to ascertain the value of mortgaged properties. In reality, Countrywide went to great lengths to make certain that its appraisers danced to the tune of the loan officers.

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[3] *Former Countrywide CEO Angelo Mozilo to Pay SEC's Largest-Ever Financial Penalty Against a Public Company's Senior Executive*, U.S. Securities and Exchange Commission, Press Release, Oct. 15, 2010, http://www.sec.gov/news/press/2010/2010-197.htm.

[4] Alex Dobuzinskis, *Angelo Mozilo: From housing hero to subprime foe*, Reuters, Oct. 15, 2010, *available at* http://www.reuters.com/article/2010/10/15/us-sec-mozilo-newsmaker-idUSTRE69E5ZU20101015.

6. Countrywide told Ambac that it had fraud management and quality control procedures to root out improper origination practices. In reality, Countrywide's fraud prevention executives were fired for doing their jobs properly; those not fired were subservient to the leaders of the production divisions, who acted with contempt for anti-fraud measures. With neutered fraud prevention and quality control divisions, employee fraud ran rampant. Employees competed with each other for outsized compensation based on the volume of mortgage originations, without regard for credit quality.

7. In the wake of the financial crisis, Countrywide's fictions began to unravel, and now all know the truth. Governmental investigations and private lawsuits have led to the disclosure of a wealth of information about the enormity of Countrywide's deception. This lawsuit concerns the truth about Countrywide, and the lies Countrywide told Ambac to bury that truth.

8. Following the now-familiar pattern of victims of Countrywide's fraudulent practices seeking to be made whole for the harm suffered at Countrywide's hands, this case arises out of eight residential mortgage-backed securitization transactions (each a "Transaction," and collectively, the "Transactions") that closed between 2005 and 2007, which were backed in whole or in part by mortgage collateral originated by Countrywide.[5] Two of the Transactions (each a "Harborview Transaction," and collectively, the "Harborview Transactions") were underwritten by Greenwich Capital Markets, Inc., an affiliate of the Royal Bank of Scotland ("Greenwich" or "RBS Greenwich"), through an RBS Greenwich-affiliated shelf known as

[5]References to the conduct of "Countrywide" encompass Countrywide Financial Corp., Countrywide Home Loans, and Countrywide Securities.

Harborview Mortgage.[6] One of the Transactions, CWALT 2005-81, was underwritten by Goldman, Sachs & Co. ("Goldman Sachs"). Another of the Transactions, CWALT 2006-OA19, was underwritten by Countrywide Securities (together with CWALT 2005-81, the "CWALT Transactions"). Four of the Transactions (each a "Lehman Transaction," and collectively, the "Lehman Transactions") were underwritten by Lehman Brothers Inc. ("Lehman"), through a Lehman-affiliated shelf known as Lehman XS.[7]

9. Each of the Transactions involved the securitization of mortgage loan collateral, which is the aggregation of thousands of mortgage loans into one or more "pools" of loans. These pools of loans were sold to a trust specially created for the purpose of consummating a securitization transaction. The trust, in turn, issued securities – i.e., certificates or notes – that were to be paid from the cash flow generated by the pooled mortgage loans. Underwriters organized the securitizations and were responsible for the issuance of the securities. The securities in most of the Transactions were issued in several classes with different priorities of claims to the mortgage loan cash flows. To enhance the marketability of the notes, underwriters frequently contracted with financial guaranty insurance companies – commonly referred to as monolines – to issue insurance policies that guaranteed the payments due on various classes of the securities.

10. As part of the standard securitization process, Countrywide provided loan-level data that was used by the credit rating agencies (e.g., Standard & Poor's and Moody's) to analyze the transactions. Using the Countrywide data, the rating agencies determined that the certificate classes in the Transactions insured by Ambac posed the lowest possible risk of having

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[6]The Harborview Transactions are: (1) Harborview Mortgage Loan Trust 2005-16; and (2) Harborview Mortgage Loan Trust 2006-9.

[7]The Lehman Transactions are: (1) Lehman XS 2005-7N; (2) Lehman XS 2006-2N; (3) Lehman XS 2007-7N; and (4) Lehman XS 2007-15N.

shortfalls in the cash flow used to pay noteholders, with Standard & Poor's rating each as "AAA" even without the benefit of Ambac's insurance policies. This meant that Ambac agreed to insure portions of transactions that were viewed by market participants as being comparatively safe relative to other structured finance investments.

11. All of the Countrywide mortgage loans used as collateral in the Transactions are a particular type of mortgage known as a negative amortization (or "NegAm") mortgage. Amortization is the process of paying off debt over time. While a borrower who has a traditional mortgage gradually pays off his or her loan balance by making monthly payments of principal and interest (i.e., the loan is self-amortizing), a borrower with a negative amortization mortgage makes monthly payments for an initial time period that do not cover the interest owed for that month. As a result, a borrower with a negative amortization mortgage sees his or her principal loan balance increase during that initial time period. This arrangement is used during an introductory period of an agreed-upon duration so as to permit the borrower to make a lower monthly payment than will be required after the loan "recasts" and becomes self-amortizing. Borrowers who have negative amortization mortgages may experience a "payment shock" because their monthly payments will increase when the initial low-rate period concludes and their mortgages become self-amortizing. As a result, the underwriting of such mortgage loans must be conservative and attuned to the risk of payment shock.

12. The Countrywide negative amortization mortgage collateral involved in the Transactions was referred to by Countrywide as "PayOption ARM NegAm" collateral. An "ARM" is an adjustable rate mortgage, which means that the mortgage's interest rate changes during the life of the mortgage loan. By contrast, a traditional fixed-rate self-amortizing mortgage loan has a specified interest rate that does not change over the life of the mortgage

loan. In the case of the mortgages included in the Transactions, the interest rate adjusted annually after the conclusion of a low-interest rate "teaser" period. The "Option" feature of the mortgage program allowed borrowers to decide whether to make only the minimum payment (thereby allowing the mortgage to negatively amortize) or to make greater payments that would permit earlier amortization of the loan.

13. Countrywide made specific representations about its NegAm PayOption ARM program to Ambac during the time period relevant to this lawsuit. Countrywide assured Ambac that it did not let borrowers use the product to buy homes that they could not otherwise afford. Countrywide told Ambac that borrowers were qualified at the fully amortizing rate and would be able to make loan payments after the mortgage rates reset. Most notably, Countrywide told Ambac that PayOption loans performed twice as well as traditional, fixed-rate mortgages.

14. In reality, none of this was true. Worse still, Countrywide knew to a certainty that none of this was true when it made these encouraging representations to Ambac. Countrywide executives knew that PayOption ARMs were the riskiest product on the market. CEO Angelo Mozilo himself knew that borrowers were lying about their income and that they would not be able to make their payments after the mortgage rates reset. Countrywide executives instructed their employees that the PayOption ARM program non-owner-occupied properties were so toxic that every single one should be sold. Even knowing all of these facts, Countrywide's chief of loan production urged that origination standards be lowered even further in order to increase loan volume. As Mozilo recognized in an e-mail to his colleagues, Countrywide was "flying blind on how these loans will perform" in the future. Not a single word of this distressing forecast was disclosed to Ambac.

15. Based on Countrywide's lies – its fraudulent representations and

omissions to Ambac in meetings, public statements, and Prospectus Supplements – Ambac was induced to issue financial guaranty insurance policies (collectively, the "Policies") covering the payments due on certain classes of the securities issued in the Transactions. Countrywide further induced Ambac to issue the Policies by providing detailed statistical data about each of the loans that were in the Transactions. The information about Countrywide's origination processes and the information about the loans in the Transactions was false and misleading. Had Ambac known the truth about Countrywide's deception, it would never have insured the Transactions.

16. Based on Countrywide's historic fraud, Plaintiffs seek from Countrywide damages sufficient to place Ambac in the same position that it would have been in had it not insured the Transactions.

THE PARTIES

17. 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").

18. 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").

19. 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 Wis. Stat. § 645.33(1), the Commissioner has appointed a full-time Special Deputy Commissioner to rehabilitate the Segregated Account.

20. Ambac Assurance Corporation is a Wisconsin corporation which 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.

21. Defendant Countrywide Home Loans is a New York corporation with its principal executive offices in Calabasas, California. Countrywide Home Loans is a wholly owned subsidiary of Countrywide Financial Corp. Countrywide Home Loans supplied all of the loans supporting the Harborview and CWALT 2005-81 certificates insured by Ambac, and a significant portion of the loans supporting the CWALT 2006-OA19 and Lehman certificates insured by Ambac.

22. Defendant Countrywide Securities, a wholly owned subsidiary of Countrywide Financial Corp., is a California corporation with its executive offices in Calabasas, California. Countrywide Securities is or was a registered broker-dealer and acted as an underwriter for the CWALT 2006-OA19 Transaction.

23. Defendant Countrywide Financial Corp. is a Delaware corporation with its principal executive offices in Calabasas, California. Countrywide Financial Corp., itself or through its subsidiaries, was engaged in mortgage lending and other real-estate-finance-related business, including mortgage banking, securities dealing, and insurance underwriting.

24. Defendant Bank of America is a Delaware corporation with its principal executive offices in Charlotte, North Carolina. The three Countrywide entities involved with the Transactions – Countrywide Home Loans, Countrywide Securities, and Countrywide Financial Corp. – became wholly owned subsidiaries of Bank of America following the merger of Countrywide Financial Corp. into a Bank of America subsidiary on July 1, 2008. Bank of America is a successor-in-interest to Countrywide's liabilities, and Bank of America and Countrywide are alter egos of one another.[8]

JURISDICTION AND VENUE

25. This Court has original jurisdiction over this action pursuant to N.Y. C.P.L.R. 301 and 302. Countrywide Home Loans, Countrywide Securities, Countrywide Financial Corp., and Bank of America are registered or licensed to do business within New York and have agreed to the jurisdiction of this Court within the State over matters arising out of their activities within the State. Each has or had offices and regularly transacts or transacted business within the State. Each 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 themselves occurred within the State.

26. Venue is proper in this Court pursuant to N.Y. C.P.L.R. 503(a) and (c).

FACTUAL ALLEGATIONS

A. The Rise And Fall Of Countrywide

1. *Countrywide Rises To Prominence And Profit*

27. In the early- to mid-2000s, Countrywide was widely considered to be –

[8] A California federal court noted that "Countrywide's remaining operations and employees have been transferred to Bank of America, and Bank of America ceased using the Countrywide name in April 2009." *Securities and Exchange Commission v. Mozilo*, No. 09-CV-3994, slip op. at 3 n.2 (C.D. Cal. Sept. 16, 2010) (hereinafter "*SEC v. Mozilo*").

and touted itself as – the premier mortgage company. Others in the mortgage industry believed that Countrywide could be relied upon for high-quality mortgage loans and that the company was a financially healthy and responsible counterparty in business dealings. Countrywide capitalized on this trust, and business boomed: Countrywide Home Loans, the primary mortgage lending subsidiary of parent company Countrywide Financial Corp., increased loan originations from $242 billion to over $421 billion between 2002 and 2006, and in the same time span its pre-tax profit grew by more than 210%. Countrywide Financial Corp. as a whole profited even more handsomely: total mortgage loan originations grew from $251 billion to over $468 billion, and pre-tax profit increased by more than ***300%***.

28. These ballooning profits were the product of a single-minded campaign to corner the mortgage market. In 2003, Countrywide had endeavored to increase its market share from 13% to an ambitious 30% in just three years, and the ensuing years saw a number of changes to the traditional Countrywide model – implemented from the top of the company all the way down – aimed at achieving this goal. As described in more detail below, changes were made to loan programs, documentation requirements, exception approval processes, and various safeguards, and Countrywide was aware that these changes often had negative consequences for loan quality.

29. For example, Countrywide Home Loans' Consumer Markets Division sought to meet its 2004 goal of 20% growth in purchase market share by adopting a policy that required it to price and originate "all saleable loans." This was despite an internal finding by Countrywide that "[c]ontrols over underwriting policy exceptions ***do not sufficiently mitigate the credit portfolio risk,*** **"** in part because "exceptions are considered/granted without verification

of loan data."[9] Years later, senior management continued to express concern that exceptions to the guidelines were being granted and loans originated without "actual underwriting," and approved "regardless of performance," as long as the company could sell the loans.[10]

30. When Countrywide's loosening (or abandonment) of guidelines and safeguards failed to produce enough loans at the frantic pace required to meet the aggressive market share goals laid down by senior management, employees needed to turn to other solutions. These ranged from data "adjustments," to ensure a borrower was approved by the automated underwriting system even if he or she was not eligible for a loan, to outright forgery and fraud.

31. Countrywide's actual policies were invisible to its many counterparties. While Countrywide's *official* guidelines and stated lending criteria were sometimes accessible to counterparties such as Ambac, its secret *internal* policies – such as making loans regardless of the borrowers' ability to repay, or avoiding defaults by serially refinancing a borrower's loan based on inflated property valuations and credit characteristics – were concealed.

2. *Countrywide Falsely Claimed That Its Growth Would Not Affect Loan Quality*

32. In reaching for its goal of market domination, Countrywide grew its mortgage loan originations by underwriting loans under standards that differed diametrically from Countrywide's public characterization of its mortgage lending practices and its own written underwriting guidelines. Countrywide's repeated public statements, including those made in Transaction documents, constructed a Potemkin Village of prudent mortgage banking, built upon a foundation of fraud, misrepresentations and deception.

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[9] *MBIA Ins. Corp. v. Countrywide Fin. Corp.*, No. 602825-2008 (N.Y. Sup. Ct.) (hereinafter "*MBIA*"), Aff. of Manisha Sheth in Opp. to Countrywide's Mot. for Summ. J. filed Oct. 19, 2012 ("Sheth Aff.") Ex. 139 (Oct. 19, 2004 CMD Audit Report) at 5 (emphasis added).

[10] *MBIA*, Sheth Aff. Ex. 64 (Transcript of Jens Christian Ingerslev Deposition, May 20, 2011) at 462-64.

33. Before 2003, Countrywide made primarily traditional first-lien loans to highly creditworthy individuals. At that time, Countrywide's market share was 13%. In 2003, however, Countrywide's Chief Executive Officer, Angelo Mozilo, implemented an aggressive growth strategy, calling for Countrywide to capture an unprecedented 30% of the national residential loan market. Mozilo announced this directive during a July 22, 2003 conference call with analysts, stating that Countrywide's goal was "to dominate the purchase market and to get [Countrywide's] overall market share to the ultimate thirty percent by 2006-2007."

34. Countrywide and Mozilo repeatedly claimed that this focus on growth would not come at the expense of loan quality:

- During a January 2004 analyst conference call, Mozilo stated that "going for 30% mortgage share here is totally unrelated to quality of loans we go after . . . . There will be no compromise in that as we grow market share."

- On a March 15, 2005 analyst conference call, Mozilo again represented that "under no circumstances will Countrywide ever sacrifice sound lending and margins for the sake of getting to that 30% market share."

- In a July 26, 2005 earnings call, Mozilo claimed that he was "not aware of any change of substance in [Countrywide's] underwriting policies" and that Countrywide had not "taken any steps to reduce the quality of its underwriting regimen."

- At an investor forum in 2006, Mozilo boasted of Countrywide's position as an industry leader and a role model, stating: "We take seriously the role as responsible lender for all of our constituencies . . . . To help protect our bondholder customers, we engage in prudent underwriting guidelines."

35. Similarly, in its filings with the SEC, Countrywide touted the strength of its underwriting, quality control, and fraud detection systems. In these filings, Countrywide portrayed its underwriting process as tightly controlled and "designed to produce high quality loans" through a rigorous pre-funding screening procedure and post-funding auditing, appraisal,

and underwriting reviews.

36. For example, in its Annual Report filed with the SEC for 2007 (Form 10-K), Countrywide represented that it ensured compliance with its underwriting standards through various control procedures:

> We help to ensure that our origination standards are met by employing accomplished and seasoned management, underwriters and processors and through the extensive use of technology. We also employ proprietary underwriting systems in our loan origination process that improve the consistency of underwriting standards, assess collateral adequacy and help to prevent fraud, while at the same time increasing productivity.
>
> We supplement our loan origination standards and procedures with a post-funding quality control process. Our Quality Control Department is responsible for completing loan audits that may consist of a re-verification of loan documentation, an underwriting and appraisal review, and, if necessary, a fraud investigation. We also employ a pre- and post-funding proprietary loan performance evaluation system. This system helps to identify fraud and poor performance of individuals and business entities associated with the origination of our loans. The combination of this system and our audit results allows us to evaluate and measure adherence to prescribed underwriting guidelines and compliance with laws and regulations.[11]

37. Countrywide made similar statements in the offering documents for the securities like those at issue in this case, including documents that Countrywide knew would induce investors and insurers to enter into transactions with Countrywide or into transactions supported by Countrywide collateral. As described more fully below, in the Prospectus Supplements filed with the SEC for each Transaction in this lawsuit, Countrywide projected a false image of (i) the underwriting procedures it utilized for origination of loans, (ii) the material

[11] Countrywide Financial Corp., Annual Report for Fiscal Year 2007 (Form 10-K), at 117-18 (February 29, 2008). Countrywide's Form 10-Ks for fiscal years 2006 and 2005 contain representations that are substantively identical. *See* Countrywide Financial Corp., Annual Report for Fiscal Year 2006 (Form 10-K), at 100-01 (March 1, 2007); Countrywide Financial Corp., Annual Report for Fiscal Year 2005 (Form 10-K), at 93 (March 1, 2006).

characteristics of the loans included in the securitizations, and (iii) the material risks relating to investing in the securities.

3. *The Financial Crisis Arose From – And Ended – Countrywide's Fraud*

38. Countrywide could mask these abuses while the real estate bubble expanded, inflated in large part by Countrywide's own supply of easy money (and enormous fees for itself) in a cycle of cash-out refinances and speculative purchase transactions. As one employee later reflected, if you had a pulse, Countrywide gave you a loan.[12] Yet internal concerns over credit quality mounted as time progressed. Employees pushed to originate new loans in "the proverbial race to the bottom," as a former finance executive at Countrywide described one of the company's policies.[13] At the same time, senior Countrywide managers began to express concern that the loans being originated were of poor quality – "very dicey assets" according to Countrywide's Chief Credit Officer[14] – and more importantly, that these bad loans might remain on Countrywide's books instead of being sold into a securitization. However, the concerns of Countrywide's credit risk department were repeatedly ignored by the loan production departments, which kept pushing through riskier policies and loans.[15] Indeed, the "license" given from Mozilo himself was to "be aggressive . . . to gain market share."[16] In

[12]Statement of former Countrywide loan officer, Kourosh Partow, Dateline NBC: Inside the Financial Fiasco (NBC television broadcast Mar. 27, 2009).

[13]Third Am. Complaint ¶ 15, *American International Group, Inc. v. Countrywide Financial Corp.*, 2:11-cv-10549-MRP-MAN (C.D. Cal., filed Oct. 10, 2013) (hereinafter "*AIG v. Countrywide*").

[14]*MBIA*, Sheth Aff. Ex. 197 (Email from John McMurray to Kevin Bartlett, dated Dec. 17, 2006) at 1.

[15]*See, e.g.*, *MBIA*, Sheth Aff. Ex. 199 (Internal Audit review of Enterprise Wide Business Development and Product Management, dated Sept. 30, 2006, which rates as "moderate risk" the fact that "[f]ormal escalation procedures for new products or product changes allow the Chief Production Officer to summarily override any objections by the Chief Credit Officer"); *MBIA*, Sheth Aff. Ex. 208 (Email from John McMurray to David Sambol, dated Nov. 16, 2006, giving example of a product that proceeded without the required risk approvals or in contradiction of established policy); *MBIA*, Sheth Aff. Ex. 64 (Transcript of Jens Christian Ingerslev Deposition, May 20, 2011) at 380-381.

[16]*MBIA*, Sheth Aff. Ex. 64 at 512-513.

lieu of avoiding bad loans, Countrywide chose to reduce its risk by moving bad loans from its own balance sheet by selling them into securitization pools, enabling Countrywide to transfer the risk of default to unwitting market participants.

39. When the housing market collapsed – an event caused in part by Countrywide itself – Countrywide no longer could refinance unfit borrowers into new loans, and borrowers no longer could flip their mortgaged properties to avoid defaults. Thus, Countrywide's scheme finally came to an end.

40. As a consequence of Countrywide's unscrupulous practices, billions of dollars' worth of Countrywide mortgage loans have defaulted since late 2007, and loans continue to default to this very day. This disaster has inflicted massive damage on all investors with direct and indirect interests in Countrywide-originated loans, as well as on the global financial system.

41. Indeed, Countrywide's conduct has harmed the entire national economy. The mortgage meltdown and resulting recession in the United States starting in 2008 were largely caused by reckless mortgage origination and securitization practices, and as the nation's largest mortgage originator, Countrywide led the race to the bottom. Notwithstanding Countrywide's role in causing the financial crisis, Countrywide executives concluded in a November 2007 internal memo that due to the "huge upside in good times," "[n]et/net it was probably worth it."[17]

B. Countrywide's Representations To Ambac

1. *Representations At Meetings With Ambac*

42. Ambac had an extensive history of dealing with Countrywide and its affiliates. Like many other market participants, Ambac only learned of Countrywide's fraud

[17] Third Am. Complaint ¶ 14, *AIG v. Countrywide*.

well after the financial crisis began. It was not for lack of trying, however, as Ambac took many steps to learn about Countrywide's mortgage banking and securitization business.

43. In the years preceding the Transactions, Ambac conducted comprehensive operational due diligence of Countrywide, which included, among other things, a detailed review and commitment to understand Countrywide's origination, underwriting and servicing practices. During the period from 2004 to 2007, Ambac regularly communicated with Countrywide's executives and visited Countrywide's headquarters in Calabasas, California to conduct in-person due diligence meetings with Countrywide's management.

44. In face-to-face due diligence meetings between the companies' executives, Countrywide consistently misrepresented the rigor of its credit risk management and underwriting practices. At these due diligence meetings – which took place, among other times, in July 2004, November 2004, April 2005, September 2005, February 2006, August 2006, and February 2007 – Countrywide executives educated Ambac employees about Countrywide's underwriting and other loan origination processes, appraisal practices, quality control procedures, and legal and regulatory compliance. Several of the due diligence meetings in which Countrywide paraded its underwriting conservatism are described in greater detail below.

45. On July 20, 2004, Ambac conducted a thorough due diligence of Countrywide's mortgage loan origination and servicing practices, which, among other things, included a detailed review of underwriting practices and quality control processes, as well as a financial review of Countrywide and its related entities. During this July 2004 due diligence meeting, Countrywide executives portrayed the company as a sophisticated and responsible lender with a seasoned management team that primarily targeted "A" quality borrowers. Countrywide executives praised Countrywide's purportedly disciplined underwriting standards,

including the assertions that all loan-approval processes were centralized and any exceptions to the underwriting guidelines were reviewed and approved by authorized and senior underwriters.

46. On November 11, 2004, executives from Ambac's underwriting, surveillance and risk management departments returned to Countrywide for another comprehensive operational due diligence visit. During the November 2004 due diligence visit, Countrywide executives, including Chief Credit Officer (and later Chief Risk Officer) John McMurray, again touted the quality of their mortgage origination process. Countrywide executives described the company's conservative risk management practices, emphasizing that the company would rather price itself out of the market than sacrifice its underwriting standards. In addition, Countrywide executives flaunted their sophisticated automated underwriting and modeling capabilities. Countrywide executives from Product Management (who oversaw the various loan programs and the applicable underwriting guidelines used by the production departments) informed Ambac that Countrywide's selection process produced higher quality Option ARMs and Interest Only loans from sophisticated borrowers. In addition to meeting multiple Countrywide executives from Compliance, Credit Risk, Product Management, and Servicing, Ambac also requested various manuals and reports, including Countrywide's underwriting guidelines, which Ambac underwriters reviewed.

47. In 2005, Countrywide executives continued to extol the company's purportedly conservative underwriting standards, expertise and sophisticated capabilities in loan origination and servicing. The meetings concerned various collateral types, including first-lien and second-lien mortgages, as well as Option ARM collateral. For example, an internal Ambac memorandum concerning Ambac's credit decision on the CWALT 2005-81 Transaction describes a September 20, 2005 operational due diligence meeting attended by two Ambac

underwriters and a senior credit officer. The memorandum describes the meeting as follows:

> Among others[, the Ambac employees] met with the chief credit officer of Countrywide Financial Corp, John P. McMurray. Overall, the results of the meeting were very positive highlighting [Countrywide Financial Corp.'s] conservative credit approach in mortgage originations and quality and corporate controls.
>
> We openly shared opinions about market assessment, credit risk, origination practices and product development. Their underwriting process is intended to assess the applicant's credit standing and repayment ability, and the value and adequacy of the real property as collateral for the proposed loan. Exceptions to their underwriting guidelines are made only by senior officers when compensating factors are present. These factors include the borrower's employment stability, favorable credit history, equity in the related property, and the nature of the underlying first mortgage loan.
>
> Countrywide follows a conservative approach in qualifying borrowers for Option-ARMs at the fully-indexed rate . . . . In order to qualify for a first lien (including Option ARMs), the borrower should have sufficient monthly income to maintain credit obligations deriving not only from the first lien but also from any second lien mortgages (i.e. they qualify the first using both the first and second lien payments)[.]
>
> We believe that CFC's credit management is conservative and qualified as it relates to mortgage origination practices and credit quality controls.

48. During the September 2005 meeting, Countrywide executives assured Ambac that Countrywide was cognizant of the potential property bubbles and risks associated with negative amortization products. Countrywide again assured Ambac that it would sooner price itself out of the market than originate risky loans. Countrywide's management also emphasized its sophisticated systems and access to extensive historic information, which allowed the lender to stay ahead of the market. Countrywide executives assured Ambac that Countrywide's focus remained on internal controls and fraud prevention and detection.

49. In 2006, Countrywide executives persisted in their false claims of

disciplined underwriting standards and rigorous credit management. On or about February 3, 2006, Ambac employees performed further operational due diligence on Countrywide with a focus on the origination and securitization practices for second-lien home equity line of credit ("HELOC") and PayOption ARM loans. During the February 2006 meeting, Countrywide again highlighted its conservative credit approach and quality controls. Countrywide executives continued touting the company's underwriting process and claimed that exceptions to the underwriting guidelines were made only by senior underwriters when compensating factors were present.

50. In August 2006, Ambac conducted two operational due diligence visits to Countrywide. On August 10, 2006, Ambac performed a thorough due diligence review of Countrywide's servicing practices. During the servicing review, Countrywide executives discussed, among other product types, PayOption ARM collateral, and gave a detailed PayOption ARM product presentation to Ambac. In the presentation, Countrywide claimed that it responsibly marketed the PayOption ARM program to borrowers who had the financial ability to repay the loans. According to the presentation, Countrywide's underwriting guidelines and qualification standards prevented borrowers from using this product to buy homes they could not otherwise afford. Countrywide claimed that the guidelines provided flexibility to borrowers without adding "unreasonable risk." The presentation stated that borrowers were qualified using a fully amortizing payment, thus making a potential payment shock less severe than that associated with traditional ARM products. The presentation praised the performance history of the PayOption ARM product, claiming not only that the performance was "much better" than other comparable fixed rate and adjustable rate mortgage products, but also that the PayOption ARM product performed "twice as well" as fixed rate collateral.

51. A week later, on August 17, 2006, Countrywide executives reiterated to Ambac the benefits of the PayOption ARM program and Countrywide's conservative underwriting guidelines and qualification standards for the program. Countrywide's Executive Vice President of Credit Risk Management Christian Ingerslev explained the qualification process for PayOption ARM borrowers as involving a fully amortizing payment resulting in reduced future payment shock. Ingerslev also informed Ambac executives, including Ambac's Chief Credit Officer William McKinnon and managing director Iain Bruce (who oversaw Ambac's RMBS business), that the PayOption ARM product was correlated with high value homes.

52. When Countrywide executives provided Ambac inaccurate and misleading information concerning PayOption ARM loans and other negative amortization products, Countrywide was aware that Ambac relied on the information provided by Countrywide when assessing the credit risk inherent in the securitizations containing this type of collateral. As early as April 2005, Countrywide executives were aware that Ambac was analyzing transactions consisting of Countrywide's negative amortization collateral. In fact, in advance of its April 4, 2005 due diligence visit to Countrywide, Ambac requested the performance history of Countrywide's negative amortization products. Subsequent to the April 2005 requests, Countrywide continuously provided information about PayOption ARM and other negative amortization products to Ambac. Countrywide encouraged Ambac to rely, and was aware that Ambac in fact relied, on information that Countrywide provided during its meetings and other communications with Ambac.

