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and The Segregated Account of Ambac Assurance Corporation

SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

AMBAC ASSURANCE CORPORATION and THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION,	Index No. 652321/15
Plaintiffs,	
v.	**COMPLAINT**
COUNTRYWIDE HOME LOANS, INC.,	
Defendant.	

Plaintiffs Ambac Assurance Corporation ("Ambac") and The Segregated Account of Ambac Assurance Corporation (the "Segregated Account"), by and through their attorneys Patterson Belknap Webb & Tyler LLP, for their complaint against Defendant Countrywide Home Loans, Inc. ("Countrywide Home Loans") allege as follows:

NATURE OF THE ACTION

1. Plaintiffs seek recovery for Countrywide Home Loans' fraudulent inducement of Ambac to issue five policies insuring against losses resulting from residential

mortgage-backed securities ("RMBS"). The five policies at issue, AB0877BE, AB0913BE, AB0918BE, AB0929BE, and AB0930BE (the "Policies"), have been allocated to the Segregated Account, and, as of October 31, 2014, Plaintiffs have paid, accrued, or expects to pay more than $350 million in policy claims resulting from misrepresentations about loans originated by Countrywide Home Loans and included in five RMBS transactions: Harborview Mortgage Loan Trust 2005-2, Harborview Mortgage Loan Trust 2005-8, Harborview Mortgage Loan Trust 2005-10, Harborview Mortgage Loan Trust 2005-12, and Harborview Mortgage Loan Trust 2005-13 (the "Transactions").

PARTIES

2. Plaintiff the Segregated Account 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").

3. 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").

4. 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.

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5. Plaintiff Ambac is a Wisconsin-domiciled stock insurance corporation authorized to transact surety and financial guaranty insurance. Ambac 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.

6. 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.

JURISDICTION AND VENUE

7. This Court has personal jurisdiction over Countrywide Home Loans pursuant to CPLR §§ 301 and 302 because Countrywide Home Loans is a New York corporation, is registered or licensed to do business within New York, and engaged in conduct within the State that gives rise to Plaintiffs' claims.

8. Venue in New York County is proper pursuant to CPLR § 503(a) and (c).

FACTUAL BACKGROUND

9. This is a case about fraud. Ambac Assurance Corporation seeks to right the wrongs perpetrated against it by Countrywide,[1] a mortgage bank. Countrywide fraudulently induced Ambac to issue insurance policies that have and will require Plaintiffs to make more

[1] References to the conduct of "Countrywide" encompass Countrywide Home Loans; its parent, Countrywide Financial Corp.; and its affiliate, Countrywide Securities Corp. Countrywide Home Loans acted in concert with other Countrywide entities in order to perpetrate the fraudulent inducement detailed in this Complaint.

than $350 million in claims payments on the five Transactions at issue in this suit. 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.

10. 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.[2]

- 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.[3]

- Countrywide's former Chief Executive Officer, Angelo Mozilo, paid a record $22.5 million penalty to the Securities and Exchange Commission ("SEC"), the largest penalty ever paid by a public company's senior executive in an SEC settlement.[4] Mozilo was

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[2] *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.

[3] *$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.

[4] *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.

> also ranked as the second worst chief executive in the history of the United States by a national business magazine.[5]

11. None of this was known or indeed knowable to Ambac in 2005, when it insured 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.

12. 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.

13. 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.

14. Countrywide told Ambac that it had fraud management and quality control procedures to root out improper origination practices. In reality, Countrywide's fraud prevention

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[5] 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.

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.

15. 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.

16. 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 five Transactions that closed in 2005, which were backed by mortgage collateral originated by Countrywide. The 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 Harborview Mortgage.

17. 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 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.

18. 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 insured by Ambac in the Transactions posed the lowest possible risk of having 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.

19. 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.

20. 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 the initial low-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.

21. 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 produced higher quality PayOption ARM loans from sophisticated borrowers. Countrywide touted its purportedly conservative approach in qualifying borrowers for PayOption ARM loans. In particular, 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.

22. 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 the PayOption ARM program was the riskiest product on the market. Countrywide executives instructed their employees that PayOption ARMs for non-

owner-occupied properties were so toxic that every single one should be sold. This distressing observation was not disclosed to Ambac.