53. In 2007, when conditions in the mortgage market began to change, Countrywide's message to the market, including Ambac, was that stricter credit guidelines had

been implemented and that the performance of the 2007 vintage was expected to improve due to revised underwriting guidelines. In February 2007, during Ambac's due diligence meetings, Countrywide executives informed Ambac of the newly instituted procedures in the Product Resolution Group designed to reduce the number of fraudulent loans. Countrywide executives continued assuring Ambac that Countrywide's focus remained on improving underwriting and quality of the funded loans. In emphasizing the investor community's trust in Countrywide and the company's new protective methods, such as the use of additional mortgage insurance on a loan- and pool-wide basis, Countrywide executives deliberately withheld true mortgage performance data from Ambac.

54. Over the course of several years, Countrywide made regular presentations to Ambac employees at meetings held at Countrywide's headquarters as part of Ambac's operational due diligence. As discussed above, and as contemporaneously documented in Ambac's internal memoranda, at these meetings Countrywide boasted about its conservative approach to origination and quality of corporate controls, and encouraged Ambac to rely upon information that Countrywide provided at these meetings in order to secure Ambac's participation in Countrywide's giant securitization machine.

2. *Countrywide's False Representations In Prospectus Supplements And Loan Tapes*

55. Despite repeatedly seeking, and obtaining, assurances from Countrywide that its origination practices and loan production were as advertised, Ambac did not rely only on its extensive operational due diligence of Countrywide. Ambac also studied and relied upon the representations made by Countrywide under penalty of law in the Prospectus Supplements for the Transactions. The representations included thorough summaries of loan origination practices and underwriting guidelines. In addition, the Prospectus Supplements contain detailed

descriptions of the securitized loans, including group-level information about the occupancy status of borrowers, loan-to-value ratios and, in some cases, debt-to-income ratios.

56. Furthermore, Ambac relied on the detailed, loan-level information provided by Countrywide in mortgage loan "tapes." The tapes are large spreadsheets that purported to contain true and accurate information concerning the proposed loan pools, including key metrics for assessing the borrowers' ability to repay their loans and the sufficiency of the underlying properties as collateral. It is widely understood in the industry that these loan tapes are used by all market participants – investors, rating agencies, and insurers – to model and understand the collateral that is backing a given transaction, as well as the transaction's structural elements. Countrywide routinely made contractual representations to its counterparties that the information contained in these documents was true, accurate and correct.

57. Countrywide intended purchasers of the loans it originated and acquired to rely on the information from the loan tapes to analyze the risks of and pricing for the proposed Transactions. Ambac did rely on this information. Countrywide knew or should have known – in view of its knowledge of pervasive fraud – that the information on the mortgage loan tapes provided for the Transactions was materially false and misleading.

58. In addition, Countrywide knew or should have known that the credit rating agencies also relied on the accuracy of the mortgage loan tapes. Countrywide benefited when transactions including its loans were highly rated by Standard & Poor's and Moody's because this enhanced the transactions' marketability to investors and thereby increased the demand for Countrywide mortgage loan collateral. The AAA "shadow ratings" bestowed by these agencies on the Transactions that included Countrywide collateral, which represented the rating agencies' performance expectations for the securities if no financial guaranty policy were obtained, also

helped make the Transactions more appealing to Ambac, because the high ratings indicated that the risk of loss on these Transactions was relatively low.

a. *<u>Harborview Prospectus Supplements And Loan Tapes</u>*

59. The Prospectus Supplements for the Harborview Transactions were filed with the SEC by Greenwich, but Greenwich was given a summary of the supposedly applicable underwriting guidelines by Countrywide for inclusion in the Harborview Prospectus Supplements.[18] Countrywide's representations of stringent underwriting practices, reflected there and elsewhere, induced Ambac to insure ultimately disastrous transactions backed by Countrywide collateral. In light of its wholesale abandonment of reasonable underwriting standards, Countrywide knew that its representations were false and misleading.

60. The Prospectus Supplement for the Harborview 2005-16 Transaction provides a representative sample of the deceptive statements Countrywide was making to Harborview Transaction investors regarding its underwriting guidelines. The exacting underwriting standards described in the document bear no relation to the turnstile approach employed by Countrywide.

61. The Harborview 2005-16 Prospectus Supplement begins by setting forth a description of "the underwriting guidelines used for mortgage loans originated by Countrywide."[19]

62. The Prospectus Supplement explains that Countrywide's guidelines are intended "to evaluate the prospective borrower's credit standing and repayment ability and the value and adequacy of the mortgaged property as collateral."[20] It then states, falsely, that "[a]ll

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[18]See Harborview 2005-16 Prospectus Supplement at S-69-73; Harborview 2006-9 Prospectus Supplement S-63-67.
[19]Harborview 2005-16 Prospectus Supplement at S-68.
[20]*Id.* at S-69.

of the mortgage loans originated or acquired by Countrywide have been originated or acquired in accordance with its credit, appraisal and underwriting standards."[21] Although Countrywide acknowledges that certain exceptions may be made to the guidelines, it claims that this would be permitted only "if compensating factors are demonstrated by a prospective borrower."[22] In practice, Countrywide routinely allowed exceptions whether compensating factors existed or not.

63. The Prospectus Supplement describes a variety of guidelines purportedly followed by Countrywide to assess the borrower's repayment ability. For example, it states that "Countrywide generally requires a description of income,"[23] and that Countrywide requires verification of income through "pay stub[s] and/or W-2 forms" when required by Countrywide's underwriting guidelines.[24] It states that "[f]or all mortgage loans originated or acquired by Countrywide, Countrywide obtains a credit report relating to the applicant from a credit reporting company" and that "[a]ll adverse information in the credit report is required to be explained by the prospective borrower to the satisfaction of the lending officer."[25] Given Countrywide's abandonment of its underwriting standards in practice, the summary of the guidelines Countrywide presented on paper provided false comfort to investors and insurers regarding the quality of Countrywide loans.

64. The Harborview 2005-16 Prospectus Supplement also states that Countrywide originated or acquired loans according to either its "Standard Underwriting Guidelines . . . which are consistent in many respects with the guidelines applied to mortgage

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[21] *Id.* at S-69.
[22] *Id.* at S-70.
[23] *Id.* at S-69.
[24] *Id.* The Prospectus Supplement explains that in certain circumstances Countrywide would allow borrowers to apply for a loan under one of several streamlined documentation processes.
[25] *Id.* at S-70.

loans purchased by Fannie Mae and Freddie Mac,"[26] or under "Expanded Underwriting Guidelines" which were purportedly applied in circumstances in which the mortgage loans "have higher Loan-to-Value Ratios" or "higher debt-to-income ratios."[27] These categorizations provided a misleading account of the stringency of Countrywide's actual underwriting practices.

65. Countrywide also made representations for inclusion in the Prospectus Supplement as to the practices it used to ensure that the mortgaged properties are adequate as collateral. The Prospectus Supplement states:

> Except with respect to mortgage loans originated pursuant to its Streamlined Documentation Program, Countrywide 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. . . . . All appraisals are required to conform to Fannie Mae and Freddie Mac appraisal standards then in effect.[28]

66. As will be discussed below, Countrywide routinely used appraisers who lacked independence and who were pressured to provide appraisals to support imprudent mortgage origination. Worse still, Countrywide executives were aware of these practices and did nothing sufficient – and often nothing at all – to stop it.

67. The Harborview 2005-16 Prospectus Supplement also contains Countrywide's representation that for mortgage loans originated by a third party, Countrywide "conducts a quality control review of a sample of the mortgage loans" to ensure that they comply with Countrywide's underwriting guidelines.[29] In practice, Countrywide's quality control process was wholly inadequate, and wholesale exceptions were frequently granted to high-volume third party originators, as will be explained below.

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[26] *Id.* at S-70.
[27] *Id.* at S-72.
[28] *Id.* at S-70.
[29] *Id.* at S-69.

68. Ambac relied on the accuracy of Countrywide's repeated representations of its purportedly stringent underwriting standards in deciding to insure certificates backed by Countrywide collateral. Ambac was unaware that Countrywide's undisclosed abandonment of underwriting standards had resulted in securitized Harborview pools being replete with loans made to borrowers with little or no ability to repay.

69. At the same time that Countrywide was misleading investors through false representations in prospectus supplements, it also was deceiving Ambac by providing false and misleading loan level data to Greenwich, who, as Countrywide knew, would provide that false information to investors and to insurers like Ambac, for use in determining whether to participate in transactions backed by Countrywide loans. While being solicited to bid to insure the Harborview Transactions, Ambac also received mortgage loan tapes for the Harborview Transactions from Greenwich containing loan-level data supplied by Countrywide. Countrywide understood that demand for its loans would dry up if monoline insurers like Ambac refused to insure Countrywide-backed transactions, which they indeed would have refused to do had they accurately understood the poor quality of the Countrywide collateral. Investors surely would have declined to buy such certificates if they had known the full story.

70. The Prospectus Supplements also contained transaction- and group-level data on several characteristics of the securitized loans, including the borrower's occupancy status and the loan-to-value ratio ("LTV") of the loans, that are key to accurately assessing the loans' risk of default. The representations in the Prospectus Supplements for the Harborview Transactions regarding occupancy and loan-to-value ratio are summarized in the chart below:

Transaction	Loan Group	Occupancy Status			Weighted Average LTV
		Primary	Investor	Second	
Harborview 2005-16	1	43.25%	44.73%	12.02%	77.97%
Harborview 2005-16	2	80.58%	12.83%	6.60%	77.40%
Harborview 2005-16	3	80.90%	13.73%	5.37%	75.63%
Harborview 2005-16	4	55.85%	8.98%	35.18%	77.37%
Harborview 2006-9[30]	2	89.97%	5.81%	4.23%	75.22%

71. Countrywide provided the detailed loan information necessary to compile this data for the Harborview Prospectus Supplements, and in an Indemnification Agreement executed at the close of each Harborview Transaction, it agreed to indemnify RBS Greenwich for claims arising out of certain information supplied by Countrywide. For Harborview 2005-16, Countrywide agreed to indemnify RBS Greenwich for "any material misstatement or omission contained in the Prospectus Supplement regarding information or statistics therein regarding the Mortgage Loans" based on information provided by Countrywide. For Harborview 2006-9, Countrywide agreed to indemnify RBS Greenwich for information it provided for the Prospectus Supplement regarding its origination and servicing practices, and for "static pool data" contained in the Final Marketing Materials filed with the SEC.

72. In addition to the Prospectus Supplements, Ambac received loan tapes with loan-level detail on the securitized loans. The following chart summarizes the dates when the Harborview mortgage loan tapes were disseminated to Ambac via e-mail and when the closing for each Transaction took place:

[30]The Prospectus Supplement for Harborview 2006-9 also provided that the weighted average debt-to-income ratio for Group 2 loans was 39.56%.

Transaction	Date Loan Tape Disseminated	Sponsor Analyst Disseminating the Loan Tape	Closing Date
Harborview 2005-16	November 10, 2005	Michael McKeever, RBS Greenwich Capital	November 30, 2005
Harborview 2006-9	September 22, 2006	Michael McKeever, RBS Greenwich Capital	October 4, 2006

b. *CWALT Prospectus Supplements And Loan Tapes*

73. Just as with the Harborview Transactions, the Prospectus Supplements filed with the SEC for the CWALT Transactions contained Countrywide's purported descriptions of the (i) underwriting procedures it utilized for origination of loans, (ii) material characteristics of the loans included in the securitizations, and (iii) material risks of investing in the securities. Not surprisingly, the summaries are quite similar to those provided in the Harborview Prospectus Supplements.

74. The Prospectus Supplements for the CWALT Transactions represent that "Countrywide Home Loans' underwriting standards are applied . . . to evaluate the prospective borrower's credit standing and repayment ability and the value and adequacy of the mortgaged property as collateral."[31] Exceptions to underwriting guidelines may be made only if compensating factors are present.[32] As part of its evaluation of a borrower's repayment ability, Countrywide Home Loans "generally requires a description of income."[33] In particular, for salaried borrowers, Countrywide Home Loans obtains employment verification and/or employment confirmation, when required by its underwriting guidelines.[34]

[31]CWALT 2005-81 Prospectus Supplement at S-42; CWALT 2006-OA19 Prospectus Supplement at S-58.

[32]CWALT 2005-81 Prospectus Supplement at S-42; CWALT 2006-OA19 Prospectus Supplement at S-58.

[33]CWALT 2005-81 Prospectus Supplement at S-41; CWALT 2006-OA19 Prospectus Supplement at S-57.

[34]CWALT 2005-81 Prospectus Supplement at S-41; CWALT 2006-OA19 Prospectus Supplement at S-57. The Prospectus Supplements explain that the nature of the information and whether the information

75. The Prospectus Supplements for the CWALT Transactions also describe Countrywide Home Loans' underwriting guidelines with respect to purported maximum debt-to-income ratio ("DTI"), an important metric in assessing the prospective borrower's ability to repay a loan. Under Countrywide Home Loans' Standard Underwriting Guidelines, which are described as being "consistent in many respects with the guidelines applied to mortgage loans purchased by Fannie Mae and Freddie Mac,"[35] Countrywide Home Loans generally permits "a debt-to-income ratio based on the borrower's monthly housing expenses of up to 33% and a debt-to-income ratio based on the borrower's total monthly debt of up to 38%."[36] Countrywide Home Loans' Expanded Underwriting Guidelines for mortgage loans with non-conforming original principal balances, as described in the Prospectus Supplement for the 2006-OA19 Transaction, generally allow "a debt-to-income ratio based on the borrower's monthly housing expenses of up to 36% and a debt-to-income ratio based on the borrower's total monthly debt of up to 40%; provided, however, that if the Loan-to-Value Ratio exceeds 80%, the maximum permitted debt-to-income ratios are 33% and 38% respectively."[37]

76. Countrywide Home Loans touted its purportedly prudent underwriting

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is verified depends, in part, on the documentation program used to originate a mortgage loan. CWALT 2005-81 Prospectus Supplement at S-41; CWALT 2006-OA19 Prospectus Supplement at S-58.

[35]CWALT 2005-81 Prospectus Supplement at S-43; CWALT 2006-OA19 Prospectus Supplement at S-59.

[36]CWALT 2005-81 Prospectus Supplement at S-44; CWALT 2006-OA19 Prospectus Supplement at S-60.

[37]CWALT 2006-OA19 Prospectus Supplement at S-61. All of the mortgage loans in the CWALT 2005-81 Transaction were underwritten pursuant to Countrywide Home Loans' Standard Underwriting Guidelines. CWALT 2005-81 Prospectus Supplement at S-44 and S-46. While a debt-to-income ratio measures the borrower's monthly debt obligations in comparison to his monthly income (thus indicating how much extra income the borrower has each month), the loan-to-value ratio compares the loan amount to the value of the collateral (and therefore reveals how much, if any, equity the borrower has in the property). An LTV of 80% indicates that the loan covers 80% of the property's value, and the borrower has 20% equity in the property. If the LTV (or combined loan-to-value ("CLTV") ratio, used when the borrower has multiple loans on a property) exceeds 100%, the borrower owes more than the property is worth, and the property is said to be "underwater."

standards for negative amortization loans in the Prospectus Supplements for the CWALT Transactions. For example, the Prospectus Supplement for the 2006-OA19 Transaction provides that "[i]f the prospective borrower has applied for a Negative Amortization Loan, the interest component of the monthly housing expense calculation is based upon the greater of 4.25% and the fully indexed mortgage note rate at the time of loan application."[38] The information disclosed in the Prospectus Supplement is consistent with the information supplied by Countrywide regarding the borrower qualification process which was provided to Ambac during the August 2006 due diligence meetings.

77. Just like the Harborview Prospectus Supplements, the CWALT Prospectus Supplements provide that: (a) "[a]ll adverse information in the credit report is required to be explained by the prospective borrower to the satisfaction of the lending officer,"[39] (b) Countrywide Home Loans must obtain appraisals from independent appraisers for all properties that secure mortgage loans,[40] and (c) Countrywide Home Loans conducts a quality control review of a sample of mortgage loans purchased from correspondent lenders, who represent that Countrywide Home Loans' underwriting standards have been met.[41]

78. The CWALT Prospectus Supplements also contained transaction- and group-level data on several characteristics of the securitized loans, including the borrower's

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[38]CWALT 2006-OA19 Prospectus Supplement at S-58; *see* CWALT 2005-81 Prospectus Supplement at S-42.

[39]CWALT 2005-81 Prospectus Supplement at S-43; CWALT 2006-OA19 Prospectus Supplement at S-59.

[40]CWALT 2005-81 Prospectus Supplement at S-43; CWALT 2006-OA19 Prospectus Supplement at S-59. The only exception to this rule disclosed by the Prospectus Supplements for the CWALT securitizations applies to "mortgage loans originated pursuant to [Countrywide Home Loans'] Streamlined Documentation Program, whose values were confirmed with a Fannie Mae proprietary automated valuation model." *Id.*; *see* CWALT 2005-81 Prospectus Supplement at S-43.

[41]CWALT 2006-OA19 Prospectus Supplement at S-58; *see* CWALT 2005-81 Prospectus Supplement at S-42.

occupancy status and the loan-to-value ratio of the loans, that are key to accurately assessing the loans' risk of default. The representations in the Prospectus Supplements for the CWALT Transactions regarding occupancy and LTV are summarized in the chart below.

Transaction	Occupancy Status			Weighted Average LTV
	Primary	Investor	Second	
CWALT 2005-81	80.81%	15.12%	4.07%	75.31%
CWALT 2006-OA19	83.47%	10.51%	6.03%	75.41%

79. As in the Harborview Transactions, loan tapes were transmitted to Ambac for each CWALT Transaction. Ambac acted based on the understanding that the information in the loan tapes was true, accurate and correct. On December 20, 2005, Rajarshi Chakravorti of Goldman Sachs' Structured Products Group sent to Ambac the loan tape for the CWALT 2005-81 Transaction. On November 20, 2006, David Grijalva of Countrywide Securities sent to Ambac the loan tape for the CWALT 2006-OA19 Transaction.

c. *Lehman Prospectus Supplements And Loan Tapes*

80. Just as with the other Transactions, Countrywide supplied Lehman Brothers with false and misleading information to be included in the Prospectus Supplements for each Lehman Transaction. Among other things, these documents set forth Countrywide's representations regarding its conservative underwriting procedures, compliance with underwriting guidelines, and information regarding the mortgage loans, including the loan-to-value ratio and the debt-to-income ratio. Just as with the other Transactions, these representations were false and misleading. The description of Countrywide's processes did not differ materially from that in the Harborview or CWALT Prospectus Supplements.

81. The Prospectus Supplements also contained transaction- and group-level data on several characteristics of the securitized loans, including the borrower's occupancy status

and the LTV of the loans, that are key to accurately assessing the loans' risk of default. The representations in the Prospectus Supplements for the Lehman Transactions regarding occupancy and LTV are summarized in the chart below.

Transaction	Group	Occupancy Status			Weighted Average LTV
		Primary	Investor	Second	
Lehman XS 2005-7N	1	90.50%	7.13%	2.38%	73.82%
Lehman XS 2005-7N	3	67.57%	25.91%	6.53%	76.52%
Lehman XS 2006-2N	1	87.60%	9.31%	3.09%	74.43%
Lehman XS 2006-2N	2	79.16%	16.59%	4.25%	72.63%
Lehman XS 2007-7N	2	77.26%	17.78%	4.96%	76.97%
Lehman XS 2007-15N	3	65.38%	28.11%	6.52%	77.68%
Lehman XS 2007-15N	4	86.76%	9.11%	4.13%	76.14%

82. Lehman Brothers also provided to Ambac loan-level collateral characteristics of residential mortgage pools in the loan tapes. The following chart summarizes the dates when the Lehman mortgage loan tapes were disseminated to Ambac via e-mail and when the closing for each Transaction took place:

Transaction	Date Loan Tape Disseminated	Sponsor Analyst Disseminating the Loan Tape	Closing Date
Lehman XS 2005-7N	November 21, 2005	Nicholas Stimola, Lehman Brothers	November 30, 2005
Lehman XS 2006-2N	January 10, 2006	Nicholas Stimola, Lehman Brothers	January 31, 2006
Lehman XS 2007-7N	May 3, 2007	Nicholas Stimola, Lehman Brothers	May 31, 2007
Lehman XS 2007-15N	July 12, 2007	Roderick Eschert, Lehman Brothers	July 31, 2007

C. Countrywide Abandons Prudent Mortgage Banking

83. Despite the reassuring language Countrywide used with potential investors and insurers in meetings and in the Prospectus Supplements, by the time Countrywide originated the loans at issue in this lawsuit, it had completely abandoned its prudent mortgage origination

practices in favor of a system that was designed to reward quantity over quality in loan origination and to conceal the unsavory practices necessary to keep the loan origination pipeline flowing. Countrywide loosened and then ignored its underwriting guidelines, even resorting to outright fraud to close as many loans as possible. The anemic systems the company put in place to uncover and eliminate these risky and unethical practices were ill-equipped to tackle such a monumental task and were oftentimes actively circumvented and undermined by Countrywide's own management. Countrywide used its overwhelming market share to exert its influence over even ostensibly independent sectors of the mortgage industry such as appraisers and due diligence underwriters, ensuring that as many of its loans as possible were approved and securitized without ever being properly reviewed to ensure the borrower had the ability to repay.

84. This wrongful conduct has been cataloged in numerous public and private actions against Countrywide, and hundreds of damning documents have been publicly released. For example, the SEC filed a civil fraud action against Mozilo, former Countrywide President and Chief Operating Officer David Sambol, and former Countrywide Chief Financial Officer Eric Sieracki.[42] The SEC's complaint alleges that from "2005 through 2007, these senior executives misled the market by falsely assuring investors that Countrywide was primarily a prime quality mortgage lender which had avoided the excesses of its competitors."[43] It continues by alleging that the credit risk that Countrywide was taking during this time period "was so alarming to Mozilo that he internally issued a series of increasingly dire assessments of various Countrywide loan products and the risks to Countrywide in continuing to offer or hold those loans, while at the same time he, Sambol, and Sieracki continued to make public statements

[42] *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. 2009).

[43] Complaint ¶ 6, *SEC v. Mozilo*.

obscuring Countrywide's risk profile and attempting to differentiate it from other lenders."[44]

85. On September 16, 2010, the U.S. District Court for the Central District of California denied the defendants' motion for summary judgment in the SEC's action, citing to hundreds of pages of internal Countrywide documents and depositions of Countrywide employees evincing that Countrywide failed to disclose material information and risks associated with its loans and origination practices.

86. The evidence gathered by the SEC is reiterated and reaffirmed by the admissions of former Countrywide employees and Countrywide's internal documents recited with particularity in myriad other actions. Among these is the case of *MBIA v. Countrywide Financial Corporation*, which was brought in this Court against Countrywide by another monoline insurance company and in which the Court denied Countrywide's motion for summary judgment. The *MBIA* action is noteworthy in part because of the wealth of documents relating to Countrywide's fraudulent practices that became public in connection with the filing of the parties' motions for summary judgment. The allegations, admissions, documents and rulings in such actions, which are relied upon herein, together demonstrate that Countrywide drove loan origination growth by shifting to loan products with a greater risk of default, while abandoning the very underwriting policies it purportedly implemented to control for that risk.

1. *Countrywide's Growth Strategy Was Designed For – And Handsomely Rewarded – Quantity Over Quality*

87. As Countrywide pursued its growth strategy, the company emphasized loan production over all else. Brian Koss, a former Countrywide Senior Regional Vice President, explained that Countrywide became a victim of "public company panic." Instead of following its proven practices for generating quality loans, the company began "reacting to each

[44] Complaint ¶ 7, *SEC v. Mozilo*.

quarter's earnings and making short term decisions. They approached making loans like making widgets, focusing on cost to produce and not risk or compliance. . . . The fiduciary responsibility of making sure whether the loan should truly be done was not as important as getting the deal done."[45]

88. With this singular new focus on maintaining and expanding the loan origination pipeline came immense pressure on Countrywide employees to constantly generate new business. The ethos of Countrywide emphasized producing as many loans as quickly as possible, regardless of quality. According to the Illinois Attorney General, Countrywide directed its underwriters to approve and process purchase files in 24 hours and refinance files in 48 to 72 hours. One Countrywide underwriter stated that, for a period of time, Countrywide required her to underwrite 25 loan files a day during the week and 25 to 35 loan application files over the weekend.[46]

89. Similarly, Mark Zachary, a former Countrywide Regional Vice President, has testified that he was instructed by his superiors to give unconditional approvals to 10% of the backlog of loan applications at his branch on a daily basis, without regard to whether borrowers actually qualified for a mortgage. When Zachary resisted this directive because "nowhere near 10% of the backlog" was made up of qualified borrowers, his superiors intervened and granted the necessary approvals over his objection.[47]

90. Countrywide's compensation system was specifically designed to incentivize loan officers to achieve the company's production goals. Loan officers' bonuses

[45]Chris Palmeri, *One Insider's View of Countrywide*, Bloomberg Businessweek, Jan. 17, 2008, *available at* http://www.businessweek.com/the_thread/hotproperty/archives/2008/01/on_insiders_vie.html.

[46]Complaint ¶ 89, *People of the State of Illinois v. Countrywide Fin. Corp.*, No. 08CH22994 (Ill. Cir. Ct. Jun. 25, 2008).

[47]*MBIA*, Sheth Aff. Ex. 5 (Transcript of Anthony Mark Zachary, Jan. 25, 2012) at 42-46, 99-100, 101-05.

were based on the number and amount of loans they closed during the relevant compensation period, without regard to how the loans ultimately performed. Countrywide also developed monthly contests that rewarded the production of certain loan products, with the loan officers who closed the highest number of that type of loan receiving additional bonuses. Not surprisingly, in months when Countrywide was offering financial incentives to loan officers who closed PayOption ARMs, the majority of the loans originated during that time frame were PayOption ARMs.[48]

91. The chain of command at Countrywide reflected this emphasis on production volume above all else. Sales associates could override underwriters who determined that loans should not be approved, and employees reported that everyone was expected to obey the will of loan officers in all respects, doing whatever it took to ensure that loans were approved.[49]

92. The constant pressure to increase loan production gave rise to a system in which sales associates were encouraged to bend, and even break, the rules while other employees turned a blind eye. When borrowers' applications were denied, supervisors encouraged underwriters and loan officers to move those borrowers into loan products with less rigorous requirements to ensure their approval, contrary to Countrywide's stated policies.[50] The prevailing attitude at Countrywide was that the rules and regulations did not matter so long as revenues were being generated. In the words of Eileen Foster, Countrywide's former Executive

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[48]*MBIA*, Sheth Aff. Ex. 6 (Transcript of Mari Eisenman Deposition, Feb. 14, 2012), at 30-31.

[49]Michael Hudson, *Countrywide Protected Fraudsters by Silencing Whistleblowers, Say Former Employees*, The Center for Public Integrity, Sept. 22, 2011, http://www.publicintegrity.org/2011 /09/22/6687/countrywide-protected-fraudsters-silencing-whistleblowers-say-former-employees; Interview by the Financial Crisis Inquiry Commission with Eileen Foster, Countrywide (July 30, 2010) (hereinafter "Foster FCIC Interview"), audio available at http://fcic.law.stanford.edu/interviews/ view/381, at 19:59-20:38.

[50]*MBIA*, Sheth Aff. Ex. 6 (Transcript of Mari Eisenman Deposition, Feb. 14, 2012), at 33-34.

Vice President of Fraud Risk Management, "[t]he organization built its business to take advantage of the fraud. . . . It benefitted from the fraud. And it protected the fraud."[51]

2. *Countrywide's Underwriting Guidelines Were Both Loosened And Ignored*

93. Although Ambac was told that Countrywide only originated loans outside of its published guidelines when compensating factors were present, Mozilo later testified that it is "ridiculous" to ask how closely prudent underwriters adhere to guidelines, because "[g]uidelines aren't the 10 commandments."[52] Mozilo's view of underwriting guidelines was shared by Countrywide employees throughout the mid-2000s, as adherence to underwriting guidelines was overshadowed by the need to continuously increase production. Starting in 2003, Countrywide shifted its origination strategy from making fixed-rate loans to creditworthy borrowers to making adjustable rate loans to marginal borrowers. As a result, Countrywide increased the size and risk of its mortgage loan portfolio, as well as its need to sell off the increasingly risky loans.

a. Countrywide Set Up Borrowers For Failure And Foreclosure

94. In pursuing its growth strategy, Countrywide implemented and then continued programs known internally to have heightened risks of default and delinquency, such as PayOption and low documentation loans, taking comfort in the fact that it sold off as much of this risk as possible. However, executives acknowledged that as the largest lender in America, the company's actions had great consequences on the market: "the more people you have

[51]Michael Hudson, *Mortgage Industry Whistleblower Wins Case Against Bank of America*, The Center for Public Integrity, Sept. 14, 2011, http://www.publicintegrity.org/2011/09/14/6467/mortgage-industry-whistleblower-wins-case-against-bank-america; *see also* Michael Hudson, *Countrywide Protected Fraudsters by Silencing Whistleblowers, Say Former Employees*, The Center for Public Integrity, Sept. 22, 2011, http://www.publicintegrity.org/2011/09/22/6687/countrywide-protected-fraudsters-silencing-whistleblowers-say-former-employees.