23. Based on Countrywide's lies – its fraudulent representations and omissions to Ambac in meetings, public statements, and Prospectus Supplements – Ambac was induced to issue 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.

24. Based on Countrywide's historic fraud, Plaintiffs seek from Countrywide damages sufficient to compensate them fully for the harm they have incurred from being fraudulently induced to participate in the Transactions.

A. The Rise And Fall Of Countrywide

1. *Countrywide Rises To Prominence And Profit*

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

26. 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.

27. 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."[6] In the following years, 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.[7]

28. When Countrywide's loosening (or abandonment) of guidelines and safeguards failed to produce enough loans at the frantic pace required to meet the aggressive

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[6] *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).

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

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.

29. 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*

30. 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.

31. 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."

32. 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."

33. 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.

34. For example, in its Annual Report filed with the SEC for 2005 (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, under the direction of the Chief Credit Officer, 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.[8]

35. 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 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*

36. 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.[9] 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

[8] Countrywide Financial Corp., Annual Report for Fiscal Year 2005 (Form 10-K), at 93 (March 1, 2006).

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

described one of the company's policies.[10] Indeed, the "license" given from Mozilo himself was to "be aggressive . . . to gain market share."[11] In lieu of avoiding bad loans, Countrywide chose to reduce its risk by removing 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.

37. 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.

38. 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.

39. 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."[12]

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[10] Third Am. Compl. ¶ 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*").

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

[12] Third Am. Compl. ¶ 14, *AIG v. Countrywide*.

B. Countrywide's Representations To Ambac

1. *Representations At Meetings With Ambac*

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

41. Prior to issuing financial guaranty insurance policies, 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 2005, 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.

42. 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, and September 2005 – 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.

43. 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.

44. 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.

45. 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 Harborview 2005-12 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.

46. 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.

47. 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.

48. Thus, over the course of 2004 and 2005, 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*

49. 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 contained detailed descriptions of the securitized loans, including group-level information about the occupancy status of borrowers and loan-to-value ("LTV") ratios.

50. 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.

51. 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.

52. 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 containing 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.

53. The Prospectus Supplements for the 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.[13] 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.

54. The Prospectus Supplement for the Harborview 2005-10 Transaction provides a representative sample of the deceptive statements Countrywide was making to Transaction investors regarding its underwriting guidelines.[14] The exacting underwriting

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[13] *See* Harborview 2005-2 Prospectus Supplement at S-58-62; Harborview 2005-8 Prospectus Supplement at S-92-98; Harborview 2005-10 Prospectus Supplement at S-48-53; Harborview 2005-12 Prospectus Supplement at S-48-53; Harborview 2005-13 Prospectus Supplement at S-48-53.

[14] The Prospectus Supplement for the Harborview 2005-2 Transaction differs in that it does not differentiate between the "standard" and "expanded" underwriting guidelines described herein.

standards described in the document bear no relation to the turnstile approach employed by Countrywide.

55. The Harborview 2005-10 Prospectus Supplement begins by explaining that the information regarding the "Countrywide Underwriting Guidelines" "has been provided by Countrywide."[15] Greenwich expressly disclaims any liability for the accuracy of this information, placing the blame for any inaccuracy squarely on Countrywide's shoulders.

56. 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."[16] It then states, falsely, that "[a]ll of the mortgage loans originated or acquired by Countrywide have been originated or acquired in accordance with its credit, appraisal and underwriting standards."[17] 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."[18] In practice, Countrywide routinely allowed exceptions whether compensating factors existed or not.

57. 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," and that Countrywide requires verification of income through "pay stub[s] and/or W-2 forms" when required by Countrywide's underwriting guidelines.[19] It states that "[f]or all mortgage loans originated or acquired by

[15] Harborview 2005-10 Prospectus Supplement at S-47.

[16] *Id.* at S-49.

[17] *Id.* at S-48.

[18] *Id.* at S-49.

[19] *Id.* at S-48. The Prospectus Supplement explains that in certain circumstances Countrywide would allow borrowers to apply for a loan under one of several streamlined documentation processes.

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."[20] 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.

58. The Harborview 2005-10 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 loans purchased by Fannie Mae and Freddie Mac,"[21] 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."[22] These categorizations provided a misleading account of the stringency of Countrywide's actual underwriting practices.

59. 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

[20] *Id.* at S-50.

[21] *Id.* at S-50.

[22] *Id.* at S-51. 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."

> 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 or Freddie Mac appraisal standards then in effect.[23]

60. 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.

61. The Harborview 2005-10 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.[24] 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.

62. 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 the securitized Harborview pools being replete with loans made to borrowers with little or no ability to repay.

63. 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 monoline insurers like Ambac for use in determining whether to

[23] *Id.* at S-50.

[24] *Id.* at S-49.

participate in transactions backed by Countrywide loans. While being solicited to bid to insure the Transactions, Ambac received mortgage loan tapes for the Transactions from Greenwich containing loan-level data supplied by Countrywide. Countrywide understood that demand for its loans would dry up if monoline insurers 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.

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

Transaction	Loan Group	Occupancy Status			Weighted Average LTV
		Primary	Investor	Second	
2005-2	2	86.74%	9.18%	4.07%	73.27%
2005-8	1-A1	66.71%	26.43%	6.87%	77.54%
	1-A2	85.57%	9.51%	4.92%	75.29%
	2-A1	60.84%	29.59%	9.58%	77.21%
	2-A2	83.50%	10.57%	5.93%	74.12%
2005-10	1	73.01%	20.35%	6.63%	77.20%
	2	86.06%	9.46%	4.49%	74.63%
2005-12	1	77.63%	18.27%	4.10%	78.36%
	2	88.18%	8.33%	3.49%	74.90%
2005-13	1	73.06%	21.07%	5.86%	78.78%
	2	80.97%	13.53%	5.50%	77.11%

65. 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 Transaction it 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.

66. 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:

Transaction	Date Loan Tape Disseminated	Sponsor Analyst Disseminating the Loan Tape	Closing Date
2005-2	April 4, 2005	Max Jaeger, RBS Greenwich Capital	April 12, 2005
2005-8	July 15, 2005	Shakti Radhakishun, RBS Greenwich Capital	July 29, 2005
2005-10	August 2, 2005	Sean Curran, RBS Greenwich Capital	August 31, 2005
2005-12	August 31, 2005	Sean Curran, RBS Greenwich Capital	September 30, 2005
2005-13	September 16, 2005	Matt Miles, RBS Greenwich Capital	September 30, 2005

C. Countrywide Abandons Prudent Mortgage Banking

67. 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, 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.

68. 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.[25] 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."[26] 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 obscuring Countrywide's risk profile and attempting to differentiate it from other lenders."[27]

69. 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.

70. 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 against Countrywide by another monoline insurance company and in which a New York court denied Countrywide's motion for summary judgment. The *MBIA* action is noteworthy in part because of the wealth of documents relating to

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

[26] Compl. ¶ 6, *SEC v. Mozilo*.

[27] *Id.* ¶ 7.

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 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*

71. 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 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."[28]

72. 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

[28] 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.

to underwrite 25 loan files a day during the week and 25 to 35 loan application files over the weekend.[29]

73. 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.[30]

74. Countrywide's compensation system was specifically designed to incentivize loan officers to achieve the company's production goals. Loan officers' bonuses 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.[31]

75. 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

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

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

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

the will of loan officers in all respects, doing whatever it took to ensure that loans were approved.[32]

76. 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.[33] 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 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."[34]

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

77. 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

[32]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.

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

[34]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.

"[g]uidelines aren't the 10 commandments."[35] 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*

78. 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. That is, 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."[36] 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 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."[37]

79. Nonetheless, Countrywide's executives remained silent and did nothing to halt the growing reality that the quality of loans originated by Countrywide was deteriorating,

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[35] *MBIA*, Sheth Aff. Ex. 2 (Transcript of Angelo Mozilo Deposition, Jun. 21, 2011) at 27.

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

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

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."[38]

b. *Countrywide Knew About And Ignored Problems In Its PayOption ARM Program.*

80. 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.[39] 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.[40]

81. 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 . . .