[52]*MBIA*, Sheth Aff. Ex. 187 (Transcript of Angelo Mozilo Deposition, Jun. 21, 2011) at 27.

defaulting in a neighborhood, the worse it is for the rest of the neighborhood. . . . If you have foreclosed properties on a street, the more of them you have, the greater the potential for the values on the rest of the street to come down."[53]

95. Nonetheless, Countrywide's executives remained silent and did nothing to halt the growing reality that the quality of loans originated by Countrywide was deteriorating, and would continue to worsen. For instance, on September 1, 2004, Mozilo wrote an e-mail to other Countrywide executives, Stan Kurland and Keith McLaughlin, in which he stated: "As I look at production trends . . . at Countrywide . . . , there is a clear deterioration in the credit quality of loans being originated over the past several years. In addition, from my point of view, the trend is getting worse as the competition for sub-prime, Alt-A and nonconforming in general continues to accelerate."[54]

96. Loan programs were created based on "whether or not [Countrywide] would retain the risk, and so to the extent the foreclosure frequency exceeded a certain level, the company's guidelines and policies were not necessarily not to offer it, but just not to retain the risk."[55] For example, the "Extreme Alt-A" program, which was ultimately implemented over the Chief Risk Officer's serious concerns, had what Countrywide internally described as "extreme credit risk layering," and management was warned that "poor performance should be expected."[56] However, Countrywide decided that the risk of this program was offset because the loans would be "sold with no retained credit risk" – even though some managers were concerned

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[53]*MBIA*, Sheth Aff. Ex. 63 (Transcript of Jens Christian Ingerslev Deposition, Mar. 2, 2011) at 201.

[54]*SEC v. Mozilo*, Decl. of John M. McCoy III In Opp. To Mot. for Summ. J. filed Aug. 16, 2010 ("McCoy Decl."), Ex. 196 (Email from Angelo Mozilo to Stan Kurland, et al., dated Sept. 1, 2004).

[55]*MBIA*, Sheth Aff. Ex. 68 (Transcript of David Sambol Deposition, Jun. 7, 2011) at 45.

[56]*MBIA*, Sheth Aff. Ex. 200 (Email from Christian Ingerslev to Rod Williams, dated Mar. 31, 2006, attaching Extreme Alt A Presentation); *MBIA*, Sheth Aff. Ex. 208 (Email from John McMurray e-mail to David Sambol, et al., dated Nov. 16, 2006).

that expanding guidelines so drastically would ultimately have a domino effect on foreclosures and home values in a neighborhood.[57]

(i) Countrywide Knew About And Ignored Problems In Its PayOption ARM Program

97. PayOption loan programs, in which borrowers could make minimal payments that were not sufficient to cover the monthly interest (therefore resulting in the total loan balance increasing), were recognized by Countrywide to be resulting in high rates of payment shock and negative amortization. In one internal analysis from mid-2005, it was found that 70% of borrowers who had recently received PayOption loans experienced negative amortization after three months.[58] Borrowers could experience "a 65-108% increase in payment at the end of Year 5 . . . and a 17%-57% increase over the qualification payment." During this time, Mozilo expressed "increasing[] concern[]" about the PayOption product.[59]

98. This trend did not improve, and Countrywide recognized the increasing risk. By early 2006, Countrywide's executives understood that "Pay Option A[RM]s were . . . the riskiest product on the market."[60] Countrywide's solution to this hazard was to keep as many of its PayOption loans off of its books as possible. For example, on August 1, 2005, Countrywide Financial Corp.'s Chairman instructed the presidents of Countrywide Home Loans and Countrywide Bank that they "should never put a non-owner occupied pay option A[RM] on [Countrywide's] balance sheet . . . . [I]t is unacceptable." When Countrywide Home Loans'

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[57]*MBIA*, Sheth Aff. Ex. 63 (Transcript of Jens Christian Ingerslev Deposition, Mar. 2, 2011) at 201.

[58]*MBIA*, Aff. of Manisha Sheth in Supp. Of Pl.'s Mot. for Summ. J. on Breach of Insurance Agreement, filed Sept. 19, 2012 ("Sheth Aff. II"), Ex. 182 (Corp. Credit Risk Committee presentation, Jun. 28, 2005) at 18-19.

[59]*SEC v. Mozilo,* Decl. of Lynn M. Dean in Opp. To Mot. for Summ. J., filed Aug. 16, 2010 ("Dean Decl."), Ex. 40 (E-mail from Angelo Mozilo to David Sambol, et al., dated Jul. 6, 2005).

[60]In re Bank of America Corporation, Settlement Agreement between Dept. of Justice and Bank of America (hereinafter "BAC Settlement"), Annex 1 at 13, Release No. 72888, File No. 3-16028 (Aug. 21, 2014).

President responded that this policy had "securitization implications" because it could give the impression that Countrywide was cherry picking the assets on its own books and overwhelming its securitization pools with higher risk loans – "an adversely selected pool" – Countrywide Financial Corp.'s Chairman responded that although PayOption loans presented a risk whether they were on Countrywide's balance sheet or placed into securitizations, "by placing less attractive loans in the secondary market we will know exactly the economic price we will pay when the sales settle."[61] That is, Countrywide's exposure was alleviated once the sale was made.

99. On May 25, 2006 – a significant date because Countrywide gave rosy descriptions of the program to Ambac during diligence visits both before and afterwards – the chairman of the board of Countrywide Bank internally reported that he had spoken to Chief Operating Officer Sambol regarding PayOption loans, and Sambol's plan was to sell off the loans that were likely about to default: "Spoke with Sambol. He believes historical payoption performance trends can help disclose problems but are not sufficient/capable of providing comfort. ***Sambol is concerned about payment shock at recast and inability to absorb increased payments*** thru income or refi (due to low equity). So Sambol believes high cltv loans with no mi [mortgage insurance], particularly those with high dti are ***risky***. Maybe also those with low ficos. If the loans are in markets that have slowed ***the risk is exacerbated***. He wants us to propose a strawman action plan. For example, for those segments in the markets that have stopped appreciating, ***sell the most recent production*** and stop portfolioing cltv greater than 80 and high dti loans. For markets that are expected to continue to appreciate, monitor and maybe stop portfolioing high cltv and dti loans."[62]

100. In fact, Mozilo was aware by June 1, 2006 – ***prior to*** two meetings in

[61] BAC Settlement Annex 1 at 12-13.

[62] *SEC v. Mozilo*, slip op. at 20-21 (citation omitted) (emphases added).

which the program was touted to Ambac as conservative and safe – that the PayOption portfolio was largely underwritten on a reduced documentation basis and that there was evidence that borrowers were lying about their income in the application process.[63] Mozilo concluded that borrowers would reach the 115% negative amortization cap sooner than they expected, and the payments would then be "substantially higher than the buyer expects and what was used in the initial qualification." Mozilo expected such payment shocks would be "difficult if not impossible for them to manage." Because "we know or can reliably predict what's going to happen in the next couple of years," Mozilo directed that the issue be addressed immediately – by selling off as many of these loans as possible. A few weeks later, he again commented that it was "quite alarming" that the PayOption loans with negative amortization appeared to have "a higher delinquency than our standard book of business."[64]

101. Despite these widespread concerns, Countrywide executives attempted to conceal the "alarming" nature of the company's PayOption loans. On July 25, 2006, The Wall Street Journal reported on a recent study concluding that Countrywide's PayOption ARMs performed worse than the option ARM loans of other large mortgage originators.[65] Countrywide commented in the article that "its option ARMs are performing within company expectations and have delinquency rates that compare well with other types of loans, including 30-year fixed-rate mortgages." The company also stated in the article that the study was flawed because it failed to analyze all of the PayOption ARMs that Countrywide had originated.

102. That same day, Countrywide held its quarterly earnings call and again

[63] *SEC v. Mozilo*, Dean Decl., Ex. 17 (E-mail from Angelo Mozilo to David Sambol, et al. June 1, 2006).

[64] *SEC v. Mozilo*, Dean Decl., Ex. 15 (E-mail from Angelo Mozilo to Steve Bailey, Jul. 10, 2006).

[65] James R. Hagerty, *Moving the Market – Tracking the Numbers/Street Sleuth: Do Countrywide's Loans Stack Up? Study of Option ARMs Sees a Performance Gap in Comparison with Rivals*, Wall St. J., July 25, 2006, at C3, *available at* http://www.wsj.com/articles/SB115379104229316090.

attacked the article and the study. Mozilo called the timing of the article "suspicious" and said "it [was] great for wrapping fish." He explained that Countrywide had no way of knowing whether the comparison between the loans analyzed was valid. Mozilo also reassured the attendees on the call that "we originate these loans on an equal basis and the decision in securitization is more of a timing decision than it is a credit quality decision."[66] Kurland chimed in to add that the comparison in the article was "outrageous" and was "kind of a horrible type of comparison to make and to confuse everyone over."[67]

103. Ambac relied on Countrywide's public repudiation of the article when analyzing whether or not to insure the transactions at issue in this suit. When the article was released, it was circulated via e-mail among the Ambac executives working on these transactions. Ambac underwriter Ervin Pilku responded to the group that Countrywide had rebutted the Wall Street Journal article during the earnings call: "[Countrywide] believes that the comparison was made only on limited information based on the securitized paper, which does not include the overall production, a good portion of which sells as wholeloan [*sic*]" – the very loans insured by Ambac. Pilku also relayed Countrywide's assurance that it had "not seen the NegAm loans perform any differently from last year [and the PayOption ARMs] do not vary from the other first-lien products."

104. On August 15, 2006 – in the midst of two Ambac diligence visits on August 10 and 17 that specifically discussed PayOptions and how much *better* their performance was than other products' – Chief Risk Officer McMurray e-mailed Chief Production Officer Drew Gissinger to say that a recent decision to reduce the minimum payment rates on certain

[66] *Q2 2006 Countrywide Financial Corporation Earnings Conference Call – Final,* FD (Fair Disclosure) Wire, Jul. 25, 2006, at 13, 16.

[67] *Id.*

PayOption ARMs was "a really bad idea" which could lead to "any number of adverse outcomes."[68] In the Chief Risk Officer's opinion, "[w]e need to be moving minimum rates up to reduce the huge disparity between minimum payment rates and accrual rates." Such public statements, repeated to Ambac, were at odds with the true facts known to Countrywide about PayOption ARM mortgages. McMurray specifically cautioned that most borrowers would "recast before the third year" because they made only minimum payments, and if a borrower wanted to avoid the "large payment shock" from this early recast, they would face prepayment penalties on the loans. The next day, an employee in Product Leadership responded to McMurray and several others, including Ingerslev, and explained why the decision had been made to reduce the rate: PayOption applications had "been on the decline," and competitors were offering lower start rates. The following day, Ingerslev emphasized to Ambac the benefits of the PayOption ARM program and Countrywide's conservative underwriting guidelines and qualification standards.

105. And just weeks after Countrywide executives told Ambac in August 2006 that the PayOption product performed "much better" than fixed rate mortgage products and was correlated with high value homes, Mozilo cautioned his employees that "[w]e have no way, with any reasonable certainty, to assess the real risk" of the PayOption program, and that Countrywide was "flying blind on how these loans will perform in a stressed environment of higher unemployment, reduced values and slowing home sales."[69]

106. By mid-2007, the situation was getting dire. As of June 2007, over 86% of the PayOption portfolio was negatively amortizing, and "[a]s in past months, [Countrywide]

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[68] *SEC v. Mozilo*, Dean Decl. Ex. 76 (Email from John McMurray to Brian Kuelbs, et al., dated Aug. 15, 2006).

[69] *SEC v. Mozilo*, Dean Decl. Ex. 18 (Email from Angelo Mozilo to David Sambol, et al., dated Sept. 26, 2006).

continue[d] to see the number of loans within the ranges of 105% – 115% significantly increase each month."[70] Mozilo warned that "the fact that almost 90% of the pay options are making the minimum payment in a market where real estate values are dropping precipitously is a formula for disaster."

(ii) Countrywide Knew About And Ignored Evidence of Widespread Fraud In Its Low Documentation Program

107. One sure way of increasing originations was to permit loan applicants merely to state – rather than verify – their income. According to Countrywide's Technical Manual (which is part of Countrywide's underwriting guidelines), reduced documentation loans allowed Countrywide to rapidly process loans for borrowers with income that is not easily documented, like self-employment income and trust income.[71] But the limited income verification associated with these loans "does not eliminate the need to analyze and evaluate the borrower's ability and willingness to repay the mortgage debt," which "must include a judgment about the reasonableness of the income stated on the application in relation to the borrower's occupation and credit information."[72] And Countrywide's Technical Manual expressly states that reduced documentation loans "are not intended for those borrowers who do not have adequate income to qualify for a full documentation loan."[73] These borrowers were often required to have higher FICO scores than were borrowers whose loans were originated as part of full documentation programs.

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[70] Decl. of Spencer Bendell In Opp. To Mot. for Summ. J., filed Aug. 16, 2010 ("Bendell Decl."), Ex. 304 (Email from Angelo Mozilo to Steve Bailey, dated Jul. 9, 2007, attaching June 2007 Flash Report).

[71] *MBIA*, Reply Aff. of Manisha M. Sheth in Further Support of MBIA's Mot. for Summ. J. on Breach of Insurance Agreements, filed Dec. 10, 2012 ("Sheth Aff. III"), Ex. 16 (Countrywide Technical Manual § 0.2.3).

[72] *Id.*

[73] *Id.*

108. Countrywide executives made public statements about these loan programs designed to persuade people that the borrowers in these programs were high-quality borrowers. For example, in an August 2006 statement to the Wall Street Journal, the company said that it had "not found a significant enough difference in performance between fully documented loans and stated income loans to cause us concern."[74]

109. However, Countrywide was keenly aware of risks in its low documentation programs. In response to the call to increase volume, Countrywide ignored its formal policies and began to funnel into these programs borrowers who could not qualify for loans under full-documentation programs because they did not have the necessary income or financial strength. Within Countrywide, stated income programs were known to be more likely to default. As alleged by the SEC, "Countrywide conducted studies to identify the effect that certain variables had on the probability that a loan would go into serious delinquency or default. One study concluded that there was an inverse relationship between the level of documentation associated with a loan and the likelihood of default."[75]

110. Countrywide's internal comparisons of stated income with income actually reported to the IRS revealed stark differences. On June 2, 2006, Sambol received an e-mail reporting on the results of a quality control audit conducted by Countrywide Bank that showed that 50% of the stated income loans audited by the bank showed a variance in income from the borrowers' IRS filings of greater than 10%. Of those, 69% had an income variance of greater than ***50%***.[76]

111. It was not only through a *post hoc* comparison to IRS data that problems

[74]Lingling Wei, *"Stated Income" Home Mortgages Raise Red Flags*, Wall St. J., Aug. 22, 2006.
[75]Complaint ¶ 35, *SEC v. Mozilo*.
[76]*MBIA*, Sheth Aff. Ex. 99 (Transcript of the John McMurray Deposition, dated May 11, 2011) at 186-87.

with the stated income program were revealed. Rather, it was not uncommon for a loan to have income that was unreasonable on its face yet not questioned by Countrywide underwriters – for example, McDonald's workers and maids who supposedly made $15,000 per month.[77]

112. Countrywide also knew that stated income was unreasonable because of impossible increases since the last time the borrower had taken out a loan with Countrywide – often just months before, with no significant change in job title. In one instance, a borrower's monthly stated income supposedly increased from $7,200 in February to $30,000 in November of the same year, which even the head of Countrywide's Quality Control department agreed was an unreasonable income for a mechanic.[78] Nonetheless, the loan was approved and funded by Countrywide – and then securitized in a monoline-insured deal.

b. *Countrywide Engaged In Predatory Lending*

113. Countrywide also engaged in predatory and abusive lending practices in marketing its products to borrowers who could not afford them. Among other wrongful conduct, Countrywide enticed borrowers to borrow beyond their means by promoting loans with low introductory "teaser" interest rates while obfuscating the steep increase in monthly payments that would occur when these teaser rates reset at higher levels. These PayOption ARM loan programs are precisely those pursuant to which loans in the Transactions were originated. These and related Countrywide practices were the subject of consumer protection actions by the Attorneys General of California, Connecticut, Florida, Illinois, Indiana, and West Virginia.

114. For example, the Attorney General of California described a deceptive scheme to fuel Countrywide's growth by originating loans with little or no regard for the

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[77] *MBIA*, Sheth Aff. Ex. 236 (Affidavit of James Clarkson) ¶ 12; *MBIA*, Sheth Aff. Ex. 36 (Transcript of Nashikeata Mann Deposition, dated Jan. 27, 2012) at 67.

[78] *MBIA*, Sheth Aff. II Ex. 102 (Transcript of Cynthia Simantel Deposition, dated Apr. 28, 2011) at 810-12).

borrowers' ability to afford them or to sustain homeownership. Among other things, the scheme was effectuated through

> [m]isleading marketing practices designed to sell risky and costly loans to homeowners, the terms and dangers of which they did not understand, including by (a) advertising that it was the nation's largest lender and could be trusted by consumers; (b) encouraging borrowers to refinance or obtain purchase money financing with complicated mortgage instruments like hybrid adjustable rate mortgages or payment option adjustable rate mortgages that were difficult for consumers to understand; (c) marketing these complex loan products to consumers by emphasizing the very low initial "teaser" or "fixed" rates while obfuscating or misrepresenting the later steep monthly payments and interest rate increases or risk of negative amortization; and (d) routinely soliciting borrowers to refinance only a few months after Countrywide or the loan brokers with whom it had "business partnerships" had sold them loans.[79]

115. Connecticut's complaint against Countrywide echoes the same allegations. It states that Countrywide

> made loans to consumers on terms that differed materially from those represented to consumers prior to closing, which were not suitable and affordable, were not appropriate for consumers' specific situations, and were not made based on consumers' ability to pay. By way of example [Countrywide's] loan representative expressly misrepresented to a consumer that the consumer's proposed monthly payment would include a property tax escrow. In truth, the payment did not include such an escrow, a fact the [loan representative] revealed only at the loan closing, and as a result, the consumer's actual financial obligation associated with the loan was significantly greater than she had been lead to believe it would be.[80]

116. Indiana's complaint against Countrywide contains specific allegations regarding Countrywide's deceptive and misleading lending practices:

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[79]First Amended Complaint ¶ 21, *People of the State of California v. Countrywide Fin. Corp.*, No. LC081846 (Cal. Super. Ct. 2008).

[80]Complaint ¶ 16, *State of Connecticut v. Countrywide Fin. Corp.*, No. 09-CV-4042969 S (Ct. Super. Ct. 2008).

> Countrywide knowingly made deceptive or misleading representations or omissions regarding loan terms and charges including, but not limited to, the interest rate of the loan, the presence or the mechanics of the adjustable rate features of the loan, and the interest rate or the material costs of the proposed loan; Countrywide engaged in a practice of misleading borrowers about the presence, the significance, and/or the meaning of a prepayment penalty, and/or the duration of a prepayment penalty on their loans; Countrywide engaged in acts and practices which resulted in fabricated and/or inflated income information for prospective borrowers, who would have otherwise failed to qualify for the loans.[81]

117. Indiana's complaint also describes two cases involving negative amortization ARM loans in which brokers misled borrowers about the duration of the 1.75% introductory rate on Countrywide products. In one case, the broker led the borrower to believe that the introductory rate would last for five years instead of just a few months. In the other, the broker led the borrower to believe that an introductory rate would last for an entire year, when in fact the rate increased after the first payment.[82]

118. Illinois' complaint against Countrywide contains detailed allegations of Countrywide's unfair and deceptive sales practices, including direct mailings that pushed consumers to refinance into risky mortgage products, e-mails trumpeting complimentary loan reviews that induced consumers to refinance their existing mortgages, television and radio commercials that advertised no closing cost mortgage refinancing, and sales pitches for risky mortgages. According to the complaint, through these practices Countrywide "often hid or obscured the risks associated with different mortgage products and refinancing."[83]

119. Illinois' complaint describes these practices in great detail with respect to

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[81] Complaint ¶¶ 9-11, *State of Indiana v. Countrywide Fin. Corp.*, No. 76C01-0808-PL-0652 (Ind. Cir. Ct. 2008).

[82] *Id.* ¶¶ 13-14.

[83] Complaint ¶¶ 231-69, *People of the State of Illinois v. Countrywide Fin. Corp.*, No. 08CH22994 (Ill. Cir. Ct. 2008).

Countrywide's development and marketing of its lucrative PayOption ARMs.[84] Countrywide's own employees described these loans as "ticking time bombs" that were "built to fail," because Countrywide insisted on layering additional risks of illusory teaser rates, prepayment penalties, high loan-to-value ratios, and reduced documentation requirements.[85] Rather than shying away from such loans, Countrywide pursued them with gusto, creating a broker compensation structure that specifically incentivized the origination of PayOption ARMs above all others. This is because brokers could most easily conceal wider interest rate spreads by misleading consumers about the complicated structure of these products.[86]

120. Similarly, West Virginia alleged in its complaint against Countrywide that "consumers either were not told about or did not understand [Countrywide's] risky, unconscionable products or terms [such as PayOption loans and ARMs]. If consumers did question these loans or terms, they were simply told they could refinance later."[87] In one case, Countrywide misrepresented the amount of even the minimum introductory payment on a PayOption ARM. The unsuspecting borrower did not discover until after the closing that his initial monthly payment was more than he thought he would be obligated to pay.[88]

c. Countrywide's Competitor Match Program Hit The Lowest Common Denominator

121. Although Countrywide had committed in its Transaction documents and in its meetings with counterparties to approving exceptions only on a case-by-case basis when valid and sufficient compensating factors existed, such a system could not generate loans at the scale

[84] *Id.* ¶¶ 123-208.

[85] *Id.* ¶¶ 136-57.

[86] *Id.* ¶¶ 176-85.

[87] Complaint ¶ 30, *State of West Virginia ex rel. Darrell V. McGraw, Jr., Attorney General v. Countrywide Fin. Corp.*, No. 08-C-268 (W. Va. Cir. Ct. 2008).

[88] *Id.* ¶ 53.

or speed that Countrywide desired. Therefore, Countrywide instituted a "competitor match" program whereby it would approve any loan that it believed a competitor would approve. Countrywide's Chief Risk Officer explained that it is not possible to comprehend Countrywide's underwriting policies without an understanding of the matching strategy;[89] as he mused in late 2006, "Will we match anything and everything that's in the market? I think [President and Chief Operating Officer of Countrywide Home Loans] Drew [Gissinger]'s answer would be yes."[90]

122. Although the production divisions wholeheartedly supported the competitor match program, those on the credit and risk side of the company repeatedly expressed concerns that the program caused Countrywide to "often end up with the most aggressive offerings in the market" because the composite "guidelines" that Countrywide adhered to after taking the riskiest pieces of other lenders' programs did not also include the other lenders' safeguards.[91] Countrywide's method also resulted in a race to the bottom in which Countrywide only focused on whether a product was for offer somewhere, anywhere – not whether the product was a worthy risk. In fact, Countrywide's models predicted such dismal results with one particular program that Countrywide assumed the models must be wrong – "if our own models reflected foreclosure frequencies in this very high range, it must be that our own models were generating results that were different than the rest of the industry's models."[92] Countrywide therefore went ahead with that program.

123. As a California federal court found in the SEC action against Mozilo, Countrywide's executives knew well – but did not disclose – that Countrywide's guidelines were

[89] *SEC v. Mozilo*, McCoy Decl. Ex. 267 (Transcript of John P. McMurray, Jul. 8, 2008) at 667-687.

[90] *MBIA*, Sheth Aff. Ex. 197 (Email from John McMurray to Kevin Bartlett, dated Dec. 17, 2006).

[91] *MBIA*, Sheth Aff. Ex. 197; *MBIA*, Sheth Aff. Ex. 302 (Email from John McMurray e-mail to Jess Lederman, dated Sept. 7, 2007).

[92] *MBIA*, Ex. 68 (Transcript of David Sambol Deposition, Jun. 7, 2011) at 44-45.

the most aggressive in the industry:[93]

- Countrywide's Chief Risk Officer, John McMurray, explained in his deposition, that Countrywide mixed and matched guidelines from various lenders in the industry, which resulted in Countrywide's guidelines being a composite of the most aggressive guidelines in the industry: "And so, . . . if you match one lender on – on one – on certain guidelines or for certain products and then you match a separate lender on a different product or a different set of guidelines, then in my view the composite of that – of that two-step match would be more – would be more aggressive than either one of those competitor reference points viewed in isolation." McMurray repeatedly explained his view and the risks of the matching strategy to others within Countrywide, including Sambol.

- Moreover, in addition to demonstrating that Countrywide executives were aware of the facts which made their statements misleading, the SEC has presented evidence that Sambol and Sieracki knew that Countrywide's Chief Risk Officer John McMurray firmly believed that Countrywide should include greater credit risk disclosures in its SEC filings. For example, in January 2007, McMurray sent an e-mail to Sieracki outlining "why delinquencies will increase and the impact this increase will have on [Countrywide's] financial results," and specifically pointed out "widened guidelines" as one of the principal reasons.

- In a June 24, 2005 e-mail, Countrywide's Chief Risk Officer John McMurray explained to Sambol that "because the matching process includes comparisons to a variety of lenders, our [guidelines] will be a composite of the outer boundaries across multiple lenders. For example, First Franklin is used as a comparison for some guidelines where they are more aggressive (e.g., high LTV/CLTV) and not used where they are less aggressive (e.g. stated doc loans). As a result, our composite guides are likely among the most aggressive in the industry."

- On November 2, 2006, Sambol was again made aware of McMurray's concern that when Countrywide's matching strategy was "done across lenders, across products and across guidelines, the composite set of guidelines will be the most aggressive credit in the market."

- In a February 11, 2007 e-mail, McMurray advised Sambol that he doubted Countrywide's composite matching strategy "would play

[93] *SEC v. Mozilo*, slip op. at 12, 20-21 (citation omitted).

> well with regulators, investors, rating agencies, etc. To some, this approach might seem like we've simply ceded our risk standards and balance sheet to whoever has the most liberal guidelines."

d. *Exception Loans Became The Rule*

124. Despite the loosened underwriting requirements created by the competitor match program, there still remained some borrowers who could not qualify for loans even under Countrywide's extremely aggressive guidelines. In order to reach this dubious sector of the market, Countrywide created a system of "shadow guidelines" and exception desks, so that loans rejected by Countrywide's automated underwriting system ("CLUES") were routed to individual underwriters, their branch managers, divisional "Structured Loan Desks," and finally a Secondary Marketing Structured Loan Desk, until the application reached an officer with sufficient authority to override the written guidelines and approve the loan.

125. Ostensibly, Countrywide's policies mandated that the company only approve loans that did not conform to its underwriting guidelines – "exception" loans – in "[s]pecial situations or unusual circumstances," and only when "approved by a qualified employee."[94] In fact, Countrywide told Ambac that only senior officers could approve exceptions. However, as the company's growth strategy increased the pressure to generate higher loan volumes, exceptions became the norm rather than being granted only in "moderation."[95]

126. By June 2005, 15% of all Consumer Markets Division ("CMD") loans and 8% of all Wholesale Lending Division ("WLD") loans were generated as exceptions, figures already above "moderation."[96] One year later, the production of exception loans had

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[94] *MBIA*, Sheth Aff. II Ex. 117 (CLD Underwriter Reference Guide, dated March 2007) at 11.

[95] *MBIA*, Sheth Aff. Ex. 280 (Countrywide Technical Manual § 0.2.10).

[96] *MBIA*, Sheth Aff. II Ex. 182 (Corp. Credit Risk Committee presentation, dated Jun. 28, 2005) at 14.

skyrocketed: 44.3% of Countrywide's PayOption ARMs, 37.3% of its subprime first liens, and 55.3% of its standalone home equity loans had been underwritten on an exceptions basis.[97]

127. One of the factors driving this sudden increase in exception loans was a policy enacted in July 2005 that "to the widest extent possible . . . allow[ed] exceptions on all requests, regardless of loan program, for loans less than 3 million." In conjunction with this policy, Countrywide "assum[ed] securitization in all cases" for the loans generated as exceptions.[98]

128. At the heart of Countrywide's exception program was the principle that the company would "price all saleable loans."[99] This principle was illustrated by an internal Countrywide presentation listing the following objectives:

- Approve virtually every borrower and loan profile with pricing add on when necessary. . . .
- Process and price exceptions on standard products for high risk products.
- Process exceptions for:
    - Credit Scores
    - LTV [loan-to-value] and loan amounts
    - Cash out amounts
    - Property types[100]

129. The result of this exception-laden system was clear: As former Countrywide loan officer Kourosh Partow told an interviewer for Dateline NBC, if a borrower had a pulse, Countrywide would give the borrower a loan.[101] Not surprisingly, this shift in focus to salability and volume resulted in an attendant decrease in the quality of the loans being

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[97]*SEC v. Mozilo*, Dean Decl. Ex. 4 (Countrywide Home Loans Credit Risk Leadership Reporting Package, dated June 2006) at 42; Dean Decl. Ex. 5 (Countrywide Home Loans Credit Risk Leadership Reporting Package, dated June 2006) at 54.