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

[39] *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.

[40] *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).

the riskiest product on the market."[41] 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' 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."[42] That is, Countrywide's exposure was alleviated once the sale was made.

c. *Countrywide Knew About And Ignored Evidence of Widespread Fraud In Its Low Documentation Program.*

82. 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.[43] But the limited income verification associated with these loans "does not eliminate the need to analyze and evaluate the

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[41] 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).

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

[43] *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).

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."[44] 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."[45] These borrowers were often required to have higher FICO scores than were borrowers whose loans were originated as part of full documentation programs.

83. However, 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. Countrywide was keenly aware of risks this created. 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."[46]

84. Countrywide's internal comparisons of stated income with income actually reported to the IRS revealed stark differences. Furthermore, it was not uncommon for a loan to have income that was unreasonable on its face yet not questioned by Countrywide

[44] *Id.*

[45] *Id.*

[46] Compl. ¶ 35, *SEC v. Mozilo*.

underwriters – for example, McDonald's workers and maids who supposedly made $15,000 per month.[47]

85. 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.[48] Nonetheless, the loan was approved and funded by Countrywide – and then securitized in a monoline-insured deal.

d. *<u>Countrywide Engaged In Predatory Lending</u>*

86. 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.

87. 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

[47] *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.

[48] *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.[49]

88. 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.[50]

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

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

[50] Compl. ¶ 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.[51]

90. 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.[52]

91. 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."[53]

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

[52] *Id.* ¶¶ 13-14.

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

92. Illinois' complaint describes these practices in great detail with respect to Countrywide's development and marketing of its lucrative PayOption ARMs.[54] 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.[55] 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.[56]

93. 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."[57] 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.[58]

e. *<u>Countrywide's Competitor Match Program Hit The Lowest Common Denominator</u>*

94. 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

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[54] *Id.* ¶¶ 123-208.

[55] *Id.* ¶¶ 136-57.

[56] *Id.* ¶¶ 176-85.

[57] Compl. ¶ 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).

[58] *Id.* ¶ 53.

and sufficient compensating factors existed, such a system could not generate loans at the scale 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.

95. While the production divisions wholeheartedly supported the competitor match program, Countrywide's method 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."[59] Countrywide therefore went ahead with that program.

96. 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 the most aggressive in the industry:[60]

- 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.

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

[60] *SEC v. Mozilo*, No. 09-CV-3994, slip op. at 12, 20-21 (C.D. Cal. Sept. 16, 2010) (citation omitted).

- 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.

- 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."

f. *Exception Loans Became The Rule*

97. 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.

98. Ostensibly, Countrywide's policies mandated that the company approve loans that did not conform to its underwriting guidelines – "exception" loans – only in "moderation."[61] 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.

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

99. 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."[62] One year later, the production of exception loans had 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.[63]

100. 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.[64]

101. At the heart of Countrywide's exception program was the principle that the company would "price all saleable loans."[65] 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[66]

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

[63] *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.

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

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

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

102. 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.[67] Not surprisingly, this shift in focus to salability and volume resulted in an attendant decrease in the quality of the loans being 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.[68]

103. 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.[69]

104. 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.[70]

105. "Business decisions" also justified, in Countrywide's view, deviation from the guidelines without compensating factors and "despite . . . its risk and/or probable losses"[71] – and again, such loans could be securitized. As an employee in the Secondary Marketing

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

[68] ***MBIA***, Sheth Aff. II Ex. 115 (Transcript of Nathan Joshua Adler Deposition, Apr. 12, 2011) at 688-90.

[69] ***MBIA***, Sheth Aff. Ex. 31 (Transcript of Moses Sulukyan Deposition, Jun. 8, 2011) at 185-86.

[70] ***Id.*** at 171-72.

[71] ***Id.*** at 115.

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 upper levels of management."[72] 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.[73]

106. 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.[74]

107. 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.[75]

108. 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

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

[73] *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").