[98]*MBIA*, Sheth Aff. Ex. 30 (Transcript of David Spector Deposition, Aug. 26, 2011) at 150-53.

[99]*MBIA*, Sheth Aff. Ex. 139 (CMD Audit Report, dated Oct. 19, 2004) at 5.

[100]*See United States v. Partow*, No. 06-CR-00104 (HRH) (D. Alaska 2006).

[101]Dateline NBC: *Inside the Financial Fiasco* (NBC television broadcast Mar. 27, 2009).

generated through the exceptions process. Underwriters in Secondary Marketing did not conduct any analysis to determine whether the loan, even if saleable, met underwriting guidelines. They relied on the production department to ensure the loans complied with guidelines. They also relied on production to identify any red flags associated with fraud.[102]

130. The speed with which exceptions were being approved also indicates that the Structured Loan Desk was not conducting thorough reviews of the loan files being submitted. In February 2005, the average response time to an exception request was only 53 minutes, and by May 2006, the average response time had decreased to a mere 21 minutes.[103]

131. Countrywide employees readily acknowledge that compensating factors were not necessarily required for a loan to be approved outside of the guidelines. If the borrower was a so-called "Friend of Angelo [Mozilo]," the Structured Loan Desk had no choice but to approve and price the loan, regardless of any compensating factors, and the loan could nonetheless be placed into a securitization.[104]

132. "Business decisions" also justified, in Countrywide's view, deviation from the guidelines without compensating factors and "despite . . . its risk and/or probable losses"[105] – and again, such loans could be securitized. As an employee in the Secondary Marketing Structured Loan Desk testified, even when a "hard stop" or a "definite no or a definite guideline that could not be exceeded" was in place, the hard stop could be exceeded "if, for example, it was an executive decision if, you know, it was . . . a justifiable business reason made by very

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[102]*MBIA*, Sheth Aff. 2 Ex. 115 (Transcript of Nathan Joshua Adler Deposition, Apr. 12, 2011) at 688-90.
[103]*MBIA*, Sheth Aff. Ex. 31 (Transcript of Moses Sulukyan Deposition, Jun. 8, 2011) at 185-86.
[104]*Id.* at 171-72.
[105]*Id.* at 115.

upper levels of management."[106] One frequently used "business reason" was that Countrywide wanted to incentivize brokers or builders to funnel a steady stream of loans to Countrywide rather than other lenders.[107]

133. Even the lenient rule of approving all "salable" loans was stretched at management's request. Loans were approved "despite [their] unsalability" when Structured Loan Desk employees were told to do so by Countrywide management.[108]

134. When Countrywide purchased loans from other sellers (commonly referred to as "correspondent lenders"), Countrywide routinely granted certain "variances" or "accommodations" to the lenders, often based on how much business the lender provided Countrywide. This practice permitted the lenders to sell loans to Countrywide that did not comply with the guidelines, yet were not evaluated on a case-by-case basis for compensating factors.[109]

135. Even when the Structured Loan Desk did condition approval on certain conditions being met, there was no system for verifying that the conditions had been met before the loan closed. The originating branch could still make the loan knowing that even the minimal requirements imposed by Secondary Marketing had not been satisfied.[110]

136. The complaint in a shareholder class action, *In re Countrywide Financial Corporation Securities Litigation*, aptly summarizes the exceptions process. It alleges, based on statements from a loan underwriter in Countrywide Home Loans' CMD, that "loan applications

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[106] *Id.* at 64-65.

[107] *MBIA*, Sheth Aff. Ex. 62 (Transcript of Gene Soda Deposition, May 11, 2011) at 105 ("the borrower is one of the big builders in the area and we want to preserve the relationship").

[108] *MBIA*, Sheth Aff. Ex. 21 (Transcript of Moses Sulukyan Deposition, Jun. 8, 2011) at 138.

[109] *MBIA*, Sheth Aff. III Ex. 43 (CLD variance letter, dated Jun. 23, 2006).

[110] *MBIA*, Aff. of Sarah Concannon in Opp. To Pl.'s Mot. for Summ. J., filed Nov. 28, 2012 (Concannon Aff.) Ex. 23 (Transcript of Kathryn Tinsley Deposition, April 1, 2011) at 470-73.

that should never have been approved were constantly kicked further up the corporate ladder until they reached a level where they would be approved by those driven solely by corporate profits and greed."[111]

137. Unsurprisingly, the abandonment of nearly all underwriting guidelines when approving loans on an exception basis brought with it an increase in credit risk on those loans. Countrywide's senior management was aware that "exceptions have a higher default risk, all else equal."[112] As early as 2005, Chief Credit Officer John McMurray warned that Countrywide's exception loans would lead to "higher rates of default . . . and third parties coming back to us seeking a repurchase or indemnification."[113] Despite this knowledge, Countrywide continued to pursue its exceptions policy wholeheartedly.

3. *Countrywide Knowingly Relied On Unreliable Loan Origination Systems*

a. *Employees Did Not Question CLUES, Despite Known Errors*

138. To the public and the participants in its securitizations, Countrywide extolled the integrity and consistency of its automated underwriting system, known as the Countrywide Loan Underwriting Expert System, or "CLUES," which used an algorithm for determining in the first instance a borrower's compliance with Countrywide's underwriting

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[111]Second Consolidated Class Action Complaint ¶ 180, *In re Countrywide Fin. Corp. Sec. Litig.*, Lead Case No. 07-CV-05295 (C.D. Cal. filed, Jan. 6, 2009). The federal district court denied Countrywide's motion to dismiss the shareholder class action, holding that the allegations "present the extraordinary case where a company's essential operations were so at odds with the company's public statements that many statements that would not be actionable in the vast majority of cases are rendered cognizable to the securities laws." The court explained that descriptions like "'high quality' are generally not actionable; they are vague and subjective puffery not capable of being material as a matter of law." But here, the complaint "adequately alleges that Countrywide's practices so departed from its public statements that even 'high quality' became materially false or misleading." *In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1144 (C.D. Cal. 2008). Countrywide agreed to settle this lawsuit by paying $600 million. Chad Bray, *N.Y. Funds Reach Settlement with Countrywide, KPMG*, Wall St. J., May 7, 2010.

[112]*MBIA*, Sheth Aff. Ex. 74 (Transcript of John Patrick McMurray Deposition, July 12, 2011) at 82-83.

[113]*SEC v. Mozilo*, Decl. of Daniel P. Lefler In Support Of Defendants' Motions for Summ. J., filed Aug. 2, 2010 ("Lefler Decl.") Ex. 239 (McMurray E-mail to David Sambol, May 22, 2005).

guidelines. The algorithm was effectively a "black box," containing a blueprint or formula known only to Countrywide's senior executives.[114]

139. Here, as in so many other areas, the truth did not match Countrywide's depictions. Countrywide claimed that CLUES only approved exception loans when specific and strong compensating factors were present. But in fact, CLUES was programmed to "accept" loan applications where such factors were not present. Worse still, when the CLUES program itself deemed compensating factors inadequate to allow the approval of a loan, the system "referred" the loan application for "manual" underwriting, and a manual underwriter could rely on the very same "compensating" factors that CLUES deemed insufficient to approve the loan.[115]

140. Due to its swiftly evolving guidelines, Countrywide did not have the resources to keep CLUES up-to-date, and there was often a significant lag between new guidelines being implemented and the CLUES system being updated. Therefore, a loan could be "accepted" by CLUES even though it did not meet the current guidelines.[116]

141. Apart from this time lag factor, CLUES was also known to grant "accepts" due to misprogramming or other technical errors. In one case – described as "beyond belief" by Countrywide's Chief Risk Officer – CLUES granted "accept" decisions to supposedly A-grade loans with FICO scores below 580, despite the fact that there was supposed to be a minimum

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[114]In announcing Bank of America's plan to acquire Countrywide on January 11, 2008, Ken Lewis, Bank of America's then-Chairman and CEO, cited as key drivers of the deal Countrywide's "industry-leading technology" and "best mortgage platform in the business," a core component of which was CLUES. *MBIA*, Aff. of Jonathan B. Oblak in Supp. Of Pl.'s Mot. for Summ. J., filed Sept. 28, 2012 ("Oblak Aff."), Ex. 13 (Jan. 11, 2008 e-mail from Riddell to Shearer et al. attaching BAC Strategic Announcement Discussion transcript).

[115]Only in mid-2007 did Countrywide amend its underwriting manuals to explicitly prohibit this practice. *See* Complaint ¶ 30, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. 2009).

[116]*MBIA*, Concannon Aff. Ex. 2 (Transcript of Scott Berry Deposition, Sept. 9, 2011) at 426.

floor of 585.[117] Despite these serious inaccuracies, Countrywide "had a business philosophy that . . . would honor a CLUES accept, even if we knew CLUES was wrong."[118] As described by one employee familiar with CLUES, "the philosophy at Countrywide was to . . . not reunderwrite loans underwritten by CLUES."[119]

b. *Loans Were Approved By Employees Without Proper Authority Or Procedures*

142. The extent of the problems with underwriting did not begin or end with CLUES. The manual underwriting system was likewise flawed due to improper training and lax enforcement of underwriter authority requirements. One branch operations manager in Colorado, Mari Eisenman, later confirmed that underwriters in her branch were hired without the proper training and qualifications.[120] Although underwriters were supposedly only able to approve loans up to certain limits, a March 2006 internal audit noted – as a repeat finding – that 31% of "CLUES Refer" loans were underwritten by employees without designated underwriting authority.[121]

143. Proper procedures were also discarded if they got in the way of loan origination. For example, Eisenman explained that her supervisor would approve loans that Eisenman would not otherwise have approved when Eisenman was away at training.[122] Similarly, an underwriting supervisor at another branch, Enid Thompson, reported that "her decisions on several loans had been changed without her knowledge, and without her name being

[117] *Id.* at 415-20.

[118] *Id.* at 406.

[119] *Id.*

[120] *MBIA*, Sheth Aff. Ex. 6 (Transcript of Mari Eisenman Deposition, Feb. 14, 2011) at 38-39.

[121] *MBIA*, Sheth Aff. Ex. 141 (IA Audit of CMD, dated Mar. 31, 2006).

[122] *MBIA*, Sheth Aff. Ex. 6 (Transcript of Mari Eisenman Deposition, Feb. 14, 2014) at 34-35.

taken off as the responsible underwriter. In some of the cases, the loans were changed from decline to approve. In others, she had placed strict conditions that had to be met prior to approval and required that the loans be approved through her, and then learned that the loans were approved without the conditions being met and without her seeing the matter again."[123]

144. A managing director for business segment compliance noted in a June 2006 e-mail that CMD "can greatly enhance its standing with the credit group by showing it doesn't have tolerance for blatant noncompliance with critical project and loan approval requirements, and that CMD will take action when such instances come to light."[124] This managing director was not sure if such action was ever taken.

4. *Countrywide Exerted Undue Influence Over Appraisers And Condoned Appraiser Fraud*

145. Another tactic Countrywide pursued to increase its loan production and circumvent the requirements of its own loosened underwriting guidelines was to exert improper influence over the appraisal process to achieve overstated values on the properties being financed. Countrywide adopted this practice notwithstanding that its own Technical Manual states that Countrywide is 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 uses "do not engage in unacceptable practices."[125]

146. In order to maximize the amount of influence it exerted over the appraisal process, Countrywide funneled most of its appraisals through its affiliate, Landsafe, Inc. Landsafe contracted with third party appraisers to perform the initial appraisals on properties and

[123] Complaint ¶ 79, *Thompson v. Countrywide Financial Corp*., Case No. 08-01910 (Cal. Super. Ct. Jul. 29, 2008).

[124] *MBIA*, Sheth Aff. Ex. 17 (Transcript of Marc Fisher Deposition, Jul. 19, 2011) at 92-97.

[125] *MBIA*, Sheth Aff. II Ex. 119 (Countrywide Technical Manual § 3.12.1).

also employed staff appraisers to conduct reviews of all Countrywide appraisals. While this system gave an appearance of independence and rigorous quality control that Countrywide could market to investors, in reality Landsafe acted as a conduit for pressure being exerted by Countrywide on the third party appraisers, and the "review" process became a stopgap measure to ensure that the final appraised value on all Countrywide properties was sufficiently inflated for all loans to close.[126]

147. In many cases, Countrywide loan officers contacted allegedly independent appraisers directly to request that legitimate appraisal values be increased.[127] Countrywide Regional Vice President Mark Zachary has testified that it was common practice throughout the company for loan officers to request that appraisal values be increased to justify larger loan amounts so that closing costs could be "rolled up" into the mortgages.[128]

148. Countrywide funneled its work to those appraisers whom it knew would inflate property values to achieve Countrywide's origination goals, while appraisers who resisted this pressure were blacklisted and denied additional work on Countrywide loans.[129] One former appraiser, Debbie Cottingham, has testified that she was explicitly informed by the local Countrywide branch manager that she would no longer be receiving Countrywide work because the highest volume loan producer in the branch was unhappy with the values on Cottingham's appraisals.[130] Kyle Lagow, a former Landsafe employee, has alleged multiple other incidents where Countrywide representatives explicitly stated that they would not work with certain

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[126]Complaint, ¶ 108, *U.S. ex rel. Lagow v. Countrywide Financial Corp.*, 09-cv-02040 (E.D.N.Y. 2009).

[127]*MBIA*, Concannon Aff. Ex. 5 (Transcript of Debbie Cottingham Deposition, Dec. 20. 2011) at 86-88; Complaint ¶ 109, *U.S. ex rel. Lagow v. Countrywide Financial Corp.*

[128]*MBIA*, Sheth Aff. Ex. 5 (Transcript of Anthony Mark Zachary Deposition, Jan. 25, 2012) at 36-37, 127-28.

[129]Complaint ¶¶ 120, 133-43, *U.S. ex rel. Lagow v. Countrywide Financial Corp.*

[130]*MBIA*, Sheth Aff. Ex. 5 (Transcript of Debbie Cottingham Deposition) at 81-84.

appraisers because they consistently came in "under value."[131] Such blacklisting represented a significant threat to the livelihoods of independent appraisers in light of Countrywide's dominance of the residential mortgage market.

149. When an appraiser refused to inflate the stated value of a property, Landsafe would simply conduct a "review" of that appraiser's work to ensure that the property was appraised at Countrywide's desired value.[132] Eisenman has testified that she personally witnessed loan officers removing previous appraisals from a loan file and entering only the highest-valued appraisal into the CLUES system for approval, which was a blatant violation of Countrywide's policies.[133]

150. By exerting its influence as the largest mortgage lender in the country, Countrywide was able to manipulate the appraisal process and systematically overstate the value of the properties it was financing. As a result, loan officers were able to circumvent Countrywide's underwriting guidelines with respect to loan-to-value ratios – which were based on the property value – and understate the credit risk associated with the loans being securitized.

5. *Countrywide Employees Committed Fraud*

151. When loosening or ignoring underwriting guidelines was not enough to get a loan approved, in many cases Countrywide employees resorted to outright fraud to close the loan. Evidence suggests that loan officers across the country intentionally misstated key loan information, routinely manipulated Countrywide's automated systems, and altered or forged documents to increase loan production and fraudulently generate revenues for Countrywide.

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[131] Complaint ¶¶ 133-43, *U.S. ex rel. Lagow v. Countrywide Financial Corp.*

[132] Complaint ¶ 138, *U.S. ex rel. Lagow v. Countrywide Financial Corp.*

[133] *MBIA*, Sheth Aff. Ex. 6 (Transcript of Mari Eisenman Deposition, Feb. 14, 2012) at 130-31.

a. *<u>Countrywide Employees Intentionally Misstated Information On Loan Applications</u>*

152. Countrywide employees deliberately and covertly misstated information such as owner occupancy or borrower income on loan applications in order to circumvent Countrywide's underwriting guidelines and guarantee that loans were approved. For example, Eisenman testified that she witnessed multiple instances of loan officers misstating the owner-occupancy status of a loan. When she would review such loans, the supporting documentation in the loan file would frequently contradict the claim that the borrower intended to occupy the property being financed. She was also aware of cases in which the same loan officer would close multiple loans for the same customer in a single month, with each new property being listed as the borrower's primary residence on the loan application. The owner-occupancy status of a loan is an important indicator of credit risk, and Countrywide used more lenient underwriting guidelines and awarded lower interest rates for "owner-occupied" loans. Thus, by falsely representing the occupancy status of a property, loan officers were underreporting the potential risk associated with that loan.[134]

153. There also have been multiple reports of Countrywide loan officers inflating borrowers' income on loan applications without the knowledge of those borrowers. Zachary has detailed one such instance in which the duped customer sent an e-mail to Countrywide stating: "I was told that my loan had been turned over to Countrywide's internal fraud department for review because a loan officer increased my income figures without authorization in order to get me approved for the stated income loan. I was told by several

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[134] *MBIA*, Sheth Aff. Ex. 6 (Transcript of Mari Eisenman Deposition, Feb. 14, 2012) at 56, 59, 96.

people at Countrywide that this was done just to get me qualified and that nobody would check on it."[135]

154. Audrey Sweet of Maple Heights, Ohio, a victim of Countrywide's predatory lending practices, told a similar story of falsified loan documents in her testimony before the Joint Economic Committee of Congress. Sweet stated that when she reviewed her loan application after her loan had closed, she

> discovered several things I had apparently overlooked until then. The first was that my gross monthly income was recorded as $726 dollars more than it actually was. Secondly, I have two sets of loan documents, one that was created 10 days before we closed and one that was created the day of closing. The closing day documents list my assets as $9,400 in my Charter One Bank Account. I have never had $9,400 in the bank. Indeed, coming up on payday, I am fortunate to have $94 left. The final item I noticed was that the tax amount listed on the appraisal report was $1981.34, which comes to about $165.00 per month but Countrywide listed $100 as the tax amount.

155. Investigations by Countrywide's Fraud Risk Management department revealed that loan officers throughout entire regions were routinely moving borrowers whose actual income was insufficient into stated income loans that listed falsely inflated incomes, and then destroying the supporting documentation (such as paystubs or W-2 forms) that reflected the borrowers' true income.[136]

156. The testimony of former due diligence underwriters who worked on Countrywide securitizations reveals that the inflation of borrower incomes on stated income loan products was a part of the corporate culture at Countrywide. These underwriters report that during their reviews of random cross-sections of Countrywide loans they routinely encountered

[135] Second Amended Complaint ¶ 17, *Zachary v. Countrywide Fin. Corp.*, No. 08-CV-00214 (S.D. Tex. filed Apr. 9, 2008).

[136] Foster FCIC Interview at 53:55-55:23.

stated income loans listing fantastical incomes, such as McDonald's workers and maids who made $15,000 per month.[137]

157. Further, as noted above, Countrywide's executives were aware of, but failed to disclose, internal findings that representations of incomes on stated loan applications were overwhelmingly inflated. Countrywide's management knew that nearly 40% of the reduced documentation loans held in Countrywide Bank's portfolio had misstated incomes, and therefore misstated debt-to-income ratios.[138] Countrywide did not disclose these facts to either Ambac or the investing public.

b. *Countrywide Employees Manipulated Countrywide's Automated Underwriting System*

158. Countrywide employees also manipulated the automated underwriting system to circumvent Countrywide's built-in guidelines and protections and generate approvals for loans that would not otherwise have been funded. For example, Eisenman has testified that she personally witnessed an underwriter in her branch run a CLUES report multiple times for the same loan application, increasing the borrower's income each time until the CLUES system approved the loan. When she reported this behavior to Countrywide's corporate fraud investigators, they confirmed that there were multiple CLUES entries for loans in her branch with each entry increasing the borrower's income until the loan was approved. Upon discovering that the CLUES system left a record of such manipulation, the area manager advised employees simply to use a sufficiently inflated income at the outset so that the CLUES system

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[137] *MBIA*, Sheth Aff. Ex. 236 (Affidavit of James Clarkson, Nov. 17, 2011) ¶ 12; *MBIA*, Sheth Aff. Ex. 36 (Transcript of Nashikeata Mann Deposition, Jan. 27, 2012) at 67-68.

[138] *SEC v. Mozilo*, Dean Decl. Exs. 113 (Email from Clifford Rossi to Jim Furash, et al., dated Jun. 2, 2006), at CFC2007D814286; 114 (Countrywide Bank Credit Risk Committee Report, dated Apr. 2006), at CW-G078657-0014 and 117 (Email from Carlos Garcia to David Sambol, dated Jun. 2, 2006) at CFC007182178.

would approve the loan on the first run.[139]

159. Similarly, in an NBC News report, one former Countrywide loan officer said that he had seen Countrywide supervisors stand by and watch as loan officers repeatedly entered fictitious income figures into Countrywide's system until it approved the borrower for a loan. A borrower stated in the same report that a Countrywide loan officer advised her to double her salary when completing her loan application.[140]

160. The results of multiple investigations by Countrywide's Fraud Risk Management department reveal that the practice of running CLUES multiple times with false information to generate loan approvals was prevalent across all regions and divisions of the company.[141] The widespread nature of this practice is corroborated by the testimony of former due diligence underwriters, who report frequently seeing multiple CLUES reports in the loan files they reviewed.[142]

c. *Countrywide Employees Altered And Forged Loan Documents*

161. What Countrywide employees could not accomplish through misstatements and manipulation, they achieved through simple forgery. Internal investigations by the Fraud Risk Management department revealed that document alteration was a systemic problem in multiple regions and divisions of the company. These investigations revealed

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[139] *MBIA*, Sheth Aff. Ex. 6 (Transcript of Mari Eisenman Deposition, dated Feb. 14, 2012), at 36, 63, 222, 224.

[140] Lisa Myers, *Countrywide Whistleblower Reports 'Liar Loans': Former Regional Manager Sues Mortgage Company for Wrongful Termination*, NBC Nightly News, July 1, 2008, http://www.msnbc.com/id/25465130/ns/nightly_news/.

[141] *MBIA*, Sheth Aff. Ex. 350 (Ltr. from Matthew Tonkovich to Susan Kamlet, Regional Investigator, Occupational Safety and Health Admin, U.S. Dep't of Labor, dated Sept. 11, 2009), at 16, 18; Foster FCIC Interview at 53:56-54:10.

[142] *MBIA*, Sheth Aff. Ex. 236 ¶ 14; *MBIA*, Sheth Aff. Ex. 38 (Transcript of James W. Clarkson Deposition, dated Dec. 17, 2011) at 91-92, 96, 99-102; *MBIA*, Sheth Aff. Ex. 36 (Transcript of Nashikeata Mann Deposition, dated Jan. 27, 2012) at 63-65, 69-73, 211-13, 222.

evidence that loan officers were forging borrowers' signatures on loan documents, cutting and pasting documents to alter information, and filling out blank templates of bank statements in order to manufacture supporting documents for the loan files. In some instances, employees received formal training in document forgery as a part of their official new employee training.[143]

162. As another example, in order to circumvent the loan-to-value ratio limits required by Countrywide's guidelines, loan officers would enter an address into the automated valuation system that would generate a sufficient property value, print the report, paste the real address of the property to be purchased over the false address, and then photocopy the document for the loan file to make it appear as if the automated system had generated the requisite value for the property being financed.[144]

163. Despite the evidence of rampant fraud by loan officers and brokers throughout the company, Countrywide failed to disclose such evidence to its investors, insurers, shareholders, or the public.

6. *Countrywide's Fraud Detection And Prevention Program Was Inadequate*

164. Countrywide failed to detect and properly address the widespread employee fraud outlined above. At best, Countrywide's internal fraud division was inadequate, lacking the resources and experience necessary to combat a culture that encouraged employees to

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[143] Eileen Foster, *Obama Administration Needs to Tap, Not Stiff-Arm, Wall Street Whistleblowers*, Rolling Stone, Aug. 9, 2012, *available at* http://www.rollingstone.com/politics/news/the-obama-administration-needs-to-tap-not-stiff-arm-wall-street-whistleblowers-20120809; *MBIA*, Sheth Aff. Ex. 350 (Ltr. from Matthew Tonkovich to Susan Kamlet, Regional Investigator, Occupational Safety and Health Admin, U.S. Dep't of Labor, dated Sept. 11, 2009), at 18; *MBIA*, Sheth Aff. Ex. 3 (Transcript of Eileen Foster Deposition, dated Feb. 22, 2012) at 76, 98-99; *MBIA*, Sheth Aff. Ex. 6 (Transcript of the Mari Eisenman Deposition, dated Feb. 14, 2012) at 150-53; *MBIA*, Sheth Aff. Ex. 95 (Secretary's Findings re: Bank of America Corp. et al. / Foster / 9-3290-09-013, Occupational Safety and Health Admin., U.S. Dep't of Labor, dated Sept. 13, 2011) at 2, 6.

[144] *MBIA*, Sheth Aff. Ex. 350 (Ltr. from Matthew Tonkovich to Susan Kamlet, Regional Investigator, Occupational Safety and Health Admin, U.S. Dep't of Labor, dated Sept. 11, 2009), at 16; Foster FCIC Interview at 52:17-53:21; *MBIA*, Sheth Aff. Ex. 3 (Transcript of Eileen Foster Deposition, dated Feb. 22, 2012) at 72-73.

do whatever it took to approve a loan. At worst, Countrywide purposefully designed its fraud reporting process to circumvent the centralized fraud detection unit, protect high-producing loan officers, and punish those employees who were brave enough to speak out against fraudulent practices.

165. Although Countrywide did establish a centralized fraud hotline to address reports of fraud across all of its divisions, it failed to employ an adequate number of fraud investigators to handle the number of fraud complaints it was receiving. Eileen Foster, head of the Fraud Risk Management department, testified that there were not enough fraud investigators employed in her division, which resulted in unmanageable caseloads for the employees she did have. For example, when Foster first went to work in Fraud Risk Management, there were only 32 investigators employed to address the approximately 2,400 fraud reports that Countrywide received each month. This meant that some investigators were responsible for as many as 300 cases at a time.[145]

166. The few fraud investigators that Countrywide did employ lacked the training and experience necessary to root out fraud at Countrywide. Foster has stated that of the 32 investigators in her unit when she took over, only three had the knowledge necessary to perform fraud investigations. The rest were data entry clerks, transferred to her division from the customer service department, who lacked a background in mortgage lending.[146]

167. The dangers that arose as a result of the inadequacy of the Fraud Risk Management department were compounded by the fact that Countrywide often failed to follow its own established procedures for detecting and reporting fraud. For example, a February 2005

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[145] *MBIA*, Sheth Aff. Ex. 3 (Transcript of the Eileen Foster Deposition, dated Feb. 22, 2012) at 37-38, 123-124; Foster FCIC Interview at 30:19-31:04.

[146] Foster FCIC Interview at 30:19-31:31.

audit of CMD revealed that 76% of Quality Verification and Documentation Questionnaires ("QVDQs") had not been completed and signed by approved underwriters for the section related to the detection of fraud. The audit report describes the QVDQ as "the primary control used to ensure potential fraud indicators are assessed by a qualified underwriter" and identifies the failure to properly complete the fraud section of the QVDQ as a "considerable risk" to CMD.[147]

168. Countrywide employees viewed the fraud detection procedures as a hindrance, rather than a necessary part of their business model. The general attitude toward the Fraud Risk Management department was that "it was not fraud prevention, it was loan prevention." As a result of this attitude, the relationship between the production divisions and the fraud division at Countrywide was adversarial, and there were even instances where the corporate fraud investigation team was banned from certain branches or needed permission from production to visit certain branches.[148]

169. In some instances, Countrywide purposefully circumvented the established fraud reporting procedures of the Fraud Risk Management department. Both CMD and Full Spectrum Lending ("FSL," which specialized in subprime origination) established internal fraud detection departments that circumvented the corporate fraud investigation unit and diverted fraud reports from the centralized fraud hotline.[149] These divisional fraud investigation groups refused to provide suspicious activity reports to Foster's department, which resulted in the gross underreporting of suspected fraud.[150]

170. Reports of fraud were also systematically diverted to the Employee

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[147] *MBIA*, Sheth Aff. Ex. 138 (CMD Audit Report, dated Feb. 28, 2005), at 5-8.

[148] Foster FCIC Interview at 24:50-26:42.

[149] Foster FCIC Interview at 24:50-26:42.

[150] Foster FCIC Interview at 38:10-43:03.