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

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

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.[76]

109. 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 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."[77]

110. 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."[78] 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

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[76] *MBIA*, Aff. of Sarah Concannon in Opp. To Pl.'s Mot. for Summ. J., filed Oct. 19, 2012 (Concannon Aff.) Ex. 23 (Transcript of Kathryn Tinsley Deposition, April 1, 2011) at 470-73.

[77] Second Consolidated Class Action Compl. ¶ 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.

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

coming back to us seeking a repurchase or indemnification."[79] 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

111. 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 guidelines. The algorithm was effectively a "black box," containing a blueprint or formula known only to Countrywide's senior executives.[80]

112. 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.[81]

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[79] *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).

[80] 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).

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

113. 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.[82]

114. 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 floor of 585.[83] Despite these serious inaccuracies, Countrywide "had a business philosophy that . . . would honor a CLUES accept, even if we knew CLUES was wrong."[84] As described by one employee familiar with CLUES, "the philosophy at Countrywide was to . . . not reunderwrite loans underwritten by CLUES."[85]

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

115. 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.[86] Although underwriters were supposedly only able to approve loans up to certain limits, a March 2006 internal audit noted – as a repeat finding – that

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

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

[84] *Id.* at 406.

[85] *Id.*

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

31% of "CLUES Refer" loans were underwritten by employees without designated underwriting authority.[87]

116. 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.[88] 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 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."[89]

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

117. 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."[90]

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

[88] *MBIA*, Sheth Aff. Ex. 6 (Transcript of Mari Eisenman Deposition, Feb. 14, 2012) at 34-35.

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

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

118. 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 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.[91]

119. In many cases, Countrywide loan officers contacted allegedly independent appraisers directly to request that legitimate appraisal values be increased.[92] 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.[93]

120. 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.[94] 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

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

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

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

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

the highest volume loan producer in the branch was unhappy with the values on Cottingham's appraisals.[95] Kyle Lagow, a former Landsafe employee, has alleged multiple other incidents where Countrywide representatives explicitly stated that they would not work with certain appraisers because they consistently came in "under value."[96] Such blacklisting represented a significant threat to the livelihoods of independent appraisers in light of Countrywide's dominance of the residential mortgage market.

121. 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.[97] 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.[98]

122. 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*

123. 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

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

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

[97] *Id.* ¶ 138.

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

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.

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

124. 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.[99]

125. 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

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

authorization in order to get me approved for the stated income loan. I was told by several people at Countrywide that this was done just to get me qualified and that nobody would check on it."[100]

126. 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.

127. 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.[101]

128. 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

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

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

during their reviews of random cross-sections of Countrywide loans they routinely encountered stated income loans listing fantastical incomes.[102]

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

129. 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 would approve the loan on the first run.[103]

130. 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

[102] *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.

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

loan. A borrower stated in the same report that a Countrywide loan officer advised her to double her salary when completing her loan application.[104]

131. 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.[105] 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.[106]

c. Countrywide Employees Altered And Forged Loan Documents

132. 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 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.[107]

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[104] 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/.

[105] *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.

[106] *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.

[107] 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-

133. 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.[108]

134. 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*

135. 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 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.

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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.

[108] *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.

136. 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.[109]

137. 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.[110]

138. 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 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

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

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

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.[111]

139. 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.[112]

140. 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.[113] These divisional fraud investigation groups refused to provide suspicious activity reports to Foster's department, which resulted in the gross underreporting of suspected fraud.[114]

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

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

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

[113] *Id.* at 26:47-29:09.

[114] *Id.* at 38:10-43:03.

themselves, and often conducted their own investigations into the alleged fraud, despite lacking any competency to conduct such investigations.[115]

142. 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.[116]

143. 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 back at the whistleblowers."[117]

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[115] *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.

[116] *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.

[117] 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.

144. 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.[118]

145. 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.[119]

146. 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*

147. As noted earlier, Countrywide told Ambac and the investment community that its Quality Control department "complet[ed] comprehensive loan audits that consist[ed] of a re-verification of loan documentation, an in-depth underwriting and appraisal review, and, if necessary, a fraud investigation" and that this system "identifies fraud and poor performance of

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

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

individuals and business entities associated with the origination of our loans."[120] Nothing could have been further from the truth.