Relations division. Employee Relations representatives failed to direct employees to the fraud hotline when those employees reported suspicions of fraud, failed to report the suspected fraud themselves, and often conducted their own investigations into the alleged fraud, despite lacking any competency to conduct such investigations.[151]

171. Contrary to Countrywide's established fraud reporting procedures, employees were at times affirmatively directed to report allegations of fraud to Employee Relations or to the internal fraud units at CMD and FSL, rather than to the centralized fraud hotline. The investigators in those divisions reported to the same individuals who oversaw sales production, and thus any allegations diverted into these channels would not receive a full review by competent and independent fraud investigators. Furthermore, because these divisions did not forward the reports they received to Fraud Risk Management, the allegations ultimately would not be reflected in reports to regulators, investors, and shareholders.[152]

172. More disturbingly, rather than properly investigate the alleged fraud or inform Fraud Risk Management of the allegations, Employee Relations would often reveal the identity of whistleblowers to the employees whom they had accused of committing fraud, thus permitting these whistleblowers to be subjected to retaliation. Foster has described the system as follows: "Countrywide directed [whistleblowers] to report their allegations to the suspect officials' managers. It was a trap, and the system was rigged. Instead of taking action, the managers would then share the information with the suspects themselves, who would then hit

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[151]*MBIA*, Sheth Aff. Ex. 95 (Secretary's Findings re: Bank of America Corp. et al. / Foster / 9-3290-09-013, Occupational Safety and Health Admin., U.S. Dep't of Labor, dated Sept. 13, 2011) at 3.

[152]*MBIA*, Sheth Aff. Ex. 3 (Transcript of Eileen Foster Deposition, Feb. 22, 2012), at 111:20-113:03; *MBIA*, Sheth Aff. Ex. 350 (Ltr. from Matthew Tonkovich to Susan Kamlet, Regional Investigator, Occupational Safety and Health Admin, U.S. Dep't of Labor, dated Sept. 11, 2009), at 2, 4.

back at the whistleblowers."[153]

173. Even when reports of fraud that had been improperly concealed from Fraud Risk Management were eventually investigated by the appropriate division, Employee Relations insisted on being present during fraud investigation interviews conducted by Fraud Risk Management – a significant deviation from conventional investigatory practices.[154]

174. Foster reported to her superiors at Countrywide her concerns that Employee Relations was systematically concealing widespread fraud from the Fraud Risk Management group. She was terminated shortly thereafter. Other individuals were similarly retaliated against soon after reporting concerns regarding fraud at Countrywide. In one instance, an individual suffered retaliation within hours of sending an e-mail reporting fraudulent and unethical practices to Mozilo.[155]

175. Thus, not only were the fraud detection procedures at Countrywide wholly inadequate to address the level of fraud occurring, what procedures did exist were widely ignored and certain divisions within Countrywide actively worked to circumvent those procedures and conceal widespread fraud at the company so that high-producing loan officers could continue to generate revenues.

7. *Countrywide's Quality Control Procedures Were Inadequate*

176. As noted earlier, Countrywide told Ambac and the investment community that its Quality Control department "complet[ed] loan audits that may consist of a re-verification of loan documentation, an underwriting and appraisal review, and, if necessary, a fraud

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[153]Eileen Foster, *Obama Administration Needs to Tap, Not Stiff-Arm, Wall Street Whistleblowers*, Rolling Stone, Aug. 9, 2012, http://www.rollingstone.com/politics/news/the-obama-administration-needs-to-tap-not-stiff-arm-wall-street-whistleblowers-20120809.

[154]*MBIA*, Sheth Aff. Ex. 350, at 17.

[155]Compl. ¶¶ 24-25, *Thompson v. Countrywide Financial Corp.*, C08-01910 (Cal. Super. Ct. July 29, 2008).

investigation" and that this system "helps to identify fraud and poor performance of individuals and business entities associated with the origination of our loans."[156] Nothing could have been further from the truth.

177. Countrywide's public representations notwithstanding, the company lacked an adequate and independent quality control program to uncover and address lax underwriting. For example, the structure of the Quality Control department hampered its ability to ensure that employees were adhering to Countrywide's stated policies and procedures. As a result of the reporting structure in the company, Quality Control functioned merely as an auditor of the Countrywide loan divisions, reporting on whether or not policies and guidelines were being followed rather than actually ***enforcing*** those policies and guidelines.[157]

178. Instead, it was Countrywide's production department that was tasked with ensuring that loan officers were abiding by Countrywide's underwriting policies – an inherent conflict of interest between production and risk management goals.[158] This conflict was evidenced by reports from Quality Control employees to the fraud hotline that they were being intimidated into disregarding their standards and findings and steered away from auditing certain loans.[159]

179. As a result of the Quality Control department's inability to enforce underwriting guidelines, quality control audits continued to reveal serious deficiencies in Countrywide's underwriting process. For example, at a December 2006 Credit Risk

[156] Countrywide Financial Corp., Annual Report for Fiscal Year 2007 (Form 10-K), at 118 (Feb. 28, 2008).

[157] *MBIA*, Sheth Aff. Ex. 105 (Transcript of Rodney Russell Williams Deposition, Sept. 21, 2011) at 99:06-100:13.

[158] *MBIA*, Sheth Aff. Ex. 105 (Transcript of Rodney Russell Williams Deposition, Sept. 21, 2011) at 99:06-100:13.

[159] *MBIA*, Sheth Aff. Ex. 3 (Transcript of Eileen Foster Deposition, Feb. 22, 2012) at 92-93.

Management Committee meeting, Managing Director of the Credit Risk Management group Rod Williams reported that one out of every four loans that had been audited by Quality Control contained some defects.[160]

8. *Countrywide Manipulated Its Third-Party Diligence Providers*

180. When Countrywide securitized loans through Countrywide Securities, as was the case with CWALT 2005-81, it typically would engage a third-party due diligence provider to perform due diligence underwriting on a sample of the loans in the proposed securitization pool. While this practice gave the appearance of an independent review meant to assure potential investors of the quality of Countrywide's product, in reality Countrywide manipulated the due diligence process from start to finish, ensuring that it was able to securitize as many loans as possible.

181. Although the due diligence was performed by third-party underwriters, Countrywide had the ability to dictate the parameters of the review based on the guidelines it sent to the due diligence providers. Countrywide frequently failed to provide its due diligence underwriters with the applicable loan program guidelines, leaving them unable to verify properly whether the sample loans from the pool conformed to those guidelines. Consistent with Mozilo's disparaging comments about the irrelevance of underwriting guidelines, one due diligence underwriter has testified that the attitude of the due diligence providers was "[g]uidelines, we don't need no stinking guidelines."[161]

182. When Countrywide did transmit loan program guidelines to its due diligence providers, those guidelines were often out of date or inaccurate. Employees from

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[160] *MBIA*, Sheth Aff. Ex. 300 (Credit Risk Committee Meeting Minutes, dated Dec. 2006) at 6-7.

[161] *MBIA*, Sheth Aff. Ex. 38 (Transcript of James W. Clarkson Deposition, Dec. 17, 2011) at 124; *see also id.* at 77-80, 121-124.

several of the due diligence companies that Countrywide retained testified that they were instructed to use out-of-date guidelines when conducting their due diligence review, even if a different version of the guidelines had been in effect when the loan was approved.[162]

183. In its settlement with the Department of Justice, Bank of America admitted that "[i]n certain instances, Countrywide provided the due diligence providers with what were known as 'Seller Loan Program Guides,' which . . . frequently listed lower credit scores or higher DTI and LTV ratios than the applicable Loan Program Guides or the applicable Shadow Guidelines."[163] As a result, a due diligence underwriter using these Seller Loan Program Guides in place of the actual loan program guidelines might incorrectly report that a certain loan conformed to the guidelines, when in fact it was a non-compliant loan. Countrywide did not want to provide these Seller Loan Program Guides to potential investors out of concern that "the outer bounds might scare them."[164]

184. Countrywide also placed tight time constraints on its due diligence reviewers, and in doing so virtually ensured that the third-party underwriters would be unable to complete a proper review of all of the sample loans. Former due diligence underwriters have testified that they had to "emphasize[] speed over quality" as a result of the pressure from Countrywide to complete the review within a shortened time frame. In an effort to meet Countrywide's demands, the due diligence providers created financial incentives for those underwriters who could consistently review a high volume of loans. Underwriters were expected to review as many as twenty loans per day – an "impossible" pace. When underwriters

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[162] *MBIA*, Sheth Aff. Ex. 36 (Transcript of Nashikeata Mann Deposition, Jan. 27, 2012) at 140, 146; *MBIA*, Sheth Aff. Ex. 35 (Transcript of Robert Thornton Deposition, Dec. 20, 2011) at 77-79.

[163] BAC Settlement, Annex 1 at 8.

[164] *MBIA*, Sheth Aff. Ex. 64 (Transcript of Jens Christian Ingerslev, May 20, 2011) at 628.

complained that they could not meet their targets while completing a thorough review of the loan files, they were instructed to merely copy the information from the loan applications into the underwriting program without verifying it, with the assurance that "the client understands." As a result, many underwriters did not review the loan files at all when conducting due diligence.[165]

185. Due diligence underwriters also were instructed to ignore red flags and discrepancies in the loan data they were reviewing. On many occasions, underwriters found that the loan tape data differed from the information in the loan files. However, they were instructed to simply accept the loan tape data as accurate and enter it into the underwriting system.[166] Due diligence underwriters also were directed by their team leads not to question patently unreasonable incomes and to ignore contradictory evidence of a borrower's income in the loan file when they reviewed stated-income products.[167]

186. Reviewers uncovered rampant evidence of fraud in Countrywide loan files. For example, there was evidence that in many cases the CLUES system had been run multiple times in order to generate an "accept." In such instances, the due diligence underwriters were instructed to use only the final run of CLUES when entering data into the due diligence system. Despite these red flags, however, underwriters were specifically instructed not to use the word "fraud" in their comments on the due diligence system because the "clients" (i.e., Countrywide) did not want to conduct a fraud review on the loans. Underwriters were admonished that they were not fraud investigators, they were just data collectors. The mantra

[165] *MBIA*, Sheth Aff. Ex. 236 (Affidavit of James Clarkson, Nov. 17, 2011) ¶ 9.

[166] *MBIA*, Sheth Aff. Ex. 38 (Transcript of the James W. Clarkson Deposition, Dec. 17, 2011) at 192-95; *MBIA*, Sheth Aff. Ex. 36 at 105, 110-11.

[167] *MBIA*, Sheth Aff. Ex. 236 ¶¶ 11, 16; *MBIA*, Sheth Aff. Ex. 38 at 85-88.

repeated by the due diligence providers was that "there are no bad loans, there are just bad prices."[168]

187. Due diligence underwriters were often pressured to upgrade their initial loan ratings by finding "compensating factors" in the loan file. However, the factors identified typically would not have justified increasing the loan grade. Underwriters were instructed to be "creative" in identifying compensating factors and their directive was that "whatever it takes, make it a 2," which was an acceptable grade on the due diligence scale. This practice was so widespread that it became a joke in the industry that if the borrower was breathing, that was a compensating factor to justify an exception loan.[169]

188. In some cases, representatives of Countrywide would request that the grades on certain loans be increased.[170] Even absent such a request, Countrywide had the ability to override the underwriters' grading decisions, and by the end of a typical due diligence project nearly half of the loans in the sample pool would be upgraded from a failing to a passing grade. In one instance, Tonya LyBrand, a Countrywide Securities employee, called the due diligence provider to discuss a pool of loans and by the end of the conversation, 45% of those loans had been upgraded to a passing grade, without any substantial justification for the increase.[171]

189. Thus, despite the veneer of independence created by engaging third-party contractors to conduct due diligence on their loans included in transactions underwritten by Countrywide Securities, Countrywide controlled all aspects of the due diligence process by

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[168]*MBIA*, Sheth Aff. Ex. 236, ¶ 14; *MBIA*, Sheth Aff. Ex. 38 at 91-92, 96, 99-102; *MBIA*, Sheth Aff. Ex. 36 at 63-65, 69-73, 211-13, 222.

[169]*MBIA*, Sheth Aff. Ex. 35 at 103, 111, 114, 120; *MBIA*, Sheth Aff. Ex. 38 at 69-70, 110-14, 144-45.

[170]*MBIA*, Sheth Aff. Ex. 38 at 44.

[171]*MBIA*, Sheth Aff. Ex. 36 at 222-23; *MBIA*, Sheth Aff. Ex. 236 ¶ 18; *MBIA*, Sheth Aff. Ex. 38 at 178-82.

dictating the terms of the review and exerting pressure on the due diligence providers, thereby ensuring that their loans would be securitized without ever being subjected to a thorough review.

D. Countrywide Management Knew Its Procedures Were Inadequate

190. By the time the Transactions at issue in this lawsuit closed, Countrywide's management was fully aware that it had created a system that incentivized risk-taking and fraud and that it lacked any meaningful procedures to ensure the quality of its product. As reflected by the numerous reports of unsound lending practices to management during this time, as well as by the admissions of several high-ranking executives, it is clear that Countrywide had begun to suspect that the loans were destined to fail, and yet did nothing to address the numerous problems it faced or to warn those who insured or invested in mortgage-backed securities with Countrywide collateral of the dangers ahead.

1. *Management Ignored Reports Of Fraud And Punished Employees Who Made Such Reports*

191. As early as 2005, concerned Countrywide employees began raising the alarm about the abandonment of prudent underwriting guidelines and widespread employee fraud. Several individuals contacted the highest levels of Countrywide management directly with their concerns. Unfortunately, many of these individuals were retaliated against and their reports were ignored.

192. In February 2005, branch operations manager Mari Eisenman sent two letters to Countrywide CEO Angelo Mozilo and Managing Director and Chief Production Officer of CMD Brian Hale, informing them of the fraud she had uncovered at her branch, including use of multiple appraisals, misstatements of occupancy status on loans, and manipulation of borrower incomes in CLUES. She also expressed her concern that upper-level management at her branch had participated in the fraud and retaliated against her for reporting it.

Eisenman specifically warned that Countrywide was selling fraudulent loans to third parties.[172]

193. Similarly, in March 2007, underwriting supervisor Enid Thompson e-mailed Mozilo regarding her concerns that the pressure placed on employees to close as many loans as possible without regard to the quality of the loan or the ability of the borrower to repay it was leading to the approval of fraudulent loans. Within twelve hours of sending the e-mail, Thompson began to experience an escalating pattern of retaliation that culminated in her dismissal.[173]

194. Beginning in the fourth quarter of 2007, Eileen Foster repeatedly warned Countrywide executives that her investigators in Fraud Risk Management were uncovering widespread fraud across multiple lending divisions. In December 2007, Foster informed Managing Director of Production Risk Management, Mark Miller, and Vice President of Internal Audit, Bryan Coleman, that Fraud Risk Management had uncovered severe and systemic fraud in the FSL division and that it appeared that fraud incidents there were being grossly underreported. Foster later discussed with Miller her concerns that the Employee Relations division was obstructing fraud investigations and protecting high-producing loan officers. She also expressed these concerns to high ranking managers in the Employee Relations and Ethics and Loss Prevention departments. Foster even began compiling a list of loans sold to investors that had been identified as fraudulent and sent it to Miller. He instructed Foster to stop keeping track of that information. Finally, in May 2008, Foster reported the results of her investigation into widespread fraud in CMD to representatives of CMD and Employee Relations. She also wrote a memorandum to the Internal Audit division formally complaining of the Employee Relations

[172]*MBIA*, Sheth Aff. Ex. 6 (Transcript of the Mari Eisenman Deposition, Feb. 14, 2012) at 199-208, 210-12.

[173]Complaint ¶¶ 20, 24-25, 31, *Thompson v. Countrywide Financial Corp., et al.*, C08-01910 (Cal. Super. Ct. July 29, 2008).

department's obstruction of her investigations. A few months later, she was fired.[174]

2. *Management Ignored Audit Findings Concerning Systemic Flaws*

195. Countrywide's own Internal Audit and Risk Management departments also began reporting to Countrywide executive management about systemic flaws in the company's risk management strategies.

196. An October 2004 CMD audit report sent to high-level Countrywide management concluded that there were significant risks associated with the creation of CMD's Structured Loan Desk, which had been developed to pursue the strategic plan to "price all saleable loans." The report identifies several potential areas of risk, including that loan data was never verified by SLD employees and that unauthorized users had access to the system to approve exception loans.[175]

197. A February 2005 CMD audit report sent to high-level Countrywide management revealed that the fraud sections of QVDQs, which represented a chief branch-level control to address potential fraud, were not being properly completed and signed by approved underwriters for the section related to the detection of fraud. The report identified the failure to properly complete the fraud section of the QVDQ as a "considerable risk" to CMD.[176]

198. A June 2005 Countrywide Credit Risk Committee report indicated that certain categories of exception loans were severely underperforming conforming loans. For example, exception loans greater than $650,000 were performing 2.8 times worse than non-

[174] *MBIA*, Sheth Aff. Ex. 95 (Secretary's Findings re: Bank of America Corp. et al. / Foster / 9-3290-09-013, Occupational Safety and Health Admin., U.S. Dep't of Labor, dated Sept. 13, 2011) at 2-5; *MBIA*, Sheth Aff. Ex. 3 (Transcript of the Eileen Foster Deposition, Feb. 22, 2012) at 136:06-140:07.

[175] *MBIA*, Sheth Aff. Ex. 139 (CMD Audit Report, dated Oct. 19, 2004) at 5-9.

[176] *MBIA*, Sheth Aff. Ex. 138 (CMD Audit Report, dated Feb. 28, 2005) at 4-5.

exception loans.[177]

199. A September 2006 Internal Audit report that was distributed at the March 12, 2007 meeting of the Credit Risk Committee cautioned that the Countrywide Home Loans reporting structure, whereby the Chief Production Officer could override the Chief Credit Officer, "pos[ed] a conflict of interest that could prevent credit quality issues from being appropriately considered."[178]

200. Other materials distributed at that same Credit Risk Committee meeting warned that 12% of the loans reviewed by Countrywide's internal Quality Control department were rated severely unsatisfactory or high risk, and that one of the principal causes for such a rating was that loans had debt-to-income, loan-to-value, or FICO scores outside of Countrywide's already broad underwriting guidelines.[179]

201. A November 2007 summary review of Quality Control detailed the high incidence of severely unsatisfactory ratings for loans and cautioned that "the ongoing level of non-compliance indicates a significant breakdown in the manufacturing quality, and if extrapolated to the entire population, indicates a heightened level of risk."[180]

202. Thus, for years, Countrywide management received reports of widespread employee fraud and the failure of the company's risk management systems, yet did nothing to address these issues or inform investors, insurers, or the public of the growing risk within the company.

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[177] BAC Settlement, Annex 1 at 11-12.

[178] *SEC v. Mozilo*, Dean. Decl. Ex. 90 (Internal Audit Department Review, dated Sept. 29, 2006) at 5.

[179] *SEC v. Mozilo*, Dean Decl. Ex. 146 (Minutes of the Meeting of the Credit Risk Management Committee of Countrywide Financial Corporation, dated Mar. 12, 2007) at 6; *SEC v. Mozilo*, Dean Decl. Ex. 133 (Countrywide Financial Corporation Credit Risk Committee Presentation, dated Mar. 12, 2007) at 43.

[180] *SEC v. Mozilo*, Dean Decl. Ex. 119 (Summary Review: Quality Control) at 4.

3. *Senior Management Expressed Concerns About Increased Risk, But Nothing Was Done Or Disclosed*

203. In addition to the direct reports of fraud and other improper practices to Countrywide management, there is documentary evidence suggesting that Countrywide executives were aware of the exponential increase in risk generated by Countrywide's aggressive growth strategy and had begun to fear the worst.

204. As early as 2005, Countrywide executives began expressing concerns to each other about the growing risk associated with their growth strategy. In a May 22, 2005 e-mail, McMurray warned Sambol that although Countrywide had sold most of the risk associated with high risk transactions away to third parties, "we will see higher rates of default on the riskier transactions and third parties coming back to us seeking a repurchase or indemnification based on an alleged R&W breach as the rationale." He also stated that "guidelines and credit standards have become increasingly more aggressive" and that "exceptions are generally done at terms even more aggressive than our guidelines." McMurray suggested that "[g]iven the expansion in guidelines and growing likelihood that the real estate market will cool, this seems like an appropriate juncture to revisit our approach to exceptions."[181] This e-mail was sent in response to an earlier presentation given by Sambol to senior Countrywide executives in which Sambol explained that there was a risk that salespeople would submit loans to be closed without making sure they complied with guidelines.[182]

205. During 2006, the highest level of executives at the company was also expressing serious concerns regarding the potential risk associated with PayOption loans. In a June 1, 2006 e-mail, Mozilo indicated that he had just been informed that the majority of

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[181]*SEC v. Mozilo*, Lefler Decl. ¶ 237, Ex. 239 (E-mail from McMurray to Sambol, dated May 22, 2005) at 1, 2.

[182]*MBIA*, Sheth Aff. Ex. 68 (Transcript of the David Sambol Deposition, dated Jun. 7, 2011) at 147-50.

PayOption loans were being originated as stated-income products, and that there was evidence that the stated income on the loans did not "match up with IRS records." Mozilo observed that given the rise in interest rates, "[i]t is clear that the lower fico borrowers are going to experience a payment shock which is going to be difficult if not impossible for them to manage." He cautioned that "[s]ince we know or can reliably predict what's going to happen in the next couple of years it is imperative that we address the issue right now." Mozilo suggested that Countrywide "comb the assets to assess the risks that we face on Fico's under 700 and determine if we can ***sell them out of the Bank*** and replace them with higher quality paper."[183]

206. In a September 26, 2006 e-mail, Mozilo explained that "[w]e have no way, with any reasonable certainty, to assess the real risk of holding [PayOption] loans on our balance sheet."[184] Thus, at the time when the Transactions at issue in this suit were closing, Countrywide's CEO understood that there was no way to assess the risk of the products that Countrywide was selling, and his solution to this problem was to get those products off of Countrywide's books by selling them into securitization pools.

207. By mid-2007 it had become clear to Countrywide managers that something was seriously wrong with the quality of the loans it was generating. A performance report circulated to a group of managing directors in June 2007 revealed that non-conforming loans originated in 2006 were exhibiting early serious delinquencies. The report explained that such delinquencies were usually the result of failed investments or borrowers not understanding the products they were purchasing and warned that "[n]either situation is picked up well with any of our pricing or risk models." In discussing the performance of non-conforming first-lien loans

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[183] *SEC v. Mozilo,* Dean Decl. Ex. 17 (Email from Angelo Mozilo to Carlos Garcia, et al., dated Jun. 1, 2006, SEC Investigation Testimony Ex. 214) (emphasis added).

[184] *SEC v. Mozilo,* Dean Decl. Ex. 18 (Email from John McMurray to Angelo Mozilo, dated Sept. 26, 2006, SEC Investigation Testimony Ex. 221) at 2.

from 2006, the report concluded that these loans "exhibit astoundingly poor performance for purportedly prime credit loans, particularly the Low Docs."[185]

208. In denying Countrywide executives' motions for summary judgment, the California federal court in *SEC v. Mozilo* pointed to additional evidence indicating that Countrywide's executives "were aware that Countrywide routinely ignored its underwriting guidelines," including:

- On June 28, 2005, Sieracki attended a Corporate Credit Risk Committee meeting, in which he was informed that 1/3 of the loans which were referred from CLUES violated "major" underwriting guidelines and 1/3 violated "minor" guidelines. At that same June 28, 2005 meeting, Sieracki learned that Countrywide was originating non-owner occupied loans with 95% combined loan to value ratios, which were exceptions to Countrywide's underwriting guidelines. Countrywide's chief operating officer opined that Countrywide "appear[ed] to have unacceptable risk on [its] balance sheet" from these loans.

- Mozilo was acutely aware of the breakdown in Countrywide's procedures and the lack of compliance with Countrywide's underwriting guidelines as a result of HSBC's demand that Countrywide "buy-back" many of the "80/20" loans that it had purchased. . . . On April 13, 2006, Mozilo sent another e-mail to Sieracki and Sambol, stating that he had "personally observed a serious lack of compliance with our origination system as it relates to documentation and generally a deterioration in the quality of loans originated versus the pricing of those loan[s]. . . ."

- On May 29, 2007, Sambol and Sieracki attended a Credit Risk Committee Meeting, during which they were informed that even as Countrywide had been purportedly tightening guidelines, "loans continue[d] to be originated outside guidelines" primarily via the Secondary Structured Lending Desk without "formal guidance or governance surrounding Secondary SLD approvals." The presentation also included a recommendation from the credit management department that two divisions "cease to grant exceptions where no major competitor is offering the guideline."[186]

[185] *SEC v. Mozilo*, Dean Decl., Ex. 9 (Email from Christian Ingerslev to Andrew Gissinger, dated Jun. 29, 2007, Adler Depo. Ex. 1067) at 2, 3 (citations omitted).

[186] *SEC v. Mozilo*, No. 09-CV-3994, slip op. at 19-20 (C.D. Cal. Sept. 16, 2010) (citation omitted).

209. Thus, as a result of whistleblowers within the company, its own internally generated audit reports, and discussions among high-level executives, Countrywide management was fully aware that it was generating high-risk products without proper quality controls, and failed to disclose this risk to regulators, insurers, shareholders, or investors.

E. Countrywide Fraudulently Induced Ambac To Issue Its Policies

210. Amidst this incriminating backdrop of undisclosed fraudulent activity, Countrywide entered the marketplace to sell the tens of thousands of loans that are included in the eight Transactions that are the subject of this lawsuit. The eight Transactions at issue in this litigation share important common features, though they are governed by separate sets of contracts. The steps taken by Countrywide to induce participation in the securitizations do not differ in significant regards.

211. First, in each Transaction, Countrywide originated or acquired loans that it later sold to another party. Countrywide knew that it would not hold the loans as long-term investments, but that the loans instead would be sold and/or bundled into securitizations. This reduced Countrywide's incentive to originate loans only to creditworthy borrowers and fit comfortably with Countrywide's "price any loan" approach to mortgage banking. Countrywide concealed this knowledge with reassuring public statements meant to draw attention away from any warning signs about these loans. These statements were material to Ambac's decision of whether or not to insure the Transactions, and Ambac relied on them in making its determination.[187]

212. Second, Countrywide made regular presentations to Ambac employees in meetings held at Countrywide's headquarters between 2004 and 2007. As discussed above and

[187] *See supra* ¶ 103 (Pilku email discussing Q2 2006 earnings call).

as documented in internal memoranda, Countrywide told Ambac about loan origination practices and procedures that Countrywide executives knew or should have known were not being followed. The false statements were consistent with Countrywide's carefully crafted public front as a responsible lender and were intended to induce Ambac's reliance upon them. Had Ambac known that these statements were false, it would not have agreed to insure the Transactions.

213. Third, as explained above, Countrywide supplied loan tapes for the Transactions knowing that the information in the tapes would be relied upon. The loan tapes contained crucial information about the loans Countrywide sold – such as the LTV ratios and owner-occupancy status – that were key to assessing the risk that the loans would default.

214. Countrywide knew that this information would be passed on to third parties participating in the securitization process, including Ambac and investors. Because the information about the loans supplied by Countrywide was necessary to assess the riskiness of the loans, Countrywide knew that this information was material to third parties like Ambac, and intended for Ambac to rely on the information it provided in determining whether to participate in securitizations that included the loans. Given Countrywide's abandonment of prudent underwriting, it knew or should have known that the information on the tapes was false and misleading. Moreover, had Ambac known that these representations and information were false, it would not have agreed to issue financial guarantee policies for the Transactions.

215. Fourth, Countrywide knew that the underwriters for the transactions would arrange for the rating agencies, Standard & Poor's and Moody's, to issue "shadow ratings" as part of the securitization process. The shadow rating was important to Ambac's analysis of each of the Transactions because the rating represented the rating agencies' expectations of the performance of the securities to be issued, assuming that no financial guaranty policy is secured.

Although the underwriters of the Transactions – rather than Countrywide – arranged for the rating agencies to issue shadow ratings, the rating agencies used mortgage loan data provided by Countrywide to model the expected performance of the collateral that backed the securities being rated.[188] As with Ambac's modeling of the Transactions, the models used by the rating agencies depended on the accuracy of the information in the loan tapes. Countrywide's provision of loan tapes with false information not only prevented Ambac's models from properly projecting Ambac's exposure, but also led the rating agencies to provide incorrect shadow ratings.

216. Countrywide intended securitization participants to rely, and Ambac did rely, on the shadow ratings when deciding whether to insure the Transactions. All of the Transactions at issue in this litigation received the highest shadow rating from Standard & Poor's, AAA, meaning that the rating agencies believed that there was the lowest possible likelihood that there would be insufficient cash flow to pay the noteholders, or that Ambac would therefore be required to pay claims. The fact that Transactions were shadow-rated AAA helped induce Ambac to issue the Policies, and Ambac would not have issued the Policies had it known the truth.

217. Fifth, Countrywide made certain representations about the loans when it sold them. Though the specific representations (discussed in more detail below) differed in their particulars, for each loan it sold Countrywide always represented that the loan complied with the applicable underwriting guidelines.

218. Ambac and the investors in the certificates benefited from Countrywide's contractual representations and warranties because those representations and warranties were assigned to the Trustee for the benefit of the securitization trust. The Trustee has an obligation to

[188] With respect only to CWALT 2005-81 among the Transactions in this lawsuit, Countrywide Securities, the underwriter for this Transaction, engaged the rating agencies to provide shadow ratings.

enforce Countrywide's contractual representations and warranties by demanding that Countrywide cure or repurchase any loan that fails to comply.

219. As was the general practice in the industry, and as provided for in the parties' agreements, Countrywide and Ambac assumed risk and undertook due diligence consistent with their respective roles in the Transactions. Countrywide assumed the risk and the burden of assessing the validity of the represented attributes of the mortgage loans that it conveyed to the trusts, including that the loans were originated pursuant to the appropriate underwriting guidelines. Ambac, as the certificate insurer, bore the risk and the burden of evaluating whether loans bearing the attributes represented by Countrywide would perform after the closing of the Transactions.

220. That was a reasoned risk allocation. Countrywide established and implemented the underwriting guidelines, made each lending decision, and owned and held the loan files, which afforded it access and control over information required to evaluate the loans. Countrywide thus was in the best position, and had the means before the closing of the Transactions, to assess the quality of the loans. In contrast, Ambac never owned the loans or the loan files, and was several steps removed from the borrowers and the lending decisions underlying the individual loans. It therefore made sense for the sophisticated parties to agree that Countrywide would bear the loan origination risk, and Ambac would bear the risk that the loans would perform poorly, assuming accurate disclosures by Countrywide.

221. Countrywide's acceptance of the risk and the burden of assessing the validity of the represented attributes of the mortgage loans was, from Ambac's perspective, a reasonable and customary risk allocation consistent with Countrywide's position as the loan originator. Countrywide understood, could control for, and could measure the risk of loss

relating to the underwriting of its own mortgage loans. In contrast, Ambac could not readily assess whether Countrywide had prudently originated and underwritten the mortgage loans or whether the mortgage loan attributes were accurately stated in the materials provided to Ambac.

222. Absent Countrywide's explicit agreement to bear the loss if the loans failed to comply with representations and warranties, Ambac would not have agreed to issue the Policies.

223. The following sections describe the series of agreements that effectuated Countrywide's transfer of loans to the securitizations at issue and the information that was provided to Ambac to induce its participation as certificate insurer.

F. Ambac Issued Its Policies In Reliance On Countrywide's Misrepresentations

1. *The Harborview Transactions*

a. *Countrywide's Representations And Warranties*

224. In the two Harborview Transactions, Countrywide Home Loans sold thousands of negative amortization first lien loans to serve as collateral for publicly offered securities.

225. The Harborview Transactions were effectuated through a series of contractual agreements. First, Countrywide Home Loans, as seller and servicer, sold and assigned its interest in the mortgage loans to Greenwich Capital Financial Products, Inc. pursuant to a Master Mortgage Loan Purchase and Servicing Agreement ("MMLPSA"), dated April 1, 2003, as amended on November 1, 2004.

226. In the MMLPSA, Countrywide made numerous representations and warranties about the loans being assigned, including that

- each loan was underwritten generally in accordance with Countrywide's underwriting guidelines in effect at the time of origination;

- no fraud was committed by Countrywide in the origination of the loans and, to the best of Countrywide's knowledge, no fraud was committed by the borrower or any other person involved in the loan's origination;

- the origination practices used by Countrywide "have been in all respects legal, proper, prudent and customary" and Countrywide "ha[d] no knowledge of any circumstances [] or condition" with respect to the loans "that can reasonably be expected to cause the Mortgage Loan to become delinquent"; and

- the information contained in the Mortgage Loan Schedule was "complete, true and correct."

227. In the MMLPSA, Countrywide also agreed to indemnify Greenwich Capital Financial Products for any losses, damages, judgments, legal costs or other expenses arising out of a claim based upon Countrywide's breach of a representation and warranty.

228. After Greenwich Capital Financial Products acquired loans from Countrywide, each Harborview Transaction was effectuated through a Pooling Agreement (for Harborview 2005-16) or Pooling and Servicing Agreement (for Harborview 2006-9) between Greenwich Capital Acceptance, Inc. (the Depositor), Greenwich Capital Financial Products, Inc. (the Seller), and the Trustee; and a Mortgage Loan Purchase Agreement between Greenwich Capital Acceptance, Inc. (the Purchaser) and Greenwich Capital Financial Products, Inc. (the Seller). Ambac is an express third-party beneficiary of the Pooling Agreement and Pooling and Servicing Agreement.

229. For each Harborview Transaction, Countrywide provided RBS Greenwich with information for the loans to be securitized as well as information about its origination and underwriting practices. In an Indemnification Agreement, Countrywide agreed to indemnify RBS Greenwich for any claims, losses, liabilities, expenses or damages arising out of or based upon any untrue statement or omission of material fact based on certain information provided by Countrywide for inclusion in the Prospectus Supplements.

230. In addition, each Harborview Transaction is accompanied by a Reconstituted Servicing Agreement ("RSA") between Greenwich Capital Financial Products, Inc. and Countrywide. The RSA was also acknowledged by the securitization Trustee. In each RSA, Countrywide restated the representations and warranties it made in the MMLPSA and RBS Greenwich gives the Trustee all the rights under the MMLPSA to enforce Countrywide's obligations, including its obligation to cure or repurchase noncompliant loans. Countrywide also agreed to indemnify the seller, the depositor, the trustee, and the trust fund for claims or losses that arise out of a breach of a representation and warranty.

b. <u>Ambac's Involvement And Transaction-Specific Analysis</u>

231. Ambac's involvement in each Harborview Transaction followed a similar pattern: Greenwich would approach Ambac, soliciting a bid to insure certificates in the Transaction, and sending by e-mail the relevant loan tape containing information supplied by Countrywide regarding its loans.

232. Prior to issuing an insurance policy, Ambac reviewed and analyzed each Harborview Transaction. Much of Ambac's due diligence was summarized in a detailed internal risk assessment memorandum ("Credit Memorandum"). Following the conclusion of its review process, Ambac determined to issue a financial guaranty policy for each Transaction.

233. Ambac performed both qualitative and quantitative analysis, the latter of which included running two models to estimate the expected performance of the Transactions. Ambac first employed its proprietary loan-level model, generally referred to as the "CAS Model," to make an initial estimation of the expected loss associated with the related pool. The CAS Model was a deterministic model that applied a foreclosure frequency and loss severity estimate to each loan based on the information provided by Countrywide in the loan tapes.

234. Ambac also used a third-party stochastic model called the Loan

Performance Model ("LPS Model"). The LPS Model used Countrywide's mortgage loan data, but rather than generating a single modeled loss, the LPS Model ran 3,000 different scenarios with varying macroeconomic conditions and adjusting for a range of pool characteristics to determine expected performance. The accuracy of both of these models depended on the accuracy of the loan-level information supplied by Countrywide.

235. On the day each Harborview Transaction closed, Ambac issued a financial guaranty policy to the Trustee, for the benefit of the holders of insured classes of certificates, in exchange for a premium. The Trust then issued securities to investors. The securities were underwritten and marketed by RBS Securities.

236. Ambac's policy numbers for the Harborview Transactions and the insured classes of certificates are as follows:

Transaction	Ambac Policy Number	Insured Certificates	Original Face Value of Ambac-Insured Certificates
Harborview 2005-16	AB0949BE	Class 1-A1B Class 2-A1C Class 3-A1C Class 4-A1B	$348,361,900
Harborview 2006-9	AB1037BE	Class 2A-1C2	$166,727,000

237. Ambac's involvement in one Harborview Transaction – Harborview 2005-16 – is described in greater detail below. Harborview 2005-16 provides a representative example of the process by which Ambac insured these Transactions.

238. On November 10, 2005, RBS Greenwich analyst Michael McKeever e-mailed Ambac a request for a bid to issue the financial guaranty insurance policy for the Harborview 2005-16 Transaction. McKeever also sent the loan tape for the Transaction, containing Countrywide's representations as to the quality of the collateral backing the

certificates that Ambac would insure.

239. Ambac then analyzed the Transaction to determine its expected performance. It analyzed the structure of the Transaction and applied its CAS Model to the loan level data provided by Countrywide in the loan tape. The results of this due diligence are reflected in, among other things, Ambac's Harborview 2005-16 Credit Memorandum dated November 21, 2005. The Credit Memorandum provided a detailed analysis of the structure and other characteristics of the Harborview 2005-16 Transaction, as well as the results of Ambac's CAS and LPS Models. Based on the information in Countrywide's loan tape, both models indicated that the Transaction could be insured with only a remote risk of Ambac ever having to pay claims on the Transaction.

240. The Credit Memorandum for the Harborview 2005-16 Transaction revealed Ambac's reliance on Countrywide's stated underwriting standards in Ambac's evaluation of the Transaction. It states, for example, that "[Countrywide] originates high quality ('A') first lien mortgage loans via both internal and third-party originations." The Harborview 2005-16 Credit Memorandum also describes an operational due diligence visit on September 20, 2005, which is described in greater detail in paragraphs 47 and 48. After this meeting, Ambac concluded that Countrywide's "credit management is conservative and qualified as it relates to mortgage origination practices and credit quality controls."

241. Following the conclusion of its analysis, Ambac agreed to provide financial guaranty insurance for the Harborview 2005-16 Transaction.

2. *The CWALT Transactions*

a. <u>Countrywide's Representations And Warranties</u>

242. Like the Harborview Transactions, the CWALT Transactions were effectuated through Pooling and Servicing Agreements between CWALT, Inc. (as Depositor),

Countrywide Home Loans and Countrywide affiliates (as Sellers),[189] Countrywide Home Loan Servicing LP (as Master Servicer), and Bank of New York (as Trustee). Through the Pooling and Servicing Agreements, the Sellers sold and assigned their interest in the mortgage loans to CWALT, Inc., the Depositor. Immediately afterward, and pursuant to the same contract, CWALT, Inc. sold and assigned the loans to a securitization trust.

243. Countrywide made numerous representations and warranties about the securitized loans in the Pooling and Servicing Agreements, including that

- no loan had an LTV ratio exceeding 95% (for CWALT 2005-81) or exceeding 100% (for CWALT 2006-OA19);
- the mortgage loans conform to the descriptions in the related Prospectus Supplement, including that the loans were originated or acquired by Countrywide in accordance with its credit, appraisal and underwriting standards; and
- the information in the mortgage loan schedule is "true and correct in all material respects."

244. On the day the CWALT Transactions closed, Ambac issued a financial guaranty insurance policy to the Trustee for the benefit of the holders of insured certificates. Ambac's policy numbers for the CWALT Transactions and the insured classes of certificates are as follows:

Transaction	**Ambac Policy Number**	**Insured Certificates**	**Original Face Value of Ambac-Insured Certificates**
CWALT 2005-81	AB0959BE	A-3	$96,725,000
CWALT 2006-OA19	AB1045BE	A-3A	$100,000,000

[189] In addition to Countrywide Home, the Sellers for the CWALT Transactions are Park Granada LLC, Park Monaco Inc., and Park Sienna LLC. All of the loans backing CWALT 2005-81 were originated or acquired by Countrywide; in CWALT 2006-OA19, 87% of the loans were originated or acquired by Countrywide.

b. *Ambac's Involvement And Transaction-Specific Analysis*

245. *CWALT 2005-81*. On December 20, 2005, Rajarshi Chakravorti of Goldman Sachs' Structured Products Group invited Ambac to insure the Class A-3 senior mezzanine adjustable rate bond of its upcoming CWALT 2005-81 Transaction. Chakravorti followed up his e-mail with a phone call to Ambac executive Jeffrey Nabi. Also, on December 20, 2005, Chakravorti forwarded to Ambac the loan tape compiled from the information provided by Countrywide and the preliminary term sheet.

246. Ambac transaction underwriters prepared a Credit Memorandum dated December 21, 2005. The Credit Memorandum provided qualitative and quantitative analysis of the Transaction, and included a discussion of recent operational due diligence of Countrywide conducted by Ambac. Ambac also considered Countrywide's extensive experience in originating the PayOption ARM collateral and the supposed strong performance of this mortgage product. The memo also set out results from the CAS Model and the LPS Model, both of which suggested that the transaction could be insured with a remote risk of claims payments by Ambac.

247. The CWALT 2005-81 Transaction closed on December 29, 2005. On the day the securitization closed, Ambac issued a financial guaranty policy (Number AB0959BE) agreeing to insure certain payments of principal and interest with respect to the Class A-3 certificates in exchange for a premium. The Trust then issued securities that were sold to investors. In the 2005-81 Transaction, the securities were underwritten and marketed by Goldman Sachs.[190]

248. *CWALT 2006-OA19.* On November 20, 2006, David Grijalva, Vice

[190]Around the same time, Ambac issued financial guaranty policies for several transactions backed by collateral originated by Countrywide Home Loans. On December 28, 2005, Ambac insured the CWABS 2005-16 Transaction, and on December 29, 2005, Ambac insured CWABS 2005-17 and CWHEQ 2005-L. All three of these transactions were underwritten by Countrywide Securities.

President of the ARM Desk and CMO Structurer at Countrywide Securities, e-mailed Ambac a request for bid to issue the financial guaranty insurance policy for a Class A-3A senior mezzanine tranche of the CWALT 2006-OA19 Transaction. The e-mail contained two loan tapes and a structure summary for the transaction.

249. The loan tapes provided by Countrywide and the prospectus supplement for the CWALT 2006-OA19 Transaction indicate that over 80% of the collateral was originated by Countrywide Home Loans, with the remaining loans originated by MortgageIT, Flagstar Capital Markets, Residential Funding Corp., First Horizon Home Loans, American Mortgage Express Financial, and Quick Loan Funding. The loan-level information provided on the tape contained false and misleading information on which Ambac relied in modeling the proposed transaction. Among other things, the loan tape listed that all the borrowers had an "A" credit grade.

250. Using the information provided by Countrywide on the loan tape, Ambac underwriters evaluated the transaction collateral and modeled the transaction using both the CAS and LPS Models. To determine the sufficiency of credit enhancement, Ambac performed its modeling using conservative assumptions and applying harsh adjustments and stress scenarios to account for the negative amortization feature of the collateral.

251. The CWALT 2006-OA19 Transaction closed on November 30, 2006. On the day the securitization closed, Ambac issued a financial guaranty policy (Number AB1045BE) to the Trustee in exchange for a premium, agreeing to insure certain payments of principal and interest with respect to the Class A-3A notes. The Trust then issued securities that were sold to investors. In the 2006-OA19 Transaction, the securities were underwritten and marketed by Countrywide Securities.

3. *The Lehman Transactions*

a. *Countrywide's Representations And Warranties*

252. Countrywide also sold thousands of loans to Lehman Brothers entities which were eventually securitized in the four Lehman Transactions. Like the Harborview Transactions, the Countrywide loans securitized by Lehman Brothers are negative amortization first-lien mortgages.

253. Countrywide sold loans to Lehman Brothers Bank pursuant to contracts called Flow Seller's Warranty and Servicing Agreements, dated June 1, 2004, and June 1, 2006 (the "Flow Agreements"). In the 2004 Flow Agreement, Countrywide made representations about the mortgage loans, including that

- the loans were underwritten in accordance with Countrywide's underwriting guidelines;
- no error, omission, misrepresentation, negligence or fraud took place on the part of Countrywide or, to the best of Countrywide's knowledge, any other person; and
- the information in the mortgage loan schedule is "complete, true and correct."

254. In the Flow Agreements, Countrywide also agreed to indemnify Lehman Brothers Bank against all claims, losses, damages, judgments, legal fees, and other expenses related to an assertion of a breach of representation and warranty.

255. Lehman Brothers Bank then assigned and sold the loans to Lehman Brothers Holdings Inc. in an Assignment and Assumption Agreement. The Assignment and Assumption Agreement provides that Lehman Brothers Holdings Inc. can enforce Countrywide's representations made in the Flow Agreements.

256. In the next step, Lehman Brothers Holdings Inc. assigned and sold the loans to Structured Asset Securities Corp., the Depositor, in a Mortgage Loan Sale and

Assignment Agreement. The Depositor was likewise assigned the right to enforce Countrywide's representations and warranties.

257. For each Lehman Transaction, Countrywide provided a Lehman entity with static pool information for the loans to be securitized and with information about its operations, including its underwriting practices. In an Indemnification Agreement, Countrywide agreed to indemnify the Lehman entities for any claims, losses, liabilities, expenses, or damages arising out of or based upon any untrue statement or omission of material fact in the information provided by Countrywide.

258. The final step in the securitization was the transfer of loans from the Depositor to the securitization trust through a Trust Agreement. In the Trust Agreement, the Trustee was assigned the right to enforce Countrywide's representations and to require Countrywide to cure or repurchase breaching loans.

b. *Ambac's Involvement And Transaction-Specific Analysis*

259. Countrywide acted as one of the originators of mortgage loans in the Lehman Transactions.[191] In connection with its role as an originator, Countrywide provided to Lehman Brothers false and misleading information concerning mortgage loans that were included in the four Lehman Transactions. As a frequent participant in the securitization market, Countrywide was aware that information provided to Lehman Brothers would be included in the

[191]In addition to mortgage loans originated by Countrywide, the certificates insured by Ambac in the Lehman transactions are backed by non-Countrywide collateral. The Ambac-insured certificates in the 2005-7N and 2006-2N Transactions contain mortgage loans originated by IndyMac Bank FSB. For the Ambac-insured certificates in the 2007-7N Transaction, the originators are Countrywide Home Loans, American Home Mortgage Corp., Lehman Brothers Bank, FSB, and Quicken Loans, Inc., with the bulk of mortgages originated by American Home Mortgage Corp., and Countrywide Home Loans (46.91% and 38.43% respectively). For the Ambac-insured certificates in the 2007-15N Transaction, in addition to Countrywide Home Loans, the loan originators are GreenPoint Mortgage Funding, Inc., Residential Funding Company, LLC, IndyMac Bank FSB, SunTrust Mortgage, Inc., and Bank of America, National Association.

loan tape distributed to various market participants and that market participants would rely on the accuracy of the information contained on the loan tape when assessing the merits of the Transactions.

260. With this false and misleading information from Countrywide regarding mortgage loans and Countrywide's mortgage origination and underwriting practices, Lehman Brothers approached Ambac to insure certificates from a senior mezzanine tranche, which had received an AAA shadow rating from a rating agency even in the absence of insurance. On the day each securitization closed, Ambac issued a financial guaranty policy to the Trust in exchange for a premium. Ambac's policy numbers for the Lehman Transactions and the insured classes of certificates are as follows:

Transaction	**Ambac Policy Number**	**Insured Certificates**	**Original Face Value of Ambac-Insured Certificates**
Lehman XS 2005-7N	AB0947BE	1-A3 2-A2 3-A2	$289,306,000
Lehman XS 2006-2N	AB0970BE	1-A3 2-A2A	$214,016,000
Lehman XS 2007-7N	AB1081BE	2-A1B 2-A2B	$148,020,000
Lehman XS 2007-15N	AB1105BE	3-A2 4-A3	$314,440,000

261. Ambac's involvement in the Lehman Transactions all followed a similar pattern. One Lehman Transaction – Lehman XS Trust, Series 2005-7N – is described in greater detail below.

262. On November 11, 2005, Nicholas Stimola of Lehman Brothers

approached Ambac via e-mail to gauge its interest in wrapping senior mezzanine bonds in the upcoming Lehman XS 2005-7N Transaction. On November 21, 2005, Stimola sent to Ambac by e-mail preliminary levels with respect to the capital structure of the Transaction, the term sheet for the transaction, and the loan tape containing detailed loan-level collateral information, including information from Countrywide about its loans.

263. To assess the merits of the transaction, Ambac performed a detailed analysis of the 2005-7N Transaction, memorialized in Ambac's Credit Memorandum. The Credit Memorandum provided a detailed analysis of the collateral, structure, and other characteristics of the Transaction. The Credit Memorandum also contained the results of Ambac's modeling using Ambac's proprietary CAS Model and the LPS Model.[192] As with the other Transactions, Ambac applied conservative assumptions in calculating modeled loss amounts for the 2005-7N Transaction.

264. The Credit Memorandum for the 2005-7N Transaction contained a detailed analysis of the originators and servicers of the Transaction, i.e., Countrywide and IndyMac. The Credit Memorandum emphasized Countrywide's conservative origination and underwriting practices and provided a detailed account of the September 20, 2005 due diligence visit to Countrywide, which is described earlier at paragraphs 47-48 herein.

265. Following the conclusion of its review process, Ambac agreed to provide financial guaranty insurance for the Lehman XS Trust 2005-12 Transaction.

G. Countrywide Made Fraudulent Representations To Ambac

1. *Countrywide's Representations Were Not Consistent With The Underlying Reality Of Countrywide's Mortgage Banking Business*

266. As Countrywide's management was well aware, the representations made

[192] For the Lehman 2007-7N Transaction only, Ambac did not use the LPS Model.

by Countrywide about its conservative underwriting practices, independent appraisal process, and quality control procedures bore no resemblance to the manner in which Countrywide was actually conducting business. In reality, Countrywide had loosened or outright abandoned its underwriting guidelines and continued to ignore evidence of widespread employee fraud throughout the company.

267. Furthermore, Countrywide knew or should have known that the loan tapes it provided contained multiple inaccuracies and that many of the loan files in the securitization pools were missing documents. A March 2006 Internal Audit report found that the CLUES system permitted employees to fund loans with serious document deficiencies, and noted that all of the particular loans identified in the audit as suffering from document deficiencies "had been sold to investors with no subsequent repurchase to date."[193] In fact, Countrywide executives instructed employees not to share certain due diligence results with monoline insurers on some occasions because the insurers "kept questioning the data integrity results."[194]

268. As detailed above, former Countrywide employees and internal documents have revealed Countrywide's pervasive, imprudent, and unlawful origination practices, including:

- a high-level corporate strategy to find a way to make every loan regardless of the borrowers' ability to pay, and thereby pursue origination volume at the expense of mortgage underwriting standards;
- the processing of exceptions to underwriting guidelines without a reasonable basis and in such volumes as to make exceptions the rule;

[193] *MBIA*, Sheth Aff. Ex. 141 (Countrywide's Internal Audit Department Review of Consumer Markets Division Operations Support, dated Mar. 31, 2006) at 9.

[194] *MBIA*, Sheth Aff. Ex. 237 (Email from Garrett Galati to Tonya LyBrand, dated Dec. 28, 2005).

- actively and systematically funneling into its reduced documentation loan programs unqualified borrowers who it knew were not likely to be able to repay indebtedness in a timely fashion;

- repeatedly soliciting the same borrowers to frequently refinance and thereby manipulating data to artificially improve performance;

- 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, employee, broker, and borrower fraud on a massive scale.

269. Overall, Countrywide's representations to Ambac cannot be reconciled with the underlying truths that have been unearthed by litigants over the past five years. Countrywide made false representations to Ambac.

2. *Countrywide's Fraud Is Borne Out By The Transactions' Dismal Performance*

270. As of November 30, 2014, the pools of loans in the Transactions supporting Ambac-insured certificates had experienced cumulative collateral losses of more than ***$3 billion***:

Transaction (Loan Group)	**Realized Cumulative Loss**
HVMLT 2005-16	$312,739,495
HVMLT 2006-9 (Group 2)	$502,670,807
Harborview Total	**$843,799,154**
CWALT 2005-81	$246,360,273
CWALT 2006-OA19	$374,019,099
CWALT Total	**$620,379,372**
Lehman XS 2005-7N (Groups 1 and 2)	$445,221,114
Lehman XS 2006-2N (Groups 1 and 2)	$403,949,146
Lehman XS 2007-7N (Group 2)	$256,862,356
Lehman XS 2007-15N (Groups 3 and 4)	$530,477,800
Lehman Total	**$1,636,510,416**
GRAND TOTAL	**$3,072,300,090**

271. The severe losses realized by the Transactions have resulted in Ambac having to make claim payments to insured Noteholders. As of October 31, 2014, Ambac had paid, accrued, and expected claims of over $600 million. Ambac reserves its right to update paid, accrued, and expected losses through the time of trial and judgment.

3. *Ambac's Claims Are Timely*

272. On November 21, 2011, Ambac executed a tolling agreement with the Defendants, and that agreement has been continually renewed and tolled all applicable statutes of limitations for claims arising out of or relating to the Transactions through December 31, 2014.

4. *Ambac's Forensic Findings Confirm Countrywide's Fraud*

273. In addition to making material misrepresentations and omissions regarding the protocols in place to ensure the quality of the securitized loan pools, Countrywide knowingly made material misrepresentations and omissions regarding the particular loans included in the Transactions. The results of Ambac's loan-level forensic analyses – as well as the abysmal performance of the Transactions – confirm that Countrywide's fraudulent practices described above materially affected the credit quality of the loans included in the Transactions.

274. As set forth earlier, Countrywide provided to the Transactions' lead underwriters (or their affiliates) false and misleading loan-level data, with the knowledge and intent that the underwriters would in turn pass on this false information to Ambac prior to the closing of the Transactions, and that Ambac would rely upon this information in determining whether to participate in the Transactions. For each Transaction, Countrywide provided the underlying information in the loan tapes that set 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. Countrywide also provided the underlying information for the data metrics in the Prospectus Supplements for each Transaction that

reflected the attributes of the securitized loans.

275. Before it was able to wrest loan files for the Transactions from Countrywide, Ambac (through its counsel) undertook a forensic review of certain loan attributes for over 9,000 loans included in the Transactions. As described below, this review revealed that the information provided by Countrywide on the loan tapes prior to the closing of the Transactions, and reflected in the Prospectus Supplements, was materially false and misleading. For example, a large number of the loans that the tapes showed as being "owner occupied" have strong indications that they were actually investor properties or second homes, which have a higher risk of default. A large number of loans also had LTV ratios that were higher than Countrywide represented on the tapes. Indeed, a large number of the loans reviewed had LTV ratios greater than 100%, meaning that the size of the loan was already greater than the value of the property ***at origination***.

276. Therefore, the loans were of much poorer credit quality and much more likely to default than Ambac reasonably expected based on Countrywide'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. Ambac would not have issued the Policies had it known the truth about the loans' attributes. Ambac's findings – including understated percentages of owner-occupied properties and inflated appraisals that led to undervalued LTV ratios – were well known to Countrywide at the time of the Transactions.

a. Contrary To Countrywide's Representations, There Are Numerous Indications That Borrowers Did Not Actually Occupy the Mortgaged Properties

277. To determine whether a given borrower actually occupied the property as claimed, consultants, retained by Ambac's attorneys, conducted a number of tests. First, they

investigated tax information for the reviewed 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.

278. Second, Ambac's consultants 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.

279. Third, 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. Fourth, Ambac's consultants determined whether the tax bills on those other properties were being mailed to the subject address. 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.

280. Fifth, 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. Sixth, the consultants reviewed the other lien records to determine how the borrower reported his or her occupancy. 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.

281. The below tables set forth the results of Ambac's loan-level analysis of

true owner-occupancy rates of the loans reviewed. Failing two or more of the above tests gives a strong indication that the borrower did not in fact reside at the mortgaged property and instead used it as a second home or investor property. These statistics therefore demonstrate that a much higher percentage of borrowers than Countrywide had represented in the loan tapes did not occupy the mortgaged properties.

282. In order to investigate the accuracy of Countrywide's representations relating to whether the loans in the Transactions were owner-occupied, Ambac reviewed 1,825 loans included in the Harborview Transactions which were reported to be owner-occupied by Countrywide. Ambac found that over 18% of the loans it reviewed had strong indications that they were actually investment properties or second homes, which have a higher risk of default. For example, Ambac's consultant reviewed 500 loans from Harborview 2006-9. Of those 500, 459 (or 92%) were reported on the loan tape as secured by owner-occupied properties. Of the 459 loans represented as owner-occupied on the loan tape, Ambac found that 88 loans, or 19% of the reviewed loans reported as owner-occupied, had strong indications that the borrower did not in fact reside at the mortgaged property. The results of Ambac's review of owner-occupancy status is summarized in the chart below.