148. 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.[121]

149. 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.[122] 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.[123]

150. 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.

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[120] Countrywide Financial Corp., Annual Report for Fiscal Year 2004 (Form 10-K), at 75 (Dec. 31 2004).

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

[122] *Id.*

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

D. Countrywide Management Knew Its Procedures Were Inadequate

151. 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*

152. By 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.

153. 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.[124]

154. Similarly, another Countrywide employee, Shahima Shaheem e-mailed Mozilo directly to report unethical and fraudulent underwriting practices at the company. Shaheem never received a response from Mozilo, but she was harassed and retaliated against after sending this e-mail.[125]

2. *Management Ignored Audit Findings Concerning Systemic Flaws*

155. 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.

156. 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.[126]

157. 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

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

[125] Compl. ¶¶ 8-9, *Shaheem v. Countrywide Financial Corp., et al.*, C05-02537 (Cal. Super. Ct. Dec. 1, 2005).

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

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.[127]

158. 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-exception loans.[128]

159. Thus, during the time the Transactions were being executed, Countrywide management was receiving 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.

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

160. 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.

161. In 2005, Countrywide executives expressed 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

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

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

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."[129] 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.[130]

162. 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 . . . loans that it had purchased.'" "On April 13, 2006, Mozilo sent an[] e-mail to Sieracki and Sambol, stating that he had 'personally observed a serious lack of compliance with our origination system as it relates

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

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

> to documentation and generally a deterioration in the quality of loans originated versus the pricing of those loan[s]. . . .'"[131]

163. 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

164. Amidst this incriminating backdrop of undisclosed fraudulent activity, Countrywide entered the marketplace to sell the hundreds of thousands of loans that are included in the five Transactions that are the subject of this lawsuit. The five 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.

165. First, in each Transaction, Countrywide originated or acquired loans that it later sold to RBS Greenwich. 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 its 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.

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

166. Second, Countrywide made regular presentations to Ambac employees in meetings held at Countrywide's headquarters in 2004 and 2005. As discussed above and 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.

167. 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.

168. 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.

169. Fourth, Countrywide knew that the underwriter 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. 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.

170. 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.

171. 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 loans complied with the applicable underwriting guidelines.

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

173. 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.

174. 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.

175. 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.

176. 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.

177. 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. *Countrywide's Representations And Warranties*

178. For these five Transactions, Countrywide Home Loans sold thousands of negative amortization first lien loans to serve as collateral for publicly offered securities.

179. The 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.

180. 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."

181. 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.

182. After RBS Greenwich, the underwriter for the Transactions, acquired loans from Countrywide, each Transaction was effectuated through a "Pooling Agreement" or "Pooling and Servicing Agreement"[132] 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 Agreements.

183. For each 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

[132] The contract is called a Pooling Agreement for Harborview 2005-10, 2005-12 and 2005-13. It is called a Pooling and Servicing Agreement for Harborview 2005-2 and 2005-8.

upon any untrue statement or omission of material fact based on the information provided by Countrywide.

184. In addition, each 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 restates 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.

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

185. Ambac's involvement in each 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.

186. Prior to issuing an insurance policy, Ambac reviewed and analyzed each Transaction. Much of Ambac's analysis was summarized in a detailed internal risk assessment memorandum ("Credit Memorandum"). Following a meeting of the Ambac Senior Credit Committee, Ambac determined to issue a financial guaranty policy for each Transaction.

187. 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.

188. 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.

189. On the day each 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.

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

Transaction	**Ambac Policy Number**	**Insured Certificates**	**Original Face Value of Ambac-Insured Certificates**
2005-2	AB0877BE	Class 2-A-1C	$175,000,000
2005-8	AB0913BE	Class 1-A1B Class 1-A2C Class 2-A1B Class 2-A2B	$432,623,000
2005-10	AB0918BE	Class 1-A1B Class 2-A1C1	$258,350,000
2005-12	AB0929BE	Class 1-A1B Class 2-A1B	$224,480,000
2005-13	AB0930BE	Class 1-A1B Class 2-A1C	$177,052,000

191. Ambac's involvement in one Transaction – Harborview 2005-12 – is described in greater detail below. Harborview 2005-12 provides a representative example of the process by which Ambac insured these Transactions.

192. On August 31, 2005, RBS Greenwich analyst Sean Curran e-mailed Ambac a request for a bid to issue the financial guaranty insurance policy for the Harborview 2005-12 Transaction. Curran 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.

193. 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 analysis are reflected in, among other things, Ambac's Harborview 2005-12 Credit Memorandum dated September 26, 2005. The Credit Memorandum provided a detailed analysis of the structure and other characteristics of the Harborview 2005-12 Transaction, as well as the results of Ambac's CAS and LPS Modeling. 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.

194. The Credit Memorandum for the Harborview 2005-12 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 2005-12 Credit Memorandum also gives an account of an operational due diligence visit on September 20, 2005, which is described in more detail in paragraphs 45 and 46. 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."

195. Ambac held a Securitization Senior Credit Committee meeting to discuss insuring the Harborview 2005-12 Transaction on September 28, 2005.

196. Following the conclusion of its analysis, Ambac agreed to provide financial guaranty insurance for the Harborview 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*

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

198. 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."[133] In fact, Countrywide executives

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

instructed employees not to share certain due diligence results with monoline insurers on some occasions because the insurers "kept questioning the data integrity results."[134]

199. 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;

- 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.

200. 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.

[134] *MBIA*, Sheth Aff. Ex. 237 (E-mail from Garrett Galati to Tonya Lybrand, dated Dec. 28, 2005).

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

201. As of May 30, 2015, the pools of loans in the Transactions supporting Ambac-insured certificates had experienced cumulative collateral losses of more than ***$1.16 billion***:

Transaction (Loan Groups)	**Realized Cumulative Loss**
2005-2 (Group 2)	$99,000,545
2005-8 (Groups 1 and 2)	$374,381,230
2005-10 (Groups 1 and 2)	$345,021,259
2005-12 (Groups 1 and 2)	$198,830,997
2005-13 (Groups 1 and 2)	$146,716,679
Total	**$1,163,950,710**

202. The severe losses realized by the Transactions have resulted in Ambac having to make claim payments to insured Noteholders. As of October 31, 2014, the Segregated Account has paid, accrued, or expected claims of almost $350 million. Plaintiffs reserve their right to update paid, accrued, and expected losses through the time of trial and judgment.

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

203. 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.

204. 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.

205. Ambac only recently obtained loan files for the Transactions. To date, an independent consultant retained by Ambac's counsel has reviewed a total of 491 loans from the five Transactions. The results of Ambac's loan-level reunderwriting revealed 432 loans 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 **88%**.

Transaction	Loans Reviewed	Loans Not Conforming to Representations	Percentage of Loans Not Conforming to Representations
2005-2	100	81	81%
2005-8	100	100	100%
2005-10	91	70	77%
2005-12	100	92	92%
2005-13	100	89	89%
Total	**491**	**432**	**88%**

206. These 432 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 the MMLPSA. 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.

207. In addition, a similar review undertaken by U.S. Bank, N.A., as Trustee, of 786 loans from the Harborview 2005-10 Transaction revealed that 520 loans breached one or more of Countrywide's contractual representations made to the Trustee, a breach rate of 66 percent. The defects uncovered by U.S. Bank included: (i) misrepresentations of income, employment, and debt obligations; (ii) debt-to-income ratios that exceeded underwriting guidelines; (iii) loan-to-value ratios that exceeded underwriting guidelines; and (iv) relevant documents that were either defective or missing from the loan file.[135]

208. 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

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[135] *See* Third Amended Compl. ¶ 62, *U.S. Bank N.A., as Trustee for Harborview Mortgage Loan Trust, Series 2005-10 v. Countrywide Home Loans, Inc., et al.*, Index No. 652388/2011 (N.Y. Sup. Ct. N.Y. Cnty. Nov. 14, 2014).

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.

209. 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. Plaintiffs Are Entitled to Relief Against Countrywide

210. 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.

211. Plaintiffs have incurred significant harm, and continue to incur significant harm, as a consequence of Countrywide's malfeasance, including more than $285 million in claims payments they have made or are 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, Plaintiffs face tens of millions of dollars in future claims.