Transaction	Loan Group	Sample Size	Loan Tape Reported Percentage of Owner-Occupied Properties	Percentage of Owner-Occupied Properties Based on Ambac's Review	Percentage of Loans Reported as Owner-Occupied with Strong Indication of Non-Owner Occupancy
Harborview 2005-16	Group 1	500	40.4%	35.0%	13.4%
	Group 2	508	75.0%	57.7%	23.1%
	Group 3	500	81.2%	66.8%	17.7%
	Group 4	418	90.2%	74.6%	17.2%
Harborview 2006-9	Group 2	500	91.8%	74.2%	19.2%

283. Ambac also reviewed 601 loans included in the CWALT Transactions and reported by Countrywide to be secured by owner-occupied properties. In CWALT 2005-81, 14% of the loans reviewed had strong indications that they were actually investment properties or second homes, despite being reported as owner-occupied on the loan tapes. For CWALT 2006-OA19, over 20% of the loans Ambac reviewed had a strong indication of false occupancy information:

Transaction	Sample Size	Loan Tape Reported Percentage of Owner-Occupied Properties	Percentage of Owner-Occupied Properties Based on Ambac's Review	Percentage of Loans Reported as Owner-Occupied with Strong Indication of Non-Owner Occupancy
CWALT 2005-81	500	78.4%	67.0%	14.5%
CWALT 2006-OA19	301	69.4%	55.5%	20.1%

284. Ambac also reviewed 5,778 loans included in the Lehman Transactions that were originated by Countrywide, which revealed that on average, over 18% of the loans reviewed that were shown on the tapes as "owner occupied" have strong indications that they were actually investment properties or second homes:

Transaction	Loan Group	Sample Size	Loan Tape Reported Percentage of Owner-Occupied Properties	Percentage of Owner-Occupied Properties Based on Ambac's Review	Percentage of Loans Reported as Owner-Occupied with Strong Indication of Non-Owner Occupancy
Lehman XS 2005-7N	Pool 1	1,091	68.9%	56.6%	18.0%
	Pool 3	1,347	57.5%	46.5%	19.1%
Lehman XS 2006-2N	Pool 1	1,909	79.8%	63.9%	19.9%
	Pool 2	319	55.2%	46.4%	15.9%
Lehman XS 2007-7N	Pool 1	848	84.6%	70.4%	16.7%
	Pool 2	947	62.1%	55.1%	11.2%
Lehman XS 2007-15N	Pool 3	788	70.3%	57.4%	18.4%
	Pool 4	772	89.8%	69.9%	22.1%

285. As described above, Countrywide knew that it had systemically abandoned its own underwriting guidelines, and that it permitted and encouraged borrowers to falsify occupancy information. *See, e.g.*, ¶¶ 83 *et seq.*, 152 *supra*. Countrywide therefore knew that the information supplied to Ambac and other third parties on the loan tapes and in the Prospectus Supplements regarding occupancy data was false.

b. <u>The LTV Ratios On The Loan Tapes Were Based On Incorrect Appraisals And Therefore Were Severely Understated</u>

286. For each of the reviewed loans, the underlying property was valued by an industry-standard automated valuation model ("AVM"). AVMs are routinely used in the industry as a way of valuing properties during prequalification, origination, portfolio review, and servicing. AVMs have become 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 are 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 these data. The consultants retained by Ambac's counsel used an AVM that incorporates a database of 50 million mortgage transactions covering ZIP codes that represent more than 97% of the homes, occupied by more than 99% of the population, in the United States. Independent testing services have determined that this AVM is the most accurate of all such models.

287. Applying the AVM to the available data for the loans reveals that the appraised value given to many of the mortgaged properties was significantly higher than what those properties were actually worth. Using this re-appraised value affects the LTV ratios by decreasing the actual value of the properties relative to the loan amount, thereby increasing the overall loan-to-value ratio. This overvaluation affected numerous statistics set forth on the data tapes.

288. For instance, Countrywide misrepresented the number of loans with LTV ratios greater than 90%. LTVs in excess of 90% provide the lender little value cushion to protect against borrower default and loss upon foreclosure. The AVM indicates that a much higher percentage of loans had LTVs higher than 90% than was reported on the tapes.

289. Further, the tapes uniformly show that none of the loans that collateralized a certificate insured by Ambac had LTV ratios greater than 100%, meaning the size of the loan is greater than the value of the property. Loans with 100% LTV afford the lender no equity cushion and leave the lender with inadequate collateral from the outset of the loan. Ambac's analysis has found that, despite Countrywide's representations, a substantial number of the loans had LTV ratios greater than 100%. The results are summarized in the chart below:[195]

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[195]These results are based on the loans for which Ambac's consultant was able to obtain an AVM "match" to the mortgaged property. The actual number of loans with LTVs greater than 90% and 100% is likely even higher than reported in this chart. The results for loans in the Lehman Transactions are based on a review of Countrywide loans only.

Transaction	Loan Group	Percentage of Reviewed Loans with an LTV Greater than 90% Reported on Loan Tape	Percentage of Reviewed Loans with an LTV Greater than 90% Based on Ambac's Review	Percentage of Reviewed Loans with an LTV Greater than 100% Based on Ambac's Review
Harborview 2005-16	Group 1	3.8%	34.5%	16.1%
Harborview 2005-16	Group 2	8.5%	29.1%	16.3%
Harborview 2005-16	Group 3	3.2%	29.8%	11.4%
Harborview 2005-16	Group 4	5.0%	38.8%	17.4%
Harborview 2006-9	Group 2	5.6%	39.1%	19.4%
CWALT 2005-81	n/a	0.8%	30.4%	14.9%
CWALT 2006-OA19	n/a	5.6%	34.4%	15.1%
Lehman XS 2005-7N	Pool 1	4.0%	27.3%	11.5%
Lehman XS 2005-7N	Pool 3	4.4%	24.2%	10.1%
Lehman XS 2007-7N	Pool 1	1.8%	42.5%	23.5%
Lehman XS 2007-7N	Pool 2	1.1%	41.1%	19.5%
Lehman XS 2007-15N	Pool 3	2.0%	49.2%	26.1%
Lehman XS 2007-15N	Pool 4	5.1%	49.1%	29.5%

290. As described above, Countrywide knew that its appraisal process was subject to fraud and manipulation encouraged by Countrywide management, *see, e.g.*, ¶¶ 145-150 *supra*, and therefore knew that the LTV ratios reported on the loan tapes and Prospectus Supplements were materially understated.

c. Many Of Countrywide's Representations Regarding Other Aspects Of The Loans Were Also False And Misleading

291. In addition to the foregoing analysis, Ambac has sought to evaluate whether individual loans complied with Countrywide's representations about other loan characteristics and underwriting guidelines generally. But until very recently, Countrywide and the Trustees have stymied Ambac's efforts to obtain the loan files necessary to conduct this more expansive review by refusing to provide access to the loan files.

292. Ambac only recently obtained loan files for certain of the Transactions. To date, an independent consultant retained by Ambac's counsel has reviewed a total of 300 loans from the Harborview 2005-16 Transaction and 100 loans from the Lehman XS 2007-15N Transaction. The results of Ambac's loan-level reunderwriting revealed 240 loans from Harborview 2005-16 and 91 loans from Lehman XS 2007-15N that conform neither to the description of the loan underwriting characteristics provided by Countrywide in the Prospectus Supplements and loan tapes nor to the representations and warranties made by Countrywide about the mortgage loan collateral. This reflects a defect rate of ***80%*** for Harborview 2005-16 and ***91%*** for Lehman XS 2007-15N.

293. These 331 defective loans contain one or, in most cases, more than one defect that materially altered the loans' risk profile. The defects also constitute a breach of one or more of the numerous representations and warranties made by Countrywide. In all, the defects identified evince gross malfeasance, misconduct, and negligence in connection with the origination of the loans by Countrywide, reflecting a wholesale abandonment of any attempt to gauge the ability and willingness of borrowers to repay their obligations. 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; 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, or (ii) with DTI and LTV ratios above the allowed maximums.

294. These findings confirm Countrywide's abandonment of underwriting guidelines and the falsity of its representations that securitized loans complied with those guidelines. Further, they confirm that Countrywide systematically misrepresented key loan

characteristics, and that the loan- and pool-level information provided on loan tapes and in the Prospectus Supplements was false for a large percentage of the loans included in the Transactions. Finally, these results demonstrate the falsity of Countrywide's representations to Ambac about the soundness of its origination practices and policies.

295. As described above, Countrywide knew that it had abandoned its own underwriting guidelines, permitted and encouraged borrowers to falsify information, and that its appraisal processes were subject to fraud and manipulation. Countrywide therefore knew that its representations to Ambac about the soundness of its origination practices and policies and the information supplied to Ambac and other third parties on the loan tapes and in the Prospectus Supplements were false.

H. Ambac Is Entitled to Relief Against Countrywide

296. Countrywide's fraudulent misrepresentations and omissions induced Ambac to issue the Policies and thereby insure Transactions that it would never have insured had it known the truth about Countrywide's lending practices, financial condition and wide-ranging fraud. Countrywide's pervasive misrepresentations and omissions resulted in the Countrywide-originated loan portfolios sold into the Transactions bearing no resemblance to what Countrywide represented and warranted would be transferred.

297. Ambac has incurred significant harm, and continues to incur significant harm, as a consequence of Countrywide's malfeasance, including hundreds of millions of dollars in claims payments it has made or is obligated to make, and interest on those amounts. Due to the high rate of delinquency and expected defaults, future borrower re-payment shortfalls affecting the Transaction are inevitable as well.

298. Countrywide's misconduct entitles Ambac to be compensated for the harm incurred as a result of participating in 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.

I. Bank of America is Countrywide's Successor and Alter Ego, Rendering it Vicariously Liable

1. *As Countrywide's Successor And Alter Ego, Bank Of America Is Vicariously Liable For Countrywide's Actions*

299. As Countrywide's successor in liability, and because Countrywide and Bank of America are alter egos of one another, Bank of America is jointly and severally liable for any and all damages resulting to Plaintiffs from the wrongful actions of Countrywide.

300. Bank of America's successor liability arises from its design and implementation of a series of coordinated transactions through which Bank of America merged with Countrywide in fact (i.e., effected a de facto merger), even though Bank of America eschewed formal merger as part of a deliberate, but unavailing, attempt to insulate itself from Countrywide's massive contingent liabilities, which, to a substantial extent, were known at the time Bank of America orchestrated the transactions.

301. Bank of America's consolidation with Countrywide (the "Consolidation") – a process that was announced in January 2008 and was not complete until the second half of 2010 – was a de facto merger because, as a result of the Consolidation, (a) Countrywide shareholders became shareholders in Bank of America; (b) Countrywide ceased its ordinary business operations and effectively was rendered a shell entity; (c) Bank of America continued Countrywide's business enterprise, including Countrywide's management, personnel, physical location, assets, and general business operations; and (d) Bank of America assumed the liabilities ordinarily necessary to continue Countrywide's business unabated.

302. The asset transfers through which the Consolidation was accomplished were approved, at Bank of America's direction, through a cursory process that omitted any

substantive investigation or analysis of the impact of those transfers on Countrywide's solvency or Countrywide's ability to satisfy existing unconditional and contingent creditors, in contravention of legally mandated, prudent, and customary corporate business practices applicable to such transactions. By leaving Countrywide without adequate wherewithal to satisfy its outstanding debts, and by causing much of the consideration that Countrywide did receive to cycle back into other Bank of America subsidiaries or to be used for their benefit, Bank of America has defrauded Countrywide's creditors.

303. Bank of America's alter-ego liability for Countrywide's debts flows from Bank of America's exercise of its complete domination and control of Countrywide to effect the transfer of Countrywide's marketable and revenue-generating assets to Bank of America and non-Countrywide subsidiaries of Bank of America, at a time when Bank of America was acutely aware of Countrywide's exposure to potential litigation and put-back claims by victims of Countrywide's fraudulent practices, such as Ambac. Bank of America used its domination and control over Countrywide to compel Countrywide to divest its assets in a manner that primarily benefitted the Bank of America corporate family to the detriment of Ambac and Countrywide's other contingent creditors, who were left without an adequate source of recovery to redress Countrywide's wrongs.

2. *The 2007 Investment And Acquisition Negotiations*

304. As early as 2007, Bank of America, led by then-Chairman and CEO Ken Lewis, sought to acquire a stake in Countrywide. Bank of America viewed Countrywide's mortgage product as the missing piece needed to make Bank of America a one-stop shop for consumer financial products.

305. On August 23, 2007, Bank of America purchased $2 billion of convertible preferred shares in Countrywide Financial Corp., with the intent of using that investment as a

foothold to acquire Countrywide. As Lewis explained in an October 2010 interview, "we came to [the] conclusion that . . . $2 billion . . . would be a vote of confidence that would help and . . . the reason we did it obviously was to have a close strategic relationship so that . . . if in fact we made a decision to buy them [at] some other date then we would be familiar with each other and it could be done more quickly."[196]

306. In the same month that Bank of America made its $2 billion investment in Countrywide, investors in MBS initiated four separate actions against Countrywide, asserting that Countrywide had abandoned its loan-underwriting standards and placed deceptively risky loans in MBS.

307. Undeterred by the mounting evidence of Countrywide's pervasive misconduct relating to its loan-origination and securitization practices, Bank of America charged forward with its plan to parlay its investment in Countrywide into a formal acquisition.

308. Bank of America began negotiating the terms of possible acquisition with Countrywide in or about November 2007. In connection with those negotiations, according to Lewis, Bank of America conducted "extensive due diligence, probably twice as long as we've ever done on a deal."[197] The due diligence revealed, in part, that Countrywide's underwriting standards fell well short of the standards employed by Bank of America. It also left Lewis with "[n]o question" that more lawsuits would be filed against Countrywide as a result of its origination practices.[198]

309. Bank of America's due diligence team also reported its concern that

[196] Interview by the Financial Crisis Inquiry Commission with Ken Lewis, former CEO, Bank of Am. Corp., in New York, N.Y. (Oct. 22, 2010) (hereafter "Lewis FCIC Interview"), audio available at http://fcic.law.stanford.edu/interviews/view/418.

[197] Maria Bartiromo, *A Chat with BofA's Ken Lewis*, Bloomberg Businessweek Magazine, Jan. 15, 2008, *available at* http://www.businessweek.com/stories/2008-01-15/a-chat-with-bofas-ken-lewis.

[198] *Id.*

Countrywide Financial Corp.'s representations-and-warranties ("R&W") reserves were "significantly understated" due to the failure to account for "the rapid increase in claims" made in the second half of 2007.[199] Countrywide Financial Corp.'s reserves calculations were based on obsolete historical claims data that predated the deluge of R&W claims that had been flooding Countrywide Financial Corp. for months.

310. Notwithstanding the troubling due diligence findings, Lewis explained that "as we went into December," Bank of America believed that it "could structure a deal that would be a good benefit . . . both to the shareholders and help us with our customer base because the mortgage product is such an important product to the consumer."[200] As a consequence of Bank of America's due diligence findings, a primary objective in "structur[ing] a deal" to acquire Countrywide was to obtain the benefit of Countrywide's mortgage-loan-generating assets while attempting to shield Bank of America from the potentially catastrophic liabilities that Countrywide had created for itself, even if that meant leaving Countrywide's victims such as Ambac without a pool of assets sufficient to redress the wrongful conduct of Countrywide.

311. By December 2007, investors in Countrywide MBS had initiated two additional lawsuits against Countrywide alleging that Countrywide had abandoned its loan-underwriting standards. As one court has concluded, the mounting number of lawsuits filed against Countrywide regarding underwriting and origination practices would have placed a reasonable investor "on notice of Countrywide's misrepresentations regarding underwriting standards by late 2007 or early 2008."[201] And as Countrywide conceded in its briefing to that

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[199]*MBIA*, Oblak Aff. Ex. 186 (E-mail from Randy Shearer to Neil Cotty, dated Jan. 9, 2008).

[200]Lewis FCIC Interview.

[201]*Stichting Pensioenfonds ABP v. Countrywide Fin. Corp.*, 802 F. Supp. 2d 1125, 1136-37 (C.D. Cal. 2011).

court, "[t]hese *same exact allegations* [of Countrywide's fraud and abandonment of underwriting guidelines] have been made in numerous private lawsuits, government investigations, and news articles *starting in [August] 2007*."[202]

312. Despite all of the red flags, and with knowledge of the potential for vast Countrywide exposure arising from years of misrepresentations about Countrywide's mortgage operations, Bank of America determined that the opportunity to acquire a leader in the mortgage business and ubiquitous brand name was too good to pass up. According to Lewis, "we were number one in virtually every other consumer product, particularly deposits and credit cards, and this was the last important product we didn't have a number one share in."[203]

3. *The January 2008 Agreement And Plan of Merger*

313. On January 11, 2008, Bank of America and Countrywide publicly announced an Agreement and Plan of Merger ("Plan of Merger"). Pursuant to the Plan of Merger, Bank of America would absorb Countrywide Financial Corp. through a forward triangular merger with Red Oak Merger Corp., a wholly owned Bank of America subsidiary (the "Red Oak Merger"); the newly merged entity, wholly owned by Bank of America, would continue the name Countrywide Financial Corporation. In exchange, Bank of America agreed to pay Countrywide Financial Corp. $4.1 billion in Bank of America shares for all outstanding shares of Countrywide Financial Corp. stock and to cancel the $2 billion worth of Countrywide Financial Corp. convertible preferred shares it had purchased in August 2007.

314. After unveiling the Plan of Merger, Bank of America developed a detailed plan to execute the Consolidation, through which Bank of America intended to transfer all of

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[202]Countrywide Defs.' Mem. of P. & A. in Supp. of Mot. to Dismiss First Am. Compl. at 9-10, *Stichting Pensioenfonds ABP v. Countrywide Fin. Corp.*, No. CV 10-07275-MRP (C.D. Cal. Mar. 25, 2011), (emphases in original).

[203]Bartiromo, *A Chat with BofA's Ken Lewis*.

Countrywide's marketable and revenue-generating assets to Bank of America and other direct and indirect wholly owned subsidiaries of Bank of America (the "Non-Countrywide Subsidiaries"), leaving behind only token, mostly illiquid and "toxic" assets; massive contingent liabilities; and a shell entity through which R&W and repurchase claims would pass.

315. The first stage in the Consolidation was Bank of America's "assessment" of Countrywide, which lasted through the end of the first half of 2008. During the assessment phase, Bank of America's transition team, working in tandem with Countrywide personnel, evaluated which Countrywide assets and operations would be carried over to the "target state environment" – the term that Bank of America used internally to refer to the going-forward mortgage business to be operated under the Bank of America umbrella (the "Combined Mortgage Business") – and which assets and operations would remain behind at the Countrywide shell entity.

316. Bank of America determined that the best way for it to profit from the Countrywide acquisition – and to distance itself from the legal and reputational risk associated with Countrywide – would be to orchestrate the transfer of Countrywide's assets, personnel, and platforms used in its mortgage business to other Bank of America subsidiaries and to continue those operations, serving both legacy Countrywide and Bank of America customers, under a new brand name. In the words of Bank of America Transition Executive Mary Kanaga, the objective was to "br[ing] the Bank of America and Countrywide families together from a people[,] process and technology perspective," "taking everything, people, process, and technology activities from [the] two companies and blending them to get to the target state," "so we are operating as one organization as opposed to two."[204] Lewis similarly testified that "the objective was to present a

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[204] *MBIA*, Oblak Aff. Ex. 20 (Transcript of Mary Kanaga Deposition, May 10, 2012) at 14; 42; 74.

common set of products and a common brand to our . . . combined set of customers."[205]

317. Bank of America planned that, immediately following the Red Oak Merger, Countrywide Financial Corp. and Countrywide Home Loans would sell substantially all of their assets to Bank of America and certain of the Non-Countrywide Subsidiaries, primarily NB Holdings Corp. ("NB Holdings") and Bank of America, N.A. ("BANA"). Countrywide Securities would transfer its entire trading portfolio to a wholly owned Bank of America subsidiary and thereafter be de-registered as a licensed securities trader. Bank of America planned to retire the Countrywide brand shortly after those asset transfers. By the end of the Consolidation, the vast majority of legacy Countrywide's assets – including those needed to operate the Combined Mortgage Business – would end up in or controlled by BANA, which in turn was controlled by Bank of America. In a presentation to Bank of America's Board of Directors, Bank of America's CFO Joe Price made plain the design of the Consolidation:

> From an operational standpoint, we want to consolidate as much of the business operations of Countrywide and Bank of America Mortgage as possible [to] drive the operational efficiencies we desire. . . . [W]e intend to move the mortgage origination and servicing operations housed in Countrywide Home Loans, or CHL, and CHL Servicing into BANA on the merger date or shortly thereafter. . . . Once this is completed, most of the former [C]ountrywide operations will be housed in either Countrywide Bank FSB, their savings bank[,] or BANA, our lead bank. . . . As part of this process, . . . we will need to recapitalize Countrywide FSB.[206]

318. But Bank of America also realized that permitting Countrywide to remain in existence, even as a shell stripped of all assets needed to generate revenue, offered tremendous value as a repository of "toxic" and illiquid assets and contingent liabilities. By siphoning out

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[205] *MBIA*, Aff. of Renee Bea in Supp. of Pl.'s Mot. for Summ. J. filed Nov. 7, 2012 ("Bea Aff.") Ex. 111 (Transcript of Ken Lewis Deposition, Apr. 19, 2012) at 21.

[206] *MBIA*, Oblak Aff. Ex. 12 (Talking points prepared for delivery by Joe Price at Bank of America Board of Directors meeting held on Jun. 25, 2008).

the marketable assets for itself and sequestering the associated risk and exposure in Countrywide, Bank of America sought to derive the benefit of Countrywide's market share and industry-leading mortgage platform, separate itself from responsibility for Countrywide's debts, and deplete the potential recovery available to Countrywide's creditors.

319. In the course of its assessment phase, Bank of America discovered that Countrywide's reserves were patently inadequate to cover the projected magnitude of R&W-, monoline-, and other litigation-related liabilities. In a June 25, 2008 presentation, Bank of America management informed the Board of Directors of billions of dollars of estimated exposure beyond what Countrywide had reserved. In particular, Bank of America calculated an additional $1.3 billion in R&W claims, $1.0 billion in exposure for monoline-repurchase claims, and $1.0 billion in litigation exposure related to Countrywide.[207] Despite its awareness of those liabilities, Bank of America declined to increase the reserve amounts on its mid-2008 financial statements to reflect the anticipated securitization-related exposures.

320. And yet Countrywide's exposure continued to swell. On June 25, 2008 – the same day on which the Consolidation formally was unveiled to the Bank of America Board – the attorneys general of Illinois and California brought suit against Countrywide on behalf of tens of thousands of borrowers in those states, alleging that Countrywide had misled borrowers and dramatically relaxed its originating standards to generate more loans.

4. *The Red Oak Merger And The LD1-3 Transactions*

321. As of June 30, 2008, the day before the Red Oak Merger, Countrywide's consolidated assets were valued at $172.1 billion. Of that total, approximately $36.6 billion resided in Countrywide Financial Corp. and approximately $50.9 billion resided in Countrywide

[207] *Id.*

Home Loans.

322. In the days leading up the Red Oak Merger, as per Bank of America's plan for the Consolidation, directors of Countrywide Financial Corp. and Countrywide Home Loans began to resign en masse. By July 1, 2008, only one director, Andrew Gissinger, remained on the board of Countrywide Home Loans. As Gissinger testified, Bank of America "came to me and said, listen, we would . . . like to have you take this role in the event that it's needed or there's any signatures or documents that would be required. I said yes."[208]

323. On July 1, 2008 (referred to in the context of the Consolidation as "Legal Day 1" or "LD1"), Bank of America executed the Red Oak Merger. As a result, Countrywide Financial became a wholly owned subsidiary of Bank of America. Countrywide Financial Corp. shareholders became shareholders – and thus, part owners – of Bank of America. In a July 1, 2008 press release, Barbara Desoer, identified as the head of the "combined mortgage, home equity and insurance businesses" of Bank of America and Countrywide, proclaimed: "Now we begin to combine the two companies and prepare to introduce our new name and way of operating."[209]

324. At all times following the Red Oak Merger, Countrywide Financial Corp. and Countrywide Home Loans operated, and continue to operate, as mere agents and instrumentalities of Bank of America. Countrywide Financial Corp. and Countrywide Home Loans are owned and controlled as parts of a single, integrated enterprise run without regard to corporate formalities under the Bank of America umbrella. In deposition testimony, current CEO Brian Moynihan stated that "my job is to lead the company and we lead it through activities

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[208] *MBIA*, Bea Aff. Ex. 4 (Transcript of Andrew Gissinger Deposition, May 12, 2011) at 28.

[209] *Bank of America Completes Countrywide Financial Purchase*, Bank of America, Press Release, Jul. 1, 2008, http://newsroom.bankofamerica.com/press-release/consumer-banking/bank-america-completes-countrywide-financial-purchase.

and lines of business. What . . . particular activity . . . goes on in a particular entity . . . I don't have the knowledge of that at my fingertips. It is not the way to run the company."[210] When asked whether any Countrywide entities operate independently of Bank of America, Moynihan stated, "I'm saying we combined operations. I don't know what businesses are running in what legal entities."[211] Moynihan added, "I don't know what you mean by independently. We own the stock of all of those subsidiaries and they operate – there is not independent [sic] in terms of – they operate as part of our family [of] 3,000 enterprises."[212]

325. Completion of the Red Oak Merger touched off the next step in the Consolidation, the "execution" phase. The execution phase opened with a flurry of transactions from July 1-3, 2008, in which Countrywide Home Loans, in tandem with other Countrywide Financial Corp. subsidiaries, transferred billions of dollars in mortgage loans and control of Countrywide's mortgage servicing rights and advances to the Non-Countrywide Subsidiaries (the "LD1-3 Transactions").

326. The LD1-3 Transactions were not arm's-length transactions. Each of the LD1-3 Transactions was approved by Countrywide entities at a time when Countrywide Financial Corp. – as well as Countrywide Financial Corp.'s wholly owned subsidiaries, including Countrywide Home Loans and Countrywide Securities – were wholly owned and completely controlled by Bank of America. Moreover, the LD1-3 Transactions involving Countrywide Home Loans were approved by the lone member of Countrywide Home Loans' Board of Directors (the "CHL Board"), Andrew Gissinger, who was hand-picked by Bank of America to sign off on each resolution without partaking in any deliberation, investigation, or analysis, in

[210] *MBIA*, Oblak Aff. Ex. 96 (Transcript of Brian Moynihan Deposition, May 2, 2012) at 42-43.
[211] *Id.* at 215.
[212] *Id.* at 216.

contravention of norms of corporate governance applicable to transactions like the LD1-3 Transactions.

327. Countrywide did not exercise any genuine business discretion in approving the LD1-3 Transactions. Rather, those transactions were carried out by Bank of America proxies who sat at both sides of the negotiating table.

328. On July 1, 2008, Countrywide Home Loans sold a pool of residential mortgage loans, including first- and second-lien loans, HELOCs, and construction loans, to NB Holdings in exchange for a promissory note for approximately $6.9 billion (the "LD1 Loan Sale Transaction"). Countrywide Home Loans approved the LD1 Loan Sale Transaction through a unanimous written consent signed only by Gissinger, the sole member of the CHL Board. Gissinger has testified that he understood himself to be employed by Bank of America at the time and continued to be employed at Bank of America for approximately four months thereafter.[213]

329. NB Holdings approved the LD1 Loan Sale Transaction by unanimous written consent of its three directors, Lewis, Amy Woods Brinkley, and Joe Price – all of whom were also executives of Bank of America.

330. Also on July 1, 2008, Countrywide Home Loans novated a portfolio of derivative instruments to BANA in exchange for approximately $1.5 billion (the "LD1 Novation of Derivatives," and collectively with the LD1 Loan Sale Transaction, the "LD1 Transactions").

331. Immediately following the LD1 Transactions, Countrywide Home Loans repaid in full approximately $11.5 billion of its unsecured, revolving lines of credit and bank loans. Countrywide Home Loans applied the entire proceeds it received in the LD1 Transactions

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[213] *MBIA*, Oblak Aff. Ex. 72 (Transcript of Andrew Gissinger Deposition, Aug. 9, 2012) at 319, 324, 326.

– approximately $8.4 billion – towards that credit-line repayment. On information and belief, Bank of America caused those payments to be made selectively to creditors in a way that it believed would inure to its benefit in the future.

332. The CHL Board (i.e., Gissinger) did not perform any analysis of Countrywide Home Loans' ability to satisfy its obligations to other creditors before approving that approximately $11.5 billion repayment. Indeed, neither the CHL Board nor Countrywide Financial Corp.'s Board of Directors (the "CFC Board") performed any independent solvency analysis in the period from June 30, 2008 to November 30, 2008.

333. On July 2, 2008, Countrywide Home Loans sold to NB Holdings its partnership interests in two subsidiaries of Countrywide Home Loans, Countrywide GP, LLC and Countrywide LP, LLC, whose sole assets consisted of 100% of the equity in Countrywide Home Loans Servicing, LP (the "LD2 CHLS Sale Transaction"). Countrywide Home Loans Servicing controlled the mortgage-servicing rights for the vast majority of Countrywide loans and held billions of dollars in servicing advances. In exchange, NB Holdings issued a promissory note for approximately $19.7 billion, the value of which was later adjusted to approximately $18.3 billion.