212. Countrywide's misconduct entitles Plaintiffs 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 Plaintiffs of all claims payments made and accrued to date and all future claims payments required to be made.

1. *Plaintiffs' Claims Are Timely*

213. Plaintiffs' claims are timely under New York's two-year fraud discovery statute of limitations because, within the two-year period before this action was filed (taking into account all applicable tolling), Plaintiffs could not have discovered that Countrywide had made misrepresentations as to the particular loans included in the Transactions. While public accounts of Countrywide's shoddy origination practices were beginning to emerge, Plaintiffs lacked information tying Countrywide's practices to these five Transactions that would be sufficient to allow them to plead with particularity that Countrywide's statements inducing Ambac to insure the Transactions were false. Countrywide itself has argued – successfully – that claims should be dismissed when the plaintiff failed to link allegations of improper origination practices to the specific loans at issue in a fraud suit.

214. Prior to the two-year discovery period, Plaintiffs had not paid or accrued any claims on these five Transactions. Nor had Plaintiffs obtained any loan files for the Transactions, and they had no contractual right to demand loan files from Countrywide. Even in the Countrywide transactions for which Plaintiffs have a clear and direct right to obtain loan files (deals not at issue in this litigation), Countrywide delayed, stymied, and otherwise dragged its feet in allowing Plaintiffs access to those loans files for many, many months.

215. In addition, Plaintiffs were not aware of any products or analytic tools that would have allowed them to conduct loan-level analysis without access to loan files in order verify the accuracy of representations made by Countrywide about the specific loans included in

the Transactions. Only later did Plaintiffs learn of a product that enabled them to determine the accuracy of representations about the loan-to-value ratios for mortgages and owner-occupancy status of mortgages included in RMBS securitizations. Eventually, within two years of filing this action, Plaintiffs also obtained loan files for the Transactions. Based on their review of loan files and their analysis of the accuracy of representations regarding loan-to-value ratios and owner-occupancy information, Plaintiffs were able to confirm that Countrywide made numerous material misrepresentations about the Transactions and that Countrywide's statements about its operational controls were false with respect to these specific Transactions. This information about the loans underlying these specific Transactions enabled Plaintiffs to allege Countrywide's fraud with the requisite particularity.

2. *The Wisconsin Action*

216. On December 30, 2014, Ambac and the Segregated Account filed suit against Countrywide in Wisconsin Circuit Court (the "Wisconsin Court"), commencing *The Segregated Account of Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*, No. 14-CV-3511 (Wis. Cir. Ct. Dane Cnty.) (the "Wisconsin Action"). The claims asserted, and the relief sought, in the Wisconsin Action are the same as Plaintiffs assert in this litigation.

217. On July 2, 2015, the Wisconsin Court issued an order dismissing the Wisconsin Action without prejudice for lack of personal jurisdiction over Countrywide Home Loans. Plaintiffs have commenced an appeal of that determination and intend to continue pursuing their fraudulent inducement claim in the Wisconsin courts. Plaintiffs filed the present action to preserve their rights to pursue their claims in New York without being prejudiced by the further running of the statute of limitations should they be unable to litigate the merits of their claims in Wisconsin.

CAUSE OF ACTION

(Fraudulent Inducement)

218. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 217 of this Complaint.

219. As set forth above, Countrywide made materially false public statements, and omitted material facts, with the intent to defraud the public and Ambac. 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. Absent Countrywide's fraudulent inducement, Ambac never would have issued the Policies.

220. On numerous occasions between 2004 and the closing of the last of the Transactions, 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.

221. 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.

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

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

224. 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.

225. 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.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs Ambac and the Segregated Account respectfully pray for the following relief:

A. For an award in favor of Plaintiffs and against Defendant under the common law of damages and New York Insurance Law § 3105 to be proven at trial, including but not limited to, all claims paid and accrued under the Policies to date and all claims due for payment in the future under the Policies, and Plaintiffs' other compensatory, consequential, and punitive damages;

B. For an order of prejudgment interest; and

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

Dated: New York, New York
July 21, 2015

Respectfully submitted,

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