334. The CHL Board approved the LD2 CHLS Sale Transaction through a unanimous written consent signed by Gissinger. Gissinger has testified that he does not recall whether he reviewed any information about this transaction before granting his approval.[214]

335. Also on July 2, 2008, Countrywide Securities sold its trading portfolio, consisting of a pool of asset- and mortgage-backed securities, to Blue Ridge Investments, LLC, a wholly owned Bank of America subsidiary, in exchange for $147 million (the "LD2 Securities

[214] *MBIA*, Oblak Aff. Ex. 72 (Transcript of Andrew Gissinger Deposition, Aug. 9, 2012) at 381.

Sale Transaction," and together with the LD2 CHLS Sale Transaction, the "LD2 Transactions").

336. On July 1 & 2, 2008, Countrywide Home Loans, at Bank of America's instruction, used approximately $18.7 billion of its assets to repay outstanding debts owed to Countrywide Financial Corp. and certain contractual creditors. On July 1, 2008, the CHL Board approved (again, by a unanimous written consent signed by Gissinger) an approximately $7.3 billion cash transfer from Countrywide Home Loans to Countrywide Financial Corp. to repay certain outstanding intercompany loans. After receiving the cash transfer on July 2, 2008, Countrywide Financial Corp. immediately made an approximately $5.5 billion capital contribution to Countrywide Bank. That injection of funds was consistent with Bank of America's plan to capitalize Countrywide Bank, which was responsible for virtually all of Countrywide's mortgage loan production activities, the ownership of which Bank of America intended to, and did, ultimately transfer to BANA. As Bank of America has admitted, Countrywide Financial Corp. also paid BANA $700 million in connection with Countrywide Home Loans' repayment of two lines of credit for which BANA served as administrative agent.[215] Thus, despite being on notice of Countrywide's potential exposure to contingent creditors, including monoline insurers, Bank of America directed Countrywide Home Loans to use at least $8.0 billion of its assets to repay debts owed to other Bank of America subsidiaries in July 2008.

337. On July 3, 2008, Countrywide Commercial Real Estate Finance, Inc., an indirect Countrywide Financial Corp. subsidiary, sold a pool of commercial mortgage loans to NB Holdings in exchange for a promissory note for approximately $238 million (the "LD3 Commercial Loan Sale Transaction").

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[215] *See* Bank of America Ans. to Second Am. Compl. ¶ 209, *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*, No. 651612-2010 (N.Y. Sup. Ct. Jul. 31, 2013).

338. Also on July 3, 2008, Countrywide Home Loans sold a pool of residential mortgage loans, including first- and second-lien loans, HELOCs, and construction loans, to NB Holdings in exchange for a promissory note for $2.5 billion (the "LD3 Residential Loan Sale Transaction," and together with the LD3 Commercial Loan Sale Transaction, the "LD3 Transactions").

339. The LD1-3 Transactions substantially depleted the assets held and the equity maintained by Countrywide. The value of Countrywide Home Loans' assets alone plummeted from $50.9 billion immediately prior to the Red Oak Merger to $30.3 billion at the end of July 2008, and Countrywide Home Loans' $2.4 billion equity cushion deflated to only $83 million.

340. Moreover, Countrywide Home Loans' incremental liabilities (e.g., expected R&W, monoline, and litigation exposure), which were not reflected on Countrywide Home Loans' balance sheet, dwarfed Countrywide Home Loans' remaining equity. Thus, by virtue of the LD1-3 Transactions orchestrated by Bank of America, Countrywide Home Loans not only was left inadequately capitalized, but actually was rendered insolvent.

341. On or about September 23, 2008, with the LD1-3 Transactions complete, Bank of America removed Gissinger from the CHL Board and informed him that his employment was terminated.

5. *The LD100 Transactions*

342. In two transactions in November 2008 (individually the "Stock Purchase Transaction" and the "Asset Purchase Transaction," and collectively the "LD100 Transactions"), Countrywide Financial Corp. and Countrywide Home Loans transferred to Bank of America substantially all of their remaining assets.

343. Before the LD100 Transactions were approved by the CFC and CHL

Boards, and nearly six weeks before those transactions were executed, MBIA Insurance Corporation, a monoline insurer, had filed a complaint against Countrywide Financial Corp. and Countrywide Home Loans. MBIA's complaint alleged that those entities' fraudulent acts and omissions and breaches of representations and warranties, including breaches of Countrywide's repurchase obligations, had caused MBIA to sustain "hundreds of millions of dollars" in losses and had exposed MBIA to additional "enormous risks of [claims] payments" to the Trusts.[216] Bank of America thus proceeded with the LD100 Transactions with full knowledge that Countrywide's monoline exposure could, and in all likelihood would, culminate in litigation seeking damages awards far beyond the ability of Countrywide to satisfy.

344. On November 7, 2008, pursuant to a Stock Purchase Agreement, Countrywide Financial Corp. transferred "substantially all" of its assets to Bank of America. The transferred assets consisted of all equity interests in Effinity Financial Corporation ("Effinity"), the holding company of Countrywide Bank; all equity interests in Effinity's subsidiaries; and all equity interests in fifty-five other direct and indirect subsidiaries of Countrywide Financial Corp. In exchange, Countrywide Financial Corp. received a promissory note for approximately $3.5 billion, which subsequently was reduced to approximately $1.8 billion, and Bank of America's agreement to assume Countrywide Financial Corp.'s liabilities for publicly issued debt securities having a carrying value of approximately $9.7 billion.

345. Countrywide Financial Corp. approved the Stock Purchase Transaction through a unanimous written consent executed by its board of directors on October 3, 2008. By that time, the CFC Board consisted of three members, Greg Hobby, Helga Houston, and Helen Eggers, each of whom had been a Bank of America employee for years prior to the Stock

[216] Complaint ¶¶ 89-90, *MBIA*.

Purchase Transaction. Hobby was a Bank of America employee at the time, and Houston and Eggers have testified that they believed that they were Bank of America employees when they sat on the Countrywide Financial Corp. board.[217]

346. Also on November 7, 2008, pursuant to an Asset Purchase Agreement, Countrywide Home Loans transferred "substantially all" of its remaining assets to Bank of America (the "Asset Purchase Transaction"). The assets transferred in the Asset Purchase Transaction included: (i) a pool of residential mortgages; (ii) remaining mortgage-servicing rights; (iii) bank-eligible and investment-grade securities; (iv) real estate acquired through foreclosure on mortgage loans; (v) Countrywide's technology platform; (vi) furniture, fixtures, and equipment; (vii) third-party contract rights, including real estate leases, vendor contracts, and intellectual property licenses; (viii) real property owned by Countrywide Home Loans; and (ix) mortgage-servicing advance receivables. In exchange, Bank of America gave Countrywide Home Loans a promissory note for approximately $3.0 billion, which was later adjusted to approximately $3.6 billion.

347. Countrywide Home Loans approved the Asset Purchase Agreement through a unanimous written consent executed by the CHL Board on October 14, 2008. At the time, the CHL Board consisted of Jack Schakett and Kevin Bartlett. Schakett was appointed to the CHL Board effective September 23, 2008, to replace Gissinger, and Bartlett was appointed on October 14, 2008 – the same day that he approved the Asset Purchase Agreement transferring billions of dollars of Countrywide Home Loans' assets to Bank of America.

348. Following the Asset Purchase Transaction, Countrywide Home Loans was

[217] *MBIA*, Bank of America's Resps. to MBIA's Rule 19-A Statement of Undisputed Material Facts, dated Nov. 7, 2012, Resp. to ¶ 149; *MBIA*, Oblak Aff. Ex. 67 (Transcript of Helga Houston Deposition, Apr. 23, 2012) at 56; *MBIA*, Oblak Aff. Ex. 70 (Transcript of Helen Eggers Deposition, Apr. 27, 2012) at 265.

left with only $15.2 billion in assets – $5.1 billion of which was offset by a corresponding $5.4-billion liability – and $172.5 million in net equity.

349. Similarly, after the Asset Purchase Transaction, Countrywide Home Loans' incremental liabilities vastly outsized its equity. By November 30, 2008, Countrywide Home Loans was not only inadequately capitalized, but also insolvent. Countrywide Financial Corp. similarly was drained of substantially all of its assets and was left inadequately capitalized. Accordingly, Bank of America left neither Countrywide Home Loans nor Countrywide Financial Corp. with assets or earning ability sufficient to meet their respective contingent liabilities.

350. As with the LD1-3 Transactions, Countrywide's approval of the LD100 Transactions was provided by directors installed by Bank of America following the Red Oak Merger who were beholden to Bank of America for their employment. The LD100 Transactions, like the LD1-3 Transactions, were not arm's-length transactions because the putative Countrywide directors who approved those transactions were Bank of America proxies who singularly were motivated to further the interests of Bank of America at the expense of Countrywide's creditors. Like the LD1-3 Transactions, the LD100 Transactions were approved without due regard for corporate business practices pertaining to the sales of substantially all of Countrywide Financial Corp.'s and Countrywide Home Loans' assets.

6. *The Gutting Of Countrywide Securities*

351. Like Countrywide Financial Corp. and Countrywide Home Loans, Countrywide Securities was left a shell. On October 29, 2008, Countrywide Securities was de-registered as a securities broker-dealer. Bank of America's decision not to maintain Countrywide Securities' license to trade mortgage-backed securities and mortgage loans, coupled with the sale, at Bank of America's behest, of Countrywide Securities' trading portfolio to BANA in the LD2 Securities Sale Transaction, rendered Countrywide Securities incapable of

carrying on its capital-markets business and of generating any future revenues. Bradley Williams, the Bank of America executive responsible for transferring Countrywide's security positions from Countrywide Securities to Bank of America, testified that following LD1, his role was relegated to "final cleanup," i.e., "boxing up desks, making sure the computers got returned, general admin of check the box project management things since that was no longer going to be in operation," because "Countrywide Securities was no longer going to be a broker dealer."[218] By the end of 2008, Countrywide Securities' assets, valued at approximately $5.1 billion on the day before the Red Oak Merger, had been whittled down to less than $120 million.[219]

7. *Snapshot Of A Decimated Countrywide Following The LD100 Transactions*

352. The net effect of the LD100 Transactions, in tandem with the LD1-3 Transactions and the de-registration of Countrywide Securities, was to reduce drastically the amount that Countrywide's existing and future creditors could hope to recover from Countrywide. Bank of America knew, or reasonably should have known, that Countrywide Financial Corp., Countrywide Home Loans, and Countrywide Securities would be unable to satisfy their creditors once Bank of America caused them to sell virtually all of their revenue-generating assets to itself and the Non-Countrywide Subsidiaries, which positioned Bank of America to collect tremendous revenues by continuing the Combined Mortgage Business through Bank of America subsidiaries.

353. The LD1-3 and LD100 Transactions also left both Countrywide Financial Corp. and Countrywide Home Loans as mere shell corporations incapable of conducting ongoing

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[218] *MBIA*, Oblak Aff. Ex. 289 (Transcript of Bradley Williams Deposition, Feb. 2, 2012) at 65.

[219] Compare *MBIA*, Aff. of Jonathan Rosenberg in Supp. of Bank of America's Mot. for Summ. J. filed Sept. 28, 2012 ("Rosenberg Aff.") Ex. 54 (Countrywide Financial Corp.'s Consolidating Balance Sheet as of Jun. 30, 2008), with *MBIA*, Rosenberg Aff. Ex. 118 (Countrywide Financial Corp.'s Consolidating Balance Sheet as of Nov. 30, 2008).

business independent of Bank of America. Countrywide Financial Corp. and Countrywide Home Loans each entered into wind-down mode, and their only ongoing business, to the extent it still exists, primarily is limited to resolving the multitude of claims lodged against them. Countrywide Securities has been shut down.

354. Following the LD100 Transactions, Countrywide ceased submitting filings to the SEC. Countrywide's financial results are now consolidated into Bank of America's filings.

355. Bank of America formally assumed responsibility for all of Countrywide's obligations necessary to carry on the Combined Mortgage Business's origination, banking, servicing, and insurance services without interruption. Those liabilities included the deposit liabilities of Countrywide Bank, the wages and benefits of Countrywide employees migrated to Bank of America, and real estate leases and third-party vendor contracts needed to operate the day-to-day business.

356. Bank of America also acquired all of the legacy Countrywide assets it viewed as important to running the Combined Mortgage Business, including servicing rights and operations, deposits, technology platforms, furniture, fixtures, equipment, and a robust customer base.

357. Bank of America also chose to employ many legacy Countrywide employees, including key members of Countrywide's senior management. Approximately 19,300 of the 42,815 people employed at legacy Countrywide as of July 1, 2008, were migrated to Bank of America and its Non-Countrywide Subsidiaries.[220] As of November 1, 2011,

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[220] *MBIA*, Oblak Aff. Ex. 10 (Bank of America's First Supplemental Resps. & Objections to Pl.'s Interrogs., dated May 2, 2012) at 27-28.

Countrywide Financial Corp.'s subsidiaries continued to employ only 270 employees.[221]

358. Bank of America immediately reaped profits from its absorption of Countrywide: Bank of America reported to the SEC that "[a]t July 1, 2008, the Countrywide acquisition contributed $86.2 billion to total loans and leases, $17.4 billion to securities, $17.2 billion to MSRs, and $63.0 billion to total deposits."[222] In its Third Quarter 2008 Presentation, Bank of America reported that "Countrywide added $259 million to earnings in its first quarter of inclusion,"[223] and in its 2008 year-end SEC disclosures, Bank of America announced that "[m]ortgage banking income increased $3.2 billion in large part as a result of the Countrywide acquisition."[224] As Bank of America boasted, "[w]e were able to acquire the best mortgage platform in the business, with state-of-the-art technology systems, at an attractive price, immediately becoming the No. 1 provider of both mortgage originations and servicing."[225]

8. *Migration Of The Combined Mortgage Business To BANA*

359. On April 1, 2009, termed "Associate Day 1" or "AD1" in the context of the Consolidation, remaining Countrywide employees' benefits and payroll were converted over from Countrywide's systems to Bank of America's systems.

360. On April 27, 2009, termed "Customer Day 1" or "CD1" in the context of the Consolidation, Bank of America de jure merged Countrywide Bank into BANA.

361. Also on Customer Day 1, Bank of America announced that "[t]he

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[221] *MBIA*, Bank of America's Responses to MBIA's Rule 19-A Statement of Undisputed Material Facts, dated Nov. 7, 2012, Resp. to ¶ 194.

[222] Bank of America, Quarterly Report for Quarterly Period Ended Sept. 30, 2008 (Form 10-Q), at 68 (Nov. 7, 2008).

[223] Bank of America Third Quarter 2008 Results presentation dated Oct. 6, 2008, at 9, *available at* http://library.corporate-ir.net/library/71/715/71595/items/309870/BAC3Q08Presentation-Final.pdf.

[224] Bank of America, Annual Report for Fiscal Year 2008 (Form 10-K), at 19 (Feb. 27, 2009).

[225] Bank of America, 2008 Annual Report (2008) at 14, *available at* http://media.corporate-ir.net/media_files/irol/71/71595/reports/2008_AR.pdf.

Countrywide brand has been retired." Bank of America advised that it would be operating the Countrywide home loan and mortgage business under the brand Bank of America Home Loans, which "represents the combined operations of Bank of America's mortgage and home equity business and Countrywide Home Loans."[226] Legacy Countrywide employees were instructed to no longer mention Countrywide in marketing materials; instead, when speaking to customers, they were instructed to refer to themselves as BANA or Bank of America Home Loans.[227]

362. As Bank of America had decided during the assessment phase, Countrywide's headquarters in Calabasas, California was selected as Bank of America's "Mortgage Line of Business Headquarters," out of which Bank of America Home Loans currently operates. Furthermore, Bank of America and the Non-Countrywide Subsidiaries continue to conduct mortgage business out of many former Countrywide office locations. Bank of America's website states that "Countrywide customers . . . have access to Bank of America's 6,100 banking centers."[228] Countrywide's former website redirects customers to Bank of America's website.

363. By December 2010, the final phase of the Consolidation, Bank of America's integration of legacy Countrywide's systems, including the deposits and mortgage-origination and fulfillment systems, was complete. Following system consolidations, as Kanaga testified, "we were working under one name and one brand and so it wasn't this is Countrywide

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[226]*Bank of America Responds to Consumer Desire for Increased Transparency in Home Loan Process with Tools that Clarify Mortgage Terms and Foster Informed Homeownership*, Bank of America, Press Release, Apr. 27, 2009, *available at* http://newsroom.bankofamerica.com/press-release/countrywide/bank-america-responds-consumer-desire-increased-transparency-home-loan-pro.

[227]*See, e.g.*, *MBIA*, Oblak Aff. Ex. 11 (Transcript of Christopher Dumont Deposition, Jan. 27, 2012) at 99-100.

[228]*Bank of America Responds to Consumer Desire for Increased Transparency in Home Loan Process with Tools that Clarify Mortgage Terms and Foster Informed Homeownership*, Bank of America, Press Release, Apr. 27, 2009, http://newsroom.bankofamerica.com/press-release/countrywide/bank-america-responds-consumer-desire-increased-transparency-home-loan-pro.

and this is Bank of America. It was all one."[229]

9. ***The Aftermath***

364. Having scavenged everything of value that once resided at Countrywide, Bank of America continues to prop up Countrywide Financial Corp. and Countrywide Home Loans as shell entities in an effort to prevent Countrywide's creditors from seeking recourse against Bank of America directly.

365. In a June 2011 valuation analysis of Countrywide Financial Corp.'s consolidated balance sheet, Capstone Valuation Services, LLC ("Capstone") concluded that as of March 31, 2011, Countrywide Financial Corp. and its subsidiaries had only $10.7 billion in assets, as compared with $11.0 billion in liabilities.[230] Capstone noted that Countrywide Financial Corp. had "negative earnings and minimal operating revenues," "no operations that by themselves are economically viable on a go-forward basis," and "no intangible assets . . . with any [material] value," and "lacked any operations except for managing its obligations under certain servicing agreements which remained at [Countrywide Financial Corp.] and certain repurchase agreements for assets sold prior to the Acquisition."[231]

366. Countrywide's principal remaining operation – winding down its contingent liabilities – is dominated and controlled by Bank of America, and has been since the Red Oak Merger. The legacy Countrywide and legacy Bank of America repurchase departments were merged together after LD1, meaning that legacy Countrywide employees involved in

[229]*MBIA*, Oblak Aff. Ex. 20 (Transcript of Mary Kanaga Deposition, May 10, 2012) at 26.

[230]Bruce B. Bingham, Capstone Valuation Services LLC, Countrywide Fin. Corp. Valuation Analysis prepared for Bank of New York Mellon, Ex. B (Jun. 6, 2011), *available at* http://www.cwrmbssettlement.com/docs/Valuation%20Analysis.pdf.

[231]*Id.* at 7-8.

repurchases "were now reporting up through Bank of America."[232] A repurchase request made to Countrywide typically cannot be approved without a consensus of a joint committee of Bank of America and Countrywide employees, meaning the vote of a single Bank of America committee member can override the proposed course of action recommended by the rest of the group.[233] And Bank of America controls repurchase negotiations with counterparties, such as the monoline insurers, as well as the funding of repurchases.

367. Countrywide Financial Corp. and Countrywide Home Loans are financially incapable of satisfying the many potential judgments or settling the myriad claims against them. When it is expedient for Bank of America to do so, Bank of America pays the debts, or represents that it will pay the debts, of Countrywide. Through its conduct and public statements, Bank of America has proclaimed to the market its intent to assume all of Countrywide's debts, while privately purporting to reserve the right not to do so.

368. Bank of America, using its own assets, selectively capitalizes Countrywide Financial Corp. and Countrywide Home Loans to avoid incurring catastrophic reputational harm. In four settlements alone, the aggregate amount that Bank of America has paid or agreed to pay on behalf of Countrywide Home Loans is 4.6 times greater than the reserves recorded at Countrywide Home Loans as of July 31, 2008. Without those infusions of capital from Bank of America, Countrywide Home Loans would have recorded significant negative equity in each month from March 2009 through at least April 2012 and further would have been unable to satisfy its obligations over time.

369. Bank of America has taken responsibility for Countrywide's pre-merger liabilities, including restructuring hundreds of thousands of loans created and serviced by

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[232] *MBIA*, Oblak Aff. Ex. 247 (Transcript of Cynthia Simantel Deposition, Feb. 23, 2011) at 134.
[233] *Id.* at 129.

Countrywide. A spokesperson for Bank of America confirmed: "We bought the company and all of its assets and liabilities."[234] Similarly, a January 23, 2009 New York Times article quoted Lewis (who at the time was still Bank of America's Chairman and CEO), acknowledging that Bank of America had factored Countrywide's liabilities into the price it paid to acquire Countrywide: "We looked at every aspect of the deal, from their assets to potential lawsuits and we think we have a price that is a good price."[235]

370. As current CEO of Bank of America, Moynihan repeatedly has represented that Bank of America will pay for Countrywide's debts:

- "Our company bought [Countrywide] and we'll stand up; we'll clean it up."[236]
- "[W]hen we look at the rep and warranty claims and the claims by the various investors, we're not just going to put this behind us to make us feel good. We're protecting your money. We're protecting the shareholders' money, and we're going to make sure that we'll pay when due, but not just do a settlement to move the matter behind us."[237]
- "There's a lot of people out there with a lot of thoughts about how we should solve this, but at the end of the day, we'll pay for the things that Countrywide did."[238]

371. As a result of the Consolidation, Bank of America's litigation-driven

[234]Amy Miller, *Countrywide in Crosshairs as Mortgage Crisis Fuels Litigation*, Corporate Counsel, Feb. 22, 2008, at 2.

[235]Julie Creswell, *Bank of America Joins Parade of Mortgage-Related Losses*, New York Times, Jan. 23 2008, *available at* http://www.nytimes.com/2008/01/23/business/23bank.html?_r=0.

[236]Nelson D. Schwartz, *Batting Cleanup at Bank of America*, New York Times, Dec. 11, 2010, *available at* http://www.nytimes.com/2010/12/12/business/12brian.html?pagewanted=all.

[237]Bank of America, Q3 2010 Earnings Call (teleconference held Oct. 19, 2010), transcript available at http://www.nasdaq.com/aspx/call-transcript.aspx?StoryId=230870&Title=bank-of-america-corporation-ceo-discusses-q3-2010-results-earnings-call-transcript.

[238]Hugh Son & David Mildenberg, *Bank of America in "Hand-to-Hand" Combat Over Mortgage Disputes, CEO Says*, Bloomberg, Nov. 16, 2010, http://www.bloomberg.com/news/2010-11-16/bofa-in-hand-to-hand-combat-over-mortgage-disputes-chief-moynihan-says.html.

position that it is not the legal successor to Countrywide's obligations would mean that Ambac's capacity to collect in full on any judgment against Countrywide is subject to the whim of Bank of America.

FIRST CAUSE OF ACTION

(Fraudulent Inducement Against Countrywide Financial Corp., Countrywide Home Loans, and Countrywide Securities)

372. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 371 of this Complaint.

373. As set forth above, Countrywide made materially false public statements, and omitted material facts, with the intent to defraud the public and Ambac.

374. As a corporate parent, Countrywide Financial Corp. directed the activities of Countrywide Home Loans and Countrywide Securities. Countrywide Financial Corp. and Countrywide Home Loans were responsible for selecting the mortgage loans for some of the Transactions. Countrywide Home Loans was responsible for transferring the mortgage loans into the trusts, and entering into agreements with the trusts and other parties. As part of its fraudulent scheme, Countrywide needed, and fraudulently induced Ambac to provide, credit enhancement to improve the marketability of the notes and certificates issued in connection with each of the Transactions. Countrywide Securities, a broker-dealer, was responsible for off-loading the risks associated with certain of the mortgage loans originated by Countrywide Home Loans, and underwriting and managing the offering of some of the notes and certificates issued in connection with the Transactions to buyers in the secondary market. Countrywide Securities marketed some of the notes and certificates by fraudulently representing that the mortgage loans had been originated consistent with Countrywide's traditional underwriting standards, and the strength of Countrywide's reputation for conservative lending practices and high quality loans.

375. Countrywide made materially false statements and omitted material facts with the intent to defraud Ambac through pre-transactional communications between Ambac and Countrywide officers. Absent Countrywide's fraudulent inducement, Ambac never would have issued the Policies.

376. On numerous occasions between 2004 and the present, Countrywide knowingly and with the intent to defraud, caused its employees and agents to submit materially false and misleading documents to induce Ambac to issue the Policies.

377. Countrywide, knowingly and with the intent to defraud, delivered to Ambac, directly and through the underwriters of the Transactions, materially false and misleading documents, including loan tapes and the Prospectus Supplements, for each Transaction and fraudulently induced shadow ratings by the rating agencies. Countrywide's representations regarding the mortgage loans underlying the Transactions were materially false and misleading.

378. Ambac reasonably relied on Countrywide's statements and omissions when it issued its Policies.

379. As a result of Countrywide's statements and omissions, Ambac insured certain payments of principal and interest to the Noteholders from eight pools of loans that had a risk profile far higher than Countrywide led Ambac to understand.

380. As a result of Countrywide's false and misleading statements and omissions, Plaintiffs have suffered, and will continue to suffer, damages including claims payments under the Policies.

381. Because Countrywide committed these acts and omissions maliciously, wantonly, oppressively, and with the knowledge that they would affect the general public –

which they have – Plaintiffs are entitled to punitive damages.

SECOND CAUSE OF ACTION

(Successor and Vicarious Liability Against Bank of America)

382. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 381 of this Complaint.

383. As Countrywide's successor-in-liability, and because Countrywide and Bank of America are alter egos of one another, Bank of America is jointly and severally liable for any and all damages resulting to Plaintiffs from the wrongful actions of Countrywide.

384. Through the Consolidation, Bank of America has de facto merged with Countrywide because (a) Countrywide shareholders became shareholders in Bank of America; (b) Countrywide ceased its ordinary business operations and effectively was rendered a shell entity; (c) Bank of America continued Countrywide's business enterprise, including Countrywide's management, personnel, physical location, assets, and general business operations; and (d) Bank of America assumed the liabilities ordinarily necessary to continue Countrywide's business unabated.

385. Moreover, (a) the Consolidation was accomplished through transfers of substantially all of Countrywide's assets to Bank of America and its non-Countrywide subsidiaries, which were approved by the Bank of America-controlled Countrywide directors without regard for legally mandated, prudent and customary corporate business practices governing such transactions; (b) the consideration that Countrywide received in exchange for its assets was inadequate, since, among other things, Bank of America directed Countrywide to use much of that consideration to repay preferred creditors or capitalize other Bank of America subsidiaries; (c) Countrywide, at Bank of America's instruction, failed to perform adequate due

diligence concerning the effects of those asset transfers on Countrywide's solvency and its ability to satisfy creditors before approving the transfers, thus significantly reducing the likelihood that Ambac can recover against Countrywide; and (d) by depriving Countrywide of its ability to satisfy its debts as they come due, Bank of America has defrauded Countrywide's creditors, including Ambac.

386. Bank of America and Countrywide are mere alter egos of one another. Bank of America, through its 100% ownership and control of Countrywide, caused Countrywide to transfer substantially all of Countrywide's valuable revenue-generating assets needed to carry on its pre-Red Oak Merger business to Bank of America and to Bank of America's non-Countrywide subsidiaries, despite Bank of America's knowledge of unsatisfied (and, by virtue of the asset transfers, unsatisfiable) creditor claims, both matured and unmatured, against Countrywide. By design, the asset transfer transactions were dressed up to appear as if they were exchanges for fair consideration when, in fact, much of the consideration was destined to be (and was) round-tripped back to Bank of America and its non-Countrywide subsidiaries. And by design, Bank of America maintains Countrywide as a front to provide separation between Bank of America and the claims of Countrywide's unconditional and contingent creditors, including Ambac, who, Bank of America now contends, have been consigned to seek recovery from shells gutted of their former capacity to earn profits. Through its domination and control of Countrywide, Bank of America has deprived Countrywide of sufficient funds to pay its liabilities to Ambac, and Ambac has, and continues to be, harmed thereby.

387. Bank of America, through its public conduct and statements, also has assumed responsibility for Countrywide's pre-merger liabilities.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs respectfully pray for the following relief:

A. For an award in favor of Plaintiffs and against Defendants under the common law and New York Insurance Law § 3105 of damages to be proven at trial, including but not limited to:

1. All claims paid and accrued under the Policies to date and all claims due for payment in the future under the Policies.
2. Plaintiffs' other compensatory, consequential, and punitive damages.

B. For a declaration that Bank of America is the successor-in-interest to Countrywide, and/or that Bank of America and Countrywide are alter egos of one another;

C. For an order of prejudgment interest pursuant to C.P.L.R. 5001; and

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

Dated: New York, New York
December 30, 2014

Respectfully submitted,

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